(8)

Risk Management

The Risk Management report contains audited financial information except principally for the discussion of Operational Risk on page 19 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 Alliance and Leicester plc (the 'Company', and together with its subsidiaries, the 'Group'), and includes more detail on the Company'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 pages 17 to 18;

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 19 to 20.

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 21 to 30:

- **Risks in Retail Banking** – The risks in these segments are described on pages 21 to 24, 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 24 to 25, consisting of:
    - **Credit risk**, including its management and mitigation.
    - **Market risk**, including its management.

- **Risks in Treasury** – The risks in this segment are described on pages 26 to 30, including:
    - **Credit risk**, including its management, mitigation, and the disclosure of exposure by rating and geography.
    - **Market risk**, including its management, and disclosures on short-term market risk and structural market risk.

The Impact of the Current Credit Environment – Detailed disclosures can be found on pages 30 to 32, 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 can be found on page 32.

Introduction

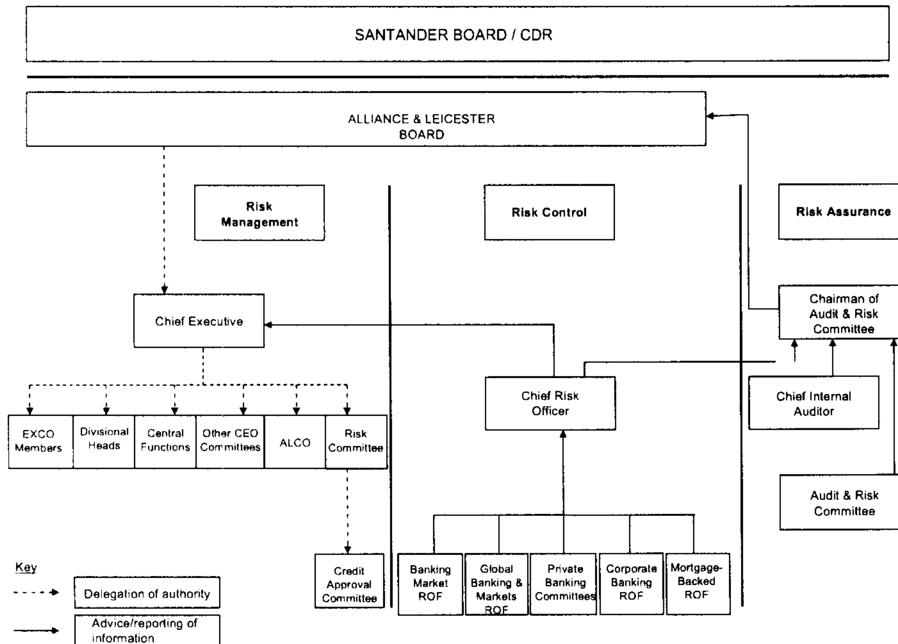
The Group accepts that risk arises from its full range of activities, and actively manages and controls it. The management of risk is an integral part of the Group's activities. Risk is defined as the uncertainty around the Group's ability to achieve its business objectives and execute its strategy effectively. 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 (Corporate), Credit Risk (Treasury), 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 a business imperative. The Company's Risk Framework ensures 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.

Authority for Risk Management flows from the Alliance & Leicester plc Board of Directors 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

This 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 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, Corporate Banking and Treasury business.

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 and Treasury.

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.

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 co-ordinated 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 exposures to credit risk derived from its three segments of Retail Banking, Corporate Banking, and Treasury. Within Retail Banking, the most significant exposures to credit risk derive from the residential mortgage portfolio and unsecured personal lending businesses. Within Corporate Banking, significant exposures also derive from the commercial loans portfolio. Within Treasury, significant exposures result from its asset portfolio.

The residential mortgage portfolio comprises loans to private individuals secured against residential properties in the UK. This is a prime portfolio with total balance sheet exposure of £37.7bn at 31 December 2008. The Unsecured Personal Loan portfolio comprises unsecured loans to private individuals issued in the UK. Total exposure stood at £3.4bn at 31 December 2008. The commercial loans portfolio in Corporate Banking comprises loans to companies and associated derivatives. The total exposure to this portfolio was £10.4bn at 31 December 2008.

