(14)

Risk Management

The Risk Management report contains audited financial information except principally for the discussion of Operational Risk on page 39 that, in accordance with the guidance in paragraph BC65 of IFRS 7, is unaudited.

Summary

This Risk Management report describes the Risk Governance Framework of Abbey National plc (the 'Company', and together with its subsidiaries, the 'Group'), and includes more detail on the Group's key risks, on a segmental basis or aggregated where relevant. It is divided into the following sections:

Introduction - A description of the Group's Risk Governance Framework, including the three tiers of the Risk Governance structure. This can be found on page 37.

Financial Risks and Risk Management - Group-wide disclosures about specific risks which do not originate in any single operating segment, such as operational risk and pension obligation risk, as well as Group-wide disclosures about market risk and concentrations of credit risk are described on pages 38 to 40.

Discussion of Key Risks by Operating Segment- Detailed discussions about risk exposures, measurement information and management policies presented by operating segment can be found on pages 41 to 51:

- **Risks in Retail Banking**– The risks in this segment are described on pages 41 to 45, including:
  - **Credit risk**, including its management, an analysis of types and credit quality of retail lending, and disclosures relating to provisioning, arrears and recoveries.
  - **Market risk**, including its management.

- **Risks in Corporate Banking** – The risk in this segment is described on pages 45 to 46, comprising:
  - **Credit risk**, including its management, mitigation, and the disclosure of exposure by rating of counterparty.
  - **Market risk**, including its management.

- **Risks in Global Banking & Markets** – The risks in this segment are described on pages 47 to 49, including:
  - **Credit risk**, including its management, mitigation, and the disclosure of exposure by rating of counterparty.
  - **Market risk**, including its management, and disclosures on short-term market risk and structural market risk.
  - **Trading risk**, including details of segmental exposures and trading derivatives.

- **Risks in Private Banking** – The risks in this segment are described on page 49, including a description of credit risk and market risk in the entities which this segment incorporates.

- **Risks in Group Infrastructure** – The risks in this segment are described on pages 50 to 51, including:
  - **Credit risk**, including its management, an analysis of types and credit quality of lending, and disclosures relating to provisioning, arrears and recoveries.
  - **Market risk**, including its management, and disclosure of Net Interest Margin Sensitivity and the Market Value of Equity sensitivity.
  - A description of the types of derivative contracts used to hedge risks in these segments.

The Impact of the Current Credit Environment – Detailed disclosures can be found on pages 52 to 53, including a description of the Group's exposures to certain classes of financial assets and off-balance sheet entities.

Liquidity Risk – A description of the liquidity risks the Group faces, along with their management and activity in 2008 and 2007, can be found on pages 54 to 56.

Introduction

The Group accepts that risk arises from its full range of activities, and actively manages and controls it. The management of risk is an integral part of the Group's activities. Risk is defined as the uncertainty around the Group's ability to achieve its business objectives and execute its strategy effectively. Risk constitutes the Group's exposure to uncertainty and the consequent variability of return. Specifically, risk equates to the adverse impacts on profitability arising from different sources of uncertainty including Credit Risk (Retail), Credit Risk (Wholesale), Market Risk, Operational Risk, Securitisation Risk, Concentration Risk, Liquidity Risk, Reputational Risk, Strategic Risk, Pension Obligation Risk, Group Risk and Regulatory Risk. Risk measurement is used to capture the source of the uncertainty and the magnitude of its potential effect on the profitability and solvency of the Group. Effective risk management and control is therefore of fundamental importance to the Group's long-term success.

Understanding and controlling risk is critical for the effective management of the business. The Company's Risk Framework aims to ensure that risk is managed and controlled on behalf of shareholders, customers, depositors, employees and the firm's regulators. Effective and efficient risk governance and oversight provide management with assurance that the Group's business activities will not be adversely impacted by risks that could have been reasonably foreseen. This in turn reduces the uncertainty of achieving the Group's strategic objectives.

Risk Management continued

Dedicated Business Risk Oversight Fora (ROFs) advise and support the Chief Risk Officer in fulfilling his risk control responsibilities and help to ensure that risks are suitably understood, managed and controlled.

The Risk Division provides independent challenge to all business areas in respect of risk management and compliance with policies and advises the business when they are approaching the limits of the Group's Risk Appetite.

The Board, as supported by the Risk Division, is responsible for ensuring compliance with Group policies and limits imposed by Banco Santander, S.A. including:

> Group-wide risk policies;
> Group-wide risk limits/parameters;
> Approval processes relating to transactions that exceed local risk limits;
> The systematic review of exposures to large clients, sectors, geographical areas and different risk types; and
> Reporting to Banco Santander, S.A..

Third tier of risk governance

Risk assurance provides independent objective assurance on the effectiveness of the management and control of risk across the Group. This is provided through the Non–Executive Directors, Internal Audit function and the Audit and Risk Committee.

Non-Executive Directors
The Non-Executive Directors are members of the Board who have a particular responsibility for constructively challenging and contributing to the development of strategy, scrutinising the performance of management in meeting agreed goals and objectives and monitoring reporting performance, and assuring themselves that the financial controls and systems of risk management are robust and defensible.

Internal Audit
The Internal Audit function supports the Audit and Risk Committee by providing independent and objective opinions on the effectiveness and integrity of the Group's risk governance arrangements. It does this via a systematic programme of risk-based audits of the controls established and operated by the "first tier" risk management functions and those exercised by the "second tier" risk control functions.

The audit opinions and underlying rationale of findings and recommendations form the basis upon which the Audit and Risk Committee can take reasonable (but not absolute) assurance that the risk governance arrangements are fit for purpose and working properly. The Audit and Risk Committee also receive reports from management, the risk control functions and the external auditors to help them to discharge their risk governance oversight responsibilities.

Audit and Risk Committee
The Audit and Risk Committee is made up of Non-Executive Directors, and is a committee of the Board. The Committee has responsibility for:

> The oversight of the risk governance framework;
> Review of the effectiveness of the Group's internal and external audit process;
> Review of control policies and procedures including regulatory compliance and financial reporting;
> The identification, assessment and reporting of risks; and
> The risk governance structure and associated compliance with risk control policies and procedures.

Financial Risks and Risk Management

The financial risks affecting the Group are discussed below. Risks are generally managed through tailored management policies within the business division or operating segment in which they are originated.

Group-wide disclosures including about specific risks which do not originate in any single operating segment, are described separately at the beginning of this section, apart from liquidity risk which is discussed at the end of the section, following the detailed disclosures about the impact of the current credit environment.

Following the Group-wide disclosures are detailed discussions about risk exposures, measurement information and management policies presented by operating segment, being Retail Banking, Corporate Banking, Global Banking & Markets, Private Banking, and Group Infrastructure (which includes Asset and Liability Management ('ALM')).

The risk exposure and management information relating to the Company principally arise in Retail Banking and Group Infrastructure. Following the outsourcing of key IT and operations processes to group companies, risk governance of these entities is crucial. The use of service level agreements and key metrics support this governance.

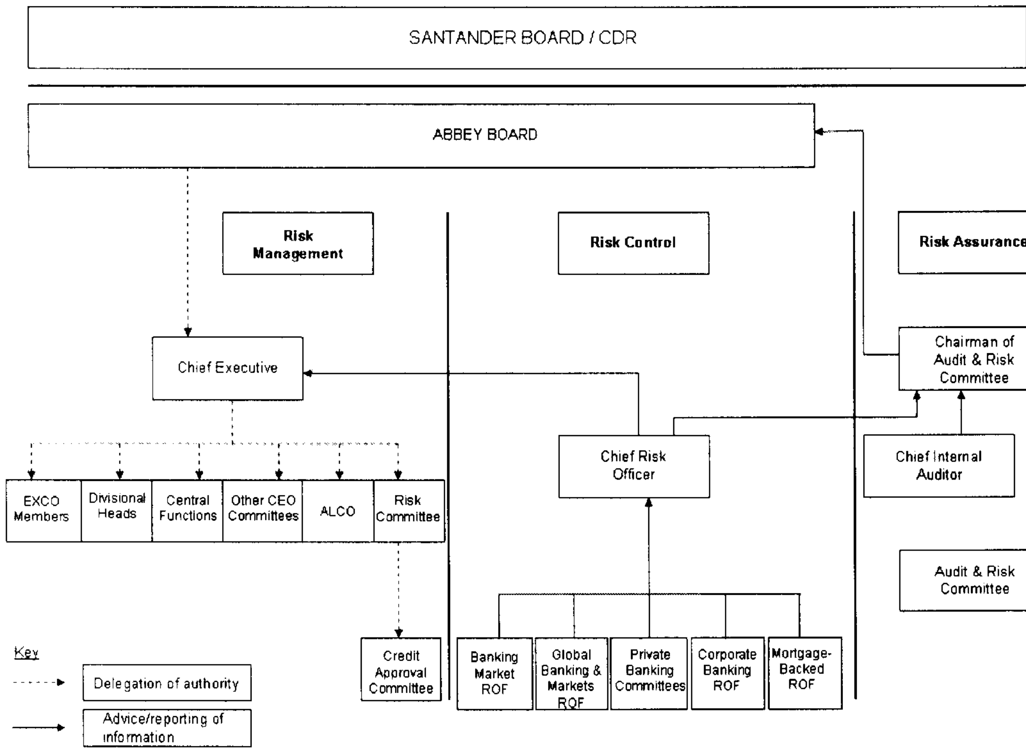
Financial Instruments

The Group uses financial instruments to manage the structural balance sheet exposures that arise from its banking activities, in accordance with Risk policies and the Asset and Liability Management Committee's direction. The Group also trades in financial instruments where it takes positions in traded and over the counter instruments, including derivatives, to take advantage of short-term market movements in the equity and bond markets and in currency and interest rates.

Authority for Risk Management flows from the Abbey National plc Board of Directors (the 'Board') to the Chief Executive and from him to specific individuals. Formal standing committees are maintained for effective management or oversight. Their authority is derived from the person they are intended to assist.

