LISTING MEMORANDUM

ABBEY NATIONAL

Abbey National plc

(incorporated with limited liability under the Companies Act 1985, registered number 2294747)

Placing of 100,000,000 10⅜ per cent. Non-Cumulative Sterling Preference Shares of £1 each Issue Price 108.935 pence per Sterling Preference Share

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Application has been made to the London Stock Exchange Limited (the "London Stock Exchange") for the Sterling Preference Shares (as defined below) to be admitted to the Official List. Copies of this Listing Memorandum, which comprises listing particulars which have been approved by the London Stock Exchange, have been delivered to the Registrar of Companies in England and Wales as required by Section 149 of the Financial Services Act 1986.

The Sterling Preference Shares will have a nominal value of £1 each and will be issued fully paid for cash. The terms of, and the rights attaching to, the Sterling Preference Shares will be identical in all respects to the terms of, and the rights attaching to, the 10⅜ per cent. Non-Cumulative Preference Shares of £1 each of Abbey National which were allotted by the Directors of Abbey National on October 23, 1995 (the "Original Sterling Preference Shares"), save in relation to the entitlement to the dividend payable on April 6, 1996. The first dividend instalment on the Sterling Preference Shares will be payable on April 9, 1996 and will be in respect of the period from (and including) February 13, 1996 to (but excluding) April 6, 1996.

The Sterling Preference Shares will rank *pari passu* inter se and with all other shares expressed to rank *pari passu* therewith (including the Original Sterling Preference Shares, save to the extent described above) and in priority as regards participation in profits or assets to the Ordinary Shares of 10p each (the "Ordinary Shares") and any other shares of Abbey National.

A summary of the provisions of the Articles of Association of Abbey National applicable to, and of the rights attaching to, the 100,000,000 10⅜ per cent. Non-Cumulative Sterling Preference Shares of £1 each (the "Sterling Preference Shares") is set out under "Description of the Sterling Preference Shares" herein.

Merrill Lynch International Limited

Kleinwort Benson Limited

Barclays de Zoete Wedd Limited

HSBC Markets

SBC Warburg

A Division of Swiss Bank Corporation

February 9, 1996

the best of the knowledge and belief of the directors (having taken all reasonable care to ensure that such is the case) the information contained in this Listing Memorandum is in accordance with the facts and does not omit anything likely to affect the import of such information.

In this Listing Memorandum, references to "Abbey National plc", "Abbey National" and the "Company" are references to Abbey National plc, and references to the "Group" are to Abbey National and its subsidiaries. References to "conversion" are to the transfer of the business of Abbey National Building Society (the "Society") to Abbey National under Section 97 of the Building Societies Act 1986 which became effective on 12 July 1989 on the completion of the offer of shares in Abbey National and the admission of the share capital of Abbey National to the Official List of the London Stock Exchange.

The Sterling Preference Shares have not been and will not be registered under the U.S. Securities Act of 1933 as amended (the "Securities Act"). The Sterling Preference Shares are subject to U.S. tax law requirements. Subject to certain exceptions, the Sterling Preference Shares may not be offered, sold or delivered within the United States or to U.S. persons. Neither the delivery of this Listing Memorandum nor any sale made hereunder shall, under any circumstances, create any implication or constitute a representation that there has been no change in the affairs of Abbey National or the Group since the date hereof. This Listing Memorandum does not constitute an offer of, or an invitation by or on behalf of Abbey National or the Managers (as defined under "Placing of the Sterling Preference Shares " below) to subscribe for or purchase, any of the Sterling Preference Shares.

No person is authorised in connection with the offering of the Sterling Preference Shares to give any information or to make any representation not contained in this document and any information or representation not contained herein must not be relied upon as having been authorised by Abbey National or any of the Managers. The distribution of this Listing Memorandum in certain jurisdictions may be restricted by law. Neither Abbey National nor any of the Managers represents that this Listing Memorandum may be lawfully distributed in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assumes any responsibility for facilitating any such distribution or offering. In particular, save for obtaining the approval of this Listing Memorandum as listing particulars by the London Stock Exchange and delivery of copies of this Listing Memorandum to the Registrar of Companies in England and Wales, no action has been taken by Abbey National or the Managers which would permit distribution of this Listing Memorandum in any jurisdiction where action for that purpose is required. Accordingly, neither this Listing Memorandum nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws.

In connection with the placing of the Sterling Preference Shares Merrill Lynch International Limited may over-allot or effect transactions on the London Stock Exchange which stabilise or maintain the market price of the Sterling Preference Shares at a level which might not otherwise prevail on that exchange. Such stabilising, if commenced, may be discontinued at any time.

In this Listing Memorandum, unless otherwise specified or the context otherwise requires, all references to "Dollars", "U.S. dollars" and "US$" are to the currency of, and the references to "United States" and "U.S." are to, the United States of America and references to "pounds", "Sterling" and "£" are to the currency of the United Kingdom of Great Britain and Northern Ireland (the "United Kingdom").

TABLE OF CONTENTS

SUMMARY

The following summary is qualified in its entirety by the detailed information and the Consolidated Financial Statements and Unaudited Interim Consolidated Financial Statements appearing elsewhere in this Listing Memorandum.

The Abbey National Group

General. The Abbey National Group is the fifth largest banking group based in the United Kingdom in terms of assets, with total assets of £103.8 billion and shareholders' equity of £3.9 billion as at June 30, 1995. The Group's business focuses on providing financial services to individuals in the United Kingdom, particularly secured residential mortgage loans and investment and savings products. In 1994, Abbey National ranked as the second largest residential mortgage lender in the United Kingdom, accounting for an estimated 12.4% of the £374.3 billion total outstanding U.K. residential mortgage loans as at December 31, 1994, with 1.2 million residential mortgage account relationships. For the year ended December 31, 1994, Abbey National had net income of £610 million, 56.4% higher than for the year ended December 31, 1993, and the Tier 1 capital ratio as at the year end was 9.14%, compared to 9.38% as at the 1993 year end. The Group's net income for the six months ended June 30, 1995 was £324m, 18.7% higher than in the six months ended June 30, 1994 and the Tier 1 capital ratio as at June 30, 1995 was 8.86% as compared with 9.52% as at June 30, 1994. The Group has been consistently profitable over the last five years.

Abbey National was formed in 1944 as a result of the merger of the Abbey Road Building Society and The National Building Society. In 1989, in order to improve its competitiveness, Abbey National converted from a building society into a public limited company regulated as a bank by the Bank of England, the first such U.K. society to have so converted. The Group is comprised of three main interdependent businesses: U.K. Retail Banking, Life Insurance Operations and Treasury and Offshore. Retail banking in the United Kingdom is the core activity of the Group, and the Life Insurance Operations and Treasury and Offshore businesses complement and operate in a highly integrated fashion with this core activity.

Due to the focus of the Group on retail lending, it currently has no exposure to highly leveraged transactions or to countries which are not members of the Organisation for Economic Cooperation and Development (with the exception of Cayman Islands, Singapore, Hong Kong and Saudi Arabia). The security on the Group's U.K. residential mortgage loans, together with the strong credit ratings of the investment assets held in Treasury and Offshore, provide the Group with what management believes is strong asset quality.

U.K. Retail Banking. U.K. Retail Banking is the Group's largest business, with total assets of £49.4 billion and income before taxes of £650 million as at and for the year ended December 31, 1994. The retail banking activities are focused on U.K. residential mortgage lending and on offering a range of liquid savings products, personal cheque accounts and non-life insurance.

The Group has one of the largest retail banking operations in the United Kingdom, with a national network of 676 branches spread throughout the country, each offering Abbey National's full retail product range. In recent years the retail branch network has been substantially modernised and available sales area has tripled. As at June 30, 1995, the retail branch network serviced over 12.6 million deposit and cheque accounts and provided Abbey National with a retail funding base, composed primarily of variable rate liabilities, of £37.2 billion (an estimated 8.4% of the aggregate balance of United Kingdom liquid savings).

Abbey National is the second largest provider of residential mortgages in the United Kingdom with outstanding residential mortgage loans of £46.5 billion as at December 31, 1994. The Group's portfolio of loans and advances to customers consists primarily of residential mortgages, with approximately 93.3% of the portfolio secured on residential property. Mortgage loans are made after a comprehensive credit and collateral review process and typically have original terms of up to 25 years, with an average life of approximately six years. Approximately 80% of Abbey National's residential mortgage loans bear interest at variable rates, which is typical in the United Kingdom. These rates are determined at Abbey National's discretion primarily by reference to the general level of market interest rates and competitive conditions. The remainder of the mortgage loan portfolio is represented by fixed-rate mortgages, on which interest rates are fixed usually for the first two to five years before switching thereafter to variable rates of interest.

Mortgage loans generally are issued with a maximum loan-to-value ratio of 95%. All mortgages with initial loan-to-value ratios in excess of 75% are covered by mortgage indemnity guarantees covering credit risk on the portion of the mortgage in excess of 75% of the lower of the purchase price or the valuation of the property. For loans originated prior to 1993 such credit risks are fully insured with third-party insurance companies. For loans originated thereafter, Abbey National has obtained its mortgage indemnity guarantee insurance from its insurance subsidiary, Carfax Insurance Limited ("Carfax"). It is Carfax's policy to reinsure a portion of these risks where commercially appropriate and although Carfax chose not to reinsure these risks in 1993 for commercial reasons, reinsurance arrangements are in place for 1994 and 1995.

In August 1994, the Group announced the formation of a joint venture with Commercial Union plc, one of the largest U.K. composite or multiline insurers. Over time this venture is expected to provide the bulk of Abbey National's non-life insurance product range.

Life Insurance Operations. To extend the range of financial products offered to retail customers, the Group operates two life insurance companies, Abbey National Life plc ("Abbey National Life") and Scottish Mutual Assurance plc ("Scottish Mutual"), each of which is a wholly-owned subsidiary of Abbey National.

Scottish Mutual, which the Group acquired in 1992, serves independent financial advisers through which it distributes a comprehensive range of life insurance, pension and long-term savings products. Scottish Mutual's experience provided a basis for the launch of Abbey National Life, which commenced operations in February 1993 and utilises the Group's retail branch network to distribute its products. Both companies share selected policy processing and administration operations. The Group had life insurance assets of £4.6 billion under management as at June 30, 1995, and, for the year ended December 31, 1994, generated new business premiums of £726 million. In 1994, Life Insurance Operations contributed income before taxes of £94 million, compared with £61 million in 1993.

Treasury and Offshore. The Group's Treasury and Offshore business is comprised of treasury activities conducted through Abbey National Treasury Services plc ("ANTS") and the Group's Gibraltar and Jersey operations. ANTS' main objectives are to manage the liquidity needs of the Group, to provide the Group with wholesale funding and risk management services and to invest in high quality assets. ANTS is a wholly-owned subsidiary of Abbey National and an authorised U.K. banking institution. Abbey National has fully and unconditionally guaranteed the obligations of ANTS that have been or will be incurred before July 31, 1999. In turn, ANTS has fully and unconditionally guaranteed the unsecured and unsubordinated obligations of Abbey National that have been or will be incurred before December 31, 1999. Each guarantee is of any obligation issued or incurred before its expiration, and covers payments to maturity, even if the guarantee is no longer in effect for subsequent obligations. As a result of the guarantee from Abbey National, ANTS has the same short- and long-term credit ratings as Abbey National.

Through ANTS, Abbey National has been one of the largest issuers of debt securities in the international bond markets over the last two years. In addition, ANTS has built a substantial investment portfolio consisting primarily of highly liquid investment grade debt securities, mortgage-backed and other asset-backed securities and finance leases. As at June 30, 1995, Treasury and Offshore had total assets of £47.2 billion, which represented 45.5% of the Group's total assets. As at such date more than 96.9% of ANTS' investment assets were rated A– or better (or the equivalent), and a substantial majority were rated AA– or better (or the equivalent), by one or more rating organisations. Treasury and Offshore's income before taxes was £190 million in the year ended December 31, 1994, compared with £198 million in 1993. Treasury and Offshore includes Abbey National Financial Products, which provides risk management services in the currency and interest rate swap and option markets.

Other operations. The Group has operations in France, Spain and Italy which principally provide mortgage finance. The operation in Spain also takes retail deposits. The Group has other activities including the provision of consumer credit, investing in certain structured debt securities and providing independent financial advice and investment services to clients.

Strategy. The Abbey National Group's strategy is to continue to focus on its three interdependent businesses. Within U.K. Retail Banking, management is seeking to further improve Abbey National's market position in the U.K. personal financial services market, increasing its market share of the aggregate balances of both mortgages and liquid savings. The Group also intends to continue to broaden its earnings base to reduce dependence on traditional mortgage and savings activities. In addition, Abbey National is seeking, over the long term, to strengthen its presence in the personal financial services markets of certain Continental European countries, particularly Spain, while managing the problem loans, now substantially provided for, which had built up in its Continental Europe business during the economic recession of the early 1990s (see "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group"). Through ANTS the Group also intends to establish branches or offices in major financial centres outside the United Kingdom as part of ongoing efforts to diversify wholesale funding sources.

Complementing these strategic goals are the Group's objectives to maintain strong management of, and control over, risks, to further improve efficiency and thus maintain a low cost:income ratio (as compared to the U.K. clearing banks), to maintain a prudent capital base and to preserve and further enhance its strong brand name in the markets in which the Group operates.

Recent Developments

In July 1995, Abbey National and National & Provincial Building Society ("National & Provincial") announced that they had reached agreement in principle on the terms of a proposed merger which will be unanimously recommended by the board of directors of National & Provincial to its members. The total consideration being offered by Abbey National is £1.35 billion. Completion of the proposed merger is subject to a number of conditions. In August 1995, Abbey National acquired First National Finance Corporation p.l.c. ("FNFC") for £285 million. FNFC's predominant business activity is consumer credit.

Summary Selected Consolidated Financial and Statistical Data of the Group

	Six months ended/ as at June 30, 1995	1994
	(in millions, unaudited)	
Income statement data		
Net interest income	£ 748	£ 642
Commissions, fees and other income	177	197
Total operating income	925	839
Operating expenses	(412)	(377)
Provisions for bad and doubtful debts	(28)	(41)
Income before taxes	483	423
Net income	324	273
Balance sheet data		
Shareholders' equity	£ 3,928	£ 3,593
Subordinated liabilities	1,572	1,044
Deposits by banks, customer accounts and debt securities in issue	89,754	77,088
Loans and advances to banks and customers and net investment in finance leases	56,861	52,375
Total assets	103,755	88,810

	Year ended/ as at December 31, (1)				
	1994	1993	1992	1991	1990
	(in millions)				
Income statement data					
Net interest income	£ 1,394	£ 1,338	£ 1,265	£ 1,143	£ 956
Commissions, fees and other income	365	376	319	265	189
Total operating income	1,759	1,714	1,584	1,408	1,145
Operating expenses	(755)	(763)	(706)	(635)	(508)
Provisions for bad and doubtful debts	(74)	(218)	(274)	(155)	(55)
Income before taxes	932	704	564	618	582
Net income	610	390	317	414	377
Balance sheet data					
Shareholders' equity	3,704	3,386	3,184	2,971	2,699
Subordinated liabilities	1,520	868	648	388	233
Deposits by banks, customer accounts and debt securities in issue	81,835	73,471	64,116	52,353	42,175
Loans and advances to banks and customers and net investment in finance leases	53,668	50,858	46,074	41,650	36,253
Total assets	94,319	83,802	72,223	57,405	46,496

(1) The Consolidated Financial Statements included elsewhere in this Listing Memorandum for the years ended December 31, 1994, 1993 and 1992, from which certain data herein has been extracted, reflect the changes resulting from the Companies Act 1985 (Bank Accounts) Regulations 1991 (the "Bank Accounts Regulations"), which reflect the requirements of the European Community Bank Accounts Directive (the "Bank Directive") and which are effective from the 1993 fiscal year. The Group's Consolidated Financial Statements for 1992, but not for prior years, have been restated to reflect the Bank Directive requirements. There are, as a result, certain classification differences affecting net interest income and commissions, fees and other income in comparing results prior to 1992 with those of 1992 and 1993. For 1992, the net differences amounted to a £16 million reduction in commissions, fees and other income, with an increase in net interest income of £19 million and the reclassification of £3 million as adjustments to/(amounts written off) fixed asset investments. There was no effect on net income for 1992. In addition to certain reclassifications required by the statutory format of the Bank Directive, certain other assets and liabilities which were previously shown net are required to be shown gross. The effect on the 1992 balance sheet was to increase both assets and liabilities by £300 million. The implementation of the British Bankers' Association Statement of Recommended Accounting Practice ("SORP") on securities resulted in a further increase in both assets and liabilities of £111 million in the 1992 balance sheet.

	Year ended/ as at December 31, (1)				
	1994	**1993**	**1992**	**1991 (2)**	**1990 (2)**
	(per cent., except ratio of earnings to fixed charges)				
Selected financial statistics					
Profitability ratios:					
Return on average total assets (3)	0.69	0.50	0.49	0.80	0.90
Return on average shareholders' equity (4)	16.56	11.62	10.55	14.60	14.64
Return on average risk weighted assets (5)	1.59	1.14	1.08	1.72	1.93
Net interest margin (6)	1.73	1.89	2.10	2.26	2.34
Cost:income ratio (7)	42.92	44.52	44.57	45.10	44.37
Capital ratios:					
Dividends as a percentage of net income	38.19	47.18	47.63	33.33	33.16
Average shareholders' equity as a percentage of average total assets	4.18	4.34	4.66	5.46	6.15
Risk asset ratios: (8)					
Total	11.53	10.49	10.88	12.11	11.42
Tier 1	9.14	9.38	9.86	11.22	12.39
Credit quality data:					
Allowances as a percentage of year-end loans and advances to customers excluding finance leases	0.74	0.98	0.88	0.45	0.26
Provisions for bad and doubtful debts as a percentage of average loans and advances to customers excluding finance leases	0.16	0.49	0.67	0.42	0.17
Ratio of earnings to fixed charges: (9)					
Excluding interest on retail deposits	1.45	1.37	1.28	1.41	1.43
Including interest on retail deposits	1.24	1.19	1.12	1.13	1.12

(1) See Note 1 to the preceding table.

(2) All averages (other than average risk weighted assets) for 1991 and 1990 are based upon simple averages obtained by averaging the balances at the beginning and end of the relevant period. Average risk weighted assets are calculated on a semi-annual basis.

(3) Net income divided by average total assets.

(4) Net income divided by average shareholders' equity.

(5) Net income divided by average risk weighted assets. Average risk weighted assets are calculated on a semi-annual basis.

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

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

(8) In 1990, the Group's Tier 1 capital ratio was larger than its total risk asset ratio because Bank of England supervisory deductions, primarily for the priority liquidation distribution (a deduction arising from the terms of the Conversion), exceeded the value of subordinated debt then in issue. See Note 41 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum for information on the priority liquidation distribution.

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

DESCRIPTION OF THE STERLING PREFERENCE SHARES

At the Annual General Meeting held on April 28, 1994, Abbey National's shareholders gave the Board of Directors of Abbey National (the "Directors") authority to allot during the period ending on April 27, 1999 *inter alia* up to £500,000,000 aggregate nominal value of preference shares denominated in Sterling. The terms of, and the rights attaching to, the Original Sterling Preference Shares and the Sterling Preference Shares (together with all other shares expressed to rank *pari passu* therewith, the "Preference Shares") are contained in Abbey National's Articles of Association (the "Articles") and in resolutions of a duly constituted Committee of the Board of Directors of Abbey National passed on September 26, 1995 and February 8, 1996, respectively (together, the "Terms of Issue").

The summary set forth below does not purport to be complete and is subject to, and qualified in its entirety by reference to, Abbey National's Memorandum of Association and Articles and the resolutions adopted by the Board of Directors of Abbey National or an authorised committee thereof establishing the rights, preferences, privileges, limitations and restrictions relating to the Sterling Preference Shares.

Denomination and Form

The Sterling Preference Shares will have a nominal value of £1 each and will be issued fully paid for cash. The Sterling Preference Shares will rank *pari passu* inter se and with all other shares expressed to rank *pari passu* therewith (including the Original Sterling Preference Shares, save in relation to the entitlement to the dividend payable on April 9, 1996) and in priority to the Ordinary Shares of 10p each ("Ordinary Shares") and any other shares of Abbey National.

The Sterling Preference Shares will be in registered form. Certificates shall be delivered to the persons entitled thereto as soon as practicable after admission of the Sterling Preference Shares to the Official List of the London Stock Exchange and, in any case, no later than three business days thereafter.

Transfers of the Sterling Preference Shares must be in writing, in the usual common form, or in such other form as the Directors may approve. The Directors may refuse to register a transfer of shares if:—

(i) the transfer is in respect of more than one class of shares; or

(ii) the transfer is not lodged, duly stamped, at the registered office of Abbey National or at such other place as the Directors may appoint, accompanied by the certificate of the shares to be transferred and such other evidence (if any) as the Directors may require to show the right of the intending transferor to make the transfer; or

(iii) the transfer is to more than four joint holders.

The Directors may also decline to register any transfer of a share which is not fully paid up.

Title to Sterling Preference Shares will pass by transfer and registration on the register for the Sterling Preference Shares. Any such registration of transfer will be effected without charge to the person requesting such registration, but subject to payment by such person of any taxes, stamp duties or other governmental charges payable in connection therewith.

Dividends

(a) Each Sterling Preference Share shall entitle the holder thereof to receive a non-cumulative preferential dividend at the rate of 10⅜ per cent. per annum of the nominal amount of such share calculated on the basis set out in sub-paragraph (b) below which will be payable in Sterling in equal half-yearly instalments in arrear on April 6 and October 6 in each year (each a "Dividend Payment Date") and shall accrue from (and including) the preceding April 6 or October 6, respectively, provided that the first dividend instalment shall be payable on April 9, 1996 and shall be in respect of the period from (and including) February 13, 1996 to (but excluding) April 6, 1996.

Such dividend shall only be payable to the extent that payment of the same can be made out of profits available for distribution under the provisions of the Companies Act 1985, as amended (the "Companies Act") as at each Dividend Payment Date. The Sterling Preference Shares shall rank as regards participation in profits *pari passu* inter se and with all other shares to the extent that they are expressed to rank *pari passu* therewith and in priority to the Ordinary Shares and any other class of shares.

(b) (i) Subject to the Companies Act, the dividend payable on each Sterling Preference Share on any Dividend Payment Date shall be fixed at such rate per annum as will ensure that the sum of (1) the dividend payable on such date and (2) the Associated Tax Credit (as defined below) in respect of any such dividend represents an annual rate equal to 10⅜ per cent. per annum of the nominal amount of such share provided that if, as a result of any actual change in, or amendment to, the laws of the United Kingdom or any political sub-division thereof or any authority having power to levy or impose in the United Kingdom any taxes, duties, assessments or governmental charges of whatsoever nature ("tax") or any change in the application of official or generally accepted interpretation of such laws, which change or amendment becomes effective after October 23, 1995, Abbey National is obliged to pay any amount representing tax by reference to any dividend payable on the Sterling Preference Shares (the "Dividend") and the aggregate of the Dividend and any such amount representing tax exceeds the amount calculated by applying an annual rate of 10⅜ per cent. per annum to the nominal amount of the Sterling Preference Shares, the amount of the Dividend shall be reduced so that the amount of the Dividend together with the amount representing tax shall be no more than an annual rate of 10⅜ per cent. of the nominal amount of the Sterling Preference Shares.

(ii) For these purposes, Abbey National shall not be regarded as being obliged to pay an amount representing tax to the extent that it (or any of its subsidiaries (as defined for the purposes of the Companies Act)) is entitled as a matter of law to any credit (which term shall include any allowance, reduction, or other relief) for such amount against its own liability to tax (even if it (or any of its subsidiaries (as defined for the purposes of the Companies Act)) did not make the necessary claim to get the credit, or have profits, make gains, or bear tax in relation to which to use the credit).

(iii) For these purposes, the term "Associated Tax Credit" means any United Kingdom taxation in accordance with, and at the rate specified by, United Kingdom law in effect at the relevant time (a) which is, or is treated as having been, borne by a recipient of dividends on the Sterling Preference Shares by deduction at source or otherwise or (b) for which a credit (which term shall include an absence of or relief from liability and, if appropriate, a repayment of United Kingdom taxation) in respect of United Kingdom taxation is available to the recipient of such dividends, in each case on the assumption that such recipient is an individual resident in the United Kingdom for United Kingdom taxation purposes.

(iv) For the avoidance of doubt, if Abbey National were to elect for any dividend paid on the Sterling Preference Shares to be treated as a "foreign income dividend" with the result that such dividend does not carry an Associated Tax Credit, Abbey National shall be required to increase the rate of the cash dividend paid on the Sterling Preference Shares on the basis described above so that the sum of the dividend payable on the Sterling Preference Shares on the relevant Dividend Payment Date, together with the Associated Tax Credit (if any) in respect of such cash dividend, expressed as an annual rate, shall equal 10⅜ per cent. of the nominal amount of such shares subject to the proviso to the first sub-paragraph of this paragraph (b).

Any reference in this paragraph (b) to the United Kingdom shall mean the United Kingdom, any political sub-division thereof and any authority having power to levy or impose taxation therein.

(c) If, in the opinion of the Directors, the profits of Abbey National available for distribution are sufficient to enable payment in full of dividends on the Sterling Preference Shares on any Dividend Payment Date and also the payment in full of all other dividends stated to be payable on the same date on any other shares (including any arrears or deficiency of dividend on such other shares that are in cumulative form) ranking *pari passu* as to dividends with the Sterling Preference Shares, then such dividends on the Sterling Preference Shares and such other shares shall be declared and paid in full.

(d) If, in the opinion of the Directors, the profits of Abbey National available for distribution are insufficient to cover the payment in full of dividends on the Sterling Preference Shares on any Dividend Payment Date and also the payment in full of all other dividends stated to be payable on such date on any other shares (including any arrears or deficiency of dividend on any such other shares that are in cumulative form) expressed to rank *pari passu* with the Sterling Preference Shares as regards participation in profits then dividends shall be declared by the Directors *pro rata* on such Sterling Preference Shares and on such other shares to the extent of the profits (if any) available for distribution so that the amount of dividend declared per share on each such Sterling Preference Share and on each such other share shall bear to each other the same ratio as the dividends accrued per share on each such Sterling Preference Share and on each such other share (including any arrears or deficiency of dividend on any such other shares that are in cumulative form) bear to each other. If it shall subsequently appear that any such dividend which has been paid should not, in accordance with the provisions of this and the preceding sub-paragraph, have been so paid, then, provided the Directors shall have acted in good faith, they shall not incur any liability for any loss which any shareholder may suffer in consequence of such payment having been made.

(e) If, in the opinion of the Directors, the payment of any dividend on any Sterling Preference Shares would breach or cause a breach of the Bank of England's capital adequacy requirements from time to time applicable to Abbey National, then none of such dividend shall be declared or paid unless the Bank of England shall otherwise agree.

(f) Subject to any right to be allotted additional Sterling Preference Shares in accordance with sub-paragraph (g) below, Sterling Preference Shares shall carry no further right as regards participation in the profits of Abbey National and if on any occasion a dividend (or any part thereof) is not paid for the reason specified in sub-paragraph (d) or (e) above, the holders of the Sterling Preference Shares shall have no claim in respect of such non-payment.

(g) (i) The provisions of this sub-paragraph shall apply where any dividend or any part thereof otherwise payable on a particular Dividend Payment Date on any Sterling Preference Shares (a "Relevant Payment") is, for a reason specified in sub-paragraphs (d) or (e) above, not payable and the amounts (if any) standing to the credit of Abbey National's profit and loss account together with the amount of the reserves of Abbey National available for the purpose (including any share premium account and capital redemption reserve) are sufficient to be applied and capable of being applied in paying up in full at par additional Sterling Preference Shares on the basis provided in (ii) below.

(ii) On the Dividend Payment Date of the Relevant Payment had such payment been payable in cash, the Directors shall, subject to the Companies Act, in lieu of such cash payment and in discharge of any entitlement thereto allot and issue credited as fully paid to each holder of Sterling Preference Shares such additional nominal amount of Sterling Preference Shares as is, ignoring fractions, equal to the amount which would have been payable to him had such payment been made in cash, plus any Associated Tax Credit (as defined in paragraph (b)(iii) above had such cash payment been made) but subject to the proviso set out in paragraph (b)(i) as applied to the allotment of the Sterling Preference Shares rather than to the dividend which they represent but not subject to that proviso in relation to the calculation of the cash amount.

(h) For the purposes of paying up the Sterling Preference Shares to be allotted pursuant to sub-paragraph (g) above, the Directors shall capitalise, out of such of the accounts or reserves of Abbey National available for the purpose as they shall determine (including any share premium account and capital redemption reserve), a sum equal to the aggregate nominal amount of the additional Sterling Preference Shares then to be allotted and shall apply such sum in paying up in full the new Sterling Preference Shares referred to in sub-paragraph (g) above.

(i) The additional Sterling Preference Shares so allotted pursuant to sub-paragraph (g) shall be denominated in Sterling and shall confer the same rights and be subject to the same limitations as, and shall rank *pari passu* and pro rata in all respects with, the Sterling Preference Shares save only as regards participation in the Relevant Payment.

(j) If any additional Sterling Preference Shares falling to be allotted under sub-paragraph (g) above cannot be allotted by reason of any insufficiency in Abbey National's authorised share capital or in the amount of relevant securities which the Directors are authorised to allot in accordance with Section 80 of the Companies Act, at the next annual general meeting of Abbey National, the Directors shall propose a resolution or resolutions to effect an appropriate increase in the authorised share capital of Abbey National and to grant to the Directors the appropriate authority to allot the additional Sterling Preference Shares.

(k) If any Dividend Payment Date is not a day on which banks in London are open for business and on which foreign exchange dealings may be conducted in London (a "Sterling Business Day"), then payment of the dividend otherwise payable on such Dividend Payment Date will be made on the next succeeding Sterling Business Day (and without any interest or other payment in respect of such delay) unless such day shall fall within the next calendar month in which case such payment will be made on the preceding Sterling Business Day.

(m) Dividends payable on Sterling Preference Shares in respect of any period shorter or longer than a full dividend period will be calculated on the basis of a 365 day year and the actual number of days elapsed in such period.

(n) If any dividend stated to be payable on any Sterling Preference Share is not declared and paid in full (or a sum is not set aside to provide for such payment in full) or additional Sterling Preference Shares have not been allotted in respect thereof in accordance with sub-paragraph (g) above, then until such time as:—

(i) all dividends on preference shares of Abbey National in cumulative form (including any arrears or deficiency of dividend in respect thereof) have been paid in full or a sum has been set aside for payment in full; and

(ii) all dividends on Sterling Preference Shares have been paid in full or a sum has been set aside for payment in full or, where relevant, additional Sterling Preference Shares have been allotted in respect thereof in accordance with sub-paragraph (g) above, in respect of the then most recently ended half-yearly dividend period in relation to the Sterling Preference Shares,

Abbey National may not (without the written consent of three-fourths in nominal value of, or the sanction of an extraordinary resolution passed at a seperate general meeting of the holders of Sterling Preference Shares) thereafter redeem, reduce, purchase or otherwise acquire for any consideration any other share capital of Abbey National ranking as regards participation in the assets of Abbey National *pari passu* with or after the Sterling Preference Shares and, save as provided in sub-paragraph (o) below, no dividends may be paid or declared on any other share capital of Abbey National ranking as regards participation in profits after the Sterling Preference Shares.

(o) Notwithstanding any of the foregoing or any provision in the Articles, the Directors may, subject to the Statutes, pay a special dividend (net of any Associated Tax Credit) on the Sterling Preference Shares of an amount not exceeding £0.01 per share if, in the opinion of the Directors, it is necessary to do so to preserve the status of Abbey National's shares as wider range investments under the Trustee Investments Act 1961 as amended or re-enacted from time to time.

Capital

(a) On a return of capital or on a distribution of assets on a winding up (but not on a redemption or purchase by Abbey National of shares of any class) the Sterling Preference Shares shall rank *pari passu* inter se and with any other shares that are expressed to rank *pari passu* therewith as regards participation in assets, and otherwise in priority to any other share capital of Abbey National. On such a return of capital or winding up, each Sterling Preference Share shall, out of the surplus assets of Abbey National available for distribution amongst the members after payment of Abbey National's liabilities, carry the right to receive an amount equal to the amount paid up or credited as paid up on such Sterling Preference Share together with any premium paid on issue, and also together with:—

(i) the full amount of any dividend thereon, whether or not declared or earned, which would otherwise be due for payment and is not otherwise paid on a Dividend Payment Date falling on or after the date of commencement of the winding up or other return of capital but which is payable in respect of a period ending on or before such date; and

(ii) in respect of any period in respect of which a dividend thereon would otherwise be payable and is not otherwise paid that begins before, but ends after, the date of the commencement of the winding up or other return of capital, the proportion, whether or not declared or earned, of the dividend that would otherwise have been payable thereon in respect of such period that is attributable to the part of the period that ends on such date.

(b) If, upon any such return of capital or winding up, the amounts available for payment are insufficient to cover the amounts payable in full on the Sterling Preference Shares and on any other shares expressed to rank *pari passu* therewith as regards participation in assets, then the holders of the Sterling Preference Shares and such other shares will share rateably in the distribution of surplus assets (if any) in proportion to the full respective preferential amounts to which they are entitled.

(c) No Sterling Preference Share shall confer any right to participate on a return of capital or a distribution of assets of Abbey National other than that set out in (a) and (b) above.

Redemption

The Sterling Preference Shares shall not be redeemable.

Voting

The holders of Sterling Preference Shares shall only be entitled to receive notice of or to attend, speak and/or vote at General Meetings of Abbey National in the following circumstances:

(i) if the dividend on the Sterling Preference Shares has not been paid in full (or the entitlement thereto discharged by the allotment of additional Sterling Preference Shares in accordance with these terms and conditions) for the three consecutive dividend periods immediately prior to the notice convening the relevant General Meeting; or

(ii) if a resolution is to be proposed at the General Meeting varying, altering or abrogating any of the rights, privileges, limitations or restrictions attaching to the Sterling Preference Shares and then only on the relevant resolution; or

(iii) if a resolution is to be proposed at the General Meeting to wind up Abbey National and then only on the relevant resolution;

but not otherwise. Whenever holders of the Sterling Preference Shares are entitled to vote at a General Meeting, on a show of hands every such holder who is present in person shall have one vote and, on a poll, every such holder who is present in person or by proxy shall have one vote for each Sterling Preference Share held.

Purchases

Subject to the provisions of the Companies Act, the Articles and, if applicable, the rights conferred on any class of shares of Abbey National, Abbey National may at any time purchase any Sterling Preference Shares in issue in the market, by tender or by private treaty upon such terms and conditions as the Directors may think fit. No repurchase of any Sterling Preference Shares will be made without the prior consent of the Bank of England.

Variations of Rights and Further Issues

(a) Save with the written consent of the holders of three-quarters in nominal value of the Preference Shares then in issue, or with the sanction of an Extraordinary Resolution passed at a separate General Meeting of the holders of the Preference Shares then in issue, the Directors shall not authorise or create, or increase the amount of, any shares of any class, or any securities convertible into shares of any class, ranking as regards rights to participate in the profits or assets of Abbey National (other than on a redemption or purchase by Abbey National of any such share) in priority to the Sterling Preference Shares.

(b) Subject to sub-paragraph (a) above, the rights attaching to the Sterling Preference Shares shall not be deemed to be varied by the creation or issue of any other preference shares or other shares, or any securities convertible into shares of any class, ranking, as regards participation in profits or assets, *pari passu* with or after the Sterling Preference Shares, whether carrying identical rights in all respects with the Sterling Preference Shares or carrying rights differing therefrom in any respect including as to dividend, premium on a return of capital, redemption, conversion, denomination and currency of issue.

Notices

Any notice required to be given by Abbey National to the holders of the Sterling Preference Shares shall be sufficiently given if posted to such holders in accordance with the Articles.

Registrar and Paying Agent

The registrar's department of Abbey National, presently located at Carbrook House, 5 Carbrook Hall Road, Sheffield S9 2EG, will act as registrar and paying agent for the Sterling Preference Shares.

RIGHTS ATTACHING TO THE SHARE CAPITAL OF ABBEY NATIONAL

The following is a summary of certain rights attaching to the Ordinary Shares and of certain provisions of Abbey National's Articles of Association. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the Articles of Association, copies of which are available for inspection (see "Documents available for inspection") below. The rights attaching to the Sterling Preference Shares are summarised in the section headed "Description of the Sterling Preference Shares". Save in relation to the entitlement to the preferential dividend on April 6, 1996, the rights attaching to the Original Sterling Preference Shares are identical to those attaching to the Sterling Preference Shares.

Income

Dividends may only be declared and paid out of the distributable profits of Abbey National.

Subject to the rights of the holders of shares having special rights as to dividends, Abbey National may by ordinary resolution from time to time declare dividends on the Ordinary Shares in amounts not exceeding the amounts recommended by the board. The board may pay interim dividends on the Ordinary Shares according to the financial position of Abbey National. Dividends on the Ordinary Shares may be declared or paid in any currency. No dividends may be paid or declared on the Ordinary Shares until such time as all dividends on any class of share capital ranking prior to the Ordinary Shares have been paid in full.

Except in so far as the rights attaching to, or the terms of issue of, any share otherwise provide, all dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid and all dividends shall be apportioned and paid pro rata according to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid.

Any dividend unclaimed after a period of twelve years from the date when it becomes due for payment will be forfeited and revert to Abbey National.

Abbey National may by ordinary resolution direct, upon the recommendation of the board, that a dividend shall be satisfied wholly or partly by the distribution of assets.

The board may, if authorised by an ordinary resolution of Abbey National, offer any holders of Ordinary Shares the right to elect to receive Ordinary Shares, credited as fully paid, instead of cash in respect of the whole (or some part, to be determined by the board) of any dividend specified in such resolution.

Capital

In the event of a return of capital on a winding up, or otherwise, after payment of all liabilities and subject to the rights of the holders of any shares with preferential rights on a return of capital, the remaining assets of Abbey National will be divided among the holders of the Ordinary Shares according to the number held thereof.

Alteration of share capital

Abbey National may from time to time by ordinary resolution:

(a) increase its share capital by such sum divided into shares of such amount as the resolution shall direct; or

(b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares; or

(c) (subject to the provisions of the Companies Acts) sub-divide its shares, or any of them, into shares of smaller amount and the resolution may determine that, as between the resulting shares, one or more of such shares may be given preference over the others; or

(d) cancel any shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person and diminish the amount of its share capital by the amount of the shares so cancelled.

Subject to the provisions of the Companies Acts and to the rights conferred on any class of shares, Abbey National may from time to time by special resolution reduce its share capital, any capital redemption reserve and any share premium account.

Voting Rights

Subject to any special terms as to voting upon which any shares may be issued or may for the time being be held or any suspension or any abrogation of voting rights, upon a show of hands every holder of Ordinary Shares who is present in person at a general meeting shall have one vote, and on a poll every holder of Ordinary Shares who is present in person or by proxy shall have one vote for every Ordinary Share of which he is the holder. Voting at a general meeting is by show of hands unless a poll is demanded.

Pre-emption Rights

Holders of Ordinary Shares have no pre-emptive rights under the Articles of Association. However, the ability of the directors to (a) allot any shares or rights to subscribe for, or to convert any security into, any shares of Abbey National under any circumstances or (b) to issue for cash Ordinary Shares or rights to subscribe for, or to convert any security into, Ordinary Shares otherwise than by way of rights to existing holders of Ordinary Shares is restricted by law and (except in certain cases) requires appropriate authorisation to be given by shareholders in general meeting.

Variation of Rights

Subject to the provisions of the Companies Acts, all or any of the rights for the time being attached to any class of shares for the time being issued may from time to time be varied with the consent in writing of the holders of not less than three-fourths in nominal value of the issued shares of that class or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of those shares.

Transfer of Shares

Any member may transfer all or any of his Ordinary Shares by an instrument of transfer in any usual form or in any other form which the board may approve. The instrument of transfer shall be executed by or on behalf of the transferor and (in the case of a partly paid share) the transferee, and the transferor shall be deemed to remain the holder of the share until the name of the transferee is entered in the register in respect of it.

The board may, in its absolute discretion and without giving any reason for so doing, decline to register any transfer of any share which is not a fully paid share. The board may also decline to register a transfer unless the instrument of transfer:

(a) is lodged with Abbey National at its registered office (or at such other place as the board may appoint) accompanied by the certificate for the shares to which it relates and such other evidence as the board may reasonably require to show the right of the transferor to make the transfer;

(b) is in respect of only one class of shares; and

(c) if to joint transferees, is in favour of not more than four such transferees.

ORIGINAL PREFERENCE SHARES AND EXCHANGEABLE CAPITAL SECURITIES

On October 23, 1995, Abbey National issued 100,000,000 10⅜ per cent. Non-Cumulative Sterling Preference Shares of £1 each (the "Original Preference Shares") and £200,000,000 10$\frac{1}{16}$ per cent. Exchangeable Capital Securitities (the "Capital Securities") which are exchangeable (as described below) into 10⅜ per cent. Non-Cumulative Sterling Preference Shares of £1 each (the "New Sterling Preference Shares"). The Sterling Preference Shares rank and the New Sterling Preference Shares, if allotted, would rank *pari passu* with the Sterling Preference Shares. The Original Sterling Preference Shares and the Capital Securities have been admitted to the Official List. All of the Capital Securities remain outstanding.

Abbey National may, having given not less than 30 and not more than 60 days' notice to the holders of the Capital Securities (the "Holders") exchange all or part of the Capital Securities (having an principal amount which is an integral multiple of £25,000,000) for New Sterling Preference Shares on the basis that the

Holders will receive one New Sterling Preference Share for each £1 principal amount of Capital Securities held. In the case of a partial exchange, serial numbers for the Capital Securities will be drawn in a manner approved by the trustee for the Holders. Abbey National is at liberty to make such number of partial exchanges as it may consider appropriate.

PROCEEDS OF ISSUE

The net proceeds from the issue of the Sterling Preference Shares will be used to strengthen the Group's capital base in line with the Group's strategy and in the light of recent and proposed acquisitions (see "Recent Developments").

CAPITALISATION

The following table sets forth the authorised and issued share capital of Abbey National and the capitalisation of the Group as at December 31, 1994 and October 31, 1995.

	October 31, 1995	December 31, 1994
	(in millions of £) (unaudited)	
ABBEY NATIONAL		
Authorised ordinary share capital comprising shares of 10p each	175	175
Authorised preference share capital	506	506
Equity Shareholders' Funds		
Issued and fully paid ordinary shares of 10p each	132	131
Share premium	843(1)	840
Reserves	104(1)	104
Retained earnings	2,850(1)	2,629
Non Equity Shareholders' Funds		
Issued and fully paid preference shares of £1 each	100	—
Share premium	2	—
	4,031	3,704
GROUP		
Subordinated Notes (2)(3)		
Due within one year	129	128
Due after more than one year and less than five years	8	17
Due after five years	1,890	1,375
Exchangeable Capital Securities	200(1)	—
	2,227	1,520
Medium-Term Notes (2)(3)		
Due within one year	2,406	2,390
Due after more than one year and less than five years	1,721	2,628
Due after five years	285	285
	4,412	5,303
Other Loan Capital (2)(3)		
Floating/Variable Rate Notes		
Due within one year	251	538
Due after more than one year and less than five years	1,017	1,330
Due after five years	319	—
	1,587	1,868
Fixed-Rate Bonds/Notes		
Due within one year	1,234	626
Due after more than one year and less than five years	4,891	4,604
Due after five years	3,110	3,060
	9,235	8,290
Total Capitalisation (4)(5)	21,492	20,685

(footnotes on next page)

(1) As at June 30, 1995.

(2) All of the bonds and notes are guaranteed by Abbey National, with the exception of certain unsecured indebtedness of Abbey National which amounted to £22 million and £839 million as at December 31, 1994 and October 31, 1995, respectively, and certain secured indebtedness of Abbey National which amounted to £1,127 million and £828 million as at December 31, 1994 and October 31, 1995, respectively.

(3) Liabilities in foreign currencies are translated into sterling at market exchange rates prevailing at December 31, 1994 or October 31, 1995, as appropriate. For the adjustments made in Note 4, market exchange rates prevailing at October 31, 1995 are used.

(4) Based on market exchange rates prevailing at October 31, 1995, the total capitalisation of the Group has decreased by £580 million between October 31, 1995 and February 9, 1996 as a result of issues and repayments amounting to £685 million and £1,265 million, respectively.

(5) Except for the information disclosed above, there has been no material change in the authorised and issued share capital of Abbey National and no material change in the capitalisation of the Group since October 31, 1995. Abbey National expects to have £200,000,000 of issued and fully paid preference share capital after completion of the offering of the Sterling Preference Shares offered hereby.

SELECTED CONSOLIDATED FINANCIAL AND STATISTICAL DATA

The financial information set forth below for the twelve months ended December 31, 1994, 1993 and 1992, and as at December 31, 1994 and 1993, has been extracted from the Consolidated Financial Statements of the Group included elsewhere in this Listing Memorandum. The financial information set forth below for the six-month periods ended June 30, 1995 and 1994 has been extracted from the Unaudited Interim Consolidated Financial Statements of the Group included elsewhere in this Listing Memorandum. The information should be read in connection with, and is qualified in its entirety by reference to, the Group's Consolidated Financial Statements and the notes thereto. Financial information set forth below for the twelve months ended December 31, 1991 and 1990, and as at December 31, 1992, 1991 and 1990, has been derived from the audited consolidated financial statements of the Group for 1992, 1991 and 1990. The consolidated financial statements of the Group for each of the five years ended December 31, 1994 have been audited by Coopers & Lybrand, independent chartered accountants. The Group's Consolidated Financial Statements and Unaudited Interim Consolidated Financial Statements, each as included elsewhere in this Listing Memorandum have been prepared in accordance with U.K. GAAP, which differ in certain significant respects from U.S. GAAP. Certain significant differences between U.K. GAAP and U.S. GAAP are discussed in Note 47 to the Consolidated Financial Statements which includes reconciliations of certain amounts calculated in accordance with U.K. GAAP to U.S. GAAP.

	Six months ended/as at June 30,	
	1995	1994
	(in millions, except per share data) (unaudited)	
Income statement data		
Net interest income	£ 748	£ 642
Commissions, fees and other income	177	197
Total operating income	925	839
Operating expenses	(412)	(377)
Provisions for bad and doubtful debts	(28)	(41)
Adjustments to/(amounts written off) fixed asset investments	(2)	2
Income before taxes and exceptional items	483	423
Exceptional items, net	—	—
Income before taxes	483	423
Net income	324	273
Per share information:		
Net income (1)	24.7p	20.8p
Dividends	7.25	5.7
Balance sheet data		
Shareholders' equity	£ 3,928	£ 3,593
Subordinated liabilities	1,572	1,044
Deposits by banks, customer accounts and debt securities in issue	89,754	77,088
Loans and advances to banks and customers and net investment in finance leases	56,861	52,375
Total assets	103,755	88,810
Book value per share	298.0p	274.1p

(1) Net income divided by the average number of shares outstanding.