Although Corporate Banking 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. A significant proportion of Corporate Banking exposures were to counterparties that reside in the EU. Treasury exposures result from its asset portfolio. At 31 December 2008 treasury investment securities stood at £14.3bn. Details on credit ratings and geographic analysis can be found on pages 27 to 30.

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	–	1,439
Loans and advances to banks	**1,239**	2,885
Derivative financial instruments	**2,876**	970
Financial assets designated at fair value	**63**	891
Available-for-sale securities	**1,658**	12,773
Loan and receivable securities	**14,250**	210
Loans and advances to customers	**51,402**	55,056
Other	**348**	497
Third party exposures[1]	**71,836**	74,721

(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 34 to the Consolidated Financial Statements on page 89.

In managing the gross exposures, the Group uses the policies and processes described in the credit risk sections below. Collateral is also held in the form of security over the mortgaged property and through market standard collateral agreements in its treasury business.

Basel II (unaudited)

The Group has applied the retail internal ratings-based (IRB) approach for credit risk to its key retail portfolios from 1 January 2007. The foundation internal ratings based approach has been applied to the majority of commercial loans and exposures to financial institutions from the same date. The remaining assets are currently on the standardised approach. The standardised approach has also been applied to Operational Risk from 1 January 2007.

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 defined benefit staff pension scheme. The scheme is 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 scheme, 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 scheme 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 64 and in Note 33 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 pages 87 to 89.

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 Group losing the principal amount lent, the interest accrued and any unrealised gains (less any security held). Credit risk occurs mainly in the Group's loan and investment assets (including residential mortgages and secured lending, personal and business banking), and in derivative contracts. The Group actively manages and controls credit risk.

Residential mortgages and secured lending

The Group lends on many types of property but only after a credit risk assessment of the borrower, including affordability modelling, and an assessment of the property are 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, affordability and the mortgage credit score.

The majority of loans provided by the Group are secured on UK properties. All properties must be permanent in construction; mobile homes are not acceptable.

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 Royal Institute of Chartered Surveyors and Group guidelines. Normally, in the case of additional lending, when the total loan remains below 90% loan-to-value, the original property value is subject to indexation and no further survey is carried out. If the loan exceeds 90% loan-to-value, a revaluation is carried out by a qualified surveyor. In low risk re-mortgage cases where a reputable automated valuation within high confidence limits is available this may substitute for a surveyor's valuation.

Progressively stricter lending criteria are applied to mortgages above a loan-to-value of 75%. Only 2% 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
Loan-to-value analysis:		
New business		
> 90%	**2%**	8%
75% – 90%	**36%**	36%
< 75%	**62%**	56%
Average (at inception)	**63%**	67%
Average loan-to-value of stock (indexed)	**49%**	46%
New business profile:		
First-time buyers	**17%**	25%
Home movers	**44%**	45%
Remortgages	**25%**	24%
Further advances	**14%**	6%
Average earnings multiple	**3.1**	3.3

(1) Excludes any fees added to the loan, and only includes the drawn loan amount, not drawdown limits. Includes prime mortgage lending and excludes buy to let.

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 average loan to value ('LTV') on new business completions gradually reducing through the year, with the 4th quarter at 56% (Q3 08: 61% Q4 07: 65%). The indexed stock LTV increased to 49% 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 0.47% in December 2007 to 0.83% 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 1.88%.
- Completions in excess of 75% LTV have fallen from 44% in 2007 to 38% in 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 and 2007 for the Group 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 2007	0.65
31 December 2008	**0.76**
61 to 90 days in arrears	
31 December 2007	0.28
31 December 2008	**0.37**

	Group	CML[2](unaudited)
	(Percentage of total mortgage loans by number)	
3 to 5 months in arrears		
31 December 2007	0.29	0.62
31 December 2008	**0.47**	**1.01**
6 to 11 months in arrears		
31 December 2007	0.13	0.35
31 December 2008	**0.26**	**0.62**
12 months or more in arrears		
31 December 2007	0.05	0.13
31 December 2008	**0.10**	**0.25**

(1) Alliance & Leicester 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 – Data as at 31 December 2008.