Risk Governance Framework

The diagram below shows the Risk Governance Framework in operation in respect of risk management and oversight.



The Risk Division at Banco Santander, S.A. reports to the President of the Comisión Delegada de Riesgos (Delegated Risk Committee or 'CDR').

The main elements of risk governance within the Group are as follows:

First tier of risk governance

Risk management is provided by the Board. It approves the Group's Risk Appetite in consultation with Banco Santander, S.A. as appropriate, approves the strategy for managing risk and is responsible for the Group's system of internal control. The Board is supported by the Chief Executive and Executive Management, who have primary responsibility for understanding, identifying, and owning the risks generated by their lines of business and establishing a framework for managing those risks within the Board-approved Risk Appetite of the Group. In addition, understanding, identifying, and owning the risks generated by the Group's operations are the responsibility of the Divisional Heads and central functions. These functions provide technical support and advice to assist in the management and control of risk. Within this tier, there is a process for transaction review and approval within certain thresholds, discharged by the Credit Approval Committee. Transactions reviewed which exceed the threshold limits set are subject to prior review by Banco Santander, S.A.'s Risk Division before final approval by the Credit Approval Committee.

Risk Committee

The Risk Committee is a management committee, established under the authority of and chaired by the Chief Executive. The Risk Committee reviews risk issues, gives advice and recommendations to the Chief Executive, the Executive Committee, or other parties as appropriate as well as makes decisions on risk issues within its sphere of responsibility.

Second tier of risk governance

Risk control is provided by the Board independently supported by the Risk Division. The roles of the Chief Risk Officer, the Head of Wholesale Risk, and the Risk Division include development of risk measurement methodologies, risk approval, risk monitoring, risk reporting and escalation of risk issues in line with the relevant risk policy for all risks across all lines of Retail Banking, Global Banking & Markets, Corporate Banking and Private Banking business.

Operational Risk – Group-wide (unaudited)

Operational risk is the risk of loss to the Group, resulting from inadequate or failed internal processes, people and systems, or from external events. Such risks can materialise as frauds, process failures, system downtime or damage to assets due to fire, floods etc. When such risks materialise they have not only immediate financial consequences for the Group but also an effect on its business objectives, customer service, regulatory responsibilities and reputation. Operational risk exposures arise across the Group's business divisions and operating segments, and are managed on a consistent basis.

Managing operational risk (unaudited)

The Group undertakes extensive activity to minimise the impacts operational risks may have on business areas. An independent central operational risk function (Enterprise and Operational Risk) has responsibility for establishing the framework within which these risks are managed and is aligned to operational risk professionals within business areas to ensure consistent approaches are applied across the Group. The primary purpose of the framework, which is approved by the Risk Committee, is to define and articulate the Group-wide policy, processes, roles and responsibilities. The framework incorporates industry practice and regulatory requirements, particularly those emanating from the Basel Committee, European Union Directives and the UK Financial Services Authority.

The day-to-day management of operational risk is the responsibility of business managers who identify, assess and monitor the risks, in line with the processes described in the framework. The operational risk function ensures that all key risks are regularly reported to Risk Fora, the Risk Committee and Board.

Key operational risk activity in 2008 (unaudited)

During 2008, the Group has continued to respond to the developing operational risk environment with coordinated responses. The Group continues to perform detailed control reviews in response to major industry events.

Following many high profile customer data security lapses experienced by other organisations in the UK, the Group has taken proactive steps to minimise similar risks. A corporate information security programme has been established which involves the strengthening of controls for the management of sensitive data and includes the implementation of encryption standards across the Group. A review of trading controls was carried out in response to the incident at Société Générale and the opportunity was taken to further enhance trading controls even though it was confirmed that existing controls were robust in this area. To highlight awareness of such issues, Operational Risk training has been made available to management and staff involved in control functions throughout the Group. In line with UK Financial Services Authority guidance and industry practice, the Group has crisis management and disaster recovery arrangements to ensure that critical business processes are maintained in the event of an unforeseen interruption. Insurance policies are also purchased to provide cover for a range of potential operational risk losses. In response to the increased threats of terrorism, flooding, and pandemic disasters, contingency strategies continue to be refined and key progress has included the development of dispersed contingency sites and automated system switch over facilities.

The Group continues to strengthen its point of sale compliance and control procedures to minimise risk and serve its customers. To this end, work continues to progress in implementing new systems which are already successfully operating in Banco Santander, S.A.. The increased use of data analytics and modelling for fraud prevention continues to have an impact in reducing exposure to third party fraud activity.

Credit Risk – Group-wide

Significant concentrations of credit risk

During 2008, the Group's most significant exposures to credit risk derived from the residential mortgage portfolio and unsecured personal lending businesses in Retail Banking, unsecured lending and derivatives exposure to banks and non-banking financial institutions in Global Banking & Markets, and secured lending and derivatives exposures to real estate entities and social housing associations in Corporate Banking.

The residential mortgage portfolio comprises loans to private individuals secured against residential properties in the UK. This is a prime portfolio with total exposure of £115.5bn at 31 December 2008. The Unsecured Personal Loan portfolio comprises unsecured loans to private individuals issued in the UK. Total exposure stood at £3.25bn at 31 December 2008. The real estate and social housing portfolios in Corporate Banking comprise loans and associated derivatives secured on UK property. The total committed facilities exposure to these portfolios was £10.9bn at 31 December 2008.

Although Global Banking & Markets' operations are based mainly in the UK, it has built up exposures to various entities around the world and is therefore exposed to concentrations of risk related to geographic area. At 31 December 2008, 9% of Global Banking & Markets' credit exposures were to counterparties from the United States, and 47% were to counterparties from the UK. 1% of Global Banking & Markets' exposures were to countries that are not members of the Organisation for Economic Co-operation and Development ('OECD'). The remaining exposures were mainly to European counterparties. Geographical exposures are governed by country limits set by Santander centrally and determined according to the classification of the country (whether it is a developed OECD country or not), the rating of the country and its gross domestic product. The Group is further constrained in its country risk exposure, within the group limits, and by its capital base. The Corporate Banking operations may include the development of niche portfolios.

Risk Management continued

Maximum exposure to credit risk

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

	2008 £m	2007 £m
Trading assets	**24,230**	32,378
Purchase and resale agreements	**9,936**	24,049
Derivatives	**32,281**	9,951
Financial assets designated at fair value	**11,314**	11,783
Loans and advances to customers	**129,023**	112,147
Loans and advances to banks	**15,621**	3,441
Other	**3,664**	3,241
Third party exposures[1]	**226,069**	196,990

(1) In addition, the Group is exposed to credit risk in respect of guarantees granted, loan commitments and stock borrowing and lending agreements. The estimated maximum exposure to credit risk is described in Note 37 to the Consolidated Financial Statements on page 121.

In managing the gross exposures, the Group uses the policies and processes described in the credit risk sections below. Collateral, when received, can be held in the form of security over the mortgaged property, full debentures over a company's assets and through market standard collateral agreements in its treasury business.

Basel II (unaudited)

From 1 January 2008, the Group applied the retail internal ratings-based (IRB) approach for credit risk to its key retail portfolios. The advanced internal ratings-based (AIRB) approach has been employed for the principal wholesale portfolios from the same date. For the remaining credit exposures, currently on the Basel II standardised approach, a rolling programme of transition to the appropriate IRB approach is underway. From 1 January 2008, the standardised approach was adopted for Operational Risk, and the Group applied Basel II to its Internal Capital Adequacy Assessment Process (ICAAP) and to the risk and capital disclosures made to the market. The Group has applied Santander's approach to risk management in its application of Basel II. Further information on the Group's capital position under Basel II is included in Note 47 in the Consolidated Financial Statements. Further information on the Basel II risk measurement of the Group's exposures will be included in Santander's Pillar 3 report. The Group's Pillar 3 disclosures are set out in the Balance Sheet Business Review on pages 28 to 30.

Market risk – Group-wide

Market risk is the potential for loss of income or decrease in the value of net assets caused by movements in the levels and prices of financial instruments including interest rate and foreign currency risks. The Group accepts that market risk arises from its full range of activities. The Group aims to actively manage and control market risk by limiting the adverse impact of market movements whilst seeking to enhance earnings within clearly defined parameters. The Market Risk Manual, which is reviewed and approved by the Head of Wholesale Risk on an annual basis, sets the framework under which market risks are managed and controlled. Business area policies, risk limits and mandates are established within the context of the Market Risk Manual. Executive directors are responsible for ensuring that they have sufficient expertise to manage the risks originated and retained with their business divisions. The business areas are responsible for ensuring that they have sufficient expertise to manage the risks associated with their operations. The independent Risk function, under the direction of the Head of Wholesale Risk, aims to ensure that risk-taking and risk control occur within the framework prescribed by the Market Risk Manual. The Risk function also provides oversight of all risk-taking activities through a process of reviews. The Group aims to ensure that exposure to market risks is measured and reported on an accurate and timely basis to senior management. In addition to the regular reporting for the purposes of active risk management, the Board also receives reporting of all significant market risk exposures on a monthly basis where actual exposure levels are measured against limits. Senior management recognise 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 range of complementary measures, covering both value and income as appropriate.

Pension obligation risk – Group-wide

The Group has statutory funding obligations as the sponsoring employer for a number of defined benefit staff pension schemes. The schemes are managed by independent trustees in accordance with legislation and trust deeds and rules, for the benefit of members. The Group accepts that it is exposed to pension obligation risk that could give rise to an unexpected increase in the Group's obligations to fund the schemes, either because of a loss of net asset value or because of changes in legislation or regulatory action. The principal risks to the net asset value of the schemes are an increase in the value of the liabilities arising from adverse changes in the longevity, inflation, and scheme assets being adversely affected by market movements. Further information on pensions can be found in "Critical Accounting Policies" within the Accounting Policies on page 79 and in Note 36 to the Consolidated Financial Statements.

Risk management

The Chief Financial Officer is responsible for managing the Group's exposure to pension obligation risk, in conjunction with the trustees. Further details of the funding arrangements for the pension schemes can be found on page 119.

