Additional Capital and Risk Management Disclosures

As a principal subsidiary of Banco Santander, S.A., Santander UK plc does not produce separate Pillar 3 disclosures. The Santander UK group has however implemented the October 2012 recommendations of the Enhanced Disclosure Task Force ('EDTF') of the Financial Stability Board and, additionally, there are a number of disclosures required by the UK Financial Services Authority ('FSA') following on from recommendations by the UK Interim Financial Policy Committee. The following disclosures meet these requirements or recommendations where they do not fit naturally into the Annual Report and Accounts.

Impact of CRD IV

The FSA requires UK banking groups to disclose reconciliations of accounting and regulatory measures of capital under the draft CRD IV rules[1], the EU implementation of Basel III. Since these rules have yet to be finalised, banking groups are required to base the disclosure on the text of the EU Commission's proposal from July 2011. Additionally, banking groups are required to disclose their "glide path" to Basel III explaining how end-point requirements will be met.

The following tables set out the Santander UK group's best estimate of the impact of CRD IV on the basis that it is implemented on 31 December 2012 and that the rules due to apply at the end of the transition period are in force as at 31 December 2012 ('End Point').

Pro Forma CRD IV capital and Risk-Weighted Assets

	Reported 31 December 2012 Current FSA rules £m	Proforma 31 December 2012 CRD IV End Point £m
Core Tier 1 Capital ('CT1') - current FSA rules	**9,302**	**9,302**
CRD IV Adjustments to CT1		
Excess of expected losses over impairment		(370)
Other (see below)		(125)
Common Equity Tier 1 Capital ('CET1') - CRD IV		**8,808**
Pillar 1 Risk-Weighted Assets ('RWA') - current FSA rules	**76,524**	**76,524**
CRD IV Adjustments to RWA		
Securitisation		970
Counterparty Risk (see below)		2,028
RWA - CRD IV		**79,522**
CT1 or CET1 Capital / RWA Ratio	12.2%	11.1%
Difference to CT1 Ratio		**(1.1)%**

The pro forma results included above are based on our interpretation of the draft July 2011 CRD IV rules (reflecting those both in the draft Capital Requirements Regulation and associated Directive).

Securitisation positions which are currently treated as deductions are reflected as 1,250% risk weighted assets under CRD IV. The Other adjustments to Core Tier 1 capital include the effect of deferred tax, securitisation, defined benefit pension adjustment and unrealised profits on available-for-sale securities. The Counterparty Risk adjustments to Risk-Weighted Assets include Credit Valuation Adjustment, Central Counterparty Clearing and Asset Value Correlation. For Credit Valuation Adjustment capital, it has been assumed that EU corporates and sovereigns are excluded from the scope of the charge. For Central Counterparties it has been assumed that all are deemed to be 'qualifying' and the capital requirements have been determined using an approach consistent with that specified by the Basel Committee in July 2012.

No adjustments have been made to Core Tier 1 Capital (under current FSA rules) for Prudent Valuation Adjustments in the pro forma results as the relevant CRD IV technical standard has not yet been finalised. For a similar reason, potential changes to the approach for assessing the excess of expected losses over impairment losses under CRD IV have also not been reflected in the pro forma results.

Under this analysis, the Group would have exceeded the minimum Common Equity Tier 1 capital requirements under end point CRD IV on 31 December 2012 and no further capital actions would be required. The actual impact of the implementation of CRD IV could vary as a consequence of differences in the final CRD IV rules from the assumed rules used for this analysis.

[1] The Capital Requirements Directive IV and Capital Requirements Regulation ('CRR') legislative package

Composition of Regulatory Capital under CRD IV – Transitional Own Funds Disclosure

This disclosure below provides the FSA requested reconciliations of accounting and regulatory measures of capital under CRD IV, in a format consistent with Annex VI Transitional own fund disclosure template to the European Banking Authority Consultation Paper on Draft Implementing Technical Standards on Disclosure for Own Funds by institutions.

The results in the first column reflect the potential composition of regulatory capital under CRD IV in the first year of the transitional implementation period, which for the purposes of this disclosure is assumed to be 2012. This uses the 31 December 2012 balance sheet position. For this analysis the FSA guidance dated 26 October 2012 has been reflected, with the minimum pace of transition in CRD IV being followed, subject to the stated exemption for deferred tax assets.

