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2019 Annual Report

Santander Financial Services plc

PART OF THE BANCO SANTANDER GROUP

Index

Important information for readers
Santander Financial Services plc (the Company or SFS) operates primarily in the UK, the Isle of Man and Jersey, and is part of Banco Santander (comprising Banco Santander SA and its subsidiaries). Santander Financial Services plc is regulated by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The Isle of Man branch is regulated by the Isle of Man Financial Services Authority. The Jersey branch is regulated by the Jersey Financial Services Commission.

This Annual Report contains forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in such forward-looking statements.

For more information see www.aboutsantander.co.uk.

Strategic report

On 30 September 2019, Santander Financial Services plc (SFS or the Company) changed its legal name from Abbey National Treasury Services plc (ANTS) to better reflect its current business direction and strategy, and to align the Company's legal name to the Santander brand.

The Company is a subsidiary of Santander UK Group Holdings plc (together with its subsidiaries, Santander UK or the Santander UK group). The Company is required to set out in this report a fair review of its business and a description of its principal risks and uncertainties, including a balanced and comprehensive analysis of the development and performance of the business in the year and of its position at the end of the year. This information can be found below and in the following sections of this Annual Report, which are incorporated into and form part of this Strategic report.

Under the UK Companies Act 2006, a safe harbour limits the liability of Directors in respect of statements in and omissions from the Directors' Report (for which see page 9 and the Strategic report). Under English law, the Directors would be liable to the Company, but not to any third party, if one or more of these reports contained errors as a result of recklessness or knowing misstatement or dishonest concealment of a material fact, but would otherwise not be liable. Pages 9 to 14 inclusive comprise the Directors' Report, pages 2 and 3 comprise the Strategic report, each of which have been drawn up and presented in accordance with and in reliance upon English company law and the liabilities of the Directors in connection with these reports shall be subject to the limitations and restrictions provided by such law.

The Directors, in preparing this Strategic report, have complied with Section 414C of the Companies Act 2006.

Principal activities and business review

SFS is an operating company whose principal activity is to undertake banking and financial services transactions to customers in Jersey and the Isle of Man. It also holds a small pool of residual assets and liabilities, which is intended to be run down and/or managed for value.

The Company historically provided corporate and wholesale banking, and treasury services to UK clients and the wider Santander UK group, of which SFS is a part. The Financial Services (Banking Reform) Act 2013 inserted provisions into the Financial Services and Markets Act 2000 (FSMA) and related legislation requiring the Santander UK group amongst a number of other UK banking groups, to operationally and legally separate certain retail banking activities from certain wholesale or investment banking activities by 1 January 2019. This is known as 'ring-fencing'.

Under Santander UK's ring-fencing plans, Santander UK plc became the ring-fenced bank of the Santander UK group. To support this, in 2018, SFS was emptied of most assets and liabilities, except for a small pool of residual assets and liabilities, and was sold by Santander UK plc, becoming a wholly-owned direct subsidiary of Santander UK Group Holdings plc. As a result, the businesses transferred or run-down are presented in the Financial Statements as discontinued operations. In addition, on 17 December 2018, the businesses of the Crown Dependency branches (Jersey and Isle of Man) of Santander UK plc were sold to SFS.

SFS had previously entered into agreements to provide capital and/or liquidity to Santander UK plc and other members of the Santander UK group, in order to facilitate efficient intercompany funding arrangements. Following the implementation of the Santander UK group's ring-fencing plans and in order to comply with ring-fencing legislation, the previous capital agreement expired on 31 December 2018, and SFS withdrew from the liquidity arrangements on the same date. With effect from 1 January 2019, SFS formed a new capital core UK group with Santander UK Group Holdings plc and Santander Equity Investments Limited (the Non-Ring Fenced Bank Capital Support Deed). In addition, with effect from 1 January 2019 SFS now manages its own liquidity separately.

In addition, SFS had previously given a full and unconditional guarantee in respect of certain unsubordinated liabilities of Santander UK plc (excluding debt securities). Via this guarantee, the Company had previously also indirectly guaranteed the obligations of Cater Allen Limited incurred prior to 31 December 2018. As part of the Santander UK group's ring-fencing plans, this guarantee was terminated and was of no further force and effect such that, with effect from 1 January 2019, the Company was released and discharged from all related present and future obligations and liabilities.

For more on these agreements, see Note 19 to the Financial Statements.

Development and performance of our business in 2019
Information on the development and performance of our business in the year is set out in the 'Income statement review' section of the Financial review.

Our position at 31 December 2019
Information on our position at the end of the year is set out in the 'Balance sheet review' section of the Financial review.

2020 operating environment
The Company is closely monitoring an outbreak of respiratory illness, known as COVID-19, which has spread from Asia into the UK and across the world. The situation remains complex and is evolving rapidly.

Prior to the COVID-19 outbreak, despite a more certain political backdrop, we expected economic growth in the UK to remain relatively subdued with continued uncertainty regarding the UK's future trade relationship with the EU. In addition, with a highly competitive banking market and demanding regulatory change agenda, we remained somewhat cautious in our 2020 outlook.

