SANTANDER EQUITY INVESTMENTS LIMITED

Registered in England and Wales
Company Number 03053574

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

STRATEGIC REPORT

The Directors submit the Strategic Report together with their Report of the Directors' and the audited financial statements for the year ended 31 December 2018.

Fair review of the Company's business

The principal activity of Santander Equity Investments Limited (the "Company") is to act as an investment company.

During the year, as a result of changes to the Santander UK Group Holdings plc group structure due to banking reform, the Company became the parent entity for a number of group companies as noted in note 9. The companies which were acquired are largely dormant entities or those which have low trading activity.

The Santander UK Group Holdings plc group (the "HoldCo Group") manages its 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 performances of the divisions of Santander UK Group Holdings plc, which include the Company, are discussed in the HoldCo 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 statement during the year. Nothing in this report should be construed as a profit forecast.

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.

By order of the Board

Steve Affleck
Director

15 October 2019
Registered office: 2 Triton Square, Regent's Place, London NW1 3AN

REPORT OF THE DIRECTORS

The Directors submit their report together with the audited financial statements for the year ended 31 December 2018.

Principal activity and review of the year

The principal activity of Santander Equity Investments Limited (the "Company") is that of an investment company. The Company's primary source of income is interest earned on amounts due from related group entities.

On 2 November 2018, an agreement was completed to transfer the company from Abbey National Treasury Services plc to Santander UK Group Holdings Plc.

Results and dividends

The profit for the year after taxation amounted to £2,903,335 (2017: £161,451).

The Company did not pay an interim dividend for the year (2017: £nil). The Directors do not recommend the payment of a final dividend (2017: £nil).

Impact of Brexit

The process for the UK leaving the EU impacts the economic, legal and regulatory environment across the financial services industry. The HoldCo Group has put in place appropriate plans to address the potential risks and will update and implement in this Company as necessary.

Future developments

The Company continues to act as an investment entity and future investment opportunities will be considered by the Directors as they arise.

Directors

The Directors who served throughout the year and to the date of this report were as follows:

AR Honey	(Resigned 6 September 2018)
RJ Morrison	(Resigned 2 August 2018)
SK Stearns	(Appointed 30 July 2018)
MR Scenna	(Appointed 30 July 2018)
SD Affleck	(Appointed 30 July 2018)

Statement of Directors' responsibilities in respect of the financial statements

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

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 the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- 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;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors 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.

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.

Statement of Going Concern and Financial Management

The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, notes 2 and 14 to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives and its exposures to credit risk, liquidity risk and market risk.

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.

REPORT OF THE DIRECTORS *(continued)*

Qualifying third party indemnities

Enhanced indemnities are provided to the Directors of the Company by Santander UK Group Holdings plc against liabilities and associated costs which they could incur in the course of their duties to the Company. All of the indemnities remain in force as at the date of this Report and Financial statements. A copy of each of the indemnities is kept at the registered office address of Santander UK Group Holdings plc.

Statement of disclosure of information to 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.

Independent Auditors
PricewaterhouseCoopers LLP are deemed to be re-appointed as auditors under section 487 (2) of the Companies Act 2006.

By order of the Board

Steve Affleck
Director

15 October 2019
Registered office: 2 Triton Square, Regent's Place, London, NW1 3AN

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SANTANDER EQUITY INVESTMENTS LIMITED

Report on the audit of the financial statements

Opinion

In our opinion, Santander Equity Investments 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 2018; the income statement, the statement of comprehensive income, the cash flow statement, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

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, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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 SANTANDER EQUITY INVESTMENTS 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 in respect of the financial statements 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.

Liam Thompson-Clarke (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
15 October 2019

INCOME STATEMENT

For the year ended 31 December

	Note	2018 £	2017 £
Interest income		455,737	199,939
Interest expense		(1,897,354)	-
Operating expenses		(835,853)	-
Net trading and other income	4	5,883,366	-
Profit before tax		3,605,896	199,939
Tax	5	(702,561)	(38,488)
Profit for the year		2,903,335	161,451

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

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

	2018 £	2017 £
Profit for the year	2,903,335	161,451
Total comprehensive income for the year	(3,093,550)	-
Attributable to equity holders of the company	(190,215)	161,451

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

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December

	Share capital £	Retained earnings £	Other Reserves £	Total equity £
Balance as at 1 January 2017	33,005,000	8,968,572	-	41,973,572
Profit and total comprehensive income for the year	-	161,451	-	161,451
Balance as at 31 December 2017	33,005,000	9,130,023	-	42,135,023
Balance as at 1 January 2018	33,005,000	9,130,023	-	42,135,023
Profit and total comprehensive income for the year	-	2,903,335	-	2,903,335
Cash flow hedge reserve movement	-	-	(3,093,550)	(3,093,550)
Balance as at 31 December 2018	33,005,000	12,033,358	(3,093,550)	41,944,808