Properties in possession	Group	CML[2](unaudited)
	(Percentage of total mortgage loans by number)	
31 December 2007	0.02	0.10
31 December 2008	**0.03**	**0.21**

Carrying amount of assets obtained as collateral	**£m**
31 December 2007	12
31 December 2008	**16**

Restructured loans

Some mortgage loans have had arrears capitalised. The value of capitalised arrears on loans was less than £1m in both 2008 and 2007.

Unsecured personal loans. The Group 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 the Group and how the customer uses their bank account together with a monthly update of the customer's external borrowing via credit bureaux. 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. The Group 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.

Unsecured personal loan arrears

	2008 £m	2007 £m
Total unsecured personal loan arrears[1,2]	**213**	203
Total unsecured personal loan asset	**3,534**	4,041
Unsecured personal loan arrears as a % of asset	**6.03**	5.02

(1) Unsecured personal loans include current account customers.
(2) Unsecured personal loans 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 the Group's loan portfolio from homogeneous portfolios of assets and individually identified loans. A proportion of the Group'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 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. During the year, 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 12 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 the Group'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.

Movements in provisions for impairment losses on loans and advances

	2008 £m
Provisions at 1 January 2008	136
Amounts written off	
Advances secured on residential properties - UK	(10)
Unsecured personal advances - UK	(102)
Total amounts written off	(112)
Observed provisions charged against profit	
Advances secured on residential properties - UK	46
Unsecured personal advances - UK	202
Total observed provisions charged against profit	248
Incurred but not yet observed provisions charged against profit	26
Total provisions charged against profit	274
Provisions at the end of the year	298

Risk Management continued

Recoveries

	2008 £m
Advances secured on residential properties - UK	1
Unsecured personal advances - UK	13
Total amount recovered	14

Retail Banking non-performing loans and advances[1]

	2008 £m
Non-performing loans and advances that are impaired	186
Non-performing loans and advances that are not impaired	344
Total non-performing loans and advances[2]	530
Non-performing loans and advances as a percentage of loans and advances to customers[3]	1.29%
Provision as a percentage of total non-performing loans and advances	56.2%

(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 include residential mortgages, unsecured personal loans and current account overdrafts.

Accounting estimates have been refined reflecting the state of the UK economy as described in Note 8 to the financial statements. As a result, comparatives for 2007 are not available in the above format. Movement in provisions for 2007 can be found in Note 16 on page 75.

In 2008, non-performing loans and advances as a percentage of loans and advances to customers was 1.29%. This reflects the impact of the deteriorating market environment on the performance of the unsecured personal loan and residential mortgage portfolio and a refinement in accounting estimates.

Interest income recognised on Retail Banking loans that are more than three months in arrears amounted to £14m (2007: £25m).

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 Treasury and Group Items, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities. Funds received with respect to deposits taken are lent on to Treasury and Group Items on matching terms as regards interest rate repricing and maturity. Similarly, loans are funded through matching borrowings from Treasury and Group Items.

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. Subsequent to its acquisition, the management of Corporate Banking credit risk has been aligned with the processes and procedures used within Abbey National's Corporate Banking unit. Alliance & Leicester's credit risk appetite is therefore now measured and controlled by a maximum Economic Capital value, which is defined as the maximum level of unexpected loss that Alliance & Leicester 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 Approvals 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% (95% prior to acquisition) 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 we aim to achieve controlled growth, mainly in the area of structured lending to the Real Estate, Education and Health sectors. 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.

The following tables provide details of provisions, recoveries, arrears and non-performing loans for the Corporate Banking portfolio as at 31 December 2008.