Risk Management in Retail Banking

Credit risk in Retail Banking

Credit risk is the risk that counterparties will not meet their financial obligations, which may result in the Retail Banking losing the principal amount lent, the interest accrued and any unrealised gains (less any security held). Credit risk occurs mainly in Retail Banking's loan and investment assets (including residential mortgages and secured lending, personal and business banking). Retail Banking actively manages and controls credit risk.

Residential Mortgages and secured lending

Retail Banking 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 assets are reviewed in accordance with policy to ensure they perform as expected. Residential lending is subject to lending policy and lending authority levels, which are used to structure lending decisions to the same high standard across the retail network, a process further improved by mortgage credit scoring, underwriter accreditation and regular compliance reviews.

Details concerning the prospective borrower and the mortgage are subject to a criteria-based decision-making process. Criteria for assessment include credit references, loan-to-value ratio, borrower status and the mortgage credit score.

The majority of loans provided by Retail Banking are secured on UK properties. All properties must be permanent in construction; mobile homes are not generally acceptable. The Group can provide a mortgage for the purchase of properties outside the UK where the property is a second home and the loan is secured on the main property located in the UK.

Prior to granting any first mortgage loan on a property, the Group has the property valued by an approved and qualified surveyor, who may be a Group employee. The valuation is based on set Group guidelines, which build upon the Royal Institute of Chartered Surveyors guidance on valuation methods. In the case of re-mortgages, where the loan-to-value ('LTV') is 75% or lower, and the risk judged by the size of the advance requested and the credit score of the applicant is considered medium or low, and an accurate, reputable automated valuation is available, this may substitute for a surveyor's valuation.

For additional lending where a first-charge mortgage is already held with the Group and the loan-to-value is less than 90%, the original property value used to be subject to indexation and no further survey carried out. During 2008, this practice was phased-out, with all additional loans requiring an automated valuation or surveyor's valuation. The use of an automated valuation depends upon the availability of a reliable automated valuation, and the level of credit risk posed by the proposed loan.

Progressively stricter lending criteria are applied to mortgages above a loan-to-value of 75%. Only 1% of new secured loan advances in 2008 were made with a loan-to-value of more than 90%. Loans with higher loan-to-value ratios carry a higher risk due to the increased likelihood that liquidation of the collateral will not yield sufficient funds to cover the loan advanced and costs of liquidation. These loans generally attract higher margins as a result.

Mortgage credit quality(1)

	2008	2007	2006
Loan-to-value analysis:			
New business			
> 90%	**2%**	3%	4%
75% - 90%	**35%**	45%	33%
< 75%	**63%**	52%	63%
Average (at inception)	**64%**	64%	61%
Average loan-to-value of stock (indexed)	**51%**	46%	44%
New business profile:			
First-time buyers	**9%**	13%	11%
Home movers	**23%**	37%	38%
Remortgagers	**68%**	50%	51%
Average earnings multiple	**3.0**	3.0	2.9

(1) For main advances only. Does not include further advances. Excludes any fees added to the loan, and only includes the drawn loan amount, not drawdown limits.

The residential mortgage portfolio has started to show an increasing trend of payment arrears with the deterioration in economic conditions. Credit quality remains strong, with the LTV on new business completions gradually reducing through the year, with the 4th quarter at 60% (Q3 08: 62%, Q4 07: 66%). The indexed stock LTV increased to 51% (Q3 08: 50%, Q4 07: 46%) as a result of declining house prices, mitigated by the reduction in new business LTVs. Credit criteria have been progressively tightened in response to the changing market environment. As a result, the LTV profile of new lending has improved significantly.

> Arrears more than 90 days past due have increased from 0.60% in December 2007 to 0.95% at the end of 2008. In the same period, industry arrears more than 90 days past due are forecast by the UK Council of Mortgage Lenders to have increased from 1.10% to 2.03%.

> Monthly mortgage completions in excess of 75% LTV fell from 47% in December 2007 to 13% in December 2008.

Mortgage arrears and repossessions

Collections & Recoveries Department is responsible for all debt management initiatives on the secured portfolio for Retail Banking. Debt management strategies, which include negotiating repayment arrangements and concessions and debt counselling, can start as early as the day after a repayment is past due and will continue until legal action. Different collection strategies are applied to different segments of the portfolio subject to the perceived levels of risk for example, loan-to-value, collections score and account characteristics.

Risk Management continued

If the agreed repayment arrangement is not maintained, legal proceedings may be taken and may result in the property being taken into possession. The Group sells the repossessed property at market price and uses the sale proceeds, net of costs, to pay off the outstanding value of the mortgage. The stock of repossessed properties held by the Group varies according to the number of new possessions and the buoyancy of the housing market.

The following tables set forth information on UK residential mortgage arrears, and properties in possession, at 31 December 2008, 2007 and 2006 for Retail Banking compared to the industry average as provided by the Council of Mortgage Lenders ('CML'), as well as the carrying amount of assets obtained as collateral.

Mortgage arrears	Group[(1)(2)] (Percentage of total mortgage loans by number)
31 to 60 days in arrears	
31 December 2006	1.19
31 December 2007	1.48
31 December 2008	**1.35**
61 to 90 days in arrears	
31 December 2006	0.50
31 December 2007	0.59
31 December 2008	**0.76**

	Group	CML[(2)] (unaudited)
	(Percentage of total mortgage loans by number)	
3 to 5 months in arrears		
31 December 2006	0.42	0.57
31 December 2007	0.49	0.62
31 December 2008	**0.67**	**1.01**
6 to 11 months in arrears		
31 December 2006	0.17	0.31
31 December 2007	0.17	0.35
31 December 2008	**0.26**	**0.62**
12 months or more in arrears		
31 December 2006	0.03	0.14
31 December 2007	0.03	0.13
31 December 2008	**0.02**	**0.25**

(1) Group data is not readily available for arrears less than 31 days
(2) Council of Mortgage Lenders data is not available for arrears less than 3 months

Properties in possession	Group	CML (unaudited)
	(Percentage of total mortgage loans by number)	
31 December 2006	0.04	0.08
31 December 2007	0.05	0.10
31 December 2008	**0.07**	**0.21**

Carrying amount of assets obtained as collateral	£m
31 December 2006	43
31 December 2007	64
31 December 2008	**113**

Restructured loans

Loans have been restructured or renegotiated by capitalising the arrears where customers in arrears have maintained an agreed monthly repayment for a period of five months. The value of capitalised arrears on loans that would have been impaired if the terms had not been renegotiated at 31 December 2008 were £17m (2007: £12m).

Banking and Consumer Credit. Retail Banking uses systems and processes to manage the risks involved in providing unsecured personal loans and overdraft lending or in granting bank account facilities. These include the use of application and behavioural scoring systems to assist in the granting of credit facilities as well as regular monitoring of scorecard performance and the quality of the unsecured lending portfolios. Behavioural scoring examines the lending relationships that a customer has with Retail Banking and how the customer uses their bank account. This information generates a score that is used to assist in deciding the level of risk (in terms of overdraft facility amount, card facilities granted and preferred unsecured personal loan value) for each customer that the Group is willing to accept. Individual customer scores are normally updated on a monthly basis. Retail Banking has successfully extended the use of behavioural scoring into other areas of the business, including the refinement of debt management strategies and bank account transaction processing.

Personal Financial Services banking and unsecured personal loan arrears

	2008 £m	2007 £m	2006 £m
Total banking and unsecured personal loan arrears[(1,2)]	**158**	134	167
Total banking and unsecured personal loan asset	**2,691**	3,119	3,936
Banking and unsecured personal loan arrears as a % of asset	**5.87%**	4.30%	4.25%

(1) In 2008, banking arrears was defined as customers that had been in arrears for greater than 90 days. In prior years, it was defined as customers whose borrowings exceed their overdraft by over £100. If the prior year definition were applied to 2008 data, the total arrears would increase by £53m.
(2) Unsecured personal loan and credit card arrears are defined as the balances of accounts that are three or more months in arrears (> 4 instalments).

Provisions on loans and advances to customers

The charge for provisions on loans and advances to customers adjusts the balance sheet provisions to the level that management deems adequate to absorb actual and inherent losses in Retail Banking's loan portfolio from homogeneous portfolios of assets and individually identified loans. A proportion of Retail Banking's provisions on loans and advances to customers relate to loans and advances secured either by a first charge on residential property in the UK, or by other appropriate security depending on the nature of the loan.

The Group's provisioning policy is as follows. Further information is set out in the Accounting Policies in the Consolidated Financial Statements:

> **Observed provision** - an observed provision is established for all past due 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 any applicable security. The length of the default period depends on the nature of the advance and is generally no more than three months. Once a loan misses a payment (breach of contractual terms) an assessment of the likelihood of collecting the principal and overdue payments is made. This assessment is generally made using statistical techniques developed on previous experience and on projections of current market conditions to the time the loss is expected to crystallise. These techniques estimate the propensity of loans to go to write off and as a separate exercise, the loss incurred on written off debt is monitored. For advances secured on residential property, the propensity of loans to reach repossession is determined with repossessed properties assessed on an individual basis through the use of an external valuation, anticipated disposal costs and the current exposure.

> **Incurred but not yet observed provision** - an incurred but not yet observed provision is made against loans, which have not missed a payment but are known from past experience to have deteriorated since the initial decision to lend was made. Based on historical evidence, the number of accounts likely to default in the future as a result of events present at the balance sheet date are identified through use of statistical techniques.
>
> From 1 January 2005, these statistical techniques were expanded and enhanced. In particular, further detailed examination is now performed on the losses that emerge over a defined period of time after the reporting date called the emergence period. This period is determined to ensure that only those accounts which have credit deterioration at the reporting date are captured and excludes accounts which will suffer credit deterioration after the reporting period. The emergence period is two to three months for unsecured lending and twelve months for secured lending. The provision methodology outlined for observed provisions is then applied to accounts identified as impaired in the performing portfolios.