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

CASH FLOW STATEMENT

For the year ended 31 December

	Note	2018 £	2017 £
Net cash flows generated from operating activities	12	131,035,679	178,979
Investing activities:			
Interest in other entities	9	(10,078,345)	-
Purchase of financial investments	7	(65,377,546)	-
Net cash flow used in investing activities		(75,455,891)	-
Net increase in cash and cash equivalents		55,579,788	178,979
Cash and cash equivalents at beginning of the year	12	42,181,015	42,002,036
Cash and cash equivalents at end of the year	12	97,760,803	42,181,015

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

BALANCE SHEET

As at 31 December

	Note	2018 £	2017 £
Non-current assets			
Interest in other entities	9	10,078,345	-
Total non-current assets		10,078,345	-
Current assets			
Cash	12	1,994,420	42,092
Financial assets at amortised cost	6	108,901,847	42,138,923
Other assets		170,251	-
Financial assets at fair value through profit or loss	7	78,981,572	-
Derivative financial instruments	8	23,359,786	-
Deferred tax asset	5	878,289	-
Total current assets		214,286,165	42,181,015
Total assets		224,364,510	42,181,015
Current liabilities			
Financial liabilities at amortised cost	10	(140,404,106)	-
Other liabilities		(24,161,628)	-
Bank overdrafts	12	(13,135,464)	-
Derivative financial instruments	8	(3,787,100)	-
Current tax liabilities – group relieved		(87,757)	(45,992)
Current tax liabilities		(843,647)	-
Total current liabilities		(182,419,702)	(45,992)
Total liabilities		(182,419,702)	(45,992)
Net assets		41,944,808	42,135,023
Equity			
Share capital	11	33,005,000	33,005,000
Cash flow hedge reserve		(3,093,550)	-
Retained earnings		12,033,358	9,130,023
Total equity		41,944,808	42,135,023

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

The financial statements on pages 6 to 21 were approved by the board of directors, authorised for issue and signed on its behalf by:

Stephen Affleck

15 October 2019

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

1. ACCOUNTING POLICIES

Santander Equity Investments Limited is a private company limited by shares, incorporated and domiciled in England and Wales. The registered office is 2 Triton Square, Regent's Place, London, NW1 3AN.

The principal accounting policies adopted in the presentation of the financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

Basis of preparation

The Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee (IFRS IC) 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 and on a going concern basis as disclosed in the Directors' statement of going concern set out in the Report of the Directors.

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

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.

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 accounting policies have had no significant impact upon the Company.

Revenue/expense recognition

Interest income on financial assets that are classified as loans and receivables and interest expense on financial liabilities is determined using the effective interest rate method. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument but not future 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 a financial instrument and all other premiums or discounts.

Income taxes, including deferred income taxes

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. The tax effects of income tax losses available to carry forward are recognised as an asset when it is probable that future taxable profits will be available, against which these losses can be utilised.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Currently enacted tax rates are used in the determination of deferred income tax.

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, net loans and advances to banks, amounts due from other banks, short term investments in securities and bank overdrafts repayable on demand.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

For the year ended 31 December 2018

1. ACCOUNTING POLICIES *(continued)*

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 and investments in debt instruments measured at FVOCI.

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:

- Financial assets and financial liabilities held for trading
- Debt instruments that do not have solely payments of principal and interest (SPPI) characteristics. Otherwise, such instruments are measured at amortised cost or FVOCI, and
- Equity instruments that have not been designated as held at FVOCI.

Financial assets and financial liabilities are classified as held for trading if they are derivatives or if they are acquired or incurred principally for the purpose of selling or repurchasing in the near-term, or form part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

In certain circumstances, other financial assets and financial liabilities are designated at FVTPL where this results in more relevant information. This may arise because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains or losses on them on a different basis, where the assets and liabilities are managed and their performance evaluated on a fair value basis or, in the case of financial liabilities, where it contains one or more embedded derivatives which are not closely related to the host contract.

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

a) 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 and government and corporate bonds. Classification and subsequent measurement of debt instruments depend on the Santander UK group'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. If neither of these is applicable, such as where the financial assets are held for trading purposes, then the financial assets are classified as part of an 'other' business model and measured at FVTPL. 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 and measured as presented in Note 6. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method. When 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.
- FVOCI – Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are recognised in OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net trading and other income/(expenses)'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.
- 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 in 'Net trading and other income/(expenses)' in the period in which it arises. The C 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

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

For the year ended 31 December 2018

1. ACCOUNTING POLICIES *(continued)*

b) Financial assets and liabilities (continued)

i) Classification and subsequent measurement (continued)

a) Financial assets: debt instruments (continued)

change. Such changes are expected to be very infrequent.