	Year ended/as at December 31, (1)					
	1994 (2)	1994	1993	1992	1991	1990
		(in millions, except per share data)				
U.K. GAAP income statement data						
Net interest income	$ 2,184	£ 1,394	£ 1,338	£ 1,265	£ 1,143	£ 956
Commissions, fees and other income	572	365	376	319	265	189
Total operating income	2,756	1,759	1,714	1,584	1,408	1,145
Operating expenses	(1,183)	(755)	(763)	(706)	(635)	(508)
Provisions for bad and doubtful debts	(116)	(74)	(218)	(274)	(155)	(55)
Adjustments to/(amounts written off) fixed asset investments	3	2	1	(3)	—	—
Income before taxes and exceptional items	1,460	932	734	601	618	582
Exceptional items, net (3)	—	—	(30)	(37)	—	—
Income before taxes	1,460	932	704	564	618	582
Net income	956	610	390	317	414	377
Per share information:						
Net income (4)	72.9¢	46.5p	29.7p	24.2p	31.6p	28.8p
Dividends	27.9	17.8	14.0	11.5	10.5	9.5
ANTS net income (5)	$ 172	£ 110	£ 117	£ 113	£ 72	£ 12
U.S. GAAP income statement data						
Net income (6)	$ 822	£ 525	£ 345	£ 324	£ 419	£ 360
Per share (4)(6)	62.7¢	40.0p	26.3p	24.7p	32.0p	27.5p
U.K. GAAP balance sheet data						
Shareholders' equity	$ 5,802	£ 3,704	£ 3,386	£ 3,184	£ 2,971	£ 2,699
Subordinated liabilities	2,381	1,520	868	648	388	233
Deposits by banks, customer accounts and debt securities in issue	128,195	81,835	73,471	64,116	52,353	42,175
Loans and advances to banks and customers and net investment in finance leases	84,071	53,668	50,858	46,074	41,650	36,253
Total assets (7)	147,751	94,319	83,802	72,223	57,405	46,496
Book value per share	442.1¢	282.2p	258.3p	242.9p	226.8p	206.0p
ANTS total assets (5)	$ 70,615	£45,078	£37,240	£28,107	£18,775	£10,854
ANTS net assets (5)	1,545	986	878	760	647	275
U.S. GAAP balance sheet data						
Shareholders' equity (6)	6,097	3,892	3,552	3,371	3,183	2,892
Book value per share	464.6¢	296.6p	270.9p	257.1p	243.0p	220.8p
Total assets (7)	$141,389	£ 90,258	£79,959	£69,473	£57,504	£46,590

(1) See Note 1 to the Summary Selected Consolidated Financial and Statistical Data of the Group above.

(2) Amounts stated in dollars have been translated from sterling at the rate of £1.00 = $1.5665, the Noon Buying Rate on December 30, 1994.

(3) Exceptional items include losses on disposal/reorganisation of the Group's residential estate agency business of £30 million and £138 million in the years ended December 31, 1993 and 1992, respectively, partially offset by a gain on the sale of unclaimed shares of £101 million in the year ended December 31, 1992.

In August 1993, Abbey National sold its residential estate agency business. A loss on the disposal of such business of £30 million was recognised as an exceptional item in the year ended December 31, 1993. In December 1992, the Group sold 29 million shares unclaimed by former Abbey National Building Society members who were eligible for a distribution of free shares as a result of Abbey National's Conversion to a public limited company in July 1989. The net proceeds from the sale of these shares, together with a small number of misallocated shares sold in August 1992, was £106 million and is net of a provision for the possibility that valid claims will continue to be received. Following the sale, the Abbey National Charitable Trust was endowed with a sum of £5 million. £101 million is reflected as an exceptional item for the year ended December 31, 1992. For further explanation see Note 12 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

Also in 1992, Abbey National made further residential estate agency branch closures (and recorded an exceptional charge of £12 million in respect of closures made or announced) as part of an ongoing rationalisation of its residential estate agency operations and took an exceptional charge of £113 million as an exceptional item to reflect a permanent diminution in the value of goodwill in such business. In addition, there were related charges in 1992 of £13 million in respect of the loss of goodwill on the sale and closure of certain segments of the residential estate agency business.

(4) Net income divided by the average number of shares outstanding. See Note 16 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

(5) Net income, total assets and net assets for ANTS has been extracted from ANTS' consolidated financial statements. Financial information on ANTS differs from financial information disclosed for the business segment Treasury and Offshore as a result of the inclusion of certain intra-group transactions in ANTS' consolidated financial statements, the inclusion of the results of Abbey National North America Corporation and Abbey National (Gibraltar) in Treasury and Offshore, and an adjustment to the income of Treasury and Offshore to reflect a consistent allocation of Group capital across the Group's business segments. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations of the Group by Principal Business Segment" below and Notes 1 and 53 to the Consolidated Financial Statements.

(6) See Note 47 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum for a discussion of certain significant differences between U.K. GAAP and U.S. GAAP and reconciliations of net income and shareholders' equity to U.S. GAAP.

(7) Long-term insurance fund assets are included in U.K. GAAP total assets but are excluded from U.S. GAAP total assets. See Note 23 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

	Year ended/as at December 31, (1)				
	1994	1993	1992	1991 (2)	1990 (2)
	(percent, except ratio of earnings to fixed charges)				
Selected U.K. GAAP financial statistics					
Profitability ratios:					
Return on average total assets (3)	0.69	0.50	0.49	0.80	0.90
Return on average shareholders' equity (4)	16.56	11.62	10.55	14.60	14.64
Return on average risk weighted assets (5)	1.59	1.14	1.08	1.72	1.93
Net interest margin (6)	1.73	1.89	2.10	2.26	2.34
Cost:income ratio (7)	42.92	44.52	44.57	45.10	44.37
Capital ratios:					
Dividends as a percentage of net income	38.19	47.18	47.63	33.33	33.16
Average shareholders' equity as a percentage of average total assets	4.18	4.34	4.66	5.46	6.15
Risk asset ratios: (8)					
Total	11.53	10.49	10.88	12.11	11.42
Tier 1	9.14	9.38	9.86	11.22	12.39
Credit quality data: (9)					
Non-performing loans as a percentage of loans and advances to customers excluding finance leases (9)(10)	4.93	6.57	8.87	7.39	5.06
Allowances as a percentage of loans and advances to customers excluding finance leases (9)	0.74	0.98	0.88	0.45	0.26
Allowances as a percentage of non-performing loans (9)(10)	14.98	14.93	9.91	6.10	5.19
Provisions for bad and doubtful debts as a percentage of average loans and advances to customers excluding finance leases (9)	0.16	0.49	0.67	0.42	0.17
Ratio of earnings to fixed charges: (11)					
Excluding interest on retail deposits	1.45	1.37	1.28	1.41	1.43
Including interest on retail deposits	1.24	1.19	1.12	1.13	1.12
Selected U.S. GAAP financial statistics					
Return on average total assets (3)	0.62	0.47	0.52	0.81	0.86
Return on average shareholders' equity (4)	14.11	9.76	10.11	13.79	12.99
Dividends as a percentage of net income	38.83	45.22	43.83	30.79	32.50
Average shareholders' equity as a percentage of average total assets	4.37	4.77	5.14	5.84	6.61
Ratio of earnings to fixed charges: (11)					
Excluding interest on retail deposits	1.39	1.35	1.28	1.41	1.41
Including interest on retail deposits	1.21	1.18	1.12	1.13	1.11

(1) See Note 1 to the Summary Consolidated Financial and Statistical Data of the Group above.

(2) All averages (other than average risk weighted assets) for 1991 and 1990 are based upon simple averages obtained by averaging the balances at the beginning and end of the relevant year. Average risk weighted assets are calculated on a semi-annual basis.

(3) Net income divided by average total assets.

(4) Net income divided by average shareholders' equity.

(5) Net income divided by average risk weighted assets. Average risk weighted assets are calculated on a semi-annual basis.

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

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

(8) In 1990, the Group's Tier 1 capital ratio was larger than its total risk asset ratio because supervisory deductions, primarily for the priority liquidation distribution (a deduction arising from the terms of the Conversion), exceeded the value of subordinated debt then in issue. See Note 41 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

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

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

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

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

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

For these reasons, the value of the non-performing loans is not necessarily indicative of the value of losses which Abbey National is likely to suffer. Management believes that it is important to consider the quality of Abbey National's U.K. residential mortgage portfolio compared with those of its competitors. Over the reporting periods covered by this document, the number of mortgage loans which are six months or more in arrears as a percentage of the total number of outstanding mortgage loans has consistently been below the U.K. Council of Mortgage Lenders' ("CML") industry average. As at December 31, 1994, Abbey National's percentage was 1.40% compared with a CML average of 2.40%. The value of these Abbey National non-performing loans as a percentage of its total U.K. residential mortgage loan assets was 1.97%. Non-performing loans in this table also include the value of arrears cases between three and six months in arrears and the value of properties in possession. On this basis, the non-performing U.K. residential mortgage loans are 4.44% of its total U.K. residential loans and advances. Including the remainder of the Group's loans and advances, this ratio increases to 4.97%.

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

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

The following discussion is based on the Consolidated Financial Statements and Unaudited Interim Consolidated Financial Statements of the Group included elsewhere in this Listing Memorandum. Such financial statements have been prepared in accordance with U.K. GAAP. Certain significant differences between U.K. GAAP and U.S. GAAP are discussed in Note 47 to the Consolidated Financial Statements, which include reconciliations of certain amounts calculated in accordance with U.K. GAAP to U.S. GAAP. Unless otherwise indicated, financial information for the Group included in this Listing Memorandum is presented on a consolidated basis, as discussed in the "Accounting Policies" section of the Consolidated Financial Statements.

Overview

From 1990 to 1993, the United Kingdom went through a period of economic recession, with the residential housing market particularly depressed. Although since 1993 the U.K. economy emerged from the recession, growth in the housing market has remained subdued.

In the early 1990s, the U.K. mortgage lending industry experienced increases in non-performing loans and repossessions and decreases in the values of residential properties on which mortgage loans were secured. Consequently, participants in the industry made historically high provisions for bad and doubtful debts during this period. During this period, however, a smaller proportion of Abbey National's U.K. residential mortgage loans were in arrears than was the experience of the U.K. residential mortgage lending industry as a whole. As the U.K. economy improved in 1993 and 1994, the number of mortgage arrears fell sharply and provisions for bad and doubtful debts decreased substantially. This decrease continued in the first six months of 1995, but at a slower rate. U.K. Retail Banking was able to increase the net interest spread earned on its assets and liabilities as provisions increased in the early 1990s. Although competitive pressure in a declining bad debt environment resulted in the U.K. retail net interest spread narrowing in 1993, it has remained broadly unchanged from 1993 through the first six months of 1995, reflecting Abbey National's ability to manage both mortgage lending and savings deposit interest rates. Since Conversion in 1989, U.K. Retail Banking has invested heavily in its distribution network, increasing threefold the selling space in existing branches. This investment programme is nearing completion, and U.K. Retail Banking is seeking to increase the cross-selling of its broad range of personal financial products through the enhanced distribution network and to improve processing efficiency, thereby compensating for possible downward pressure on the retail net interest spread.

Life Insurance Operations, created following the acquisition of Scottish Mutual, an established company in the U.K. life insurance market, made its first contribution to income in 1992. Overall demand for insurance and pensions products in the U.K. increased during 1992 and 1993 but eased during 1994 and the first half of 1995. Scottish Mutual has increased the sales of new policies generated through independent financial advisers in each of the last three years with income before taxes increasing correspondingly. Abbey National Life, utilising Scottish Mutual's expertise, began operations in February 1993 and has increased sales of new policies generated through the U.K. Retail Banking network in each subsequent reporting period.

Treasury and Offshore substantially increased its investment assets in 1992 and 1993, with profits also increasing substantially as a result. Growth in investment assets was slower in 1994, reflecting competition in the markets in which ANTS operates, although strong asset growth resumed in the first half of 1995. Tightening of interest spreads between yields on investment assets and Treasury and Offshore's borrowing costs, together with slower asset growth, led to a reduction in Treasury and Offshore's profit in 1994. However, profit increased by 10.1% in the first half of 1995, as compared to the first half of 1994, as a result of stronger asset growth. Treasury and Offshore's risk management policy of endeavouring to lock in a spread on assets by matching the maturity, currency and interest rate character of its investment assets with corresponding liabilities meant that it has not been materially affected by volatility in the bond markets since 1993.

Continental Europe incurred large provisions for bad and doubtful debts in 1992 and 1993, predominantly in France and, to a lesser extent, Spain, as a result of poor credit decisions in prior years and of the property market recessions in those countries, which led to an increase in non-performing loans secured on commercial property, compounded by decreases in loan security values. Both loan security values and asset quality stabilised in the second half of 1993, with losses before taxes in 1994 and the first half of 1995 significantly reduced as a consequence. New management teams are now in place in France and Spain, the bad and doubtful debts have now been substantially provided for and no further commercial property lending commitments have been entered into in France since 1992.

U.K. Retail Banking remains the major contributor to Group income before taxes, but the combined contribution from sources other than U.K. Retail Banking has increased to 34.6% of Group income before taxes and exceptional items in the six months ended June 30, 1995 from 24.8% of Group income before taxes and exceptional items for the year ended December 31, 1992.

Results of Operations of the Group by Principal Business Segment

Set out below is a discussion and analysis of the Group's income before taxes and exceptional items, income before taxes and net income for each of the three years ended December 31, 1994 and for the six-month periods ended June 30, 1995 and 1994. The discussion includes references to the contributions to income before taxes and exceptional items, as well as total assets, by principal business segment.

Effective as at and for the six-month period ended June 30, 1995, the Group has assumed a consistent allocation of Group capital across its business segments in order to improve comparability of results. This change is reflected in the analysis of results of operations of the Group by principal business segment. The results of operations now reflect the regulatory capital notionally absorbed by each principal business segment based on the Group's Bank of England regulatory requirements. To achieve this result, a notional adjustment has been made to the profit before tax of each business segment where relevant, by applying an average market-related interest rate to the difference between the capital held in the segment and the capital which would be required if the Group's Bank of England risk asset ratio was applied to that segment.

The method of analysis previously adopted was based on the actual levels of capital of the legal entities within the principal business segments, except that the earnings on the equity capital of both U.K. Retail Banking and certain Treasury and Offshore operations were shown in the U.K. Retail Banking segment.

In addition, effective July 1995, the following changes in the classification of businesses within segments have been made in order to provide a clearer analysis of the nature of the Group's business activities:

- A new principal business segment, Consumer Credit, has been separately disclosed. This segment includes the personal unsecured lending operations previously included in U.K. Retail Banking, and will include the results of First National Finance Corporation plc from the date of its acquisition. See "Recent Developments" below.
- The operations in Jersey and Gibraltar, which were previously included in the business segment known as Continental Europe and Offshore, have been reclassified into the business segment formerly known as Treasury Operations, reflecting the increasing similarities in the activities of these operations. The segments have been renamed Continental Europe and Treasury and Offshore.

The segmental results for the six-month period ended June 30, 1994 and the three years ended December 31, 1994 have been restated. The following table summarises the effect of the change on the results of operations for the comparative periods.

Summary of Effect of Changes

	Income Before Taxes and Exceptional Items							
	Six months ended June 30, 1994		Year ended December 31, 1994		Year ended December 31, 1993		Year ended December 31, 1992	
	Revised Basis	Previously Reported Basis	Revised Basis	Previously Reported Basis	Revised Basis	Previously Reported Basis	Revised Basis	Previously Reported Basis
	(unaudited)							
U.K. Retail Banking	271	314	650	741	543	618	452	540
Consumer Credit	14	N/A	31	N/A	22	N/A	17	N/A
Life Insurance Operations	47	47	94	94	61	61	22	22
Treasury and Offshore	99	70	190	128	198	145	173	100
Continental Europe	(18)	(17)	(36)	(33)	(108)	(105)	(50)	(46)
Other Operations	10	9	3	2	20	17	7	5
Residential Estate Agency	—	—	—	—	(2)	(2)	(20)	(20)
	423	423	932	932	734	734	601	601

The discussion and analysis of previous periods has been revised to reflect these changes to the classification of principal business segments.

The following tables set forth the Group's income before taxes and exceptional items for each principal business segment for each of the three years ended December 31, 1994 and for the six-month periods ended June 30, 1995 and 1994 and total assets by principal business segment as at the end of such periods.

Income Before Taxes and Exceptional Items by Principal Business Segment

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(unaudited)	(in millions of £)			
U.K. Retail Banking	316	271	650	543	452
Consumer Credit	17	14	31	22	17
Life Insurance Operations	52	47	94	61	22
Treasury and Offshore	109	99	190	198	173
Continental Europe	(11)	(18)	(36)	(108)	(50)
Other Operations	—	10	3	20	7
Residential Estate Agency	—	—	—	(2)	(20)
Total	483	423	932	734	601

Total Assets by Principal Business Segment

	As at June 30,		As at December 31,		
	1995	1994	1994	1993	1992
	(unaudited)		(in millions of £)		
U.K. Retail Banking	49,077	46,658	49,363	45,652	41,929
Consumer Credit	465	310	442	266	224
Life Insurance Operations	5,071	4,108	4,492	4,197	3,056
Treasury and Offshore	47,210	34,902	37,030	30,889	24,107
Continental Europe	1,406	1,250	1,361	1,173	1,230
Other Operations	526	1,582	1,631	1,625	1,637
Residential Estate Agency	—	—	—	—	40
Total assets	103,755	88,810	94,319	83,802	72,223

Six months ended June 30, 1995 compared to six months ended June 30, 1994

In the six months ended June 30, 1995, the Group's income before taxes and exceptional items increased by 14.1% to £483 million from £423 million for the six months ended June 30, 1994, principally as a result of increased operating income in the three principal business segments, U.K. Retail Banking, Life Insurance Operations and Treasury and Offshore, together with reduced losses incurred by Continental Europe and reduced provisions for bad and doubtful debts. In the six months ended June 30, 1995, the Group's after tax income increased by 18.7% to £324 million, compared to £273 million in the six months ended June 30, 1994, as a result of the increase in income before taxes and a reduced effective corporation tax rate. The Group's effective tax rate for the six months ended June 30, 1995 was 32.9% compared to 35.5% for the six months ended June 30, 1994. The lower tax rate resulted from a reduction in unrelievable losses in Continental Europe.

U.K. Retail Banking was the major contributor to the Group's income before taxes. In the six months ended June 30, 1995, U.K. Retail Banking's income before taxes increased by 16.6% to £316 million from £271 million for the six months ended June 30, 1994, primarily as a result of higher net interest income, which increased 9.1% to £578 million from £530 million in the first half of 1994. The increase in net interest income resulted from growth in average interest earning assets and a wider retail net interest spread, which increased from 1.91% to 2.07% between June 30, 1994 and June 30, 1995. Although the spread narrowed from the exceptionally high level of 2.17%, achieved in the second half of 1994, it remained above the 2.04% level recorded in the full year ended December 31, 1994. Commissions, fees and other income increased 9.4% to £105 million, reflecting a doubling of income from personal banking and other money transmission activities, partially offset by lower fees from fixed rate mortgages and a small reduction in insurance commissions. Operating expenses increased by 5.1% as against the prior period, with the increase in part attributable to the operating costs of HMC Group PLC ("HMC") (acquired in November 1994), and a 3.6% increase in average salaries and higher marketing expenditure.

Consumer Credit, comprising Abbey National's unsecured lending operations, reported separately for the first time and increased pre-tax profit by 21.4% to £17 million compared to £14 million in the first half of 1994. This reflected a 49.4% increase in loan assets to £460 million compared to assets of £308 million as at June 30, 1994, resulting from a more active marketing of unsecured loans and competitive pricing.

Life Insurance Operations' income before taxes increased 10.6% from £47 million to £52 million, of which Scottish Mutual contributed £25 million, an increase of £2 million compared to the same period in 1994. Scottish Mutual's new business premium income arising from policies in the period decreased by 7.6%, but increased by 23% on an annualised equivalent basis. (The annualised equivalent is calculated as total annual premiums plus one-tenth of single premiums.) This reflected strong annual premium pension business, which doubled, and a 15% increase in single premium pension business, partly offset by lower single premium life business. Abbey National Life's income before taxes was £27 million for the six months ended June 30, 1995 compared to £24 million for the same period in 1994. Abbey National Life's new business premiums from policies sold in the six months to June 30, 1995 were more than double that for the first half of 1994 and increased by 52% on an annualised equivalent basis. The growth in business reflected the sale of non-mortgage related investment, pension and protection products, particularly sales of the Abbey National Life Guaranteed Bond and Abbey National PEP, each introduced in the first half of 1995.

Treasury and Offshore's income before taxes for the six months ended June 30, 1995 increased by 10.1% to £109 million from £99 million for the first half of 1994. This was driven by a 28% increase in average assets with total assets increasing to £47,210 million at June 30, 1995, compared to £34,902 million at June 30, 1994, partially offset by higher operating expenses reflecting continued investment in IT systems and a reduction in income earned by Abbey National Financial Products ("ANFP").

Continental Europe's losses before tax of £11 million for the six months ending June 30, 1995 are below those for the first half of 1994 (£18 million), largely as a result of a reduction in provisions for bad and doubtful debts. Further progress was made in working out problem loans, particularly in France, with the provisions charge reduced to £6 million, as compared with £15 million for the first half of 1994.

The decrease in Other Operations' income before taxes and exceptional items reflects the absence of profits from Abbey National Investments Holdings Ltd., following the exercise of early redemption rights by counterparties on certain investment assets.

Year ended December 31, 1994 compared to year ended December 31, 1993

In the year ended December 31, 1994, the Group's income before taxes and exceptional items increased by 27.0% to £932 million principally as a result of reduced provisions for bad and doubtful debts and increased operating income in U.K. Retail Banking, an increase in Life Insurance Operations' income before taxes and reduced losses incurred by Continental Europe. In the year ended December 31, 1994, the Group's after tax income increased by 56.4% to £610 million compared to £390 million in the year ended December 31, 1993, as a result of the increase in income before taxes and a reduced effective corporation tax rate. The Group's effective tax rate in 1994 was 34.5% compared to 44.6% for 1993. The lower tax charge and effective tax rate primarily resulted from a reduction in unrelievable losses in Continental Europe.

U.K. Retail Banking was the major contributor to the Group's income before taxes. In the year ended December 31, 1994, U.K. Retail Banking's income before taxes increased by 19.7% to £650 million, primarily as a result of a reduction in provisions for bad and doubtful debts to £39 million compared to £112 million in 1993. U.K. Retail Banking's net interest income increased by 4.6% in 1994, with 6.0% growth in average interest earning assets being partially offset by a slight narrowing of the net interest margin. The growth in average interest earning assets reflects both mortgage lending through the retail distribution network, and the acquisitions of HMC and the U.K. residential mortgage operation of the Canadian Imperial Bank of Commerce ("CIBC"). The retail net interest spread in 1994 was broadly unchanged from 1993, despite competition in the mortgage market, with the spread widening between the first half and second half of the year. Commissions, fees and other income were lower, reflecting reduced fees from fixed-rate mortgages as these products declined in popularity, partly offset by increased income from buildings and contents insurance policies and from personal banking products. Operating expenses increased slightly, with the increase attributable to the operating costs of the acquired businesses. Other than these particular costs, inflationary increases were offset by reduced promotional expenditure and a small reduction in headcount over the year (excluding acquisitions).

Consumer Credit increased pre-tax profit by 40.9% to £31 million in the year ended December 31, 1994. This reflected a 66.1% increase in loan assets to £442 million, as a result of more active marketing of unsecured loans and a fall in provisions for bad and doubtful debts of £3 million.

Life Insurance Operations' income before taxes increased from £61 million in 1993 to £94 million in 1994, of which Scottish Mutual contributed £46 million, an increase of £6 million compared to 1993. Scottish Mutual's new business premium income arising from policies sold in the period increased by 20.8% to £471 million, with two-thirds of new business being pension-related and the remainder consisting of life insurance and other long-term savings products. This increase was achieved against an industry background of lower demand for life and pension products. Consumers' preference for single, rather than annual (or regular) premium contracts continued in 1994. Abbey National Life's income before taxes in 1994 was £48 million compared to £21 million in 1993, the year in which it commenced operations. Abbey National Life's new business premiums from policies sold in 1994 totalled £255 million, 75.9% higher than in 1993. The growth in business reflected the sale of non mortgage-related investment, pensions and protection products to U.K. Retail Banking customers, with more than half of the policies sold falling into this category. Abbey National Life's sales of regular premium endowment products (which have been traditionally sold alongside mortgage loans) also increased during the year.

The decrease in Treasury and Offshore's income before taxes was caused largely by the maturity in 1993 of a number of highly profitable investments. Growth in average interest earning assets was slower than in previous years, reflecting both competition in the markets in which ANTS invests and Abbey National's strategy of limiting the capital employed by Treasury and Offshore's investment book relative to the capital of the Group as a whole. Increased competition contributed to a tightening of the average net interest spread earned on the investment portfolio. Treasury and Offshore's policy of endeavouring to lock in a spread on investment assets meant that income before taxes was not materially affected by volatility in the bond markets. ANFP made a positive contribution to income before taxes. ANFP was not involved in any way with the events that resulted in the administration of Barings on February 26, 1995. An examination of Abbey National's financial relationship with Barings confirmed that Abbey National's 1994 results were unaffected by that administration. Arrangements were in place to provide protection against credit exposure on swaps between ANFP and Barings, which ensured that no exposure between the two companies arose when these transactions automatically terminated on the appointment of the administrators. In respect of the market risk which arose on termination, replacement hedging transactions were promptly put in place. See "Business Description — Treasury and Offshore — Abbey National Financial Products" below.

Continental Europe's losses before taxes of £36 million were substantially lower than those for 1993 (£108 million), largely as a result of a reduction in provisions for bad and doubtful debts to £29 million from £97 million. The improvement occurred principally in France where losses before taxes decreased to £24 million compared to losses of £92 million in 1993, reflecting management actions taken to stabilise loan quality. In Spain, losses were also reduced as a result of a decline in the number of non-performing loans. The operation in Italy made a small positive contribution to Group profit.

The decrease in Other Operations' income before taxes resulted principally from two factors: firstly, lower earnings in respect of Abbey National Investments Holdings Ltd. in anticipation of counterparties exercising early redemption rights on certain investments; and secondly, a write down of £10 million in the value of the goodwill relating to J Trevor & Webster, the commercial estate agency business, to reflect a permanent diminution in its value. See "Business Description — Other Operations" below.

Year ended December 31, 1993 compared to year ended December 31, 1992

In the year ended December 31, 1993, the Group's income before taxes and exceptional items increased by 22.1% to £734 million principally due to increases in net interest income. A 20.4% reduction in provisions for bad and doubtful debts also contributed to this increase. The Group's income before taxes increased by 24.8% in 1993 to £704 million. Although the effective corporation tax rate increased in 1993 to 44.6%, principally as a result of losses incurred by Continental Europe for which tax relief was not then available, Group after-tax income for the year increased by 23.0% to £390 million.

U.K. Retail Banking's income before taxes and exceptional items increased by 20.1% to £543 million, due to an increase in average interest earning assets caused by strong lending of fixed-rate mortgage products. This offset a narrowing of the net interest spread due to competition for lending during a period of relatively low market volume. An increase in commissions, fees and other income principally reflected higher insurance commission and fixed-rate mortgage fee income associated with the higher level of new mortgages. Operating expenses increased largely as a result of profit share bonus payments to staff, higher pension costs and increased promotional expenditures. Provisions for bad and doubtful debts fell by almost half, reflecting significant reductions in mortgage arrears and repossessions.

Consumer Credit increased pre-tax profit by 29.4% to £22 million in the year ended December 31, 1993. This reflected an 18.8% increase in loan assets to £266 million.

Life Insurance Operations' income before taxes and exceptional items increased to £61 million from £22 million in the prior year, of which Scottish Mutual contributed £40 million, a 25% increase from 1992. Scottish Mutual's new business premiums, which are an important factor in determining the level of earnings, more than doubled in 1993 to £390 million, with strong growth in both single premium life and single premium pension business. New annual premium business was slightly lower than the level achieved in 1992, which was similar to the general industry trend. After a rationalisation of its branch office structure, Scottish Mutual reduced its numbers of staff and branch offices and held costs at 1992 levels while continuing to support the increase in new business. Abbey National Life commenced trading on February 1, 1993 and generated £145 million of new business premiums in its first eleven months of operations. As with Scottish Mutual, single premium business provided the bulk of this total, representing over three-quarters of new business premiums. Approximately 38% of new business policies related to mortgage endowments, with the remainder taken out as forms of long-term savings. Abbey National Life's income before taxes in 1993 was £21 million, net of approximately £2 million of launch costs incurred in January.

Treasury and Offshore increased its income before taxes and exceptional items by 14.5% to £198 million. This increase largely reflected substantial growth in investment assets, including investments in floating rate notes, mortgage-backed securities and finance leases. In addition, income before taxes and exceptional items benefited from investments made at advantageous margins near the end of 1992 (primarily sovereign debt instruments which had yields significantly above the London interbank offered rate at the time of their purchase as a result of volatility in the currency markets and related uncertainties regarding the European Exchange Rate Mechanism).

Continental Europe incurred a loss before taxes and exceptional items of £108 million compared to £50 million in 1992, principally as a result of additional provisions for commercial lending in France. The additional provisions in 1993 reflected a downturn in the French property markets and stemmed in part from poor lending decisions in prior years. Provisions in France of £88 million were incurred principally in the first half of the year, with a lower second half charge of £11 million reflecting some stabilisation in the commercial property market. Lending secured on commercial property ceased in France in 1992, new management was employed and action was taken to improve recoveries on existing non-performing loans. In Spain, provisions were reduced to £10 million in 1993 from £18 million in 1992. New lending to Spanish residential property developers, against which most of these provisions were made, ceased in 1993. Italy contributed £2 million to income before taxes.

Income before taxes and exceptional items for Other Operations increased to £20 million in 1993, from £7 million in the prior year. The improvement reflected a £10 million reduction in the loss incurred by Abbey National Homes to £3 million in 1993 following stabilisation in property sales prices. As a result of such stabilisation, no further significant write down in the value of completed properties and work in progress was deemed necessary by management. No additional development commitments have been undertaken by Abbey National Homes since mid-1990. Abbey National Independent Financial Advisers Ltd. ("ANIFA"), previously named Abbey National Financial Services Ltd., and Abbey National Investments Holdings Ltd. continued to make a positive contribution to Group income before taxes.

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

Set forth below is a discussion and analysis of the results of operations of the Group by nature of income and expense.

Net Interest Income

The following table sets forth net interest income for each of the three years ended December 31, 1994 and for the six-month periods ended June 30, 1995 and 1994.

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(unaudited)		(in millions of £)		
Interest receivable	3,024	2,558	5,329	4,974	5,786
Interest payable	(2,276)	(1,916)	(3,935)	(3,636)	(4,521)
Net interest income	748	642	1,394	1,338	1,265

The principal factors affecting the level of net interest income earned by the Group are the volume of interest earning assets and the net interest margin earned on such assets. Since 1992, the volume of interest earning assets has increased substantially, whereas the Group net interest margin has declined. This reduction in Group net interest margin was attributable to two main factors: first, the increasing proportion of narrower-spread Treasury and Offshore assets in the Group balance sheet; and secondly, the decline in average U.K. interest rates reducing the benefit from the investment of shareholders' equity.

Management believes that the Group's net interest margin will continue to be influenced by, among other factors, the proportion of the Group's balance sheet represented by Treasury and Offshore assets, the general level of U.K. interest rates, competitive pressures in the U.K. residential mortgage and liquid savings markets, the economic cycle and its expected impact on the level of provisions for bad and doubtful debts, the sophistication of the retail products offered to customers and competitive pressures in the markets for high-quality investment assets. The proportion of Treasury and Offshore assets in the Group balance sheet is expected to grow more slowly in the future and therefore the downward effect this factor has had on Group net interest margin is likely to be less than it has been in the past. Changes in the net interest spread earned on these assets will continue to influence the margin. The benefit from the investment of shareholders' equity will continue to be affected by the general level of U.K. interest rates, although Abbey National's risk management policies seek to limit the effect of interest rate volatility on net interest income.

Future changes in the retail net interest spread will depend, among other factors, on the demand for residential mortgages and liquid savings products and on the level of competition among suppliers of these retail products. Subject to competitive pressures and market conditions, Abbey National is able to set prices for both retail assets and liabilities unilaterally and expects to use this ability, where appropriate, to limit any further downward pressure on the retail net interest spread. Additionally, the Group utilises the expertise of Treasury and Offshore to design retail products that are attractive to customers and that contribute positively to margin management.

Six months ended June 30, 1995 compared to six months ended June 30, 1994

In the six months ended June 30, 1995, the Group's net interest income increased by 16.5% to £748 million, reflecting a 15% increase in average interest earning assets during such period and a widening in the Group net interest margin to 1.68% from 1.66%. The strong growth in assets reflects expansion of Treasury and Offshore investment assets, the acquisition of HMC in November 1994 and growth in U.K. mortgage balances. The increased Group net interest margin was due principally to a wider U.K. Retail Banking net interest spread. The Group's net interest margin also benefitted from the maturing of certain investment transactions in early 1995. The funding costs of these transactions had been previously charged to the net interest income category while income from the transactions had been classified as investment dividends (in the commissions, fees and other income category). The maturing of these transactions had the effect of contributing approximately £20 million to net interest income and, accordingly, reducing commissions, fees and other income by the same amount. The increase in net margin was tempered by the further increase in the proportion of Treasury and Offshore assets within the Group balance sheet (the spreads on which are generally narrower than on U.K. retail assets). The average net interest spread earned on U.K. Retail Banking assets increased to 2.07% from 1.91% for the prior period, although the spread was broadly unchanged from the 2.04% reported for 1994 as a whole.

Year ended December 31, 1994 compared to year ended December 31, 1993

In the year ended December 31, 1994, the Group's net interest income increased by 4.2% to £1,394 million, with 14.0% growth in average interest earning assets being partially offset by a reduction in the Group net interest margin to 1.73% from 1.89%. The strong growth in assets reflects expansion of both the Treasury and Offshore investment portfolio and of mortgage assets in the U.K. Retail Banking business. The reduced Group margin resulted from a further increase in the proportion of Treasury and Offshore assets within the Group balance sheet, the spreads on which are generally narrower than on U.K. Retail Banking assets, and a tightening of the spread earned on Treasury and Offshore assets. The average net interest spread earned on U.K. Retail Banking assets (the average spread between lending and funding rates) was broadly unchanged from the average in 1993, although both this spread and the Group margin increased between the first half and the second half of 1994.

Year ended December 31, 1993 compared to year ended December 31, 1992

The Group's net interest income increased by 5.8% to £1,338 million in 1993. Average interest earning assets grew by 17.7% to £70,761 million, with the increase resulting from growth in investment assets within Treasury and Offshore and, to a lesser extent, from growth in U.K. Retail Banking residential mortgage loans. The growth in average interest earning assets offset a reduction in the Group net interest margin, which declined to 1.89% in 1993 from 2.10% in 1992. The reduction in net interest margin reflected principally an increase in the proportion of the Group's balance sheet represented by Treasury and Offshore assets, reduced benefit from the Group's investment of shareholders' equity due to the general decline in U.K. interest rates, and a lower interest spread in U.K. Retail Banking.

The following tables set forth prevailing average interest rates and yields, spreads and margins for each of the three years ended December 31, 1994 and for the six-month period ended June 30, 1995.

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(unaudited)		(per cent.)		
Prevailing Average Interest Rates					
United Kingdom:					
U.K. banks base rate	6.66	5.30	5.46	6.01	9.55
Abbey National base mortgage rate (1)	8.31	7.75	7.83	8.07	10.80
London inter-bank offered rate:					
three month sterling	6.74	5.22	5.65	5.94	9.63
three month eurodollar	6.21	4.02	4.80	3.29	3.82
United States:					
prime rate	8.92	6.40	7.02	6.00	6.25

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(unaudited)		(per cent.)		
Yields, Spreads and Margins					
Gross yield: (2)					
Group	7.46	6.83	6.86	7.29	9.85
Interest spread: (3)					
Group	1.27	1.32	1.38	1.53	1.49
Net interest margin:					
Group	1.68	1.66	1.73	1.89	2.10

(1) Abbey National's base mortgage rate represents the rate charged on loans of up to £59,999. Changes in the level of Abbey National's base mortgage rate are influenced by changes in monetary policy. Abbey National may apply different rates depending upon the amount borrowed and the precise type of mortgage and such rates may not relate to the base mortgage rate.

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

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

The following table sets forth average interest earning assets and average interest bearing liabilities for each of the three years ended December 31, 1994 and for the six-month period ended June 30, 1995.

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(unaudited)		(in millions of £)		
Average interest earning assets:					
Group	89,890	78,161	80,658	70,761	60,144
Average interest bearing liabilities:					
Group	83,947	73,363	75,440	66,438	55,888

Commissions, Fees and Other Income

The following table sets forth commissions, fees and other income for each of the three years ended December 31, 1994, and for the six-month period ended June 30, 1995 and 1994.

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(unaudited)		(in millions of £)		
Net fees and commissions receivable	99	87	169	231	214
Income from long-term insurance policies (1)	50	46	91	61	31
Other operating income	28	64	105	84	74
Total	177	197	365	376	319

(1) Income from long-term insurance policies represents the present value of profits expected to emerge in the future from policies currently in force, together with the Group's interest in the surplus retained within the long-term insurance funds. See the "Accounting Policies" section of, and Note 23 to, the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

Six months ended June 30, 1995 compared to six months ended June 30, 1994

In the six months ended June 30, 1995, commissions, fees and other income decreased by 10.2% to £177 million from £197 million for the six months ended June 30, 1994. Insurance commissions receivable decreased by 6% to £50 million from £53 million for the first half of 1994, as a result of lower commissions earnings from building insurance policies reflecting a reduction in the volume of mortgage lending. Other net fees and commissions receivable increased by 44.1% for the first half of 1995 to £49 million from £34 million for the comparable period in 1994, reflecting a doubling of income from personal banking and other money transmission activities, partly offset by lower fixed-rate mortgage arrangement fees. Income from long term assurance business increased by 8.7% to £50 million, with both Scottish Mutual and Abbey National Life contributing higher income. Other operating income decreased 56.3% to £28 million, resulting mainly from a reduction in investment dividend income and lower income from ANFP. For an explanation of the reduction in investment dividend income, see "— Results of Operations of the Group by Nature of Income and Expense — Net Interest Income — Six months ended June 30, 1995 compared to six months ended June 30, 1994" above.

Year ended December 31, 1994 compared to year ended December 31, 1993

In the year ended December 31, 1994, commissions, fees and other income decreased by 2.9% to £365 million. Net fees and commissions receivable decreased by 26.8% to £169 million. Excluding net fees and commissions receivable by the Group's discontinued residential real estate brokerage business of £33 million in the year ended December 31, 1993, net fees and commission receivable decreased by 14.6% in 1994. This decrease principally reflects reduced arrangement fees for fixed-rate mortgages as a result of a change in customer preferences away from fixed-rate towards variable-rate mortgages during the first half of the year. The reduced income in this category also reflected increased arrangement fees payable by ANFP, a factor more than offset by increased dealing profits earned by ANFP. Both the increased dealing profits and arrangement fees payable reflect the first full year of operations of ANFP, which began operations in October 1993. The higher dealing profits were reflected in the 25.0% increase in other operating income to £105 million. Income from long-term insurance policies increased by 49.2% to £91 million, resulting from increases in new business premiums generated by Scottish Mutual and Abbey National Life. See the "Accounting Policies" section of, and Note 23 to, the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

Year ended December 31, 1993 compared to year ended December 31, 1992

In the year ended December 31, 1993, commissions, fees and other income increased 17.9% to £376 million. Net fees and commissions receivable increased by 7.9% to £231 million. Insurance commissions, principally from the sale of buildings and contents insurance policies for third-party insurers through Abbey National's retail branch network, represented the largest element of this increase. The remainder of the increase in net fees and commissions receivable was accounted for by increased fee income associated with the higher lending volumes achieved during the year, particularly arrangement fees for fixed-rate mortgages. As a result of the sale of the residential real estate brokerage business in August 1993, real estate brokerage fees in 1993 were £5 million lower than in 1992. Income from long-term insurance policies doubled to £61 million in the year ended December 31, 1993, reflecting an increase in new business premiums generated by Scottish Mutual and the commencement of trading by Abbey National Life in February 1993. The increase in other operating income to £84 million in the year ended December 31, 1993 principally reflects an increase in dividends earned on certain investments within Treasury and Offshore.

Operating Expenses

The following table sets forth operating expenses for each of the three years ended December 31, 1994, and for the six-month periods ended June 30, 1995 and 1994.

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(in millions of £)				
	(unaudited)				
Salaries	138	133	274	268	242
Other staff costs	31	29	60	54	41
Property and equipment expenses	54	62	126	120	119
Other administrative expenses	147	112	211	237	227
Depreciation and amortisation	42	41	84	84	77
Total operating expenses	412	377	755	763	706
Headcount (full-time equivalent)	17,726	17,107	17,376	16,867	17,760

Six months ended June 30, 1995 compared to six months ended June 30, 1994

Total operating expenses for the six months ended June 30, 1995 increased 9.3% to £412 million from £377 million for the six months ended June 30, 1994. Of the £35 million increase, £11 million was attributable to the operating costs of businesses acquired since June 30, 1994. Staff costs rose by 4.3% to £169 million, reflecting an increase of 3.6% in the average number of full time equivalent staff to 17,726 at June 30, 1995 from 17,107 at June 30, 1994. This increase of 619 full time equivalent staff includes 492 staff employed in businesses acquired since June 1994 with the remainder employed in Consumer Credit and Treasury and Offshore activities. Headcount in U.K. Retail Banking has remained broadly unchanged. Property and equipment expenses for the six months ended June 30, 1995 decreased 12.9% to £54 million from £62 million for the six months ended June 30, 1994. This decrease reflects a fall in branch refurbishment costs in the six months to June 30, 1995. Other property and equipment expenses remained broadly unchanged. Other administrative expenses rose by 31.3% to £147 million reflecting the operating expenses of acquired businesses, higher marketing expenditure and increased expenditure on information technology development.

Year ended December 31, 1994 compared to year ended December 31, 1993

Total operating expenses for the year ended December 31, 1994 were reduced by 1.0% from £763 million to £755 million. Excluding £35 million of costs arising from the discontinued residential real estate brokerage business incurred in 1993, operating expenses increased by 3.7% or £27 million, from £728 million to £755 million. Excluding salaries and other staff costs of £19 million attributable to the discontinued residential real estate brokerage business, combined salaries and other staff costs increased by 10.2% to £334 million in 1994. This increase reflected approximately 3% growth in average salaries and an approximately 4% increase in the average number of full-time equivalent staff (excluding Life Insurance Operations staff, whose salary costs are reflected in income from long-term insurance policies). The growth in average staff numbers reflects headcount increases during 1993, with staffing broadly unchanged in 1994 if the additional 465 employees acquired with HMC, CIBC's U.K. residential mortgage lending business and GM Benefit Consulting Group are excluded. Property and equipment costs rose by 5.0% to £126 million due to increased expenditure on information technology development and distribution network enhancements. See "— Capital Resources and Financial Condition of the Group — Capital Expenditure" below. Other administrative expenses decreased by 11.0% to £211 million principally as a result of reduced promotional expenditure and the absence of expenses associated with the discontinued residential real estate brokerage business.

Year ended December 31, 1993 compared to year ended December 31, 1992

In the year ended December 31, 1993, operating expenses increased by 8.0% to £763 million. Salary costs increased by £26 million or 10.7%, reflecting approximately 4% growth in average salaries and the payment of a profit share bonus of 10% of salary to eligible members of staff compared with the previous year in which no such payment was made. Other staff costs, consisting mainly of pension costs and National

Insurance (similar to Social Security in the United States), increased by £13 million in 1993 as a result of a £10 million increase in pension costs, following the triennial pension fund valuation. See Note 45 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum. Other administrative expenses increased by 4.4% to £237 million in 1993 from £227 million in 1992 due to an increase in the level of promotional expenditure. The increase in promotional expenditure reflects the particularly active promotion of U.K. residential mortgage products during the year. Depreciation and amortisation increased by £7 million in 1993, principally as a result of capital expenditure related to the improvement and modernisation of the branch network. See "— Capital Resources and Financial Condition of the Group — Capital Expenditure" below.

Provisions for Bad and Doubtful Debts

The following table sets forth the provisions for bad and doubtful debts for each of the three years ended December 31, 1994, and for the six month periods ended June 30, 1995 and 1994.

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(in millions of £) (unaudited)				
Credit risk provisions charge:					
Specific	36	53	103	232	212
General	(8)	(12)	(29)	(14)	62
Total	28	41	74	218	274
Credit risk provisions charge:					
U.K. Retail Banking	18	23	39	111	218
Consumer Credit	4	3	5	8	9
Continental Europe	6	15	30	99	47
Total	28	41	74	218	274

Six months ended June 30, 1995 compared to six months ended June 30, 1994

In the six months ended June 30, 1995, provisions for bad and doubtful debts decreased 31.7% to £28 million from £41 million for the same period in 1994. In U.K. Retail Banking, provisions for bad and doubtful debts fell 21.7% to £18 million, as a result of the continued fall in mortgage arrears and in the stock of repossessed residential properties. For those repossessed properties on which purchase offers were received, the average provision per property for capital losses and interest arrears was £12,355 at June 30, 1995 compared to £15,700 at June 30, 1994. Despite a 49.9% increase in loan assets in Consumer Credit from June 30, 1994 to June 30, 1995, provisions charges increased by only £1 million. In Continental Europe, provisions for bad and doubtful debts were £6 million compared to £15 million for the first half of 1994. This reduction in provisions continued to reflect management actions taken to stabilise loan quality and stabilisation of the French commercial property market.

Allowances for lending losses as a percentage of loans and advances to customers (excluding finance leases) decreased to 0.70% as at June 30, 1995 from 0.92% as at June 30, 1994 largely as a result of the decline in U.K. residential mortgage provisions for bad and doubtful debts and the decline in provisions in Continental Europe. Allowances for lending losses as a percentage of non-performing loans was broadly unchanged at 13.67% compared to 13.98% for the same period in 1994. See "Selected Statistical Information — Analysis of Allowance for Lending Losses" below.

Year ended December 31, 1994 compared to year ended December 31, 1993

In the year ended December 31, 1994 provisions for bad and doubtful debts decreased substantially to £74 million from £218 million in 1993. In U.K. Retail Banking, provisions for bad and doubtful debts for 1994 were more than halved to £39 million, principally as a result of a continued reduction in mortgage arrears and repossessions and a halt in the decline of residential real estate prices. The reduction in arrears and repossessions was largely a consequence of lower U.K. interest rates and general improvement in the U.K. economy. For those repossessed properties in the U.K. on which purchase offers were received, the average provision for capital losses and interest arrears fell to £15,700 compared to £18,800 at December 31, 1993. This reduction in the average provision for repossessed properties reflects the decline in interest arrears as mortgage rates fell and an arrest in the decline in house prices and hence a stabilisation in capital losses. The provision in U.K. Retail Banking included a reduction in general provisions of £18 million, reflecting reduced uncertainty over settlement of mortgage indemnity claims by insurance companies. This follows a similar general provision release in 1993, with specific provisions again being made where claims in certain cases were not met in full by the insurance companies.

In Continental Europe, provisions for bad and doubtful debts were £30 million compared to £99 million in 1993. This reduction in provisions reflects management actions taken to stabilise loan asset quality and an improved economic environment, and includes a general provision release of £11 million. The reduction occurred principally in Abbey National France, where provisioning was highest in 1993.

Allowances for lending losses as a percentage of loans and advances to customers (excluding finance leases) decreased from 0.98% to 0.74% largely as a result of the decline in U.K. residential mortgage provisions for bad and doubtful debts and the decline in provisions in Continental Europe. Allowances for lending losses as a percentage of non-performing loans was broadly unchanged at 14.98% compared to 14.93% for 1993. See "Selected Statistical Information — Analysis of Allowance for Lending Losses" below.

Year ended December 31, 1993 compared to year ended December 31, 1992

Total provisions for bad and doubtful debts decreased by 20.4% to £218 million. Although U.K. residential mortgage provisions were lower, provisions in Continental Europe increased significantly in part due to poor credit decisions and in part due to the continuing deterioration in the French and Spanish commercial property markets. New management teams are now in place in France and Spain and no further commercial property lending commitments have been entered into since 1992.

In U.K. Retail Banking, provisions declined by £107 million, mainly due to significant reductions in the level of mortgage arrears and repossessions. The main causes of these reductions were lower U.K. interest rates and general improvement in the U.K. economy, which began during 1993 and which have led to a decline in provisions throughout the U.K. banking industry from the historically high levels of 1991 and 1992. For those repossessed properties on which purchase offers were received, the average provision per property for capital losses and interest arrears was £18,800 at December 31, 1993, slightly higher than the £18,400 at December 31, 1992, although lower than the £19,600 at June 30, 1993. A provisions write back of £1 million was made against other secured advances compared with a £10 million provision in 1992.