Movements in provisions for impairment losses on loans and advances:

	2008 £m
Provisions at 1 January 2008	27
Amounts written off	
Secured	(7)
Unsecured	(10)
Total amounts written off	(17)
Observed provisions charged against profit	
Secured	82
Unsecured	73
Total observed provisions charged against profit	155
Incurred but not yet observed provisions charged against profit	120
Total provisions charged against profit	275
Provisions at the end of the year	285

Recoveries

	2008 £m
Secured	-
Unsecured	1
Total amount recovered	1

Accounting estimates have been refined reflecting the state of the UK economy as described in Note 8 to the financial statements. As a result, comparatives for 2007 are not available in the above format. Movement in provisions for 2007 can be found in Note 16 on page 75.

Corporate Banking arrears

	2008 £m	2007 £m
Total Corporate lending arrears	89	39
Total Corporate lending assets	9,948	8,157
Corporate lending arrears as a % of asset	0.89	0.48

Corporate Banking non-performing loans and advances

	2008 £m	2007 £m
Non-performing loans and advances that are impaired	343	10
Non-performing loans and advances that are not impaired	-	-
Total non-performing loans and advances	343	10
Non-performing loans and advances as a percentage of loans and advances to customers	3.45	0.12
Provision as a percentage of total non-performing loans and advances	83	270

Market risk in Corporate Banking

Market risk is not taken within Corporate Banking. Market risks arising in the Corporate Banking division are transferred from the originating business to ALM within Treasury and Group Items, 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 Treasury and Group Items on matching terms as regards interest rate repricing and maturity. Similarly, loans are funded though matching borrowings from Treasury and Group Items.

Risk Management in Treasury

Credit risk in Treasury

Credit risk is the risk that counterparties will not meet their financial obligations resulting in Treasury 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 Treasury making loans, investing in debt securities or other financial instruments or entering into financing transactions or derivative contracts.

Managing credit risk in Treasury

The Alliance & Leicester Group Risk department has been integrated into the Abbey National plc Wholesale Credit Risk department where responsibility for the credit control of assets held by Treasury, as well as for all country, sovereign and financial institution exposures is managed. Risks are managed in accordance with limits, asset quality plans and criteria set out in the relevant policy statement.

Decisions are based on independent credit risk analysis, supplemented by the output of internal ratings tools and external rating agency analysis. An internal ratings model is used to grade financial institution exposures and to generate probability of default and expected loss. The Group uses external ratings supplemented by internal analysis to assess the risks associated with structured credit and securitisation investments. Individual exposures are reviewed at least annually. Asset quality monitoring is reported by regular executive and management reporting, and exception reporting against a range of asset quality triggers, which include expected loss analysis.

The Treasury investment portfolio is monitored for potential impairment as soon as an event occurs to suggest a counterparty's creditworthiness merits attention. Once specific events give rise to a reasonable expectation that future anticipated cash flows may not be received, the asset originating these doubtful cash flows will be deemed to be impaired.

For structured investment vehicles (SIVs), Collateralised Debt Obligations (CDOs) and Collateralised Loan Obligations (CLOs) impairment is deemed to have occurred when one or more of the following events have occurred:

- the vehicle has realised losses arising from sale of assets that make it probable that the note-holders will not receive principal and base coupon in full;
- the vehicle has been restructured and the terms of the restructuring make it probable that the note-holders will not receive principal and base coupon in full;
- the Group expects to participate in a restructuring or refinancing of the vehicle which has been proposed by the vehicle's manager or sponsor and the likely terms make it probable that the note-holders will not receive principal and base coupon in full;
- the vehicle has entered into enforcement; or
- the funding and market conditions are such that the vehicle is expected either to sell assets or restructure such that it is probable that the note-holders will not receive principal and base coupon in full.

Collateralised debt obligations (CDOs) containing sub-prime US mortgage assets and other structured credit assets are deemed impaired if estimated losses on the underlying assets exceed the level of credit support. Asset backed securities are assessed on an individual basis.