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.

b) Financial assets: equity instruments
Equity instruments are instruments that meet the definition of equity from the issuer's perspective, being instruments that do not contain a contractual obligation to pay cash and that evidence a residual interest in the issuer's net assets. All equity investments are subsequently measured at FVTPL, except where management has elected, at initial recognition, to irrevocably designate an equity investment at FVOCI. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. ECLs (and reversal of ECLs) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the right to receive payments is established. Gains and losses on equity investments at FVTPL are included in the 'Net trading and other income' line in the income statement.

c) 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, financial liabilities held for trading and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in the income statement (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability) and partially in profit or loss (the remaining amount of change in the fair value of the liability)
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Santander UK group recognises any expense incurred on the financial liability, and

ii) Impairment of debt instrument financial assets
The Company assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortised cost and. The Company recognises a loss allowance for such losses at each reporting date. 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.

Investment in other entities

Investment in other entities is carried at cost less any provision for impairment.

Share capital

Incremental external costs directly attributable to the issue of new shares, other than on a business combination, are deducted from equity net of any related income taxes.

Dividends

Dividends on ordinary shares are recognised in equity in the period in which they are declared and approved.

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 held for risk management purposes. Derivatives are classified as held for trading unless they are designated as being in a hedge accounting relationship. The Company chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria, as further described in 'Hedge accounting' below.

Derivatives are recognised initially (on the date on which a derivative contract is entered into), and are subsequently remeasured, 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, such as the conversion option in a convertible bond. If the hybrid contract contains a host that is a financial asset, then the Santander UK group 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.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*
For the year ended 31 December 2018

1. ACCOUNTING POLICIES *(continued)*

Derivative financial instruments (derivatives) continued

Contracts containing embedded derivatives are not subsequently reassessed for separation unless either there has been a change in the terms of the contract which significantly modifies the cash flows (in which case the contract is reassessed at the time of modification) or the contract has been reclassified (in which case the contract is reassessed at the time of reclassification).

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. Gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement, and included within net trading and other income.

Hedge accounting
The Company applies hedge accounting to represent, to the maximum possible extent permitted under accounting standards, the economic effects of its risk management strategies.

At the time a financial instrument is designated as a hedge (i.e. at the inception of the hedge), the Company formally documents the relationship between the hedging instrument(s) and hedged item(s), its risk management objective and strategy for undertaking the hedge. The documentation includes the identification of each hedging instrument and respective hedged item, the nature of the risk being hedged and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk is to be assessed. Accordingly, the Company formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives have been and will be highly effective in offsetting changes in the fair value attributable to the hedged risk during the period that the hedge is designated. A hedge is normally regarded as highly effective if, at inception and throughout its life, the Company can expect, and actual results indicate, that changes in the fair value or cash flow of the hedged items are effectively offset by changes in the fair value or cash flow of the hedging instrument. If at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

Where derivatives are held for risk management purposes, and when transactions meet the required criteria for documentation and hedge effectiveness, the derivatives may be designated as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments (fair value hedges); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedges); or (iii) a hedge of a net investment in a foreign operation (net investment hedges). The Company applies cash flow hedge accounting, but not hedging of a net investment in a foreign operation or fair value hedge accounting.

- **Cash flow hedge accounting**
  The effective portion of changes in the fair value of qualifying cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Critical accounting judgements and key sources of estimation uncertainty
The preparation of the financial statements requires management to make judgements and accounting estimates 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 judgements and accounting estimates, which are based on historical experience and on various other factors that are believed to be reasonable under the circumstances, on an ongoing basis. Actual results may differ from these accounting estimates under different assumptions or conditions.

In the course of preparing the financial statements, the directors believe that the only significant judgements made in relation to accounting estimates relate to the unquoted equity investments.

The unquoted equity investments comprises investments in companies providing infrastructure services to the financial services industry. In the valuation of equity financial instruments requiring dynamic hedging, 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 equity prices, bid-offer spread, foreign currency exchange rates. The significant unobservable input is contingent litigation costs and related expenses in respect of convertible preferred stock in Visa Inc has been estimated by reference to best estimates received from third party legal counsel and has been included in note 14.

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 credit risk and liquidity risk. The Company manages its risk in line with the central risk management function of Santander UK Group Holdings plc (the Santander UK Group). Santander UK 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 Group 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 Group Holdings 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. It occurs in intercompany assets held by the Company.

Maximum exposure to credit risk without taking into account collateral or credit enhancements can be found in note 5 to the financial statements.