While it is too early to accurately predict the financial and business impact of the COVID-19 outbreak, we expect a negative effect on UK, Isle of Man and Jersey economic growth and hence, our 2020 financial results.

Our principal risks and uncertainties

Information on our principal risks and uncertainties is set out in the Risk review by type of risk. In addition, Brexit and LIBOR transition are areas of focus.

COVID-19
Global institutions are now closely monitoring an outbreak of respiratory illness, known as COVID-19, which has spread from Asia into the UK and across the world. The situation remains complex and is evolving rapidly.

While it is too early to predict the financial and business impact of this crisis, we expect a negative effect on the UK, Isle of Man, Jersey and global economic environment as well as our 2020 financial results.

Brexit and LIBOR
The process for the UK leaving the EU impacts the economic, legal and regulatory environment for our customers and across the financial services industry. In addition, the use of LIBOR, which is expected to cease in 2021, and its transition to (near) Risk Free Reference Rates (RFR) is also a significant issue across the industry. The Santander UK group has put in place appropriate plans to address the potential risks and will update and implement in this Company as necessary.

Key performance indicators

The directors of the Company's ultimate UK parent, Santander UK Group Holdings plc, manage the operations of the Santander UK group (which includes SFS) on a business division basis. Key performance indicators are not set, monitored or managed at the Company level. As a result, the Company's Directors believe that analysis using key performance indicators for the Company is not necessary or appropriate for an understanding of the development, performance or position of the Company. The development, performance and position of the business of the Company is set out in the Financial review. The key performance indicators of the Santander UK group can be found on pages 16 and 17 of its 2019 Annual Report, which does not form part of this report.

Section 172 Statement

The Directors have acted in a way that they considered, in good faith, to be most likely to promote the long-term success of the Company for the benefit of its members, having regard to the following:

(a) Likely consequences of any decision in the long term. The Company is wholly owned by Santander UK Group Holdings plc and as such will always operate to the standards set by the Santander UK group. Any decision taken will be aligned to the strategy of the wider Santander UK group and be made in the best interests of all stakeholders. Impacts of any decisions will be determined through ongoing risk assessment conducted with all relevant stakeholders.
(b) Interests of the Company's employees: Except for the staff of the Jersey branch, the Company's staff have employment contracts with Santander UK plc, or in the case of the staff of the Isle of Man branch ALIL Services Limited, rather than with the Company. The Company participates in Santander UK's policies and wants to involve and inform employees on matters that affect them. For more on this, see 'Employees' in the Directors' report.
(c) Business relationships with suppliers, customers and others: The Company recognises the importance of building strong relationships with suppliers and customers and actively engages with representatives of contracting parties to ascertain their views and take them into account.
(d) Community and the environment: The Company encourages its employees to support community programmes and to factor the impact on the environment, both local and more extended, into decision making processes.
(e) Reputation for high standards: The Company's reputation is fundamental to the long-term success of the Company and significant effort is expended to ensure that performance and processes attain and wherever possible exceed expectations. Santander UK (including SFS) is committed to maintaining high ethical standards – adhering to laws and regulations, conducting business in a responsible way and treating all stakeholders with honesty and integrity. These principles are further reflected in Santander UK's Code of Ethical Conduct. For more on this, see 'Code of Ethical Conduct' in the Directors' report, and
(f) Need to act fairly as between members of the Company: The Company is wholly owned by Santander UK Group Holdings plc and that shareholder supervises key decisions of the Company on a periodic basis. Information is shared effectively to ensure that the shareholder is engaged.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the UK Companies Act 2006.

By Order of the Board

M.D

Madhukar Dayal
Director
27 March 2020

INCOME STATEMENT REVIEW

SUMMARISED INCOME STATEMENT

	2019 £m	2018 £m
Net interest income	7.8	1.8
Non-interest income[1]	7.1	2.7
Total operating income	**14.9**	4.5
Operating expenses before credit impairment losses, provisions and charges	(18.0)	(2.7)
Operating credit impairment losses, provisions and charges	(1.0)	-
(Loss)/profit on continuing operations before tax	**(4.1)**	1.8
Tax on (loss)/profit on continuing operations	(2.6)	(0.4)
(Loss)/profit on continuing operations after tax	**(6.7)**	1.4
Profit in respect of discontinued operations after tax	-	17.8
(Loss)/profit after tax	**(6.7)**	19.2

(1) Comprised of Net trading and other income.

A more detailed income statement is contained in the Financial Statements.

2019 compared to 2018

The 2019 and 2018 results reflect the impact of Santander UK's ring-fencing plans on the Company. Under Santander UK's ring-fencing plans, Santander UK plc became the ring-fenced bank of the Santander UK group. To support this, in 2018, the Company was emptied of most assets and liabilities, except for a small pool of residual assets and liabilities, and was sold by Santander UK plc, becoming a wholly-owned direct subsidiary of Santander UK Group Holdings plc. As a result, the businesses transferred or run-down in 2018 are presented in the Financial Statements as discontinued operations.