> **Amounts written off** - Unsecured loans are written off when all internal avenues of collecting the debt have failed and the debt is passed onto external collection agencies. On secured loans, the write off takes place on ultimate realisation of collateral value, or from claiming on any mortgage indemnity guarantee or other insurance. All write offs are on a case by case basis, taking account of the exposure at the date of write off, after accounting for the value from any collateral or insurance held against the loan. The write-off policy is regularly reviewed.

Security is realised in accordance with Retail Banking's internal debt management programme. Contact is made with customers with the aim 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 write-off policy, the provisions will be made a significant time in advance of the related write-off on all products. The exception to this rule is the discovery of fraud, where the exposure is written off once full investigations have been completed and the probability of recovery is minimal. The time span between the discovery and write off will be a short period and may not result in a provision being raised.

Analysis of provisions on loans and advances to customers

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Observed provision					
Advances secured on residential properties - UK	**174**	73	45	21	9
Other secured advances - UK	**37**	34	75	126	148
Unsecured personal advances - UK	**227**	249	242	158	133
Corporate advances - UK	**13**	-	-	-	67
Total observed provisions	**451**	356	362	305	357
Incurred but not yet observed provision					
Advances secured on residential properties - UK	**123**	102	60	35	58
Other secured advances - UK	**11**	8	3	-	3
Unsecured personal advances - UK	**44**	85	111	54	35
Corporate advances – UK	**13**	-	-	-	14
Total incurred but not yet observed provisions	**191**	195	174	89	110
Total provisions	**642**	551	536	394	467

Risk Management continued

Movements in provisions for impairment losses on loans and advances

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Provisions at 31 December	**551**	536	394	467	-
IFRS reclassifications	**-**	-	-	(40)	-
Provisions at 1 January	**551**	536	394	427	865
Disposal of subsidiary undertakings	**-**	-	-	-	(70)
	551	536	394	427	795
Amounts written off					
Advances secured on residential properties - UK	**(32)**	(9)	(11)	(5)	(2)
Other secured advances - UK	**(9)**	(25)	(27)	(36)	(39)
Unsecured personal advances - UK	**(262)**	(339)	(205)	(247)	(136)
Corporate advances - UK	**-**	-	-	-	(144)
	(303)	(373)	(243)	(288)	(321)
Advances secured on residential properties - non-UK	**-**	-	-	-	(2)
Other secured advances - non-UK	**-**	-	-	-	(2)
Total amounts written off	**(303)**	(373)	(243)	(288)	(325)
Observed provisions charged against profit					
Advances secured on residential properties - UK	**132**	38	35	12	3
Other secured advances - UK	**14**	(17)	(25)	11	155
Unsecured personal advances - UK	**239**	346	289	221	98
Corporate advances – UK	**13**	-	-	-	71
	398	367	299	244	327
Advances secured on residential properties - non-UK	**-**	-	-	(3)	(1)
Unsecured personal advances - non-UK	**-**	-	-	-	1
Total observed provisions charged against profit	**398**	367	299	241	327
Incurred but not yet observed provisions charged against profit	**(4)**	21	86	14	(330)
Total provisions charged against profit (including discontinued operations)	**394**	388	385	255	(3)
Provisions at the end of the year	**642**	551	536	394	467

IFRS reclassifications related primarily to provisions on certain corporate loans in businesses and portfolios that were inconsistent with the Group's strategy, and were sold during 2005 or transferred to Corporate Banking.

Recoveries

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Advances secured on residential properties - UK	**1**	2	2	3	16
Other secured advances - UK	**12**	6	7	7	8
Unsecured personal advances - UK	**33**	36	32	27	28
Total amount recovered	**46**	44	41	37	52

Group non-performing loans and advances(1)

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Group non-performing loans and advances that are impaired	**614**	296	375	314	297
Group non-performing loans and advances that are not impaired	**891**	596	451	568	844
Total non-performing loans and advances(2)	**1,505**	892	826	882	1,141
	%	%	%	%	%
Non-performing loans and advances as a % of loans and advances to customers(3)	**1.10**	0.66	0.64	0.74	1.04
Provision as a percentage of total non-performing loans and advances	**42.66**	61.77	64.89	44.67	40.93

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer
(2) All non-performing loans are UK
(3) Loans and advances to customers includes trading assets and excludes finance leases

In 2008, non-performing loans and advances as a percentage of loans and advances to customers (including trading assets and excluding finance leases) increased from 0.66% to 1.10%. This primarily reflects the impact of the deteriorating market environment on the performance of the residential mortgage portfolio. This has also increased the proportion of non-performing loans secured against residential property in the non-performing loan balance, which has in turn further reduced the average provision coverage required in respect of the eventual credit losses that are expected to emerge from these loans.

In 2007, non-performing loans and advances as a percentage of loans and advances to customers (including trading assets and excluding finance leases) increased from 0.64% to 0.66%. This is a reflection of the mortgage performance normalising from historic lows. This has also changed the proportions of mortgages and unsecured loans in the non-performing loan balance, with a greater proportion representing mortgages (which have a lower provision as a percentage of the asset), driving down the overall ratio from 64.89% to 61.77%.

In 2006, non-performing loans and advances as a percentage of loans and advances to customers (including trading assets and excluding finance leases) decreased from 0.74% to 0.64%. This reflected the continuing strength of the credit quality of the Group's loans, particularly on the secured mortgages. Provisions as a percentage of total non-performing loans and advances increased from 44.67% to 64.89% in 2006, which reflected the change in macro-economic factors such as interest rate rises.

In 2005, non-performing loans and advances as a percentage of loans and advances to customers (including trading assets and excluding finance leases) decreased from 1.04% to 0.74%. This was due to the sale of the majority of the wholesale lending book and to the run down of the Motor Finance and Litigation businesses. Provisions as a percentage of total non-performing loans and advances have increased from 40.93% to 44.67% in 2005. This movement is attributable to the sale of the majority of the wholesale lending book.

Interest income recognised on impaired loans amounted to £51m (2007: £36m, 2006: £32m).

Abbey Business

Business Banking provides a range of products to assist with the finance requirements of small businesses, including overdrafts. Risk management policies are specific to and reflect the risks inherent in each product set. Approval processes for credit risk include the use of judgement, assisted by the use of probability of default and loss given default data, and the use of credit scoring. Business Banking operates within policies and authority levels approved by the Chief Risk Officer. Business Banking has a dedicated risk team, reflecting the desire for risk control to be close to the business needs and risks. Commercial Property Finance provides mortgages to borrowers on a range of mainly non-residential property. Agreed credit assessment criteria include serviceability ratios, loan-to-value ratios, and quality of tenants, with stress testing against interest rate movements. Concentration limits per borrower and business sector are also employed to ensure a balanced loan portfolio. The management of defaulting accounts and the repossession and sale of properties is handled by a dedicated function within the risk operation.

The strategic plan to extend the customer proposition into the SME market is being supported by a workstream to manage all risks within this market and throughout the risk cycle. The development of the risk framework is overseen by the Chief Risk Officer.

Market risk in Retail Banking

Market risk is not taken within Retail Banking. Market risks arising in the Retail Banking division are transferred from the originating business to the Asset and Liability Management ('ALM') operation within Group Infrastructure, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities of ALM. Funds received with respect to deposits taken are lent on to Group Infrastructure on matching terms as regards interest rate repricing and maturity. Similarly, loans are funded through matching borrowings from Group Infrastructure.

Risk Management in Corporate Banking

Credit risk in Corporate Banking

Credit risk is the risk that counterparties will not meet their financial obligations resulting in Corporate Banking losing the monies lent, including any interest accrued, or having to close out transactions prematurely, which may incur losses after realising collateral held. Credit risk arises by Corporate Banking making loans, investing in debt securities or other financial instruments or entering into financing transactions or derivative contracts.

Managing credit risk

The Board has approved a set of risk appetite limits to cover different types of risk, including credit risk, arising in Corporate Banking. The Group's credit risk appetite is measured and controlled by a maximum Economic Capital value, which is defined as the maximum level of unexpected loss that the Group is willing to sustain over a one-year period. Within these limits, credit mandates and policies are approved to cover detailed industry, sector and product limits. All transactions falling within these mandates and policies are accommodated under credit limits approved by the appropriate credit authority. Specific approval is usually required by the Credit Approval Committee (a specific committee established under the authority of the Chief Executive) for any transaction that falls outside the mandates.

Analysis of credit exposures and credit risk trends are provided each month to the Corporate Banking Risk Oversight Forum, with key issues escalated to the Risk Committee as required. Large Exposures (as defined by the UK Financial Services Authority) are reported quarterly to the Risk Committee and the UK Financial Services Authority.

Credit risk on derivative instruments is calculated using the potential future mark-to-market exposure of the instruments at a 97.5% statistical confidence level and adding this value to the current value. The resulting "loan equivalent" or credit risk is then included against credit limits, along with other non-derivative exposures. In addition, there is a policy framework to enable the collateralisation of derivative instruments including swaps. If collateral is deemed necessary to reduce credit risk, any unsecured risk threshold, and the nature of any collateral to be accepted, is determined by management's credit evaluation of the counterparty.

Corporate Banking has been targeted as an area where the Group aims to achieve controlled growth, mainly in the area of structured lending to the Real Estate, Education and Health sectors. The Group intends to achieve more modest growth in terms of lending to corporate counterparties in broadly the £500m to £2bn turnover range as well as the initial development of an offering to smaller corporate entities. Focus is being given to the control of credit risks within this expansion with, amongst other things, the development and implementation of robust Credit Policy Mandates and models covering both risk appetite and ratings.

Risk Management continued

Corporate Banking committed facilities net exposure by credit rating of the issuer or counterparty[1]

2008	Social Housing £m	Other £m	Total £m
AAA	-	124	124
AA	1,008	100	1,108
A	5,222	450	5,672
BBB	1,821	3,016	4,837
BB	100	825	925
B	10	41	51
D	-	22	22
Total	**8,161**	**4,578**	**12,739**

2007	Social Housing £m	Other £m	Total £m
AAA	-	110	110
AA	1,915	18	1,933
A	5,646	227	5,873
BBB	2,827	703	3,530
BB	383	636	1,019
B	86	2	88
Total	10,857	1,696	12,553

(1) Internal ratings are applied to all exposures.