Under the terms of the mortgage indemnity guarantee cover taken out with leading insurance companies, Abbey National was able to make claims which limited the losses realised by the Group where properties were repossessed and sold. However, certain of these claims remained unsettled at December 31, 1992. Uncertainty over payment in respect of these claims was one of the factors underpinning the increase in the general provision for bad and doubtful debts in 1992. Settlements were negotiated with some insurance companies and in cases where agreement was reached, specific provisions were made in 1993. The likelihood of future non-payment was assessed and as a result general provisions for U.K. residential mortgages were reduced by a net £20 million from £96 million to £76 million.

In Continental Europe, a provisions charge of £99 million, compared to £47 million in 1992, was made. This charge was made mainly in the first half of 1993, and the lower charge of £18 million in the second half reflected some stabilisation of the French commercial property market when compared with the first half of the year.

Allowances for lending losses as a percentage of loans and advances to customers (excluding finance leases) increased from 0.88% to 0.98% as a result of the increased charge for provisions for bad and doubtful debts in Continental Europe. Allowances for lending losses as a percentage of non-performing loans increased from 9.91% to 14.93% as a result of the above charge and a 25.3% decrease in the value of non-performing loans in the U.K. as the number of mortgage loans in arrears fell. See "Selected Statistical Information — Analysis of Allowance for Lending Losses" below.

Taxes

The following table sets forth a reconciliation of taxes payable at the standard U.K. corporation tax rate and the Group's effective tax rate for each of the three years ended December 31, 1994 and for the six-month periods ended June 30, 1995 and 1994. The effective tax rate is obtained by dividing taxes by income before taxes (but after exceptional items).

	Six months ended June 30,		Year ended December 31,		
	1995	1994	1994	1993	1992
	(in millions of £ except percentages) (unaudited)				
Taxation at standard U.K. corporation tax rate (33%)	159	140	308	232	186
Effect of non-allowable provisions	8	4	8	31	2
Effect of goodwill on disposals previously written off	—	—	3	1	41
Effect of unrelieved overseas losses	(8)	6	—	36	16
Adjustment to prior year tax provisions	—	—	3	14	2
Taxes	159	150	322	314	247
Effective tax rate	32.9%	35.5%	34.5%	44.6%	43.8%

Six months ended June 30, 1995 compared to six months ended June 30, 1994

In the six months ended June 30, 1995, taxes increased by 6% to £159 million compared to £150 million in the six months ended June 30, 1994, as a result of the increase in income before taxes, partly offset by a reduction in the Group effective tax rate to 32.9% compared to 35.5% in 1994. The lower effective tax rate resulted from the lower levels of unrelieved overseas tax losses.

Year ended December 31, 1994 compared to year ended December 31, 1993

In the year ended December 31, 1994, taxes increased by 2.5% to £322 million compared to £314 million in the year ended December 31, 1993, as a result of the increase in income before taxes, partly offset by a reduction in the Group's effective tax rate to 34.5% in 1994 compared to 44.6% in 1993. The lower effective tax rate resulted primarily from the absence of an effect of unrelieved overseas losses, and the reduced effect of non-allowable provisions in 1994 without the loss associated with the disposal of the residential real estate brokerage business in 1993.

Year ended December 31, 1993 compared to year end December 31, 1992

In the year ended December 31, 1993, taxes increased by 27.1% to £314 million from £247 million in the prior year. This increase primarily reflects the increase in 1993 in income before taxes and exceptional items. In addition, although the standard U.K. corporation tax rate remained constant, the effective tax rate increased in 1993 to 44.6% from 43.8% in 1992, reflecting an increase in the effect of non-allowable provisions, an increase in unrelieved losses in Continental Europe and an increase in the adjustment to prior year tax provisions. The increase in the effective tax rate was partially reduced by a decrease in goodwill on disposals previously written off relating to the permanent diminution in value of the residential real estate brokerage operations.

Capital Resources and Financial Condition of the Group

The following table sets forth the Group's capital resources as at December 31 and June 30 of the years indicated.

	As at June 30,		As at December 31,		
	1995	1994	1994	1993	1992
	(in millions of £)				
	(unaudited)				
Shareholders' equity	3,928	3,593	3,704	3,386	3,184
Subordinated liabilities	1,572	1,044	1,520	868	648
Total capital resources	5,500	4,637	5,224	4,254	3,832

The increase in the Group's capital resources in the first half of 1995 reflects an increase in shareholders' equity of £224 million which includes £228 million in retained earnings and other movements in reserves, and a net increase in subordinated liabilities of £52 million, compared to an increase in shareholders' equity of £207 million, of which £197 million were retained earnings, and a net increase in subordinated liabilities of £176 million in the period to June 30, 1994.

The increase in the Group's capital resources in 1994 reflects an increase in shareholders' equity of £318 million, of which £312 million were retained earnings, and a net increase in subordinated liabilities of £652 million. The increase in capital resources in 1993 reflects the net increase of £220 million of subordinated liabilities and an increase in shareholders' equity of £202 million, of which £174 million were retained earnings.

Capital Adequacy Requirements

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

The basic instrument of capital monitoring is the risk asset ratio as developed by the Basle Committee. This ratio derives from a consideration of capital as a cover for the credit risk inherent in Group assets. Capital is defined by reference to the European Community ("EC") Own Funds Directive, and divided into "Tier 1" capital — consisting largely of shareholders' equity and "Tier 2" capital — including general provisions and certain debt capital instruments, particularly subordinated debt. Assets (both on- and off-balance sheet) are weighted to allow for relative risk according to rules derived from the EC Solvency Ratio Directive using a series of risk weighting factors ranging from 0% to 100%. Abbey National's main class of asset, mortgage loans secured on residential property, is assigned a weighting of 50%.

The Basle Committee sets a minimum risk asset ratio for international banks of 8%. The Bank of England sets minimum risk asset ratios on an individual basis for the banks it supervises. These are set with regard to the minimum standard set by the Basle Committee and the particular circumstances of each bank.

The following risk asset ratios which exceed both the Basle Committee minimum risk asset ratio of 8% and the Bank of England's specific recommendation for Abbey National, are calculated for the Group as supervised by the Bank of England. Abbey National recognises the additional security inherent in Tier 1 capital, and hence also presents a Tier 1 to risk weighted assets ratio.

Capital Adequacy Data

	As at June 30,		As at December 31,		
	1995	1994	1994	1993	1992
	(in millions of £, except percentages)				
	(unaudited)				
Tier 1	3,928	3,593	3,704	3,386	3,184
Tier 2	1,486	1,010	1,465	832	712
less supervisory deductions	(539)	(444)	(496)	(432)	(381)
Total capital resources	4,875	4,159	4,673	3,786	3,515
Risk weighted assets					
On-balance sheet	43,170	37,039	39,760	35,322	31,693
Off-balance sheet	1,170	711	786	770	601
Total	44,340	37,750	40,546	36,092	32,294
Capital ratios					
Risk asset ratio	10.99%	11.02%	11.53%	10.49%	10.88%
Tier 1 ratio	8.86%	9.52%	9.14%	9.38%	9.86%

The growth in risk weighted assets between 1992 and 1993 was broadly matched by the increase in both Tier 1 and total capital resources, with the result that there was no significant fluctuation in the risk asset and Tier 1 ratios. In 1994, the risk asset ratio increased, reflecting an increase in subordinated debt, including the issuance of a $500 million subordinated bond in the U.S. public market following registration with the Commission in October 1994. The Tier 1 ratio in particular remains strong relative to most other U.K. banks. Total qualifying Tier 2 capital as a percentage of Tier 1 capital as at December 31, 1994 was 39.6%. In 1995, the risk asset ratio decreased, reflecting a 24% growth in the risk weighted assets of ANTS in the six months ended June 30, 1995, while only £33m of new subordinated debt capital was raised. Total qualifying Tier 2 capital as a percentage of Tier 1 capital as at June 30, 1995 was 37.8%. Total capital resources are shown after supervisory deductions, which include the value of the Group's investment in long-term life insurance operations and the value of the priority liquidation distribution right available to members of the Society at the date of Conversion. See Note 41 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum for details of the priority liquidation distribution.

Capital Expenditure

	As at June 30,		As at December 31,		
	1995	1994	1994	1993	1992
	(in millions of £)				
	(unaudited)				
Capital expenditure	57	43	114	101	115

Capital expenditure over the period 1992 to 1994 has been, to a large extent, incurred for the purpose of extending, modernising and in some cases resiting U.K. retail branches. As part of this programme, administrative processes for mortgages and checking accounts were transferred from the branches to a number of dedicated administration centres. As a result of the programme, selling space within the branch network has tripled without a significant change in the number of branches. The programme is approaching completion, with 604 of the 675 branches (as of December 31, 1994) modernised by the end of 1994. Capital expenditure on the programme will therefore diminish. In addition, expenditure has been incurred on enhancing information technology in each of the Group's major businesses to improve processing efficiency, decision-making and point-of-sale transactions with customers.

RECENT DEVELOPMENTS

On July 10, 1995, Abbey National and National & Provincial Building Society ("National & Provincial") announced that they had reached agreement in principle on the terms of a proposed merger which will be unanimously recommended by the board of directors of National & Provincial to its members. The merger is to be effected by a transfer of National & Provincial's business to Abbey National. The combined organisation would operate under the Abbey National name.

The total consideration being offered by Abbey National is £1.35 billion, to be paid to N&P's eligible saving and borrowing members and eligible employees and pensioners in a mixture of cash and Abbey National shares. The election whether to receive shares or cash remains to be made by the members of National & Provincial. Completion of the proposed merger is subject to a number of conditions including approval by National & Provincial's members in April 1996 in accordance with the Building Societies Act 1986 and confirmation by the Building Societies Commission. Subject to satisfaction of the applicable conditions, the merger is not expected to take place until the third quarter of 1996.

As of December 31, 1994, National & Provincial was the United Kingdom's ninth largest building society based on total assets, with approximately three million customers and net assets of £732 million. In 1994 National & Provincial's share of the liquid savings and residential mortgage markets was approximately 2.0% and 2.7%, respectively. As of December 31, 1994, National & Provincial had 324 branches in the U.K. During 1994, the average number of National & Provincial full and part time employees was 4,550. After rationalisation to eliminate overlapping branches resulting from the merger, Abbey National expects the combined organisation would have a national network of approximately 880 branches.

Abbey National believes that the merger will enable it to strengthen its existing position in an increasingly competitive U.K. residential mortgage market. The combined organisation would have a market share of over 15% of the U.K. residential mortgage market, and a share of over 10% of the U.K. liquid savings market, based on 1994 figures. Abbey National believes that this market position in mortgages and savings will provide it with a platform from which to expand sales of its mortgage-related insurance products and other personal financial products.

In August 1995, Abbey National acquired First National Finance Corporation p.l.c. ("FNFC") for £285 million. FNFC's predominant business activity is consumer credit. FNFC's strategy is to concentrate its efforts on the consumer credit business while reducing the level of its activity in commercial lending and property development. Abbey National management believes that the acquisition of FNFC will enable Abbey National to expand in the area of consumer credit which is related and complimentary to its existing business.

SELECTED STATISTICAL INFORMATION

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

Average Balance Sheet

	1994 Average balance (1)	1994 Interest	1994 Average rate	1993 Average balance (1)	1993 Interest	1993 Average rate	1992 Average balance (1)	1992 Interest	1992 Average rate
			(in millions of £, except percentages)						
Assets									
Treasury bills and other eligible bills									
U.K.	149	5	3.12%	426	18	4.15%	624	43	6.93%
Non-U.K.	9	—	3.69	1	—	4.99	3	—	5.73
Loans and advances to banks									
U.K.	3,434	167	4.87	2,512	118	4.69	2,076	154	7.40
Non-U.K.	73	5	6.44	37	4	9.74	55	6	10.69
Loans and advances to customers (2)									
U.K.	45,498	3,533	7.77	43,088	3,456	8.02	39,925	4,120	10.32
Non-U.K.	1,346	94	7.01	1,249	109	8.71	1,100	120	10.86
Lease receivables									
U.K.	2,278	133	5.85	2,047	141	6.90	1,141	115	10.04
Non-U.K.	29	2	6.56	29	1	4.12	30	3	11.66
Debt securities									
U.K.	27,728	1,590	5.73	21,371	1,312	6.14	15,156	1,361	8.98
Non-U.K.	114	4	3.06	1	—	4.90	34	2	6.28
Total average interest earning assets and interest income .	80,658	5,533	6.86	70,761	5,159	7.29	60,144	5,924	9.85
Allowance for loan losses . . .	(563)	—	—	(527)	—	—	(347)	—	—
Non-interest earning assets									
Long-term insurance fund assets	3,811	—	—	3,247	—	—	2,181	—	—
Other	4,260	—	—	3,829	—	—	2,437	—	—
Total average assets and interest income	88,166	5,533	6.28	77,310	5,159	6.67	64,415	5,924	9.20
Percentage of total — Non-U.K.	1.84%	—	—	1.70%	—	—	1.90%	—	—
Net interest income (3)(4) . .	—	1,399	—	—	1,331	—	—	1,253	—
Net interest income allocated to dealing profits	—	(5)	—	—	7	—	—	12	—
Total average interest earning assets and net interest income	80,658	1,394	1.73	70,761	1,338	1.89	60,144	1,265	2.10

Average Balance Sheet

	1994 Average balance (1)	1994 Interest	1994 Average rate	1993 Average balance (1)	1993 Interest	1993 Average rate	1992 Average balance (1)	1992 Interest	1992 Average rate
	(in millions of £, except percentages)								
Liabilities and shareholders' equity									
Deposits by banks									
U.K.	15,313	840	5.48%	13,088	716	5.47%	9,525	793	8.33%
Non-U.K.	973	53	5.41	621	46	7.44	168	18	10.46
Customer accounts — demand deposits (5)									
U.K.	21,511	941	4.38	19,960	914	4.58	21,086	1,564	7.42
Non-U.K.	103	5	5.20	—	—	—	—	—	—
Customer accounts — time deposits (5)									
U.K.	13,340	844	6.33	13,367	878	6.57	11,172	986	8.82
Non-U.K.	721	49	6.74	507	33	6.43	423	50	11.81
Customer accounts — wholesale time deposits (5)									
U.K.	1,830	107	5.83	1,342	91	6.81	1,210	116	9.57
Non-U.K.	5	—	5.56	—	—	—	—	—	—
Bonds and medium-term notes									
U.K.	13,315	836	6.28	9,192	659	7.17	5,415	560	10.34
Non-U.K.	406	30	7.39	402	42	10.49	428	49	11.46
Other debt securities in issue									
U.K.	4,779	261	5.46	4,743	298	6.28	3,724	383	10.30
Non-U.K.	2,028	91	4.48	2,398	85	3.53	2,295	101	4.41
Dated and undated loan capital and other subordinated liabilities									
U.K.	690	51	7.33	539	50	9.24	342	44	12.75
Non-U.K.	426	26	6.24	279	16	5.73	100	7	6.70
Total average interest bearing liabilities	75,440	4,134	5.48	66,438	3,828	5.76	55,888	4,671	8.36
Non-interest bearing liabilities									
Long-term insurance fund liabilities	3,811	—	—	3,247	—	—	2,181	—	—
Other	5,231	—	—	4,268	—	—	3,342	—	—
Shareholders' equity	3,684	—	—	3,357	—	—	3,004	—	—
Total average liabilities, shareholders' equity and interest expense (4)	88,166	4,134	4.69	77,310	3,828	4.95	64,415	4,671	7.25
Percentage of total — Non-U.K.	5.45%	—	—	5.44%	—	—	5.30%	—	—
Net interest margin									
Interest income as a percentage of average interest earning assets			6.86			7.29			9.85
Interest expense as a percentage of average interest bearing liabilities			5.48			5.76			8.36
Interest spread			1.38			1.53			1.49
Net interest margin			1.73			1.89			2.10

(1) Average balances for 1994 are based on monthly data. For 1992 and 1993 they are based on monthly data for U.K. Retail Banking and Treasury and Offshore and quarterly data for all other operations.

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

(3) Net interest income includes an immaterial amount of loan fees.

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

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

Interest Rate Sensitivity

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

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

Changes in Net Interest Income — Volume and Rate Analysis

The following tables allocate changes in interest income, interest expense and net interest income between changes in volume and changes in rate for the year ended December 31, 1994. Volume and rate variances have been calculated on the movement in the average balances and the change in the interest rates on average interest earning assets and average interest bearing liabilities. The variance caused by changes in both volume and rate has been allocated to rate changes.

	1994/1993			1993/1992		
	Total change	Changes due to increase/(decrease) in: Volume	Rate	Total change	Changes due to increase/(decrease) in: Volume	Rate
	(in millions of £)			(in millions of £)		
Interest income						
Treasury bills and other eligible bills						
U.K.	(13)	(12)	(1)	(25)	(14)	(11)
Non-U.K.	—	—	—	—	—	—
Loans and advances to banks						
U.K.	49	43	6	(36)	32	(68)
Non-U.K.	1	4	(3)	(2)	(2)	—
Loans and advances to customers						
U.K.	77	193	(116)	(664)	326	(990)
Non-U.K.	(15)	8	(23)	(11)	16	(27)
Lease receivables						
U.K.	(8)	16	(24)	26	91	(65)
Non-U.K.	1	—	1	(2)	—	(2)
Debt securities						
U.K.	278	390	(112)	(49)	558	(607)
Non-U.K.	4	—	4	(2)	(2)	—
Total interest income (1)						
U.K.	383	700	(317)	(748)	1,036	(1,784)
Non-U.K.	(9)	22	(31)	(17)	10	(27)
Total (1)	374	722	(348)	(765)	1,046	(1,811)

	1994/1993 Total change	1994/1993 Changes due to increase/(decrease) in: Volume	Rate	1993/1992 Total change	1993/1992 Changes due to increase/(decrease) in: Volume	Rate
		(in millions of £)			(in millions of £)	
Interest expense						
Deposits by banks						
U.K.	124	122	2	(77)	297	(374)
Non-U.K.	7	26	(19)	28	47	(19)
Customer accounts — demand deposits						
U.K.	27	71	(44)	(650)	(84)	(566)
Non-U.K.	5	5	—	—	—	—
Customer accounts — time deposits						
U.K.	(34)	(2)	(32)	(108)	194	(302)
Non-U.K.	16	14	2	(17)	10	(27)
Customer accounts — wholesale time deposits						
U.K.	16	33	(17)	(25)	13	(38)
Non-U.K.	—	—	—	—	—	—
Bonds and medium-term notes						
U.K.	177	296	(119)	99	393	(294)
Non-U.K.	(12)	—	(12)	(7)	(3)	(4)
Other debt securities in issue						
U.K.	(37)	2	(39)	(85)	105	(190)
Non-U.K.	6	(13)	19	(16)	5	(21)
Dated and undated loan capital and other subordinated liabilities						
U.K.	1	14	(13)	6	25	(19)
Non-U.K.	10	8	2	9	8	1
Total interest expense (1)						
U.K.	274	495	(221)	(840)	830	(1,670)
Non-U.K.	32	24	8	(3)	52	(55)
Total (1)	306	519	(213)	(843)	882	(1,725)
Net interest income (1)	68	276	(207)	78	20	58

(1) The analysis into volume and rate components of the changes in total interest income, total interest expense and net interest income are based on the volume and rate changes to these totals. The figures so derived, therefore, do not necessarily equate to a simple addition of the volume and rate components of the asset and liability sub-headings. The 1993/1992 figures have been restated to be consistent with this approach.

Deposits

The following tables set forth the average balances of deposits for each of the three years ended December 31, 1994. Average deposits are based on the location of the office in which the deposits are recorded.

	Average: Year ended December 31, 1994	1993	1992
		(in millions of £)	
Deposits by banks			
U.K.	15,313	13,088	9,525
Non-U.K.	973	621	168
Total	16,286	13,709	9,693
Customers' accounts			
U.K.	36,681	34,669	33,468
Non-U.K.	829	507	423
Total	37,510	35,176	33,891

Customers' Accounts — By Type

	Average: Year ended December 31,		
	1994	1993	1992
	(in millions of £)		
U.K.			
Demand deposits	21,511	19,960	21,086
Time deposits	13,340	13,367	11,172
Wholesale time deposits	1,830	1,342	1,210
	36,681	34,669	33,468
Non-U.K.			
Demand deposits	103	—	—
Time deposits	721	507	423
Wholesale time deposits	5	—	—
Total	37,510	35,176	33,891

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

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

Time deposits are distinguished from demand deposits by having fixed maturity requirements or by requiring notice to be given before withdrawal.

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

Short-term Borrowings

The following tables set forth certain information regarding short-term borrowings (composed of deposits by banks, commercial paper and negotiable certificates of deposit) for each of the three years ended December 31, 1994. While deposits by banks are reported in the "Deposits" section above, they are also shown under "Short-term borrowings" because of their importance as a source of funding to the Group.

Deposits by Banks

	Year ended December 31,		
	1994	1993	1992
	(in millions of £, except percentages)		
Year-end balance	17,826	16,368	13,103
Average balance (1)	16,286	13,709	9,693
Maximum balance	20,857	16,733	13,868
Average interest rate during year	5.48%	5.56%	8.37%
Year-end interest rate (2)	6.07	4.85	6.55

Commercial Paper

	Year ended December 31,		
	1994	1993	1992
	(in millions of £, except percentages)		
Year-end balance	2,378	2,739	2,718
Average balance (1)	2,020	2,392	2,198
Maximum balance	2,756	3,032	2,781
Average interest rate during year	4.24%	3.44%	4.24%
Year-end interest rate (2)	5.70	3.33	3.59

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

Negotiable Certificates of Deposit

	Year ended December 31,		
	1994	1993	1992
	(in millions of £, except percentages)		
Year-end balance	5,519	4,523	4,864
Average balance (1)	4,579	4,639	3,779
Maximum balance	6,407	5,063	5,159
Average interest rate during year	4.94%	4.88%	7.59%
Year-end interest rate (2)	6.02	4.55	6.17

(1) Average balances for 1994, 1993 and 1992 are based upon monthly data.

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

Certificates of Deposit and Certain Time Deposits

The following table sets forth the maturities of the Group's certificates of deposit and other large wholesale time deposits from non-bank counterparties in excess of £50,000 (or the non-sterling equivalent of £50,000) at December 31, 1994. A proportion of the Group's retail time deposits also exceed £50,000 at any given date; however, the ease of access and other terms of these accounts means that they may not have been in excess of £50,000 throughout 1994. Furthermore, the customers may withdraw their funds on demand upon payment of an interest penalty. For these reasons, no maturity analysis is presented for such deposits. See "— Short-term Borrowings" above for information on amounts and maturities of claims under issues of commercial paper.

	Not more than three months	In more than three months but not more than six months	In more than six months but not more than one year	In more than one year	Total
	(in millions of £)				
Certificates of deposit:					
U.K.	4,376	838	191	97	5,502
Non-U.K.	17	—	—	—	17
Wholesale time deposits:					
U.K.	1,863	182	51	6	2,102
Total	6,256	1,020	242	103	7,621

Securities

The following table sets forth the book and market values of securities as at December 31 for each of the three years indicated. Investment securities are valued at cost, adjusted for the amortisation of premiums or discounts to redemption, less provision for any permanent diminution in value. For further information, see Notes 21 and 22 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

	1994 Book Value	1994 Market Value (1)	1993 Book Value	1993 Market Value (1)	1992 Book Value	1992 Market Value (1)
			(in millions of £)			
Investment securities (2)(3)						
Debt securities:						
British Government	1,308	1,416	1,222	1,274	454	474
U.S. Treasury and other U.S. Government agencies and corporations	3,486	3,419	2,493	2,643	1,504	1,518
Other public sector securities	5,346	5,430	3,350	3,537	1,619	1,769
Bank and building society certificates of deposit	180	181	127	127	79	78
Other issuers (4):						
Floating rate notes	2,342	2,344	2,784	2,861	1,597	1,591
Mortgage-backed securities	4,905	4,864	4,421	4,542	3,706	3,692
Other asset-backed securities	2,675	2,653	2,246	2,309	2,455	2,446
Other	9,287	9,243	6,183	6,312	6,341	6,323
Shares of preferred and common stock	42	42	523	527	435	436
General provision against debt securities	(3)	—	—	—	—	—
Sub Total	29,568	29,592	23,349	24,132	18,190	18,327
Other securities (5)						
Debt securities:						
British Government	340	340	222	222	520	520
U.S. Treasury and other U.S. Government agencies and corporations	447	447	434	434	233	233
Bank and building society certificates of deposit	1,740	1,740	1,307	1,307	1,055	1,055
Other issuers	279	279	—	—	—	—
Sub Total	2,806	2,806	1,963	1,963	1,808	1,808
Total	32,374	32,398	25,312	26,095	19,998	20,135

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

(2) Investment securities include government securities held as part of the Group's treasury management portfolio for asset/liability, liquidity and regulatory purposes and are for use on a continuing basis in the activities of the Group. In addition, the Group holds as investment securities listed and unlisted corporate securities. As at December 31, 1994, most of the Group's securities portfolio was held through ANTS. A substantial majority of ANTS' securities portfolio was rated AA− or better (or the equivalent) by one or more rating organisations.

(3) Abbey National has complied with the requirements of Statement of Financial Accounting Standard 115 on Accounting for Certain Investments in Debt and Equity Securities as from January 1, 1994. Under this standard the majority of investments classified as investment securities were reclassified as "available for sale" securities and reported at fair value at December 31, 1994, with unrealised gains and losses reported in a separate component of shareholders' equity. Further details are provided in Note 47 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

(4) As at December 31, 1994, in excess of 95% of exposure to other issuers constituted securities issued or guaranteed by banks or other financial institutions.

(5) Other securities comprise securities that are not held for investment and are carried at market value.

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

British Government Securities

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

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

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

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

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

Other Public Sector Securities

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

Bank and Building Society Certificates of Deposit

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

Other Issuers: Floating Rate Notes

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

Other Issuers: Mortgage-backed Securities

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

Other Issuers: Asset-backed Securities

This category comprises investment in a range of mostly floating rate asset-backed securities including home equity loan, auto, dealer and credit card receivables. A number of the credit card receivables incorporate cap features.

Other Issuers: Other Securities

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

The following table sets forth the maturities and weighted average yields of investment securities at December 31, 1994.

	Maturing within one year:		Maturing after one but within five years:		Maturing after five years but within ten years:		Maturing after ten years:		Total	
	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1
	(in millions of £, except percentages)									
British Government	1	8.87%	773	7.55%	475	8.28%	59	8.45%	1,308	7.85%
U.S. Treasury and other U.S. Government agencies and corporations (2)	—	—	213	7.19	10	6.38	3,263	5.49	3,486	5.60
Other public sector securities	240	9.87	4,250	9.48	827	10.66	29	11.10	5,346	9.69
Bank and building society certificates of deposit (3)	139	8.64	41	9.01	—	—	—	—	180	8.72
Other issuers (2)	1,653	6.95	6,441	6.66	4,703	6.14	6,412	6.42	19,209	6.48
Sub-total	2,033	7.41	11,718	7.76	6,015	6.93	9,763	6.13	29,529	7.03
Shares of preferred and common stock (4)	6		—		—		36		42	
Total book value before general provision	2,039		11,718		6,015		9,799		29,571	
General provision against debt securities									(3)	
Total book value									29,568	
Total market value	2,027		11,541		5,860		10,164		29,592	

(1) The weighted average yield for each range of maturities is calculated by dividing the annualised interest income prevailing at December 31, 1994 by the book value of securities held at that date.

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

(3) Bank and building society certificates of deposit are freely negotiable and have original maturities of up to five years, but are typically held for shorter periods.

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

The following table sets forth the book and market values of those securities of individual counterparties where the aggregate amount of those securities exceeded 10% of Abbey National's shareholders' equity at December 31, 1994.

	Book Value	Market Value
	(in millions of £)	
British Government	1,648	1,756
Republic of Italy (1)	3,265	3,408
Republic of Finland	611	583
Banco Santander S.A. (2)	402	394

(1) A total of £1,899 million in book value (£1,927 million market value) is covered by contractual agreements with highly rated banks which protect the Group against credit risk.

(2) These securities consist mainly of floating-rate notes and fixed-rate bonds.

The only addition to the securities which exceeded 10% of Abbey National's shareholders' equity during the period December 31, 1993 to December 31, 1994 was the addition of Banco Santander S.A. (with a book value of £402 million and a market value of £394 million). In the same period, the book value of securities of the Woolwich Building Society, Nationwide Building Society, Alliance and Leicester Building Society, the Kingdom of Spain and ACP Treasury Limited fell below 10% of shareholders' equity. For the purposes of determining the above changes, shareholders' equity amounted to £3,704 million at December 31, 1994.

Loans and Advances to Banks

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

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

Loans and Advances to Banks

	Year ended December 31,				
	1994	1993	1992	1991	1990
	(in millions of £)				
U.K.	2,866	3,510	2,229	2,081	1,287
Non-U.K.	40	46	47	51	77
Total	2,906	3,556	2,276	2,132	1,364

The following tables set forth loans and advances to banks by maturity and interest rate sensitivity at December 31, 1994.

Maturity Analysis of Loans and Advances to Banks

	On demand	Not more than three months	In more than three months but not more than one year	In more than one year but not more than five years	In more than five years	Total
	(in millions of £)					
U.K.	315	2,257	119	—	175	2,866
Non-U.K.	9	31	—	—	—	40
Total	324	2,288	119	—	175	2,906

Interest Rate Sensitivity of Loans and Advances to Banks

	Fixed rate	Variable rate	Total
	(in millions of £)		
Interest bearing loans and advances to banks:			
U.K.	2,400	288	2,688
Non-U.K.	32	8	40
	2,432	296	2,728
Items in the course of collection (non-interest bearing)			178
Total			2,906

Loans and Advances to Customers

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

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

Loans and Advances to Customers

	Year ended December 31,				
	1994	1993	1992	1991	1990
	(in millions of £)				
U.K.					
Advances secured on residential properties	46,464	43,147	39,855	37,342	33,603
Other secured advances	115	155	274	327	414
Corporate lending	554	641	791	108	—
Unsecured personal lending	448	309	268	315	239
Finance lease receivables	2,249	2,224	1,703	761	104
	49,830	46,476	42,891	38,853	34,360
Non-U.K.					
Advances secured on residential properties	861	774	821	642	491
Other secured advances	396	469	425	334	281
Unsecured lending	7	—	—	—	—
Finance lease receivables	29	29	34	28	—
	1,293	1,272	1,280	1,004	772
Total	51,123	47,748	44,171	39,857	35,132

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

The following tables set forth loans and advances to customers by maturity and interest rate sensitivity at December 31, 1994. In the maturity analysis, overdrafts are included in the "On demand" category. Advances secured by residential properties are included in the maturity analysis at their stated maturity; however, such advances may be repaid early and the average life of Abbey National's mortgages is approximately six years.

Maturity Analysis of Loans and Advances to Customers

	On demand	Not more than three months	In more than three months but not more than one year	In more than one year but not more than five years	In more than five years	Total
			(in millions of £)			
U.K.						
Advances secured on residential properties	2,865	94	263	1,689	41,553	46,464
Other secured advances	—	—	1	8	106	115
Corporate lending	—	9	—	—	545	554
Unsecured personal lending	17	55	145	231	—	448
Finance lease receivables	—	2	47	528	1,672	2,249
Total U.K.	2,882	160	456	2,456	43,876	49,830
Non-U.K.						
Advances secured on residential properties	192	12	29	172	456	861
Other secured advances	162	7	15	87	125	396
Unsecured lending	—	2	5	—	—	7
Finance lease receivables	—	1	1	7	20	29
Total Non-U.K.	354	22	50	266	601	1,293
Total	3,236	182	506	2,722	44,477	51,123

Interest Rate Sensitivity of Loans and Advances to Customers

	Fixed rate	Variable rate	Total
	(in millions of £)		
U.K.	10,436	39,394	49,830
Non-U.K.	870	423	1,293
Total	11,306	39,817	51,123

Analysis of Allowance for Lending Losses

The largest part of the Group's allowance for lending losses relates to loans and advances secured on residential property in the U.K. For such loans, the Group's provisioning policy is in accordance with U.K. industry best practice expressed in the British Bankers' Association Statement of Recommended Practice on Advances and is as follows:

Suspended interest — loans are deemed to be impaired or non-performing when they are 90 days overdue. Interest continues to be debited to all impaired loans. The homogenous nature of the loans, together with the size of the loan portfolio, permits a reasonably accurate estimate to be made of the amount of this interest for which eventual recovery is doubtful. This amount is omitted from the profit and loss account and placed in suspense.

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

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

Amounts charged off — losses are charged off when it becomes certain how much is not going to be recovered either from repayment, from realising the security, or from claiming on the mortgage indemnity guarantee insurance. This charge-off is made when the security has been realised, and since the values can then be calculated with some certainty, the instances for further charge-offs or recoveries are minimal.

A similar provisioning policy is applied to other categories of loans and advances.

As a result of the charge-off policy, the allowances may be made a significant time in advance of the related charge-off. This is particularly the case for the other secured advances category which consists largely of loans secured on commercial properties. The complexity of the legal proceedings to take possession and the depressed state of the commercial property markets in Europe mean that, although the likely losses have been identified and appropriate allowances made on a case-by-case basis, few losses have yet been determined precisely and been charged off. New commercial lending has ceased in the United Kingdom and France and no longer represents a significant portion of the Group's business in Spain and, as a result of this and the downturn in the commercial property market, the allowances as a percentage of loans and advances in these categories increased significantly.

Analysis of End of Year Allowance for Lending Losses

	1994	1993	1992	1991	1990
	(in millions of £, except percentages)				
Specific					
Advances secured on residential properties — U.K.	104	152	146	67	23
Other secured advances — U.K.	5	25	26	18	13
Unsecured personal lending — U.K.	26	28	30	31	20
Advances secured on residential properties — Non-U.K.	33	31	25	6	7
Other secured advances — Non-U.K.	119	110	32	2	2
Unsecured lending — Non-U.K.	3	—	—	—	—
Total specific allowances	290	346	259	124	65
General					
Advances secured on residential properties — U.K.	56	76	96	34	14
Other secured advances — U.K.	1	1	1	1	1
Unsecured personal lending — U.K.	6	3	3	6	5
Advances secured on residential properties — Non-U.K.	3	9	10	10	6
Other secured advances — Non-U.K.	5	11	4	1	1
Total general allowances	71	100	114	52	27
Total allowances	**361**	**446**	**373**	**176**	**92**
Ratios			(per cent.)		
Allowances at the year end as a percentage of year-end loans and advances to customers					
Advances secured on residential properties — U.K.	0.34	0.53	0.61	0.27	0.11
Other secured advances — U.K.	5.22	16.77	9.85	5.81	3.38
Unsecured personal lending — U.K.	7.14	10.03	12.31	11.75	10.46
Advances secured on residential properties — Non-U.K.	4.18	5.17	4.26	2.49	2.65
Other secured advances — Non-U.K.	31.31	25.80	8.47	0.90	1.07
Unsecured lending — Non-U.K.	37.88	—	—	—	—
Total loans and advances to customers (1)	0.74	0.98	0.88	0.45	0.26
Amounts charged off (net of recoveries) (1)	0.34	0.30	0.20	0.15	0.03

(1) Total allowances and amounts charged off (net of recoveries) ratios are expressed as a percentage of year-end loans and advances to customers excluding finance leases.

Movements in the Allowance for Lending Losses

	1994	1993	1992	1991	1990
			(in millions of £)		
Allowance at the beginning of the year	446	373	176	92	36
Amounts charged off — net of recoveries					
Advances secured on residential properties — U.K.	(101)	(121)	(58)	(48)	(4)
Other secured advances — U.K.	(19)	—	(1)	(1)	(1)
Unsecured personal lending — U.K.	(11)	(15)	(22)	(11)	(5)
	(131)	(136)	(81)	(60)	(10)
Advances secured on residential properties — Non-U.K.	(11)	(1)	(2)	—	—
Other secured advances — Non-U.K.	(24)	—	—	—	—
Total amounts charged off	(166)	(137)	(83)	(60)	(10)
Provisions charged against income					
Advances secured on residential properties — U.K.	53	127	137	89	21
Other secured advances — U.K.	(1)	(1)	10	6	8
Unsecured personal lending — U.K.	10	13	21	27	16
	62	139	168	122	45
Advances secured on residential properties — Non-U.K.	12	11	19	4	(6)
Other secured advances — Non-U.K.	26	82	25	4	2
Unsecured lending — Non-U.K.	3	—	—	—	—
	41	93	44	8	(4)
Total provisions charged against income	103	232	212	130	41
Movement in general provisions	(29)	(14)	62	25	14
Exchange and other adjustments	7	(8)	6	(11)	11
Allowance at the end of the year	361	446	373	176	92

Interest in Suspense

	1994	1993	1992	1991	1990
			(in millions of £)		
Interest in suspense at the beginning of the year	150	134	68	12	4
Net interest suspended during the year	85	109	106	45	8
	235	243	174	57	12
Interest written off	(102)	(89)	(42)	—	—
Exchange and other adjustments	3	(4)	2	11	—
Interest in suspense at the end of the year	136	150	134	68	12

Potential Credit Risk Elements in Lendings

U.S. banks typically stop accruing interest when loans become overdue by 90 days or more, or when recovery is doubtful. In accordance with the U.K. Statement of Recommended Practice on Advances, Abbey National continues to charge interest for collection purposes to accounts whose recovery is in doubt, but the interest is suspended as it accrues and is excluded from interest income in the income statement. This suspension of interest continues until such time as its recovery is considered to be unlikely at which time the advance is written off. While such practice does not affect net income in comparison with the practice followed in the United States, it has the effect of increasing the reported level of potential credit risk elements in lendings. The amount of this difference as at December 31, 1994 was £136 million. Other than for the net interest suspended during the year, interest income in the income statement is the same as would have been credited if all loans had been current in accordance with their original terms. The amount of this difference for the year ended December 31, 1994 was £85 million.

The following table presents the potential credit risk elements in Group lendings. Additional categories of disclosure are included, however, to record lendings where interest continues to be accrued and where either interest is being suspended or specific provisions have been made. Normal U.S. banking practice would be to place such lendings on non-accrual status. The amounts are stated before deductions of the value of security held and the specific allowances provided or interest suspended.

The Group has no loans that constitute "troubled debt restructurings".

Non-performing Lendings

	1994	1993	1992	1991	1990
		(in millions of £, except percentages)			
Accruing lendings on which a proportion of interest has been suspended and on which specific allowance has been made:					
U.K.	614	921	1,456	775	207
Non-U.K.	388	366	274	57	21
	1,002	1,287	1,730	832	228
Accruing lendings 90 days overdue on which no interest has been suspended and on which no specific allowance has been made:					
U.K.	1,400	1,672	2,015	2,046	1,541
Non-U.K.	8	29	20	9	4
	1,408	1,701	2,035	2,055	1,545
Total non-performing lendings:					
U.K.	2,014	2,593	3,471	2,821	1,748
Non-U.K.	396	395	294	66	25
	2,410	2,988	3,765	2,887	1,773
Allowances as a percentage of total non-performing lendings:	14.98%	14.93%	9.91%	6.10%	5.19%

Potential problem lendings

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

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

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

	1994	1993	1992	1991	1990
		(in millions of £)			
6 months to 12 months in arrears	742	785	995	694	373
12 months or more in arrears	421	527	585	358	124
Properties in possession	243	398	631	579	208

Country Risk Exposure

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

Cross Border Outstandings

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

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

At December 31, 1994, the countries where cross border outstandings exceeded 1% of adjusted assets (as defined below) were Finland, Germany, Italy and Japan and consisted substantially of balances with banks and other financial institutions and governments and official institutions. In this context, adjusted assets are total assets, as presented in the consolidated balance sheet, excluding long-term insurance fund assets and balances arising from off-balance sheet financial instruments. On this basis, adjusted assets amounted to £89.6 billion as at December 31, 1994 compared to £79.2 billion as at December 31, 1993 and £68.5 billion as at December 31, 1992. Comparison between 1993 and 1992 is affected by the 13% appreciation of the yen against sterling.

The only addition to the aggregate cross border outstandings that exceeded 1% of adjusted assets between December 31, 1993 and December 31, 1994 was the addition of outstandings with Germany which represented £1.2 billion or 1.29% (represented solely by balances with banks and other financial institutions) of adjusted assets.

Cross Border Outstandings Exceeding 1% of Adjusted Assets (1)

	As % of adjusted assets	Total	Banks and other financial institutions	Governments and official institutions	Commercial, industrial and other private sector
		(in millions of £, except percentages)			
At December 31, 1994:					
Finland	1.32%	1,181	463	718	—
Germany	1.29	1,158	1,158	—	—
Italy	1.54	1,378	600	778	—
Japan	1.97	1,763	1,704	32	27
At December 31, 1993:					
Finland	1.61	1,278	554	724	—
France	1.86	1,475	1,457	18	—
Italy	1.35	1,069	593	476	—
Japan	2.61	2,070	2,014	32	24
Sweden	1.27	1,002	595	407	—
At December 31, 1992:					
Finland	1.21	827	606	221	—
France	1.48	1,014	980	34	—
Japan	3.27	2,243	2,122	23	98
Sweden	1.30	945	628	317	—

(1) Adjusted assets are total assets, as presented in the consolidated balance sheet, excluding long-term insurance fund assets and balances arising from off-balance sheet financial instruments.

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

At December 31, 1994, Belgium, France, Sweden and Switzerland had aggregate cross border outstandings between 0.75% and 1% of adjusted assets with aggregate outstandings of £3.3 billion.

At December 31, 1993, Germany and Hong Kong had aggregate outstandings of £1.4 billion. At December 31, 1992, the aggregate outstandings in this category were £1.2 billion and related to Hong Kong and Italy.

RISK MANAGEMENT

Risk management at Abbey National focuses on three major risks — credit risk, market risk and liquidity. Credit risk occurs mainly in Abbey National's U.K. residential mortgage portfolio, and in ANTS. Market risk mainly arises in ANTS as a result of investment, funding and hedging activities. Liquidity risk arises mainly from the Group balance sheet although liquidity is managed on behalf of the Group by ANTS.

Management Structure

Abbey National has a well developed structure for managing risk, which consists of a comprehensive set of committees, the main ones being the Asset and Liabilities Committee ("ALCO"), which is charged with the responsibility of monitoring and controlling the level of structural balance sheet risk in the Group, and the Group Credit Committee, which monitors and reviews credit exposures and recommends Group credit policies to ALCO for approval. Other key committees include the Treasury Credit Committee and the Treasury Risk Committee, which are responsible for credit and market risk issues, respectively. The Treasury Credit Committee and the Retail Credit Committee report to the Group Credit Committee. The credit and market risk control functions of Continental Europe and certain offshore operations within the Treasury and Offshore business are carried out locally within the framework of delegated authority adopted by each operation, with credit risk being monitored by the Group Credit Committee. Risk issues arising from all of these committees are reported to ALCO.

An ANTS Board Credit Committee was established in January 1995 and took over responsibility for approving many ANTS' credit transactions previously subject to approval by the Group Credit Committee. The Treasury Credit Committee is authorised to approve a more limited range of credit transactions. At the same time, the terms of reference of the Group Credit Committee were amended so that it now approves all Group credit policies. These developments were intended to focus credit decision making and to streamline the process within guidelines specified by the Group Credit Committee and ALCO.

Credit Risk

Abbey National's systems for managing and monitoring the quality of its mortgage assets and other personal and unsecured loans are described in "Business Description — U.K. Retail Banking — Credit Risk" below. With respect to asset quality in ANTS, a clear set of credit mandates and policies has been established by ALCO which is designed to ensure that a substantial majority of credit exposure is rated AA– or better (or the equivalent) by one or more rating organisations. All transactions falling within these mandates and policies are scrutinised by the Treasury Credit Department and the Treasury Credit Committee. Specific approval is required for all transactions which fall outside these mandates. ANFP operates within ANTS' overall mandates. The controls over, and risk assumed by, ANFP are closely monitored and tight risk control limits are consistently applied. Analyses of credit exposures and credit risk trends are provided in summary for the ANTS Board each month, and in detail each quarter. Large Exposures (as defined by the Bank of England) are reported monthly internally and quarterly to the Bank of England.

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

Market Risk

The principal aim of the Group's market risk exposure management is to limit the adverse impact of interest and other rate movements on profitability. In addition, it seeks to enhance interest earnings within clearly defined parameters. In managing market risk, Abbey National's philosophy is to ensure that the business areas within the Group have sufficient expertise to manage the risks associated with their operations, and to devolve the responsibility for managing risk to them. Within this framework policies and mandates are established and monitored by ALCO each month.

The Group Risk Department is responsible for ensuring that policies and mandates are established for the Group as a whole. The department monitors Group interest rate positions and uses quantitative models to forecast the potential balance sheet mismatches under a variety of interest rate scenarios. ALCO is responsible for managing Abbey National's non interest bearing liabilities, primarily shareholders' equity, balancing the need to maximise potential return with the management of the potential volatility of this earnings stream. This is effected by use of both on-balance sheet assets and off-balance sheet instruments.

Managing Market Risk in U.K. Retail Banking

The U.K. Retail Banking balance sheet is dominated on the asset side by variable rate mortgages and on the liability side by variable rate retail deposits. The variable interest rates on both these assets and liabilities are set by Abbey National and are not directly linked to money market rates. This structure has the advantage that Abbey National is able to re-price separately both the retail liabilities and variable rate mortgage assets, subject to competitive pressures. As a result, Abbey National believes it is able to mitigate the impact of interest rate movements on net interest income in U.K. Retail Banking.

New mortgages generally have a nominal life of 25 years, though in practice the average life is approximately six years. As well as variable rate mortgages, Abbey National has also a significant volume of fixed rate mortgages on which the rate is typically fixed for between two and five years. These loans then revert to a variable rate, though the customers may opt to take up a subsequent fixed rate offer. Abbey National has a policy of fully hedging its fixed rate product exposures. However, during the period of product launches it is not possible to hedge exactly and limits on the maximum potential exposure are maintained during that period.

Prepayment risk is reduced by a penalty charge for any early redemptions, even for the very short duration offers where this risk is much less. Prepayment across the whole portfolio is also monitored and an estimate of prepayment rates is incorporated in determining the hedging of the fixed rate portfolio.

Managing Market Risk in ANTS

As described under "Selected Statistical Information — Securities" above, ANTS organises its investment activities by means of matched currency investment books in a number of currencies. The matching process is achieved either by (i) raising funding directly in the currency of assets or (ii) hedging assets or liabilities into one of the main currencies, mainly through the use of currency swaps. Wherever possible, ANTS avoids the risks associated with movements in market prices such as interest rates or exchange rates. However, given the Group's involvement in a range of financial activities, a level of trading risk is inevitable. For example, it is rare for hedging to produce exact cover. Abbey National has developed and implemented structures and systems to manage this trading risk exposure.

The ANTS Board has established the maximum level of market risk that may be taken, referred to as the "Treasurer's Mandate". The Treasurer's Mandate is endorsed by ALCO. The level of risk is regularly monitored against the Treasurer's Mandate and ANTS operates consistently within the approved limits. The overall limit is based on the total loss that could occur overnight under adverse market movements and there are also a number of sublimits for interest rate risk. These adverse movements are derived from an analysis of historic data using a range of statistical techniques.

Currently approved limits of overnight risk at a 95% confidence level are £8 million for interest rate risk and £20 million for total market risk, which together relate to exposure to changes in absolute interest rate levels, the shape of the yield curve, foreign exchange rates, interest rate volatility, mortgage prepayment rates, cash/futures basis levels and asset spread levels. Exposures to foreign exchange rate movements are small and exposures to other types of market risk, including equity and commodity risks, are not material. Limits are allocated to individual books and positions are monitored against such limits. A comprehensive set of reports is produced on both a daily and a weekly basis to monitor the risk position. Specific limits have been set for ANFP within the overall ANTS limits, and these are monitored and reported daily. These limits are similar to those operated within Treasury and Offshore as a whole.