In addition, on 17 December 2018, the businesses of the Crown Dependency branches (Jersey and Isle of Man) of Santander UK plc were sold to the Company.

The increase in total operating income and operating expenses before credit impairment losses, provisions and charges is mainly due to the inclusion of the results of the Crown Dependency branches for a full year in 2019. The loss on continuing operations before tax of £6.7m reflects the impact of lower yields on cash and balances at central banks.

Critical factors affecting results

The preparation of our Financial Statements requires management to make estimates and judgements that affect the reported amount of assets and liabilities at the balance sheet date 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 other factors 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 have been made in the process of applying the Company's accounting policies.

BALANCE SHEET REVIEW

SUMMARISED BALANCE SHEET

	2019 £m	2018 £m
Assets		
Cash and balances at central banks	**5,215**	4,433
Financial assets at fair value through profit or loss	**490**	462
Financial assets at amortised cost	**1,014**	1,171
Property, plant and equipment	**3**	3
Tax, intangibles and other assets	**11**	19
Total assets	**6,733**	6,088
Liabilities		
Financial liabilities at fair value through profit or loss	**251**	222
Financial liabilities at amortised cost	**6,123**	5,431
Tax, other liabilities and provisions	**40**	89
Total liabilities	**6,414**	5,742
Equity		
Total shareholders' equity	**319**	346
Total equity	**319**	346
Total liabilities and equity	**6,733**	6,088

A more detailed balance sheet is contained in the Financial Statements.

2019 compared to 2018

Assets

Cash and balances at central banks
Cash and balances at central banks increased by 18% to £5,215m at 31 December 2019 (2018: £4,433m), representing increased balances held with the Bank of England.

Financial assets at fair value through profit or loss
Financial assets at fair value through profit or loss remained relatively flat at £490m at 31 December 2019 (2018: £462m) reflecting the retention of a small portfolio of receivables and related derivatives held in run-off.

Financial assets at amortised cost
Financial assets at amortised cost reduced by 13% to £1,014m (2018: £1,171m) reflecting a decrease in both amounts due from fellow Santander UK group subsidiaries and placements with other banks.

Liabilities

Financial liabilities at fair value through profit or loss
Financial liabilities at fair value through profit or loss increased by 13% to £251m at 31 December 2019 (2018: £222m) mainly due to mark to market movements on derivatives held for hedging financial assets at fair value through profit or loss.

Financial liabilities at amortised cost
Financial liabilities at amortised cost increased by 13% to £6,123m at 31 December 2019 (2018: £5,431m), due to growth in retail Crown Dependency deposits, partially offset by a reduction in deposits with other Banco Santander entities.

Tax, other liabilities and provisions
Tax, other liabilities and provisions decreased to £40m at 31 December 2019 (2018: £89m) reflecting a reduction in tax liabilities and expense accruals.

Equity

Total equity
Total shareholders' equity decreased by 8% to £319m at 31 December 2019 (2018: £346m) impacted by the loss for the year, the release of currency translation balances and dividends paid.

BOARD OF DIRECTORS

NON-EXECUTIVE DIRECTORS

Simon Lloyd

Chair

Timothy Simon Lloyd was appointed as Non-Executive Director and Chair of the Company on 11 August 2016. Simon has extensive experience as a Company Secretary and General Counsel in the financial services industry and was the Chief Administration Officer of Santander UK plc until his retirement from that company on 31 December 2016. Previously he occupied the role of Chief People Officer (2008 – 2015) at Santander UK plc and Company Secretary for Alliance & Leicester plc (2003 - 2007). Simon trained as a solicitor and spent seven years in private practice before moving into the financial services industry, where he has also held roles as Company Secretary and General Counsel at Bristol & West plc, and Head of Legal for UK Retail Banking at Lloyds Bank plc. Simon is also Chairman of Milton Keynes University Hospital NHS Foundation Trust.

Victor Matarranz

Non-Executive Director

Victor Matarranz was appointed as Non-Executive Director of the Company on 7 March 2020. He is currently Group Senior Executive and Global Head of Wealth Management and Insurance at Banco Santander. Victor brings an immense amount of experience to the role having previously held the positions of Director of Strategy (2014 – 2017) with Banco Santander and prior to this he held the position of Director of Strategy and Chief of Staff to the CEO in Santander UK (2012 – 2014), as well as a Partner during his employment at McKinsey & Company in Spain (2000 - 2012) where he worked in Strategy, mainly in Retail and Corporate Banking.

Charles Shepherd

Non-Executive Director

Charles Shepherd was appointed as Non-Executive Director of the Company on 7 March 2020. Charles is the current General Counsel, Retail, Corporate and Wholesale Banking Legal, Santander UK plc. He joined Santander UK in 2004 as a senior lawyer providing legal support to the Global Banking & Markets division. Charles has played a key role in managing and successfully implementing Santander UK's Ring-Fencing Programme. He brings a lot of experience having worked in Retail, Corporate and Commercial and Wealth Management divisions.