The Directors do not consider the credit risk to be significant given the immediate parent entity, Santander Plc, is an A rated counterparty.

As at 31 December 2018 there were no assets that were either past due or impaired £nil (2017: £nil).

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 by maintaining sufficient liquid resources to ensure it can meet its obligations as they fall due.

Maturities of financial liabilities can be found in note 9 to the financial statements. Bank overdrafts are repayable in less than 90 days.

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 arises as a result of interest rates and foreign currency rates.

Currency risk

The main operating or "functional" currency of the Company's operations is sterling. There are also 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 £	2018 US Dollars £	2017 Euro £	2017 US Dollars £
Cash	-	818,655	-	-
Investment in subsidiaries	107	9,415	-	-
Financial assets at fair value	(29,032,612)	100,833,049	-	-
Financial assets at amortised cost	29,651,162	972	-	-
Derivative asset	-	6,051,762	-	-
Total assets	**618,657**	**107,713,853**	-	-
Financial liabilities at amortised cost	-	107,885,938	-	-
Bank overdraft	187,046	-	-	-
Total liabilities	**187,046**	**107,885,938**	-	-

A 10% adverse movement in USD exchange rates would result in a fall in revenue of £15,644 (2017: £nil) a 10% favourable movement in USD exchange rates would result in an increase in revenue of £15,644 (2017: £nil).

A 10% adverse movement in Euro exchange rates would result in a fall in revenue of £39,205 (2017: £nil) a 10% favourable movement in Euro exchange rates would result in an increase in revenue of £39,205 (2017: £nil).

Interest rate risk

The Company's income is exposed to movements in LIBOR interest rates on receivables and payables from/to group companies.

Interest rate sensitivity analysis

A 50 basis point adverse movement in LIBOR rates would result in a fall in revenue of £293,362 (2017: £172,000) a 50 basis point favourable movement in rates would result in an increase in revenue of £293,362 (2017: £255,103).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*
For the year ended 31 December 2018

3. PROFIT FROM OPERATIONS

No Directors were remunerated for their services to the Company. Directors' emoluments are borne by Santander UK plc. The Directors' services to the Company are an incidental part of their duties. No emoluments were paid by the Company to the Directors during the year (2017: £nil).

The Company had no employees in the current or previous financial year.

The profit from operations in the current year has been arrived at after charging audit fees of £35,000 which are payable to the Company's auditors for the statutory audit of the Company's annual financial statements amounting to £5,500 plus £29,000 of audit fees payable on behalf of the Company's subsidiaries. The audit fees in relation to 2017 which amounted to £5,500 were borne by Santander UK plc and were not recharged.

4. NET TRADING AND OTHER INCOME

	2018 £	2017 £
Net trading and funding of other items by the trading book	(4,096,143)	-
Net gains on other financial assets at fair value through profit or loss	5,308,963	-
Hedge ineffectiveness	410,604	-
Management fees for managing the share save scheme	4,416,637	-
Other	(156,695)	-
	5,883,366	-

5. TAX

	2018 £	2017 £
Current tax:		
UK corporation tax for the year	843,648	38,488
Overseas withholding tax on distributions	103,583	-
Total current tax	947,231	38,488
Deferred tax:		
Origination and reversal of temporary differences	(273,454)	-
Change in rate of UK Corporation tax	28,784	-
Total deferred tax	(244,670)	-
Tax charge for the year	702,561	38,488

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 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 £	2017 £
Profit before tax from continuing operations:	3,605,896	199,939
Tax calculated at a tax rate of 19.00% (2017: 19.25%)	685,120	38,488
Non-deductible expenses	17,396	-
Non-taxable income	(132,322)	-
Effect of change in tax rate on deferred tax provision	28,784	-
Overseas withholding tax	103,583	-
Tax charge for the year	702,561	38,488

Deferred tax:
The table below shows the deferred tax assets including the movement in the deferred tax account during the year

	Available for sale £	Other temporary differences £	Total £
At 1 January 2018	-	-	-
Income statement credit	-	244,670	244,670
Credited to other comprehensive income	633,619	-	633,619
At 31 December 2018	633,619	244,670	878,289

6. FINANCIAL ASSETS AT AMORTISED COST

	2018 £	2017 £
Current:		
Amounts due from group companies	108,901,847	42,138,923
	108,901,847	42,138,923

The Directors consider that the carrying amount of receivables approximates to their fair value.

Amounts due from group companies are repayable on demand with interest fixed quarterly at three month LIBOR.

