CATER ALLEN LIMITED

Registered in England and Wales
Company Number 00383032

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

STRATEGIC REPORT

Cater Allen Limited (the Company) is a wholly owned subsidiary of Santander UK plc, authorised by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The Directors present the Company's Strategic Report together with their Report of the Directors and the audited financial statements for the year ended 31 December 2018.

Business Review and principal activities

The principal activity of the Company is to be an authorised deposit taker under the Financial Services and Markets Act 2000. The Company operates as a private bank, engaging with customers through intermediaries. The Company offers a range of current, savings and fixed term deposit accounts to meet the differing requirements of personal, business and specialist clients. The Company also provides a variety of Structured products to customers in the form of Structured deposits. However, new investments into these Structured products have not been accepted since March 2015.

Further information on the Company can be found via the Company's external website, www.caterallen.co.uk.

During the year, the Company acquired the beneficial interest of certain Home Reversions policies over which Santander UK plc holds security. The Company paid a nominal value of a £1 for this as the residual net proceeds are subject to the interest of Santander UK plc.

The financial results are set out page 8 and reflect profit after tax of £60.1m. The Company delivered strong income performance positively impacted by the August base rate increase.

Continued growth saw customer deposits increase £61m over the previous year.

The Company's capital, funding and liquidity requirements are managed centrally by Santander UK plc (the Group) and described in the Group's Annual Report which does not form part of this Report.

Likely Future Developments

The Directors do not expect any significant change in the level of business in the foreseeable future.

Principal risks and uncertainties facing the Company

The Company's principal risks and uncertainties together with the processes that are in place to monitor and mitigate those risks where possible can be found in Note 2 to the financial statements.

Financial Risk Management

The Company's risks are managed at a group level by the Group. Note 30 within these financial statements explains the relationship between the Group and the Company.

The financial risk management objectives and policies of the Group; the policy for hedging each major type of forecasted transaction for which hedge accounting is used; and the exposure of the Group to price risk, credit risk, liquidity risk and cash-flow risk are outlined in the Group financial statements.

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments shall be undertaken.

Further disclosures regarding financial risk management objectives and policies and the Company's exposure to principal risks can be found in note 2.

Key performance indicators

The directors of the Group manage the Group's operations on a divisional basis. For this reason, the Company's Directors believe that further key performance indicators for the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The performance of the divisions of the Group, which include the Company, are discussed in the Group's Annual Report which does not form part of this Report.

The purpose of this Report is to provide information to the members of the Company and as such it is only addressed to those members. The Report may contain certain forward-looking statements with respect to the operations, performance and financial condition of the Company. By their nature, these statements involve inherent risks and uncertainties since future events, circumstances and other factors can cause results and developments to differ materially from the plans, objectives, expectations and intentions expressed in such forward-looking statements. Members should consider this when relying on any forward-looking statements. The forward-looking statements reflect knowledge and information available at the date of preparation of this Report and the Company undertakes no obligation to update any forward-looking statements during the year. Nothing in this Report should be construed as a profit forecast.

On behalf of the Board,

Antonio Roman
For and on behalf of
Cater Allen Limited
Director

25 April 2019

Registered Office Address: 2 Triton Square, Regent's Place, London, NW1 3AN

REPORT OF THE DIRECTORS

Directors

The Directors who served throughout the year and at the date of this report (except as noted) were as follows:

S M Allen	
A V F Durbin	(appointed 15 November 2018)
P Halliday	
I M Bas Soria	(resigned 1 August 2018)
C P Sullivan	(resigned 31 October 2018)
A Roman	

Statement of directors' responsibilities

The directors are responsible for preparing the Strategic Report, the Report of the Directors and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Results and dividend

The profit for the year amounted to £60.1m (2017: £64.8m).

The Directors did not recommend payment of a final dividend in respect of the year ended 31 December 2018 (2017: £nil).

Information included within the Strategic Review

Information relating to risk management and likely future developments are contained within the Strategic Report on page 1 and incorporated into this report by reference.

Political donations

The Company did not make any political donations during the financial year (2017: £nil).

Qualifying Third Party Indemnities

Enhanced indemnities are provided to the Directors of the Company by the Group against liabilities and associated costs which they could incur in the course of their duties to the Company. All of the indemnities were in force during the financial year and at the date of approval of the Report and financial statements. All of the indemnities were qualifying third party indemnities. A copy of each of the indemnities is kept at the registered office address of Santander UK plc.

Independent Auditors

Each of the Directors as at the date of approval of this report has confirmed that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the Director has taken all steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

In accordance with Sections 485 and 487 of the Companies Act 2006, PricewaterhouseCoopers LLP are re-appointed as auditors of the Company.

Post Balance Sheet Events

Cater Allen Limited does not have any post balance sheet events requiring disclosure.

REPORT OF THE DIRECTORS (continued)

Statement of Going Concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, note 2 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk, market risk, liquidity risk and other risks.

The Company has adequate financial resources. As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for at least the period of 12 months from the date the financial statements are authorised for issue. Accordingly, they continue to adopt the going concern basis of accounting in preparing the annual report and financial statements.

On behalf of the Board

Antonio Roman
Director

For and on behalf of
Cater Allen Limited,

25 April 2019

Registered Office Address: 2 Triton Square, Regent's Place, London, NW1 3AN

Independent auditors' report to the members of Cater Allen Limited

Report on the audit of the financial statements

Opinion

In our opinion, Cater Allen Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December; the statement of comprehensive income, the statement of changes in equity, the cash flow statement for the year ended 31 December; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to those charged with governance.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

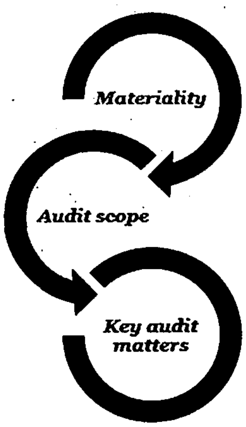
We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

We have provided no non-audit services to the company in the period from 1 January 2018 to 31 December 2018.

Our audit approach

Overview



- Overall materiality: £4,116,450 (2017: £4,455,050), based on 5% of profit before tax from continuing operations.

- The scope of our audit and the nature, timing and extent of the audit procedures performed were determined by our risk assessment.
- All material financial statement line items have been scoped in, over which we have performed full scope procedures.

- Risk of error in the calculation of interest income.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Independent auditors' report to the members of Cater Allen Limited (continued)

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to review of the financial statement disclosures to underlying supporting documentation, review of correspondence with the regulators, enquiries of management and review of legal expenses, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006 and the Financial Services and Markets Act 2000 and UK tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to fraudulent extraction of customer monies. Audit procedures performed by the engagement team included:

- Discussions with management and communication with those charged with governance in relation to known or suspected instances of non-compliance with laws and regulation and fraud;
- Assessment of matters reported on the group's whistleblowing helpline and the results of management's investigation of such matters;
- Identifying and testing journal entries, in particular any journal entries posted by senior management;
- Reviewing customer complaints in the year and the results of the investigation of such matters.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	***How our audit addressed the key audit matter***
Risk of error in the calculation of interest income We focused on the calculation of interest income as it is a material balance (£105m) and is calculated through a manual process thus increasing the risk of error. Interest income is derived from three material revenue streams, relating to overnight, fixed and variable rate deposits. A range of deposit products are offered to customers with the funds invested only within the Santander UK Group and therefore interest income is internally generated. The interest income is calculated on a monthly basis by applying the interest rate applicable to each product type as per a quarterly rate card.	We understood the process for the calculation of interest income including understanding the source of relevant inputs. Our procedures were substantive in nature and included in the following: We obtained the customer account balances and quarterly rate cards across a sample of months, and re-performed the interest income calculations focusing on the accuracy of the calculation, ensuring the correct rates had been applied to the appropriate product lines and balances. We tested the completeness and accuracy of key data inputs into the interest income calculation. We confirmed that the model calculated interest income agreed to the entries booked in the general ledger and the Santander UK Group intercompany matrix. Our testing did not identify any material misstatements in the calculation of interest income.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

In order to achieve the desired level of audit evidence on each material account balance in the financial statements, we performed specific audit procedures over those account balances.