EXECUTIVE DIRECTORS

Madhukar Dayal

Chief Executive Officer and Chief Financial Officer

Madhukar Dayal was appointed Chief Executive Officer and Executive Director and Chief Financial Officer of the Company on 16 September 2019. He is also Chief Financial Officer of Santander UK plc and Santander UK Group Holdings plc. Before joining Santander UK, he worked for Santander US in Boston as CFO of Santander Holdings (April 2016 – July 2019) and President and CEO of Santander Bank NA (September 2017 – July 2019). Prior to joining Santander, Madhukar was with BNP Paribas for six years, where he served as Chief Financial Officer for BNP Paribas USA Holdings, BancWest and Bank of the West. Before that he helped lead a private equity start-up for JP Morgan Chase & Co, Brysam Global Partners. Prior to that, he spent eight years with Citi.

Patricia Halliday

Chief Risk Officer

Patricia Halliday was appointed as Executive Director and Chief Risk Officer of the Company on 22 January 2018. She is also Chief Risk Officer for Santander UK plc and Santander UK Group Holdings plc. Patricia joined Santander UK in May 2017 and brings a wealth of expertise to this role having spent over 25 years in senior risk roles, including in GE Capital, Deutsche Bank and Barclays Capital.

Tom Ranger

Executive Director

Tom Ranger was appointed as Executive Director of the Company on 23 January 2019. He is also Treasurer of Santander UK plc. Tom joined Santander UK plc in 2009 as part of the integration of Alliance & Leicester which he joined in 2007. Tom brings a breadth of experience on treasury and regulatory matters having held senior positions for the last 20 years in the banking sector.

Directors' report

INTRODUCTION

The Directors have pleasure in submitting their report together with the financial statements for the year ended 31 December 2019.

HISTORY AND CORPORATE STRUCTURE

The Company was established in 1989 for the purpose of managing the liquidity, risk management and wholesale banking needs of Abbey National plc (subsequently renamed Santander UK plc) and its subsidiaries.

In 1997, Abbey National plc acquired the business and assets of Cater Allen Holdings plc (CAH) for £195m. The synergies between the Company and CAH provided the Company with opportunities for growth in strategically important markets with CAH's then principal businesses comprising money markets, a share dealing service and onshore and offshore retail banking.

On 12 November 2004, Banco Santander SA, a company incorporated in Spain, completed the acquisition of the entire issued ordinary share capital of the then parent company of the Company, Santander UK plc, at which point the Company became an indirect subsidiary of Banco Santander SA.

In 2010, all of the business and assets of Cater Allen International Limited, a subsidiary of CAH and a significant participant in the repo and wholesale money markets, were transferred to the Company. The principal purpose of the transfer was to increase the efficiency of the Company and the Santander UK group. No gain or loss was recognised on the transfer.

In 2018, Santander UK Group Holdings plc acquired the entire issued share capital of the Company from Santander UK plc. On 17 December 2018, the businesses of Santander UK plc's Jersey and Isle of Man branches were transferred to two new Jersey and Isle of Man branches of the Company. The principal purpose of the transfers was to comply with ring-fencing legislation by moving the Company and prohibited businesses out of Santander UK plc, the ring-fenced bank.

On 30 September 2019, the Company changed its legal name to Santander Financial Services plc (SFS) from Abbey National Treasury Services plc (ANTS) to better reflect its current business direction and strategy, and to align the Company's legal name to the Santander brand.

The Company is now a wholly owned subsidiary of Santander UK Group Holdings plc which, in turn, is a wholly-owned subsidiary of Banco Santander SA. The ordinary shares of the Company are not traded on the London Stock Exchange.

RESULTS AND DIVIDENDS

The loss after tax for the year was £(6.7)m (2018: profit after tax £19.2m). The Directors do not recommend the payment of a final dividend for 2019 (2018: £nil) on the ordinary shares in issue. An interim dividend of £10m was paid during the year on the ordinary shares (2018: Interim dividends of £600m and £2,946m).

Details of the Company's activities and business performance during 2019 are set out in the Strategic report on pages 2 to 3, and the Financial review on pages 4 to 6.

EVENTS AFTER THE BALANCE SHEET DATE

There have been no material post balance sheet events except as described in Note 27.

DIRECTORS

Directors who served during the year and to the date of signing the financial statements were as follows:

Name of Director	Date of appointment
Simon Lloyd (Chair and Non-Executive)	11 August 2016
Madhukar Dayal (Chief Executive Officer and Chief Financial Officer)	16 September 2019
Patricia Halliday (Chief Risk Officer)	22 January 2018
Tom Ranger	23 January 2019
Victor Matarranz (Non-Executive)	7 March 2020
Charles Shepherd (Non-Executive)	7 March 2020

During the year and to the date of signing the financial statements, the following director resigned:

Name of Director	Date of resignation
Antonio Roman (Chief Executive Officer and Chief Financial Officer)	15 September 2019
Vicky Wallis (Non-Executive)	6 March 2020
Andrew Honey (Non-Executive)	6 March 2020

None of the Directors have service contracts with the Company. All Directors except the Chair are employed by companies within Banco Santander and have employment contracts which are for an indefinite term, except for the Chair who, since retiring from Santander UK plc on 31 December 2016, has served under a contract for services. Directors may be paid instead of being required to work during their notice period. None of the Directors' employment contracts provide for benefits to be paid on termination of employment other than for redundancy.