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 revalued daily and collateral is adjusted accordingly to reflect deficits/surpluses. Collateral taken must comply with 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 £566m.

Treasury investments

Investment securities

	Nominal £m	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m
Floating rate notes (FRN)	10,132	(182)	(55)	38	9,933
Asset backed securities (ABS)	4,001	(186)	(25)	(74)	3,716
Collateralised debt obligations (CDO)	366	(15)	(72)	(115)	164
Collateralised loan obligations (CLO)	352	(25)	(1)	(5)	321
Principal protected notes (PPN)	42	(6)	(5)	3	34
Other	138	-	(7)	14	145
Total	15,031	(414)	(165)	(139)	14,313

Investment securities include loan & receivable securities and financial assets designated at fair value.

Other includes discounts and premiums, accrued interest and amortisation of mark-to-market losses. The fair value of loan & receivable securities was £13.2bn compared to a balance sheet value of £14.3bn at 31 December 2008.

Analysis of provisions on investment securities

	2008 £m
Provisions as at 1 January	122
Charge for the year: Increase in impairment	414
Amounts written off in period	(411)
Provisions as at 31 December	125

Provisions on investment securities are all individual provisions. The total Treasury impairment loss charge for 2008 was £426m (Note 8). This includes a £12m charge for loans and advances to banks.

Investment securities by credit rating of the issuer or counterparty[1]

	FRN £m	Other £m	Total £m
AAA	-	3,809	3,809
AA	2,333	176	2,509
A	6,596	170	6,766
BBB	712	77	789
Below BBB	292	148	440
Total	9,933	4,380	14,313

(1) Internal ratings are applied to all exposures.

Floating Rate Notes

Country	Nominal £m	Nominal %	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m	Holding value as % of nominal value
UK	942	9	(21)	(17)	9	913	97
Italy	1,101	11	(10)	-	8	1,099	100
Spain	2,338	23	(43)	-	13	2,308	99
Rest of Europe	3,393	33	(62)	(38)	12	3,305	97
US	994	10	(36)	-	(10)	948	95
Rest of World	1,364	14	(10)	-	6	1,360	100
Total	10,132	100	(182)	(55)	38	9,933	98

Risk Management continued

Credit rating	Nominal £m	Nominal %	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m	Holding value as % of nominal value
AA	2,350	23	(24)	-	7	2,333	99
A	6,703	66	(127)	-	20	6,596	98
BBB	735	7	(27)	-	4	712	97
Below BBB	344	4	(4)	(55)	7	292	85
Total	10,132	100	(182)	(55)	38	9,933	98

Asset-Backed Securities

Country/Asset type	Nominal £m	Nominal %	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m	Holding value as % of nominal value
UK							
ABS	31	1	-	-	-	31	100
MBS	1,302	32	(29)	(11)	(7)	1,255	96
US							
ABS	962	24	(56)	-	(25)	881	92
MBS	393	10	(61)	(11)	(44)	277	70
Rest of Europe							
ABS	98	3	(3)	-	1	96	98
MBS	929	23	(34)	(3)	3	895	96
Rest of World							
ABS	36	1	-	-	-	36	100
MBS	250	6	(3)	-	(2)	245	98
Total	4,001	100	(186)	(25)	(74)	3,716	93

Credit Rating /Asset type	Nominal £m	Nominal %	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m	Holding value as % of nominal value
AAA							
ABS	1,052	26	(56)	-	(5)	991	94
MBS	2,613	66	(102)	(13)	(28)	2,470	95
AA							
ABS	18	-	-	-	(3)	15	83
MBS	105	3	(11)	-	(9)	85	81
A							
ABS	83	2	(3)	-	(13)	67	81
MBS	38	1	(8)	-	(1)	29	76
BBB							
ABS	17	-	-	-	(5)	12	71
MBS	33	1	(6)	-	(5)	22	67
Below BBB							
MBS	42	1	-	(12)	(5)	25	60
Total	4,001	100	(186)	(25)	(74)	3,716	93