The results in the second column provide the adjustments required to the transitional results (first column) to reach the CRD IV end point position. The end point position can be derived as the sum of the transitional result and the associated end point adjustment. It has been assumed for end point CRD IV that certain capital instruments ultimately will meet the CRD IV requirements for full recognition as Tier 2 capital.

The assumptions adopted for the Pro Forma CRD IV capital and RWA disclosure above have been reflected in this disclosure.

Composition of Regulatory Capital under CRD IV – Transitional Own Funds Disclosure

	31 December 2012 £m	Amounts subject to pre-CRR treatment or CRR prescribed residual amount £m
Common Equity Tier 1 capital: instruments and reserves		
Capital Instruments and the related share premium accounts	8,725	-
Retained earnings	3,329	-
Accumulated other comprehensive income (and other reserves)	1	-
Common Equity Tier 1 prior to adjustments	**12,055**	**-**
Common Equity Tier 1: regulatory adjustments		
Intangible Assets (net of related tax liability)	-	(2,325)
Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	(6)	(57)
Negative amounts resulting from the calculation of expected loss amounts	-	(594)
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	(6)	-
Defined-benefit pension fund assets	(266)	-
Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment		
Regulatory adjustments relating to unrealised gains and losses	(1)	1
of which: unrealised gains on available-for-sale debt instruments	(1)	1
Amounts to be deducted from or added to Common Equity Tier 1 capital with regard to additional filters and deductions required pre-CRR	108	(102)
of which: defined benefit pension fund	102	(102)
of which: other	6	-
Qualifying Additional Tier 1 deductions that exceed the Additional Tier 1 capital of the institution	(1,163)	1,163
Total Regulatory adjustments to Common Equity Tier 1	**(1,334)**	**(1,913)**
Common Equity Tier 1 Capital	**10,721**	**(1,913)**
Additional Tier 1 capital: instruments		
Amount of qualifying items and related share premium amounts subject to phase out from Additional Tier 1	1,459	(1,459)
Additional Tier 1 before regulatory adjustments	**1,459**	**(1,459)**
Additional Tier 1 capital: regulatory adjustments		
Regulatory adjustments applied to Additional Tier 1 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out		
Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period	(2,622)	2,622
of which: Intangible Assets (net of related deferred tax liability)	(2,325)	2,325
of which: Negative amounts resulting from the calculation of expected loss	(297)	297
Qualifying Additional Tier 1 deductions that exceed the Additional Tier 1 capital of the institution	1,163	(1,163)
Total regulatory adjustments to Additional Tier 1 capital	**(1,459)**	**1,459**
Additional Tier 1 capital	**-**	**-**
Tier 1 (T1) Capital	**10,721**	**(1,913)**

	£m	£m
Tier 2 Capital: instruments and provisions		
Capital Instruments and the related share premium accounts	1,573	3,086
Amount of qualifying items and related share premium accounts subject to phase out from Tier 2	995	(995)
Credit Risk adjustments	261	-
Tier 2 before Regulatory adjustments	**2,829**	**2,091**
Tier 2 capital: regulatory adjustments		
Regulatory adjustments applied to Tier 2 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out		
Residual amounts deducted from Tier 2 capital with regard to deduction from Common Equity Tier 1 during the transitional period	(297)	297
of which: negative amounts resulting from the calculation of expected loss amounts	(297)	297
Total Regulatory adjustments to Tier 2 capital	**(297)**	**297**
Tier 2 (T2) Capital	**2,532**	**2,388**
Total Capital (TC = T1 + T2)	**13,253**	**474**

Leverage Ratio

Santander UK manages leverage on the basis of an internal measure of adjusted total assets against Tier 1 capital, taking into account the Santander UK group's Risk Appetite and balance sheet structure. The following table summarises Santander UK's leverage at 31 December 2012.