All Directors are appointed and retired in accordance with the Company's Articles of Association and the UK Companies Act 2006. The Company does not require the Directors to offer themselves for re-election every year, or that new Directors appointed by the Board offer themselves for election at the next Annual General Meeting.

Details of aggregate remuneration received by the Directors of the Company in 2019 and 2018 are found in Note 23 to the Financial Statements. The remuneration, excluding pension contributions, of the highest paid Director and details of Director participation in defined benefit pension schemes are contained in Note 23 to the Financial Statements. For a description and details of related party transactions, see Note 24 to the Financial Statements.

Directors' 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 were in force during the financial year and at the date of approval of the Annual Report. 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 Group Holdings plc.

EMPLOYEES

Except for the staff of the Jersey branch, the Company's staff have employment contracts with Santander UK plc, or in the case of the staff of the Isle of Man branch ALIL Services Limited, rather than with the Company. The cost of their services is recharged by Santander UK plc and ALIL Services Limited to the Company.

As part of the Santander UK group, we continue to ensure that our remuneration policies are consistent with our strategic objectives and are designed with the long-term success of the Company in mind. In doing so we aim to attract and retain the most talented and committed people with first class development schemes and a customer-focused culture that empowers people, values individuality and encourages collaboration. A highly motivated and engaged workforce provides the best service for our customers.

Employee involvement

Communication

The Company participates in Santander UK's policies and wants to involve and inform employees on matters that affect them. The intranet is a focal point for communications with daily updates on what is happening across Santander UK (including SFS). The 'We are Santander' website connects staff to all the information they need about working for Santander UK (including SFS). Santander UK (including SFS) also uses face-to-face communication, such as team meetings, regional roadshows and annual staff conventions for strategic updates. All these channels are designed to keep employees fully informed of news and developments which may have an impact on them, and to keep them up to date on financial, economic and other factors which affect the Company's performance. Santander UK (including SFS) considers employees' opinions and asks for their views on a range of issues through regular Company-wide surveys.

Consultation
Santander UK (including SFS) has a successful history of working in partnership with its recognised trade unions, Advance and the Communication Workers Union (CWU). Both trade unions are affiliated to the Trades Union Congress. We consult Advance and the CWU on significant proposals and change initiatives within the business at both national and local levels.

Employee share ownership
Santander UK (including SFS) continues to operate two all-employee, HMRC-approved share schemes: a Save-As-You-Earn (Sharesave) Scheme and a Share Incentive Plan (SIP), the latter of which allows employees to purchase Banco Santander SA shares from gross salary. Eligible senior management can participate in a Banco Santander long-term incentive plan. See Note 23 to the Financial Statements for a description of the plans and the related costs and obligations.

DISABILITY

Santander UK (including SFS) is committed to equality of access and quality of service for disabled people and embraces the spirit of the UK Equality Act 2010 throughout its business operations. Santander UK (including SFS) has processes in place to help train, develop, retain and promote employees with disabilities. It is committed to giving full and fair consideration to applications for employment made by disabled people, having regard to their particular aptitudes and abilities, and for continuing the employment of employees who have become disabled by arranging appropriate training and making reasonable adjustments within the workplace.

CODE OF ETHICAL CONDUCT

Santander UK (including SFS) is committed to maintaining high ethical standards – adhering to laws and regulations, conducting business in a responsible way and treating all stakeholders with honesty and integrity. These principles are further reflected in Santander UK's Code of Ethical Conduct, as updated in October 2018. This sets out the standards expected of all employees and supports The Santander Way and Santander UK's (including SFS's) commitment to being Simple, Personal and Fair.

Under their terms and conditions of employment, staff are required to act at all times with the highest standards of business conduct in order to protect Santander UK's (including SFS's) reputation and ensure a Company culture which is free from any risk of corruption, compromise or conflicts of interest. Staff are also required to comply with all Company policies, including the Anti-Bribery and Corruption Policy.

These require employees to:
- Abide by all relevant laws and regulations
- Act with integrity in all their business actions on behalf of Santander UK (including SFS)
- Not use their authority or office for personal gain
- Conduct business relationships in a transparent manner and
- Reject all improper practices or dealings they may be exposed to.

POLITICAL CONTRIBUTIONS

In 2019 and 2018, no contributions were made for political purposes and no political expenditure was incurred.

SHARE CAPITAL

Details of the structure of the Company's capital, including the rights and obligations attaching apply to each class of share in the Company, can be found in Note 20 to the Financial Statements which are incorporated by reference into this report. The powers of the Directors in relation to share capital are set out in the Company's Articles of Association as determined by the Companies Act 2006.