Collateralised Debt Obligations

Country	Nominal £m	Nominal %	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m	Original exposure to sub-prime %	Original credit enhancement %	Holding value as % of nominal value
UK	24	7	(6)	-	(1)	17	-	27	71
Rest of Europe	3	1	-	-	-	3	-	-	100
US	339	92	(9)	(72)	(114)	144	21	28	42
Total	366	100	(15)	(72)	(115)	164	19	27	45

Credit rating	Nominal £m	Nominal %	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m	Original exposure to sub-prime %	Original credit enhancement %	Holding value as % of nominal value
AAA	147	40	(12)	-	(44)	91	1	34	62
AA	38	10	(1)	-	(19)	18	10	35	47
A	11	3	-	-	(7)	4	13	23	36
BBB	18	5	(2)	(1)	(8)	7	14	8	39
Below BBB	152	42	-	(71)	(37)	44	41	21	29
Total	366	100	(15)	(72)	(115)	164	19	27	45

Collateralised Loan Obligations

Country	Nominal £m	Nominal %	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m	Holding value as % of nominal value
UK	115	33	(5)	(1)	(1)	108	94
Rest of Europe	47	13	(7)	-	1	41	87
US	190	54	(13)	-	(5)	172	91
Total	352	100	(25)	(1)	(5)	321	91

Credit rating	Nominal £m	Nominal %	Fair value through reserves (pre-tax) £m	Fair value & impairment through income statements £m	Other £m	Balance sheet value as at 31.12.08 £m	Holding value as % of nominal value
AAA	276	78	(12)	(1)	(6)	257	93
AA	42	12	(7)	-	1	36	86
A	30	9	(4)	-	-	26	87
BBB	4	1	(2)	-	-	2	50
Below BBB	-	-	-	-	-	-	-
Total	352	100	(25)	(1)	(5)	321	91

Other

Other investments total £145m. The majority of these are Corporate lending transactions were completed by the Corporate Bank.

Risk Management continued

Secured Loan to Conduit
As at 31 December 2008:

Asset Type	Credit rating	Nominal value £m	Impairment £m	Original credit enhancement %	Original sub-prime exposure %	Original vintage Pre-2005 %	2005 %	2006 %	2007 %
ABS									
US RMBS	AAA	46	-	32	-	39	61	-	-
(ALT-A)	AA	5	-	18	-	-	-	-	-
Total ABS		51	-	30	-	35	55	-	-
CLO									
	AAA	442	-	24	-	99	-	-	1
	AA	33	-	29	-	82	18	-	-
	A	30	-	26	-	100	-	-	-
Total CLO		505	-	24	-	98	1	-	1
CDO									
ABS CDO	AAA	19	-	24	36	100	-	-	-
	AA	26	-	28	44	100	-	-	-
	BBB	28	4	26	45	100	-	-	-
	Below BBB	45	17	30	65	100	-	-	-
		118	21	28	51	100	-	-	-
Synthetic CDO									
	AAA	27	-	19	-	-	100	-	-
	A	76	6	10	-	32	68	-	-
	BBB	17	14	10	-	-	100	-	-
	Below BBB	34	31	5	-	-	100	-	-
		154	51	10	-	16	84	-	-
Other									
	AAA	73	-	45	-	45	-	55	-
	AA	17	-	61	-	-	41	59	-
	A	11	-	49	-	-	100	-	-
		101	-	48	-	32	18	50	-
Total CDO		373	72	26	16	47	40	13	-
Total Conduit assets		929	72			74	19	6	1

The Group's Conduit facility is currently funded by the Group via secured loans. The Group assesses impairment based on the performance of the underlying assets within the Conduit. The Conduit is not consolidated into the Group accounts on the basis that the Special Purpose Vehicles (SPVs) within the Conduit are not controlled by the Group.

Market risk

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's exposure to market risk is governed by a policy approved by the Asset and Liability Management Committee (ALCO) and ratified by the Risk Committee. The policy sets out the nature of risk which may be taken, and applicable maximum risk limits. The Group risk limits are allocated by ALCO to all business units.