	31 December 2012 £m
Total Assets	**293,044**
Goodwill, Intangibles & Deferred Tax	(2,388)
Counterparty Netting	(46,220)
Total Adjusted Assets (including Liquidity Assets)	**244,437**
Liquidity Assets	(27,584)
Total Adjusted Assets (excluding Liquidity Assets)	**216,852**

	31 December 2012 £m
Leverage Ratios, excluding Liquidity Assets (Exposure as detailed above)	
Tier 1 capital (current FSA rules)	**11,203**
Leverage ratio expressed as a percentage	**5.2%**
Leverage ratio expressed as a multiple	**19x**
Leverage Ratios, including Liquidity Assets	
Tier 1 capital (current FSA rules)	**11,203**
Leverage ratio expressed as a percentage	**4.6%**
Leverage ratio expressed as a multiple	**22x**

Regulatory Leverage

The Basel III rules include proposals for the use of a leverage ratio as a backstop measure. These proposals will develop as European legislation and technical standards are finalised. In the interim, the UK's Financial Policy Committee has recommended that UK banks disclose leverage ratios on the basis that draft rules had been in place at 31 December 2012.

The table below provides three leverage ratio calculations. The first measure uses the current Tier 1 Capital Base under FSA rules. The second measure, the 'Adjusted End Point CRD IV Measure', reflects the estimated end point CRD IV CET1 capital base as at 31 December 2012 and the 31 December 2012 Other Tier 1 capital under current FSA rules. The third measure reflects solely the estimated end point CRD IV Tier 1 capital as at 31 December 2012, which is equal to end point CET1 as all current Other Tier 1 capital is assumed to be ineligible. Santander UK exceeds the proposed minimum of 3% under all measures.

(issued 2/4/13)

	31 December 2012 £m
Total Assets	**293,044**
Goodwill, Intangibles & Deferred Tax	(2,388)
Counterparty Netting	(46,220)
Off-Balance Sheet	24,467
Total Regulatory Exposure	**268,904**

	Expressed as a Ratio	Expressed as a multiple
Regulatory Leverage as at 31 December 2012		
Tier 1 Measure (current FSA rules)	**4.2%**	**24x**
Less End Point CRD IV CET1 adjustments	**(0.2%)**	
Adjusted End Point CRD IV Measure	**4.0%**	**25x**
Less currently eligible Other Tier 1 Capital(1)	**(0.7%)**	
End Point CRD IV Measure	**3.3%**	**30x**

(1) The End Point CRD IV measure of capital makes the assumption that all current Other Tier 1 instruments are ineligible. It does not allow for the natural replacement of these instruments over the transition period.

Probability of Default ('PD') disclosures

The following tables show the distribution by credit quality of the value of exposures, credit risk parameters and capital for the Group's IRB portfolios.

For the Corporates and Institutions portfolios, the PD bands for an individual counterparty exposure are determined by the through-the-cycle PD value assigned to the counterparty exposures. This through-the-cycle PD is also used in the calculation of average PD, RWA and Risk Weighting for these portfolios. For the Retail Mortgages, Qualifying Revolving Retail Exposures and Other Retail portfolios, the PD band and PD range reflect the point-in-time PD of an individual counterparty exposure, but the PD used for Average PD, RWA and Risk Weighting is cycle-adjusted and hence can be different to the point-in-time PD. This results in the Average PD being outside the specified PD range for some PD bands.

For all portfolios the Average PD and Average loss given default ('LGD') reflect exposure at default-weighted values. Corporates and Institutions analysis includes both banking book exposures and counterparty risk exposures.

As at 31 December 2012

Corporates

PD Band	PD Range %	Exposure at default estimate £m	Average PD %	Average LGD %	RWA £m	Average Risk Weighting %	External Rating Equivalent Range	External Rating Equivalent Average PD
1	0.000 to 0.160	10,382	0.068	18	1,441	14	AAA to A-	A
2	0.160 to 0.290	3,100	0.206	34	1,322	43	A- to BBB	BBB+
3	0.290 to 0.530	2,264	0.406	38	1,266	56	BBB to BBB-	BBB-
4	0.530 to 0.920	1,181	0.755	39	920	78	BBB- to BB+	BB+
5	0.920 to 1.560	780	1.360	38	711	91	BB+ to BB	BB
6	1.560 to 2.700	419	2.670	43	506	121	BB to BB-	BB-
7	2.700 to 35.000	375	9.724	43	600	160	BB- to C	B-
	In default	118	100.000	43	-	-		
	Total	18,620			6,767	36		