Independent auditors' report to the members of Cater Allen Limited (continued)

Certain procedures including those relating to the hosting and monitoring of the IT systems used by the company were performed at a Santander UK level. As part of the planning and execution of the audit, we ensured that the procedures performed were sufficient for out purposes. This gave us the evidence we needed for our opinion on the financial statements as a whole.

As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud. We did not identify any key audit matters relating to irregularities, including fraud.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	£4,116,450 (2017: £4,455,050).
How we determined it	5% of profit before tax.
Rationale for benchmark applied	Profit Before Tax (PBT) is a key measure used by the shareholders in assessing the performance of the company, and is a generally accepted auditing benchmark.

We agreed with those charged with governance that we would report to them misstatements identified during our audit above £205,823 (2017: £222,753) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Report of the Directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Independent auditors' report to the members of Cater Allen Limited (continued)

Strategic Report and Report of the Directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Report of the Directors for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Report of the Directors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities set out on page 2, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of those charged with governance, we were appointed by the directors on 31 March 2016 to audit the financial statements for the year ended 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement is 3 years, covering the years ended 31 December 2016 to 31 December 2018.

H Anderson

Hamish Anderson (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
25 April 2019

STATEMENT OF COMPREHENSIVE INCOME

For the years ended 31 December

Continuing Operations	Note	2018 £000	2017 £000
Interest and similar income		104,934	114,127
Interest expense and similar charges		(12,379)	(14,907)
Net interest income	3	92,555	99,220
Fee and commission income		1,384	1,992
Fee and commission expense		(2,023)	(2,060)
Net fee and commission expense	4	(639)	(68)
Other operating result	5	2	-
Total income		91,918	99,152
Operating expenses	6	(9,959)	(10,051)
Operating profit		81,959	89,101
Provisions for other liabilities and charges	22	368	-
Profit before tax		82,327	89,101
Taxation expense	11	(22,228)	(24,279)
Profit for the year after tax		60,099	64,822
Total comprehensive income for the year attributable to the equity holders of the Company		60,099	64,822

The accompanying notes form an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY

For the years ended 31 December

	Share Capital £000	Share Premium £000	Retained Earnings £000	Total Equity £000
Balance at 1 January 2018	100,000	2,950	330,940	433,890
Profit for the year	-	-	60,099	60,099
31 December 2018	100,000	2,950	391,039	493,989
Balance at 1 January 2017	100,000	2,950	266,118	369,068
Profit for the year	-	-	64,822	64,822
31 December 2017	100,000	2,950	330,940	433,890

The accompanying notes form an integral part of the financial statements.

BALANCE SHEET

As at 31 December

	Note	2018 £000	2017 £000
Assets			
Financial assets at fair value through profit or loss:			
- Derivative financial instruments	9	-	31,961
- Other financial assets at fair value through profit or loss	10	110,520	-
Financial assets at amortised cost:			
- Loans and advances to banks	13	4,993,508	4,983,228
- Loans and advances to customers	14	115	195
Goodwill	15	30,000	30,000
Property, plant and equipment	16	6	6
Other assets	17	3,597	1,453
Total assets		5,137,746	5,046,843
Liabilities			
Financial liabilities at fair value through profit or loss:			
- Derivative financial instruments	9	8,942	29,654
Financial liabilities at amortised cost:			
- Deposits by banks	18	702	1,152
- Customer accounts	19	4,596,886	4,535,866
- Amounts due to group companies	20	11,403	16,697
Other liabilities	21	25,731	29,042
Provisions	22	93	542
Total liabilities		4,643,757	4,612,953
Equity			
Share capital	23	100,000	100,000
Share premium account		2,950	2,950
Retained earnings		391,039	330,940
Total shareholders' equity		493,989	433,890
Total equity attributable to equity holders of the Company		493,989	433,890
Total liabilities and equity		5,137,746	5,046,843

The accompanying notes form an integral part of the financial statements.

The financial statements were approved by the Board of Directors, authorised for issue and signed on its behalf by:

Antonio Roman
Director
25 April 2019

CASH FLOW STATEMENT

For the years ended 31 December

	Note	2018 £000	2017 £000
Net cash generated from operating activities	24(a)	10,280	306,342
Net increase in cash and cash equivalents		10,280	306,342
Cash and cash equivalents at the beginning of the year		4,983,228	4,676,886
Cash and cash equivalents at the end of the year	24(b)	4,993,508	4,983,228

The accompanying notes form an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES

The principal accounting policies applied to Cater Allen Limited (the Company) in the preparation of financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

General information

The Company is a limited liability company, incorporated and registered in England and Wales and part of Santander UK Group Holdings plc whose ultimate parent is Banco Santander SA. The registered office address of the Company is 2 Triton Square, Regent's Place, London NW1 3AN.

Basis of preparation

The financial statements of Cater Allen Limited have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRS IC) interpretations as adopted by the European Union and the Companies Act 2006 applicable to companies reporting under IFRS.

The financial statements have been prepared under the historical cost convention modified to include the fair valuation of certain financial instruments to the extent required or permitted under IFRS 9 'Financial Instruments' (IFRS 9) as set out in the relevant accounting policies and on a going concern basis as disclosed in the Directors' statement of going concern set out in the Report of the Directors.

The functional and presentation currency of the Company is sterling.

Recent accounting developments

On 1 January 2018, the Company adopted IFRS 9 'Financial Instruments' (IFRS 9) and IFRS 15 'Revenue from Contracts with Customers' (IFRS 15). The new or revised accounting policies are set out below.

The impact of applying IFRS 9 is disclosed in note 31 "Transition to IFRS 9". The accounting policy changes for IFRS 9, set out below, have been applied from 1 January 2018. Comparatives have not been restated. As a result of the change from IAS 39 to IFRS 9, some disclosures presented in respect of certain financial assets are not comparable because their classification may have changed between the two standards. This means that some IFRS 9 disclosures are not directly comparable and some disclosures that relate to information presented on an IAS 39 basis are no longer relevant in the current period.

As explained in note 31"Transition to IFRS 9", the classification and measurement changes to financial assets that arose on adoption of IFRS 9 have been aligned to the presentation in the balance sheet.

The application of IFRS 15 had no material impact on the Company as there were no significant changes in the recognition of in scope income.

Future accounting developments

At 31 December 2018, the Company had not yet adopted the following significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective:

- IFRS 16 'Leases' (IFRS 16) – In January 2016, the IASB issued IFRS 16. The standard is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both lessees and lessors. For lessee accounting, IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise a right-of-use (ROU) asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments for all leases with a term of more than 12 months, unless the underlying asset is of low value. For lessor accounting, IFRS 16 substantially carries forward the lessor accounting requirements from the existing leasing standard (IAS 17) and a lessor continues to classify its leases as operating leases or finance leases and to account for those two types of leases differently.

The application of IFRS 16 is not expected to have any impact on the Company.

Revenue recognition

a) Interest income and expense

Interest and similar income comprises interest income on financial assets measured at amortised cost. Interest expense and similar charges comprises interest expense on financial liabilities measured at amortised cost.

Interest income on financial assets measured at amortised cost and interest expense on financial liabilities other than those at fair value through profit or loss (FVTPL) is determined using the effective interest rate method.

The effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the gross carrying amount of the financial asset (i.e. its amortised cost before any impairment allowance). or to the amortised cost of a financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument excluding expected credit losses. The calculation includes all amounts paid or received by the Company that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of the financial instrument and all other premiums or discounts.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for financial assets that have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the ECL provision.)

1. ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

b) Fee and commissions income and expense

Fees and commissions which are not an integral part of the effective interest rate are recognised when the service has been performed.