SUBSIDIARIES AND BRANCHES

The Company has no subsidiaries, associates or joint ventures. The Company has branch offices in Jersey and the Isle of Man. For further information, see Note 14 to the Financial Statements.

FINANCIAL INSTRUMENTS

The Company's risks are managed on a group level by Santander UK Group Holdings plc. The financial risk management objectives and policies of Santander UK (including SFS) and the exposure of SFS to credit risk, market risk, liquidity risk and capital risk are outlined in the Risk review.

RESEARCH AND DEVELOPMENT

New products, campaigns and business initiatives are reviewed by Santander UK's Product Approval and Oversight Committee.

SUPERVISION AND REGULATION

The Company is authorised by the PRA and regulated by the FCA and the PRA. The Isle of Man branch is regulated by the Isle of Man Financial Services Authority. The Jersey branch is regulated by the Jersey Financial Services Commission. While the Company is a UK registered entity, it is also subject to the laws and regulations of the other jurisdictions in which it operates.

BOARD COMMITTEES

The Company maintains a standing Board Audit Committee, Board Risk Committee and Board Nomination Committee. Each Committee is chaired by the Company Chair and met regularly throughout the year.

INTERNAL CONTROLS

Risk management and internal controls
The Board and its Committees are responsible for reviewing and ensuring the effectiveness of management's system of risk management and internal controls. We have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. For further details, see the Risk review.

Management's report on internal control over financial reporting
Internal control over financial reporting is a component of an overall system of internal control. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting, and the preparation and fair presentation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and endorsed by the European Union.

The Company's internal control over financial reporting includes:

- Policies and procedures that relate to the maintenance of records that fairly and accurately reflect the transactions and dispositions of assets
- Controls providing reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with IFRS, and that receipts and expenditures are being made only as authorised by management
- Controls providing reasonable assurance regarding prevention or timely detection of unauthorised acquisition, and use or disposition of assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or because the degree of compliance with policies or procedures may deteriorate.

Management is responsible for establishing and maintaining adequate internal control over the financial reporting of the Company. Management assessed the effectiveness of the Company's internal control over financial reporting at 31 December 2019 based on the criteria established in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in May 2013 (the 2013 Framework).

Based on this assessment, management concluded, at 31 December 2019, that the Company's internal control over financial reporting was effective.

GOING CONCERN

The going concern of the Company is reliant on preserving a sufficient level of capital and adequately funding the balance sheet. The Company's business activities and financial position, together with the factors likely to affect its future development and performance, are set out in the Strategic report on pages 2 to 3, and the Financial review on pages 4 to 6. The Company's objectives, policies and processes for managing the financial risks to which it is exposed, including capital, funding and liquidity, are described in the Risk review.

In assessing going concern, the Directors take account of all information of which they are aware about the future, which is at least, but is not limited to, 12 months from the date that the financial statements are approved.

As described in the Strategic Report, the Company is a wholly owned direct subsidiary of Santander UK Group Holdings plc. The Company's principal activity is to undertake banking and financial services transactions for customers in Jersey and the Isle of Man, whilst also holding a small pool of residual assets and liabilities.

The Company is reliant on Santander UK Group Holdings plc for a portion of its funding. In this context, the Board of Santander UK Group Holdings plc has confirmed that Santander UK Group Holdings plc is a going concern, and that it will provide funding to the Company for the foreseeable future. In giving this commitment to provide funding to the Company, the Board of Santander UK Group Holdings plc have considered the uncertainties within the Company when preparing the forecasts and budgets of the businesses of the Santander UK Group Holdings plc group.

With effect from 1 January 2019, and in accordance with our ring-fenced structure, the Company, Santander UK Group Holdings plc and Santander Equity Investments Limited entered into a Capital Support Deed dated 13 November 2018 (the NRFB Capital Support Deed). The parties to the NRFB Capital Support Deed have been permitted by the PRA to form a core UK group as defined in the PRA Rulebook, a permission which expires on 31 December 2021. Exposures of each of the three entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the NRFB Capital Support Deed is to facilitate the prompt transfer of available capital resources between, or repayment of liabilities by, the members in the event that one of the members breached or was at risk of breaching its capital resources requirements or risk concentrations requirements.

With effect from 1 January 2019, and in accordance with our ring-fenced structure, the Company manages its own liquidity.

Having assessed the principal risks and the other matters discussed above, the Directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report 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 IFRS as adopted by the EU. In preparing the financial statements, the directors have also elected to comply with IFRS, issued by the IASB. 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 IFRS as adopted by the EU and IFRS issued by the IASB have been followed for the financial statements, subject to any material departures disclosed and explained in the financial statements
- Make judgements and accounting estimates that are reasonable and prudent
- 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 UK Companies Act 2006. The Directors are responsible for the maintenance and integrity of the Company's website.

Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Having taken into account all the matters considered by the Board and brought to its attention during the year, the Directors are satisfied that the Annual Report taken as a whole is fair, balanced and understandable, and provides the information necessary to assess Santander UK's performance, business model and strategy.