Utilisation against the defined limits is assessed either by performing scenario analysis on the underlying positions or by using theoretical models to assess the sensitivity of the position to changes in the underlying variables.

Liquidity Risk

Abbey National views the essential elements of liquidity management as controlling potential cash outflows, maintaining prudent levels of highly liquid assets and ensuring that access to funding is available from a diversity of sources. These elements are underpinned by a comprehensive management and monitoring process. Abbey National monitors closely the level of wholesale and retail funding in the business, particularly the maturity profile of wholesale funding and the diversity of credit lines available to the Group. Abbey National's liquidity policy is based in part on the Bank of England consultative document issued in 1988 (but not subsequently implemented) in respect of having a certain ratio of "High Quality Liquid" assets to liabilities of up to eight days' maturity. As part of this policy a key concern is the value of retail deposits which could be withdrawn on demand. The potential outflows of these funds are modelled using various scenarios in evaluating the prudent level of liquidity to be held. Abbey National reports to the Bank of England on its liquidity position on a monthly basis.

The Bank of England has recently implemented a new High Quality Liquidity policy. Abbey National has continued to maintain its High Quality Liquidity portfolio at a prudent level and will conform with the new Bank of England policies.

Impact of Repricing Risks on the Group

The interest rate repricing gap information set forth in the table below is as at December 31, 1994 and gives an estimate of the repricing profile of the Group's assets, liabilities and off-balance sheet exposures. However, the positions shown reflect both the repricing behavior of the administered rates on mortgage and savings products (over which Abbey National has some control as discussed in the review on interest rate sensitivity above) and contracted wholesale and off-balance sheet positions (which are determined by market rates). The table therefore does not purport to measure market risk exposure.

Interest Rate Repricing Gap

	Not more than three months	In more than three months but not more than six months	In more than six months but not more than twelve months	In more than one year but not more than five years	In more than five years	Non-interest bearing amounts	Total
			(in millions of £)				
Assets							
Treasury and other eligible bills	17	237	178	—	—	—	432
Loans and advances to banks (1)	2,609	111	8	—	—	178	2,906
Loans and advances to customers	39,079	156	1,187	6,983	1,079	—	48,484
Net investment in finance leases	100	1,135	164	814	65	—	2,278
Securities and investments	17,455	1,303	1,498	8,814	3,262	42	32,374
Other assets	—	—	—	—	—	3,753	3,753
Total assets (2)	59,260	2,942	3,035	16,611	4,406	3,973	90,227
Liabilities							
Deposits by banks (1)	14,719	2,053	664	147	—	243	17,826
Customer accounts	34,418	283	179	3,176	—	—	38,056
Debt securities in issue	9,414	3,122	1,815	5,925	3,137	—	23,413
Subordinated liabilities	478	128	—	—	914	—	1,520
Other liabilities (3)	—	—	—	—	—	5,708	5,708
Shareholders' equity	—	—	—	—	—	3,704	3,704
Total liabilities (2)	59,029	5,586	2,658	9,248	4,051	9,655	90,227
Off-balance sheet items	1,439	559	1,332	(5,546)	1,686	530	—
Interest rate repricing gap	1,670	(2,085)	1,709	1,817	2,041	(5,152)	—

(1) Non-interest bearing items within loans and advances to banks, and deposits by banks, relate to items in the course of collection and items in the course of transmission, respectively. These are short-term receipts and payments within the U.K. retail banking clearing system.

(2) Total assets and liabilities exclude the assets and liabilities of the long term insurance funds, both of which amount to £4,092 million. These amounts are not relevant in considering the interest rate risk management of the Group.

(3) Other liabilities include £402 million relating to creditors for the purchase of securities as at December 31, 1994. This balance may fluctuate in the short term depending on the level of purchases and sales of securities.

The above table gives an indication of the sensitivity of the Group's earnings as at December 31, 1994 to changes in interest rates. Negative gaps are liability sensitive and indicate a benefit if interest rates decline. A positive gap is asset sensitive and indicates a benefit if interest rates increase.

The risk management stance of the Group is broadly neutral, with the sensitivity profile as at December 31, 1994 attributable to the structural balance sheet risks arising from the management of the Group's capital.

The sensitivity to exchange rate movements as at December 31, 1994 was not significant.

Hedging Activity

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

DERIVATIVES

Derivatives are used in two distinct ways by the Abbey National Group. The first is as hedging instruments for activities in U.K. Retail Banking and Treasury and Offshore and for the Group's balance sheet. The second is in the market-making activity undertaken within ANFP.

Derivative instruments are contracts or agreements whose value is derived from one or more underlying indices inherent in the contract or agreement. They include interest rate and cross-currency swaps, forward rate agreements, futures, options and swaptions.

Details of the nominal and risk weighted amounts of derivatives (as defined for purposes of the preparation of the U.K. statutory accounts) are set forth in Note 50 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

The total nominal amount of the Group's outstanding interest rate contracts as at December 31, 1994 was £77,129 million (which includes £31,365 million in respect of ANFP) compared to £37,464 million (which includes £5,501 million in respect of ANFP) as at December 31, 1993 and £18,701 million as at December 31, 1992. The total nominal amount of the Group's outstanding exchange rate related contracts was £11,681 million as at December 31, 1994 compared to £15,537 million as at December 31, 1993 and £10,504 million as at December 31, 1992. The total for 1994 includes £486 million in respect of ANFP (compared to £25 million in 1993). Following a review of the classification of off-balance sheet contracts, amounts for 1993 have been restated to reflect the reclassification of certain contracts between the exchange rate and interest rate categories. The reclassification relates to exchange-traded contracts on foreign government bond futures, which for any one transaction may provide a hedge against either interest rate or exchange rate movements. As described under "Risk Management — Market Risk — Managing Market Risk in ANTS" above, ANTS organises its investment activities by means of matched currency investment books in a number of currencies. Hedging of assets or liabilities against exchange rate movements is achieved mainly through the use of currency swaps. Since the main purpose for the usage of bond futures contracts is to protect against interest rate movements, management believes that these contracts are more appropriately classified as interest rate related instruments.

Hedging Activity

Derivative products are used for a variety of hedging purposes in Abbey National. The major hedging instruments are swaps, which are used to hedge Group balance sheet exposures, fixed-rate mortgage lending and savings products in U.K. Retail Banking, Continental Europe and Treasury and Offshore as well as medium-term note issues, capital issues, fixed-rate asset purchase and other exposures to fixed interest rates and exchange rates within Treasury and Offshore. Caps, floors, swaptions and exchange traded options and futures also may be used for similar hedging activities.

As discussed under "Risk Management" above, a significant part of Abbey National's exposures can be hedged internally, by offset against other categories of exposure in the balance sheet. As described in "Selected Statistical Information — Securities" and "Risk Management — Market Risk" above, market risk management in ANTS may be undertaken either on the basis of assets and liabilities on a one-for-one basis or on an aggregate basis within one of the currency matched investment books, in which case hedging is arranged on the net or aggregated position on the book for the currency concerned. The following table sets forth certain activities undertaken by the Group, the related risks associated with such activities and provides details of the types of derivatives used in managing such risks.

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

Derivative products which are combinations of more basic derivatives (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features, for example medium-term note issues based on equity indices or a multiple of an underlying floating market rate. In such cases the derivative used will be designed to match exactly the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore fully hedged. Credit risk on these contracts is monitored within tightly defined risk limits on the basis of the contractual terms of the instruments, rather than the face or contract amount.

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

The interest rate, foreign exchange and volatility risks arising from the use of derivative instruments are captured within defined risk limits, along with the risks of the products which such instruments are intended to hedge. The authorisation of risk limits and risk reporting standards are described more fully in "Risk Management" above.

Derivative products used for hedging of accruals accounted portfolios are accounted for on an accruals basis consistent with the underlying products. Likewise, derivative instruments included in mark-to-market accounted portfolios are also marked-to-market.

Market-making Within ANFP

ANFP's objective is to gain margin value by marketing derivatives to end-users and hedging the resulting exposures efficiently. Products offered by ANFP include interest rate and cross-currency swaps, caps, floors and swaptions. ANFP has established clear guidelines for staff to ensure that end-users are aware of the potential risk of entering into complex derivative transactions. ANFP also uses these products, together with exchange-traded options and futures, for hedging purposes.

A comprehensive limit structure has been established for ANFP which includes exposures to interest rates, yield curve shape, volatility and spreads. In addition to the normal limits, additional limits covering sensitivity to large changes in the underlying variables have been imposed. Separate limits for ANFP are allocated from within the Treasury and Offshore limits. Substantially no foreign exchange risk is currently run within ANFP, other than that accruing through profits earned in currencies other than sterling. Direct interest rate exposure is also kept low, but exact hedges are often not available in the market and this will give rise to a combination of yield curve, volatility and spread risk within the established limits. The exposures arising in ANFP are combined with those arising in Treasury and Offshore for reporting against overall Group limits.

The overall management and control policy framework at ANFP is consistent with the Group of 30 recommendations regarding derivatives.

All ANFP positions are accounted for on a daily mark-to-market basis.

These arrangements continue in force following the termination of the joint initiative with Barings discussed in "Business Description — Treasury and Offshore — Abbey National Financial Products" below.

Derivative Instrument Activity

The following table sets forth the nominal amounts of derivatives held for asset and liability management and market-making purposes as at December 31, 1994, 1993 and 1992 and the net replacement cost and credit risk weighted amounts of derivatives as at December 31, 1994.

	At December 31, 1994			1993	1992
	Nominal Amounts (1)	Net Replacement Cost (2)	Credit Risk Weighted Amounts (3)	Nominal Amounts (4)	Nominal Amounts
		(in millions of £)			
Exchange rate related instruments					
Held for asset and liability management purposes	11,195	447	199	15,512	10,504
Held for market-making purposes	486	13	8	25	—
	11,681	460	207	15,537	10,504
Interest rate related instruments					
Held for asset and liability management purposes	45,764	597	215	31,963	18,701
Held for market-making purposes	31,365	336	110	5,501	—
	77,129	933	325	37,464	18,701

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

(2) Represents replacement cost of contracts with a positive value. In respect of those contracts used as hedges, the rise or fall in their market values will be offset by a substantially equivalent reduction or increase in the value of the asset or liability being hedged.

(3) The credit risk weighted amounts have been calculated in accordance with the Bank of England's guidelines implementing the guidelines of the Basle Committee on capital adequacy.

(4) Following a review of the classification of off-balance sheet contracts, the 1993 amounts have been restated to reflect the reclassification of certain contracts from the exchange rate to the interest rate category.

End-user Swap Activity

The tables below set forth, by contract amount, the activity in end-user interest rate and cross-currency swaps used for hedging purposes.

Interest Rate Swaps

	1994	1993	1992
	(in millions of £)		
At January 1	28,033	17,336	7,611
New contracts (1)	24,508	28,241	14,317
Matured and amortised contracts	(16,150)	(16,253)	(5,707)
Terminated contracts	(3,601)	(1,423)	(915)
Effect of foreign exchange rate and other movements	(392)	132	2,030
At December 31	32,398	28,033	17,336

(1) Includes £281 million of interest rate swaps acquired with HMC Group PLC in 1994.

Cross-currency Swaps

	1994	1993	1992
	(in millions of £)		
At January 1	7,826	6,481	3,593
New contracts	6,677	7,214	5,897
Matured and amortised contracts	(5,433)	(6,127)	(3,203)
Terminated contracts	(553)	(146)	(244)
Effect of foreign exchange rate and other movements	(45)	404	438
At December 31	8,472	7,826	6,481

Total Interest Rate and Cross-currency Swaps

	1994	1993	1992
	(in millions of £)		
At January 1	35,859	23,817	11,204
New contracts (1)	31,185	35,455	20,214
Matured and amortised contracts	(21,583)	(22,380)	(8,910)
Terminated contracts	(4,154)	(1,569)	(1,159)
Effect of foreign exchange rate and other movements	(437)	536	2,468
At December 31	40,870	35,859	23,817

(1) Includes £281 million of interest rate swaps acquired with HMC Group PLC in 1994.

The impact on the income statement attributable to end-user derivative activities for the year ended December 31, 1994 was a £67 million increase in interest receivable and a £282 million increase in interest payable. The figures should not be analysed in isolation since there will be compensating movements in the underlying positions against which the hedges were taken. ANFP contributed £21 million to the dealing profits of the Group. For the year ended December 31, 1994, the mark-to-market position of the market making portfolio was represented by unrealised gains of £349 million and unrealised losses of £295 million. During the year, the average net mark-to-market value of dealing derivatives amounted to £96 million.

The Group uses interest rate swaps and cross-currency swaps predominantly for hedging fixed-rate assets and liabilities effectively into floating rate. For interest rate swaps and cross-currency swaps used for these purposes, the weighted average pay fixed rates and weighted average receive fixed rates by maturity and contract amount as at December 31, 1994 were as follows:

	Pay fixed		Receive fixed	
	Contract amount	Rate	Contract amount	Rate
	(£ millions)	(%)	(£ millions)	(%)
Contracts maturing: (1)				
Less than 1 year	3,946	6.60	4,097	5.96
1 to 3 years	6,302	7.34	3,996	5.74
3 to 5 years	5,553	7.85	2,334	6.21
Over 5 years	1,644	9.09	3,623	7.15
Total	17,445		14,050	

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

(2) The total pay fixed contract amount comprises £15,448 million in respect of interest rate swaps and £1,997 million in respect of cross-currency swaps. The total receive fixed contract amount comprises £11,264 million in respect of interest rate swaps and £2,786 million in respect of cross-currency swaps.

For interest rate swaps and cross-currency swaps used for hedging purposes, the weighted average pay variable rate and the weighted average receive variable rate by maturity and contract amount as at December 31, 1994 were as follows:

	Pay variable		Receive variable	
	Contract amount	Rate	Contract amount	Rate
	(£ millions)	(%)	(£ millions)	(%)
Contracts maturing: (1)				
Less than 1 year	7,221	6.24	6,976	5.92
1 to 3 years	7,658	6.24	10,032	6.31
3 to 5 years	3,472	6.63	6,808	6.87
Over 5 years	4,835	6.84	3,004	6.89
Total	23,186		26,820	

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

(2) The total pay variable contract amount comprises £16,817 million in respect of interest rate swaps and £6,369 million in respect of cross-currency swaps. The total receive variable contract amount comprises £21,134 million in respect of interest rate swaps and £5,686 million in respect of cross-currency swaps.

A difference arises when comparing nominal contract assets and nominal contract liabilities. Whereas with single currency swaps one would expect equal and opposite nominal balances on either side of the swap leg, this is not necessarily the case with cross-currency swaps. At contract date sterling equivalent nominal amounts should be equal and opposite, however, subsequent exchange rate movements will result in divergence in the nominal amounts. This exchange rate divergence explains the difference between nominal contract asset balances and nominal contract liability balances.

The weighted average interest rates presented in the tables above reflect interest rates in a range of currencies. These rates should not be analysed in isolation from the rates on the underlying instruments. The effect of hedges has been included in the average interest rates presented in the average balance sheet set forth above.

The contract amount of each type of end-user contract (excluding cross-currency swaps and interest rate swaps which are included in the swaps detailed above) as at December 31, 1994 are set forth by currency in the table below. All hedging contracts mature during 1995.

	Contract type by contract amount			
	Forward Foreign Exchange	**Forward Rate Agreements**	**Options (OTC)**	**Futures (Exchange-Traded)**
		(in millions of £)		
Sterling	—	640	170	896
U.S. Dollars	2,282	1,071	866	7,334
European Currency Units	—	94	—	—
Swiss Francs	64	—	—	—
Canadian Dollars	206	—	—	—
Deutschemarks	73	153	2	12
French Francs	2	—	—	178
Spanish Pesetas	47	15	—	—
Netherlands Guilders	10	—	—	—
Australian Dollars	19	—	—	—
Italian Lire	—	—	1,955	—
Total	2,703	1,973	2,993	8,420

The total OTC options contracts amount to £20 million in respect of exchange rate related instruments and £2,973 million in respect of interest rate related instruments.

Gains and losses arising from the hedging of investment transactions are released to the profit and loss account over the life of the asset, liability or position against which the hedge is held. Gains and losses arising from the hedging of assets which are not held for the purpose of investment are taken directly to the profit and loss account. Where a transaction originally entered into as a hedge no longer represents a hedge, its value is restated and any change in value is taken to the profit and loss account. Gains and losses on instruments purchased or sold for trading and market-making purposes are taken directly to the profit and loss account. Any such transactions outstanding at the balance sheet date are stated at market value.

As at December 31, 1994, deferred gains and losses being fully released within one year and relating to terminated hedging contracts were gains of £35 million (1993: £4 million; 1992: zero) and losses of £69 million (1993: £21 million; 1992: £10 million). As at December 31, 1994, deferred losses of £2 million and deferred gains of £6 million were being released over a period greater than one year (1993: losses of £1 million and gains of zero; 1992: losses of zero and gains of zero).

BUSINESS DESCRIPTION

General

Abbey National and its subsidiaries constitute a major financial services group in the United Kingdom. With total assets of £103.8 billion and income before taxes of £483 million as at and for the six months ended June 30, 1995, the Abbey National Group currently ranks as the fifth largest banking group based in the United Kingdom in terms of total assets. The Group's income before taxes was £932 million for the year ended December 31, 1994.

The Group has three principal interdependent businesses: U.K. Retail Banking, Life Insurance Operations and Treasury and Offshore. Abbey National's U.K. Retail Banking is focused on the personal sector and is a major provider of residential mortgages and liquid savings products in the United Kingdom, primarily through its national network of 677 branches at June 30, 1995. As at June 30, 1995, Abbey National had a U.K. retail funding base of £37.2 billion in over 12.6 million deposit and checking accounts and total U.K. residential mortgage loan assets of £46.7 billion represented by approximately 1.2 million mortgage account relationships. Life Insurance Operations are conducted through Abbey National Life and Scottish Mutual, each of which sells a range of life insurance, pension and long-term savings and investment products. Treasury and Offshore, which primarily consists of ANTS, an authorised U.K. banking institution, manages the Group's liquidity needs and provides the Group with wholesale funding and risk management services. Treasury and Offshore also includes ANFP and the Group's Jersey and Gibraltar businesses. The Group's other business segments are Continental Europe (consisting primarily of the Group's retail banking businesses in France, Spain and Italy), Consumer Credit and Other Operations.

Results of the Group's principal business segments, and a discussion of certain changes in the presentation of such results, are contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations of the Group by Principal Business Segment" below.

Summary History of Abbey National

The Abbey National Building Society was formed in 1944 following the merger of the Abbey Road Building Society and the National Building Society. In the years following the merger, Abbey National Building Society (the "Society") was focused on the U.K. residential mortgage and savings market and establishing a national branch network. In the 1980's, the Society began to seek ways to diversify its activities, including acquisition of a residential estate agency business and expansion into certain other European countries.

Abbey National is a bank authorised by the Bank of England under the Banking Act 1987 (the "Banking Act"). It was incorporated in England and Wales in September 1988, and is the successor company to which the Society transferred its business under the provisions of the Building Societies Act 1986 (the "Building Societies Act"). The transfer of the Society's business became effective on July 12, 1989 and was part of the conversion (the "Conversion") of that business from a building society into a public limited company regulated as a bank by the Bank of England.

The Conversion was undertaken principally because the Board of the Society believed that the U.K. legislative and regulatory framework applicable to building societies limited the Society's ability to compete with other financial institutions. In particular, the Board believed that restrictions on access to capital, on the type of lending and other financial services products permitted to be offered, and on the management of the treasury function (including more limited access to wholesale funding markets) created disadvantages for building societies and increased the risk that customers would use other types of financial institutions. As a result, the Board of the Society recommended conversion from a building society into a bank. In April 1989, the Conversion was approved by a vote of both the Society's savers and borrowers, after which the Building Societies Commission confirmed the Conversion on June 6, 1989. As the final stage of the Conversion, the shares of Abbey National were floated on the London Stock Exchange on July 12, 1989 and Abbey National raised a net £965 million in equity capital through the issuance of new shares.

ANTS was established as part of the Conversion, and in 1992, Scottish Mutual was acquired at a cost of £288 million. In 1993, Abbey National Life commenced business, ANFP was established as a branch of

ANTS to provide risk management services in the currency and interest rate swap and option markets and the residential estate agency business was sold. In 1994, Abbey National acquired HMC, a U.K. centralised mortgage lender and in 1995, acquired FNFC, a consumer credit provider.

Strategy. The Abbey National Group's strategy is to continue to focus on its three interdependent businesses. Within U.K. Retail Banking, management is seeking to further improve Abbey National's market position in the U.K. personal financial services market, increasing its market share of the aggregate balances of both mortgages and liquid savings. The Group also intends to continue to broaden its earnings base to reduce dependence on traditional mortgage and savings activities. In addition, Abbey National is seeking, over the long term, to strengthen its presence in the personal financial services markets of certain Continental European countries, particularly Spain, while managing the problem loans, now substantially provided for, which had built up in its Continental Europe business during the economic recession of the early 1990s. Through ANTS the Group also intends to establish branches or offices in major financial centres outside the United Kingdom as part of ongoing efforts to diversify wholesale funding sources. In addition, from time to time the Group may have under consideration the acquisition of businesses or assets with a view to expanding or complementing its existing lines of businesses. The Group periodically receives proposals from third parties, and may initiate discussions regarding such acquisitions.

Complementing these strategic goals are the Group's objectives to maintain strong management of, and control over, risks, to further improve efficiency and thus maintain a low cost:income ratio (as compared to the U.K. clearing banks), to maintain a prudent capital base and to preserve and further enhance its strong brand name in the markets in which the Group operates.

U.K. Retail Banking

U.K. Retail Banking is the Group's largest business, with total assets of £49.1 billion and income before taxes of £316 million as at and for the six months ended June 30, 1995, and income before taxes of £650 million for the year ended December 31, 1994. U.K. Retail Banking consists of the Retail Division, the Operations Division and a number of central Group functions (such as personnel). The Retail Division manages the Group's retail branch network as well as the design, pricing, sales, marketing and distribution of the Group's retail products. These include residential mortgages, liquid savings products, personal cheque accounts and life insurance policies underwritten by Life Insurance Operations. The Retail Division also markets, as an agent of non-affiliated insurers, non-life insurance to individuals. The Operations Division supports the Retail Division by providing both systems and administrative back office support for the Retail Division's U.K. residential mortgage lending (via 48 mortgage service centres), U.K. checking account services (via a central check handling centre and 18 banking centres) and sales of non-life insurance products.

Distribution Network

The Retail Division distributes products primarily through the Group's 676 retail branches, its 13 business development units, its direct marketing activities conducted through Abbey National Direct and its approximately 1,285 automated teller machines ("ATMs"). In recent years the Group has modernised (and in some cases resited) almost 92% of its retail branches, which has tripled the amount of selling space available in branches over this period. Abbey National has a national branch network with a particular strength in the southeast of England, and this network distributes the majority of products to Abbey National's customer base. In the first six months of 1995, approximately two-thirds of mortgage completions were originated in Abbey National's retail branches. Abbey National established its business development units to directly service the U.K. mortgage intermediary market (which is composed of a wide range of entities including financial advisers, mortgage brokers, life and other insurance companies and real estate brokers who introduce mortgage customers to lenders). In 1994, mortgage intermediaries introduced approximately one-third of Abbey National's new mortgage originations. In November 1994, Abbey National acquired HMC, one of the U.K.'s largest centralised mortgage lenders, which will continue to offer HMC-branded mortgages to the intermediary market. Abbey National Direct has arranged mortgages and ancillary products over the telephone since 1989 and in November 1994 Abbey National expanded this operation by opening an additional telemarketing facility in Glasgow to provide life insurance and unsecured loans are offered in a comprehensive range of payment types, including repayment, interest only, endowment, unit-linked endowment and pension. Repayment mortgages require both principal and interest to be repaid in monthly installments over the life of the mortgage. Interest only mortgages require monthly interest payments and the repayment of principal at the end of the mortgage term (which can be arranged via endowment policies, personal equity plans, pension policies or by the sale of the property). An endowment mortgage is an interest only mortgage in which one or more "endowment" policies (which require premium payments and which are designed to provide a sum sufficient to repay the mortgage principal and perhaps provide an additional lump sum to the borrower) are taken out by the borrower; monthly interest payments are made to the mortgage provider and monthly endowment premiums are paid to the endowment policy provider. Pension mortgages are also interest only mortgages; they involve periodic payments into pension plans and are designed to enable repayment of the mortgage principal at maturity and perhaps provide an additional lump sum to the borrower.

Abbey National's mortgage loans are almost always secured by a first mortgage over property and are typically arranged for a 25 year term, with no minimum term and a maximum term of 35 years. Abbey National's mortgage loans generally have an average life of approximately six years. Interest on mortgage loans has in the past been charged predominately at floating rates, determined at the discretion of Abbey National by reference to the general level of market interest rates and competitive forces in the U.K. mortgage market, rather than being tied to any particular index.

In recent years there has been an increase in the demand for fixed-rate mortgage products. Abbey National's fixed-rate products generally are designed so that prepayment during a fixed-rate term includes a pre-payment charge. Fixed-rate mortgages comprised approximately 21% of Abbey National's U.K. residential mortgage portfolio at December 31, 1994 and approximately 20% at June 30, 1995. The interest rate risk on such mortgages is managed as part of the Group's asset and liability management procedures. See "Risk Management — Market Risk" above. In the second half of 1994 mortgages offering a discount to floating rates became popular. The discount is typically for between one and five years and is influenced by the amount of loan relative to the value of the property. After the discount period the loan reverts to the full floating rate. If a borrower redeems the mortgage before a specified period has elapsed, usually three years, then they must repay all or a proportion of the benefit arising from the discount.

Underwriting Criteria. Prior to granting a mortgage loan, Abbey National has the property valued, based on Abbey National's guidelines, by an approved and qualified surveyor who is often an employee of Abbey National. All surveyors are required to be members of the relevant professional bodies and, as such, to adhere to the applicable standards.

The amount of a mortgage to be extended to a customer is based on Abbey National's "National Lending Policy", which was established to help control the quality of lending decisions made by U.K. Retail Banking and to ensure that a thorough review of each customer's financial history and commitments is carried out. All advances are subject to a "basic advance" calculation. The basic advance value is 75% of the lower of the valuation or the purchase price of the property. All loans in excess of this ratio require additional security in the form of mortgage indemnity guarantee insurance, which is described below. The maximum size of a mortgage is normally not more than 95% of the lower of the valuation or the purchase price of the property, although for mortgages of up to £75,000 judged to be of low risk the limit may be increased (but not above 100%). If the valuation or purchase price of the relevant property exceeds £125,000, the maximum advance is 90%. Within the above limits, maximum advances for loans to borrowers vary depending upon the type of mortgage taken out, the borrower's circumstances, and the use for which the loan is intended. In common with experience throughout the U.K. mortgage market, Abbey National has a considerable number of customers who wish to provide the minimum permissible downpayment. Consequently, a substantial portion of Abbey National's new lending has a loan to value ("LTV") ratio of between 90% and 95%.

Abbey National lends on many types of property but only after a thorough assessment. The mortgage deed used by Abbey National to provide security is only applicable to U.K. properties. Abbey National can provide mortgages for people wishing to purchase property outside the United Kingdom in one of two ways:

where the property is a second home and the loan is secured on the main property which is held in the United Kingdom; or where the Group operates a Continental European branch or subsidiary. A limited mortgage service is offered to borrowers wishing to buy property in France, Spain, Italy, Portugal and Jersey. All property must be permanent in construction. The age of a property is always taken into consideration, as different valuation criteria apply depending on whether the property is new or old.

In England, Wales and Northern Ireland, property is either sold freehold or leasehold, while in Scotland the substantial majority of property is held on feudal tenure. A property is "freehold" when the owner owns the property and any associated land outright. In a "leasehold" property agreement, the freeholder owns the land and formally grants permission, through a lease, for the tenant to occupy the land for an agreed period. A lease is a legally binding contract between two parties (the freeholder and the tenant) which contains conditions or covenants applying to both parties. A new lease is normally agreed for 99 or 999 years. Existing leases on second hand properties are assigned to the new owners when they buy the property. Abbey National normally accepts leases of 55 years minimum subject to a maximum mortgage term of 25 years. In Scotland, feudal tenure means the property is effectively owned outright by the buyer subject to certain conditions with regard to use, development and other matters.

Abbey National does not accept mobile homes, river boats, farms or farming areas or commercial property as security for a mortgage. Semi-commercial property, however, where the property includes some form of living accommodation which will be occupied by the borrower, is acceptable.

Credit Risk. Abbey National has a number of systems which enhance its ability to manage and monitor the quality of its mortgage assets. Under applicable U.K. law, a mortgage borrower must be 18 years old. Although there is no maximum age, a borrower whose mortgage will mature after retirement will need to satisfy Abbey National that they will be able to maintain mortgage payments from retirement income. Group policy permits no more than four persons to take out an Abbey National mortgage on the same property, and the mortgage and property must be in the same names. Confirmation of income from employers is required before a firm mortgage offer is made.

Abbey National calculates the maximum loan principal according to one of two "status multiplier" methods, whichever is more advantageous to the borrower subject to consideration of the borrower's other commitments. Under the first method, the maximum loan amount is equal to three times the highest earner's principal income, plus the principal income of other applicants and all secondary income. Under the second method, the maximum loan amount is equal to 2.5 times the combined principal incomes of the two highest earners plus the principal income of all other applicants and all secondary income. Before applying the status multiplier, the borrower's principal annual income is reduced by the annual cost of his or her unavoidable commitments, such as loan and credit card repayments and tuition fees, if they exceed 5% of gross annual income. If an advance is made to a borrower who is or has been an owner-occupier, a reference is obtained from the previous lender. In addition, for all borrowers and all types of loans, credit references are obtained to verify the borrower's address and to establish creditworthiness.

Abbey National introduced mortgage credit scoring in August 1993 to supplement existing credit management techniques. Details concerning the prospective borrower and the proposed transaction are entered into a system that is linked to a credit referencing agency. The system then generates information to assist in making the credit decision.

Mortgage Indemnity Guarantee Insurance. Mortgage indemnity guarantee insurance is an agreement between a lender and an insurance company to underwrite the amount of every mortgage advance which exceeds the lender's basic advance LTV ratio (for Abbey National, an LTV ratio above 75%). A charge is made to the customer for a mortgage indemnity guarantee policy which is normally added to the mortgage balance. In those limited cases where the LTV is 100% and in some other high LTV cases, the mortgage indemnity guarantee will be paid in advance by the customer, and not added to the mortgage balance, in order to prevent Abbey National from lending more than the value of the property.

Mortgage indemnity guarantee insurance companies insure on a "block policy" basis; they agree a set of underwriting standards and criteria with Abbey National to cover all mortgages and Abbey National accepts individual cover on the insurer's behalf by upholding the insurer's standards at the offer stage. The primary restrictions on what the mortgage indemnity guarantee insurance companies will cover are that (i) the property must be owner-occupied and be the main residence of the borrower and (ii) lending must comply with the criteria set out in Abbey National's "National Lending Policy", as discussed above. Abbey National's residential mortgage loans taken out before January 1993 are covered by mortgage indemnity guarantee insurance policies. However, at the end of 1992 Abbey National chose not to renew the mortgage indemnity guarantee agreements which it had reached with four major general insurers, on commercial grounds. At that time, mortgage indemnity guarantee insurance premiums increased by approximately 50% while the contractual terms offered became less favorable to lenders. This occurred primarily because the levels of arrears, repossessions and losses, as well as claims on mortgage indemnity guarantee policies, had increased substantially.

For loans originated prior to 1993, credit risks on the amount of every mortgage advance which exceeded an LTV ratio of 75% at the time originated are fully insured with third-party insurance companies. The insurance companies take a stringent approach in evaluating claims; as a result, some claims are settled at a discount to their full value. The scale of such discounts is relatively small and has been negotiated with the insurers so it can be estimated with some certainty. The expected value is included in the allowance for lending losses. For loans originated thereafter, Abbey National has obtained its mortgage indemnity guarantee insurance from its insurance subsidiary, Carfax. Carfax is based in Guernsey and managed by an insurance consultant, Willis Corroon Management (Guernsey) Ltd. It is Carfax's policy to reinsure a portion of these risks where commercially appropriate. Such reinsurance will cover a layer of risk above a level of losses which Carfax believes it can prudently bear itself.

Carfax chose not to reinsure these risks in 1993 because the cost of reinsurance was such that it was not, in its judgment, commercially justifiable. It is Carfax's view that, given the high credit quality of the mortgage loans made in 1993 and given the point in the economic cycle, the premiums collected in 1993 and the investment income thereon will be sufficient to cover the amount of potential losses on loans advanced during 1993. Carfax has in place reinsurance arrangements with a number of insurance companies for loans originated in 1994 and 1995.

Mortgage Arrears and Repossessions. The recent recession in the United Kingdom, combined with high real interest rates, has produced relatively high levels of mortgage arrears and repossessions by historic standards. However, Abbey National's losses on repossessed properties were limited through having a first mortgage over the relevant property, as well as through mortgage indemnity guarantee insurance and proper credit verification procedures.

The following table sets forth information on U.K. residential mortgage arrears and properties in possession as of December 31, 1994, 1993 and 1992 and June 30, 1995 and 1994 for both Abbey National and the U.K. Council of Mortgage Lenders ("CML"), an organisation whose members account for over 80% of total U.K. new mortgage originations and which represents a widely recognised benchmark for the U.K. mortgage market. In the table, all percentages shown are percentages of total U.K. residential mortgage loans by number.

	Abbey National (1)	CML
	(percentage of total mortgage loans by number)	
6 months to 12 months in arrears		
December 31, 1992	1.51	2.07
December 31, 1993	1.15	1.62
December 31, 1994	1.00	1.28
12 months or more in arrears		
December 31, 1992	0.64	1.48
December 31, 1993	0.49	1.50
December 31, 1994	0.40	1.12
Properties taken into possession in the year ended		
December 31, 1992	0.31	0.33
December 31, 1993	0.17	0.26
December 31, 1994	0.17	0.23

(1) Abbey National figures exclude Abbey National Mortgage Finance plc (the U.K. residential mortgage operation acquired from CIBC) and HMC.

Abbey National's mortgage administration process ensures that prompt contact is made with borrowers who fall into arrears. Mortgage centres are responsible for contacting customers who have missed a contractual payment and requesting that they rectify the position. Borrowers are encouraged to make arrangements to pay off any arrears and adherence to these arrangements is monitored closely. Legal proceedings will normally be initiated against borrowers who fail to respond positively to repeated requests and who subsequently fall three monthly payments in arrears. These proceedings may result in the borrower's property being taken into possession. Abbey National takes possession of properties and sells these properties, through both legal means and voluntary action by the borrower, at market prices in order to pay off the outstanding value of the loan previously secured by the properties. The size of the stock of repossessed properties varies depending on the number of new possessions and the buoyancy of the housing market which determines the speed with which properties can be sold at reasonable prices. Abbey National's stock of repossessed properties decreased from 9,331 at December 31, 1992 to 4,797 at December 31, 1993, to 2,994 at December 31, 1994, and to 2,717 at June 30, 1995.

Liquid Savings Products

During the second half of the 1980s, banks adopted a more competitive stance which arrested the decline in their share of the U.K. liquid savings market. In the face of this increased competition, building societies maintained their market share by offering a wider range of savings accounts and by improving the services they offered to customers.

At June 30, 1995, Abbey National had approximately 12.6 million deposit and checking accounts with personal customers providing a retail funding base of £37.2 billion. Abbey National provides a full range of retail savings accounts, including demand deposit accounts, notice accounts (where access is available on a limited number of occasions each year, following which 90 days' notice is required), accounts requiring an investment of a minimum amount and for a set period (one year) and Tax Exempt Special Savings Accounts known as "TESSAs". TESSAs were introduced in 1991 by the U.K. Government to encourage savings by offering investors the opportunity to earn a tax-free return for five years. The "Instant Saver", Abbey National's current demand deposit account, is a tiered account (i.e., interest rates are tiered according to the level of savings). The "Investment Account" is also a tiered account which offers higher rates of interest than an "Instant Saver" but to which instant access is only available on a limited number of occasions each year (after which 90 days' notice is required). Abbey National offers even higher interest rates through its "High Yield Bond", which has a tiered interest rate structure but requires a minimum level of investment which must be deposited for a minimum of one year. Abbey National also offers investors the opportunity of fixing their rate of return with the "Triple Growth Bond". This account requires a minimum level of investment and offers a guaranteed interest rate increase each year over a three-year period. Interest rates on savings in the United Kingdom are primarily set with reference to the general level of market interest rates and the level of competition for such funds. For the bulk of Abbey National's retail liabilities, interest is paid on a floating rate basis.

Personal Cheque Accounts

U.K. Retail Banking has offered personal cheque account products since 1988. At the end of 1994 the Group had approximately 1.3 million cheque account customers. Cheque accounts are distributed through the retail branch network and by direct mail, and are administered through a central cheque handling centre and 18 banking centres.

In May 1995, U.K. Retail Banking launched the Abbey National Bank Account, which will eventually replace all other existing cheque accounts in the Group. The Abbey National Bank Account offers tiered interest on credit balances and an interest bonus if £500 or more is mandated to the account each month. Abbey National Bank Account customers can take advantage of telephone and ATM banking services, overdraft facilities to £5000 (depending on credit standing), a £100 cheque guarantee card and a debit card.

Behavioural scoring was introduced during 1994 and is used to decide whether to grant customers overdrafts on their cheque accounts and whether to issue them cheque guarantee and "multifunction" cards (combined cheque guarantee, debit and ATM cards). U.K. Retail Banking has centrally controlled credit scoring to enable it to manage the risks associated with overdrafts on its cheque account products.

Non-life Insurance

Residential mortgage-related insurance remains the dominant type of non-life insurance policy sold by Abbey National. The range of products offered to customers through the branch network includes property, buildings and contents, payment protection, travel and health insurance. Nearly all the non-life insurance products are sold through the retail branch network, often at the same time that a mortgage is being taken out. Until July 1995, Abbey National acted solely as agent for a panel of third-party insurers, without underwriting risk, in respect of such sales.

In July 1995, Abbey National's joint venture with Commercial Union, formed to provide non-life insurance products to the personal sector, commenced operations. Two complementary businesses have been established under the joint venture: an operations business unit and an underwriting company. The operations business unit is a division of Abbey National. The operations business unit is responsible for providing quotations, collecting premiums and issuing policies on behalf of the underwriting company, Commercial Union Underwriting Limited (CUUL). The voting share capital of CUUL is owned 85% by Commercial Union and 15% by Abbey National. CUUL is responsible for the payment of claims. The administrative expenses associated with this process are incurred within the operations business unit. Additionally, a brokerage operation is to be established within the joint venture which will be owned by the operating business unit.

The new venture has become the sole supplier of Abbey National's building and contents insurance products. Over time, the number of products provided by the venture will be increased, with the intention that in the long term it will provide the bulk of Abbey National's non-life insurance product range.

Life Insurance Operations

U.K. Life Insurance Industry

In the United Kingdom, the life insurance industry has been dominated by a large number of mutual insurance organisations, who distribute a range of products through banks, building societies, direct sales forces and a large network of independent financial advisers. In recent years, the entry of building societies and banks into the market as manufacturers, as well as distributors, has reduced this dominance. The life insurance market has grown significantly over the last decade, with total industry new business premiums increasing threefold over this period. Management believes that the increase in the average age of the U.K. population and the U.K. Government's potential difficulty in funding the provision of a state pension in the future, will cause individuals to make separate provision for their retirement. Management believes that these trends are likely to cause the life insurance market to grow further in the future and therefore considers it strategically important to have a presence in this market.

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

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

Investment and Savings. Endowment life insurance policies represent the bulk of this category. An endowment policy provides a lump sum benefit payable at the end of a specified term or on prior death. The lump sum can be in the form of a "without-profits" benefit (in which only a guaranteed minimum sum is provided), a "with-profits" benefit (in which a guaranteed minimum sum, plus a share of profits on investments, if any, is provided) or a linked or "unit-linked" benefit (in which an amount determined by reference to the level of an index or a pool of unit investments is provided). The traditional life insurance investment and savings product is the "with-profits" endowment policy. The premiums paid into a with-profits endowment policy are pooled into a life fund which is invested in cash, government bonds, shares and/or property. Policy holders receive a guaranteed minimum sum upon maturity of the contract, plus a share of profits, if any, from the fund. An increasing proportion of life contracts in this segment are "unit-linked" endowment policies. The premiums paid are used to buy units in investment (or unit trust) funds (which are similar to U.S. mutual funds).

Also included in this category are personal equity plans ("PEPs") and unit trusts. PEPs were introduced by the U.K. Government in January 1987 to encourage investment in U.K. company shares by small investors. There is a limit on the amount that can be invested in a PEP. The returns from a PEP are not subject to income tax or capital gains tax. Allowable investments also include certain European Union ("EU") shares, unit trusts and investment trusts. The U.K. Chancellor of the Exchequer's November 1994 Financial Statement widened further the scope of PEPs to include corporate bonds, convertibles and preference shares. U.K. Inland Revenue rules concerning investment in PEPs for the tax year 1995/96 are broadly as follows:

- An individual can invest up to £6,000 in shares, qualifying unit trusts or investment trusts. At least 50% of the underlying investment must be in U.K. or EU company shares. PEPs which invest in this way are known as General PEPs.
- In addition, an individual can invest up to £3,000 through a single company PEP in the shares of a single company.

A unit trust is a pool of individual investments which is held in a common fund. Unit trust funds are divided into a number of individual units which are purchased by investors. The investments may include equity shares, loan stock, property and cash. Investments may be in the United Kingdom, the EU or elsewhere. All unit trusts available to the general public are authorised by the Securities and Investments Board ("SIB") and must conform to the following principles:

- they are not generally permitted to invest more than 5% of any investment fund into the shares of any one company.
- they may not own more than 10% of the shares of any one company.
- they must only invest in loan stock and shares listed on a recognised stock exchange although some unit trusts are permitted to invest a small amount in unquoted shares.

Pensions. In the United Kingdom pensions are a tax-efficient way of saving to provide benefits on retirement. This is a result of the tax deductibility of contributions made and the generally tax-free growth granted to pension funds. Changes in the legislation governing pensions resulted in this sector experiencing rapid growth in the 1980s. The SIB is currently requiring an industry-wide review over the conduct of business involving advice to customers to transfer from occupational to personal pension plans or opt out of or not join occupational pension plans. Abbey National has made a considerable investment in the training of its financial planning advisers in recognition of the fact that sound advice is the basis on which relationships with customers are built. See Note 41 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

Distribution. Until the passing of the Financial Services Act 1986 (the "Financial Services Act"), banks, building societies and other financial advisers customarily distributed the products of a panel of life insurance companies. One of the purposes of the Financial Services Act was to ensure that customers knew when they were receiving independent financial advice as opposed to being sold products which it might be in the best interests of the distributor to sell. Under the terms of the Financial Services Act, financial advisers like Abbey National were required to be either an "appointed representative" or an "independent financial adviser". Subject to certain conditions, appointed representatives or marketing associates and independent financial advisers may co-exist within the same group. Appointed representatives, marketing associates and independent financial advisers are required to provide "best advice", which requires an assessment of the client's financial position and requirements. The appointed representative or marketing associate is required by the Financial Services Act to recommend the most suitable products from the product range of the company for which it acts as representative or with which it is associated, while the independent financial adviser must provide best advice on the complete product range that exists in the market place. An appointed representative or marketing associate thus only markets and sells the life and pension products of one company or group of companies, whereas an independent financial adviser is required to develop and maintain knowledge of a much broader range of available products.

Abbey National Group

The Group is an active participant in each of the three principal segments of the U.K. life insurance industry outlined above. Abbey National has long been a significant distributor of the products of third-party insurance companies, primarily mortgage-related life insurance, term insurance and endowment life insurance linked to residential mortgages. Through the acquisition of Scottish Mutual and launch of Abbey National Life, the Group has broadened its product range, improved its distribution capabilities and realised the benefits of underwriting the products it distributes.

Between late 1987 and February 1993, Abbey National (excluding ANIFA) acted as the appointed representative of a single life insurance group, Friends Provident Assurance. However, in 1991, the Group decided to establish its own life insurance company and commence underwriting insurance products in an effort to develop a new income stream that was not dependent upon the U.K. housing market. Life insurance underwriting was seen as a logical step for diversification given Abbey National's position as a major distributor of life insurance products. On January 1, 1992, the Group acquired the business of Scottish Mutual Assurance Society at a cost of £288 million. The acquisition of Scottish Mutual enabled Abbey National, through the use of Scottish Mutual's expertise and systems, to launch its own life insurance company, Abbey National Life, for which Abbey National acted as the appointed representative from February 1993 to January 1995, after which time Abbey National began operating as a marketing associate of Abbey National Life. As a result, Abbey National not only receives the earnings from underwriting the life insurance products it sells through the Retail Division's distribution systems but it is able to exercise control over such products' design and development.

In addition, since 1987 ANIFA has provided independent financial advice to private clients. As an independent financial adviser, ANIFA is an alternative for Abbey National customers and other private individuals who do not want the products offered by Abbey National Life or another appointed representative. ANIFA's results are included in the Group's Other Operations business segment, described below.

In recent years, the Group has been able to penetrate the markets for both independent and appointed representative advice at both the underwriting and distribution levels. At the underwriting level, Abbey

National Life underwrites products that are distributed through Abbey National's retail branch network while Scottish Mutual underwrites products that are distributed through the broader independent financial adviser market. At the distribution level, Abbey National acts as a marketing associate of Abbey National Life and Abbey National Unit Trust Managers ("ANUTM") while ANIFA acts as an independent financial adviser distributing the products of companies outside the Group. Moreover, while Scottish Mutual and Abbey National Life service distinct market segments, they share certain resources and facilities. Scottish Mutual provides services to Abbey National Life under two service agreements. The first, between Abbey National Life and Scottish Mutual, covers actuarial and technical advice and personnel, legal, secretariat, compliance, internal audit, finance, organisation, methods and systems matters. The second, between Abbey National Life and Scottish Mutual Portfolio Managers Ltd., a subsidiary of Scottish Mutual, covers investment management. Management believes that the main benefits from this sharing of resources were to enable Abbey National Life to become operational more rapidly and to enable both Scottish Mutual and Abbey National Life to operate from a lower cost base than would be possible if each were to operate on a stand-alone basis.

Abbey National Life plc

Based in Glasgow, Abbey National Life underwrites and services a wide range of life insurance products including pension, protection, investment and savings products. These products are sold exclusively through Abbey National's retail distribution network (including retail branches, Business Development Units, telephone sales made by Abbey National Direct and direct mail).

Sales of non-mortgage-related investment and pension products account for over half the new business written. Abbey National Life's product range is distributed through Abbey National's Retail Division, which introduced in 1993 a financial planning service offered to customers in its branches. Under the programme, professionally trained advisers provide confidential advice to customers. Advisers examine the financial circumstances and needs of customers identifying pension, protection, investment and savings requirements and recommend to them the appropriate products from the Abbey National, Abbey National Life and ANUTM portfolios. By June 30, 1995, this financial planning service was extended to virtually all of the 677 branches.

Under the prior appointed representative arrangement with Friends Provident Assurance, Abbey National only had control over sales and marketing of life insurance. The establishment of Abbey National Life has extended the Group's control to the design, specification, and servicing of the product range, enabling products to be tailored to meet the needs of Abbey National's customer base. As a marketing associate, Abbey National (through the Retail Division) is the sole distributor of Abbey National Life's products and also provides marketing support to Abbey National Life.

Abbey National Unit Trust Managers Ltd.

A subsidiary of Abbey National Life, ANUTM, was established in 1994 to act as the PEP and unit trust management arm of Abbey National. ANUTM manages the Abbey National UK Growth Unit Trust which was launched on March 1, 1995, drawing on the fund management expertise of the life insurance business. ANUTM offers a general lump sum contribution PEP through which customers can invest in the Abbey National UK Growth Unit Trust. Alternatively, customers may invest directly in the unit trust. The trustee of the unit trust is Citicorp and the investment manager is Scottish Mutual Portfolio Managers Ltd. As at June 30, 1995 the first Abbey National PEP had taken £87 million of premiums.