The reduction in Social Housing exposures of £2,696m in 2008 is due to the termination of a transaction involving the Group writing credit protection on a pool of Social Housing exposures, partially offset by new business. The increase in Other Lending reflects the planned expansion of the Corporate Banking business.

Corporate Banking non-performing loans and advances[1]

	2008 £m	2007 £m
Non-performing loans and advances that are impaired	54	-
Non-performing loans and advances that are not impaired	-	-
Total non-performing loans and advances[2]	54	-
Non-performing loans and advances as a percentage of loans and advances to customers[3]	1.25%	-
Provision as a percentage of total non-performing loans and advances	48%	-

(1) Amounts are only presented for 2008 and 2007 as this business only became operational in early 2007.
(2) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer.
(3) All non-performing loans are UK loans.

In 2008, non-performing loans and advances as a percentage of loans and advances to customers (including trading assets and excluding finance leases) increased to 1.25%. This reflects the impact of the deteriorating market environment on the performance of the corporate and real estate portfolios.

Interest income recognised on impaired loans amounted to £2m. In 2007, there were no impaired loans.

Credit risk mitigation
Collateralisation

The Social Housing portfolio is secured on residential real estate owned and let by UK Housing Associations. In the Other category, the real estate portfolio collateral is in the form of commercial real estate assets, the corporate portfolio is largely unsecured but holds cross-guarantee agreements or contractual and financial governance. There are also a small number of PFI transactions where collateral is held in the form of a charge over the underlying concession contract.

Restructured loans

Loans may be restructured or renegotiated by capitalising the arrears where customers in arrears have maintained an agreed monthly repayment for a period of five months. In 2008 there were no deals made where interest was capitalised to avoid the loan becoming impaired.

Market risk in Corporate Banking

Market risk is not taken within Corporate Banking. Market risks arising in the Corporate & Corporate Banking division are transferred from the originating business to ALM within Group Infrastructure, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities of ALM. Funds received with respect to deposits taken are lent on to Group Infrastructure on matching terms as regards interest rate repricing and maturity. Similarly, loans are funded though matching borrowings from Group Infrastructure.

Risk Management in Global Banking & Markets

Credit risk in Global Banking & Markets

Credit risk is the risk that counterparties will not meet their financial obligations resulting in Global Banking & Markets losing the monies lent, including any interest accrued, or having to close out transactions prematurely, which may incur losses after realising collateral held. Credit risk arises by Global Banking & Markets making loans, investing in debt securities or other financial instruments or entering into financing transactions or derivative contracts.

Managing credit risk

The Board has approved a set of risk appetite limits to cover different types of risk, including credit risk, arising in Global Banking & Markets. The Group's credit risk appetite is measured and controlled by a maximum Economic Capital value, which is defined as the maximum level of unexpected loss that the Group is willing to sustain over a one-year period. Within these limits, credit mandates and policies are approved to cover detailed industry, sector and product limits.

All transactions falling within these mandates and policies are accommodated under credit limits approved by the appropriate credit authority. Specific approval is usually required by the Credit Approval Committee (a specific committee established under the authority of the Chief Executive) for any transaction that falls outside the mandates.

Analysis of credit exposures and credit risk trends are provided each month to either the Santander Global Banking & Markets Risk Oversight Forum with key issues escalated to the Risk Committee as required. Large Exposures (as defined by the UK Financial Services Authority) are reported quarterly to the Risk Committee and the UK Financial Services Authority.

Credit risk on derivative instruments is calculated using the potential future mark-to-market exposure of the instruments at a 97.5% statistical confidence level and adding this value to the current value. The resulting "loan equivalent" or credit risk is then included against credit limits, along with other non-derivative exposures.

In addition, there is a policy framework to enable the collateralisation of derivative instruments including swaps. If collateral is deemed necessary to reduce credit risk, any unsecured risk threshold, and the nature of any collateral to be accepted, is determined by management's credit evaluation of the counterparty.

Credit risk mitigation

(i) Netting arrangements

The Group restricts its credit risk by entering into transactions under industry standard agreements which facilitate netting of transactions in the jurisdictions where netting agreements are recognised and have legal force. The netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis. However, there is scope for the credit risk associated with favourable contracts to be reduced by netting arrangements embodied in the agreements to the extent that if an event of default occurs, all amounts with the counterparty under the specific agreement can be terminated and settled on a net basis. Derivatives, repurchase and reverse repurchase transactions, stock borrowing/lending transactions and securities financing transactions are governed by industry standard agreements that facilitate netting.

(ii) Collateralisation

The Group also mitigates its credit risk to counterparties with which it primarily transacts financial instruments through collateralisation, using industry standard collateral agreements. Under these agreements, net exposures with counterparties are collateralised with cash, securities or equities. Exposures and collateral are generally revalued daily and collateral is adjusted accordingly to reflect deficits/surpluses. Collateral taken must comply with Global Banking & Markets collateral parameters policy. This policy is designed to control the quality and concentration risk of collateral taken such that collateral held can be liquidated when a counterparty defaults. Cash collateral in respect of derivatives held at the year-end was £2.8bn, not all derivative arrangements being subject to collateral agreements. Collateral obtained during the year in respect of purchase and resale agreements (including securities financing) is equal to at least 100% of the amount of the exposure.

Global Banking & Markets net exposure by credit rating of the issuer or counterparty[(1)]

	2008 £m	2007 £m
AAA	**10,625**	4,687
AA	**10,865**	16,552
A	**3,007**	4,396
BBB	**251**	445
BB	**91**	38
B	**1**	5
Total	**24,840**	26,123

(1) In accordance with the requirements of Basel II, internal ratings are applied to all exposures.

In the securities financing businesses, credit risk arises on both assets and liabilities and on both on and off-balance sheet transactions. Consequently, the above credit risk exposure arises not only from the on balance sheet assets, but also from securities financing trades classified as liabilities and off-balance sheet assets.

Risk Management continued

Market risk in Global Banking & Markets

Market risk-taking is performed within the framework established by the Market Risk Manual. A major portion of the market risk arises from exposures to changes in the levels of interest rates, equity markets and credit spreads. Interest rate exposure is generated from trading activities. Exposure to equity markets is generated by the creation and risk management of structured products by Global Banking & Markets for the Personal Financial Services market and trading activities. Credit spread exposure arises from credit risk management and trading activities within Global Banking & Markets.

Managing market risk in Global Banking & Markets

Risks are managed within limits approved by the Head of Wholesale Risk or Banco Santander, S.A.'s Board Risk Committee and within the risk control framework defined by the Market Risk Manual. For trading activities the primary risk exposures for Global Banking & Markets are interest rate, equity, credit spread and residual exposure to property indices. Interest rate risks are managed via interest rate swaps, futures and options (caps, floors and swaptions). Equity risks are managed via equity stock, index futures, options and structured equity derivatives. Credit-spread risks are managed via credit derivatives (credit default swaps, total return swaps). Property index risk is managed via insurance contracts and property derivatives.

To facilitate understanding and communication of different risks, risk categories have been defined. Exposure to all market risk factors is assigned to one of these categories. The Group considers two categories:

Short-term liquid market risk covers activities where exposures are subject to frequent change and could be closed out over a short-time horizon. Most of the exposure is generated by Global Banking & Markets.

Structural market risk includes exposures arising as a result of the structure of portfolios of assets and liabilities, or where the liquidity of the market is such that the exposure could not be closed out over a short time horizon. The risk exposure is generated by features inherent in either a product or portfolio and normally presented over the life of the portfolio or product. Such exposures are a result of the decision to undertake specific business activities, can take a number of different forms, and are generally managed over a longer time horizon.

Global Banking & Markets operates within a market risk framework designed to ensure that it has the capability to manage risk in a well-controlled manner. A comprehensive set of policies, procedures and processes have been developed and implemented to identify, measure, report, monitor and control risk across Global Banking & Markets.

For trading activities the standardised risk measure adopted is Value at Risk calculated at a 95% confidence level over a one-day time horizon. On a daily basis, market risk factor sensitivities, Value at Risk measures and stress tests are produced, reported and monitored against limits for each major activity and at the aggregate Global Banking & Markets level. These limits are used to align risk appetite with the business's risk-taking activities and are reviewed on a regular basis.

Measurement of risks can involve the use of complex quantitative methods and mathematical principles to model and predict the changes in instruments and portfolio valuation. These methods are essential tools to understand the risk exposures.

Trading Risk in Global Banking & Markets

Trading risk exposure arises only in the Abbey National Treasury Services plc group. Exposures are managed on a continuous basis, and are marked to market on a daily basis.

The following table shows the Value at Risk-based consolidated exposures for the major risk classes as at 31 December 2008, 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. The range of possible statistical modelling techniques and assumptions mean 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. Historical simulation models are used with appropriate add-ons to reflect unobservable inputs.

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 value at risk analysis. The 95% confidence interval, used as a standard across the Group, means that the theoretical loss at a risk factor level is likely to be exceeded in one period in twenty. The Group address this risk by monitoring stress-testing measures across the different business areas. For trading instruments the actual, average, highest and lowest value at risk exposures shown below are all calculated to a 95% level of confidence using a simulation of actual one day market movements over a one-year period. The effect of historic correlations between risk factors is additionally shown below. The use of a one-day time horizon for all risks associated with trading instruments reflects the horizon over which market movements will affect the measured profit and loss of these activities.

The amounts below represent the potential change in market values of trading instruments. Since trading instruments are recorded at market value, these amounts also represent the potential effect on income.