Financial Instruments

a) Initial recognition and measurement

Financial assets and liabilities are initially recognised when the Company becomes a party to the contractual terms of the instrument. The Company determines the classification of its financial assets and liabilities at initial recognition and measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Immediately after initial recognition, an expected credit loss (ECL) allowance is recognised for financial assets measured at amortised cost.

b) Financial assets and liabilities

i) Classification and subsequent measurement

From 1 January 2018, the Company has applied IFRS 9 Financial Instruments and classifies its financial assets in the measurement categories of amortised cost, FVOCI and FVTPL.

Financial assets and financial liabilities are classified as FVTPL where there is a requirement to do so or where they are otherwise designated at FVTPL on initial recognition. Financial assets and financial liabilities which are required to be held at FVTPL include debt instruments that do not have solely payments of principal and interest (SPPI) characteristics. Otherwise, such instruments are measured at amortised cost or FVOCI.

The classification and measurement requirements for financial asset debt instruments and financial liabilities are set out below.

Financial assets: debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans. Classification and subsequent measurement of debt instruments depend on the Company's business model for managing the asset, and the cash flow characteristics of the asset.

Business model
The business model reflects how the Company manages the assets in order to generate cash flows and, specifically, whether the Company's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of the assets. Factors considered in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the assets' performance is evaluated and reported to key management personnel and how risks are assessed and managed.

SPPI
Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Company assesses whether the assets' cash flows represent SPPI. In making this assessment, the Company considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the related asset is classified and measured at FVTPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are SPPI.

Based on these factors, the Company classifies its debt instruments into one of the following measurement categories:

- Amortised cost – Financial assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL recognised. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method. When the estimates of future cash flows are revised, the carrying amount of the respective financial assets or financial liabilities is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in the income statement. The Company's loans and receivables meet the conditions to be measured at amortised cost.

- FVTPL – Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt instrument that is subsequently measured at FVTPL, including any debt instruments designated at fair value, is recognised in profit or loss and presented in the income statement. The Company's equity index-linked balances including embedded derivatives do not pass the SPPI test and are presented as "Other financial assets at fair value through profit or loss" in the financial statements.

The Company reclassifies financial assets when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent.

1. ACCOUNTING POLICIES (continued)

b) Financial assets and liabilities (continued)

Financial liabilities

Financial liabilities are classified as subsequently measured at amortised cost except for financial liabilities at fair value through profit or loss: this classification is applied to derivatives.

Deposits and payables, including intercompany financial liabilities are classified and subsequently measured at amortised cost.

Contracts involving the receipt of cash on which customers receive an index-linked return are accounted for as equity index-linked deposits. The principal products are Capital Guaranteed/Protected Products which give the customers a limited participation in the upside growth of an equity index. In the event the index falls in price, a cash principal element is guaranteed/protected. The equity index-linked deposits contain embedded derivatives. These embedded derivatives, in combination with the principal cash deposit element, are designed to replicate the investment performance profile tailored to the return agreed in the contracts with customers. The cash principal element is accounted for as deposits by customers at amortised cost. The embedded derivatives are separated from the host instrument and are separately accounted for as derivatives.

ii) Impairment

Expected credit losses are recognised on all financial assets at amortised cost. The expected credit loss considers forward looking information to recognise impairment allowances earlier in the lifecycle of a product. A three-stage approach to impairment measurement is adopted as follows:

- Stage 1 - the recognition of 12 month expected credit losses (ECL), that is the portion of lifetime expected credit losses from default events that are expected within 12 months of the reporting date, if credit risk has not increased significantly since initial recognition;
- Stage 2 - lifetime expected credit losses for financial instruments for which credit risk has increased significantly since initial recognition; and
- Stage 3 - lifetime expected credit losses for financial instruments which are credit impaired.

The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Financial assets are written off when it is reasonably certain that receivables are irrecoverable.

For more on how ECL is calculated see the Credit risk section of the Risk review.

a) Write-off

All write-offs are on a case-by-case basis, taking account of the exposure at the date of write-offs. A write-off is only made when all internal avenues of collecting the debt have been exhausted. A past due threshold is applied to overdrafts where accounts that are 180 days past due are written off unless there is a dispute awaiting resolution. The write-off policy is regularly reviewed. Write-offs are charged against previously established loss allowances.

b) Recoveries

Recoveries of credit impairment losses are not included in the impairment loss allowance, but are taken to income and offset against credit impairment losses.

iii) Derecognition

Financial assets are derecognised when the rights to receive cash flows have expired or the Company has transferred its contractual right to receive the cash flows from the assets and either: (1) substantially all the risks and rewards of ownership have been transferred; or (2) the Company has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

When the Company retains the contractual rights to receive the cash flows of a financial asset, but assumes a contractual obligation to pay those cash flows to one or more entities (the "eventual recipients"), the entity treats the transaction as a transfer of a financial asset if the following three conditions are met:

a) The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset.
b) The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.
c) The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay.

The Company derecognises the financial asset if it transfers substantially all the risks and rewards of ownership of the financial asset. The Company's interest in Home Reversions policies are treated in this manner as any net proceeds are subject to the interest of Santander UK plc. Any asset being recognised meets the de-recognition rules and no asset values are recorded in Cater Allen. Santander UK plc recognises the beneficial interest in the reversionary interests in its Balance Sheet.

Financial liabilities are derecognised when extinguished, cancelled or expired.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES (continued)

b) Financial assets and liabilities (continued)

Derivative financial instruments (derivatives)

Derivatives are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement, which require no or little initial net investment and are settled at a future date.

Derivatives are recognised initially (on the date on which a derivative contract is entered into), and are subsequently re-measured, at their fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are estimated using valuation techniques, including discounted cash flow and option pricing models.

Derivatives may be embedded in hybrid contracts. If the hybrid contract contains a host that is a financial asset, then the Company assesses the entire contract as described in the financial asset section above for classification and measurement purposes. Otherwise, embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative, except where netting is permitted. The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments and, if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives are recognised in the Statement of Comprehensive Income, and included within other operating result.

Foreign currency translation

Items included in the financial statements of the Company are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that Company (the functional currency) which is sterling. The financial statements are presented in pounds sterling, which is the functional currency of the immediate parent.

Foreign currency transactions are translated into the functional currency at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the Statement of Comprehensive Income.

Pensions and other post-retirement benefits

The Company participates in the Santander UK plc Group Pension Schemes in operation. There is no contractual agreement of stated policy for charging the net cost in relation to the Pension Schemes. The contribution to be paid by the Company is calculated as the contributions made by Santander UK plc to the schemes in respect of the Company's employees.

Goodwill

Goodwill was recognised on the acquisition of the business of CA Premier Banking Limited (formerly Robert Fleming & Co Limited) in 2001 and represents the excess of the cost of an acquisition over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition.

Goodwill is subject to an impairment review each year. The impairment review comprises a comparison of the carrying amount of the asset or cash generating unit with its recoverable amount: the higher of the asset's or cash generating unit's fair value less costs to sell and its value in use. The cash-generating unit represents the lowest level at which non-financial assets including goodwill is monitored for internal management purposes and is not larger than an operating segment.

The fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Value in use is calculated by discounting management's expected future cash flows obtainable as a result of the asset's continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre-tax basis.

The carrying value of Goodwill is written down by the amount of any impairment and the loss is recognised in the Statement of Comprehensive Income in the period in which it occurs. Impairment losses on goodwill are not reversed. For conducting impairment reviews, cash generating units (CGUs) are the lowest level at which management monitors the return on investment on assets.

Income taxes including deferred taxes

The tax expense represents the sum of the income tax currently payable and deferred income tax. Income tax payable on profits, based on the applicable tax law in each jurisdiction is recognised as an expense in the period in which profits arise. Taxable profit differs from net profit as reported in the Statement of Comprehensive Income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred income tax is the tax expected to be payable or recoverable on income tax losses available to carry forward and on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which the assets may be utilised as they reverse. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill. Deferred tax assets and liabilities are not recognised from the initial recognition of other assets (other than in a business combination) and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

1. ACCOUNTING POLICIES (continued)

Income taxes including deferred taxes (continued)

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with original maturities of three months or less, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks, amounts due from other banks and short-term investments in securities.