Scottish Mutual Assurance plc

Scottish Mutual, also headquartered in Glasgow, has three active subsidiaries: Scottish Mutual Pension Funds Investment Ltd., whose business is providing long-term life insurance in connection with managed pension funds; Scottish Mutual Investment Managers Ltd., which manages Scottish Mutual's unit trusts; and Scottish Mutual Portfolio Managers Ltd., which manages PEPs and the investments of Scottish Mutual and Abbey National Life. Scottish Mutual and its predecessor companies have been in the insurance business since 1883.

As part of the acquisition of the business of Scottish Mutual, an amount of £285 million was transferred to a life and pension fund managed by Scottish Mutual on behalf of its policyholders, the Scottish Mutual With-Profits Sub-Fund. A portion of this transfer was used to pay a special bonus to "with-profits" policyholders. Under the terms of the acquisition, Abbey National receives 10% of all surpluses arising in Scottish Mutual's With-Profits Sub-Fund and 100% of all surpluses arising from other business generated by Scottish Mutual.

Scottish Mutual distributes its products solely through independent financial advisers in the United Kingdom, of which there were approximately 5,700 firms registered with the relevant regulatory body. See "Supervision and Regulation" below. The total number of independent financial adviser firms is expected to decline over time, but independent financial advisers will continue to distribute a significant volume of long-term life insurance business, particularly in the areas of pensions and investment. Scottish Mutual services these independent financial advisers through a sales force of approximately 150 sales consultants and 12 area offices located throughout the United Kingdom.

Scottish Mutual markets a broad range of products including personal pensions, protection plans, regular investment plans, single premium products and products linked to mortgages. Scottish Mutual's range of pension contracts, all of which aim to permit savings for retirement in a tax-efficient way, are marketed to individuals (both employed and self-employed), groups and companies. The primary differences between Scottish Mutual's pension contracts are due to the differing needs of each contracting party (for example, self-employed individuals, corporate executives or employees, employer pension plans or pension plan trustees). Scottish Mutual markets both conventional protection plans (term insurance) and unit-linked protection plans. The former provide life insurance for the policy term while unit-linked plans also have an investment element. Scottish Mutual's regular investment plans provide for periodic investments of funds by the plan investor. In the regular investment plan area, Scottish Mutual offers both unit-linked plans, in which the maturity value of the policy is dependent on the performance of the underlying investments, and traditional plans based on a with-profits fund. Investments in all of these plans are placed in Scottish Mutual's investment funds described below and managed by subsidiaries of Scottish Mutual. Scottish Mutual also markets a range of savings contracts to back mortgages, which include with-profits endowment mortgages, unit-linked mortgages and personal pension mortgages.

Scottish Mutual also markets single premium products, which involve a one-time payment by the consumer rather than the periodic payments required by regular premium products. Scottish Mutual's single premium products include unit trusts, personal equity plans (which take advantage of the U.K. Government's personal equity plans legislation and enable investments to be made free from income tax and capital gains tax), as well as annuities, which provide for a series of income payments contingent on survival of a specified life or lives. Investments in single premium products are also placed in Scottish Mutual's managed funds.

As at June 30, 1995 Scottish Mutual had £4.6 billion of funds under management, largely invested in U.K. equities, overseas equities (mainly in Continental Europe, the U.S.A. and Japan), U.K. Government bonds, cash and property. Scottish Mutual operates nine main funds covering a wide range of asset classes and with different investment guidelines. The Scottish Mutual With-Profits Sub-Fund is the main life and pension fund for conventional with-profits business and unitised with-profits contracts, into which Scottish Mutual places funds managed under the contracts described above. The fund can hold a broad range of asset classes including U.K. equities, overseas equities, U.K. Government bonds, U.K. and overseas fixed-income instruments and cash.

In February 1995, Abbey National acquired Pegasus Assurance Group Ltd. ("Pegasus"), a U.K. healthcare insurance provider. Pegasus provides insurance policies to cover critical illness, income protection, medical expenses and long-term care. As at December 31, 1994 Pegasus had over 20,000 policy holders and had the largest market share of U.K. critical illness policies sold through independent financial advisers. The company has been assimilated into Scottish Mutual and forms the basis of a new healthcare insurance division, which will develop the sale of healthcare insurance products to the independent financial adviser market and provide technical assistance on the development of healthcare insurance products for Abbey National Life.

Consumer Credit

Abbey National offers unsecured personal loans of between £500 and £15,000, which can be taken out for a variety of non-business related reasons. The repayment period ranges from one to five years, except for car loans (four years maximum), holidays (two years maximum) and school tuition fees (one year maximum). Repayments are fixed throughout the term of a loan and include the repayment of principal. Payment protection insurance is available on all loans to cover repayment in the event of accident, unemployment, sickness or death. Abbey National has a centralised underwriting function to facilitate properly controlled lending decisions.

Consumer Credit has centrally controlled credit scoring to enable it to manage the risks associated with its unsecured lending products as well as overdrafts on its cheque account products. The quality of the lending portfolio is regularly monitored.

Abbey National intends to launch a VISA credit card to its customers in February, 1996.

As at June 30, 1995, Consumer Credit had loan assets of £460 million. The consumer credit business of FNFC will be reported in this segment in the 1995 Directors' Report and Accounts of Abbey National.

Treasury and Offshore

ANTS is an authorised banking institution under the Banking Act 1987. Since its establishment as a subsidiary of Abbey National in January 1989, ANTS has had four main objectives. These are to (i) manage prudently the liquidity needs of the Group, ensuring that regulatory and investor interests are balanced appropriately against the cash flow requirements of the Group; (ii) ensure that wholesale funding and capital is available to the Group; (iii) contribute to the management of risks arising in the Group's balance sheet; and (iv) make a profit through investing predominantly in high-quality assets and securities.

ANTS was formed principally due to a restriction in the Building Societies Act which effectively provided that any offer, allotment or transfer of shares or debentures by Abbey National made before July 11, 1994 would be void if the offer, allotment or transfer would lead to more than 15% of the shares or debentures of Abbey National being held by, or by nominees for, any one person. This threatened to cause substantial disruption to Abbey National's continuing funding programme as any offering of bearer bonds (which are debentures for the purposes of the Building Societies Act and which then constituted the majority of its long-term funding) could not have been feasibly undertaken.

However, the Building Societies Act did not intend to prevent valid guarantees being given by Abbey National for obligations due under bonds of a subsidiary. Accordingly, ANTS was established principally to act as the vehicle to undertake long-term funding in the bond market. Subsequently, Abbey National decided that, from a managerial point of view, it was attractive to establish ANTS as a more substantial treasury vehicle with a wider range of treasury operations than simply acting as the Group's bond issuing vehicle. The separate banking entities of Abbey National and ANTS will be retained for the foreseeable future.

Abbey National has fully and unconditionally guaranteed the obligations of ANTS that have been or will be incurred before July 31, 1999. The guarantee is reviewed from time to time by Abbey National with a view to extending it. The last time this occurred was in 1991 when it was extended by five years from July 31, 1994 to July 31, 1999. In turn, ANTS has fully and unconditionally guaranteed the unsecured and unsubordinated obligations of Abbey National that have been or will be incurred before December 31, 1999. Each guarantee is of any obligation issued or incurred before its expiration, and covers payment through maturity, even if the guarantee is no longer in effect for subsequent obligations. As a result of the guarantee from Abbey National, ANTS has the same short- and long-term credit ratings as Abbey National.

Liquidity Management and Wholesale Funding

ANTS, through its investment portfolios, provides the Group with access to significant liquidity, although it is ANTS' general policy to hold its assets for the longer term.

An important feature of liquidity management is ensuring diversified sources of wholesale funding to reduce the dependence on any one funding sector. ANTS has established relationships with over 700 investing counterparties around the world, and it has a dedicated team of senior managers who manage these contacts and continually search out new investors. The primary focus of this group is Europe, the U.S.A. and the Far East. In October 1994, ANTS established a branch in Paris, primarily in order to access the French wholesale funding markets. In addition, as part of ongoing efforts to diversify wholesale funding sources, ANTS opened a representative office in Hong Kong in January 1996 and is actively considering establishing branches or offices in other major financial centres outside the United Kingdom.

ANTS is active in a number of private and public markets worldwide, and issues certificates of deposit, commercial paper, medium-term notes and Eurobonds of both senior and subordinated status. Since Conversion in 1989, ANTS has been very active in the market for accepting call deposits and time deposits. These deposits grew from £2.0 billion at the end of 1989 to £24 billion at the end of June 1995 (of which over £3 billion came from supranationals and central banks). ANTS also manages a $4 billion commercial paper programme for Abbey National North America Corporation, a subsidiary of Abbey National, and issues commercial paper in Canada. ANTS has an active $10 billion medium-term note programme. As at June 30, 1995, approximately $6.3 billion was outstanding under the programme. ANTS is also an active issuer in the Eurobond market; at June 30, 1995, 60 issues with a total value of approximately $15.6 billion were outstanding. The majority of such Eurobond funding has been swapped into floating rate sterling, U.S. dollars and European Currency Units. The strategy in respect of public issues has been to issue large benchmark issues. Thus far, this has been achieved mainly in sterling, dollars and French francs. In October 1994, ANTS established a certificate of deposit programme and a *bons à moyen terme negociable*, or BMTN, programme, each of which allow for an aggregate principal amount of debt securities of up to 10 billion French francs to be issued in the French domestic market. Following registration with the Commission in October 1994, Abbey National First Capital B.V., an indirect wholly-owned subsidiary of ANTS, issued a $500 million subordinated bond due 2004, which is guaranteed on a subordinated basis by Abbey National. In November 1994, Abbey National registered a medium-term note programme with the Commission. As of June 30, 1995, $1,396 million of such medium-term notes were outstanding.

Funding raised has been used to finance both the increase in Treasury and Offshore investment assets and mortgage lending by the U.K. Retail Banking operation. The increase in the Treasury and Offshore component of the Group's balance sheet reflects the Group's use of the funding flexibility obtained on Conversion. ANTS has been particularly active in funding retail mortgage lending by providing matched finance and risk management services for a wide range of new mortgage products, particularly fixed interest rate mortgages. Funding from the wholesale markets as a proportion of total Group funding was 54% at June 30, 1995.

Risk Management Services

ANTS provides risk management services to the Group through hedging advice and transactions, advice on risk management for the subsidiaries that constitute the Continental Europe business and certain offshore operations in the Treasury and Offshore business and management of risks within ANTS itself. ANTS aims to maintain a currency neutral book, balancing funding and investments in all foreign (non-sterling) currencies. Exposure to foreign currency movement is thus minimised, despite significant increases in the levels of U.S. dollar funding and investments. To manage risk, the Group makes use of off-balance sheet instruments, such as swaps, futures and options, which are intended to reduce the Group's exposure to changes in interest rates, currency rates and basis and reset risks. Through ANFP, Abbey National has access to experienced derivatives professionals. See "Risk Management" and "Derivatives" above for further details on risk management within Abbey National.

Asset Diversification

Since Conversion, the changes in the Group's balance sheet from the traditional building society structure are largely due to the growth of ANTS' investment portfolios together with the development of ANTS' finance leasing and other asset-backed securities activities. The £965 million of equity raised by Abbey National in 1989, in conjunction with the leverage this provided, facilitated the development of these activities which were identified as strategic areas for expansion.

The common theme in these activities is the aim of ANTS, in the first phase of diversification, to make additional profits primarily through an interest rate margin while minimising credit and interest rate risk.

The Group does not, and does not intend to, engage in foreign exchange trading or attempt to generate profits through taking large directional or speculative positions. In its asset diversification, ANTS maintains a central objective of investing primarily in government securities, highly-rated banks and financial institutions and other well capitalised and highly-rated institutions.

Investment Portfolios

ANTS manages investment portfolios denominated in two main currencies, U.S. dollars and sterling, in addition to smaller securities portfolios denominated in European Currency Units, Italian lire, deutschemarks and French francs and small money market portfolios in Spanish pesetas and Swiss francs.

In general, the U.S. dollar securities are issued or guaranteed by banks or U.S. federal agencies. ANTS' securities and investments portfolios originated from a policy implemented in 1989 of moving out of U.K. Government securities which had been held by the Society and investing in floating rate U.K. and U.S. mortgage-backed securities. This move lowered interest rate exposure because fixed-rate assets such as U.K. Government bonds give a high exposure to interest rate risk compared to floating rate instruments. The aim in 1989 was, and continues to be in 1995, to lock in spreads on the range of investment portfolios invested in by ANTS. ANTS' risk management approach is consistent with this aim of locking in spreads, although not all instruments bear floating rates of interest. The risks associated with the assets, attached funding and risk hedging are managed in such a way as to generate steady profit streams from the investment portfolios. The credit rating of these portfolios is typically between A– and AAA (or the respective equivalents), with the substantial majority of investments having ratings of AA– or better (or the equivalent) from one or more rating organisations.

The increase in book value of ANTS' securities and investments from £3.1 billion in 1989 to £32.3 billion at June 30, 1995 has been consistent with this investment strategy.

Finance Leasing

After Conversion, Abbey National was permitted to move into finance leasing. Leasing presently accounts for approximately 30% of overall U.K. investment in capital equipment. There is a developed and distinct leasing industry in the United Kingdom consisting mainly of companies involved in the financial services sector of the economy, particularly banking. ANTS entered this market in 1990 to take advantage of Abbey National's strong capital position and was able to do so because of its ability to absorb capital allowances. Since then ANTS has established itself as a significant supplier of finance leasing. In past years, ANTS benefited from the depressed profitability of its major U.K. banking rivals who are traditionally significant forces in this field. ANTS signed 16 leasing facilities in 1992, 12 in 1993, three in 1994 and four in the six months ended June 30, 1995. As at June 30, 1995, total finance lease commitments exceeded £2.4 billion, broadly unchanged from the 1993 year-end. The increasing profitability levels of major U.K. banks in 1994 has led to the return of strong price competition in this market.

ANTS focuses its leasing activity on large transactions (generally with minimum outlay of £20 million). The business is developed with particular emphasis on large capital projects requiring thorough analyses of structure and credit support. Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership to the customer, other than legal title, are classified as finance leases. Under the existing corporate tax regime in the United Kingdom, the lessor is entitled to claim the benefits arising from ownership, in the form of capital allowances which can reduce corporate tax liabilities. For equipment that qualifies, such as general plant and machinery, office equipment and aircraft, there is a 25% capital allowance. The majority of assets leased in the United Kingdom are plant and machinery assets.

Corporate Finance

This area arranges collateralised loans to mortgage lenders as well as syndicated and bilateral loans to borrowers such as banks, governments and supranational bodies which are rated AA or better (or the equivalent) by one or more rating organisations and to building societies and housing associations. Collateralised mortgage loans are privately placed loans that are typically made to special purpose vehicles that in turn hold residential first mortgage loans as security for loans made to them. The collateralised mortgage loans typically are transferred to the special purpose vehicle by the sponsor, which may be a bank seeking to improve capital ratios or a building society or other mortgage lender seeking an alternative source of funds. The corporate finance area is responsible for arranging and advising the Group on structured transactions and the development of innovative savings products. As at June 30, 1995, ANTS had drawn-down funds in respect of collateralised mortgage loans of £156 million and undrawn committed funds of £156 million. The portfolio of committed syndicated and bilateral loans at June 30, 1995 was £237 million.

Housing Associations

In January 1994, ANTS began making long-term loans to housing associations in England and Wales. Housing associations exist to provide social housing used for rental accommodation. The industry-wide annual funding need is estimated to be approximately £1.5 billion. ANTS has written commitments of £143 million and as at June 30, 1995 ANTS had signed 16 transactions with a drawn-down amount of £76 million. These loans are secured on the value of that portion of the property owned by the housing association.

Abbey National Financial Products

Following the successful establishment of ANTS' asset-driven businesses, in 1992 the Group was ready to contemplate moving into other potentially profitable areas which represented natural extensions to the treasury business. The Board identified risk management services in the interest rate and currency swap and options markets as a potential opportunity because of Abbey National's potential for competing in this market, given its strong capital position and credit ratings. In addition, ANTS uses swaps and options to obtain matched funding and to hedge interest rate and currency risks. ANTS thus has operational and risk expertise in derivatives as well as an ability to generate a significant level of business. A key concern, however, was to identify a means of entering the field which ensured that the operational risks were managed properly.

ANFP, a branch of ANTS, commenced operations on October 25, 1993 under the name of Abbey National Baring Derivatives as a joint initiative with Barings. Following the appointment of an administrator to Barings on February 26, 1995, substantially all of the assets and liabilities of Barings were purchased on March 8, 1995 by Baring Brothers Limited, a subsidiary of Internationale Nederlanden Groep N.V. ("ING"). On March 9, 1995, ANTS changed the name of the branch to Abbey National Financial Products. ANFP has ceased to be a joint operation and is operated solely by ANTS.

ANFP's activities are overseen by ANTS' Executive Management Committee, which controls the strategic development and day-to-day activities of ANFP. Adherence to agreed policies and procedures is the responsibility of the Director of Operations of ANFP, who is nominated by ANTS and reports directly to the Treasurer of Abbey National.

ANFP offers interest rate and currency swaps together with interest rate options and swap options in sterling, dollars, deutschemarks and the other main currencies within the Organisation for Economic Cooperation and Development. Staff engaged in the management of ANFP's operations execute transactions on its behalf and complete hedging operations to minimise risk.

Offshore Operations

The offshore component of the Treasury and Offshore business is composed mainly of wholesale and retail banking operations in Jersey and Gibraltar.

On January 3, 1995, Abbey National (Overseas) Ltd was renamed Abbey National Treasury International Limited and was transferred with its parent company, Abbey National (Holdings) Limited, to become a subsidiary of ANTS. This business was established in Jersey in 1987 and at June 30, 1995 had 27 staff operating from one branch in St Helier. The company's main business is to attract deposits by offering a range of deutschemark-, dollar- and sterling-denominated savings accounts. Since the transfer, activities have been expanded to include investment activities, predominantly in high-quality assets.

Abbey National (Gibraltar) Ltd. was established in 1988 and at June 30, 1995 had two offices and 19 staff. The company primarily provides savings products specifically designed for British nationals. It offers sterling-denominated mortgages for property purchases in Spain, Portugal and the Canary and Balearic Islands, in addition to savings accounts which pay interest free of U.K. withholding taxes. In early 1994, the subsidiary opened a representative office on the Portuguese Algarve, primarily to provide information on buying property in Portugal and to provide sterling-denominated mortgages.

Continental Europe

Abbey National's operations in France, Spain and Italy, which together constitute the Group's Continental Europe segment, are managed locally. The principal activity of these operations is providing mortgage finance. In addition, the operations in Spain take retail deposits. The strategy in Continental Europe has been recently reappraised and now centres on the expansion of a refocused regional retail banking operation in Spain, the managing of the existing commercial loan portfolio in France and the continued development of the mortgage lending operation in Italy. A summary of these businesses is provided below.

Abbey National Bank SAE was established in 1988 and at June 30, 1995 had branches in Madrid and Barcelona and a total of 157 staff. The subsidiary provides a range of Spanish peseta-denominated endowment and repayment mortgages and associated insurance products, primarily to Spanish nationals. It also provides financing to Spanish developers which is then subrogated to individual mortgages on completion of the development. The Group's strategy in Spain has been recently focused on developing a retail banking service in the Madrid area including checking accounts, a credit card, mortgages and savings accounts. By the end of July 1995, 17 branches and a telephone marketing centre had been opened, and further branches are planned.

Abbey National France SA, formerly called Ficofrance, was purchased by Abbey National in 1990 from Group Maison Familiale. Ficofrance was renamed Abbey National France SA on January 1, 1993. It had six offices and 149 staff at June 30, 1995. Its key activity was to provide mortgages, primarily to French nationals but also to British nationals wishing to purchase vacation homes in France and the company provides a range of French franc-denominated fixed and variable repayment and endowment mortgages and associated insurance products. The company also provided financing to property developers, which contributed to losses being reported for 1993 and 1992. As a result, in 1992 Abbey National France SA ceased making commercial loan commitments and is now concentrating on managing out the commercial loan portfolio and making residential loans.

Abbey National Bank (Italy) was established in 1989 as Abbey National Mutui SpA to provide mortgages in Italian lire primarily to Italian nationals. Through its network of 13 branches and 80 staff at June 30, 1995 the operation offers a range of lire-denominated mortgage products. The business was converted into a branch of Abbey National on December 31, 1993, at which time it adopted its present name.

Irish Permanent plc

In November 1994, Abbey National announced that it had purchased 9.9% of the shares of Irish Permanent plc. Irish Permanent plc is Ireland's largest mortgage lender and also provides unsecured loans, saving deposits, life insurance, pensions, general insurance, cheque accounts and credit cards to customers in Ireland. On October 27, 1994 Irish Permanent plc converted from building society to public limited company status, following a process similar to that undertaken by Abbey National in 1989. Under the terms of the Irish Building Society Act 1989 no single entity can acquire more than 15% of the shares of Irish Permanent plc until five years has elapsed since the conversion date. Furthermore, no more than 10% of the shares may be acquired without the consent of the Central Bank of Ireland. Abbey National intends to maintain a long-term investment in Irish Permanent plc and is reviewing with Irish Permanent plc areas for cooperation which would be of potential benefit to both parties.

Other Operations

Abbey National Independent Financial Advisers Ltd.

Abbey National Independent Financial Advisers Limited ("ANIFA") provides independent financial advice on a wide range of financial products and services to clients in their own homes and work places.

ANIFA acquired GM Benefit Consulting Group Limited from Guiness Mahon Holdings plc in July 1994. The benefit consulting division of ANIFA incorporates pension fund administration, actuarial consulting, healthcare consulting and share scheme advice.

Abbey National Homes Ltd.

Abbey National Homes Ltd. was established in 1986 to build residential housing. It has not taken on any additional housing development commitments since mid-1990 and does not intend to take any on in the future due to difficulties experienced in the market during the late 1980s.

Abbey National Property Services Ltd.

Abbey National Property Services Ltd. does business as J Trevor & Webster, a commercial estate agency.

Abbey National Investments Holdings Ltd.

Abbey National Investments Holdings Ltd. holds a portfolio of investment assets, primarily structured debt securities, with an approximate value of £1.6 billion as at December 31, 1994. As at June 30, 1995, the approximate value of these assets had reduced to £0.4 billion, as a result of counterparties exercising early redemption rights. The securities, which are held for the longer term, are supported by letters of credit from financial institutions which are rated at least A− (or the equivalent) by one or more rating organisations.

Travellers Exchange Corporation PLC

Abbey National has a 33 per cent, equity shareholding in Travellers Exchange Corporation PLC, the principal activity of which is the operation of bureaux de change and the provision of travel-related financial services via a network which spans the UK, USA, Australia, New Zealand and mainland Europe.

Description of Properties

The property interests of the Group at December 31, 1994 consisted of the following:

	Freehold	Leasehold	Total
U.K. Retail Banking branches	321	421	742
Mortgage administration centres	—	41	41
Cheque account administration centres	—	9	9
Scottish Mutual offices	1	10	11
Continental Europe	2	37	39
Commercial estate agency offices	1	15	16
ANIFA branches	—	15	15
HMC	—	4	4
Abbey National Mortgage Finance plc	—	1	1
Head office and other administration sites	9	27	36
Other sites	3	49	52
Total	337	629	966

The main head office sites and computer buildings are freehold properties. The Group's leasehold properties are subject to leases ranging from 1 to 999 years in maturity with the majority being 25 years in duration and subject to rolling five-year rent reviews. The Group currently has a number of retail property interests either in the course of development or disposal as part of the continuing branch development programme, which are included above. The majority of Abbey National's U.K. retail branches are located in the south of England, with the highest proportion located in and around London.

COMPETITION

Abbey National experiences substantial competition in its major markets, including making residential mortgage loans and attracting and retaining retail deposits in the United Kingdom.

Industry Consolidation

In recent years, the building society sector has been consolidating, with the number of building societies falling from 273 in 1980 to 81 in May 1995. In 1995, Lloyds Bank plc completed its acquisition of Cheltenham & Gloucester Building Society and TSB Bank plc. Also in 1995, the Halifax Building Society and Leeds Permanent Building Society merged and intend to convert subsequently to public limited company status, subject to approval by voting members under buildings societies' legislation. In 1996 the Woolwich Building Society and the Alliance & Leicester Building Society similarly announced their respective intentions to convert to public limited company status, subject to the same approval. The process of consolidation may increase as more building societies merge with each other and as other institutions show interest in acquiring building societies.

Her Majesty's Treasury has undertaken a review of the powers of building societies under the Building Societies Act. The results of the first stage of the review, which were announced in July 1994, included several proposals. As a result of the review, the ceiling on the proportion of funds that building societies may raise on the wholesale money market was raised from 40% to 50% with effect from January 1996. The results of the second stage of the review were announced in February 1995. Her Majesty's Treasury proposed that, in future, building societies will be able to pursue any activities allowed by their own constitutive documents, subject to pursuing an appropriate principal purpose (primarily the provision of housing finance funded substantially by the savings of its members). As a result, broader powers have been adopted.

Management does not expect this to have a major impact on the U.K. residential mortgage loan market. The increase in the wholesale funding limit applies, as a practical matter, only to those building societies which the Building Societies Commission believes have sufficient expertise to manage the risks involved. In addition, only the strongest and largest building societies have credit ratings sufficient to enable them to effectively enter the wholesale markets.

Residential Mortgages

The table below sets forth information for the last five years concerning the shares of the U.K. mortgage market (in terms of total outstanding mortgage balances) held by building societies, banks and Abbey National. Information on Abbey National is presented separately in the table for all periods; amounts and percentages shown for building societies and for banks exclude amounts and percentages relating to Abbey National.

Building Society, Bank and Abbey National Shares of the U.K. Residential Mortgage Market

	Total mortgage balances (1)	Building societies' share of mortgage balances (1)	Banks' share of mortgage balances (1)	Abbey National's share of mortgage balances (1)
	(billions of £)	(%)	(%)	(%)
1990	294.1	59.8	17.6	11.6
1991	320.0	61.5	16.5	11.8
1992	339.1	62.3	16.6	11.9
1993	356.3	61.5	18.3	12.2
1994	374.3	61.3	19.0	12.4

(1) Market share percentages have been derived by aggregating the amounts of building societies', banks', Abbey National's and other financial institutions' mortgage balances to produce the "Total Mortgage Balances" amounts, and by dividing the applicable amounts of mortgage balances by the "Total Mortgage Balances" amount. The source of mortgage balance amounts is the Council of Mortgage Lenders (using information based upon Bank of England data), except for information regarding Abbey National's mortgage balances which are taken from Abbey National's own data. Market size amounts are subject to revision by statistical authorities.

In the United Kingdom residential mortgage lending market, building societies have traditionally been Abbey National's principal key competitors. Significant competition has also come from banks and, to a much lesser extent, specialist wholesale funded lenders and local authorities. Abbey National is the second largest provider of residential mortgage loans in the United Kingdom; Abbey National's main competitor is the United Kingdom's largest building society, the Halifax Building Society. In 1994 Abbey National and the Halifax Building Society held approximately 28% of total U.K. residential mortgage loans.

Historically, mortgage lending in the United Kingdom has been predominantly made at floating rates of interest; however, during 1993 over 50% of new mortgage lending was made at fixed interest rates as a result of a significant reduction in interest rates. By the end of 1994, fixed-rate loans accounted for approximately 20% of all loans outstanding. With interest rates at historically low levels, Abbey National was able to price mortgages competitively due to its wider access to the wholesale markets. This had the effect of reducing building societies' share of the mortgage market. However, during 1994, the trend towards fixed-rate mortgages reversed, due to the increase in the cost of borrowing for two to five years. Management believes that Abbey National, with access to both the wholesale and retail liability markets, is well positioned to respond to such changes in customer demand.

Liquid Savings

Building societies', banks' and National Savings' shares of the U.K. liquid savings market for the past five years are set forth in the following table. National Savings is a U.K. Government sponsored savings and investment product distributed to individuals through the U.K. Post Office. Abbey National is included in the table as a building society, and in addition is shown separately, for all years.

Building Society, Bank, National Savings and Abbey National Shares of the U.K. Liquid Savings Market

	Total U.K. liquid savings (1)	Building societies' share of total U.K. liquid savings (1)	Banks' share of total U.K. liquid savings (1)	National Savings' share of total U.K. liquid savings (1)	Abbey National's share of total U.K. liquid savings (1)
	(billions of £)	(%)	(%)	(%)	(%)
1990 . . .	350.6	53.7	36.1	10.1	8.5
1991 . . .	375.5	55.4	34.5	10.0	8.6
1992 . . .	396.9	55.3	33.7	11.0	8.4
1993 . . .	413.3	56.3	32.4	11.3	8.4
1994 . . .	430.1	56.9	31.2	11.9	8.6

(1) Market share percentages have been derived by aggregating the amounts of building societies' savings, banks' deposits, National Savings issues and Abbey National's deposits to produce the "Total U.K. Liquid Savings" balance, and by dividing the applicable amount of savings or deposits by the "Total U.K. Liquid Savings" balance. Sources of amounts of savings and deposits are: for amounts of building societies' savings, the Handbook of the Building Societies Association (an industry trade organisation); for amounts of banks' deposits and National Savings issues, the CSO of Her Majesty's Government; and for amounts of Abbey National's deposits, Abbey National's own data. Market size amounts are subject to revision by statistical authorities.

As a result of rising U.K. interest rates, a reduction in the U.K. Government's public sector borrowing needs and a lack of demand for deposits to fund retail mortgage lending, the management of Abbey National does not believe that the demand for retail funds is as strong as it was in previous years. However, due to increasing consumer awareness, retail deposits increasingly compete with equity-based savings products such as unit trusts and life insurance and pension products.

Life Insurance Operations

In the United Kingdom, the life insurance industry has been dominated by a large number of mutual insurance organisations, who distribute a range of products through banks, building societies, direct sales forces and a large network of independent financial advisers. In recent years, the entry of building societies and banks into the market as manufacturers, as well as distributors, has reduced this dominance. The life insurance market has grown significantly over the last decade, with total industry new business premiums increasing threefold over this period. Regulations requiring increased disclosure of the costs associated with selling life insurance and pensions products were adopted on January 1, 1995. By providing greater detail to customers as to how much of their premiums are absorbed by costs, this may reduce demand for these products. Management expects that, over the longer term, this market will continue to grow, aided by demographic trends, and that it will become increasingly competitive.

MONETARY AND FISCAL POLICIES

Monetary and Fiscal Policies

The profitability and operations of U.K. banks, including Abbey National, are affected significantly by monetary and fiscal policies. The Bank of England, the government-owned central bank, influences conditions in the money and credit markets, which affect the growth in lendings, the distribution of lending between various industry sectors, interest rates and the growth of deposits. In this regard, banks in the United Kingdom are required to maintain, in non-interest bearing accounts at the Bank of England, a non-operational cash balance of 0.35% of eligible liabilities, which are sterling deposits less amounts on loan to other approved monetary institutions.

Abbey National's earnings are influenced by general domestic and overseas economic conditions and by the monetary and fiscal policies of the U.K. Government and the U.K. regulatory framework. Likewise, the monetary and fiscal policies of governments in countries in which Abbey National operates influence the operations and profitability of the Group in those countries. Accurate prediction of the effects of these policies on future lending volumes and earnings is, as yet, impossible.

Exchange Rate Mechanism and European Monetary Union

After turbulence in the currency markets in the summer of 1992, the United Kingdom and Italy withdrew from the European Community Exchange Rate Mechanism and some members of the European Community devalued their currencies within the Exchange Rate Mechanism. In August 1993, after further turbulence within the Exchange Rate Mechanism, the agreed bands within which exchange rates between member currencies can fluctuate were extended to plus or minus 15%, or an overall 30% band.

The U.K. Government has stated that sterling will only re-enter the Exchange Rate Mechanism under the appropriate conditions and not before May 1997.

Under the provisions of the treaty negotiated at Maastricht in 1991, the proposed founding of a European Monetary Union is planned to replace the Exchange Rate Mechanism. European Monetary Union involves the creation of a single currency which will be managed by a single European Central Bank. After final ratification by the member states, the Maastricht treaty came into force on November 1, 1993. Stage II of the treaty started on January 1, 1994, the principal feature of which was the creation of the European Monetary Institute. The European Monetary Institute is responsible for technical preparations for the final stage of European Monetary Union (in particular the instruments, procedures and rules needed to move to a single currency), as well as strengthening co-operation and co-ordination among the monetary authorities of member states and monitoring the functioning of the European Monetary System. Other responsibilities include assisting the use of the European Currency Unit, including the smooth functioning of the European Currency Unit clearing system. The European Monetary Institute is empowered to make recommendations on monetary policy.

The last stage of European Monetary Union is planned to be completed by 1999. This last stage will commence with the locking of exchange rates between those countries which comply with the stringent economic convergence criteria (relating to inflation, interest rates, exchange rate stability and public sector debts) in time for 1999. It is intended that the European Currency Unit eventually will replace national currencies.

The establishment of the European Monetary Union will have significant effects on foreign exchange and bond markets and would involve major modification of operations and systems internal to banks and in inter-bank payments systems. It is probable that it also would require the development of a common approach towards banking supervision among the member countries. It is impossible presently to state when or if the United Kingdom would join such a union.

SUPERVISION AND REGULATION

Substantially all U.K. companies are governed by the provisions of the Companies Acts. This legislation governs, for example, constitutional issues and matters such as company registration and the format and production of annual reports and accounts.

Many U.K. companies are also subject to further legislative regimes which require them to obtain authorisation and be supervised for certain activities or which regulate the way in which certain types of business are conducted.

The principal legislation concerning regulation of banks in the United Kingdom is the Banking Act 1987. Except for European institutions, which are credit institutions and certain of their subsidiaries incorporated and authorised in European Economic Area ("EEA") states other than the United Kingdom, the Banking Act prohibits any person in the United Kingdom from accepting a deposit for the purposes of a deposit taking business without prior authorisation from the Bank of England and also provides that the Bank of England is responsible for the supervision of persons authorised by it. European institutions are not authorised by the Bank of England and responsibility for their prudential supervision generally rests with the authorities in their home member state. The Bank of England does, however, have certain powers over their activities in the United Kingdom, and a responsibility (in co-operation with the home member state authorities) to supervise the liquidity of United Kingdom branches of such institutions. The Bank of England may not grant an application for authorisation under the Banking Act unless it is satisfied that certain criteria specified in the Banking Act have been met including, *inter alia*, that (i) every person who is, or is to be, a director, controller or manager of the institution is a fit and proper person to hold the particular position which he holds or is to hold; (ii) the institution conducts its business in a prudent manner; (iii) the business of the institution will be carried on with integrity and the professional skills appropriate to the nature and scale of its activities; (iv) the institution has a certain minimum level of initial capital and its own funds. ANTS and Abbey National are both institutions authorised, and accordingly supervised, by the Bank of England under the Banking Act.

Under the Banking Act, the Bank of England is required to establish a Board of Banking Supervision consisting of the Governor of the Bank of England, the Deputy Governor of the Bank of England and the executive director of the Bank of England for the time being responsible for the supervision of institutions authorised under the Banking Act and six independent members appointed jointly by the Chancellor of the Exchequer and the Governor of the Bank of England. Under the terms of the Banking Act, it is the duty of the independent members to advise the other three members with respect to the exercise by the Bank of England of its functions under the Banking Act. Under the Banking Act, the Bank of England is empowered under certain circumstances (principally when the authorisation of an institution is to be revoked or if the institution has served notice surrendering its authorisation or if a restricted authorisation has expired) to give such directions as appear to the Bank of England to be desirable in the interests of the institution's depositors or potential depositors, whether for the purpose of safeguarding its assets or otherwise, and may in particular require the institution to take certain steps or to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way, impose limitations on the acceptance of deposits, the granting of credit or the making of investments, prohibit the institution from soliciting deposits or from entering into any other transaction, or require the removal of any director, controller or manager. In addition, under the Bank of England Act 1946, the Bank of England is, subject to certain limitations, empowered to request information from and make recommendations to bankers and may also, if so authorised by Her Majesty's Treasury, issue directions to any banker for the purpose of securing that effect is given to any such request or recommendation. As part of its supervisory role, the Bank of England sets standards, limits and ratios for the banks under its supervision. Each bank is required to submit regular reports to the Bank of England, thus providing material for supervisory assessment. The Banking Act also permits the Bank of England to require an authorised institution to provide the Bank of England with a report from reporting accountants as to any matter about which the Bank of England requires institutions to provide information (such as the accuracy of accounting records and prudential returns and the adequacy of internal controls). Senior management of banks also meet regularly with the Bank of England to discuss relevant issues such as risk control, loan portfolio composition, profitability, capital adequacy and liquidity, organisational changes and operating practices. Whereas, traditionally, the

Bank of England's supervision of banks has been based on a system of informal co-operation, such supervision is now more formalised with specific requirements and guidance, drawn up by the Bank of England in consultation with the banks, relating to, *inter alia*, capital adequacy, liquidity and foreign currency exposure, large exposures to counterparties, the adequacy of accounting procedures and controls, advertising, the Bank of England's relationship with bank auditors, loan transfers and securitisation of loans, netting and cash collateral and the application of consolidated supervision. In September 1995 the Post-BCCI Directive was published at the EU level and is to be implemented within the next twelve months. The aim of this directive is to strengthen the surveillance of financial institutions.

Banks are required to maintain in interest-free accounts at the Bank of England a non-operational cash balance of 0.35% of eligible liabilities (primarily sterling deposits less loans to and securities issued by other United Kingdom monetary institutions). From time to time in the past, banks have also been required to make special deposits with the Bank of England to reduce excess liquidity, although no such deposits have been called for in recent years.

An authorised institution, such as Abbey National or ANTS, is required, as part of the requirement to report large exposures, to make a report to the Bank of England if it has entered into a transaction or transactions relating to any one counterparty (including any counterparty related to that counterparty), as a result of which it is exposed to the risk of incurring losses in excess of 10% of its capital. In general, an authorised institution may not enter into a transaction which would result in an exposure to an individual counterparty (including counterparties related to that counterparty) exceeding 25% of capital. In very limited circumstances the Bank of England may allow such limits to be exceeded. The aggregate of all exposures exceeding 10% of capital must not exceed 800% of capital. The Bank of England has statutory powers to object to persons who are or who intend to become controllers of 10% or more of the voting power of an authorised institution. The Bank of England also has the right to object to increased control at thresholds of 20%, 33%, 50% and 75% of the voting power of the authorised institution. The Bank of England may give notice of such objection unless it is satisfied (a) that the person concerned is a fit and proper person to become a controller of the institution, (b) that the interests of depositors and potential depositors of the institution would not be in any other manner threatened by that person becoming a controller of the institution and (c) broadly, that the institution would continue to be able to fulfill the criteria necessary to be fulfilled in order for that institution to be authorised under the Banking Act. The Bank of England may also serve a notice of objection if it is directed to do so by Her Majesty's Treasury, which may so direct if it appears to Her Majesty's Treasury that, after such a person had become such a controller, Her Majesty's Treasury would be entitled under the Financial Services Act to serve notice cancelling any authorisation of the institution concerned under the Banking Act or restricting the business which such institution may carry on. Her Majesty's Treasury is, broadly, empowered to serve such a notice if it is satisfied, by reason of laws of any country outside the United Kingdom or the action or practices of the government of such a country, that persons connected with the United Kingdom are unable to carry on investment, insurance or banking business in that country on terms as favourable as those on which persons connected with that country are able to carry on any such business in the United Kingdom.

Deposit compensation under the statutory deposit protection scheme is available to depositors. Depositors with a failed institution will receive 90% of their protected deposits from the Deposit Protection Fund. A protected deposit is a deposit in one of the currencies of the EEA states or ECU which is limited to a maximum amount of £20,000 or the sterling equivalent of ECU 22,222 (whichever is the greater), including both principal and accrued interest.

Code of Banking Practice. The voluntary Code of Banking Practice agreed by U.K. banks, building societies and card issuers took effect in March 1992 and the second edition came into effect on March 28, 1994. Abbey National has adopted the Code of Banking Practice, which sets out the standards of good banking practice to be observed by Abbey National when dealing with customers in the United Kingdom. The Code of Banking Practice covers, inter alia, the use of confidential information, losses arising from the misuse of payment and credit cards and the handling of customer complaints. Abbey National has implemented the terms of the second edition of this Code as a matter of good practice.

Building Societies

Until its conversion in 1989, Abbey National was a building society regulated by the Building Societies Act 1986. Building societies are primarily mortgage lenders and deposit-takers and are supervised by the Building Societies Commission. Although the role of the latter body is, principally, similar to that of the Bank of England, the Building Societies Act is more restrictive in terms of overseeing the prescription of the types of activities which may be carried on and the sources of funding that can be used.

Insurance

U.K. banks may provide other complementary financial services such as insurance, through subsidiary companies. Insurance business in the United Kingdom is divided into two categories: long-term life insurance (investment-related) and general insurance (which includes, for example, buildings and contents cover). Insurance business in the United Kingdom is regulated under the Insurance Companies Act 1982 which requires insurers to be authorised and supervised by the Department of Trade and Industry.

General insurance is more lightly regulated than long-term life insurance. Abbey National currently acts, in relation to building and contents insurance, as a broker for U.K. companies, receiving commissions for the policies arranged. The sale of such policies is governed by a voluntary code to which Abbey National conforms formulated by the Association of British Insurers, a trade body composed of the insurance companies.

The marketing and sale of most long-term life insurance (other than some term life assurance) is governed under the provisions of the Financial Services Act. See "Financial Services Act 1986" below.

Policyholders' Protection Act 1975. This Act resulted from public anxiety over the failure of a few small insurance companies in the early 1970s. Its aim is to protect policyholders who have been, or may be, prejudiced by the inability of U.K. authorised insurance companies to meet their liabilities. The act established the Policyholders' Protection Board to accomplish this task. Protection is only given to persons holding policies issued by an authorised insurer. The Policyholders' Protection Board has a statutory duty to protect policyholders when an insurance company is being compulsorily or voluntarily wound up.

As well as its duties in the case of a company in liquidation, the Policyholders' Protection Board also has powers to protect policyholders of a company in financial difficulties. Under these provisions, the Policyholders' Protection Board can help prevent a failure by assisting the company with a cash injection, or by arranging a transfer of business to a more stable office. In the case of business where the benefits are excessive, the assistance provided can be scaled down to an appropriate level. The Policyholders' Protection Board may also make interim payments to a company in financial difficulties.

The life insurance industry also needs to comply with other legislation, regulation, ombudsmen and codes of practice which are not discussed here.

Financial Services Act 1986

Investment business in the United Kingdom is regulated under the provisions of the Financial Services Act. Under the Financial Services Act, it is a criminal offence for any person to carry on investment business in the United Kingdom unless he is an authorised person or exempted person for the purpose of the Financial Services Act. The Financial Services Act requires that firms involved in "investment business" (which includes buying, selling, subscribing for or underwriting investments; arranging deals in investments; managing investments belonging to another person; giving investment advice; or establishing, operating or winding-up a collective investment scheme relating to defined investments such as equities, gilts, debentures (e.g. certificates of deposit, commercial paper, Eurobonds, loan stock), options, warrants, futures, contracts for differences, unit trusts and long-term insurance contracts) become authorised and then conform to rules relating to the conduct of business unless certain exemptions apply. Authorisation is granted either by the Securities and Investments Board, to whom responsibility for supervising investment business has been delegated by Her Majesty's Treasury, or by one of the "Self Regulating Organisations" recognised by the Securities and Investments Board ("SIB") under the Financial Services Act.

Certain persons will be classified as "exempted persons" for the purposes of the Financial Services Act. Both "listed money market institutions" (essentially banks operating in the wholesale markets) and tied "appointed representatives" whose authorised principals have accepted responsibility in writing for their activities are at present exempted persons. However, listed money market institutions will only be exempted persons in respect of their money market activities (not other investment business for which authorisation would be required), while appointed representatives will only be exempted persons as regards the tied investment business for which their principal has accepted responsibility. From the beginning of 1996 (in order to comply with ISD), listed money market institutions will instead be authorised under the Financial Services Act by the Bank of England, but this will not result in any change of substance.

Authorisation will allow the firm to carry on investment business but will mean that the firm must comply with, *inter alia*, the detailed Conduct of Business Rules of the Securities and Investments Board or the rules of the Self Regulating Organisation by which it is authorised. In addition to the Conduct of Business Rules, a firm will also have to observe various statutory obligations imposed by the Financial Services Act when carrying out investment business. These regulate, for example, the issue of investment advertisements in, or directed at, the United Kingdom, the making of unsolicited calls to potential clients, and the prohibition on misleading statements or practices which may induce others to enter into investment agreements. The Conduct of Business rules impose important obligations on authorised firms undertaking investment business, giving varying levels of protection for the benefit of a firm's clients. The Securities and Investments Board and Self Regulating Organisations also will monitor the financial resources of the firm and its compliance with requirements for record keeping, reporting and safeguards against insider dealing and money laundering.

The Investment Services Directive (the "ISD") and the Capital Adequacy Directive, EU directives which are aimed at creating a single financial services market in the EU, came into force on January 1, 1996. These required a number of changes to be made to the U.K. regulatory regime for financial services, including capital adequacy requirements, and to the types of activities requiring authorisation. One aim of the ISD is to confer a "passport" on firms authorised in one EU state to carry on investment business in other EU states. CAD sets minimum capital requirements for market risks in the trading books of banks and investment firms.

ANTS has been granted listed money market institution status by the Bank of England to carry on its wholesale money market activities. Although, as an "exempted person," it is free of many of the restrictions under the Financial Services Act, the Bank of England expects it to observe the "London Code of Conduct" and other regulations contained in "The Regulation of the Wholesale Markets in Sterling, Foreign Exchange and Bullion" (the so-called "Grey Book") issued by the Bank of England to regulate the operation of the wholesale money markets. A revised edition of the London Code of Conduct has been published recently incorporating changes necessary to meet the standards under ISD. ANTS has obtained direct authorisation from the SIB for its investment business activities which fall outside its wholesale money market activities. As the SIB is withdrawing from direct regulation of individual companies, ANTS has applied to be regulated by the SFA. The regulation of ANTS by the SFA commenced on October 1, 1995.

A new regulatory body, the Personal Investment Authority ("PIA"), came into effect on July 18, 1994. Its role is to regulate those companies involved in marketing and selling retail investment products. It is in the process of replacing the Life Assurance and Unit Trust Regulatory Organisation and the Financial Intermediaries, Managers and Brokers Regulatory Association in this respect and has or will also take on the regulatory function for most of the companies previously authorised by the Securities and Investments Board in respect of retail investment products.

- The PIA is the direct regulator of Abbey National Life in respect of marketing and sales of life insurance and pensions. The PIA and the Investment Management Regulatory Organisation ("IMRO") regulate ANUTM in respect of the management, marketing and sale of unit trust and PEP products. Abbey National acts as a "marketing associate," which sells only the life insurance and pensions of Abbey National Life and the unit trust PEP products of ANUTM. Abbey National's investment business activities, including those where it acts as a marketing associate, are regulated by the PIA. The PIA also regulates ANIFA, which operates as an "independent financial adviser," selling products of companies other than Group companies to Abbey National branch customers who wish to obtain independent advice as well as individuals who can be identified through ANIFA's own marketing programmes.

- The PIA regulates the sales and marketing activities of Scottish Mutual and its subsidiaries. Scottish Mutual markets its life insurance products solely through independent intermediaries. This business is run as an independent marketing group. This means that the strategic marketing and investment direction of Scottish Mutual and its subsidiaries is separate and wholly independent from that of Abbey National Life.
- IMRO regulates investment management business, both regarding unit trusts and for other portfolio purposes. Scottish Mutual Investment Managers Ltd. and Scottish Mutual Portfolio Managers are regulated by IMRO.