Risk division monitors compliance with market risk limits and reports excesses to ALCO or Risk Committee.

Interest rate risk

Interest rate re-pricing risk mainly arises from mismatches between the re-pricing dates of the assets and liabilities on the Group's balance sheet, changes in the value of non-linear interest rate positions such as interest rate caps, and from the investment of the Group's reserves and non-interest and low interest rate liabilities. The Group has established a transfer pricing system which passes interest rate re-pricing risks that arise in the various Group businesses to Treasury. Treasury manages the Group's overall interest rate risk within policy limits. In addition, strategic hedges are agreed by the ALCO for the investment of the Group's reserves and non-interest and low interest rate liabilities. These hedges are transacted by Treasury.

Interest rate risk limits are expressed as the maximum principal amount which is re-priced during a given time period. In the case of Treasury, interest rate risk is measured and limited according to the market value impact of a one basis point shift in particular points on the yield curve. In addition, Value at Risk (VaR) is used to measure the Group's total exposure to interest rate risks. The VaR measurement methodology calculates the potential loss, in market value terms, from existing risk positions as a result of movement in market interest rates. A variance-covariance VaR model is used based on historical volatility and correlation data and measures VaR to 95% confidence over a one month holding period. A separate model is used to calculate the VaR on positions, such as interest rate options, whose market value varies with changes in interest rates in a non-linear way.

Although it is a useful tool in measuring risk, VaR does contain some limitations:

> It does not accurately measure extreme events;

> The use of a 95% confidence level does not by definition include losses beyond this level of confidence;

> It relies on the historical volatility and correlation data being similar to the volatility and correlation positions going forward.

The VaR of the Group's non-trading book exposures are shown below:

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Value at Risk	**21.6**	5.4	**18.5**	5.2

The above analysis excludes strategic hedges of Group reserves, non-interest and low interest rate liabilities. Interest rate exposures arising from basis risk, prepayment risk and pipeline risk are excluded from the above measure. These risks are measured using separate techniques and are regularly reported to the ALCO.

The Group's trading activities were conducted through the Group's Treasury division. Group Treasury's control of, and approach to, market risk, with respect to its trading book activities, is defined by market risk tolerance levels documented in a policy approved by the Group Risk Committee (GRC). Market Risk in the trading book is measured and controlled through stop loss limits and interest rate and credit spread sensitivity limits. During 2008, Treasury assets which gave rise to credit spread sensitivity in the trading books were reclassified for accounting purposes as 'Loans & Receivables'. Changes in fair value due to changes in credit spreads therefore ceased to impact profit or loss.

	Group & Company			
	2008		2007	
	Sensitivity to a 1% change in interest rates £m	**Sensitivity to a 1bp change in credit spread £m**	**Sensitivity to a 1% change in interest rates £m**	**Sensitivity to a 1bp change in credit spread £m**
Highest	**1.1**	**0.2**	1.1	0.3
Lowest	**0.4**	**0.1**	0.5	0.2
Average	**0.6**	**0.1**	0.8	0.3
Exposure at 31 December	**0.8**	**0.1**	0.9	0.2

Foreign exchange risk

The Group's policy is to have no material open foreign currency positions. The Group offers foreign exchange services to customers through both Treasury and Corporate Bank operations. Detailed limits and controls are established within those businesses to control the exposure. Corporate Bank clears its positions with Treasury in accordance with the policy of transferring market risk positions to Treasury wherever possible. The foreign exchange risks arising from Treasury's wholesale funding and Treasury asset portfolio are hedged within Treasury's limits.

Equity risk

The Group's policy is to have no material exposure to equity price risk. Retail Banking sells third party stock market bonds. The equity and interest rate risks from these bonds are borne entirely by the third party. Alliance & Leicester International Limited sells stock market bonds to customers. Positions may arise in the management of such bonds due to mismatches between the hedging contracts and the underlying customer liabilities. Procedures are established to minimise these positions as tightly as is operationally practicable and to report open positions to ALCO on a monthly basis.