Provisions

Provisions are recognised for present obligations arising as consequences of past events where it is more likely than not that a transfer of economic benefit will be necessary to settle the obligation, and it can be reliably estimated.

When a leasehold property ceases to be used in the business, a provision is made where the unavoidable costs of the future obligations relating to the lease are expected to exceed anticipated rental income. The net costs are discounted using market rates of interest to reflect the long-term nature of the cash flows.

Contingent liabilities are possible obligations whose existence will be confirmed only by certain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised but are disclosed unless the likelihood of a transfer of economic benefit is considered to be remote.

Property, plant and equipment

Property, plant and equipment include office fixtures, computer equipment and computer software which is carried at cost less accumulated depreciation. Classes of property, plant and equipment are depreciated on a straight-line basis over their useful life, as follows:

Office fixtures and equipment	3 to 15 years
Computer software	3 to 7 years

Critical judgements and accounting estimates

The preparation of the financial statements requires management to make estimates and judgements that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the reporting period. Management evaluates its estimates and judgements on an ongoing basis. Management bases its estimates and judgements on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

In the course of preparing the financial statements, no significant judgements and accounting estimates have been made in the process of applying the Company's accounting policies.

2. FINANCIAL RISK MANAGEMENT

As a result of its normal business activities, the Company is exposed to a variety of risks, the most significant of which are operational risk, credit risk, market risk and liquidity risk. The Company manages its risk in line with the central risk management function of the Santander UK plc Group. Santander UK plc Group's Risk Framework ensures that risk is managed and controlled on behalf of shareholders, customers, depositors, employees and the Santander UK Group's regulators. Effective and efficient risk governance and oversight provide management with assurance that the Santander UK Group's business activities will not be adversely impacted by risks that could have been reasonably foreseen. This in turn reduces the uncertainty of achieving the Santander UK Group's strategic objectives.

Authority flows from the Santander UK plc Board to the Chief Executive Officer and from him to specific individuals. Formal standing committees are maintained for effective management of oversight. Their authority is derived from the person they are intended to assist. Further information can be found in the Santander UK plc Annual Report which does not form part of this Report.

Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes regulatory, legal and compliance risk. Operational risk is monitored and managed within the Group. Further information can be found in the Santander UK plc Annual Report which does not form part of this Report.

2. FINANCIAL RISK MANAGEMENT (continued)

Credit risk

Credit risk is the risk that counterparties will not meet their financial obligations and may result in the Company losing the principal amount lent, the interest accrued and any unrealised gains, less any security held.

Credit risk management

In accordance with Group policy, the Company manages its portfolios across the credit risk lifecycle, from drawing up risk strategy, plans, budgets and limits to making sure the actual risk profile of the Company's exposures stays in line with plans and the Company's appetite to risk.

The Introduction of IFRS 9

IFRS 9 replaced IAS 39 on 1 January 2018. IFRS 9 introduced a new impairment methodology and rules around classification and measurement of financial assets. For Cater Allen Limited, the application of IFRS 9 resulted in no change to shareholder's equity at 1 January 2018.

Key metrics

The Company uses a number of key metrics to measure and control credit risk, as follows:

Metric	Description
Expected credit losses (ECL)	ECL tells the Company what credit risk is likely to cost either over the next 12 months on qualifying exposures, or defaults over the lifetime of the exposure where there is evidence of a significant increase in credit risk since origination.
Stages 1, 2 and 3	The Company assesses the credit risk profile to determine which stage to allocate and monitors where there is a significant increase in credit risk and transfers between the stages.
Expected Loss (EL)	EL is the product of the probability of default, exposure at default and loss given default. The Company calculates each factor in accordance with group policy and risk models and an assessment of each customer's credit quality. There are differences between regulatory EL and IFRS 9 ECL. More details can be found in the Annual Report of the parent company Santander UK plc. For the rest of the Risk review, impairments, losses and loss allowances refer to calculations in accordance with IFRS, unless specifically stated otherwise. For IFRS accounting policy on impairment, see Note 1 to the Financial Statements.

Maximum exposure to credit risk

The main source of credit risk is in loans and advances to banks and also with advances to customers. Maximum exposure to credit risk is £5,104m (2017: £5,015m).

The Company's policy is to place the majority of its loans and advances with Group companies (see note 13). The Company did not recognise an ECL provision against these balances as this would be immaterial given they are nearly all payable on demand and the borrower (Santander UK plc) has sufficient accessible highly liquid assets in order to repay the loans if demanded. As at the year-end 31 December 2018, no credit impairment losses were recognised against loans and advances to Group companies.

For loans and advances to external customers, the Company structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower or group of borrowers. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. The credit quality of customer assets is managed by the credit approval process in place at account opening and during account administration. The Company has no financial assets past due but not impaired.

The table below shows the financial assets that credit risk affects which are loans and advances to customers in the form of overdrafts.

	Balance Sheet		
31 December 2018	Gross amounts £'000	Loss allowances £'000	Net exposure £'000
Financial assets at amortised cost:			
Loans and advances to customers	136	(21)	115
Total financial assets at amortised cost	136	(21)	115

For balance sheet assets, the maximum exposure to credit risk is the carrying value after impairment loss allowances. For off-balance sheet commitments such as approved but unutilised overdraft facilities, the maximum exposure is the maximum amount that the Company would have to pay if the facility were called on.

2. FINANCIAL RISK MANAGEMENT (continued)

Credit risk (continued)

Credit exposures and corresponding ECL

The following table analyses the credit risk exposure of financial instruments for which an ECL allowance is recognised, and the corresponding ECL at 31 December 2018.

31 December 2018	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Exposures				
Loans and advances to customers (Overdrafts)	85	-	51	136
Total exposures	85	-	51	136
IFRS 9 ECL				
Loans and advances to customers (Overdrafts)	(2)	-	(19)	(21)
Total ECL	(2)	-	(19)	(21)
Net exposures	83	-	32	115

Market Risk

Market risk is the potential for loss of income or decrease in the value of net assets caused by movements in the levels and prices of financial instruments. The majority of market risk, which is considered to be low arises as a result of currency foreign exchange and interest rate risk.

Currency Risk

The main operating or "functional" currency of the Company's operations is sterling. There are also small balances in Euro and US dollars. As the Company prepares its financial statements in sterling, these will be affected by movements in the euro/sterling and US dollar/sterling exchange rates. The exposure to this risk is mitigated by the use of currency matched funding. Taking this into account, the Company did not have a material financial exposure to foreign exchange gains and losses in either the year ended 31 December 2018 or the year ended 31 December 2017.

In the table below are only the Company's assets and liabilities that are denominated in foreign currency at the balance sheet date.

	2018 Euro £000	2018 US Dollars £000	2017 Euro £000	2017 US Dollars £000
Loans and advances to group companies	51,378	30,578	32,969	24,260
Loans and advances to banks	4,306	6,652	6,881	6,920
Other assets	34	1,231	309	143
Total assets	55,718	38,461	40,159	31,323
Customer accounts	55,302	38,001	40,184	31,027
Other liabilities	553	6	30	80
Total liabilities	55,855	38,007	40,214	31,107

Interest rate sensitivity

As a result of matching the profile of assets to the profile of liabilities, the Company has no material sensitivity to changes in interest rates. Where the Company offers customers products linked to a market index, a hedging derivative (an option or swap) is always purchased.

Liquidity risk

Liquidity risk is the potential that, although remaining solvent, the Company does not have sufficient liquid financial resources to enable it to meet its obligations as they fall due or can secure them only at excessive cost.

The Company manages liquidity risk with the support of its parent company, ensuring that the Company will have sufficient liquid resources in order to meet its obligations as they fall due.