With effect from January 1995, Life Insurance Operations has adopted a new commission and product disclosure regime following the imposition of stricter disclosure requirements by regulators. The disclosure regime will involve a greater degree of generic product detail being disclosed to customers, as well as disclosure of customer-specific details of surrender values, commissions earned by the policy provider or costs incurred by the provider in selling the policy and the effect of charges and commissions on the expected yield under the policy.

The impact of this new disclosure regime is difficult to assess at this time. Disclosure of selling commissions and costs on life insurance and pension products may result in unfavourable comparisons with the returns available from other longer-term savings products, possibly reducing industry-wide demand. However, Abbey National's cost per unit, which is required to be disclosed under the new regime, may compare favourably with that of its competitors' disclosed cost per unit. At the present time, the Group's management does not expect the adoption of this new disclosure regime to have a material impact on the Group's results of operations.

Other Legislation

The Consumer Credit Act 1974 regulates both brokerage and lending activities in the provision of personal secured and unsecured lending. The Data Protection Act 1986 regulates the retention and use of data held on computer relating to individual customers. The Unfair Terms in Consumer Contracts Regulations 1994 came into force in July 1995. These Regulations apply to contracts for goods and services entered into with consumers. The main effect of the Regulations is that a contractual term covered by the Regulations which is "unfair" will not be enforceable against a consumer. These Regulations apply, *inter alia*, to mortgages and related products and services.

Cadbury Code of Best Practice

The Abbey National Group complies with the Code of Best Practice issued by the Cadbury Committee on the Financial Aspects of Corporate Governance.

CONTROLLING INTERESTS

As at February 7, 1996, Abbey National did not know, and had not been notified of any interest in the register maintained under Section 211 of the Companies Act, of any person who, directly or indirectly was interested in 3% or more of the share capital of Abbey National.

The following table sets forth the aggregate shareholdings, as at December 31, 1994, of the directors and executive officers of Abbey National as a group.

Title of Class	Owner	Number Owned	% of Class
Ordinary shares of nominal value 10p each	Directors and executive officers of Abbey National	204,793	0.02

The following table sets forth, as at February 7, 1996, the beneficial interests relating to securities which have been notified by each director of Abbey National pursuant to Sections 324 or 328 of the Companies Act and which are entered in the register required to be kept by Abbey National pursuant to Section 325 of that Act.

Owner	Ordinary shares of nominal value 10p each	Owner	Ordinary shares of nominal value 10p each
Lord Tugendhat	10,000	Mair Barnes	1,000
Peter Birch	313,539	Allan Denholm	3,000
John Fry	10,572	Sir Terry Heiser	1,500
Ian Harley	20,501	Martin Llowarch	1,750
Gareth Jones	70,910	Peter Ogden	4,000
Robert Knighton	14,300	Lord Rockley	5,000
Charles Toner	20,160	James Tuckey	12,000
Charles Villiers	26,657		

MANAGEMENT

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

Name	Current position	Principal external directorships	Year appointed(1)
Lord Tugendhat	Chairman (since 1991)	Director, BOC Group plc Director, Eurotunnel plc Director, Blue Circle Industries PLC	1991
Executive Directors			
Peter Gibbs Birch, C.B.E., F.C.I.B.	Chief Executive (since 1984)	Director, Argos plc Director, Dalgety PLC	1984
John Marshall Fry, F.C.I.S., F.C.I.B.	Deputy Chairman (since 1 January 1995)		1984
Ian Harley, F.C.A.	Finance Director (since 1993)		1993
David Gareth Jones, F.C.A., F.C.T.	Treasurer (since 1993)		1993
Robert Frank Knighton	Managing Director, Operations Division (since 1993)		1993
Charles Gerard Toner	Managing Director, Retail Division (since 1993)		1992
Charles Nigel Villiers, F.C.A.	Managing Director, Corporate Development (since 1989)		1989
Non-executive Directors			
Mair Barnes		Director, Fosters Trading Company Limited Executive Chairman, Oceanhaven Limited	1992
James Allan Denholm, C.B.E., C.A.		Director, William Grant & Sons Ltd	1992
Sir Terence Michael Heiser, G.C.B.		Director, J Sainsbury plc Director, Wessex Water plc Director, McDonnell Information Systems Group plc Director, Costain Group PLC Director, Personal Investment Authority	1992
Martin Edge Llowarch, F.C.A.	Deputy Chairman (since 1994)	Chairman, Transport Development Group plc Chairman, Firth Rixson plc Director, Hickson International plc	1989
Peter James Ogden		Chairman, Computacenter Ltd Director, Anglo & Overseas Trust PLC Director, MC & Cie Ltd.	1994
Lord Rockley		Chairman, Kleinwort Benson Group plc Director, Christies' International plc Director, The Foreign and Colonial Investment Trust PLC Director, Cobham plc	1990
James Lane Tuckey, F.R.I.C.S.		Chief Executive, MEPC plc	1990
Company Secretary of Abbey National			
Ian Kinsman Treacy			1991
Executive Officer of Abbey National			
John King	Director of Human Resources		1992

(1) If the dates of appointment to the Board are before July 12, 1989, then these dates refer to appointments to the Board of Abbey National Building Society. All those directors concerned were appointed to the Board of Abbey National plc on February 28, 1989.

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

Committees of Directors

The Board of Abbey National is composed of a part-time Chairman, seven executive directors and seven non-executive directors. The Board met on 12 occasions during 1994, including a session devoted to long-term strategic planning. The Board's focus is on strategy formulation, policy and control and a framework of high level authorities is in place which maps out the structure of delegation below Board level as well as specifying those authorities which remain within the Board's preserve. The Board has developed a series of policies covering liquidity risk, credit risk and total market risks, including foreign exchange and interest rate risk.

There is an Audit Committee comprised wholly of non-executive directors, which met five times during 1994 and is chaired by J. Allan Denholm. Its principal tasks are to review the scope of external and internal audit; to receive regular reports from Coopers & Lybrand and the chief internal auditor; and, to review the interim results and annual report and accounts before they are presented to the Board focusing, in particular, on accounting policies and compliance and areas of management judgment and estimates. The Audit Committee more generally acts as a forum for discussion of internal control issues.

The Personnel and Remuneration Committee (formerly known as the Personnel Policy Committee) is now chaired by Martin E. Llowarch who is joined by three non-executive directors. This committee's principal function is to monitor the human resources policies adopted to ensure they support the business objectives and philosophy determined by the Board. It is also charged with recommending the remuneration package of executive directors. The final decision on such matters is taken by all the non-executive directors of the Board.

Directors' Liability Insurance

The Group maintains insurance cover for directors' and officers' liability, as permitted by Section 310(3) of the Companies Act 1985.

Remuneration

Non-executive directors of Abbey National (including the Chairman and Martin E. Llowarch, Deputy Chairman) receive fees for their services. The basic fee for non-executive directors of £17,500 is augmented by £2,500 for service on Board committees. The remuneration arrangements for executive directors and executive officers are as follows:

a. Basic salary is considered in relation to similar jobs in comparable organisations. The comparators include U.K. banks, building societies, insurance companies and retailers and other U.K. companies with an equivalent market capitalisation to Abbey National.

b. The basic system of discretionary performance payments was revised during 1994, and now comprises a bonus scheme based on annual performance which pays out in March 1995 and a three-year scheme which covers the period from 1994 to 1996 and may pay out in March 1997. The maximum potential payment to be shared among the executive directors and other members of the top management for both the annual scheme and the three-year scheme is 30% of that group's basic salary. Such payments are not pensionable.

   The actual level of any payment under the annual bonus scheme is determined by the Board's view of the Group's performance set against the Chief Executive's objectives.

   In determining whether or not to make a payment in 1997 under the three-year bonus scheme (covering the period from 1994 to 1996), and if so its size, the Board will be guided by a formula which will have two equally weighted components: (i) an assessment of total shareholder returns over the period 1994 to 1996 measured by two sets of indices, the Financial Times Stock Exchange 100 index (the "FTSE 100") and certain specific sectors of that index and (ii) progress against the Company's Three Year Plan 1994-1996 including a comparison with the performance of competitors not included in the FTSE 100.

In addition, the full complement of non-executive directors may in exceptional circumstances make a one-off ex-gratia payment to an individual executive director who has rendered a particular and outstanding contribution.

c. An Executive Share Option scheme and an Employee Sharesave scheme, both of which have been approved by the shareholders. Grants of Executive Share Options are made on the recommendation of the Personnel and Remuneration Committee and reflect both corporate and individual performance.

d. Taxable benefits include car expenses, medical expenses plus subsidised mortgage loans.

The Sharesave Scheme, under which options have been issued annually, is open to all eligible Group employees. For more detailed information about directors' emoluments and share options, see Note 8 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

The aggregate remuneration of all directors and executive officers of Abbey National as a group in the year ended December 31, 1994 was £3,030,000. See Note 8 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum for information on directors' emoluments. The aggregate amount set aside or accrued by the Group for pension, retirement and similar benefits for all directors and executive officers of Abbey National as a group in the year ended December 31, 1994 was £366,000. Abbey National resumed funding of its principal pension scheme in late 1993, after a contribution "holiday" of several years. See Note 45 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum. At June 30, 1995, directors and executive officers of Abbey National as a group held options to purchase 1,833,457 ordinary shares of Abbey National at prices ranging from £1.49 to £3.22 under the Sharesave Scheme and from £2.54 to £4.68 under the Executive Share Option Scheme, exercisable in the period from 1995 to 2005.

Terms of Office of Directors

One-third (or the whole number nearest to one-third) of the directors of Abbey National are required to retire by rotation at each Annual General Meeting, together with directors newly appointed since the previous Annual General Meeting in accordance with power given to the Board. The directors retiring by rotation and the newly appointed Directors are eligible to stand for re-election.

Interests of Directors and Officers

In 1994, loans made by the Group to 11 directors and 48 officers (including executive officers) of the Group were outstanding with principal amounts of £1,205,000 and £4,427,000 respectively. See Note 8 to the Consolidated Financial Statements included elsewhere in this Listing Memorandum.

In 1994 there were no other transactions, arrangements or agreements with Abbey National or its subsidiaries in which directors or executive officers or persons connected with them had a material interest, other than options to subscribe for ordinary shares under the Abbey National Executive Share Option Scheme and the Abbey National Sharesave Scheme. No director had a material interest in any contract of significance other than a service contract with the Group, or any of its subsidiaries, at any time during the year. All executive directors have a service contract whereby Abbey National is required to give them 12 months' notice to sever their employment contract.

UNITED KINGDOM TAXATION

The summary below reflects certain aspects of current law and practice in the United Kingdom and may not apply to certain classes of person (such as dealers). Prospective holders who are in doubt as to their tax position or who may be subject to tax in any other jurisdiction should consult their professional advisers.

Dividends on the Sterling Preference Shares

(a) Cash Dividends

Under current United Kingdom taxation legislation, no withholding tax will be deducted from dividends paid by the Company but the Company is required to account for advance corporation tax ("ACT") when a dividend is paid. The current rate of ACT is ¼ of the cash dividend paid. An individual preference shareholder who is resident (for tax purposes) in the United Kingdom is entitled, in respect of any cash dividend received, to a tax credit which, at current rates, is equal to ¼ of the dividend paid. The individual will be liable to United Kingdom income tax (if at all) on the total of the dividend and the related tax credit at either the lower rate of income tax (currently 20 per cent.) or the higher rate (currently 40 per cent.) depending upon the individual shareholder's circumstances. The tax credit will satisfy in full the individual shareholder's liability to lower rate income tax on the dividend plus the tax credit. To the extent that the shareholder is liable to higher rate income tax, the tax payable on the dividend plus the tax credit will be at a rate equal to the excess of the higher rate over the lower rate (i.e. 20 per cent.). If the aggregate of the tax credit and any other income tax payments or credits exceeds the individual's overall liability to income tax, the tax credit may be refunded, in whole or in part, by the Inland Revenue.

A corporate preference shareholder which is resident (for tax purposes) in the United Kingdom and receives a dividend paid by the Company will be entitled to a tax credit in respect of that dividend. The shareholder will not be liable to United Kingdom corporation tax on any dividend received from the Company and the dividend and associated tax credit will generally represent franked investment income in the hands of such a shareholder. The value of the tax credit will be an amount equal to ¼ of the dividend.

Subject to certain exceptions for Commonwealth citizens, citizens of the Republic of Ireland and certain other classes of person, the right of a preference shareholder who is not resident (for tax purposes) in the United Kingdom to a tax credit in respect of a dividend received from the Company and to reclaim from the Inland Revenue any proportion of the tax credit relating to the dividend will depend, in general, upon the provisions of any double taxation agreement or convention which exists between the United Kingdom and the country in which the shareholder is resident. Any shareholder who is not resident in the United Kingdom should consult his own tax adviser concerning his tax liability on dividends received and on the question of the double taxation provisions (if any) applying between his country of residence and the United Kingdom.

If the Company were to pay a dividend out of non-U.K. source profits it could elect for such dividend to be treated as a "foreign income dividend" with the result that (i) the Company would have a reduced, or no, liability to pay ACT, and (ii) such dividend would not carry an associated U.K. tax credit. In calculating any further tax due from an individual shareholder who receives a "foreign income dividend" the shareholder would be treated as receiving income which has borne income tax at the lower rate of 20 per cent. There would be no further tax to pay by a shareholder who is liable to income tax on dividends at the lower rate and there would be no repayment of tax to a shareholder who is not liable to income tax.

A corporate shareholder would not be liable to United Kingdom corporation tax on any "foreign income dividend". If a company which receives "foreign income dividends" during an accounting period also pays "foreign income dividends" during that period, it has to pay ACT in respect of the "foreign income dividends" it pays only to the extent that they exceed the "foreign income dividends" received. If there is a surplus of "foreign income dividends" received over "foreign income dividends" paid, the surplus can be carried forward to the next period in which it can be used. It is not possible for "foreign income dividends" received to frank the liability to pay ACT on an ordinary dividend, nor is it possible for an ordinary dividend to frank the liability to pay ACT on a "foreign income dividend".

(b) Tax treatment of additional Sterling Preference shares issued in lieu of cash dividends

Where a U.K. resident individual shareholder receives additional Sterling Preference Shares in lieu of a dividend payment as provided in paragraph (g) under "Description of the Sterling Preference Shares — Dividends", he will be treated for U.K. income tax purposes as having received income of an amount which after deduction of income tax at the lower rate (currently 20 per cent.) equals the market value of the additional Sterling Preference Shares received as determined on the first day of dealings in them on the London Stock Exchange. Thus if the market value of the additional Sterling Preference Shares received by the shareholder at that date is £100, he will be treated as having received gross income of £125 on which income tax of £25 will be treated as having been paid.

U.K. resident individual shareholders who pay tax at the lower rate (currently 20 per cent.) or the basic rate (currently 25 per cent.) only will have no further tax to pay but to the extent that U.K. resident individual shareholders pay tax at the higher rate (currently 40 per cent.), they will be liable to pay additional tax by reference to the excess of the higher rate over the lower rate on the gross amount of income they are treated as having received. The market value of the additional Sterling Preference Shares received will be added to the base cost of the Sterling Preference Shares for the purposes of tax on capital gains.

No repayable tax credit attaches to the receipt of the additional Sterling Preference Shares and, accordingly, no amount can be reclaimed from the Inland Revenue by Shareholders who are exempt from tax, or whose liability is less than the lower or basic rate, or who are entitled to the benefit of any double tax treaty.

U.K. resident corporate shareholders will not be charged to U.K. tax on any additional Sterling Preference Shares, but will not have any amount added to their base cost of Sterling Preference Shares for the purposes of tax on capital gains.

Capital Gains Tax

For the purposes of the following paragraphs, references to "U.K. Holders" are to persons who are resident or ordinarily resident in the United Kingdom for tax purposes or who are not so resident but who at the relevant time carry on a trade, profession or vocation in the United Kingdom through a branch or agency to which the relevant Sterling Preference Share is attributable.

Disposal of Sterling Preference Shares

U.K. Holders of Sterling Preference Shares may, depending upon their individual circumstances, be liable to pay United Kingdom taxation on any gain realised on a disposal of all or any part of their holding of Sterling Preference Shares.

United Kingdom stamp duty or SDRT will generally be payable in respect of the transfer of, or agreement to transfer, the Sterling Preference Shares.

PLACING OF THE STERLING PREFERENCE SHARES

Merrill Lynch International Limited, Kleinwort Benson Limited, Barclays de Zoete Wedd Limited, HSBC Markets and SBC Warburg (the "Managers") have, pursuant to a Placing Agreement dated February 9, 1996 (the "Placing Agreement"), agreed, jointly and severally, with Abbey National to procure subscribers, failing which, to subscribe themselves, for the Sterling Preference Shares at the cash price of 108.935p per Sterling Preference Share, being a premium of 8.935p per Sterling Preference Share. Abbey National has also agreed to reimburse the Managers in connection with certain expenses of the issue. The Managers are entitled to terminate the Placing Agreement in certain circumstances prior to making payment to Abbey National for the Sterling Preference Shares. The placing of the Sterling Preference Shares (the "Placing") is conditional on the Sterling Preference Shares being admitted to the Official List by the London Stock Exchange, on such admission becoming effective not later than 9.00 a.m. on February 13, 1996 and on the Placing Agreement becoming unconditional in accordance with its terms.

The Placing Agreement contains certain representations, warranties, undertakings and indemnities given by Abbey National relating, inter alia, to the accuracy of the information contained in this document. The Managers may terminate the Placing Agreement in certain exceptional circumstances (including the occurrence of a force majeure event) prior to the admission to listing becoming effective.

Abbey National has agreed to pay to the Managers commissions amounting to one per cent. of the aggregate nominal amount of the Sterling Preference Shares. Abbey National will also pay to the Managers a sum equal to any stamp or other duties or taxes (if any) payable in connection with the Placing and any value added tax payable in connection with the commission payable in connection with or arising out of the Placing.

The Placing Price for the Sterling Preference Shares will be payable in cash net of the commissions referred to above on February 13, 1996. It is estimated that the cash proceeds (net of expenses) accruing to Abbey National from the Placing will amount to approximately £107,835,000.

The Preference Shares have not been and will not be registered under the U.S. Securities Act of 1933 (the "Securities Act") and may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Each Manager has agreed that, except as permitted by the Placing Agreement, it will not offer, sell or deliver Sterling Preference Shares, (i) as part of their distribution at any time, or (ii) otherwise until 40 days after the later of the commencement of the offering and the issue date, within the United States or to, or for the account or benefit of, U.S. persons, and it will have sent to each dealer to which it sells Sterling Preference Shares during the restricted period a confirmation or other notice setting forth the restrictions on offers and sales of Sterling Preference Shares, respectively, within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering, an offer or sale of the Sterling Preference Shares within the United States by any dealer (that is not participating in the offer) may violate the registration requirements of the Securities Act.

Each Manager has agreed that:

(i) it has not offered or sold and will not offer or sell any Sterling Preference Shares to persons in the United Kingdom prior to their admission to listing in accordance with Part IV of the Financial Services Act 1986 (the "Act") except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 or the Act;

(ii) it has complied and will comply with all applicable provisions of the Act with respect to anything done by it in relation to the Sterling Preference Shares in, from or otherwise involving the United Kingdom; and

(iii) it has only issued or passed on and will only issue or pass on in the United Kingdom any document received by it in connection with the placing of the Sterling Preference Shares, other than any document which consists of or any part of listing particulars, supplementary listing particulars or any other document required or permitted to be published by listing rules under Part IV of the FSA, to a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1995 or is a person to whom such document may otherwise lawfully be issued or passed on.

GENERAL INFORMATION

1. Abbey National was incorporated in England and Wales on September 12, 1988 with registered number 2294747. The registered office of Abbey National is Abbey House, Baker Street, London NW1 6XL. The principal object of Abbey National set out in Clause 4 of its Memorandum of Association is to carry on the business of banking and other financial and monetary transactions. The Memorandum of Association is available for inspection at the address set out in "Documents available for inspection" below. The registered office of Abbey National Treasury Services plc ("ANTS") is Abbey House, Baker Street, London NW1 6XL. ANTS has authorised and issued share capital of £255,000,000.

2. It is expected that listing of the Sterling Preference Shares on the London Stock Exchange will be granted on February 13, 1996, subject only to allotment, and that dealings in the Sterling Preference Shares will commence on February 13, 1996. Transactions will normally be effected for settlement in Sterling and for delivery on the fifth working day after the date of the transaction.

3. The estimated total expenses of the issue of the Sterling Preference Shares payable by Abbey National (excluding any value added tax) are £1.1 million (of which £1 million represents the commissions due to the Managers under the Subscription and Placing Agreement).

4. It should be noted that, as part of the process of conversion, the Building Societies Act 1986 (the "Act") required that a right be conferred on every saving member of the Society (who satisfied certain conditions) to a priority liquidation distribution by Abbey National. This is a right to a distribution of a proportion of the assets of Abbey National, in the event of its being wound up, in priority to all other creditors and members (other than certain statutory preferential creditors). This right is secured by a first floating charge over the assets of Abbey National. The obligation of Abbey National to satisfy this priority liquidation distribution right is guaranteed by ANTS and the obligations of ANTS under such guarantee are secured by a first floating charge over the assets of ANTS.

   The Act also provides that saving members of the Society who were not eligible to vote at the meeting of the members of the Society at which the conversion was approved and who satisfy certain other conditions are entitled to a cash distribution. The aggregate amount of the cash distribution paid in 1989 was approximately £6,000,000, and no further material amounts have been, or are expected to be, paid. The initial aggregate amount of the priority liquidation distribution right is the amount of the Society's reserves at December 31, 1988 less the aggregate amount of the cash distribution and the costs of the conversion (except to the extent that such costs have been taken into account in calculating the amount of the reserves). The initial aggregate amount of the priority liquidation distribution (if Abbey National had been wound up immediately upon the conversion) was estimated at £1,340 million. However, the amount of a member's distribution is generally reduced by the amount such member withdraws from his relevant accounts (and does not increase should further funds be paid into such accounts). The aggregate amount of the priority liquidation distribution on December 31, 1994 was reduced to approximately £59 million. Abbey National expects the amount to continue to decrease.

5. Save as disclosed herein, there has been no significant change in the financial or trading position of the Group which has occurred since December 31, 1994.

6. Neither Abbey National nor the Group is involved in any litigation or arbitration proceedings which may have, or have had during the previous twelve months, a significant effect upon the financial position of Abbey National or the Group nor, so far as Abbey National is aware, are any such litigation or arbitration proceedings pending or threatened.

7. The directors of Abbey National expect a demand to be made against its subsidiary Abbey National Treasury Services plc by an overseas tax authority in an amount of approximately £140 million relating to the repayment of certain tax credits received and related charges. The Company has been advised that it has strong grounds to challenge the validity of the demand.

8. The consolidated accounts of Abbey National for each of the three years ended December 31, 1994 were audited by Coopers & Lybrand, chartered accountants and registered auditors, in accordance with

Auditing Standards and have been reported on without qualification. The address of Coopers & Lybrand is 1 Embankment Place, London WC2N 6NN. Coopers & Lybrand have given and have not withdrawn their written consent to the issue of these listing particulars with the inclusion of their reports and references to their name in the form and context in which they are included and have authorised the content of that part of the listing particulars which comprise their reports for the purposes of Section 152(1)(e) of the Financial Services Act 1986.

9. The summary financial information relating to the Group contained in this Listing Memorandum for each of the five years ended December 31, 1994 does not constitute statutory accounts as defined in Section 240 of the Companies Act 1985 (the "Companies Act"), but has been derived from the audited consolidated financial statements of Abbey National for those years. The statutory consolidated accounts of Abbey National for each of the five financial years ended December 31, 1994 were delivered to the Registrar of Companies in England and Wales. The auditors of Abbey National have made reports under Section 235 of the Companies Act in respect of the statutory consolidated accounts for each of the five financial years ended December 31, 1994 and each such report was an unqualified report and did not contain a statement under Section 237(2) or (3) of the Companies Act.

10. The London listing sponsor for the Sterling Preference Shares is Merrill Lynch International Limited.

Material Contract

11. The following contract (not being a contract entered into in the ordinary course of business) has been entered into in the two years preceding the date of this document and is or may be material:—

    A framework agreement dated July 9, 1995, made between National & Provincial and Abbey National, relating to the agreement in principle (referred to in "Recent Developments") for Abbey National to acquire the business of National & Provincial.

Documents available for inspection

12. Copies of the following documents will be available for inspection during usual business hours on any weekday (Saturdays and public holidays excepted) at the offices of Slaughter and May, 35 Basinghall Street, London EC2V 5DB for a period of 14 days from the date hereof:

    (a) the Memorandum and Articles of Association of Abbey National;

    (b) the audited consolidated Report and Accounts of Abbey National for the two years ended December 31, 1993 and 1994 and the unaudited interim financial statements of Abbey National for the period ended June 30, 1995;

    (c) the Placing Agreement;

    (d) the consent referred to in paragraph 8 above; and

    (e) the material contract referred to above.

13. All current directors' service contracts have previously been made available for inspection in accordance with the listing rules of the London Stock Exchange (such contracts having not been subsequently varied).

INDEX TO FINANCIAL STATEMENTS

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the Auditors' report set out below, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the accounts.

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

In respect of the accounts the directors are required to:

- ensure that appropriate accounting policies, which follow generally accepted accounting practice, have been applied consistently;
- ensure that reasonable and prudent judgements and estimates have been used in the preparation of the accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to presume that Abbey National plc and the Group will continue in business;
- state whether applicable accounting standards have been followed and to disclose and explain any material departures in the accounts.

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

We have audited the consolidated accounts of Abbey National plc and its subsidiary undertakings on pages F-4 to F-58 inclusive. These accounts are the responsibility of the Company's management. Our responsibility is to express an opinion on these accounts based on our audits.

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

In our opinion, the accounts referred to above present fairly, in all material respects, the consolidated financial position of Abbey National plc and its subsidiary undertakings at December 31, 1994 and 1993, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1994, in conformity with accounting principles generally accepted in the United Kingdom.

Accounting principles generally accepted in the United Kingdom vary in certain significant respects from accounting principles generally accepted in the United States as set out in Note 47 to the consolidated accounts.

Coopers & Lybrand
Chartered Accountants and Registered Auditors
London, England.
March 22, 1995

ABBEY NATIONAL plc

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER

	Note	1994	1993	1992
		£m	£m	£m
Interest receivable				
Interest receivable and similar income arising from debt securities	2	1,468	1,196	1,414
Other interest receivable and similar income	3	3,861	3,778	4,372
Interest payable	4	(3,935)	(3,636)	(4,521)
Net interest income		1,394	1,338	1,265
Dividend income	5	42	46	28
Fees and commission receivable		201	244	224
Fees and commission payable		(32)	(13)	(10)
Dealing profits		24	8	3
Other operating income	6	130	91	74
Total operating income		1,759	1,714	1,584
Administrative expenses	7	(671)	(679)	(629)
Depreciation and amortisation		(84)	(84)	(77)
Provisions for bad and doubtful debts	10	(74)	(218)	(274)
Amounts written off fixed asset investments		2	1	(3)
Profit on ordinary activities before tax and exceptional items		932	734	601
Exceptional items:				
Loss on disposal/reorganisation of estate agency business	11	—	(30)	(138)
Sale of unclaimed shares	12	—	—	101
Profit on ordinary activities before tax		932	704	564
Tax on profit on ordinary activities	13	(322)	(314)	(247)
Profit on ordinary activities after tax	14	610	390	317
Transfer to non-distributable reserve	38	(65)	(32)	(7)
Dividends	15	(233)	(184)	(151)
Profit retained for the financial year		312	174	159
Profit on ordinary activities before tax and exceptional items includes:				
for acquired operations		22	—	—
for discontinued operations		—	(2)	(20)
Earnings per share	16	46.5p	29.7p	24.2p

The Group's results are reported on an historical cost basis. Accordingly, no note of historical cost profits and losses has been presented.

ABBEY NATIONAL plc

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER

	Note	1994 £m	1994 £m	1993 £m	1993 £m
Assets					
Cash and balances at central banks			166		168
Treasury bills and other eligible bills	17		432		589
Loans and advances to banks	18		2,906		3,556
Loans and advances to customers	19		48,484		45,049
Net investment in finance leases	20		2,278		2,253
Debt securities	21		32,332		24,789
Equity shares and other variable yield securities	22		42		523
Long term assurance business	23		352		287
Tangible fixed assets	26		534		509
Other assets	27		1,081		1,128
Prepayments and accrued income	28		1,620		1,080
Assets of long term assurance funds	23		4,092		3,871
Total assets			94,319		83,802
Liabilities					
Deposits by banks	29		17,826		16,368
Customer accounts	30		38,056		36,143
Debt securities in issue	31		23,413		19,030
Dividend proposed			158		129
Other liabilities	32		2,528		1,732
Accruals and deferred income	34		2,623		1,979
Provisions for liabilities and charges	35		399		296
Subordinated liabilities	36		1,520		868
Liabilities of long term assurance funds	23		4,092		3,871
			90,615		80,416
Called up share capital	37	131		131	
Share premium account	37	840		836	
Reserves	38	104		39	
Profit and loss account	38	2,629		2,380	
Equity shareholders' funds			3,704		3,386
Total liabilities			94,319		83,802
Memorandum items					
Contingent liabilities					
Guarantees and assets pledged as collateral security	40		836		702
Other contingent liabilities	41		59		96
			895		798
Commitments	42		1,546		784

ABBEY NATIONAL plc

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 DECEMBER

	Note	1994	1993	1992
		£m	£m	£m
Profit on ordinary activities after tax		610	390	317
Translation differences on foreign currency net investment		(7)	(8)	4
Total recognised gains relating to the year		603	382	321

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER

		1994	1993	1992
		£m	£m	£m
Net cash inflow from operating activities	44(a)	6,343	5,738	5,971
Returns on investments and servicing of finance				
Dividends paid		(204)	(156)	(142)
Net cash outflow from returns on investments and servicing of finance		(204)	(156)	(142)
Taxation				
U.K. corporation tax paid		(93)	(46)	(156)
Overseas tax paid		(5)	(16)	(10)
Total taxation paid		(98)	(62)	(166)
Investing activities				
Purchases of investment securities		(35,346)	(22,087)	(16,027)
Sales and maturities of investment securities		28,849	17,126	9,935
Purchases of tangible fixed assets		(114)	(101)	(115)
Sales of tangible fixed assets		10	19	13
Transfers to life assurance funds		—	(40)	(285)
Purchases of shares from minority shareholders		—	—	(1)
Purchases of subsidiary undertakings		(52)	—	(3)
Sale of subsidiary undertakings		—	1	—
Net cash outflow from investing activities		(6,653)	(5,082)	(6,483)
Net cash inflow/(outflow) before financing		(612)	438	(820)
Financing				
Issue of ordinary share capital		4	—	2
Issue of loan capital		676	220	240
Repayments of loan capital		(17)	—	—
Net cash inflow from financing		663	220	242
Increase/(Decrease) in cash and cash equivalents		51	658	(578)

Cash and cash equivalents in this statement are calculated in accordance with the definitions set out in Financial Reporting Standard (FRS) 1. The Group's total liquidity includes not only these cash and cash equivalents but also certain other liquid assets which fall outside the FRS1 definition.

ACCOUNTING POLICIES

Basis of presentation

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

Accounting convention

The Group prepares its accounts under the historical cost convention, and in accordance with applicable U.K. accounting standards.

Basis of consolidation

The Group accounts comprise the accounts of Abbey National plc and its subsidiary undertakings made up to 31 December, with the exception of a number of leasing and investment subsidiaries and the companies within the HMC group, which, because of commercial considerations, have various accounting reference dates. In addition, WF Company Ltd., which was acquired on 21 December 1994, currently has an accounting reference date other than 31 December. The accounts of these subsidiaries have been consolidated on the basis of interim accounts for the year to 31 December 1994.

In order to reflect the different nature of the Group's and the policyholders' interests in the long term assurance business, the interest attributable to the Group and the assets and liabilities attributable to the policyholders have been classified under separate headings in the balance sheet.

Goodwill

Goodwill arising on consolidation as a result of the acquisition of subsidiaries and goodwill arising on the purchase of businesses are taken direct to reserves in the year in which they occur. On disposal of a business, the goodwill previously taken to reserves is recognised in the profit and loss account balanced by an equal credit to reserves. Where the directors believe that the purchased goodwill in continuing businesses has suffered a permanent diminution in value, a similar recognition in the profit and loss account and credit to reserves is made.

Deferred taxation

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

Depreciation

Tangible fixed assets are depreciated on a straight line basis over their estimated useful lives. The following annual rates are used:

Premises

Freehold buildings: 1%
Long and short leasehold premises: Over the remainder of the lease, with a maximum of 100 years.
Acquisition premiums are depreciated over the period to the next rent review.

Equipment

Office fixtures, equipment and furniture: 12.5%
Computer equipment: 25% for mainframes and 20% for peripherals
Motor vehicles: 25%

No depreciation is provided on freehold land.

Interest receivable

Interest is suspended where due but not received on mortgage accounts in arrears where recovery is doubtful.

The amounts suspended, less recoveries of amounts suspended in previous years, are excluded from the interest receivable on loans and advances.

Fees and commissions receivable

Fees and commissions receivable in respect of services provided are taken to the profit and loss account when the related services are performed. Where fees and commission are receivable which are in the nature of interest, these are taken to the profit and loss account on a systematic basis over the expected period of the loan, and are included under the heading, Interest receivable. Fees which are receivable in order to cover a proportion of future losses, as explained in more detail under Deferred Income, are taken to the profit and loss account as the relevant losses are identified and provided for, and are included under the heading, Other operating income.

Lending related fees payable and discounts

Fees and discounts payable to customers in respect of loans are charged to the profit and loss account over the minimum period of time which the Group expects to benefit from the loans where those fees and discounts are in the nature of a reduction in interest income. The profit and loss account charge for such fees and discounts is included under the heading, Interest receivable.

Deferred Income

Abbey National plc has entered into insurance arrangements with its subsidiary, Carfax Insurance Ltd, to cover a proportion of future losses on certain UK residential secured loans with high loan to value ratios. In the Group accounts, income from customers in relation to such lending is deferred and is included in the balance sheet under the heading Accruals and deferred income. The deferred income is released to the profit and loss account as relevant losses are identified and provided for.

Securities

Securities held for investment purposes are stated at cost adjusted for any amortisation of premium or discount on an appropriate basis over their estimated lives. Provision is made for any permanent diminution in value.

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

In accordance with industry practice, securities which are not held for the purpose of investment, certain money market deposits, and the associated funding of these assets are stated at market value and profits and losses arising from this revaluation are taken to the profit and loss account. The net return on these assets appears in dealing profits in the profit and loss account. This net return comprises the revaluation profit and loss referred to above, plus profits and losses on disposal of these assets, plus interest receivable on these assets less interest payable on their associated funding. The cost of securities which are not held for the purpose of investment is not disclosed as it cannot be determined without unreasonable expense.

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

Securities sold subject to agreements to repurchase are retained on the balance sheet where the risks and rewards of ownership of the securities remain with the Group. Similarly, securities purchased subject to a commitment to resell are treated as lending transactions where the Group does not acquire the risks and rewards of ownership. The difference between sale and repurchase prices for such transactions is charged or credited to the profit and loss account over the life of the relevant transactions.

Other financial instruments

Transactions are undertaken in interest rate swaps, cross currency swaps, futures, options, warrants and similar instruments for the purposes of hedging, trading and market making. Gains and losses arising from the hedging of investment transactions are released to the profit and loss account over the life of the asset, liability or position against which the hedge is held. Gains and losses arising from the hedging of assets which are not held for the purpose of investment are taken directly to the profit and loss account. Where a transaction originally entered into as a hedge no longer represents a hedge, its value is restated and any change in value is taken to the profit and loss account. Gains and losses on instruments purchased or sold for trading and market making purposes are taken directly to the profit and loss account. Any such transactions outstanding at the balance sheet date are stated at market value.

Development properties

Completed properties and work in progress are valued at the lower of cost and net realisable value. Cost comprises land purchase, building works thereon and interest.

Equipment leased to customers

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases.

The net investment in finance leases represents total minimum lease payments less gross earnings allocated to future periods. Income from finance leases, including benefits from declining tax rates, is credited to the profit and loss account using the actuarial after tax method to give a constant periodic rate of return on the net cash investment.

Provisions for bad and doubtful debts

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

Securitisations

Certain subsidiary undertakings have issued debt securities, or have entered into funding arrangements with lenders, in order to finance the purchase of certain portfolios of mortgage assets. These obligations are secured on the mortgage assets and other assets of the subsidiary undertakings.

Where the Group has retained significant benefits and risks relating to the portfolios of mortgage assets, the mortgage assets and the related liabilities are presented separately within the relevant headings in the Group balance sheet.

Long term assurance business

The value of the long term assurance business represents the present value of profits expected to emerge in the future from business currently in force, together with the Group's interest in the surplus retained within the long term assurance funds. This is known as the embedded value. In determining the embedded value, assumptions relating to future mortality, persistency and levels of expenses are based on experience of the business concerned. Future profits are discounted at a risk-adjusted discount rate after provision has been made for taxation.

Changes in the embedded value, which are determined on a post-tax basis, are included in the profit and loss account grossed up at the standard rate of corporation tax.

The post-tax increase in embedded value is treated as non-distributable until it emerges as part of the surplus arising during the year.

The value of the assets and liabilities of the long term assurance funds are determined by actuarial evaluations in accordance with the terms of the Insurance Companies Act 1982.

Foreign currency translation

Income and expenses arising in foreign currencies during the year are translated into sterling at the average rates of exchange ruling over the accounting period unless they are hedged in which case the relevant hedge rate is applied. Dividends are translated at the rate prevailing on the date the dividend is receivable. Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange current at the balance sheet date. Differences arising on the translation of opening net assets of overseas subsidiaries are dealt with through reserves as are those differences resulting from the restatement of their profits and losses from average to year-end rates. Other translation differences are dealt with through the profit and loss account.

Pensions

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

Cash equivalents

Cash equivalents are short term highly liquid investments which are readily convertible into known amounts of cash without notice and which were within three months of maturity when acquired.

Accounting for acquisitions

The requirements of Financial Reporting Standard (FRS) 6, "Acquisitions and Mergers", and FRS7, "Fair Values In Acquisition Accounting" have been implemented in respect of the acquisitions made in the year ended 31 December 1994. These have been implemented earlier than the date required in the standards. These standards are mandatory for acquisitions and mergers first accounted for in accounting periods commencing on or after 23 December 1994, but early adoption is encouraged.

NOTES TO THE CONSOLIDATED ACCOUNTS

1. Segmental analysis

The equity capital of U.K. Retail Banking and Treasury Operations is managed on a unified basis and earnings thereon are shown within the U.K. Retail Banking result. Earnings on equity capital in other segments are shown in the result of the relevant segment.

No separate geographical analysis is presented because the only significant non-U.K. businesses are shown in the Continental Europe and Offshore business segment.

	U.K. Retail Banking	Life Assurance Operations	Treasury Operations	Continental Europe and Offshore	Other Operations	Estate Agency	Group Total
	£m	£m	£m	£m	£m	£m	£m
1994							
Profit before taxation	741	94	128	(33)	2	—	932
Includes for acquired operations	22	—	—	—	—	—	22
Total assets	49,805	4,492	36,991	1,400	1,631	—	94,319
Net Assets	1,572	185	986	983	(22)	—	3,704
1993							
Profit before taxation and exceptional items	618	61	145	(105)	17	(2)	734
Exceptional items	—	—	—	—	—	(30)	(30)
Profit before taxation	618	61	145	(105)	17	(32)	704
Includes for discontinued operations	—	—	—	—	—	(32)	(32)
Total assets	45,918	4,197	30,851	1,211	1,625	—	83,802
Net assets	2,364	115	878	53	(24)	—	3,386
1992							
Profit before taxation and exceptional items	540	22	100	(46)	5	(20)	601
Exceptional items	—	—	—	—	101	(138)	(37)
Profit before taxation	540	22	100	(46)	106	(158)	564
Includes for discontinued operations	—	—	—	—	—	(158)	(158)
Total assets	42,153	3,056	24,072	1,265	1,637	40	72,223
Net assets	2,516	15	761	108	(8)	(208)	3,184

2. Interest receivable and similar income arising from debt securities

	1994	1993	1992
	£m	£m	£m
Income from listed and registered securities	1,262	942	926
Income from unlisted securities	206	254	488
	1,468	1,196	1,414

Preference dividends of £6m (1993: £31m, 1992: £31m) are included in income from unlisted securities after amortisation amounting to nil (1993: £59m, 1992: £59m).

3. Other interest receivable and similar income

	1994	1993	1992
	£m	£m	£m
On secured advances	3,513	3,424	4,087
On other lending	71	80	70
On finance leases	135	142	116
On other assets and investments	142	132	99
	3,861	3,778	4,372

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

3. Other interest receivable and similar income (Continued)

Interest due but not received on loans and advances in arrears has not been recognised in interest receivable where collectability is in doubt. The movements on suspended interest are as follows:

	On advances secured on residential properties	On other secured advances	On unsecured advances	Total
	£m	£m	£m	£m
Suspended interest				
At 1 January 1994	77	69	4	150
Exchange adjustments	1	2	—	3
Amounts suspended in the year	54	30	1	85
Irrecoverable amounts written off	(69)	(31)	(2)	(102)
At 31 December 1994	63	70	3	136
The value of loans at 31 December 1994 on which interest is suspended is as follows:				
Loans and advances to customers	684	254	29	967
Provisions on these loans	(137)	(124)	(26)	(287)

4. Interest payable

	1994	1993	1992
	£m	£m	£m
On retail customer accounts	1,841	1,813	2,563
On other deposits and loans	2,094	1,823	1,958
	3,935	3,636	4,521
Including amounts payable on subordinated liabilities	80	66	57

5. Dividend income

	1994	1993	1992
	£m	£m	£m
Income from equity shares and other variable yield securities	42	46	28

6. Other operating income

	1994	1993	1992
	£m	£m	£m
Income from long term assurance business (see note 23)	91	61	31
Profits less losses on disposal of investment securities	14	(2)	13
Rents receivable	4	5	6
Other	21	27	24
	130	91	74

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

7. Administrative expenses

	1994	1993	1992
	£m	£m	£m
Staff costs:			
Wages and salaries	274	268	242
Social security costs	24	25	22
Other pension costs	36	29	19
	334	322	283
Other administrative expenses	337	357	346
	671	679	629
Other administrative expenses include the following items:			
Hire of equipment	7	7	9
Finance charges in respect of leased assets	2	3	4
Rent and rates payable	57	57	56

The charges above exclude those incurred by Life Assurance Operations which are charged to the revenue account of the long term assurance funds.

Staff costs incurred by Life Assurance Operations are:

	1994	1993	1992
	£m	£m	£m
Staff costs:			
Wages and salaries	24	23	18
Social security costs	2	2	1
Other pension costs	4	3	2
	30	28	21

The auditors' remuneration was £1.5m (1993: £1.3m, 1992: £1.2m) for audit services and £2.4m (1993: £1.6m, 1992: £2.4m) was payable to the Group auditors for other services. Included in this remuneration is the audit fee for the companies within Life Assurance Operations of £0.2m (1993: £0.2m, 1992: £0.1m).

8. Directors' emoluments and interests

The aggregate emoluments of directors were:

	Salary/fee	Performance related bonus	Taxable benefits	Other	1994 Total	1993 Total	1992 Total
	£000	£000	£000	£000	£000	£000	£000
Chairman	228	—	14	—	242	224	212
Chief Executive (and highest paid director)	308	93	7	—	408	329	258
Fees and benefits to non-executive directors excluding the Chairman	164	—	1	—	165	176	156
Other directors	1,040	353	70	—	1,463	1,220	929
Total emoluments excluding pension contributions	1,740	446	92		2,278	1,949	1,555
Pension contributions	—	—	—	303	303	58	—
Ex-gratia payments to former directors	—	—	—	82	82	—	53
Total emoluments	1,740	446	92	385	2,663	2,007	1,608
Compensation for loss of office	—	—	—	—	—	250	266
	1,740	446	92	385	2,663	2,257	1,874

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

8. Directors' emoluments and interests (Continued)

Fees are paid to non-executive directors including the Chairman. The basic fee for non-executive directors of £17,500 is augmented by £2,500 for service on Board committees. The basic fee was last increased on 1 January 1991. Lord Rockley's fee is paid to Kleinwort Benson Group plc, of which he is Chairman.

Lord Tugendhat's emoluments are comprised wholly of fees and benefits and expenses in respect of services. He is not entitled to participate in any bonus or profit sharing arrangements nor is he entitled to participate in the Executive Share Option scheme. However, he is entitled to participate in Abbey National plc's Sharesave scheme which is available to all eligible employees. The Chairman's appointment is non-pensionable and he makes his own private pension arrangements.

The pension contribution by Abbey National plc for the benefit of the Chief Executive, Mr PG Birch was £63,841.

Salaries and performance bonuses are considered by the Personnel and Remuneration Committee. Recommendations are then made to the full complement of non-executive directors of the Board.

The remuneration arrangements for executive directors are as follows:

a) Basic salary is considered in relation to similar sized jobs in comparable organisations. The comparators include UK banks, building societies, insurance companies and retailers and other UK companies with an equivalent market capitalisation to Abbey National.

b) The basic system of discretionary performance payments was revised during 1994, and now comprises a bonus scheme based on annual performance which pays out in March 1995 and a three year scheme which covers the period from 1994 to 1996 and may pay out in March 1997. The maximum potential payment, to be shared among the executive directors and other members of the top management team, for both the annual scheme and the three year scheme, is 30% of that group's basic salary. Such payments are not pensionable.

The actual level of any payment under the annual bonus scheme is determined by the Board's view of the Group's performance set against the Chief Executive's objectives. There would have been no payout under the 1994 scheme unless pre-tax profits had reached a minimum of £766 million (compared with pre-tax profits of £704 million in 1993). The Board pays particular attention to five quantifiable objectives and then modifies that assessment in the light of its view of performance against qualitative objectives, such as customer service and product quality. The key five objectives are: achievement of a specified level of Group pre-tax profits; achievement of specified cost/income ratios; achievement of specified other income ratios; achievement of a specified risk asset ratio and a specified pre-tax return on equity ratio. Payments to individual directors reflect both corporate and individual performance.

In determining whether or not to make a payment in 1997 under the three year bonus scheme (1994-1996), and if so its size, the Board will be guided by a formula which will have two equally weighted components: (i) an assessment of total shareholder returns over the period 1994 to 1996 measured by two sets of indices, the FTSE 100 and some specific sectors of that index, and (ii) progress against Abbey National plc's Three Year Plan 1994-1996 including a comparison with the performance of competitors not covered by the FTSE.

In addition, the full complement of non-executive directors may in exceptional circumstances make a one-off ex-gratia payment to an individual executive director who has rendered a particular and outstanding contribution.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

8. Directors' emoluments and interests (Continued)

c) An Executive Share Option scheme and an employee Sharesave scheme both of which have been approved by the shareholders. These schemes include executive directors, and their interests are set out below. Grants of Executive Share Option are made on the recommendation of the Personnel and Remuneration Committee and reflect both corporate and individual performance.

d) Taxable benefits include car expenses, medical expenses plus subsidised mortgage loans.

The following table shows the number of directors, including the Chairman and the highest paid director, receiving emoluments before pension contributions within the undermentioned ranges.

£	1994	1993
0 — 5,000	1	—
15,001 — 20,000	4	5
20,001 — 25,000	1	2
25,001 — 30,000	2	—
35,001 — 40,000	—	1
50,001 — 55,000	—	1
55,001 — 60,000	1	1
80,001 — 85,000	—	1
90,001 — 95,000	1	1
150,001 — 155,000	—	1
165,001 — 170,000	—	1
170,001 — 175,000	—	1
200,001 — 205,000	—	1
210,001 — 215,000	2	—
220,001 — 225,000	—	1
225,001 — 230,000	1	—
230,001 — 235,000	1	—
235,001 — 240,000	—	1
240,001 — 245,000	2	—
275,001 — 280,000	1	—
325,001 — 330,000	—	1
405,001 — 410,000	1	—

Non-executive directors of long service may receive an ex-gratia pension. No such ex-gratia pensions have been granted this year. Accordingly no charge (nil) to the profit and loss account has been made in respect of them. Pensions paid to former directors of Abbey National plc in 1994, which have been provided for previously, amounted to £157,600 (£155,415). The Board has determined that it will no longer award such pensions to non-executive directors who joined the Board after 31 December 1988.