	Actual Exposure at 31 December		
Group trading instruments	**2008 £m**	2007 £m	2006 £m
Interest rate risks	**5.3**	3.0	1.7
Equity risks	**1.2**	2.2	2.9
Spread risks	**1.9**	1.9	0.7
Property risks	**6.8**	3.4	1.2
Other risks[1]	**0.9**	0.3	0.5
Correlation offsets[2]	**(2.5)**	(2.3)	(1.6)
Total correlated one-day Value at Risk	**13.6**	8.5	5.4

Group trading instruments	Average exposure 2008 £m	2007 £m	2006 £m	Highest exposure 2008 £m	2007 £m	2006 £m	Lowest exposure 2008 £m	2007 £m	2006 £m
	Exposure for the year ended 31 December								
Interest rate risks	**3.6**	1.7	1.8	**5.6**	3.7	2.7	**2.5**	0.9	1.2
Equity risks	**2.0**	2.4	2.7	**3.5**	3.7	3.9	**1.0**	1.6	2.0
Spread risks	**1.3**	0.9	1.6	**2.8**	2.0	2.3	**0.5**	0.4	0.7
Property risks	**4.7**	2.3	1.5	**7.4**	3.5	2.0	**3.2**	1.0	1.2
Other risks(1)	**0.6**	0.3	0.4	**1.0**	1.2	0.7	**0.2**	0.1	0.1
Correlation offsets(2)	**(2.2)**	(1.6)	(1.7)	**-**	-	-	**-**	-	-
Total correlated one-day Value at Risk	**10.0**	6.0	6.3	**14.5**	8.8	7.4	**8.0**	4.1	5.1

(1) Other risks include foreign exchange risk.
(2) The highest and lowest exposure figures reported for each risk type did not necessarily occur on the same day as the highest and lowest total correlated one-day Value-at-Risk. A corresponding correlation offset effect cannot be calculated and is therefore omitted from the above table.

Property risks have increased over the last two years and in particular 2008. The largest factor in the Value at Risk increase is from an equity release business funded by the Group, as total equity advances increased over the three-year period. A secondary factor is the significant fall in interest rates in the same period. The present value of all the cashflows has increased significantly as a result of the lower discount rates, increasing sensitivity and hence Value at Risk.

Derivatives held for Trading Purposes

Global Banking & Markets is the only area of the Group actively trading derivative products and is additionally responsible for implementing most Group derivative hedging with the external market. For trading activities, Global Banking & Markets objectives are to gain value by marketing derivatives to end users and hedging the resulting exposures efficiently; and the management of trading exposure reflected on the Group's balance sheet. Trading derivatives include interest rate, cross currency, equity, residential property and other index related swaps, forwards, caps, floors, swaptions, as well as credit default and total return swaps, equity index contracts and exchange traded interest rate futures and equity index options.

Credit Derivatives

Previously, Global Banking & Markets also operated a credit derivatives business. The business traded in single-name credit derivatives, credit derivative indices and a limited number of portfolio credit derivative transactions. The credit derivatives trading function operated within the same framework as other trading functions. Risk limits were established and monitored. Given the lack of activity in the credit markets in 2007 and early 2008, the business was closed and its activities consolidated in Spain with the equivalent Banco Santander, S.A. business area with effect from 1 January 2008. Any residual positions have been hedged with Banco Santander, S.A..

Risk Management in Private Banking

Credit risk in Private Banking

Cater Allen

Cater Allen provides a limited range of products to assist with the finance requirements of individuals and businesses. Risk management policies are specific to and reflect the risks inherent in each product set. Approval processes for credit risk include the use of judgement, assisted by the use of credit scoring and credit ratings. In 2008, Cater Allen operated within policies and authority levels approved by the Chief Risk Officer; in 2009 this is due to change to the Head of Wholesale Risk. Cater Allen has a dedicated risk team, reflecting the desire for risk control to be close to the business needs and risks.

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

	2008 £m	2007 £m
Loans and advances to customers	**3.8**	3.7
Other	**0.2**	0.3
Third party exposures	**4.0**	4.0

Abbey International

Abbey International's office is in Jersey, with a focus on attracting deposits by offering a range of savings accounts denominated in sterling, US dollars and euros. There is no credit risk associated in taking deposits.

James Hay

James Hay provides and offers administration services for self-invested personal pension schemes and the WRAP portfolio management product. Its services are provided to end customers mainly via independent financial advisers and branded financial service providers. With the exception of fees receivable, there is no credit risk associated with this type of service.

Abbey Sharedealing

Abbey Sharedealing provides a direct share dealing service to customers and provides a share-trading platform for cahoot. Customers buy and sell shares on their account with the help of the dealers at Abbey Sharedealing. No advice is provided and all trades are on an execution only basis, account customers are required to provide funds before settlement. As such there is no credit risk associated with this type of activity.

Risk Management continued

Market risk in Private Banking

Market risk arises from exposures to changes in the levels of interest rates, foreign exchange rates and equity markets. Market risk arises through the provision of retail and other banking products and services, as well as structural exposures arising in the balance sheet of the entities in Private Banking.

Managing market risk
Market risks in Private Banking arising from exposure to changes in the levels of interest rates and foreign exchanges rates are substantially transferred from the original business to ALM. Market risks arising from structured products, including exposure to changes in the levels of equity markets, are hedged with Global Banking & Markets. Risks not transferred are managed within a series of market risk mandates, which set triggers for reporting on the extent of market risk that may be retained. These limits are defined in terms of nominal amounts, sensitivity, earnings-at-risk or value-at-risk. Retained market risk exposure is minimal.

Risk Management in Group Infrastructure

Group Infrastructure consists of ALM, which is also responsible for Group Capital and Funding. ALM is responsible for managing the Group's structural balance sheet shape and, in conjunction with Risk Division, tactical liquidity risk management. This includes short-term and medium-term funding, covered bond and securitisation programmes. ALM's responsibilities also include Retail Banking's product and structural exposure to interest rates and, in that role, is a link between the Retail Banking and Global Banking & Markets. ALM recommends and helps to implement Board, Asset and Liability Management Committee and Risk Committee policies for all aspects of balance sheet management - formulating guidance for, and monitoring, the overall balance sheet shape, including maturity profile. Group Capital represents the return on the Group's capital, reserves, preference shares and subordinated debt. Funding represents the provision of funding, both to other businesses within the Group and to fellow subsidiaries of Banco Santander, S.A..

Credit risk in Group Infrastructure

Credit risk is the risk that counterparties will not meet their financial obligations resulting in Group Infrastructure losing the monies lent, including any interest accrued, or having to close out transactions prematurely, which may incur losses after realising collateral held. Credit risk arises by Group Infrastructure making loans, investing in debt securities or other financial instruments or entering into financing transactions or derivative contracts.

Managing credit risk
Credit risk arises in Group Infrastructure with respect to the division's holdings of Santander and Group-issued externally rated, European asset-backed securities and residential mortgage-backed securities principally issued by Santander Group entities, other assets held for liquidity purposes, and lending to fellow subsidiaries of the Santander Group.

All credit risk meets the criteria approved by the Board in respect to Risk Appetite parameters and all exposure, including intra-group, is captured on the global risk management systems and falls within limits approved by Santander Risk Division. The exposure is managed by the Group's Wholesale Risk Team.

Group Infrastructure net exposure by credit rating of the issuer or counterparty[(1)]

	2008 £m	2007 £m
AAA	**9,464**	7,254
AA	**3,193**	643
A	**4,982**	637
BBB+	**1,174**	43
D	**10**	5
Total	**18,823**	8,582

(1) In accordance with the requirements of Basel II, internal ratings are applied to all exposures.

Market risk in Group Infrastructure

Most market risks arising from the Retail Banking, Corporate Banking, and Private Banking divisions are transferred from the originating business to the ALM function within Group Infrastructure, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities of ALM. As a consequence, non-trading risk exposures are substantially transferred to Group Infrastructure. Market risks mainly arise through the provision of banking products and services to personal and corporate/business customers, as well as structural exposures arising in the Group's balance sheet. These risks impact the Group's current earnings and economic value.

The most significant market risks in Group Infrastructure are interest rate and credit spread risks. Yield curve risk arises from the timing mismatch in the repricing of fixed and variable rate assets, liabilities and off-balance sheet instruments, as well as the investment of non-interest-bearing liabilities in interest-bearing assets. Credit spread risk arises principally on Group Infrastructure's holdings of mortgage-backed securities. Basis risk arises, to the extent that the volume of administered variable rate assets and liabilities are not precisely matched, which exposes the balance sheet to changes in the relationship between administered rates and market rates.

The Group is also exposed to risks arising from features in retail products that give customers the right to alter the expected cash flows of a financial contract. This creates prepayment risk, for example where customers may prepay loans before their contractual maturity. In addition, the Group is exposed to product launch risk, for example where the customers may not take up the expected volume of new fixed rate mortgages or other loans.

Managing market risks in Group Infrastructure

The Asset and Liability Management Committee is responsible for managing the Group's overall balance sheet position. Natural offsets are used as far as possible to mitigate yield curve exposures but the overall balance sheet position is generally managed using derivatives that are transacted through Global Banking & Markets. The Treasurer is responsible for managing risks in accordance with the Asset and Liability Management Committee's direction.

Risks are managed within limits approved either by the Head of Wholesale Risk or Banco Santander, S.A.'s Board Risk Committee, and within the risk control framework defined by the Market Risk Manual. The key risk limits relate to yield curve risk. They are:

> Net Interest Margin sensitivity: the sensitivity of annual net interest margin to an instantaneous and unexpected adverse 100 basis point parallel shock to the yield curve.

> Market Value of Equity sensitivity: the sensitivity of the net present value of interest rate sensitive positions to an instantaneous and unexpected adverse 100 basis point parallel shock to the yield curve.

These two measures provide complementary views of potential losses from interest rate movements. Market Value of Equity sensitivity provides a long-term view covering the present value of all future cash flows, whereas Net Interest Margin sensitivity considers only the impact on net interest margin over the next 12 months. Calculation of these two measures requires modelling of expected customer and other behaviours. These models are regularly reviewed and updated.

The following table shows the results of these measures as at 31 December 2008 and 2007:

	2008 **£m**	2007 £m
Net interest margin sensitivity (100 basis points adverse parallel shock)	**(64)**	(7)
Market value of equity sensitivity (100 basis points adverse parallel shock)	**(153)**	(197)

Market risk on the Group's Santander-issued mortgage-backed securities portfolio is managed against credit spread triggers approved by the Head of Wholesale Risk and sensitivity analysis is disclosed in 'Critical accounting policies and areas of significant management judgement' within the Accounting Policies.