Each of the Directors at the date of approval of this report confirms, to the best of their knowledge, that:

- The financial statements, prepared in accordance with IFRS, as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company
- The management report, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties they face.

DISCLOSURE OF INFORMATION TO AUDITORS

Each of the Directors at the date of approval of this report confirms that:

- So far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware, and
- The Director has taken all steps that they ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the UK Companies Act 2006.

AUDITOR

PricewaterhouseCoopers LLP has expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the Company's forthcoming Annual General Meeting.

Bv Order of the Board

Madhukar Dayal
Director
27 March 2020
2 Triton Square, Regent's Place, London NW1 3AN

This Risk review consists of audited financial information, except where it is marked as unaudited. The audited financial information is an integral part of the Financial Statements.

RISK GOVERNANCE

RISK FRAMEWORK

Our risk governance structure

We are committed to the highest standards of corporate governance in every part of our business. This includes risk management. For details of our governance, including the Board and its Committees, see the 'Governance' section of this Annual Report. The Company maintains a Board Audit Committee, Board Risk Committee and Board Nomination Committee. The Board delegates certain responsibilities to Board Level Committees as needed and where appropriate.

Our risk governance structure strengthens our ability to identify, assess, manage and report risks, as follows:

- **Committees**: A number of Board and Executive committees are responsible for specific parts of the Santander UK Risk Framework
- **Key senior management roles**: A number of senior roles have specific responsibilities for risk management
- **Risk organisational structure**: We have the 'three lines of defence' model built into the way we run our business.

With effect from 1 January 2019, the Company operates within a standalone Risk Appetite Statement that was approved by the Board in November 2018.

Committees

The Santander UK Risk Framework states that operating companies of Santander UK should have a sufficient committee structure in place to allow them to discharge their risk responsibilities and escalate issues. The structure should be proportionate to the company's size and complexity.

The Board Level Committee responsibilities for risk in 2019 were:

Board Level Committee	Main risk responsibilities
The Board	– Has overall responsibility for business execution and for managing risk – Reviews the Company's adherence to the Santander UK Risk Framework and Santander UK Risk Appetite.
Board Risk Committee	– Assesses the Company's adherence to the Santander UK Risk Framework – Advises the Board on Risk Appetite, tolerance and strategy – Oversees our exposure to risk.
Board Audit Committee	– Monitors and reviews the financial statements integrity and any formal announcements on financial performance – Reviews the adequacy and effectiveness of the internal financial controls and whistleblowing arrangements – Monitors and reviews the effectiveness of the internal audit function.

The Executive Level Committee responsibilities for risk in 2019 were:

Executive Level Committee	Main risk responsibilities
Executive Committee	– Sets and monitors performance against the Company's annual plan and budget – Ensures that adequate and effective risk control processes and reporting systems are in place to identify, assess, manage and report all the relevant risks in the Company as detailed in the Santander UK Risk Framework – Monitors the risk profile of the Company – Manages the structural balance sheet risks, capital, funding and liquidity, in line with the policies, strategies and plans set by Santander UK.

The Santander UK Corporate Governance Framework and Risk Frameworks have been adopted by its subsidiaries, including the Company, to ensure consistency of application. As Santander UK Group Holdings plc is the immediate parent company of the Company, its Executive and Board level committees consider the impact on the Company, as a subsidiary, as part of their decision-making process.

Key senior management roles

Senior roles with specific responsibilities for risk management are:

Role	Main risk responsibilities
Chief Executive Officer	The Board delegates responsibility for our business activities and managing risk on a day-to-day basis to the CEO. The CEO proposes our strategy and business plan, puts them into practice and manages the risks involved. The CEO must also ensure we have a suitable system of controls to manage risks and report to the Board on it.
Chief Risk Officer (CRO)	Oversees and challenges risk activities, and ensures new lending decisions are made within our Risk Appetite. Accountable for the control and oversight of credit, market, liquidity and capital risks.
Chief Financial Officer	Responsible for developing strategy, leadership and management of the CFO and Financial Accounting & Control Divisions. In supporting our corporate goals within our risk appetite, the CFO is responsible for managing interest rate, liquidity and capital risks.
Head of Internal Audit	Designs and uses an audit system that identifies key risks and evaluates controls. The Head of Internal Audit also develops an audit plan to assess existing risks that involve producing audit, assurance and monitoring reports.

Risk organisational structure (unaudited)

We use the 'three lines of defence' model to manage risk. This model is widely used in the banking industry and has a clear set of principles to put in place a cohesive operating model across an organisation. It does this by separating risk management, risk control and risk assurance.

Line 1 - Risk management	Business Units and Business Support Units are accountable for identifying, assessing and managing the risks which originate and exist in their area, within our Risk Appetite.
Line 2 - Risk control	Risk Control Units are independent monitoring and control functions. They are under the executive responsibility of the CEO, but responsible to the CRO for overseeing the first line of defence. They make sure Business Units and Business Support Units manage risks effectively and within our Risk Appetite.
Line 3 - Risk assurance	Internal Audit is a permanent corporate function, independent of any other unit. Its role is to give assurance on how well-designed and effective our risk management and internal control processes are.