7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2018 £	2017 £
At 1 January	-	-
Acquisition of equity investments	65,377,546	-
Fair value and FX movements	13,604,026	-
Total at 31 December	78,981,572	-

The Company has designated its equity investments as fair value through profit and loss on the basis that doing so significantly reduces a measurement inconsistency that would otherwise arise from measuring these assets on a different basis from the derivatives that economically hedge the investments.

8. DERIVATIVE FINANCIAL INSTRUMENTS

Assets	2018 Notional amount £	2018 Fair value Assets £	2018 Fair value Liabilities £	2017 Notional amount £	2017 Fair value Assets £	2017 Fair value Liabilities £
Derivatives held for trading:						
Equity index swaps and similar products	105,049,639	23,359,786	34,401	-	-	-
Derivatives held for hedging:						
Equity derivative contracts	68,509,628	-	3,752,669	-	-	-
Total derivatives	173,559,267	23,359,786	3,787,070	-	-	-

Cashflow hedges

Equity risk on cash settled share-based transactions
The Company offers employees the chance to buy shares in Banco Santander SA at a discount under Share save schemes. This exposes the Company to equity price risk. The equity risk is managed by purchasing share options which allow the Company to buy shares at a fixed price. These instruments are entered into to match the amount of employee share options expected to be exercised.

The equity price risk is the change in cash flows arising from the change in share price over time. Santander UK established the hedge ratio by matching the notional of the derivative with the notional of the employee share options being hedged. Effectiveness is assessed by comparing the changes in fair value of the share options with changes in the fair value of the employee share options by using a hypothetical derivative method.

Possible sources of hedge ineffectiveness
Possible sources of hedge ineffectiveness for each type of hedge relationship are set out below:

- Hedging derivatives with a non-zero fair value at date of initial designation
- Differences in timing of cash flows between hedged item and hedging instrument
- Changes in the expected number of Share save options to be exercised

Cash flow hedge ineffectiveness recognised in net trading and other income amounted to £nil (2017: £nil).

Maturity profile and average price/rate of hedging instruments
The following table sets out the maturity profile of the hedging instruments used in the Company's hedging strategies:

	Less than one month £	Later than one month and not later than three months £	Later than three months and not later than one year £	Later than one year and not later than five years £	Later than five years £	Total £
Equity derivative contracts						
– Nominal amount (£m)	-	-	36,726,762	31,782,866	-	68,509,628

9. INTEREST IN OTHER ENTITIES

	2018 £	2017 £
At 1 January	-	-
Additions	10,078,345	-
At 31 December	10,078,345	-

Investments in subsidiary companies are shown at cost less provision for impairment. The Company has exercised the exemption under Section 400 of the Companies Act 2006, which dispenses with the requirement to prepare group financial statements. This is also in accordance with the exemption in *IAS 27 Consolidated and Separate Financial Statements.*

At 31 December 2018 the Company has a direct interest in the shareholdings of the following subsidiaries:

Name of subsidiary	Registered office	Place of incorporation ownership	Shareholdings in ordinary shares	2018 £	2017 £
A & L CF (Guernsey) Limited	B	Guernsey	100%	137,385	-
A & L CF June (2) Limited	A	England and Wales	100%	100	-
A & L CF March (5) Limited	A	England and Wales	100%	1	-
Alliance & Leicester Limited	A	England and Wales	100%	100	-
A N (123) plc	A	England and Wales	100%	2	-
Abbey National Beta Investments Limited	A	England and Wales	100%	1,332	-
Abbey National Business Office Equipment Leasing Limited	A	England and Wales	100%	240	-
Abbey National International Limited	C	Jersey	100%	5,667,323	-
Abbey National PLP (UK) Limited	A	England and Wales	100%	2	-
Abbey National Treasury Services Investments Limited	A	England and Wales	100%	100	-
Abbey National Treasury Services Overseas Holdings	A	England and Wales	100%	1,000	-
Abbey National UK Investments	A	England and Wales	100%	10,548	-
Abbey Stockbrokers Limited	A	England and Wales	100%	300,606	-
ALIL Services Limited	D	Isle of Man	100%	2,982,869	-
Alliance & Leicester Cash Solutions Limited	A	England and Wales	100%	1	-
Alliance & Leicester Commercial Bank plc	A	England and Wales	100%	1,000	-
Alliance & Leicester Investment (Derivative) Limited	A	England and Wales	100%	101,000	-
Alliance & Leicester Investments (No 2) Limited	A	England and Wales	100%	1,000	-
Alliance & Leicester Investments Limited	A	England and Wales	100%	1,000	-
ANITCO Limited	A	England and Wales	100%	1	-
Carfax (Guernsey) Limited	B	Guernsey	100%	1,005	-
Cater Allen Holdings Limited	A	England and Wales	100%	100	-
Cater Allen International Limited	A	England and Wales	100%	2	-
Cater Allen Lloyd's Holdings Limited	A	England and Wales	100%	1,000	-
Cater Allen Syndicate Management Limited	A	England and Wales	100%	61,102	-
First National Motor Business Limited	A	England and Wales	100%	100	-
First National Motor Contracts Limited	A	England and Wales	100%	1	-
First National Motor Facilities Limited	A	England and Wales	100%	100	-
First National Motor Finance Limited	A	England and Wales	100%	1	-
First National Motor Leasing Limited	A	England and Wales	100%	100	-
First National Motor plc	B	England and Wales	100%	12,500	-
Insurance Funding Solutions Limited	A	England and Wales	100%	1	-
Liquidity Limited	A	England and Wales	100%	1	-
Santander Mortgage Holdings Ltd	A	England and Wales	100%	100	-
Sheppards Moneybrokers Limited	A	England and Wales	100%	1,000	-
Solarlaser Limited	A	England and Wales	100%	492	-
Sovereign Spirit Limited	E	Bermuda	100%	9,128	-
Tuttle & Sons Limited	A	England and Wales	100%	1,000	-
Whitewick Limited	C	Jersey	100%	35,002	-
				9,328,345	-