2. FINANCIAL RISK MANAGEMENT (continued)

Liquidity risk (continued)

Maturities of financial liabilities

The maturity profile of the Company's financial liabilities based on the remaining period to the contractual maturity date at the balance sheet date was:

At 31 December 2018	Demand/ Up to 1 month £000	1- 3 months £000	3-12 months £000	1-5 years £000	Total £000
Deposits by banks	702	-	-	-	702
Customer accounts	4,426,004	39,889	101,946	29,047	4,596,886
Derivative financial instruments	-	3,302	4,867	773	8,942
Amounts due to group companies	-	2,185	7,396	1,822	11,403
Total financial liabilities	4,426,706	45,376	114,209	31,642	4,617,933

At 31 December 2017	Demand/ Up to 1 month £000	1-3 months £000	3-12 months £000	1-5 years £000	Total £000
Deposits by banks	1,152	-	-	-	1,152
Customer accounts	4,231,030	57,834	136,545	110,457	4,535,866
Derivative financial instruments	-	976	12,861	15,817	29,654
Amounts due to group companies	235	549	4,119	11,794	16,697
Total financial liabilities	4,232,417	59,359	153,525	138,068	4,583,369

Capital management and capital allocation

The Santander UK plc Board is responsible for capital management strategy and policy and ensuring that capital resources are appropriately monitored and controlled within regulatory and internal limits within each of the Santander UK plc group of companies (Santander UK plc). Authority for capital management flows to the Chief Executive and from him to specific individuals who are members of Santander UK plc's Asset and Liability Management Committee (ALCO).

ALCO adopts a centralised capital management approach that is driven by Santander UK plc's corporate purpose and strategy. This approach takes into account the regulatory and commercial environment in which Santander UK plc operates, Santander UK plc's risk appetite, the management strategy for each of Santander UK plc's material risks (including whether or not capital provides an appropriate risk mitigant) and the impact of appropriate adverse scenarios and stresses on Santander UK plc's capital requirements. This approach is reviewed annually as part of Santander UK plc's Internal Capital Adequacy Assessment Process (ICAAP).

Santander UK plc manages its capital requirements, debt funding and liquidity on the basis of policies and plans reviewed regularly at ALCO and as part of the ICAAP process. To support its capital and senior debt issuance programmes, Santander UK plc is rated on a standalone basis.

On an ongoing basis and in accordance with the latest ICAAP review, Santander UK plc forecasts its regulatory and internal capital requirements based on the approved capital volumes allocated to business units as part of the corporate planning process and the need to have access to a capital buffer. Capital allocation decisions are made as part of planning based on the relative returns on capital using both economic and regulatory capital measures. Capital allocations are reviewed in response to changes in risk appetite and risk management strategy, changes to the commercial environment, changes in key economic indicators or when additional capital requests are received.

The combination of regulatory and economic capital ratios and limits, internal buffers and restrictions, together with the relevant costs of differing capital instruments and a consideration of various other capital management techniques are used to shape the most cost-effective structure to fulfil the Santander UK plc's capital needs.

Capital adequacy

The Company manages its capital on a Basel III basis. Throughout 2018 and 2017, the Group managed internal capital allocations and targets in accordance with its capital and risk management policies.

Capital

	2018 £000	2017 £000
Total Tier 1 Capital*	433,903	367,171
Deductions from Tier 1 - Goodwill	(30,000)	(30,000)
Total Capital Resources (Tier 1)	403,903	337,171
Tier 2 Capital	-	-
Total Capital Resources	403,903	337,171

* The Company's Tier 1 capital consists of shareholders' equity, share premium and audited profits/losses for the years ended 31 December 2017. It does not include current year profits as these were unverified at the time figures were reported to the regulator.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

3. NET INTEREST INCOME

	2018 £000	2017 £000
Interest and similar income:		
Loans and advances to banks and fellow subsidiaries	104,934	114,127
Total interest and similar income	104,934	114,127
Interest and similar charges		
Deposits by customers	(12,379)	(14,907)
Total interest and similar charges	(12,379)	(14,907)
Net interest income	92,555	99,220

4. NET FEE AND COMMISSION EXPENSE

	2018 £000	2017 £000
Fee and commission income:		
Credit related fees and commissions	1,384	1,992
Total fee and commission income	1,384	1,992
Fee and commission expense:		
Introducer fees	(442)	(380)
Brokerage fees paid	(1,581)	(1,680)
Total fee and commission expense	(2,023)	(2,060)
Net fee and commission expense	(639)	(68)

5. OTHER OPERATING RESULT

	2018 £000	2017 £000
Fair value gains on derivative financial instruments	196,911	13,769
Fair value losses on derivative financial instruments	(196,911)	(13,769)
Other income	2	-
Total other operating income	2	-

During the year, the equity index-linked balances placed with Abbey National Treasury Services plc were migrated to Santander UK plc. There was no impact on the net operating results of the Company.

6. OPERATING EXPENSES

	2018 £000	2017 £000
Staff costs:		
Wages and salaries	4,020	3,732
Social security costs	195	148
Other pension costs:		
- defined contribution plans	141	122
- defined benefit plans	132	78
Other personnel costs	82	54
	4,570	4,134
Property and equipment expenses	257	223
Other administrative expenses	5,132	5,694
Total other operating expenses	9,959	10,051

Santander UK plc is the employer of all staff working for the Company and bears the staff costs before recharging them to Cater Allen Limited.

	2018 Number	2017 Number
Administrative staff	62	68
Sales staff	17	12
Monthly average number of employees	79	80

7. DIRECTORS' EMOLUMENTS

Fees totalling £1,907 were payable to Annemarie Durbin from the date of her appointment on 15 November 2018 in respect of her position as the Chair of the Company to 31 December 2018. The remuneration of the other Directors and Key Management Personnel are paid by Santander UK plc and are not recharged to the Company.

8. AUDIT AND OTHER SERVICES

The aggregate fees for audit and other services payable to the Company's auditors is analysed as follows:

	2018 £000	2017 £000
Audit services :		
Statutory audit fees for the audit of Company's financial statements	71	71
Total audit fees	71	71

9. DERIVATIVE FINANCIAL INSTRUMENTS

Assets	2018 Notional amount £000	2018 Fair value £000	2017 Notional amount £000	2017 Fair value £000
Amounts due from group company – equity index-linked balances	-	-	144,251	-
Derivative financial instruments	-	-	-	31,961
	-	-	144,251	31,961
Liabilities				
Customer accounts – equity index-linked balances (note 19)	90,175	-	130,206	-
Amounts due to group company – equity index-linked balances (note 20)	11,403	-	16,462	-
Derivative financial instruments	-	8,942	-	29,654
	101,578	8,942	146,668	29,654

The Company offers equity index-linked products to customers with returns linked to indexes such as the FTSE. As a result, the financial instruments contain embedded derivatives. The Company places the customer deposit balances with a fellow group company which undertakes all the activities in relation to the hedging and valuation of these balances. Further information in relation to the measurement and valuation of the financial instruments can be found in note 28.

On adoption of IFRS 9 from 1 January 2018, the derivative financial instruments (assets) were reclassified to 'Other financial assets at fair value through profit or loss'. For more information, see note 31.

10. OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2018 £000	2017 £000
Amounts due from group company – equity index-linked balances	110,520	-

On adoption of IFRS 9 from 1 January 2018, the Company combined the equity index-linked notional balances with the embedded derivatives and reflected the total balance under a new classification category 'Other financial assets at fair value through profit or loss'. The financial assets are mandatorily held at fair value through profit or loss. For more information see note 31.

Further information in relation to the measurement and valuation of the financial instruments can be found in note 28.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

11. TAXATION EXPENSE

	2018 £000	2017 £000
Current tax:		
UK corporation tax on profit of the year	22,219	24,276
Adjustments in respect of prior years	(1)	(17)
Total current tax	22,218	24,259
Deferred tax (note 12):		
Origination and reversal of temporary differences	10	9
Change in rate of UK corporation tax	(1)	(1)
Adjustments in respect of prior years	1	12
Total deferred tax	10	20
Tax charge on profit for the year	22,228	24,279

UK corporation tax is calculated at 19.00% (2017: 19.25%) of the estimated assessable profits for the year.