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, which require no or little initial net investment and are settled at a future date. They include interest rate, cross-currency and equity related swaps, forward rate agreements, caps, floors, options and swaptions (see below). In Group Infrastructure, derivatives are used for economic hedging.

All derivatives are classified as held at fair value through profit or loss. For accounting purposes, the Group chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria. The main hedging derivatives are interest rate and cross-currency swaps, which are used to hedge fixed-rate lending and structured savings products and medium-term note issuances, capital issuances and other capital markets funding.

Derivative products that are combinations of more basic derivatives (such as swaps with embedded option features), or that 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 economically hedged.

The following table summarises the activities undertaken within Group Infrastructure, the related risks associated with such activities and the types of hedging derivatives used in managing such risks. These risks may also be managed using on-balance sheet instruments as part of an integrated approach to risk management. Further information is contained in Note 14 of the Consolidated Financial Statements.

Activity	**Risk**	**Type of hedge**
Management of the return on variable rate assets financed by shareholders' funds and net non-interest-bearing liabilities.	Reduced profitability due to falls in interest rates.	Receive fixed interest rate swaps.
Management of the basis between administered rate assets and liabilities and wholesale market rates.	Reduced profitability due to adverse changes in the basis spread.	Basis swaps.
Management of repricing profile of wholesale funding.	Reduced profitability due to adverse movement in wholesale interest rates when large volumes of wholesale funding are repriced.	Forward rate agreements.
Fixed rate lending and investments.	Sensitivity to increases in interest rates.	Pay fixed interest rate swaps.
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 income to changes in interest rates.	Interest rate swaps.
Issuance of products with embedded equity options.	Sensitivity to changes in underlying index and index volatility causing option exercise.	Interest rate swaps combined with equity options.
Lending and issuance of products with embedded interest rate options.	Sensitivity to changes in underlying rate and rate volatility causing option exercise.	Interest rate swaps plus caps/floors.
Investment in, and issuance of, bonds with put/call features.	Sensitivity to changes in rates causing option exercise.	Interest rate swaps combined with swaptions[1] and other matched options.

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

Risk Management continued

Impact of the Current Credit Environment

The Group aims to actively manage its exposure to financial institutions and non-bank financial institutions such as pension and investment funds, monoline insurers and general insurers. This exposure arises from investment in floating rate notes, short term money market placements, derivative transactions and margin posting on securities borrowing transactions. Investments in structured assets are concentrated in residential mortgage-backed securities issued by Santander entities in Spain and Portugal, with seasoned portfolios that are performing in line with expectations on the basis of strong credit ratings.

The Group had limited exposure to Lehman Brothers Group arising from derivative contracts. The total claim lodged with the Administrators was £9m and was fully provided for at the year end. The Group had no exposure to Washington Mutual and only a £24m exposure to Iceland which is covered by credit default swap protection. At 31 December 2008, the Group also had indirect exposure of euro 3m to Madoff funds through a structured note. This note was closed out with no loss in February 2009.

Details of the Group's investing and lending arrangements with respect to floating rate notes ('FRNs'), asset-backed securities, Collateralised Debt and Loan Obligations ('CDOs' and 'CLOs'), Structured Investment Vehicles ('SIVs'), monoline Insurers, off-balance sheet entities, other holdings for liquidity purposes, and lending activities are set out below.

Floating Rate Notes

	Nominal value		Fair value movement		Provisions and write-offs	Fair value	Value as % of nominal value
			Income statement	Reserves			
Country	2008 £m	2008 %	2008 £m	2008 £m	2008 £m	2008 £m	2008 %
UK	2,153	42	(4)	-	-	2,194	102
Italy	215	4	(1)	-	-	215	100
Spain	522	10	(2)	-	-	523	100
Rest of Europe	1,722	34	(15)	-	-	1,676	97
US	108	2	-	-	-	109	101
Rest of World	384	8	(3)	-	-	384	100
	5,104	100	(25)	-	-	5,101	100

	Nominal value		Fair value movement		Provisions and write-offs	Fair value	Value as % of nominal value
			Income statement	Reserves			
Credit rating	2008 £m	2008 %	2008 £m	2008 £m	2008 £m	2008 £m	2008 %
AA and above	4,085	80	(17)	-	-	4,062	99
A	1,019	20	(8)	-	-	1,039	102
	5,104	100	(25)	-	-	5,101	100

The FRNs held are principally issued by banks and other financial institutions. On average, the FRNs have 7 months to maturity.

The above table excludes US$100m undated floating rate subordinated notes issued by Alliance & Leicester plc in October 2008, and US$220m and euro 115m undated subordinated notes issued by Alliance & Leicester plc in December 2008 all of which were subscribed for by the Company. As set out in Note 45, the Company is now the immediate parent company of Alliance & Leicester plc.

Asset-Backed Securities

The Group has acquired highly rated, European asset-backed securities ('ABS') and residential mortgage-backed securities with a total value of £4,087m (2007: £5,515m). The Group's portfolios of ABS and MBS are of high quality, containing no sub-prime element and consist almost entirely of AAA rated prime exposures.

	Nominal value		Fair value movement		Provisions and write-offs	Fair value	Value as % of nominal value
			Income statement	Reserves			
Country	2008 £m	2008 %	2008 £m	2008 £m	2008 £m	2008 £m	2008 %
Europe (excluding UK)							
ABS	363	8	(23)	-	-	336	92
MBS	4,155	92	(305)	-	-	3,751	90
	4,518	100	(328)	-	-	4,087	90

Credit rating	Nominal value 2008 £m	Nominal value 2008 %	Fair value movement: Income statement 2008 £m	Fair value movement: Reserves 2008 £m	Provisions and write-offs 2008 £m	Fair value 2008 £m	Value as % of nominal value 2008 %
AAA							
ABS	352	8	(23)	-	-	325	92
MBS	3,855	85	(266)	-	-	3,496	91
	4,207	93	(289)	-	-	3,821	91
Aa1							
ABS	11	-	(1)	-	-	10	91
MBS	300	7	(38)	-	-	256	85
	311	7	(39)	-	-	266	85
	4,518	100	(328)	-	-	4,087	90

The fair value movements above exclude the effects of changes in foreign exchange rates.

Collateralised Debt and Loan Obligations

The Group has no investments in Collateralised Debt Obligations or Collateralised Loan Obligations.

However, in the ordinary course of business, the Group entered into long-term interest rate hedging contracts with five investment vehicles whose underlying assets comprise debt securities, bank loans and energy and infrastructure financings. Although the vehicles themselves are not externally rated, the counterparty exposure ranks super-senior to the most senior notes issued by the vehicles and these notes are rated AAA or AA. The total mark-to-market exposure at 31 December 2008 was £186m.

Structured Investment Vehicles

The Group has insignificant holdings in SIVs, with a nominal value of £17m (2007: £40m) against which provisions of £12m (2007: £10m) are held, giving a book value of £5m (2007: £30m).

Monoline Insurers

The Group has a £41m exposure to a corporate bond which is wrapped by a monoline insurer. In this instance, principal risk exposure is recorded against the corporate bond, with the monoline wrap being viewed as contingent exposure.

Exposure to Off-Balance Sheet Entities sponsored by the Group

The only Special Purpose Entities ('SPEs') sponsored but not consolidated by the Group are SPEs which issue shares that back retail structured products. The Group's arrangements with these entities comprise the provision of equity derivatives and a secondary market making service to those retail customers who wish to exit early from these products. The total value of products issued by the SPEs is £3,213m (2007: £2,455m), and the total value of repurchases held by the Group is £254m (2007: £322m).

Credit Derivatives

As noted above, previously, Global Banking & Markets operated a credit derivatives business. The business traded in single-name credit derivatives, credit derivative indices and a limited number of portfolio credit derivative transactions. The credit derivatives trading function operated within the same framework as other trading functions. Risk limits were established and monitored. There is a limited number of remaining credit derivative transactions with a nominal value of £1.1bn where the Group faces external counterparties and the risk has been hedged with Banco Santander, S.A. in Spain.

Lending Activities

The Group is principally a retail prime lender and has no appetite or product offering for any type of sub-prime business. The Group's credit policy explicitly prohibits such lending and is specifically designed to ensure that any business written is responsible, affordable (both initially and an on-going basis) and of a good credit quality. The Group's principal lending activities arise in the Retail Banking division. For further information, see Risk Management in Retail Banking and Group Infrastructure.

Liquidity

In addition to funding customer loans and advances, the Group also holds available liquid assets, in the form of cash and short term deposits, to manage the day-to-day requirements of the business. The Group holds a significantly higher level of liquid assets than in 2007, in recognition of the current market conditions.

Risk Management continued

Liquidity risk

Liquidity risk is the potential that the Group has insufficient financial resources to meet its payment obligations as they fall due, or can do so only at excessive cost. Liquidity risks arise throughout the Group's businesses. Its primary business activity is commercial banking and, as such, it engages in maturity transformation, whereby it raises funds that may be withdrawn at short notice and lends them to customers at longer terms.

Following Banco Santander, S.A.'s acquisition of Alliance & Leicester plc in October 2008, the liquidity risks of the Group and Alliance & Leicester plc have been managed on a combined basis. In 2008, Santander's commitments to the UK Government and regulators to improve the Tier 1 ratio of the combined UK businesses were met using the additional £1bn of capital announced at the time of the acquisition of Alliance & Leicester plc, which was transferred into Abbey from Santander. This capital was in turn transferred to Alliance & Leicester plc in late December as planned.

The majority of funding is raised from retail deposits with the balance raised in wholesale markets. The traditional sources of wholesale funding were:

> Secured and unsecured money-market funding (including unsecured cash, repo, CD and CP issuance);

> Senior debt issuance (including discrete bond issues and MTNs);

> Mortgage-backed funding (including securitisation and covered bond issuance);

> Subordinated debt and capital issuance (although the primary purpose is not funding).