8. Directors' emoluments and interests (Continued)

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

	Number of persons	Aggregate amount outstanding
		£000
Directors		
Loans	11	1,205
Quasi loans	—	—
Credit transactions	—	—
Officers		
Loans	48	4,427
Quasi loans	—	—
Credit transactions	—	—

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

	Shares		Options						
	At 1 January 1994	At 31 December 1994	At 1 January 1994	Granted	At 31 December 1994	Exercise price	Date from which exercisable	Expiry date	Notes
M Barnes	1,000	1,000							
PG Birch	111,980	118,849							
			8,456		8,456	1.49	1.7.97	31.12.97	Sharesave
			1,939		1,939	2.32	1.10.98	31.3.99	Sharesave
			1,882		1,882	2.39	1.6.99	30.11.99	Sharesave
			194,300		194,300	2.702	21.5.94	21.5.01	Executive
			14,134		14,134	2.99	5.5.95	5.5.02	Executive
			69,478		69,478	2.54	5.5.97	5.5.02	Executive (1)
			25,215		25,215	3.69	29.3.96	29.3.03	Executive
			8,404		8,404	3.14	29.3.98	29.3.03	Executive (2)
			—	60,897	60,897	4.68	11.4.97	10.4.04	Executive
			323,808	60,897	384,705				
JA Denholm	1,500	2,000							
JM Fry	3,324	3,324							
			7,248		7,248	1.49	1.7.95	31.12.95	Sharesave
			1,616		1,616	2.32	1.10.96	31.3.97	Sharesave
			1,569		1,569	2.39	1.6.97	30.11.97	Sharesave
			84,381		84,381	2.702	21.5.94	21.5.01	Executive
			108,561		108,561	2.99	5.5.95	5.5.02	Executive
			203,375		203,375				

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

8. Directors' emoluments and interests (Continued)

	Shares		Options						
	At 1 January 1994	At 31 December 1994	At 1 January 1994	Granted	At 31 December 1994	Exercise price	Date from which exercisable	Expiry date	Notes
I Harley	3,621	5,253							
			7,248		7,248	1.49	1.7.95	31.12.95	Sharesave
			1,616		1,616	2.32	1.10.96	31.3.97	Sharesave
			1,569		1,569	2.39	1.6.97	30.11.97	Sharesave
			41,635		41,635	2.702	21.5.94	21.5.01	Executive
			12,092		12,092	2.99	5.5.95	5.5.02	Executive
			17,908		17,908	2.54	5.5.97	5.5.02	Executive (1)
			20,476		20,476	3.69	29.3.96	23.3.03	Executive
			6,825		6,825	3.14	29.3.98	29.3.03	Executive (2)
			—	23,237	23,237	4.68	11.4.97	10.4.04	Executive
			—	7,745	7,745	3.98	11.4.99	10.4.04	Executive (3)
			109,369	30,982	140,351				
Sir Terry Heiser	1,500	1,500							
DG Jones	1,000	2,632							
			7,248		7,248	1.49	1.7.95	31.12.95	Sharesave
			1,616		1,616	2.32	1.10.96	31.3.97	Sharesave
			1,569		1,569	2.39	1.6.97	30.11.97	Sharesave
			58,290		58,290	2.702	21.5.94	21.5.01	Executive
			11,678		11,678	2.99	5.5.95	5.5.02	Executive
			23,322		23,322	2.54	5.5.97	5.5.02	Executive (1)
			25,575		25,575	3.69	29.3.96	29.3.03	Executive
			8,525		8,525	3.14	29.3.98	29.3.03	Executive (2)
				24,038	24,038	4.68	11.4.97	10.4.04	Executive
				8,012	8,012	3.98	11.4.99	10.4.04	Executive (3)
			137,823	32,050	169,873				
RF Knighton	1,100	1,100							
			8,456		8,456	1.49	1.7.97	31.12.97	Sharesave
			74,019		74,019	2.702	21.5.94	21.5.01	Executive
			7,746		7,746	2.99	5.5.95	5.5.02	Executive
			27,254		27,254	2.54	5.5.97	5.5.02	Executive (1)
			22,404		22,404	3.69	29.3.96	29.3.03	Executive
			7,468		7,468	3.14	29.3.98	29.3.03	Executive (2)
				22,435	22,435	4.68	11.4.97	10.4.04	Executive
				7,478	7,478	3.98	11.4.99	10.4.04	Executive (3)
			147,347	29,913	177,260				
ME Llowarch	1,750	1,750							
S Morrison	5,000	5,000							
PJ Ogden	—	4,000							
The Lord Rockley	5,000	5,000							

8. Directors' emoluments and interests (Continued)

	Shares		Options						
	At 1 January 1994	At 31 December 1994	At 1 January 1994	Granted	At 31 December 1994	Exercise price	Date from which exercisable	Expiry date	Notes
CG Toner	1,783	1,832							
			7,248		7,248	1.49	1.7.95	31.12.95	Sharesave
			1,616		1,616	2.32	1.10.96	31.3.97	Sharesave
			1,569		1,569	2.39	1.6.97	30.11.97	Sharesave
			74,019		74,019	2.702	21.5.94	21.5.01	Executive
			7,746		7,746	2.99	5.5.95	5.5.02	Executive
			27,254		27,254	2.54	5.5.97	5.5.02	Executive (1)
			24,449		24,449	3.69	29.3.96	29.3.03	Executive
			8,149		8,149	3.14	29.3.98	29.3.03	Executive (2)
				24,038	24,038	4.68	11.4.97	10.4.04	Executive
				8,012	8,012	3.98	11.4.99	10.4.04	Executive (3)
			152,050	32,050	184,100				
JL Tuckey	2,000	12,000							
The Lord Tugendhat	10,000	10,000							
			7,845		7,845	2.39	1.6.97	30.11.97	Sharesave
			7,845		7,845				
CN Villiers	17,777	19,409							
			7,248		7,248	1.49	1.7.95	31.12.95	Sharesave
			1,616		1,616	2.32	1.10.96	31.3.97	Sharesave
			1,569		1,569	2.39	1.6.97	30.11.97	Sharesave
			98,445		98,445	2.702	21.5.94	21.5.01	Executive
			12,889		12,889	2.99	5.5.95	5.5.02	Executive
			37,111		37,111	2.54	5.5.97	5.5.02	Executive (1)
			31,145		31,145	3.69	29.3.96	29.3.03	Executive
			10,381		10,381	3.14	29.3.98	29.3.03	Executive (2)
				9,612	9,612	4.68	11.4.97	10.4.04	Executive
				3,204	3,204	3.98	11.4.99	10.4.04	Executive (3)
			200,404	12,816	213,220				

Notes:
1. Parallel standard options were granted over these shares exercisable at £2.99 from 5.5.95 to 5.5.02.
2. Parallel standard options were granted over these shares exercisable at £3.69 from 29.3.96 to 29.3.03.
3. Parallel standard options were granted over these shares exercisable at £4.68 from 11.4.97 to 10.4.04.

The option holder may exercise either option, thereby reducing both options, subject to the achievement of the performance criteria.

The options refer to those granted under Abbey National plc's executive and Sharesave schemes, as set out in note 37. Options shown under the heading "Granted" refer to options granted during the year or since appointment if later.

Options were granted during the year ended 31 December 1994 under the Executive Share Option scheme which was approved by shareholders in April 1991 (and amended in April 1992). Options were granted to directors over a total of 198,708 (139,694) ordinary shares. These included options over 164,257 shares granted at £4.68 and normally exercisable between 1997 and 2004. These options become exercisable if the average growth of earnings per share exceeds the average increase in the Retail Prices Index in any three years prior to exercise.

Options over 34,451 shares were granted at £3.98 and are normally exercisable between 1999 and 2004. These options become exercisable if the average growth of earnings per share exceeds the average increase in the Retail Prices Index by at least 10% in any five year period prior to the date of exercise. In addition, parallel options were granted over the same shares exercisable at £4.68 on the same basis as detailed in the preceding paragraph. The option holder may exercise either option, thereby reducing both options, subject to the achievement of the performance criteria.

No options were exercised or lapsed during the year.

The market price of the shares at 31 December 1994 was 430.5p (511.5p) and the range during 1994 was 380.5p to 521.5p.

No director had a material interest in any contract, other than a service contract, with Abbey National plc or any of its subsidiaries at any time during the year. The directors did not have any interest in shares or debentures of subsidiaries.

There have been no changes to the beneficial and other interests of the directors in the ordinary shares of Abbey National plc up to 31 January 1995 other than the automatic reinvestment on 6 January 1995 of dividends arising from the Abbey National Personal Equity Plan as follows:

PG Birch - 101 shares
CG Toner - 20 shares

9. Employees

The average number of staff employed by the Group during the year was as follows:

	1994	1993	1992
Full time			
Chief administrative offices	6,245	5,908	4,552
Branch offices	7,096	7,676	9,902
Life Assurance Operations	1,285	1,200	1,004
	14,626	14,784	15,458
Male	4,678	4,657	4,981
Female	9,948	10,127	10,477
	14,626	14,784	15,458
Part time			
Chief administrative offices	946	878	511
Branch offices	3,158	3,368	4,000
Life Assurance Operations	50	16	17
	4,154	4,262	4,528
Male	52	46	93
Female	4,102	4,216	4,435
	4,154	4,262	4,528

1993 numbers have been restated to reflect the reclassification of the staff employed in mortgage and banking centres from branch offices to chief administrative offices.

10. Provisions for bad and doubtful debts

	On advances secured on residential properties £m	On other secured advances £m	On unsecured advances £m	Total £m
Group				
At 1 January 1994				
General	85	12	3	100
Specific	183	135	28	346
Exchange adjustments	1	6	—	7
Transfer from profit and loss account	39	20	15	74
Irrecoverable amounts written off	(112)	(43)	(11)	(166)
At 31 December 1994	196	130	35	361
Being for the Group:				
General	59	6	6	71
Specific	137	124	29	290

11. Loss on disposal/reorganisation of residential estate agency business

	1994 £m	1993 £m	1992 £m
Loss on disposal of residential estate agency business	—	26	—
Goodwill recognised on disposal of business/branches	—	4	13
Reorganisation costs	—	—	12
Permanent diminution in value of goodwill	—	—	113
	—	30	138

Following the reorganisation and restructuring of the estate agency business in 1992, the Group sold its interests in the residential estate agency business on 31 August 1993. This business is shown as a discontinued operation in the profit and loss account. The value of goodwill on acquisition remaining for this business was recognised in the profit and loss account, having previously been taken to reserves in accordance with standard accounting practice. A permanent diminution in value of goodwill on acquisition was recognised in the profit and loss account for 1992 following a reassessment by the directors of the value taken to reserves.

12. Sale of unclaimed shares

	1994 £m	1993 £m	1992 £m
Net proceeds of share sales less provision for future claims	—	—	106
Endowment of charitable trust	—	—	(5)
	—	—	101

During 1992, Abbey National plc sold 31m shares which had remained unclaimed for more than three years after conversion, as permitted by Abbey National plc's Articles of Association. The remaining eligible borrowers and savers are entitled to the proceeds of the sale of their shares if they validate their entitlement before December 1998.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

13. Tax on profit on ordinary activities

	1994 £m	1993 £m	1992 £m
U.K. Corporation tax:			
Current at 33%	285	224	181
Deferred	34	75	63
Prior year under/(over) provision including deferred tax	3	14	2
Double tax relief	(5)	(16)	(8)
Overseas taxation	5	17	9
	322	314	247

No reduction in the tax charge for 1993 was made as a result of the exceptional item described in note 11. The charge for 1992 included £10m as a result of the items described in notes 11 and 12.

There are unrelieved overseas losses carried forward for which no tax relief has been recognised because their utilisation is currently uncertain.

14. Profit on ordinary activities after tax

The profit after tax of Abbey National plc attributable to the shareholders is £484m (1993: £230m, 1992: £210m). As permitted by section 230 of the Companies Act 1985, Abbey National plc's profit and loss account has not been included in these accounts.

15. Dividends

Dividends include the interim dividend paid of 5.7 (1993: 4.15, 1992: 3.8) pence per share and the final dividend now proposed of 12.05 (1993: 9.85, 1992: 7.70) pence per share.

16. Earnings per share

Earnings per share have been calculated by dividing the consolidated profit after tax of £610m (1993: £390m, 1992: £317m) by the average number of ordinary shares in issue of 1,312m (1993: 1,311m, 1992: 1,311m).

17. Treasury bills and other eligible bills

	1994		1993	
	Book Value £m	Market Value £m	Book Value £m	Market Value £m
Investment securities				
Treasury bills and similar securities	6	6	47	47
Other securities				
Treasury bills and similar securities	397		474	
Other eligible bills	29		68	
	426		542	
	432		589	

17. Treasury bills and other eligible bills (Continued)

The movement on treasury bills and similar securities held for investment purposes was as follows:

	1994
	£m
At 1 January 1994	47
Exchange adjustments	(3)
Additions	443
Disposals	(481)
Amortisation of discounts/(premiums)	—
At 31 December 1994	6

Unamortised discounts/(premiums) at 31 December 1994 amounted to nil (1993: nil)

18. Loans and advances to banks

	1994	1993
	£m	£m
Items in the course of collection	178	143
Other loans and advances	2,728	3,413
	2,906	3,556
Repayable:		
On demand	324	1,154
In not more than three months	2,288	2,070
In more than three months but not more than one year	119	36
In more than one year but not more than five years	—	128
In more than five years	175	168
	2,906	3,556

19. Loans and advances to customers

	1994	1993
	£m	£m
Advances secured on residential properties	47,129	43,653
Other secured advances	381	477
Unsecured loans	477	484
Collateralised and guaranteed mortgage loans	497	435
	48,484	45,049
Repayable:		
On demand or at short notice	3,236	4,010
In not more than three months	179	199
In more than three months but not more than one year	458	384
In more than one year but not more than five years	2,187	1,952
In more than five years	42,785	38,950
Less: provisions	(361)	(446)
	48,484	45,049

20. Net investment in finance leases

	1994	1993
	£m	£m
Amounts receivable	5,318	4,749
Less: deferred income	(3,040)	(2,496)
	2,278	2,253
Repayable:		
In not more than three months	3	1

20. Net investment in finance leases (Continued)

In more than three months but not more than one year	48	14
In more than one year but not more than five years	535	722
In more than five years	1,692	1,516
	2,278	2,253
Cost of assets acquired for the purpose of letting under finance leases in the year	357	729
Gross rentals receivable	301	348
Commitments as lessor for the purchase of equipment for use in finance leases	208	304
Amounts outstanding subject to a sub-participation	200	57

21. Debt securities

	1994		1993	
	Book Value	Market Value	Book Value	Market Value
	£m	£m	£m	£m
Investment securities				
Issued by public bodies:				
Government securities	5,846	6,058	4,539	4,775
Other public sector securities	4,294	4,207	2,526	2,679
	10,140	10,265	7,065	7,454
Issued by other issuers:				
Bank and building society certificates of deposit	180	181	127	127
Other debt securities	19,206	19,104	15,634	16,024
	19,386	19,285	15,761	16,151
Sub-total	29,526	29,550	22,826	23,605
Other securities				
Issued by public bodies:				
Government securities	593		656	
Other public sector securities	467		—	
Issued by other issuers:				
Bank and building society certificates of deposit	1,740		1,307	
Other debt securities	6		—	
Sub-total	2,806		1,963	
Total	32,332		24,789	
Analysed by listing status:				
Investment securities				
Listed in the U.K.	8,623	8,737	6,810	6,992
Listed or registered elsewhere	18,045	17,995	12,718	13,281
Unlisted	2,858	2,818	3,298	3,332
	29,526	29,550	22,826	23,605
Other securities				
Listed in the U.K.	839		222	
Listed or registered elsewhere	726		434	
Unlisted	1,241		1,307	
	2,806		1,963	
Total	32,332		24,789	
Analysed by maturity:				
Due within one year	4,171		2,970	
Due one year and over	28,161		21,819	
	32,332		24,789	

21. Debt securities (Continued)

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

	Cost	Provisions	Net Book Value
	£m	£m	£m
Group			
At 1 January 1994	22,844	(18)	22,826
Exchange adjustments	(416)	1	(415)
Acquisitions	35,603	—	35,603
Disposals	(25,999)	—	(25,999)
Redemptions and maturities	(2,301)	—	(2,301)
Transfers to other securities	(158)	12	(146)
Provisions released	—	2	2
Amortisation of discounts/(premiums)	(44)	—	(44)
At 31 December 1994	29,529	(3)	29,526
Unamortised discounts/(premiums) at 31 December 1994			(40)

The Group enters into sale and repurchase agreements. The total value of assets so transferred and which are included above is £111m (1993: £1,010m). Collateral associated with these transactions of £284m (1993: £324m) for the Group is included in Deposits by banks.

Market values are based on market prices of securities where available. Where market prices are not available, the directors' valuation has been used.

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

22. Equity shares and other variable yield securities

	1994		1993	
	Book Value	Market Value	Book Value	Market Value
	£m	£m	£m	£m
Investment securities				
Listed in the U.K.	24	25	1	2
Unlisted	18	17	522	525
	42	42	523	527

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

	Cost and Book Value
	£m
At 1 January 1994	523
Exchange adjustments	(5)
Acquisitions	58
Disposals	(31)
Redemptions and maturities	(503)
At 31 December 1994	42

Redemptions and maturities include 100% of the preference shares of ACP Treasury Ltd, a company incorporated in Jersey, which were redeemed in return for debt securities held by that company and valued at market value for the purpose of the transaction.

23. Long term assurance business

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

	1994 £m	1993 £m
Embedded value of policies in force and surplus retained within the long term assurance funds	352	287

The value of the long term assurance business is calculated by discounting the profits which are projected to accrue to shareholders in future years from business currently in force, and adding the shareholders' interest in the surplus retained within the long term assurance funds. The basis on which this value, known as the embedded value, is determined is reviewed regularly and in the light of changed expectations regarding future economic conditions it was decided to adjust the basis in 1994. Key elements of both the new and old basis are:

	New	Old
Discount rate (net of tax)	10.0%	12.5%
Return on equities (gross of tax)	9.0%	11.5%
Return on gifts (gross of tax)	7.5%	9.5%
Inflation	4.0%	3.0%

The effect of the change in embedded value basis was determined by calculating the value of the long term assurance business at the beginning of the year on both the old and new basis. This resulted in an increase in the value of long term assurance business of £6m before tax and £4m after tax, which has been included in income from long term assurance business for the year ended 31 December 1994.

The income from life assurance business which is included as other operating income in the consolidated profit and loss account is calculated as follows:

	1994 £m	1993 £m
Value of shareholders interest in the long term fund at 31 December	352	287
Value of shareholders interest in the long term fund at 1 January	287	215
Increase in value	65	72
Initial transfer into Abbey National Life plc	—	(40)
Net increase in value of long term assurance business	65	32
Surplus (deficit) transferred from (to) long term funds	(4)	9
Income after tax from long term assurance business	61	41
Income before tax from long term assurance business	91	61

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

	1994 £m	1993 £m
Fixed assets	40	6
Investments	3,914	3,796
Current assets	244	282
Current liabilities	(106)	(213)
	4,092	3,871
Long term assurance funds including investment reserve	4,092	3,871

24. Shares in Group undertakings

	Book value 1994 £m	Book value 1993 £m
Subsidiary undertakings		
Banks	451	314
Others	1,271	384
Total	1,722	698

The movement in shares in Group undertakings was as follows:

	1994 £m
At 1 January 1994	698
Exchange adjustments	14
Additions	1,010
Disposals	—
Amounts written off	—
At 31 December 1994	1,722

On 4 February 1994, Abbey National plc acquired the UK residential mortgage business of the Canadian Imperial Bank of Commerce. The business has been renamed Abbey National Mortgage Finance plc, and has been included in the consolidated accounts as an acquisition. The consideration for the purchase of the issued share capital was £4m payable in cash.

On 31 October 1994, Abbey National plc acquired HMC Group PLC, which is included in the consolidated accounts as an acquisition. The consideration for the purchase of the issued share capital was £60m payable in cash with the alternative of unsecured interest bearing loan notes. £58m was paid in cash, and £2m was paid in the form of loan notes, the fair value of which was not significantly different to the equivalent cash value at the date of acquisition.

During the year to 31 December 1994 Abbey National Financial Services Ltd changed its name to Abbey National Independent Financial Advisers Ltd. This company made the following acquisitions: GM Benefit Consulting Group Ltd on 18 July 1994, WF Company Ltd on 21 December 1994, and Whiting Pension Services Ltd on 22 December 1994. The amounts payable in consideration for the purchase of the issued share capital of the companies were £6m, £1.5m and £0.1m respectively. All these amounts were paid in cash with the exception of £0.4m relating to GM Benefit Consulting Group Ltd, which is deferred. GM Benefit Consulting Group Ltd has been renamed Abbey National Benefit Consulting Group Ltd.

Further disclosures relating to these acquisitions are given in note 25.

Abbey National plc subscribed for an additional FF637m (£76m) share capital directly in Abbey National France SA, and subscribed for £686m share capital in a newly formed subsidiary, Abbey National France (Holdings) Ltd, which in turn subscribed for FF5,790m (£685m) in Abbey National France SA. These capital injections were made in order to meet local regulatory requirements, and to enable Abbey National France SA to refinance its operations.

Abbey National plc subscribed for additional share capital of PTS27,000m (£132m) in Abbey National Bank SAE during 1994 in order to meet local regulatory requirements, and to provide capital to support expansion of the business.

Abbey National plc subscribed for additional share capital directly in Abbey National (Overseas) Ltd of £40m and in the holding company of that company, Abbey National (Holdings) Ltd, of £1m in order to provide additional regulatory capital to support the planned expansion of the business. Abbey National plc disposed of all its shareholdings in Abbey National (Overseas) Ltd and Abbey National (Holdings) Ltd to

24. Shares in Group undertakings (Continued)

Abbey National Treasury Services plc or subsidiaries of that company in January 1995, following which Abbey National (Overseas) Ltd was renamed Abbey National Treasury International Ltd. Its activities now include treasury operations in addition to the provision of personal financial services.

Abbey National plc made a capital injection of £7m in a newly formed subsidiary, Abbey National Unit Trust Managers Ltd, in preparation for the launch of unit trust operations in 1995.

During 1994, the business of Abbey National Personal Finance Ltd was transferred to Abbey National plc.

The principal subsidiaries of Abbey National plc at 31 December 1994 are listed below, all of which are directly held except for Abbey National Treasury International Ltd., Abbey National (Gibraltar) Ltd., Abbey National France SA, the Abbey National leasing companies and Scottish Mutual Assurance plc which are held indirectly through subsidiary companies.

	Nature of business	Country of incorporation or registration
Abbey National Treasury Services plc	Treasury operations	England & Wales
Abbey National Homes Ltd	Housing development	England & Wales
Abbey National Investments Holdings Ltd	Investment	England & Wales
Abbey National leasing companies (24 companies)	Leasing	England & Wales
Abbey National Mortgage Finance plc	Personal finance	England & Wales
Abbey National Property Services Ltd	Estate agency	England & Wales
HMC Group PLC	Personal finance	England & Wales
Abbey National Independent Financial Advisers Ltd	Personal finance	England & Wales
Abbey National France SA	Personal finance	France
Abbey National (Gibraltar) Ltd	Personal finance	Gibraltar
Carfax Insurance Ltd	Insurance	Guernsey
Abbey National Treasury International Ltd	Personal finance and treasury operations	Jersey
Abbey National Life plc	Insurance	Scotland
Scottish Mutual Assurance plc	Insurance	Scotland
Abbey National Bank SAE	Personal finance	Spain
Abbey National North America Corporation	Funding	United States

Abbey National plc holds directly or indirectly 100% of the issued ordinary share capital of its principal subsidiaries. All companies operate in their country of incorporation or registration. Abbey National Treasury Services plc also has branch offices in France and Jersey and Abbey National plc has a branch in Italy. Abbey National (Gibraltar) Ltd also operates in Portugal. All the above companies are included in the consolidated accounts.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

25. Summary of the effect of acquisitions

The following table summarises the effect of all the acquisitions of subsidiary undertakings in the year ended 31 December 1994.

	Book value before acquisition	Accounting policy adjustments	Revaluation adjustments	Total fair value adjustments	Fair value at acquisition
	£m	£m	£m	£m	£m
Loans and advances to banks	77	—	—	—	77
Loans and advances to customers	2,507	3	(12)	(9)	2,498
Other assets	58	(11)	4	(7)	51
Total Assets	2,642	(8)	(8)	(16)	2,626
Deposits by banks	911	—	—	—	911
Debt securities in issue	1,614	—	2	2	1,616
Other liabilities	95	—	(3)	(3)	92
Total Liabilities excluding shareholders' funds	2,620	—	(1)	(1)	2,619
Net assets acquired	22	(8)	(7)	(15)	7
Total fair value of consideration and costs of acquisition					73
Total goodwill					66

The profit after tax of the UK residential mortgage business of the Canadian Imperial Bank of Commerce for the period 1 November 1993 to 3 February 1994 was £4m, and for the year ended 31 October 1993 £27m. The profit after tax of HMC Group PLC for the period 1 April 1994 to 30 October 1994 was £5m, and the loss after tax for the year ended 31 March 1994 was £1m.

The profit after tax for GM Benefit Consulting Group Ltd for the period 1 January 1994 to 18 July 1994 was nil, and for the year ended 31 December 1993, £0.3m. The profit after tax for WF Company Ltd for the period 1 April 1994 to 21 December 1994 was £0.1m, and for the year ended 31 March 1994, £0.2m. The post-tax results of Whiting Pension Services Ltd for the equivalent pre-acquisition periods were very small.

26. Tangible fixed assets

	Premises	Equipment	Total
	£m	£m	£m
Cost			
At 1 January 1994	298	539	837
Acquisition of subsidiary undertaking	1	8	9
Additions	25	89	114
Disposals	(5)	(22)	(27)
At 31 December 1994	319	614	933
Depreciation			
At 1 January 1994	39	289	328
Acquisition of subsidiary undertaking	1	6	7
Charge for the year	7	77	84
Disposals	(2)	(18)	(20)
At 31 December 1994	45	354	399
Net book value			
At 31 December 1994	274	260	534
At 31 December 1993	259	250	509

26. Tangible fixed assets (Continued)

	1994 £m	1993 £m
The net book value of premises comprises:		
Freeholds	209	200
Long leaseholds	11	10
Short leaseholds	54	49
Land and buildings occupied for own activities:		
Net book value at 31 December	237	220
The net book value of equipment includes:		
Assets held under finance leases	7	19
Depreciation charge for the year on the assets	12	15
Capital expenditure which has been contracted, but has not been provided in the accounts.	15	35
Capital expenditure which has been authorised by the directors but has not yet been contracted	27	15

27. Other assets

	1994 £m	1993 £m
Residential development properties	3	29
Foreign exchange and interest rate contracts	620	747
Other	458	352
	1,081	1,128

The figure for residential development properties includes completed properties of £2m (1993: £12m) and work in progress of £1m (1993: £17m).

The amounts in respect of foreign exchange and interest rate contracts relate to translation differences arising from instruments which are used to hedge currency assets and liabilities, and to the revaluation of certain interest rate contracts where appropriate.

28. Prepayments and accrued income

	1994 £m	1993 £m
Other accrued interest	1,556	1,067
Prepayments and other accruals	64	13
	1,620	1,080

29. Deposits by banks

	1994 £m	1993 £m
Items in the course of transmission	243	246
Other deposits	17,583	16,122
	17,826	16,368
Repayable:		
On demand	29	1,316
In not more than three months	14,583	12,335
In more than three months but not more than one year	2,753	2,548
In more than one year but not more than five years	252	145
In more than five years	209	24
	17,826	16,368

30. Customer accounts

	1994 £m	1993 £m
Retail funds and deposits	35,927	34,210
Other customer accounts	2,129	1,933
	38,056	36,143
Repayable		
On demand	32,741	33,979
In not more than three months	1,716	1,888
In more than three months but not more than one year	3,480	276
In more than one year but not more than five years	119	—
	38,056	36,143

31. Debt securities in issue

	1994 £m	1993 £m
Bonds and medium term notes	14,353	11,648
Other debt securities in issue	9,060	7,382
	23,413	19,030
Bonds and medium term notes repayable:		
In not more than three months	917	1,489
In more than three months but not more than one year	2,182	2,587
In more than one year but not more than two years	3,223	1,520
In more than two years but not more than five years	4,706	3,642
In more than five years	3,325	2,410
	14,353	11,648
Other debt securities in issue repayable:		
In not more than three months	6,825	4,547
In more than three months but not more than one year	1,443	2,728
In more than one year but not more than two years	418	26
In more than two years but not more than five years	351	58
In more than five years	23	23
	9,060	7,382

32. Other liabilities

	1994 £m	1993 £m
Creditors and accrued expenses	1,301	721
Short positions in government debt securities	278	211
Income tax	159	171
Corporation tax	339	271
Foreign exchange and interest rate contracts	442	336
Obligations under finance leases (see note 33)	9	22
	2,528	1,732

The amounts in respect of foreign exchange and interest rate contracts relate to translation differences arising from instruments which are used to hedge currency assets and liabilities, and to the revaluation of certain interest rate contracts where appropriate.

33. Obligations under finance leases

	1994	1993
	£m	£m
Amounts payable:		
In not more than one year	5	13
In more than one year but not more than five years	4	9
	9	22

34. Accruals and deferred income

	1994	1993
	£m	£m
Accrued interest	2,540	1,930
Deferred income	83	49
	2,623	1,979

Insurance arrangements have been entered into with a subsidiary company, Carfax Insurance Ltd, to cover a proportion of future losses on certain U.K. residential secured loans with high loan to value ratios. In the Group accounts, income from customers in relation to such lending is deferred and is included in the balance sheet under the heading, Deferred income. The deferred income is released to the profit and loss account as losses are identified and provided for. The balance of deferred income is £83 million (1993: £49m). The amount released during the year was £6m (1993: nil).

35. Provisions for liabilities and charges

	1994
	£m
Deferred taxation	
At 1 January 1994	296
Transfer from profit and loss account	103
At 31 December 1994	399

The amounts provided and total potential liability are:

	Amount provided	Total potential liability
	£m	£m
Tax effect of timing differences due to:		
Excess of capital allowances over depreciation	18	18
Capital allowances on finance lease receivables	348	348
Other	33	33
	399	399

36. Subordinated liabilities

	1994 £m	1993 £m
Subordinated floating rate note 1995	120	120
Subordinated floating rate note 1997*	25	42
9.00% Subordinated guaranteed bond 2002 (LUX 1,000m)	20	19
Subordinated guaranteed note 2002 (US $75m)	48	51
8.00% Subordinated guaranteed bond 2002 (DFL 200m)	74	70
10.375% Subordinated guaranteed bond 2002	101	101
Subordinated floating rate note 2003 (US $100m)	64	68
Subordinated floating rate note 2004 (US $137m)	88	92
Subordinated floating rate note 2004 (CAN $100m)	45	—
8.75% Subordinated guaranteed bond 2004	151	—
8.2% Subordinated bond 2004 (US $500m)	319	—
Subordinated guaranteed floating rate note 2009 (CHF 130m)	64	—
5.56% Subordinated guaranteed bond 2015 (YEN 15 billion)	96	—
11.50% Subordinated guaranteed bond 2017	153	153
10.125% Subordinated guaranteed bond 2023	152	152
	1,520	868

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

*This subordinated floating rate note matures as follows: 1995 £8m, 1996 £8m, 1997 £9m. All other subordinated liabilities mature on the dates shown in the above table.

37. Called up share capital and share premium account

	1994 £m	1993 £m
Authorised share capital		
Ordinary share capital	175	175
Preference share capital	506	—
Issued and fully paid share capital		
Ordinary share capital	131	131
Preference share capital	—	—
Share premium account	840	836

The authorised share capital of Abbey National was increased at the Annual General Meeting on 28 April 1994, from £175 million (comprising 1,750 million ordinary shares of 10 pence each) to £675 million and US $10 million by the creation of 500 million preference shares of £1 each and 1 billion preference shares of US $0.01 each.

Under Abbey National plc's Executive and Sharesave schemes, employees hold options to subscribe for 26,094,580 (23,654,025) ordinary shares at prices ranging from 149.0 to 468.0 pence per share, exercisable up to 2004. During the year 592,300 shares were issued on the exercise of options for a consideration of £1,200,128.

In respect of 1993, under the terms of the Share Participation scheme, employees were able to elect to contribute, gross of tax, any performance related bonus to a trust fund. The trustees of the scheme used such funds to subscribe for ordinary shares in Abbey National plc on behalf of the employees. During 1994 493,213 shares were issued under the terms of the scheme for a consideration of £2,416,744.

The issue of the above shares resulted in the increase in the share premium account of £4m.

37. Called up share capital and share premium account (Continued)

As of 13 January 1995 there were 2,511,417 shareholders. The following table shows an analysis of their holdings:

Size of shareholding	Shareholders	Shares
1 - 100	1,684,768	167,474,091
101 - 1,000	793,136	370,516,203
1,001 +	33,513	774,164,327
	2,511,417	1,312,154,621

The directors have approved the establishment of a 'Level 1' American Depositary Receipt (ADR) facility for the ordinary shares of Abbey National plc. This allows the ordinary shares to be sold in the United States in the form of depositary receipts. Level 1 ADRs are not listed on any stock exchange in the United States. Under the facility, ordinary shares may be deposited with a custodian for the depositary and receipts evidencing the ownership of those shares issued to American investors. Dividends relating to the ordinary shares are converted to US dollars and distributed to the owners of the receipts by the depositary. Owners of receipts will be entitled to instruct the depositary as to the exercise of voting rights relating to the underlying shares.

38. Reserves and profit and loss account

	Profit and loss account	Non-distributable reserve
	£m	£m
At 1 January 1994	2,380	39
Retained profit for the year	312	—
Goodwill recognised in the profit and loss account in the year	10	—
Goodwill taken to profit and loss account reserve during the year	(66)	—
Exchange adjustments	(7)	—
Transfer to non-distributable reserve	—	65
At 31 December 1994	2,629	104

The cumulative amount of goodwill taken to reserves by the Group to 31 December 1994 and not yet recognised in the profit and loss account is £156m (1993: £100m).

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

39. Reconciliation of movements in shareholders' funds

	1994	1993	1992
	£m	£m	£m
Profit on ordinary activities after tax	610	390	317
Dividends	(233)	(184)	(151)
	377	206	166
Other recognised net gains and losses relating to the year	(7)	(8)	4
New share capital subscribed including share premium	4	—	2
Goodwill recognised in the profit and loss account in the year	10	4	126
Goodwill taken to profit and loss account reserve during the year	(66)	—	(85)
Net addition to shareholders' funds	318	202	213
Shareholders' funds at 1 January	3,386	3,184	2,971
Shareholders' funds at 31 December	3,704	3,386	3,184

39. Reconciliation of movements in shareholders' funds (Continued)

Shareholders' funds comprise called-up share capital, share premium account, profit and loss account and reserves.

40. Guarantees and assets pledged as collateral security

	1994 £m	1993 £m
Guarantees given to third parties	76	61
Mortgaged assets granted to secure future obligations to third parties who have provided security to the leasing subsidiaries	760	641
	836	702

Under Section 22 of the Building Societies Act 1986, Abbey National Building Society was obliged to discharge the liabilities of its associated bodies (including subsidiaries) in so far as they were unable to discharge them out of their own assets. Under the Act, the obligations of the Society at Vesting Day on 12 July 1989 in respect of its associated bodies were transferred to Abbey National plc. In addition, Abbey National plc has unconditionally and irrevocably guaranteed all the obligations of Abbey National Treasury Services plc, Abbey National North America Corporation, Abbey National Bank SAE, Abbey National Treasury International Ltd, Abbey National (Gibraltar) Ltd, Abbey National France SA, Abbey National Funding (Jersey) Ltd and Abbey National Second Capital BV. Abbey National plc has guaranteed certain liabilities of Abbey National First Capital BV and Abbey National Sterling Capital plc.

41. Other contingent liabilities

Priority liquidation distribution

The Building Societies Act 1986 requires that savers who were eligible to vote on the conversion proposals and who continued to have savings in any share account with the Society up to Vesting Day must have a right to a priority liquidation distribution by Abbey National plc. This is a right, in the unlikely event of Abbey National plc being wound up, to a distribution of a proportion of its assets in priority to all other creditors (other than statutory preferential creditors) and shareholders of Abbey National plc.

The calculation of the right is based on the reserves of the Society as at 31 December 1988 after deducting the cash distribution and costs of conversion. Initially this amount was £1.3 billion. This has reduced as members continue to operate their accounts and the amount of the right had reduced to £59m (1993: £96m) at 31 December 1994.

The priority liquidation right is secured by a floating charge over the undertaking and assets of Abbey National plc and by a guarantee by, and floating charge over the undertaking and assets of, Abbey National Treasury Services plc.

Pension transfers and opt-outs

The Securities and Investments Board (SIB) has issued detailed guidance for the review of business involving the transfers from occupational to personal pension schemes and the opting-out of and the non-joining of occupational pension schemes. The Group is in the process of carrying out a review of any potential exposures in respect of such business. In view of the uncertainty regarding this issue, estimated provisions in respect of possible compensation to customers have been made where considered appropriate. Estimated provisions of £5m (1993: £1m) have been charged to the profit and loss account for the year ended 31 December 1994, and the total of such provisions as at 31 December 1994 is £6m (1993: £1m).

42. Commitments

The tables below show the nominal principal amounts of commitments other than exchange rate and interest rate contracts, details of which are included in note 50.

	1994	1993
	£m	£m
Forward asset purchases and forward deposits placed	517	126
Formal standby facilities, credit lines and other commitments to lend:		
One year and over	899	616
Less than one year	130	42
	1,546	784

43. Assets and liabilities denominated in foreign currency

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

	1994	1993
	£m	£m
Assets	26,371	18,228
Liabilities	29,383	22,892

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

44. Consolidated cash flow statement

a) Reconciliation of profit before tax to net cash inflow from operating activities

	1994	1993	1992
	£m	£m	£m
Profit on ordinary activities before tax	932	704	564
Increase in interest receivable and pre-paid expenses	(577)	(188)	(484)
Increase in interest payable and accrued expenses	930	174	222
Provisions for bad and doubtful debts	74	218	274
Net advances written off	(166)	(137)	(83)
Increase in the value of long term assurance business	(98)	(47)	(10)
Depreciation	84	84	77
Profit on sale of tangible fixed assets and investments	(17)	(8)	(4)
Loss on disposal of subsidiary undertakings	—	30	—
Effect of other deferrals and accruals of cash flows from operating activities	22	49	118
Net cash flow from trading activities	1,184	879	674
Net increase in loans and advances	(28)	(4,219)	(4,708)
Net increase in investment in finance leases	(25)	(516)	(948)
Net decrease/(increase) in bills and securities	(655)	8	752
Net increase in deposits and customer accounts	2,461	5,060	7,050
Net increase in debt securities in issue	2,765	4,101	3,946
Net increase in other liabilities less assets	158	607	195
Exchange adjustments	483	(182)	(990)
Net cash inflow from operating activities	6,343	5,738	5,971

44. Consolidated cash flow statement (Continued)

b) Analysis of cash and cash equivalents

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

	1994	1993	1992
	£m	£m	£m
Cash and balances with central banks	166	168	150
Treasury and other eligible bills	10	—	44
Loans and advances to banks	1,789	1,712	1,574
Debt securities	939	1,036	474
	2,904	2,916	2,242

The Group is required to maintain balances with the Bank of England which at 31 December 1994 amounted to £175m (1993: £167m, 1992: £152m). These are shown in loans and advances to banks.

c) Analysis of changes in cash and cash equivalents during the year:

	1994	1993	1992
	£m	£m	£m
At 1 January	2,916	2,242	2,613
Net cash inflow/(outflow) before adjustment for the effect of foreign exchange rate changes	51	658	(578)
Effect of foreign exchange rate changes	(63)	16	207
At 31 December	2,904	2,916	2,242

d) Analysis of changes in financing during the year

	Share Capital inc. Share Premium 1994	Subordinated Liabilities 1994	Share Capital inc. Share Premium 1993	Subordinated Liabilities 1993	Share Capital inc. Share Premium 1992	Subordinated Liabilities 1992
	£m	£m	£m	£m	£m	£m
At 1 January	967	868	967	648	965	388
Net cash inflow from financing	4	659	—	220	2	240
Effect of foreign exchange adjustments	—	(6)	—	—	—	20
Amortisation of premium	—	(1)	—	—	—	—
At 31 December	971	1,520	967	868	967	648

44. Consolidated cash flow statement (Continued)

e) Purchase of subsidiary undertakings

	1994 £m	1993 £m	1992 £m
Net assets acquired:			
Loans and advances to customers	2,498	—	—
Loans and advances to banks	77	—	—
Long term assurance business	—	—	208
Other assets	51	—	1
Deposits by banks	(911)	—	—
Debt securities in issue	(1,616)	—	—
Other liabilities	(92)	—	(3)
Minority shareholders' interest	—	—	(2)
Goodwill	66	—	85
	73	—	289
Satisfied by:			
Unsecured interest bearing loan notes	2	—	—
Cash	71	—	4
Transfer to the long term assurance fund	—	—	285
	73	—	289

f) Analysis of the net outflow of cash and cash equivalents in respect of the purchase of subsidiary undertakings

	1994 £m	1993 £m	1992 £m
Cash consideration	71	—	4
Cash and cash equivalents acquired	(19)	—	—
Net outflow of cash and cash equivalents in respect of purchase of subsidiary undertakings	52	—	4

g) Sale of subsidiary undertakings

	1994 £m	1993 £m	1992 £m
Net assets disposed of:			
Fixed assets	—	15	—
Debtors	—	5	—
Cash at bank and in hand	—	7	—
Creditors	—	(3)	—
	—	24	—
Provisions made for future liabilities retained	—	10	—
Goodwill recognised on disposal	—	4	—
Loss on disposal	—	(30)	—
Consideration received	—	8	—
Satisfied by:			
Cash	—	8	—

44. Consolidated cash flow statement (Continued)

h) Analysis of the net inflow of cash and cash equivalents in respect of the sale of the subsidiary undertakings:

	1994	1993	1992
	£m	£m	£m
Cash received as consideration	—	8	—
Cash and cash equivalents disposed of	—	(7)	—
Net inflow of cash and cash equivalents in respect of sale of subsidiary undertakings	—	1	—

45. Retirement benefits

The Abbey National Amalgamated Pension Fund is the principal pension scheme within the Group, covering 84% of the Group's employees, and is a funded defined benefits scheme.

The latest actuarial valuation carried out by an independent professionally qualified actuary was made as at 31 March 1993, at which date the market value of the scheme assets was £460m.

The valuation was prepared by using the projected unit funding method and disclosed a funding level of 105% and a regular employer's contribution rate of 20.7% of pensionable salaries in respect of benefits accruing after the valuation date. On the basis of actuarial advice Abbey National plc's regular contributions have been resumed.

The main long term financial assumptions used in the valuation were:

	% per annum
Investment return	9.5
Equity dividend growth	5.0
Pension increases	4.5
General salary increases	7.0
General price inflation	5.0

The pension cost of £34m (1993: £28m, 1992: £17m) reflects the regular contribution rate less an amount in respect of the surplus being recognised over the expected remaining service lives of the members of the fund in accordance with SSAP 24 on accounting for pension costs. Contributions of £39m (1993: £6m, 1992: nil) were made to the fund in 1994 and a provision of £57m (1993: £62m, 1992: £40m) has been included in the balance sheet. Actuarial valuations of the assets and liabilities of the scheme are carried out at least once in every three years by external actuaries to determine the financial position of the fund. The next valuation will be made no later than 31 March 1996.

The Scottish Mutual Assurance pension fund covers the employees of Scottish Mutual Assurance plc amounting to 5% of the Group's employees and is also a funded defined benefits scheme. The latest actuarial valuation was made as at 31 December 1991 and disclosed a funding level of 124%. It is estimated that the surplus will be removed by 31 December 1998.

The Associated Bodies Pension Fund, which covers 1% of the Group's U.K. employees, is similarly constituted. An actuarial review was conducted as at 31 March 1993 which revealed a modest excess of assets over liabilities.

46. Post balance sheet events

Abbey National Financial Products (formerly Abbey National Baring Derivatives) ("ANFP") is a branch of Abbey National Treasury Services plc and had an operating agreement with Baring Brothers and Co. Ltd, a subsidiary of Barings plc, under which certain services, staff and premises were provided to ANFP.

46. Post balance sheet events (Continued)

An administrator was appointed to Barings plc on 26 February 1995. ANFP was not involved in any way with the events that resulted in the appointment of the administrator. The directors are satisfied that no adjustment is required to the Group accounts as a result of these events.

On 3 February 1995, Abbey National plc acquired Pegasus Assurance Group Ltd for a total consideration of £8m, of which £2m was in the form of ordinary shares in Abbey National plc, valued at the closing mid-market price on 3 February 1995, and the remainder in cash. The acquisition was made on 3 February 1995, and consequently is not included in the accounts at 31 December 1994.

47. Differences between U.K. generally accepted accounting principles ("U.K. GAAP") and U.S. generally accepted accounting principles ("U.S. GAAP")

The accounts presented in this report have been prepared in accordance with U.K. GAAP. Such principles vary in significant respects from U.S. GAAP. The significant differences applicable to Abbey National's accounts are summarised below.

U.K. GAAP	U.S. GAAP
Pension costs Where pensions are provided by means of a funded defined benefits scheme, annual contributions are based on actuarial advice. The expected cost of providing pensions is recognised on a systematic basis over the expected average remaining service lives of members of the scheme. Variations from regular cost are expressed as a percentage of payroll and spread over the average remaining service lives of current employees.	**Pension costs** Under Statement of Financial Accounting Standards (SFAS) No. 87, the same basic actuarial method is used as under U.K. GAAP, but certain assumptions differ, assets are assessed at fair value and liabilities are assessed at current settlement rates. Certain variations from regular cost are allocated in equal amounts over the average remaining services lives of current employees.
Goodwill Goodwill arising on consolidation as a result of the acquisition of subsidiaries and goodwill arising on the purchase of businesses are taken direct to reserves in the year in which they occur. On disposal of a business, the goodwill previously taken to reserves is recognised in the profit and loss account balanced by an equal credit to reserves. Where the directors believe that the purchased goodwill in continuing businesses has suffered a permanent diminution in value, a similar recognition in the profit and loss account and credit to reserves is made.	**Goodwill** Goodwill is capitalised and amortised in the consolidated statement of income over the period in which the benefits are estimated to accrue. In Abbey National's case, a period of 20 years has been used. Goodwill is written off when judged to be irrecoverable.
Leasing Income from finance leases, including benefits from declining tax rates, is credited to the profit and loss account using the actuarial after tax method to give a constant periodic rate of return on the net cash investment.	**Leasing** Application of SFAS No. 13 gives rise to a level rate of return on the investment in the lease, but without taking into account tax payments and receipts. This results in income being recognised in different periods than under U.K. GAAP.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

47. Differences between U.K. GAAP and U.S. GAAP (Continued)

U.K. GAAP	U.S. GAAP
Investments in securities Securities held for investment purposes are stated at cost adjusted for any amortisation of premium or discount. All securities not held for investment purposes are stated at market value and profits and losses arising from this revaluation are taken to the profit and loss account.	**Investments in securities** Securities are classified as trading securities, available for sale securities, and held to maturity securities in accordance with SFAS No. 115. Held to maturity securities are accounted for in the same way as securities held for investment purposes under U.K. GAAP. Trading securities are accounted for in the same way as securities not held for investment purposes under U.K. GAAP. Available for sale securities are reported at market value, with the net unrealised gains of £24 million at 31 December 1994 excluded from earnings, but reported in a separate component of shareholders' equity. Abbey National has complied with SFAS No. 115 as from 1 January 1994. The effect of implementing the standard was to increase the carrying value of securities classified as available for sale on 1 January 1994, as stated under U.S. GAAP, by £783 million, before taking into account the impact of certain hedges in place against the securities, and to increase shareholders' equity by the same amount.
Amortisation of losses in internal investment fund Where fixed interest investments have been held within an internal investment fund with a planned maturity, profits and losses arising on transactions within the fund have been spread evenly over the period to maturity of the fund.	**Amortisation of losses in internal investment fund** The profits and losses arising on all securities transactions are dealt with in the profit and loss account in the period in which they arise.
Deferred tax Deferred taxation is accounted for only where it is probable that a liability or asset will arise. Provision is calculated at rates expected to be applicable when the liability or asset crystallises. No deferred tax asset is created in respect of general allowances for lending losses which are not deductible in arriving at U.K. taxable profits.	**Deferred tax** Provision for deferred tax under the liability method is required in full for all timing differences, including general allowances for loan losses and tax loss carry forwards. Deferred tax assets are recognised subject to any adjustment for valuation allowances.
Shareholders' interest in long-term assurance policies The Shareholders' interest in the in-force policies of the long-term assurance fund is valued at the net present value of the profits inherent in such policies.	**Shareholders' interest in long-term assurance policies** The net present value of inherent profits of long-term assurance policies is not recognised by Abbey National in the results prepared under US GAAP.
Loan origination fees Loan origination fees are recognised in income in the period in which they are receivable.	**Loan origination fees** Fee income from originating a loan is spread over the life of the loan in accordance with SFAS No. 91.