The Finance Act 2016 introduced a further reduction in the corporation tax rate to 17% from 2020. The effects have been reflected in the deferred tax balances at both 31 December 2018 and 2017. The Finance (No. 2) Act 2015, provides an 8% surcharge to the UK corporation tax charged to banks from 1 January 2016 and was enacted on 18 November 2015.

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the Company as follows:

	2018 £000	2017 £000
Profit before tax	82,327	89,101
Tax calculated at a tax rate of 19.00% (2017: 19.25%)	15,642	17,152
Bank surcharge of 8% on profits	6,586	7,128
Non-deductible expenses	1	5
Effect of change in tax rate on deferred tax provision	(1)	(1)
Adjustment to prior year provisions	-	(5)
Tax charge for the year	22,228	24,279

12. DEFERRED TAX

Deferred taxes are calculated on temporary differences under the liability method using the tax rates expected to apply when the liability is settled or the asset is realised. The movement on the deferred tax account was as follows:

	2018 £000	2017 £000
At 1 January	42	62
Income statement charge	(10)	(20)
At 31 December	32	42

Deferred tax assets and liabilities are attributable to the following items:

	Balance Sheet		Income Statement	
	2018 £000	2017 £000	2018 £000	2017 £000
Deferred tax assets				
Accelerated book depreciation	30	36	(6)	(8)
Other temporary differences	2	6	(4)	(12)
	32	42	(10)	(20)

The deferred tax assets scheduled above have been recognised in the Company on the basis that sufficient future taxable profits are forecast within the foreseeable future, in excess of the profits arising from the reversal of existing taxable temporary differences, to allow for the utilisation of the assets as they reverse.

13. LOANS AND ADVANCES TO BANKS

	2018 £000	2017 £000
Placements with other banks	21,206	26,759
Amounts due from group companies*	4,972,302	4,956,469
	4,993,508	4,983,228

* Amounts due from group companies reflect placements with immediate parent company and amounts due from fellow subsidiaries which were previously disclosed separately.

13. LOANS AND ADVANCES TO BANKS (continued)

The loans and advances to banks in the above table have the following repayment behavioural profile:

	2018 £000	2017 £000
Repayable:		
On demand	4,941,660	4,711,967
In not more than three months	17,516	41,888
In more than three months but not more than one year	34,332	128,383
In more than one year but not more than five years	-	100,990
	4,993,508	4,983,228

The repayment structure reflects the deposits placed by customers into both current and term accounts. However, nearly all loans and advances to banks are repayable on demand and are classed as cash and cash equivalents for the purpose of the Cash flow statement.

The book value of loans and advances to banks approximately equals the fair value.

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

	2018 £000	2017 £000
Fixed rate	176,552	128,145
Variable rate	4,816,956	4,855,083
	4,993,508	4,983,228

14. LOANS AND ADVANCES TO CUSTOMERS

	2018 £000	2017 £000
Other unsecured advances	136	247
Loans and advances to customers	136	247
Less: Credit impairment loss allowance	(21)	(52)
Loans and advances to customers, net of loss allowance	115	195

	2018 £000	2017 £000
Repayable:		
On demand	136	247
Loans and advances to customers	136	247
Less: Credit impairment loss allowance	(21)	(52)
Loans and advances to customers, net of loss allowance	115	195

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

	2018 £000	2017 £000
Variable rate	136	247
Less: Credit impairment loss allowance	(21)	(52)
	115	195

The net book value of loans and advances to customers equals their fair value.

Movement in loan loss allowances:

	2018 Other Unsecured advances £000	2017 Other Unsecured advances £000
As at 1 January 2018	(52)	(3)
Reductions/(Additions) of impairment during the year	31	(56)
Amounts written off during the year	-	7
At 31 December 2018	(21)	(52)

£0.3m of bad debts that had been previously written off was recovered during the year (2017: £0.3m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

15. GOODWILL

	2018 £000	2017 £000
Cost:		
At 1 January and 31December	95,518	95,518
Accumulated impairment		
At 1 January and 31 December	(65,518)	(65,518)
Net book value:	30,000	30,000

The Goodwill was generated upon the purchase of CA Premier Banking Limited (formerly Robert Fleming & Co Limited) in 2001. The acquired trade and assets are fully integrated within the Company. During 2011, impairment of goodwill was recognised as a result of the reassessment of the value of certain parts of the business in light of the prevailing market conditions and regulatory developments. The remaining book value of goodwill is £30m.

Impairment testing in respect of goodwill allocated to each cash-generating unit (CGU) is performed annually or more frequently if there are impairment indicators present. For the purpose of impairment testing, the CGUs are based on customer groups within the relevant business divisions.

During 2018 and 2017, no impairment of goodwill was recognised. The calculations at 30 November 2018 indicated continued support for the existing goodwill balance and were prepared on the basis of conservative estimates of future benefits, and excluded any estimate of terminal value.

The cash flow projections for each CGU are based on the five-year plan prepared for regulatory purposes, derived from Santander UK plc's 3-Year Plan and approved by the Santander UK plc Board. The assumptions included in the expected future cash flows for each CGU take into consideration the UK economic environment and financial outlook within which the CGU operates. Key assumptions include projected GDP growth rates, the level of interest rates and the level and change in unemployment rates in the UK. The discount rate used to discount the cash flows is based on a pre-tax rate that reflects the weighted average cost of capital allocated by Santander UK to investments in the business division in which the CGU operates. The growth rate used reflects management's five-year forecasts, with a terminal growth rate for each year applied thereafter, in line with the estimated long-term average UK GDP growth rate.

16. PROPERTY, PLANT AND EQUIPMENT

	2018 Office fixtures and equipment £000	2017 Office fixtures and equipment £000
Cost:		
At 1 January	2,999	2,999
At 31 December	2,999	2,999
Accumulated depreciation:		
At 1 January and 31 December	(2,993)	(2,993)
Net Book value	6	6

The remaining balance relates to Art and Memorabilia.

17. OTHER ASSETS

	2018 £000	2017 £000
Items in the course of collection	2,457	95
Amounts due from group companies	-	100
Other accruals	1,108	1,216
Deferred tax asset (see note 12)	32	42
	3,597	1,453

The book value of other assets equals their fair value.

18. DEPOSITS BY BANKS

	2018 £000	2017 £000
Amounts due to Santander UK plc	702	1,152
Total deposits by banks	702	1,152
Repayable:		
On demand	702	1,152
	702	1,152

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

18. DEPOSITS BY BANKS (continued)

The deposits by banks in the above table have the following interest rate structures:

	2018 £000	2017 £000
Variable rate	702	1,152
	702	1,152

The fair value of deposits by banks equals book value.

19. CUSTOMER ACCOUNTS

	2018 £000	2017 £000
Amounts due to fellow subsidiaries	419	3,448
Retail deposits	4,506,292	4,402,212
Equity index-linked deposits	90,175	130,206
Deposits by customers	4,596,886	4,535,866
Derivative financial instruments (note 9)	8,942	29,654
Total deposits by customers	4,605,828	4,565,520

	2018 £000	2017 £000
Repayable:		
On demand	4,426,004	4,231,030
In not more than three months	43,191	58,810
In more than three months but not more than one year	106,813	149,406
In more than one year but not more than five years	29,820	126,274
	4,605,828	4,565,520

Contracts involving the receipt of cash on which customers received an index linked return are accounted for as equity index-linked deposits.

The customer accounts liability presented on the balance sheet includes Retail deposits and equity index-linked deposits excluding derivatives. The book value of customer accounts approximately equals their fair value.