As a result of current market conditions, the mortgage-backed funding markets, which have traditionally been important sources of funding, were effectively closed to new external issuances, except for private placements with a small number of investors. However, the Group benefitted both from the conservative proportion of retail assets that are funded in wholesale markets, as well as having entered the period of market stress in a strong liquidity position. All internal and external liquidity ratios were maintained during this period.

The Group has access to the Bank of England's and the US Federal Reserve's lending facilities. In addition, the Group has the ability to access indirectly the European Central Bank's repo facilities. The key on-going liquidity risks to the Group are therefore:

> Loss of customer deposits;

> Loss of access to wholesale funding markets (including foreign exchange swaps) or counterparties;

> Intra-day payments systems dislocation; and

> Contingent liabilities arising from mortgage-backed or other funding, such as collateral calls or early amortisation.

Liquidity risk management

The Board is responsible for the liquidity management and control framework and defines the liquidity risk appetite. Liquidity risk management is the responsibility of the Chief Financial Officer who delegates day-to-day responsibility to the Treasurer. The Group has a centralised liquidity risk management approach whereby all liquidity/funding is managed centrally by the Treasurer, under the direction of the Asset & Liability Management Committee and within the framework of the Liquidity Risk Manual. The Asset and Liability Management Committee and the Risk Committee monitor Abbey's liquidity position on a monthly basis. The Board also receives a monthly update on key liquidity issues and Abbey's liquidity position is reported to the Financial Services Authority on a weekly basis.

Abbey 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. A management and monitoring process, and a series of liquidity limits within which liquidity is managed, underpin these elements. For example, an excessive concentration in either liquid assets or contractual liabilities contributes to potential liquidity risk, and so appropriate limits have been defined under the Liquidity Risk Appetite. Management also monitors Abbey's compliance with limits set by the Financial Services Authority. In addition to such limits, liquidity ratios have trigger-review levels that require the Treasurer, Head of Asset and Liability Management, and Head of Wholesale Risk to initiate appropriate reviews of current exposure when such levels are exceeded.

In line with the policy of Banco Santander, S.A., the Group manages its funding and maintains adequate liquidity on a stand-alone basis.

While the Group's liquidity risk is consolidated and centrally controlled, liquidity risk is also measured, monitored and controlled within the specific business area or the subsidiary where it arises.

The key elements of the Group's liquidity risk management are:

Short-term, tactical liquidity management:

> **Liquid assets** – a buffer of liquid assets is held to cover unexpected cashflows in extreme but plausible stress scenarios. In the Group's case, the largest stress event is likely to include large and unexpected deposit withdrawals by retail customers.

> **Intra-day collateral management** – to ensure that adequate collateral is available to support payments in each payment or settlement system in which the Group participates, as they fall due.

Strategic liquidity management:

> **Structural balance sheet shape** – to manage the extent of maturity transformation (investment of shorter term funding in longer term assets), the funding of non-marketable assets with wholesale funding and the extent to which non-marketable assets can be used to generate liquidity.

> **Wholesale funding strategy** – to avoid over-reliance on any individual counterparty, currency, market or product, or group of counterparties, currencies, markets or products that may become highly correlated in a stress scenario; and to avoid excessive concentrations in the maturity of wholesale funding.

> **Wholesale funding capacity** – to maintain and promote counterparty relationships, monitor line availability and ensure funding capacity is maintained through ongoing use of lines and markets.

The Liquidity Contingency Plan becomes operational when the demand for cash, whether from demands for repayment, from wholesale funding or from retail deposits, exceeds the normal liquidity management process capacity. The circumstances that cause this to happen will tend to be sudden, unexpected events that trigger demands for cash that cannot be managed within the procedures, limits and controls defined in the Liquidity Risk Manual.

To be effective, the management of liquidity in a crisis must be timely, proactive and flexible enough to respond to a variety of different circumstances. The management structure for the Liquidity Contingency Plan, which is structured around a small team of individuals with the authority to agree, co-ordinate and implement actions that will control a volatile, dynamic situation, has two key elements:

> the Treasurer and Head of Asset and Liability Management is responsible for the rapid assessment of the implications of a sudden, unexpected event on the day-to-day liquidity of the Group, and for the decision to activate the Liquidity Contingency Plan; and

> the liquidity crisis management team, under the chairmanship of the Chief Financial Officer, is the decision-making authority in the event of a liquidity crisis, and is responsible for implementing the Liquidity Contingency Plan.

Risk limits or triggers are set for the key tactical and strategic liquidity risk drivers. These are monitored by the Treasurer and Risk Division and reported monthly to the Asset & Liability Management Committee, Risk Committee and the Board.

Current market conditions

During 2008, liquidity in the wholesale funding markets came under unprecedented and prolonged stress. From the Group's perspective, short-term unsecured money-market funding has been continuously available. However, investor demand for unsecured and mortgage-backed issuance has been much reduced since 2007 and at significantly wider spreads. These markets have traditionally been important sources of funding. Funding issues also came to the fore in the banking sector more generally, resulting in the introduction of government-backed funding initiatives, including the UK Government Credit Guarantee Scheme.

During this time, the Group kept its main stress scenarios under review and updated the extreme stress scenario, upon which the Board's risk appetite is based, in light of market developments. At all times, the Group sought to maintain a buffer of securities that are eligible for discount in open market operations with the central banks to which the Group has access. This buffer was at least sufficient to survive either an acute Group-specific stress during stressed market conditions, or a prolonged loss of unsecured wholesale funding during stressed market conditions. The underlying analysis of customer deposit behaviour under stressed conditions is aligned with the assumptions made in operational contingency planning.

In addition, the acquisition in September 2008 of the retail deposits of Bradford & Bingley plc significantly increased the proportion of the balance sheet that was funded by retail, rather than wholesale, liabilities.

The UK Government initiative announced in early October 2008, including the provision of liquidity and funding support and facilities to enable banks to raise new capital to strengthen their capital base, was welcomed by the Group. The Group did not use the UK Government recapitalisation scheme, nor does it expect to in the future. In 2009, with respect to liquidity and funding arrangements, rather than capital, we expect to remain flexible in our approach. We believe that the current arrangements with the Bank of England, European Central Bank and US Federal Reserve, as well as the UK Credit Guarantee Scheme that are available to the UK banking industry will help the banking sector to meet liquidity and funding needs.

During 2008, all key liquidity limits were maintained.

Risk Management continued

Maturities of financial liabilities

The table below analyses the maturities of the undiscounted cashflows relating to financial liabilities of the Group based on the remaining period to the contractual maturity date at the balance sheet date. Deposits by customers are largely made up of Retail Deposits. In particular the 'Demand' grouping includes current accounts and other variable rate savings products. The 'Up to 3 months' grouping largely constitutes wholesale funding of wholesale assets of a similar maturity. This table is not intended to show the liquidity of the Group.

						Group
At 31 December 2008	**Demand £m**	**Up to 3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Deposits by banks	**1,096**	**1,994**	**147**	**117**	**-**	**3,354**
Deposits by customers	**73,735**	**8,116**	**14,144**	**3,405**	**743**	**100,143**
Derivative financial instruments	**1,377**	**1,294**	**2,581**	**8,657**	**24,408**	**38,317**
Trading liabilities	**5,071**	**31,253**	**1,817**	**1,667**	**1,554**	**41,362**
Financial liabilities designated at fair value	**-**	**1,495**	**994**	**1,832**	**1,160**	**5,481**
Debt securities in issue	**-**	**11,122**	**5,635**	**7,357**	**42,768**	**66,882**
Other borrowed funds	**-**	**60**	**93**	**493**	**4,110**	**4,756**
Subordinated liabilities	**-**	**216**	**242**	**2,069**	**5,788**	**8,315**
Total financial liabilities	**81,279**	**55,550**	**25,653**	**25,597**	**80,531**	**268,610**

						Company
At 31 December 2008	**Demand £m**	**Up to 3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Deposits by banks	**2,907**	**18,354**	**19,638**	**58,758**	**36,477**	**136,134**
Deposits by customers	**64,514**	**18,286**	**14,516**	**14,001**	**59,490**	**170,807**
Derivative financial instruments	**176**	**-**	**-**	**2,067**	**5,258**	**7,501**
Trading liabilities	**4**	**22**	**748**	**-**	**-**	**774**
Debt securities in issue	**-**	**-**	**-**	**-**	**-**	**-**
Other borrowed funds	**-**	**45**	**46**	**245**	**1,247**	**1,583**
Subordinated liabilities	**-**	**232**	**288**	**2,316**	**8,651**	**11,487**
Total financial liabilities	**67,601**	**36,939**	**35,236**	**77,387**	**111,123**	**328,286**

						Group
At 31 December 2007	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	416	7,318	257	-	-	7,991
Deposits by customers	55,766	8,541	3,668	1,920	166	70,061
Derivative financial instruments	3	502	731	4,855	10,891	16,982
Trading liabilities	21,069	28,973	2,931	1,409	1,515	55,897
Financial liabilities designated at fair value	-	1,598	2,111	3,647	1,800	9,156
Debt securities in issue	-	8,696	2,437	8,433	47,619	67,185
Other borrowed funds	-	56	80	424	3,394	3,954
Subordinated liabilities	-	194	223	1,820	5,456	7,693
Total financial liabilities	77,254	55,878	12,438	22,508	70,841	238,919

						Company
At 31 December 2007	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	2,060	14,635	8,897	36,497	6,444	68,533
Deposits by customers	52,806	7,332	4,090	10,088	33,978	108,294
Derivative financial instruments	-	-	-	94	2,658	2,752
Debt securities in issue	-	4	-	-	-	4
Other borrowed funds	-	45	46	245	1,280	1,616
Subordinated liabilities	-	205	257	1,999	7,570	10,031
Total financial liabilities	54,866	22,221	13,290	48,923	51,930	191,230

The growth in the Company balance sheet is due to the increased use of inter-company loans and deposits rather than inter-company swaps to match the interest rate profile of customer balances.