47. Differences between U.K. GAAP and U.S. GAAP (Continued)

U.K. GAAP	U.S. GAAP
Dividend payable	**Dividend payable**
Dividends declared after the period end are recorded in the period to which they relate.	Dividends are recorded in the period in which they are declared.

Future Developments

SFAS No. 114, "Accounting for Creditors for Impairment of a Loan", requires that impaired loans be carried at the present value of expected future cash flows, discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market value, or the fair value of the collateral if the loan is collateral dependent. SFAS No. 114 is required to be adopted in 1995. Abbey National is currently reviewing this statement to determine what effect it may have on the reconciliation of net income and shareholders' equity between U.K. and U.S. GAAP.

Differences between U.K. and U.S. accounting principles

The following table summarises the significant adjustments to consolidated net income or loss and shareholders' equity which would result from the application of U.S. GAAP instead of U.K. GAAP.

	1994	1993	1992
	£m	£m	£m
Consolidated Net Income of Abbey National plc (U.K. GAAP)	610	390	317
Goodwill	(6)	(4)	20
Pensions cost	(14)	(12)	(6)
Leasing	(7)	(12)	(15)
Loan origination fees	—	—	(1)
Shareholders' interest in long-term assurance policies	(98)	(47)	(10)
Amortisation of losses in internal investment fund	—	15	8
Deferred tax effect of the above U.S./U.K. GAAP adjustments	40	18	7
Deferred tax	—	(3)	4
Consolidated Net Income of Abbey National plc (U.S. GAAP)	525	345	324
per 10 pence ordinary share	40.0p	26.3p	24.7p

	1994	1993	1992
	£m	£m	£m
Shareholders' equity (U.K. GAAP)	3,704	3,386	3,184
Goodwill	138	89	97
Pensions cost	(19)	(5)	7
Leasing	(40)	(33)	(21)
Loan origination fees	(2)	(2)	(2)
Shareholders' interest in long-term assurance policies	(155)	(57)	(10)
Dividend payable	158	129	101
Amortisation of losses in internal investment fund	—	1	(14)
Unrealised surplus on securities available for sale	24	—	—
Deferred tax effect of the above U.S./U.K. GAAP adjustments	70	30	12
Deferred tax	14	14	17
Shareholders' equity (U.S. GAAP)	3,892	3,552	3,371

47. Differences between U.K. GAAP and U.S. GAAP (Continued)

Securities and Investments

(a) Under U.S. GAAP, SFAS No. 115 requires certain disclosures relating to securities and investments as at 31 December 1994. The following table provides an analysis of the relevant balance sheet total under both U.S. and U.K. GAAP.

	As at 31 December 1994 UK GAAP	As at 31 December 1994 US GAAP
	£m	£m
Trading securities	2,806	2,806
Available for sale securities	27,587	27,608
Securities held to maturity	1,984	1,984
	32,377	32,398
Less general provision against available for sale securities	(3)	—
	32,374	32,398

Further disclosures required by SFAS No. 115 are as follows:

(b) Available for sale securities

	Amortised cost	Gross unrealised gains	Gross unrealised losses	Fair value
	£m	£m	£m	£m
Equity securities	42	—	—	42
Debt securities issued or backed by US Treasury and other US government corporations and agencies	3,486	17	(84)	3,419
Debt securities issued by foreign governments	6,656	306	(114)	6,848
Corporate debt securities	9,812	90	(130)	9,772
Mortgage backed securities	4,905	15	(56)	4,864
Other debt securities	2,686	5	(28)	2,663
	27,587	433	(412)	27,608
General provision against debt securities	(3)			
	27,584			

The majority of Corporate debt securities are guaranteed by banks or other financial institutions.

Maturity analysis	Not more than 1 year	In more than 1 year but not more than 5 years	In more than 5 years but not more than 10 years	In more than 10 years	Total
	£m	£m	£m	£m	£m
Book value before general provision	2,039	11,295	4,454	9,799	27,587
Fair value	2,027	11,118	4,299	10,164	27,608

47. Differences between U.K. GAAP and U.S. GAAP (Continued)

(c) Held to maturity securities

	Amortised cost	Gross unrealised gains	Gross unrealised losses	Fair value
	£m	£m	£m	£m
Corporate debt securities	1,984	—	—	1,984

Maturity analysis	Not more than 1 year	In more than 1 year but not more than 5 years	In more than 5 years but not more than 10 years	In more than 10 years	Total
	£m	£m	£m	£m	£m
Book value	—	423	1,561	—	1,984
Fair value	—	423	1,561	—	1,984

(d) Sales of available for sale securities during the year to 31 December 1994.

	£m
Gross proceeds from sales	26,050
Gross realised losses on sales	80
Gross realised gains on sales	(100)
Amortised cost of sales	26,030

The cost of available for sale securities is determined by using the weighted average cost basis, with premium/discount arising on purchase being amortised to profit and loss over the expected life of the security.

(e) Redemptions and purchases of held to maturity securities during the year to 31 December 1994

	£m
Value on redemption	502
Gross realised losses on redemption	6
Gross realised gains on redemption	—
Amortised cost of securities redeemed	508

Redemption of held to maturity securities represent 100% of the preference shares of ACP Treasury Ltd., a company incorporated in Jersey, which were redeemed in return for debt securities held by that company and valued at market value for the purpose of the transaction. The debt securities acquired are included in available for sale securities.

Purchases during the year to 31 December 1994 amounted to £200m.

(f) Unrealised gains and losses on transfers from available for sale securities to trading securities during the year to 31 December 1994 were as follows:

	£m
Gross unrealised gains	7
Gross unrealised losses	—
	7

(g) The net change in unrealised holding gains (losses) on trading securities included in income for the year to 31 December 1994 is a loss of £3m.

47. Differences between U.K. GAAP and U.S. GAAP (Continued)

Pension Costs

For the reconciliation above, the Group adopts the provisions of SFAS No 87, "Employers Accounting for Pensions", in respect of its principal pension plans, The Abbey National Amalgamated Pension Fund and the Scottish Mutual Assurance plc Staff Pension Scheme. Estimated pension costs for these plans computed under SFAS No 87 are as follows:

	Year ended 31 December		
	1994	1993	1992
	£m	£m	£m
Service cost	53	41	34
Interest cost	43	43	36
Actual (return)/loss on plan assets	(36)	(149)	(7)
Net amortisation and deferral	(7)	108	(38)
Pension costs	53	43	25

The estimated funded status of the Abbey National Amalgamated Pension Fund and the Scottish Mutual Assurance plc Staff Pension Scheme under SFAS No. 87 was as follows:

	Year ended 31 December	
	1994	1993
	£m	£m
Projected benefit obligation	590	584
Plan assets at fair value	640	577
Plan assets in excess (less than) projected benefit obligation	50	(7)
Amounts available to be applied as an increase (reduction) to future pension cost:		
Balance of initial transition amount	(57)	(64)
Net unrecognised losses	(87)	(14)
Unrecognised prior service cost	17	19
(Accrued) prepaid pension cost	(77)	(66)

The estimated accumulated benefit obligation at 30 September 1994 amounted to £497m (30 September 1993; £530m), of which £424m was vested (30 September 1993; £449m). The actuarial value placed upon the vested benefit obligation (VBO) is lower than that placed upon the accumulated benefit obligation primarily because the statistical assumptions used in calculating the Projected and Accumulated Benefit Obligations made provision for members to retire prior to the age from which vested benefits are payable, in view of the terms on which such retirement may, with the consent of the relevant Group company, take place. It is not appropriate to reflect such an assumption in the calculation of the VBO.

47. Differences between U.K. GAAP and U.S. GAAP (Continued)

Under SFAS No. 87, the excess of plan assets over the projected benefit obligation at the transition date (1 January 1988) would be recognised as a reduction to pension expense on a prospective basis over approximately 14 years. The financial assumptions used to calculate the projected benefit obligation at 30 September 1994 and 1993 are as follows:

	Year ended 31 December	
	1994	1993
	% pa	% pa
Discount rate	9.0	7.5
Rate of pay escalation	6.5	5.5
Rate of pension increase	4.0	3.5
Rate of return on assets	9.0	8.0

The assets of the schemes are invested primarily in equities and fixed interest securities.

The schemes' retirement benefits are generally based on the final year's pensionable salary and the number of years pensionable service with the Group at retirement.

The £52m U.S. GAAP pension cost (1993 £43m, 1992 £25m) compares with £38m (1993 £31m, 1992 £19m) under U.K. GAAP. The difference, net of U.K. corporation tax at 33% results in an additional charge to net income of £9m (1993 £8m charge, 1992 £4m charge) under U.S. GAAP.

Abbey National plc operates other pension schemes within the Group. These schemes are small and the difference in pension costs under U.K. and U.S. accounting principles is not material.

Taxes

(i) No significant element of the tax expense in each of the three years ended 31 December 1994, 1993 and 1992 is attributable to discontinued operations.

(ii) The significant components of tax expense attributable to continuing operations are shown in note 13.

(iii) A reconciliation of taxes payable at the standard UK corporation tax rate and the Group's effective tax rate for each of the three years ended 31 December 1994, 1993 and 1992 is shown as follows.

	Year ended 31 December		
	1994	1993	1992
	£m	£m	£m
Taxation at standard U.K. corporation tax rate (33%, 33%, 33.25%)	308	232	186
Effect of non-allowable provisions	8	31	2
Goodwill on disposals previously written off	3	1	41
Unrelieved overseas losses	—	36	16
Adjustment to prior year tax provisions	3	14	2
Taxes	322	314	247
Effective tax rate	34.5%	44.6%	43.8%

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

47. Differences between U.K. GAAP and U.S. GAAP (Continued)

(iv) The tax effects of the principal components of deferred tax liabilities and deferred tax assets at 31 December 1994, 1993 and 1992 were as follows:

	1994	1993	1992
	£m	£m	£m
Deferred Tax Liabilities recognised in U.K. financial statements			
Excess of capital allowances over depreciation	18	17	14
Capital allowances on finance lease receivables	348	259	167
Other	33	20	(15)
	399	296	166
Additional Deferred tax assets arising from application of U.S. GAAP			
Operating loss carry forwards	73	64	11
Deductible temporary differences	24	30	63
	97	94	74
Less valuation allowance	(83)	(80)	(57)
Deferred tax assets (U.S. GAAP)	14	14	17
Deferred tax effect of U.S. GAAP adjustments	70	30	12
Net deferred tax liabilities	315	252	137

Of the additional deferred tax asset in respect of operating loss carryforwards shown above, £2m is expected to expire at the end of 1996, £2m at the end of 1997, £21m at the end of 1998 and £20m at the end of 1999.

Consolidated Cash Flow Statement

The UK Financial Reporting Standard 1 ("FRS1"), "Cash Flow Statements", and SFAS No. 95 as amended by SFAS No. 104, are substantially similar in approach. The principal differences are in the classification of certain transactions under the categories prescribed by the statements, as follows:

	Classification under FRS1	Classification under SFAS No. 95
Dividends received	Returns on investment and servicing of finance	Investing activities
Dividends paid	Returns on investment and servicing of finance	Financing activities
Taxation paid	Taxation paid	Operating activities
Net increase in loans and advances	Operating activities	Investing activities
Net increase in investment in finance leases	Operating activities	Investing activities
Net increase in deposits and customer accounts	Operating activities	Financing activities
Net increase in debt securities in issue	Operating activities	Financing activities

Alternative Presentation of the Consolidated Profit and Loss account.

The presentation of the profit and loss account for the year ended 31 December 1994, as shown on page F-4, would be no different under U.S. GAAP.

47. Differences between U.K. GAAP and U.S. GAAP (Continued)

For the year ended 31 December 1993, the loss on sale of the residential estate agency business shown as an exceptional item in the consolidated profit and loss account on page F-4 would, under U.S. GAAP, be included within other operating expenses.

For the year ended 31 December 1992, the reorganisation and restructuring costs of the residential estate agency business, and the gain from the sale of unclaimed shares, shown as exceptional items in the consolidated profit and loss account on page F-4 would, under U.S. GAAP, be included within other operating expenses.

The following consolidated profit and loss account illustrates this presentation:

	Year ended 31 December		
	1994	1993	1992
	£m	£m	£m
Net interest income	1,394	1,338	1,265
Other income and charges	365	376	319
Operating expenses	(755)	(793)	(743)
Provisions for bad and doubtful debts	(74)	(218)	(274)
Amounts written off fixed asset investments	2	1	(3)
Profit on ordinary activities before tax	932	704	564
Tax on profit on ordinary activities	(322)	(314)	(247)
Profit on ordinary activities after tax	610	390	317
Transfer to non-distributable reserve	(65)	(32)	(7)
Dividends	(233)	(184)	(151)
Retained profit for the year	312	174	159
Profit on ordinary activities before tax includes as a result of acquisitions	22	—	30
Profit on ordinary activities before tax includes for discontinued operations	—	(32)	(158)

48. Significant group concentrations of credit risk

The Group's balance sheet still strongly reflects its history as a U.K. building society, with 50% (1993: 52%) of total assets at 31 December 1994 being residential mortgages. 98% (1993: 98%) of the residential mortgage asset is in the U.K.

Although the Group's Treasury Operations are based in the U.K., it has built up exposures to various entities around the world. This exposure is principally in respect of government and bank counterparties.

49. Fair values of financial instruments

SFAS No. 107 'Disclosures about Fair Value of Financial Instruments' requires disclosure of the fair value of financial instruments.

The fair values have been estimated using quoted market prices where available. Where no ready markets exist and hence quoted market prices are not available, the directors' valuation is given. The directors' valuation results from appropriate techniques which typically take account of the characteristics of the instruments including the future cash flows, the market interest rate and prices available for similar instruments.

By its nature, the estimation of fair values is highly subjective and the results will depend largely upon the assumptions made. Considerable caution should therefore be used in interpreting the fair values and particularly if comparing with fair values presented by other groups.

The Group attaches great value to its branch network, to its profile in the U.K. personal financial services market and to its good reputation with its customers. However, such intangible assets are not recognised for the purposes of SFAS No. 107. Furthermore, the concept of fair values assumes that the

49. Fair values of financial instruments (Continued)

financial instruments will be realised by way of sale. However, with the exception of certain securities, the Group intends to realise its assets through collection over time. Consequently, the directors believe that the fair values significantly understate the true value of the group as a going concern.

The following assets and liabilities, excluded from the scope of SFAS No. 107, are carried at market value or are short-term such that their carrying values are a reasonable approximation of fair value.

Assets	Liabilities
Cash and balances at central banks	Dividends proposed
Treasury bills and other eligible bills	Other liabilities
Long term assurance business	Accruals and deferred income
Tangible fixed assets	Provisions for liabilities and charges
Other assets	Liabilities of long term assurance funds
Prepayments and accrued income	
Assets of long term assurance funds	

The financial instruments for which fair value has been estimated are as follows:

Debt securities and equity shares and other variable yield securities

The market or appraised values of debt securities, equity shares and other variable yield securities are shown in notes 21 and 22 respectively. Securities and investments have been valued using quoted market prices where available. Where market prices are not available the directors' valuation has been used. The directors' valuation takes into consideration discounted cash flows, market prices of comparable securities and other appropriate valuation techniques.

Loans and advances to banks

The estimated fair value of loans and advances to banks as at 31 December 1994 is approximately £2,905m (1993: £3,559m), compared to a recorded value of £2,906m (1993: £3,556m).

The fair value of loans and advances to banks has been estimated by discounting future cash flows using available market interest rates offered for loans and advances with similar characteristics.

Loans and advances to customers

Loans and advances to personal customers are made both at variable and at fixed rates. As there is no active market in the U.K. for such lending, there is no reliable market value available for such a significant portfolio. However, if a market value could be ascertained, the directors believe it would reflect the expectation of a long-term and continuing relationship with a majority of the customers. Although substantial, this value is intangible and it cannot therefore be included in the fair value. Consequently the directors believe that, for the purposes of SFAS No. 107, the carrying value of the variable rate loans is a reasonable estimate of their fair value.

Certain of the loans secured on residential properties are at a fixed rate for a limited period, typically two to three years from their commencement. At the end of this period these loans revert to the relevant variable rate. The excess of fair value over carrying value of each of these loans has been estimated by reference to the market rates available at 31 December 1994 for similar loans of maturity equal to the remaining fixed period. The fixed element of such loans is substantially hedged such that any movement in the value of the loan as a result of market interest rate changes will be offset by an equivalent movement in the value of instrument used as a hedge.

The fair value for the remaining loans and advances to customers has been estimated by discounting future cash flows using available market interest rates offered for loans and advances with similar characteristics.

49. Fair values of financial instruments (Continued)

SFAS No. 107 does not require an estimate of the fair value of finance lease receivables. They are therefore included at their carrying value.

The fair value of loans and advances to customers as at 31 December 1994 is approximately £50,992m (1993: £48,063m) compared with a carrying value of £51,123m (1993: £47,748m).

Deposits by banks and customers

SFAS No. 107 states that the fair value of deposit liabilities payable on demand is equal to the carrying value. However, given the long-term and continuing nature of the relationships with its customers, the directors believe there is significant value in this source of funds.

The fair value of other deposits is estimated using discounted cash flows using available market interest rates offered for deposits with similar characteristics.

The estimated fair value of deposits by banks and customers as at 31 December 1994 is approximately £55,860m (1993: £52,557m) compared with a carrying value of £55,882m (1993: £52,511m).

Debt securities in issue and subordinated liabilities

The estimated fair value of debt securities in issue and subordinated liabilities as at 31 December 1994 is approximately £24,356m (1993: £19,930m) compared to a carrying value of £24,933m (1993: £19,898m).

The fair value of debt securities in issue and subordinated liabilities has been calculated using quoted market prices where available. Where prices are not available, the fair value has been estimated by discounting anticipated future cash flows using market interest rates, offered at 31 December for similar securities.

Financial commitments and contingent liabilities

The directors believe that, given the lack of an established market, the diversity of fee structures and the estimation required to separate the value of the instruments from the value of the overall transaction, it is generally difficult to estimate the fair value of financial commitments and contingent liabilities. However, since the majority of these are at floating rates the fair value will be close to the book value quoted. The principal amounts for these instruments are disclosed in note 42.

Off-balance sheet financial instruments

The group uses various market-related off-balance sheet financial instruments, as explained in note 50 below. The fair value of these instruments is estimated using market prices or pricing models consistent with standard market practice. Such fair values were approximately £290m below the book asset value of these off-balance sheet financial instruments.

It should be noted that, where these instruments are designated as hedges, a rise or fall in the fair value of the hedge will be offset by a substantially equivalent reduction or increase in the fair value of the asset or liability against which the hedge was placed.

50. Derivatives

Derivatives are used in two distinct ways by the Abbey National Group. The first is as hedging instruments for activities in U.K. Retail Banking and Treasury Operations and for the Group's balance sheet. The second is in the market-making activity undertaken within ANFP.

Derivative instruments are contracts or agreements whose value is derived from one or more underlying indices inherent in the contract or agreement. They include interest rate and cross-currency swaps, forward rate agreements, futures, options and swaptions.

The total nominal amount of the Group's outstanding interest rate contracts at 31 December 1994 was £77,129m (which includes £31,365m in respect of ANFP) compared to £37,464m at 31 December 1993 (which includes £5,501m in respect of ANFP) and £18,701m at 31 December 1992. The total nominal

50. Derivatives (Continued)

amount of the Group's outstanding exchange rate related contracts was £11,681m at 31 December 1994 compared to £15,537m at 31 December 1993 and £10,504m at 31 December 1992. The total for 1994 (1993) includes £486m (£25m) in respect of ANFP. Following a review of the classification of off balance sheet contracts, amounts for 1993 have been restated to reflect the reclassification of certain contracts between the exchange rate and interest rate categories. The reclassification relates to exchange traded contracts on foreign government bond futures, which for any one transaction may provide a hedge against either interest rate or exchange rate movements. ANTS organises its investment activities by means of matched currency investment books in a number of currencies. Hedging of assets or liabilites against exchange rate movements is achieved mainly through the use of currency swaps. The main purpose for the usage of bond futures contracts is therefore to protect against interest rate movements. Management therefore believe that these contracts are more appropriately classified as interest rate related instruments.

Hedging Activity

Derivative products are used for a variety of hedging purposes in Abbey National. The major hedging instruments are swaps, which are used to hedge Group balance sheet exposures, fixed rate mortgage lending and savings products in U.K. Retail Banking and Continental Europe and Offshore as well as medium-term note issues, capital issues, fixed rate asset purchase and other exposures to fixed interest rates and exchange rates within Treasury Operations. Caps, floors, swaptions and exchange traded options and futures also may be used for similar hedging activities.

A significant part of Abbey National's exposures can be hedged internally, by offset against other categories of exposure in the balance sheet. Market risk management in ANTS may be undertaken either on the basis of assets and liabilities on a one-for-one basis or on an aggregate basis within one of the currency matched investment books, in which case hedging is arranged on the net or aggregated position on the book for the currency concerned. The following table sets forth certain activities undertaken by the Group, the related risks associated with such activities and provides details of the types of derivatives used in managing such risks.

Activity	Risk	Type of Hedge
Management of the return on investment of shareholders' equity and net non-interest bearing liabilities.	Reduced profitability due to falls in interest rates.	Receive fixed interest rate swaps. Purchased floors.
Fixed rate mortgage lending.	Sensitivity to increase in interest rates.	Pay fixed interest rate swaps. Purchased caps.
Management of other net interest income on retail activities.	Sensitivity of returns to changes in interest rates.	Interest rate swaps and caps/ floors according to the type of risk identified.
Fixed rate funding (e.g. medium-term note issuance).	Sensitivity to falls in interest rates.	Receive fixed interest rate swaps.
Fixed rate asset investments.	Sensitivity to increase in interest rates.	Pay fixed interest rate swaps.
Investment in foreign currency assets.	Sensitivity to increase in foreign exchange rates.	Cross-currency swaps. Foreign currency funding.
Profits earned in foreign currencies.	Sensitivity to sterling strengthening.	Forward foreign exchange contracts. Purchased options.

50. Derivatives (Continued)

Derivative Instrument Activity

The following table sets forth the nominal amounts of derivatives held for asset and liability management and market-making purposes at 31 December 1994, 1993 and 1992 and the net replacement cost and credit risk weighted amounts of derivatives at 31 December 1994.

	At 31 December 1994			1993	1992
	Nominal Amounts (1)	Net Replacement Cost (2)	Credit Risk Weighted Amounts (3)	Nominal Amounts (4)	Nominal Amounts
	£m	£m	£m	£m	£m
Exchange rate related instruments					
Held for asset and liability management purposes	11,195	447	199	15,512	10,504
Held for market-making purposes	486	13	8	25	—
	11,681	460	207	15,537	10,504
Interest rate related instruments					
Held for asset and liability management purposes	45,764	597	215	31,963	18,701
Held for market-making purposes	31,365	336	110	5,501	—
	77,129	933	325	37,464	18,701

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

(2) Represents replacement cost of contracts with a positive value. In respect of those contracts used as hedges, the rise or fall in their market values will be offset by a substantially equivalent reduction or increase in the value of the asset or liability being hedged.

(3) The credit risk weighted amounts have been calculated in accordance with the Bank of England's guidelines implementing the guidelines of the Basle Committee on capital adequacy.

(4) Following a review of the classification of off balance sheet contracts, the 1993 amounts have been restated to reflect the reclassification of certain contracts from the exchange rate to the interest rate category.

End-user Swap Activity

The tables below set forth, by contract amount, the activity in end-user interest rate and cross-currency swaps used for hedging purposes.

Interest Rate Swaps

	1994	1993	1992
	£m	£m	£m
At 1 January	28,033	17,336	7,611
New contracts (1)	24,508	28,241	14,317
Matured and amortised contracts	(16,150)	(16,253)	(5,707)
Terminated contracts	(3,601)	(1,423)	(915)
Effect of foreign exchange rate and other movements	(392)	132	2,030
At 31 December	32,398	28,033	17,336

(1) Includes £281m of interest rate swaps acquired with HMC Group PLC in 1994.

50. Derivatives (Continued)

Cross-currency Swaps

	1994	1993	1992
	£m	£m	£m
At 1 January	7,826	6,481	3,593
New contracts	6,677	7,214	5,897
Matured and amortised contracts	(5,433)	(6,127)	(3,203)
Terminated contracts	(553)	(146)	(244)
Effect of foreign exchange rate and other movements	(45)	404	438
At 31 December	8,472	7,826	6,481

Total Interest Rate and Cross-currency Swaps

	1994	1993	1992
	£m	£m	£m
At 1 January	35,859	23,817	11,204
New contracts (1)	31,185	35,455	20,214
Matured and amortised contracts	(21,583)	(22,380)	(8,910)
Terminated contracts	(4,154)	(1,569)	(1,159)
Effect of foreign exchange rate and other movements	(437)	536	2,468
At 31 December	40,870	35,859	23,817

(1) Includes £281m of interest rate swaps acquired with HMC Group PLC in 1994.

The impact on the income statement attributable to end-user derivative activities for the year ended 31 December 1994 was a £67m increase in interest receivable and a £282m increase in interest payable. The figures should not be analysed in isolation since there will be compensating movements in the underlying positions against which the hedges were taken. ANFP contributed £ 21m to the dealing profits of the Group. For the year ended 31 December 1994, the mark-to-market position of the market-making portfolio was represented by unrealised gains of £349m and unrealised losses of £295m. During the year, the average net mark-to-market value of dealing derivatives amounted to £96m.

The Group uses interest rate swaps and cross-currency swaps predominantly for hedging fixed rate assets and liabilities effectively into floating rate. For interest rate swaps and cross-currency swaps used for these purposes, the weighted average pay fixed rates and weighted average receive fixed rates by maturity and contract amount at 31 December 1994 were as follows:

	Pay fixed		Receive fixed	
	Contract amount	Rate	Contract amount	Rate
	£m	%	£m	%
Contracts maturing: (1)				
Less than 1 year	3,946	6.60	4,097	5.96
1 to 3 years	6,302	7.34	3,996	5.74
3 to 5 years	5,553	7.85	2,334	6.21
Over 5 years	1,644	9.09	3,623	7.15
Total	17,445		14,050	

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

50. Derivatives (Continued)

(2) The total pay fixed contract amount comprises £15,448m in respect of interest rate swaps and £1,997m in respect of cross-currency swaps. The total receive fixed contract amount comprises £11,264m in respect of interest rate swaps and £2,786m in respect of cross-currency swaps.

For interest rate swaps and cross-currency swaps used for hedging purposes, the weighted average pay variable rate and the weighted average receive variable rate by maturity and contract amounts at 31 December 1994 were as follows:

	Pay variable		Receive variable	
	Contract amount	Rate	Contract amount	Rate
	£m	%	£m	%
Contracts maturing: (1)				
Less than 1 year	7,221	6.24	6,976	5.92
1 to 3 years	7,658	6.24	10,032	6.31
3 to 5 years	3,472	6.63	6,808	6.87
Over 5 years	4,835	6.84	3,004	6.89
Total	23,186		26,820	

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

(2) The total pay variable contract amount comprises £16,817m in respect of interest rate swaps and £6,369m in respect of cross-currency swaps. The total receive variable contract amount comprises £21,134m million in respect of interest rate swaps and £5,686m in respect of cross-currency swaps.

A difference arises when comparing nominal contract assets and nominal contract liabilities. Whereas with single currency swaps one would expect equal and opposite nominal balances on either side of the swap leg, this is not necessarily the case with cross-currency swaps. At contract date sterling equivalent nominal amounts should be equal and opposite, however, subsequent exchange rate movements will result in divergence in the nominal amounts. This exchange rate divergence explains the difference between nominal contract asset balances and nominal contract liability balances.

The weighted average interest rates presented in the tables above reflect interest rates in a range of currencies. These rates should not be analysed in isolation from the rates on the underlying instruments.

50. Derivatives (Continued)

The contract amount of each type of end-user contract (excluding cross-currency swaps which are included in the swaps detailed above) at 31 December 1994 are set forth by currency in the table below. All hedging foreign exchange contracts mature during 1995.

	Contract type by contract amount			
	Forward Foreign Exchange	Forward Rate Agreements	Options (OTC)	Futures (Exchange-Traded)
	£m	£m	£m	£m
Sterling	—	640	170	896
U.S. Dollars	2,282	1,071	866	7,334
European Currency Units	—	94	—	—
Swiss Francs	64	—	—	—
Canadian Dollars	206	—	—	—
Deutschemarks	73	153	2	12
French Francs	2	—	—	178
Spanish Pesetas	47	15	—	—
Netherlands Guilders	10	—	—	—
Australian Dollars	19	—	—	—
Italian Lire	—	—	1,955	—
Total	2,703	1,973	2,993	8,420

The total OTC options contracts amount to £20m in respect of exchange rate related instruments and £2,973m in respect of interest rate related instruments.

Gains and losses arising from the hedging of investment transactions are released to the profit and loss account over the life of the asset, liability or position against which the hedge is held. Gains and losses arising from the hedging of assets which are not held for the purpose of investment are taken directly to the profit and loss account. Where a transaction originally entered into as a hedge no longer represents a hedge, its value is restated and any change in value is taken to the profit and loss account. Gains and losses on instruments purchased or sold for trading and market making purposes are taken directly to the profit and loss account. Any such transactions outstanding at the balance sheet date are stated at market value.

At 31 December 1994, deferred gains and losses being fully released within one year and relating to terminated hedging contracts were gains of £35m (1993: £4m; 1992: nil) and losses of £69m (1993: £21m; 1992: £10m). At 31 December 1994, deferred losses of £2m and deferred gains of £6m were being released over a period greater than one year (1993: losses £1m, profits nil; 1992: losses nil, profits nil).

51. Further rental commitments under operating leases

	1994	1994	1993	1993
	Property £m	Equipment £m	Property £m	Equipment £m
Annual commitments under non-cancellable operating leases expiring:				
Not more than one year	—	2	1	2
Over one but not more than five years	2	4	2	5
Over five years	33	—	33	—
	35	6	36	7

52. Operating lease commitments

At 31 December 1994 the Group held various leases on land and buildings, many for extended periods, and other leases for equipment, which require the following aggregate rental payments.

	£m
Year ended 31 December	
1995	41
1996	41
1997	42
1998	42
1999	48
Total thereafter	682

	1994	1993	1992
	£m	£m	£m
Rental expense comprises:			
In respect of minimum rentals	36	41	38
Less sub-lease rentals	(4)	(2)	(2)
	32	39	36

53. Summary operating results of Abbey National Treasury Services plc

The following selected information of Abbey National Treasury Services plc ("ANTS") has been included to comply with the filing requirements of the Securities and Exchange Commission. The data has been compiled using U.K. GAAP.

Summary of statement of income

	For the year ended		
	1994	1994	1993
	$m	£m	£m
Total interest income	3,028	1,933	1,797
Total interest expense	(2,838)	(1,812)	(1,658)
Net interest income	190	121	139
Other operating income	136	87	74
Operating expenses	(47)	(30)	(20)
Income before taxes	279	178	193
Taxes	(107)	(68)	(76)
Net income	172	110	117

53. Summary operating results of Abbey National Treasury Services plc (Continued)

Summary of balance sheet data

	As at		
	1994	**1994**	**1993**
	$m	**£m**	**£m**
Total assets	70,615	45,078	37,240
including:			
Loans to banks and customers	15,457	9,867	9,589
Securities and investments	46,735	29,834	22,926
Net investment in finance leases	3,836	2,449	2,281
Total liabilities excluding shareholders' equity	69,070	44,092	36,362
including:			
Deposits by banks and customers	28,725	18,337	16,605
Debt securities in issue	31,156	19,889	16,106
Subordinated liabilities	3,280	2,094	1,230
Shareholders' equity	1,545	986	878

The above summary information has been extracted from the consolidated financial statements of ANTS. This information differs from that disclosed for the Treasury Operations segment in Note 1 as a result of the inclusion of certain intra-group transactions in ANTS' consolidated financial statements, and the inclusion of the results of Abbey National North America Corporation in the Treasury Operations segment.

Presented below are extracts from the unaudited interim consolidated accounts of the Group which were published on July 31, 1995 together with the consolidated cash flow statement and associated notes to the consolidated accounts. These were prepared using generally accepted accounting principles in the U.K. and were compiled in accordance with the listing rules made by the London Stock Exchange.

ABBEY NATIONAL plc

UNAUDITED CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE SIX MONTHS ENDED 30 JUNE 1995

	Six months ended 30 June		Year ended 31 December
	1995	1994	1994
	(Unaudited) £m	(Unaudited) £m	£m
Net interest income	748	642	1,394
Other income and charges	177	197	365
Operating expenses	(412)	(377)	(755)
Provisions for bad and doubtful debts	(28)	(41)	(74)
Amounts written off fixed asset investments	(2)	2	2
Profit on ordinary activities before tax	483	423	932
Tax on profit on ordinary activities	(159)	(150)	(322)
Profit on ordinary activities after tax	324	273	610
Transfer to non-distributable reserve	—	—	(65)
Dividends	(96)	(75)	(233)
Profit retained for the period	228	198	312
Profit on ordinary activities before tax and exceptional items includes for acquired operations	0	10	22
Earnings per share	24.7p	20.8p	46.5p
Dividend per share	7.25p	5.7p	17.75p

ABBEY NATIONAL plc

UNAUDITED CONSOLIDATED BALANCE SHEET
AT 30 JUNE 1995

	As at 30 June		As at 31 December
	1995	1994	1994
	(Unaudited) £m	(Unaudited) £m	£m
Assets			
Cash, treasury bills and other eligible bills	216	422	598
Loans and advances to banks	5,707	4,221	2,906
Loans and advances to customers	48,832	45,864	48,484
Net investment in finance leases	2,322	2,290	2,278
Securities and investments	37,058	29,280	32,374
Long-term assurance business	391	317	352
Tangible fixed assets	545	508	534
Other assets	4,053	2,158	2,701
Assets of long-term assurance funds	4,631	3,750	4,092
Total assets	103,755	88,810	94,319
Liabilities			
Deposits by banks	20,139	16,675	17,826
Customer accounts	40,162	37,726	38,056
Debt securities in issue	26,286	20,773	23,413
Other liabilities	7,037	5,249	5,708
Subordinated liabilities	1,572	1,044	1,520
Liabilities of long-term assurance funds	4,631	3,750	4,092
Total liabilities	99,827	85,217	90,615
Total shareholders' funds	3,928	3,593	3,704
Total liabilities and shareholders' funds	103,755	88,810	94,319

ABBEY NATIONAL plc

UNAUDITED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE SIX MONTHS ENDED 30 JUNE 1995

	Six months ended 30 June		Year ended 31 December
	1995	1994	1994
	(Unaudited) £m	(Unaudited) £m	£m
Profit on ordinary activities after tax	324	273	610
Translation differences on foreign currency net investment	11	(2)	(7)
Total recognised gains relating to the period	335	271	603

ABBEY NATIONAL plc

RESULTS OF BUSINESS SEGMENTS GROUP PROFIT/(LOSS) BEFORE TAXATION FOR THE SIX MONTHS ENDED 30 JUNE 1995

	Six months ended 30 June		Year ended 31 December
	1995	1994	1994
	(Unaudited) £m	(Unaudited) £m	£m
U.K. Retail Banking	316	271	650
Life Assurance Operations	52	47	94
Consumer Credit	17	14	31
Treasury and Offshore	109	99	190
Continental Europe	(11)	(18)	(36)
Other operations	0	10	3
Total	483	423	932

Effective as at and for the six-month period ended 30 June 1995, the Group has changed the analysis of results of operations of the Group by principal business segment in order to improve comparability of results across those business segments, by assuming a consistent allocation of Group capital.

The comparative segmental results for the six months ended 30 June 1994 and the three year period ended 31 December 1994 have been restated. The following table summarises effect of the change on the results of operations for the comparative periods.

	Six Months ended June 30, 1994		Year ended December 31, 1994		Year ended December 31, 1993		Year ended December 31, 1992	
	Revised Basis	Previously Reported Basis	Revised Basis	Previously Reported Basis	Revised Basis	Previously Reported Basis	Revised Basis	Previously Reported Basis
UK Retail Banking	271	314	650	741	543	618	452	540
Consumer Credit	14	N/A	31	N/A	22	N/A	17	N/A
Life Insurance Operations	47	47	94	94	61	61	22	22
Treasury and Offshore	99	70	190	128	198	145	173	100
Continental Europe	(18)	(17)	(36)	(33)	(108)	(105)	(50)	(46)
Other Operations	10	9	3	2	20	17	7	5
Residential Real Estate Brokerage	—	—	—	—	(2)	(2)	(20)	(20)
	423	423	932	932	734	734	601	601

The results now reflect the regulatory capital notionally absorbed by each principal business segment based on the Group's Bank of England regulatory requirements. To achieve this, a notional adjustment has been made to the profit before tax of each business segment where relevant, by applying an average market-related interest rate to the difference between the capital held in the segment and the capital which would be required if the Group's Bank of England risk asset ratio was applied to that segment.

The method of analysis previously adopted was based on the actual levels of capital of the legal entities within the business segments, except that the earnings on the equity capital of both U.K. Retail Banking and Treasury Operations were shown in the U.K. Retail Banking segment.

In addition, effective July 1995, the following changes in the classification of businesses within segments have been made in order to provide a clearer analysis of the nature of the Group's business activities:

- A new segment, Consumer Credit, has been separately disclosed. This segment includes the personal unsecured lending operations previously included in U.K. Retail Banking, and would include the results of FNFC plc from the date of its acquisition.
- The operations in Jersey and Gibraltar which were previously included in Continental Europe and Offshore have been reclassified into Treasury Operations, reflecting the increasing similarities in the activities of these operations. The segments have been renamed Continental Europe and Treasury and Offshore.

ABBEY NATIONAL plc

UNAUDITED CONSOLIDATED CASH FLOW STATEMENT FOR THE SIX MONTHS ENDED 30 JUNE 1995

	Six months ended 30 June		Year ended 31 December
	1995	1994	1994
	(Unaudited) £m	(Unaudited) £m	£m
Net cash inflow from operating activities	7,198	4,795	6,343
Return on investments and servicing of finance			
Dividends paid	(158)	(129)	(204)
Net cash outflow from returns on investments and servicing of finance	(158)	(129)	(204)
Taxation			
U.K. corporation tax paid	(20)	(23)	(93)
Overseas tax paid	(1)	—	(5)
Total taxation paid	(21)	(23)	(98)
Investing activities			
Purchase of investment securities	(17,618)	(18,566)	(35,346)
Sales and maturities of investment securities	12,745	15,045	28,849
Purchase of tangible fixed assets	(57)	(43)	(114)
Sales of tangible fixed assets	6	4	10
Purchase of subsidiary undertakings	(4)	15	(52)
Purchase of interests in associated undertakings	(15)	—	—
Net cash outflow from investing activities	(4,943)	(3,545)	(6,653)
Net cash inflow before financing	2,076	1,098	(612)
Financing			
Issue of ordinary share capital	1	3	4
Issue of loan capital	33	197	676
Repayment of loan capital	(8)	(17)	(17)
Net cash inflow from financing	26	183	663
Increase in cash and cash equivalents	2,102	1,281	51

Cash and cash equivalents in this statement are calculated in accordance with the definitions set out in Financial Reporting Standard (FRS) 1. The Group's total liquidity includes not only these cash and cash equivalents but also certain other liquid assets which fall outside the FRS1 definition.

NOTES TO THE UNAUDITED CONSOLIDATED INTERIM ACCOUNTS

1. Suspended interest and provisions for bad and doubtful debts

	Suspended interest						
	Residential		Commercial		Unsecured		
	U.K.	Europe	U.K.	Europe	U.K.	Europe	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 1995	40	23	4	66	3	—	136
Exchange differences	—	2	—	6	—	—	8
Transfer from profit and loss account	14	4	—	7	—	—	25
Irrecoverable amounts written off	(22)	(4)	—	(13)	(1)	—	(40)
At 30 June 1995	32	25	4	66	2	—	129

	Provisions for bad and doubtful debts						
	Residential		Commercial		Unsecured		
	U.K.	Europe	U.K.	Europe	U.K.	Europe	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 1995							
General	56	3	1	5	6	—	71
Specific	104	33	5	119	26	3	290
Exchange differences	—	3	—	10	—	—	13
Transfer (to)/from profit and loss account	15	3	—	3	7	—	28
Irrecoverable amounts written off	(22)	(13)	—	(13)	(8)	—	(56)
At 30 June 1995							
General	46	3	1	7	6	—	63
Specific	107	26	5	117	25	3	283

GROUP FINANCIAL SUMMARY

The Group financial summary for each of the five years ended 31 December 1994 shown below has been extracted from the consolidated financial statements of Abbey National plc, and is to be read in conjunction with the accompanying notes to those consolidated financial statements.

Profit and loss accounts

	New Format					
	1994	**1993**	**1992**	**1992**	**1991**	**1990**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Net interest income	1,394	1,338	1,265	1,246	1,143	956
Other income and charges	365	376	319	335	265	189
Operating expenses	(755)	(763)	(706)	(706)	(635)	(508)
Provisions for bad and doubtful debts	(74)	(218)	(274)	(274)	(155)	(55)
Amounts written off fixed asset investments	2	1	(3)	—	—	—
Exceptional items:						
Loss on disposal/reorganisation of estate agency business	—	(30)	(138)	(138)	—	—
Sale of unclaimed shares	—	—	101	101	—	—
Profit on ordinary activities before tax	932	704	564	564	618	582
Tax on profit on ordinary activities	(322)	(314)	(247)	(247)	(204)	(205)
Profit on ordinary activities after tax	610	390	317	317	414	377
Transfer to non-distributable reserve	(65)	(32)	(7)	(7)	—	—
Dividends	(233)	(184)	(151)	(151)	(138)	(125)
Retained profit for the year	312	174	159	159	276	252
Profit on ordinary activities before tax and exceptional items includes for:						
operations acquired in the year	22	—	30	30	—	4
operations discontinued in the year (with prior year comparative)	—	(2)	(20)	(20)	—	—
Earnings per share	46.5p	29.7p	24.2p	24.2p	31.6p	28.8p
Dividends per share (pence)						
Net	17.75p	14.0p	11.5p	11.5p	10.5p	9.5p
Gross equivalent	22.19p	17.5p	14.7p	14.7p	14.0p	12.7p
Dividend cover (times)	2.6	2.1	2.1	2.1	3.0	3.0

Balance sheets, together with an explanation of the old and new formats are provided on pages F-66 and F-67. The calculation of the gross equivalent dividend per share assumes a tax rate of 25% for grossing-up purposes for dividends up to and including the interim dividend for 1992. Thereafter the rate of 20% has been assumed.

GROUP FINANCIAL SUMMARY

Balance sheets (new format 1992-1994)

	1994	1993	1992
	£m	£m	£m
Assets			
Cash, treasury bills and other eligible bills	598	757	497
Loans and advances to banks	2,906	3,556	2,276
Loans and advances to customers	48,484	45,049	42,061
Net investment in finance leases	2,278	2,253	1,737
Securities and investments	32,374	25,312	19,998
Long term assurance business	352	287	215
Tangible fixed assets	534	509	518
Other assets	2,701	2,208	2,105
Assets of long term assurance funds	4,092	3,871	2,816
Total assets	94,319	83,802	72,223
Liabilities			
Deposits by banks	17,826	16,368	13,103
Customer accounts	38,056	36,143	34,348
Debt securities in issue	23,413	19,030	14,929
Other liabilities	5,708	4,136	3,195
Subordinated liabilities	1,520	868	648
Liabilities of long term assurance funds	4,092	3,871	2,816
	90,615	80,416	69,039
Total shareholders' funds	3,704	3,386	3,184
Total liabilities	94,319	83,802	72,223

The Group financial summary for the years 1992, 1993 and 1994 is shown in a format which reflects the changes resulting from the implementation of the Companies Act 1985 (Bank Accounts) Regulations 1991, which reflect the requirements of the EC Bank Accounts Directive and which were first effective for the 1993 accounts. The Group financial summary contains a summarised presentation of the main statements, while the complete Bank Accounts Directive format is provided in the accounts.

The Group financial summary before 1992 has not been restated for the new format. The new format is fundamentally different from the old format, and the directors have decided that the benefits which would be derived from restating the accounts for the years prior to 1992 would not justify the cost of such an exercise. The old and new format profit and loss accounts have been presented in the same table. However, the balance sheet formats are significantly different, and are presented separately.

GROUP FINANCIAL SUMMARY

Balance sheets (old format 1990-1992)

	1992	1991	1990
	£m	£m	£m
Assets			
Cash and short term funds	3,819	5,193	4,035
Securities and investments	17,186	9,995	6,113
Advances secured on residential property	40,399	37,867	34,044
Other advances secured on land	636	639	678
Net investment in finance leases	1,781	729	104
Other commercial assets	1,076	451	292
Long term assurance business	215	—	—
Long term investments	1,567	1,249	385
Tangible fixed assets	518	489	354
Other assets	1,799	793	491
Assets of long term assurance funds	2,816	—	—
Total assets	71,812	57,405	46,496
Liabilities and shareholders' funds			
Retail funds and deposits	33,616	32,711	29,735
Non-retail funds and deposits	29,330	19,642	12,440
Other liabilities	2,218	1,693	1,389
Subordinated liabilities	648	388	233
Liabilities of long term assurance funds	2,816	—	—
Total liabilities	68,628	54,434	43,797
Total shareholders' funds	3,184	2,971	2,699
Total liabilities and shareholders' funds	71,812	57,405	46,496

The principal reclassifications required by the Bank Accounts Directive affect the balance sheet and were reflected in the new format 1992 balance sheet as follows:

The heading Cash and short-term funds was replaced by the more restrictive heading Cash, treasury bills and other eligible bills. Certificates of deposit previously included within Cash and short term funds are now shown within Securities and investments. Short term loans to banks previously included within Cash and short term funds are now shown within Loans and advances to banks. Loans and advances are now analysed by bank and non-bank counterparties. Securities and investments now include debt securities and equity shares and other variable yield securities of all maturities. Retail and non-retail funds and deposits are now analysed into deposits by bank and non-bank counterparties, and debt securities. Accrued interest is shown separately in the accounts, and is included within Other liabilities in the Group Financial Summary.

In addition to the format reclassification, the Bank Accounts Directive requires certain other assets and liabilities, which were previously shown net, to be shown gross. The effect on the 1992 balance sheet was to increase both assets and liabilities by £300m. The implementation of the SORP on securities resulted in a further increase in both assets and liabilities of £111m in the 1992 balance sheet.

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