9. INTEREST IN OTHER ENTITIES (CONTINUED)

At 31 December 2018 the Company has an indirect interest in the shareholdings of the following subsidiaries:

Name of subsidiary	Registered office	Place of incorporation ownership	Shareholdings In ordinary shares
Abbey Stockbrokers (Nominees) Limited	A	England and Wales	100%
Abbey Business Services (India) Private Limited	F	India	100%
Athena Corporation Limited	A	England and Wales	100%
Mortgage Engine Limited	A	England and Wales	100%

At 31 December 2018 the Company has a direct interest in the shareholdings of the following joint ventures:

Name of joint venture	Registered office	Place of incorporation ownership	Shareholdings In ordinary shares	2018 £	2017 £
Syntheo Limited	A	England and Wales	50%	750,000	-
				750,000	-

**All ownership interest is direct.

Key of registered office addresses
A - 2 Triton Square, Regent's Place, London NW1 3AN
B - Fourth Floor, The Albany, South Esplanade, St. Peter Port, Guernsey GY1 4NF
C - 19-21 Commercial Street, St. Helier, Jersey JE2 3RU
D - 19/21 Prospect Hill, Douglas, Isle of Man IM99 1RY
E - Clarendon House, 2 Church Street, Hamilton HM11, Bermuda
F - The Residency, 7th Floor, 133/1 Residency Road, Bangalore, KA 560 025, India

10. FINANCIAL LIABILITIES AT AMORTISED COST

	2018 £	2017 £
Amounts due to group companies	130,975,226	-
Amounts due to third party	9,428,880	-
	140,404,106	-

The Directors consider that the carrying amount of payables approximates to their fair value.

Amounts due to group companies are repayable on demand, with interest being fixed quarterly at three month LIBOR.

11. SHARE CAPITAL

	2018 £	2017 £
Issued and fully paid:		
33,005,000 (2017: 33,005,000) ordinary shares of £1 each	33,005,000	33,005,000

12. NOTE TO CASH FLOW STATEMENT

	2018 £	2017 £
Profit for the year	2,903,335	161,451
Add back tax charge	702,561	38,488
Profit before tax from continuing operations	3,605,896	199,939
Non-cash adjustments		
Fair value adjustment to derivatives	(3,093,550)	-
Fair value and FX adjustment to financial assets at fair value	(13,604,026)	-
Changes in other assets	(170,251)	-
Changes in deferred tax assets	(878,289)	-
Changes in derivative assets	(23,359,786)	-
Changes in derivative liabilities	3,787,100	-
Change in payables	164,748,585	(20,960)
Net cash generated from operating activities	131,035,679	178,979

Where tax liabilities have been group relieved, they are accounted for as operating payables.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*
For the year ended 31 December 2018

12. NOTE TO CASH FLOW STATEMENT (CONTINUED)

Reconciliation of cash and cash equivalents:

	2018 £	2017 £
Cash and cash equivalents (excluding bank overdrafts)	1,994,420	42,092
Loans and receivables	108,901,847	42,138,923
Bank overdraft	(13,135,464)	-
Cash and cash equivalents	**97,760,803**	42,181,015

13. RELATED PARTY TRANSACTIONS

Trading transactions

The trading transactions with related parties relate to interest received on amounts due by related group entities.