20. AMOUNTS DUE TO GROUP COMPANIES

	2018 £000	2017 £000
Abbey National Treasury Services plc – customer repurchases of Equity index-linked products	-	16,462
Santander UK plc – customer repurchase of Equity index-linked products	11,403	-
Produban UK Limited	-	235
	11,403	16,697

The amounts due to fellow subsidiaries reflect balances payable to related parties within the Santander UK plc group. Up until 2018, the customer repurchases of equity index-linked products were payable to Abbey National Treasury Services plc before being transferred to Santander UK plc in 2018.

21. OTHER LIABILITIES

	2018 £000	2017 £000
Corporation tax	22,219	24,289
Accrued expenses	131	50
Items in the course of transmission	1,204	2,517
Deferred Income	-	19
Other	2,177	2,167
	25,731	29,042

The Directors consider that the carrying amount of other liabilities approximates to their fair value.
All of the amounts above represent balances due within one year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

22. PROVISIONS

	Provision for premises £000	Regulatory £000	Total £000
At 1 January 2017	368	600	968
Provisions utilised	-	(426)	(426)
As at 31 December 2017 and 1 January 2018	368	174	542
Provisions utilised	(368)	(81)	(449)
At 31 December 2018	-	93	93

	Provision for premises £000	Regulatory £000	Total £000
To be settled:			
- Within 12 months	-	93	93

i) Provision for premises

The provision for premises was for dilapidations on a lease which expired in 2013. As part of its annual review, Management assessed the probability of a claim arising in respect the property and, after considering it to be remote, released the provision in full.

ii) FSCS Compensation scheme

The FSCS is the UK's independent statutory compensation fund for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by levies on the industry (and recoveries and borrowings where appropriate). The levies raised comprise both management expenses levies and, where necessary, compensation levies on authorised firms.

Each deposit-taking institution contributes towards the management expenses levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March. In determining an appropriate accrual in respect of the management expenses levy, certain assumptions have been made, based on information received from the FSCS, and the Company's historic share of industry protected deposits.

Following the default of a number of deposit takers since 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. Whilst it is expected that the substantial majority of the principal will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, to the extent that there remains a shortfall, the FSCS will recover any shortfall of the principal by levying the deposit-taking sector in instalments.

The FSCS and HM Treasury have agreed that the terms of the repayment of the borrowings will be reviewed every three years in light of market conditions and of the actual repayment from the estates of failed banks. The ultimate amount of any compensation levies to be charged in future years also depends on a number of factors including the level of protected deposits and the population of deposit-taking participants and will be determined at a later date.

Historically, the Company's FSCS levy was borne by Santander UK plc, for which no recharges were made. Commencing 2016, Cater Allen Limited started recognising a provision for the expected FSCS levy within its own financial statements.

For the year ended 31 December 2018, no additional provisions were charged to the Income Statement by the Company towards the FSCS (2017: none). In August 2018, a total of £81,000 for the scheme year ending 31 March 2018 was paid by Santander UK plc. on behalf of Cater Allen Limited. Consequently, the provision as at 31 December 2018 has been reduced to £93,000.

23. SHARE CAPITAL

	2018 £	2017 £
Issued and fully paid:		
100,000,000 (2017: 100,000,000) ordinary shares of £1 each	100,000,000	100,000,000
100 (2017: 100) preferred ordinary shares of £1 each	100	100

There have been no changes from the previous year.

Holders of ordinary shares are entitled to:

a) receive such dividends as the Directors approve out of profits remaining after payment of the preferred dividend;
b) one vote for every share held in respect of resolutions proposed at general meetings; and
c) receive, upon winding up, an amount in respect of each ordinary share equal to the paid up capital value thereof after paying the holders of the preference shares as described above, the balance being distributed between the shareholders in proportion to their paid up ordinary shareholdings.

Holders of preferred ordinary shares are entitled to:

a) receive a specific dividend in priority to all other shareholders but have no right to a fixed coupon or a guaranteed dividend; and
b) receive notice and to attend any meetings at which any matter affecting the rights attaching to the preferred shares is to be considered.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

24. CASH FLOW STATEMENT

a) Reconciliation of profit before tax to net cash generated from/ (used in) operating activities:

	2018 £000	2017 £000
Profit before tax	82,327	89,101
Net cash flow from trading activities	82,327	89,101
Changes in operating assets and liabilities		
(Decrease)/Increase in items in course of transmission by other banks	(3,675)	(2,616)
Decrease/ (Increase) in loans and advances to customers	80	(28)
Decrease/ (Increase) in other assets	108	(1,216)
Decrease in derivative assets	31,961	2,131
Increase in financial assets at fair value through profit or loss	(110,520)	-
Increase in deposits by banks and customer accounts	39,859	241,251
(Decrease)/ Increase in amounts due to other group companies	(5,195)	5,759
Provision utilisation – FSCS compensation	(449)	(426)
Increase/ (Decrease) in other liabilities and provisions	72	(1,085)
Tax paid in the year	(24,288)	(26,529)
Net cash generated from operating activities	10,280	306,342

b) Analysis of the balances of cash and cash equivalents in the balance sheet:

	2018 £000	2017 £000
Loans and advances to banks (note 13)	4,993,508	4,983,228

25. CONTINGENT LIABILITIES AND COMMITMENTS

Material Contracts

On 18 November 2018, the Company entered into a new Capital Support Deed with Santander UK plc and with other certain subsidiaries within the Group. The new Capital Support Deed replaces the Agreement dated 14 December 2012 which supports a core UK group for the purposes of section 10 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU") of the PRA Handbook.

Under section 10.8 of BIPRU, exposures of each regulated entity to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the Capital Support Deed is to facilitate the prompt transfer of available capital resources or repayment of liabilities to a regulated entity to ensure that a regulated entity continues to comply with requirements relating to capital resources and risk concentrations. The amount of any transfer is limited to the sum of the Company's capital resources which would not cause the value of its liabilities to exceed the value of its assets, taking into account all of its contingent and prospective liabilities. The Capital Support Deed also provides that, in certain circumstances, funding received by the Company from other parties to the Capital Support Deed becomes repayable on demand, such repayment being limited to the Company's available resources.

Santander UK plc and Cater Allen Limited are party to a defined liquidity group liquidity facility agreement dated 31 August 2018 (the "DLG Facility Agreement").

The DLG Facility Agreement supports a defined liquidity group for the purposes of section 12 of BIPRU. Section 12.8 of BIPRU permits a member of a defined liquidity group to rely on the liquid resources of other members of the defined liquidity group to comply with the liquidity adequacy requirements under section 12 of BIPRU. Under the DLG Facility Agreement, each party agrees to lend, subject to certain conditions and limitations, its excess liquidity to another party.

26. UNUTILISED OVERDRAFT FACILITIES

At the balance sheet date, the total of approved but unutilised overdrafts extended to customers with a bank account with the Company was £1,160,812 (2017: £1,099,778).

27. RELATED PARTY TRANSACTIONS

During the year, the Company entered into the following transactions with its intermediate parent and fellow group companies. There were no related party transactions with its ultimate controlling party as at the year end date (2017: £nil).

The Company has no related party transactions or balances due to or from its immediate parent undertaking.

All of the amounts below are unsecured.

Expenditure and amounts due to Santander UK Technology Limited (formerly Isban UK Limited), Produban UK Limited and Santander Global Technology Limited relate to the provision of support services to the Company.
During the year, the Company entered into no transactions with directors of the Company (2017: £nil).