Inflation risk

The Group's policy is to have no material exposure to inflation risk. This risk arises due to the exposure to inflation linked bonds and loans in Corporate Banking. It is the Group's policy to fully hedge inflation risk, using inflation swaps or other effective hedge instruments.

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 swaps are settled at a future date. They include interest rate, cross-currency swaps and forward rate agreements (see table below). Derivatives are used primarily for balance sheet management purposes.

The principal derivatives used in balance sheet risk management are interest rate swaps, forward rate agreements (FRAs), futures, interest rate options and foreign exchange contracts which are used to hedge the economic exposures arising from mortgage lending, personal and commercial loans, leasing, fixed rate savings products, funding and investment activities and foreign exchange services to customers.

The following table describes the significant activities undertaken, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. These risks may alternatively be managed using on-balance sheet instruments or natural hedges that exist in the balance sheet.

Risk Management continued

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.
Equity linked investment products.	Sensitivity to changes in equity indices and interest rates.	Equity linked futures and options.
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.
Management of other net interest income on retail activities.	Sensitivity of income to changes in interest rates	Interest rate swaps.
Investment and funding in foreign currencies.	Sensitivity to changes in foreign exchange rates.	Foreign exchange contracts, cross currency interest rate swaps.
Customer foreign exchange business.	Sensitivity to changes in foreign exchange rates.	Foreign exchange contracts.

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 Alliance & Leicester plc and Abbey National plc have been managed on a combined basis. For further information, please refer to the liquidity risk discussion in the Risk Management Report of Abbey National plc's Consolidate Financial Statements. 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. Alliance & Leicester plc now sources its wholesale funding from Abbey National plc.

Maturities of financial liabilities

The table below analyses the maturities of the undiscounted cash flows 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.

At 31 December 2008						Group
	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	1,279	6,908	544	3,006	-	11,737
Deposits by customers	28,436	8,050	3,179	114	91	39,870
Derivative financial instruments	-	405	436	400	198	1,439
Financial liabilities designated at fair value	-	321	336	26	70	753
Debt securities in issue	-	2,249	4,030	6,919	12,600	25,798
Subordinated liabilities	-	18	66	359	3,009	3,452
Total financial liabilities	29,715	17,951	8,591	10,824	15,968	83,049

At 31 December 2008						Company
	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	1,907	8,345	548	2,962	-	13,762
Deposits by customers	30,524	7,616	2,962	101	91	41,294
Derivative financial instruments	-	421	457	492	196	1,566
Financial liabilities designated at fair value	-	321	336	26	70	753
Debt securities in issue	-	2,179	3,954	6,255	220	12,608
Subordinated liabilities	-	18	66	359	3,009	3,452
Funding for securitisations	-	72	79	684	12,753	13,588
Total financial liabilities	32,431	18,972	8,402	10,879	16,339	87,023

At 31 December 2007						Group
	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	639	7,804	4,804	6,269	96	19,612
Deposits by customers	24,600	5,616	1,519	286	185	32,206
Derivative financial instruments	-	51	225	196	55	527
Financial liabilities designated at fair value	-	2,376	1,788	39	77	4,280
Debt securities in issue	-	4,560	4,145	10,490	14,365	33,560
Subordinated liabilities	-	12	102	128	932	1,174
Total financial liabilities	25,239	20,419	12,583	17,408	15,710	91,359

At 31 December 2007						Company
	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	1,013	10,010	4,804	6,269	99	22,195
Deposits by customers	24,890	5,244	1,015	269	185	31,603
Derivative financial instruments	-	55	222	202	50	529
Financial liabilities designated at fair value	-	2,376	1,788	39	77	4,280
Debt securities in issue	-	4,098	3,971	9,596	761	18,426
Subordinated liabilities	-	12	102	128	932	1,174
Funding for securitisations	-	62	174	882	13,607	14,725
Total financial liabilities	25,903	21,857	12,076	17,385	15,711	92,932