Related party transactions at balance date are as follows:

	Income		Expenses		Amounts due from related parties		Amounts due to related parties	
	2018 £	2017 £	2018 £	2017 £	2018 £	2017 £	2018 £	2017 £
Immediate UK parent company	-	-	-	-	-	-	-	45,992
Fellow group company	384,932	199,939	5,991,435	-	126,060,236	42,138,923	150,829,053	-
	384,932	199,939	5,991,435	-	126,060,236	42,138,923	150,829,053	45,992

There were no related party transactions during the year, or existing at the balance sheet date, with the Company's or parent company's key management personnel.

14. FINANCIAL INSTRUMENTS

a) Measurement basis of financial assets and liabilities

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. Note 1 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised.

b) Fair value measurement and hierarchy

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:

NOTES TO THE FINANCIAL STATEMENTS *(continued)*
For the year ended 31 December 2018

14. FINANCIAL INSTRUMENTS (CONTINUED)

b) Fair value measurement and hierarchy (continued)

(ii) Fair value hierarchy (continued)

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. Level 2 positions include equity and credit derivatives.

Level 3: Significant inputs to the pricing or valuation techniques are unobservable. These unobservable inputs reflect the assumptions that market participants would use when pricing assets or liabilities and are considered significant to the overall valuation. Level 3 positions include equity and credit derivatives, equity securities, financial assets at amortised cost and financial liabilities at amortised cost.

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).

Changes in the observability of significant valuation inputs during the reporting period may result in a transfer of assets and liabilities within the fair value hierarchy. The Company recognises transfers between levels of the fair value hierarchy when there is a significant change in either its principal market or the level of observability of the inputs to the valuation techniques as at the end of the reporting period. There were no transfers during either year presented.

c) 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. The Company did not make any material changes to the valuation techniques and internal models it used in 2018 and 2017.

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.

The Company 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.

d) 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. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Company will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

The factors that are considered in this regard include:
- The extent to which prices may be expected to represent genuine traded or tradeable prices
- The degree of similarity between financial instruments
- The degree of consistency between different sources
- The process followed by the pricing provider to derive the data
- The elapsed time between the date to which the market data relates and the balance sheet date
- The manner in which the data was sourced.

The source of pricing data is considered as part of the process that determines the classification of the level of a financial instrument. Consideration is given to the quality of the information available that provides the current mark-to-model valuation and estimates of how different these valuations could be on an actual trade, taking into consideration how active the market is. For spot assets that cannot be sold due to illiquidity, forward estimates are discounted to estimate a realisable value over time. Adjustments for illiquid positions are regularly reviewed to reflect changing market conditions.

For fair values determined using a valuation model, the control framework may include, as applicable, independent development and / or validation of: (i) the logic within the models; (ii) the inputs to those models; and (iii) any adjustments required outside the models. Internal valuation models are validated independently within the Risk Department. A validation report is produced for each model-derived valuation that assesses the mathematical assumptions behind the model, the implementation of the model and its integration within the trading system. The results of the independent valuation process and any changes to the fair value adjustments methodology are approved in line with the model risk framework and policy.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

For the year ended 31 December 2018

14. FINANCIAL INSTRUMENTS (CONTINUED)

e) Fair values of financial instruments carried at amortised cost

The following tables analyse the fair value of the financial instruments carried at amortised cost at 31 December 2018 and 2017, including their levels in the fair value hierarchy – Level 1, Level 2 and Level 3. It does not include fair value information for financial assets and financial liabilities carried at amortised cost if the carrying amount is a reasonable approximation of fair value.

Balance sheet category	Level 1 £	Level 2 £	Level 3 £	Total £	2018 Carrying value £
Assets					
Financial assets at amortised cost (note 6)	-	-	108,901,847	108,901,847	108,901,847
	-	-	108,901,847	108,901,847	108,901,847
Liabilities					
Financial liabilities at amortised cost (note 10)	-	9,428,880	130,975,226	140,404,106	140,404,106
	-	9,428,880	130,975,226	140,404,106	140,404,106

Balance sheet category	Level 1 £	Level 2 £	Level 3 £	Total £	2017 Carrying value £
Assets					
Financial assets at amortised cost (note 6)	-	-	42,138,923	42,138,923	42,138,923
	-	-	42,138,923	42,138,923	42,138,923
Liabilities					
Financial liabilities at amortised cost (note 10)	-	-	-	-	-
	-	-	-	-	-

Valuation methodology for financial instruments carried at amortised cost
The fair value exposures set out in the tables above are managed by using a combination of hedging derivatives and offsetting on balance sheet positions. The valuation approach to specific categories of financial instruments is described below.

Assets:
Financial assets at amortised cost
The carrying amount of the other items is deemed a reasonable approximation of their fair value, as the transactions are very short-term in duration.