27. RELATED PARTY TRANSACTIONS (continued)

	Income		Expenditure		Amounts due from related parties		Amounts due to related parties	
	2018 £000	2017 £000	2018 £000	2017 £000	2018 £000	2017 £000	2018 £000	2017 £000
Santander UK plc – retail deposits	-	-	-	-	4,841,362	4,803,303	-	-
Santander UK plc – retail deposit interest	28,952	13,724	-	-	246	384	-	-
Santander UK plc – Bank account	-	-	-	-	124,567	1,193	-	-
Santander UK plc – management fees and recharges	-	-	4,100	4,150	-	-	702	1,152
Santander UK plc – transfer pricing	75,939	94,630	-	-	6,125	7,338	-	-
Santander UK plc – Equity index-linked balances [1]	178,236	-	15,789	-	99,117	-	-	-
Abbey National Treasury Services plc – Equity index-linked balances [1]	13,759	95,184	183,314	86,409	-	159,750	-	-
Santander UK Technology Limited (formerly Isban UK Limited) [2]	-	-	2,122	1,350	-	100	-	-
Produban UK Limited	-	-	-	895	-	-	-	235
Santander Global Technology Limited	-	-	179	-	-	-	-	-
Cater Allen Lloyds Holdings Limited – customer accounts	-	-	1	2	-	-	104	1,106
Cater Allen Syndicate Management Limited – customer accounts	-	-	1	4	-	-	315	2,342
	296,886	203,538	205,506	92,810	5,071,417	4,972,068	1,121	4,835

(1) Equity index-linked balances include derivatives and are reflected net off customer repurchases owed to the group company.
(2) In 2018, Isban UK Limited changed its name to Santander UK Technology Limited.

28. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

i) Fair value measurement

The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Company has access at that date. The fair value of a liability reflects its non-performance risk.

Financial instruments valued using observable market prices

If a quoted market price in an active market is available for an instrument, the fair value is calculated as the current bid price multiplied by the number of units of the instrument held.

Financial instruments valued using a valuation technique

In the absence of a quoted market price in an active market, management uses internal models to make its best estimate of the price that the market would set for that financial instrument. In order to make these estimations, various techniques are employed, including extrapolation from observable market data and observation of similar financial instruments with similar characteristics. Wherever possible, valuation parameters for each product are based on prices directly observable in active markets or that can be derived from directly observable market prices. Chosen valuation techniques incorporate all the factors that market participants would take into account in pricing transactions.

ii) Fair value hierarchy

The Company applies the following fair value hierarchy that prioritises the inputs to valuation techniques used in measuring fair value. The hierarchy establishes three categories for valuing financial instruments, giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three categories are: quoted prices in active markets (Level 1), internal models based on observable market data (Level 2) and internal models based on other than observable market data (Level 3). If the inputs used to measure an asset or a liability fall to different levels within the hierarchy, the classification of the entire asset or liability will be based on the lowest level input that is significant to the overall fair value measurement of the asset or liability.

The Company categorises assets and liabilities measured at fair value within the fair value hierarchy based on the inputs to the valuation techniques as follows:

Level 1: Unadjusted quoted prices for identical assets or liabilities in an active market that the Company can access at the measurement date.

Level 2: Quoted prices in inactive markets, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability.

28. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

Financial instruments valued using a valuation technique (continued)

Fair value hierarchy (continued)

Level 3: Significant inputs to the pricing or valuation techniques are unobservable.

The Company does not directly employ valuation techniques to determine the valuation of its derivatives or the hedging as set out in the next section (below). This is undertaken by Santander UK plc (this was carried out by fellow subsidiary Abbey National Treasury Services plc (ANTS plc) in accordance with Group policy in 2017 and prior years).

Valuation techniques

The main valuation techniques employed in internal models to measure the fair value of the financial instruments at 31 December 2018 and 2017 are set out below. Santander UK plc did not make any material changes to the valuation techniques and internal models it used in 2018, 2017 and 2016.

- In the valuation of equity financial instruments requiring dynamic hedging (principally equity securities, options and other structured instruments), proprietary local volatility and stochastic volatility models are used. These types of models are widely accepted in the financial services industry. Observable market inputs used in these models include the bid-offer spread, foreign currency exchange rates, volatility and correlation between indices.

Santander UK plc believes its valuation methods are appropriate and consistent with other market participants. Nevertheless, the use of different valuation methods or assumptions, including imprecision in estimating unobservable market inputs, to determine the fair value of certain financial instruments could result in different estimates of fair value at the reporting date and the amount of gain or loss recorded for a particular instrument. Most of the valuation models are not significantly subjective, because they can be tested and, if necessary, recalibrated by the internal calculation of and subsequent comparison to market prices of actively traded securities, where available.

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker. To this end, ultimate responsibility for the determination of fair values lies with the Risk Department. For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised.

Fair values of financial instruments measured at fair value

The following tables summarise the fair values of the financial assets and liabilities accounted for at fair value at 31 December 2018 and 2017, analysed by their levels in the fair value hierarchy – Level 1, Level 2 and Level 3.

Balance sheet category	Level 1 £000	Level 2 £000	Level 3 £000	2018 Total £000	Level 1 £000	Level 2 £000	Level 3 £000	2017 Total £000
Assets								
Derivative financial instruments (note 9)	-	-	-	-	-	31,961	-	31,961
Other financial assets at FVTPL (note 10)	-	110,520	-	110,520	-	-	-	-
	-	110,520	-	110,520	-	31,961	-	31,961
Liabilities								
Derivative financial instruments (note 9)	-	8,942	-	8,942	-	29,654	-	29,654
		8,942	-	8,942	-	29,654	-	29,654

The directors have re-assessed the prior year classification of financial assets.

29. RETIREMENT BENEFIT SCHEMES

The Company participates in the Santander UK plc Group Pension schemes. There is no contractual agreement of stated policy for charging the net cost in relation to the Pension Schemes. The contribution to be paid by the Company is calculated as the contributions made by Santander UK plc to the schemes in respect of the Company's employees. Details of the scheme and any associated deficit or surplus appear in the financial statements of Santander UK plc which are available from Santander Secretariat (Santander UK plc, 2 Triton Square, Regent's Place, London, NW1 3AN.

Pension costs are included in staff costs in the Statement of Comprehensive Income in Note 6. None of this amount was recognised for key management personnel for the year ended 31 December 2018 (2017: £nil).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

30. PARENT UNDERTAKING AND CONTROLLING PARTY

Cater Allen Limited is domiciled in the United Kingdom. The Company's immediate parent company is Santander Private Banking UK Limited, a company registered in England and Wales.

The Company's ultimate parent undertaking and controlling party is Banco Santander SA, a company incorporated in Spain. Banco Santander SA is the parent undertaking of the largest group of undertakings for which group financial statements are drawn up. Santander UK plc is the intermediate UK parent undertaking of the smallest group of undertakings for which group financial statements are drawn up.

Copies of all sets of group financial statements, which include the results of the Company, are available from Secretariat, Santander UK plc, 2 Triton Square, Regent's Place, London, NW1 3AN.

31. TRANSITION TO IFRS 9

Statutory balance sheet reconciliation under IAS 39 and IFRS 9

The measurement categories and carrying amounts of financial assets determined in accordance with IAS 39 and IFRS 9 are compared below.

Assets	Measurement category	IAS 39 At 1 Jan 2018 £000	Reclassifications £000	Measurement category	IFRS 9 At 1 Jan 2018 £000
Derivative financial instruments (1)	FVTPL	31,961	(31,961)		
Loans and advances to banks (2)	Loans & advances	4,983,228	(144,251)	Amortised cost	4,838,977
Other financial assets at FVTPL (3)			176,212	FVTPL (Mandatory)	176,212
Total		5,015,189	-		5,015,189

The 'Reclassifications' column in the table above captures the following changes resulting from the adoption of IFRS 9:

(1) Derivative financial instruments of £31,961,000 previously designated at FVTPL under IAS 39, are now mandatorily held at FVTPL as there is no longer an option to bifurcate embedded derivatives under IFRS 9. They are reclassified to other financial assets at FVTPL.

(2) Other financial assets at FVTPL of £144,251,000 were previously classified as loans and advances to banks (measured at amortised cost). As these financial assets do not have SPPI characteristics, they are mandatorily measured at FVTPL on adoption of IFRS 9 and reclassified to other financial assets at FVTPL.

(3) Of the other financial assets at FVTPL totalling £176,212,000, £31,961,000 was previously classified as derivative financial investments (and measured at FVTPL) and £144,251,000 was previously classified as loans and advances to banks (and measured at amortised cost). The reclassification was part of the IFRS 9 accounting classifications described above.