Institutions

PD Band	PD Range %	Exposure at default estimate £m	Average PD %	Average LGD %	RWA £m	Average Risk Weighting %	External Rating Equivalent Range	External Rating Equivalent Average PD
1	0.000 to 0.037	3,695	0.032	45	611	17	AAA to A+	A+
4	0.045 to 0.058	1,696	0.056	52	454	27	A	A
6	0.076 to 0.100	784	0.095	50	260	33	A to A-	A-
8	0.134 to 0.211	90	0.159	47	34	37	A- to BBB+	BBB+
9	0.211 to 0.339	63	0.267	61	44	69	BBB+ to BBB-	BBB
10	0.339 to 0.544	9	0.448	69	10	110	BBB- to BB+	BBB-
11-13	0.544 to 99.999	17	0.768	67	18	106	BB+ to C	BB+ to C
	In default	-	-	-	-	-		
	Total	6,356			1,429	22		

Retail Mortgages

PD Band	PD Range %	Exposure at default estimate £m	Average PD %	Average LGD %	RWA £m	Average Risk Weighting %
1	00.0 to 0.015	2,686	0.191	9	91	3
2	0.015 to 0.030	6,239	0.161	8	183	3
3	0.030 to 0.060	13,848	0.193	8	464	3
4	0.060 to 0.120	33,793	0.285	9	1,542	5
5	0.120 to 0.250	47,072	0.756	10	4,666	10
6	0.250 to 0.500	28,762	1.509	11	5,098	18
7	0.500 to 1.000	9,496	2.454	12	2,505	26
8	1.000 to 2.000	4,030	4.802	12	1,461	36
9	2.000 to 4.000	7,542	9.020	11	3,355	44
10	4.000 to 8.000	2,712	15.597	12	1,613	59
11	8.000 to 15.000	1,680	26.694	11	1,053	63
12	15.000 to 30.000	1,402	42.461	11	867	62
13	30.000 to 60.000	1,226	72.705	11	444	36
14	60.000 to 99.999	675	73.688	12	247	37
	In default	3,203	100.000	16	-	-
	Total	164,366			23,588	14

Qualifying Revolving Retail Exposures

PD Band	PD Range %	Exposure at default estimate £m	Average PD %	Average LGD %	RWA £m	Average Risk Weighting %
1	0.000 to 0.010	58	0.030	83	1	2
2	0.010 to 0.030	192	0.061	83	7	3
3	0.030 to 0.050	162	0.089	83	8	5
4	0.050 to 0.100	259	0.131	83	17	7
5	0.100 to 0.200	295	0.291	83	37	13
6	0.200 to 0.500	445	0.561	83	95	21
7	0.500 to 1.000	389	1.206	83	150	39
8	1.000 to 2.000	436	2.258	83	268	61
9	2.000 to 5.000	515	4.732	83	529	103
10	5.000 to 10.000	286	10.032	83	468	164
11	10.000 to 20.000	164	19.865	83	375	229
12	20.000 to 40.000	67	38.577	83	181	268
13	40.000 to 99.999	17	72.109	83	31	185
	In default	62	100.000	83	-	-
	Total	3,349			2,169	65

Other Retail

PD Band	PD Range %	Exposure at default estimate £m	Average PD %	Average LGD %	RWA £m	Average Risk Weighting %
4	0.050 to 0.100	2	0.233	88	1	42
5	0.100 to 0.200	6	0.486	88	4	66
6	0.200 to 0.500	46	0.549	86	32	69
7	0.500 to 1.000	449	0.715	87	360	80
8	1.000 to 2.000	643	1.463	87	701	109
9	2.000 to 5.000	726	3.215	88	949	131
10	5.000 to 10.000	208	6.847	88	296	142
11	10.000 to 20.000	72	13.505	88	126	175
12	20.000 to 40.000	25	27.044	88	59	231
13	40.000 to 99.999	38	61.262	88	82	214
	In default	63	100.000	85	-	-
	Total	2,280			2,610	114

(issued 2/4/13)

Risk-weighted assets

Risk-weighted assets by division are provided in the following table:

2012		**Regulatory exposure**			**Risk-weighting**			**Risk-weighted assets**		
	Balance sheet amount £bn	**Standardised approach £bn**	**IRB Approach £bn**	**Total £bn**	**Standardised approach %**	**IRB Approach %**	**Total %**	**Standardised approach £bn**	**IRB Approach £bn**	**Total £bn**
Retail Banking										
- Secured lending	**156.6**	**0.1**	**164.3**	**164.4**	**55.4**	**14.4**	**14.4**	**-**	**23.6**	**23.6**
- Unsecured lending	**8.7**	**6.3**	**5.6**	**11.9**	**78.4**	**84.9**	**81.5**	**4.9**	**4.8**	**9.7**
- Operational risk								**5.5**	**-**	**5.5**
Corporate Banking										
- Customer assets	**19.6**	**11.0**	**14.1**	**25.1**	**99.4**	**76.8**	**86.8**	**11.0**	**10.8**	**21.8**
- Non customer assets[1]	**16.0**	**0.6**	**0.7**	**1.3**	**55.8**	**12.5**	**33.8**	**0.3**	**0.1**	**0.4**
- Market risk								**-**	**1.3**	**1.3**
- Operational risk								**1.3**	**-**	**1.3**
Markets										
- Credit risk	**0.1**	**-**	**0.1**	**0.1**	**-**	**39.8**	**39.8**	**-**	**-**	**-**
- Counterparty risk	**28.1**	**2.0**	**4.2**	**6.2**	**25.9**	**31.2**	**29.5**	**0.5**	**1.3**	**1.8**
- Market risk								**-**	**2.7**	**2.7**
- Operational risk								**0.4**	**-**	**0.4**
Corporate Centre										
- Customer assets[2]	**11.0**	**3.4**	**9.4**	**12.8**	**64.8**	**10.8**	**25.3**	**2.2**	**1.0**	**3.2**
- Liquid assets[3]	**37.6**	**34.8**	**-**	**34.8**	**-**	**-**	**-**	**-**	**-**	**-**
- Operational risk								**1.0**	**-**	**1.0**
Intangible assets and securitisation deductions	**2.4**									
Other assets[4]	**12.9**	**5.1**	**3.5**	**8.6**	**51.8**	**32.4**	**43.9**	**2.7**	**1.1**	**3.8**
	293.0							**29.8**	**46.7**	**76.5**

(1) Non customer assets principally consist of the securities lending/borrowing and repo businesses of the money markets product area.
(2) Customer assets in the Corporate Centre largely comprise Social Housing.
(3) Regulatory exposure of liquid assets includes reverse repurchase agreements collateralised by UK Government securities.
(4) The balance sheet amounts of other assets have not been allocated segmentally, although the RWAs have been allocated to Corporate Centre

2011		Regulatory exposure			Risk-weighting			Risk-weighted assets		
	Balance sheet amount £bn	Standardised approach £bn	IRB approach £bn	Total £bn	Standardised approach %	IRB approach %	Total %	Standardised approach £bn	IRB approach £bn	Total £bn
Retail Banking										
- Secured lending	166.2	2.5	173.6	176.1	40.8	13.6	14.0	1.0	23.6	24.6
- Unsecured lending	9.3	5.9	5.8	11.7	78.5	86.1	82.2	4.7	4.9	9.6
- Operational risk								5.5	-	5.5
Corporate Banking										
- Customer assets	18.9	9.6	13.8	23.4	101.4	75.6	86.1	9.7	10.4	20.1
- Non customer assets[1]	19.4	0.8	0.8	1.6	50.7	17.6	34.4	0.4	0.2	0.6
- Market risk								-	1.1	1.1
- Operational risk								1.2	-	1.2
Markets										
- Credit risk	0.1	-	0.1	0.1	-	35.8	35.8	-	-	-
- Counterparty risk	28.6	1.8	3.4	5.2	35.9	29.9	32.0	0.6	1.1	1.7
- Market risk								-	1.6	1.6
- Operational risk								0.4	-	0.4
Corporate Centre										
- Customer assets	11.9	4.8	9.7	14.5	68.1	11.0	29.8	3.2	1.1	4.3
- Liquid assets[2]	28.4	26.1	-	26.1	-	-	-	-	-	-
- Operational risk								1.1	-	1.1
Intangible assets and securitisation deductions	2.2									
Other assets[3]	12.6	5.8	4.9	10.7	65.5	38.5	53.1	3.8	1.9	5.7
	297.6							31.6	45.9	77.5

(1) Non customer assets principally consist of the securities lending/borrowing and repo businesses of the money markets product area.
(2) Regulatory exposure of liquid assets includes reverse repurchase agreements collateralised by UK Government securities.
(3) The balance sheet amounts of other assets have not been allocated segmentally, although the RWAs have been allocated to Corporate Centre.