Liabilities:
Financial liabilities at amortised cost -
The majority of deposit liabilities are payable on demand and therefore can be deemed short-term in nature with the fair value equal to the carrying value.

f) 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 £	Level 2 £	Level 3 £	2018 Total £	Level 1 £	Level 2 £	Level 3 £	2017 Total £
Assets								
Derivative financial instruments (note 8)	-	6,051,762	17,308,024	23,359,786	-	-	-	-
Other financial assets at FVTPL (note 7)	-	-	78,981,572	78,981,572	-	-	-	-
	-	6,051,762	96,289,596	102,341,358	-	-	-	-
Liabilities								
Derivative financial instruments (note 8)	-	-	3,787,100	3,787,100	-	-	-	-
	-	-	3,787,100	3,787,100	-	-	-	-

Transfers between levels of the fair value hierarchy
During the reporting periods there have been no transfers between levels.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

For the year ended 31 December 2018

14. FINANCIAL INSTRUMENTS (CONTINUED)

g) Internal models based on information other than market data (Level 3)

The table below provides an analysis of financial instruments valued using internal models based on information other than market data together with further details on the valuation techniques used for each type of instrument. Each instrument is initially valued at transaction price:

		Balance sheet value		Fair value movements recognised in profit/(loss)	
Balance sheet line item	Category	2018 £	2017 £	2018 £	2017 £
Derivative assets	Equity and credit contracts	17,308,024	-	10,669,514	-
FVTPL assets	Equity securities	78,981,572	-	4,617,345	-
Derivative liabilities	Equity and credit contracts	(3,787,100)	-	(3,787,100)	-
		92,502,496	-	11,499,759	-

Reconciliation of fair value measurement in Level 3 of the fair value hierarchy

The following table sets out the movements in Level 3 financial instruments in 2018 and 2017:

	Assets			Liabilities	
Balance sheet category	Derivatives £	Financial assets at FVTPL £	Total £	Derivatives £	Total £
At 1 January 2018	-	-	-	-	-
Total (losses)/gains recognised in profit or loss:					
– Fair value movements	10,669,514	4,617,345	15,286,859	(3,787,100)	(3,787,100)
– Foreign exchange and other movements	-	8,986,681	8,986,681	-	-
Additions	6,638,510	65,377,546	72,016,056	-	-
At 31 December 2018	17,308,024	78,981,572	96,289,596	(3,787,100)	(3,787,100)
(Losses)/gains recognised in profit or loss relating to assets and liabilities held at the end of the year	10,669,514	13,604,026	24,273,540	(3,787,100)	(3,787,100)

There were no financial instruments valued at fair value in 2017 as such the comparative table has not been produced.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives (Level 3)

The fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data and, as such require the application of a degree of judgement. Changing one or more of the inputs to the valuation models to reasonably possible alternative assumptions would change the fair values significantly. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions.

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable input as described in the table below. The potential effects do not take into effect any hedged positions.

		Significant unobservable input				Sensitivity	
			Assumption value				
2018	Fair value £	Assumption description	Range	Weighted average	Shift	Favourable changes £	Unfavourable changes £
Derivative assets	17,308,024	Equity/FX implied correlation	(100)% – 100%	(18)%	10%	98,000	(98,000)
FVTPL equity securities	78,981,572	Contingent litigation risk	0% – 100%	29%	20%	*5,843,276*	*(5,843,276)*

15. CAPITAL MANAGEMENT AND RESOURCES

The Company's UK parent, Santander UK Group Holdings plc (the HoldCo Group) adopts a centralised capital management approach, based on an assessment of both regulatory requirements and the economic capital impacts of businesses in the HoldCo Group. The Company has no non-centralised process for managing its own capital. Disclosures relating to the HoldCo Group's capital management can be found in the Santander UK Group Holdings plc annual report and financial statements.

Capital held by the Company and managed centrally as part of the HoldCo Group, comprises share capital and reserves which can be found in the Balance Sheet on page 7.

16. PARENT UNDERTAKING AND CONTROLLING PARTY

Up until 2 November 2018, the Company's immediate parent company was Abbey National Treasury Services plc, a company registered in England and Wales. On 2 November 2018, the Company was transferred to Santander UK Group Holdings plc, a company registered in England and Wales.

The Company's ultimate parent undertaking and controlling party is Banco Santander SA, a company registered in Spain. Banco Santander SA is the parent undertaking of the largest group of undertakings for which group Financial Statements are drawn up and of which the Company is a member. Santander UK Group Holdings plc is the parent undertaking of the smallest group of undertakings for which the group Financial Statements are drawn up and of which the Company is a member.

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.

17. POST BALANCE SHEET EVENTS

No adjusting or significant non-adjusting events have occurred between the 31 December 2018 and the date of authorisation of the financial statements.