Movements in risk-weighted assets

Movements in risk-weighted assets during 2012 and 2011 were as follows:

Credit Risk	2012 £m	2011 £m
Risk-weighted assets at 1 January	**64,167**	60,963
Book size[1]	**(3,176)**	2,201
Book quality[2]	**(962)**	1,207
Model updates[3]	**2,005**	(214)
Risk-weighted assets at 31 December	**62,034**	64,167

(1) Book size relates to organic changes in book size and composition (including new business and maturing loans).
(2) Quality of book changes caused by experience such as underlying customer behaviour or demographics, including changes through model calibrations/realignments.
(3) Model implementation, change in model scope or any change to address other model issues.

Counterparty Risk	2012 £m	2011 £m
Risk-weighted assets at 1 January	**2,226**	1,492
Book size	**(46)**	657
Book quality	**72**	114
Model updates	**(9)**	(37)
Risk-weighted assets at 31 December	**2,243**	2,226

Market Risk	2012 £m	2011 £m
Risk-weighted assets at 1 January	**2,813**	3,462
Movement in risk levels[1]	**748**	(1,325)
Model updates[2]	**510**	-
Methodology and policy[3]	**-**	676
Risk-weighted assets at 31 December	**4,071**	2,813

(1) Changes in risk due to position changes and market movements.
(2) Updates to the model to reflect recent experience, change in model scope.
(3) Methodology changes to the calculations driven by regulatory policy changes.

Operational risk

Santander UK calculates its operational risk capital requirement under the standardised approach in accordance with FSA rules. The standardised approach uses the average of three years' income of each business line. The average three year income is adjusted to take into account historical income of any businesses acquired during that period. The decrease in operational risk RWA's in 2012 was a result of lower average three year income.

Significant IRB models and model performance

With £157bn of on balance sheet exposure as at 31 December 2012 the residential mortgage portfolio comprises 95% of all retail exposures. Therefore the IRB models employed to calculate the risk-weighted assets for this portfolio are considered the most significant. PD is determined by the new business application score and a bespoke default-risk scorecard for the back-book. These models produce account level, point-in-time PD estimates which are adjusted to a long-run average default rate using a variable scalar methodology employing observed and inferred default rate data back to 1989. Within each of the legacy portfolios (the former Abbey and Alliance & Leicester businesses) the scaling of the PD (grouped into 14 non-default risk grades) is performed separately across 13 risk segments driven by balance-to-value and buyer type.

LGD is calculated as the proportion of the exposure at default (EAD) expected to be written-off multiplied by the probability of a write-off occurring after a default event. The loss proportion uses a 'workout' approach, i.e. one minus the expected recovery proportion, plus direct and indirect recovery costs associated with the recovery process. Data on losses is taken from the period 2000 to 2009. The probability of write-off given default is measured from observed loss rates from quarterly tranches of accounts entering default since 2007. Downturn LGD is determined by stressing the model inputs to values observed during the worst points of the last recession. For example the forced sale discount is increased from 21% in normal times to a downturn value of 28%. The downturn probability of write-off given default uses the highest observed values, typically seen from in defaults occurring during 2008. Other parameters such as time from default to sale, balance owing at sale and property value are also adjusted to be applicable for downturn conditions.

The performance of IRB models is monitored each quarter in accordance with Santander UK's model monitoring policies. The monitoring assesses the performance of the rating system with respect to the accuracy of the calibration, discrimination and stability of the component models. The accuracy of the calibration is measured by comparing the predictions of default and loss against observed values. The model monitoring and actions taken to correct under-performance are reviewed by Santander UK's Model Committee and escalated to the Risk Management Committee as necessary.