RISK APPETITE (unaudited)

How we control the risks we are prepared to take

When our Board sets our strategic objectives, it is important that we are clear about the risks we are prepared to take to achieve them. We express this through our Risk Appetite Statement, which defines the amount and kind of risk we are willing to take. Our Risk Appetite and strategy are closely linked, and our strategy must be achievable within the limits set out in our Risk Appetite.

The principles of our Risk Appetite

Our Risk Appetite Statement lists eight principles that we use to set our Risk Appetite.

- We always aim to have enough financial resources to continue to do business in adverse but plausible stressed economic and business conditions, as well as to survive a very severe stress that would deplete our capital reserves
- We should be able to predict how our income and losses might vary – that is, how volatile they are. That applies to all our risks and lines of business
- We are an autonomous business, so we always aim to have strong capital and liquidity resources
- We set controls on large concentrations of risk, like single customers
- There are some key risks we take, but for which we do not actively seek any reward, like operational, conduct and regulatory, financial crime, legal and reputational risk. We take a risk-averse approach to these risks
- We comply with all regulations – and aim to exceed the standards they set
- Our pay and bonus schemes should support these principles and our risk culture
- We always aim to earn the trust of our people, customers, shareholders and communities.

How we describe the limits in our Risk Appetite

Our Risk Appetite sets out detailed limits for different types of risk, using metrics and qualitative statements.

Metrics

We use metrics to set limits on capital, liquidity and credit risk. We set:

- Capital limits, reflecting both the capital that regulators expect us to hold (regulatory capital)
- Liquidity limits according to a range of plausible stress scenarios for our business
- Credit limits, to control the credit quality of the mortgage portfolio.

These limits apply in normal business conditions, but also when we might be experiencing a far more difficult economic environment. A good example of this might be when the UK economy is performing much worse than we expected. We refer to conditions like this as being under stress. There is more on EC and stress scenarios later in this section.

Qualitative statements

For some types of risk we also use qualitative statements that describe in words the appetite we want to set.

How we set our Risk Appetite, and stay within it

We control our Risk Appetite through our Risk Appetite Framework. Our Board approves and oversees our Risk Appetite Statement every year. This ensures it is consistent with our strategy and reflects the markets in which we operate. Our Executive Committee is responsible for ensuring that our risk profile (the level of risk we are prepared to accept) is consistent with our Risk Appetite Statement. To do this they monitor our performance against our Risk Appetite regularly.

We also use stress testing to review how our business plan performs against our Risk Appetite Statement. This shows us if we would stay within our Risk Appetite under stress conditions. It also helps us to identify any adverse trends or inconsistencies.

We embed our Risk Appetite by setting more detailed risk limits for each business unit and key portfolio. These are set in a way so that if we stay within each detailed limit, we will stay within our overall Risk Appetite. When we use qualitative statements to describe our appetite for a risk, we link them to lower-level key risk indicators, so that we can monitor and report our performance against them.

We provide a programme of communication and training for our staff, including new joiners, which helps ensure that our Risk Appetite is well understood.

STRESS TESTING (unaudited)

Stress testing of the Company is carried out as part of the Santander UK group stress testing exercises. The following sections therefore refer to Santander UK group and the Company.

Stress testing helps us understand how different events and economic conditions could affect our business plan, earnings and risk profile. This helps us plan and manage our business.

Scenarios for stress testing

To see how we might cope with difficult conditions, we regularly develop challenging scenarios that we might face. We consult a broad range of internal stakeholders, including Board members, when we design and choose our most important scenarios. The scenarios cover a wide range of outcomes, risk factors, time horizons and market conditions. They are designed to test:

- The impact of shocks affecting the economy as a whole or the markets we operate in
- Key potential vulnerabilities of our business model, and the processes and systems which support it
- Potential impacts on specific risk types.

We describe each scenario using a narrative setting out how events might unfold, as well as a market and/or economic context. For example, the key economic factors we reflect in our ICAAP scenarios include house prices, interest rates, unemployment levels and the size of the UK economy. One scenario looks at what might happen in a recession where the output of the economy shrinks by around 5%, unemployment reaches over 9%, and house prices fall by around 30% in a context of high inflation and interest rates rising rapidly. We use a comprehensive suite of stress scenarios to explore sensitivities to market risk, including those based on historical market events.

How we use stress testing

We use stress testing to estimate the effect of these scenarios on our business and financial performance, including:

- Our business plan, and its assessment against our Risk Appetite
- Our capital strength, through our ICAAP
- Our liquidity position, through our ILAAP
- Impacts on other risk types.

We use a wide range of models, approaches and assumptions. These help us interpret the links between factors in markets and the economy, and our financial performance. For example, one model looks at how changes to key macroeconomic variables like unemployment rates might affect the number of customers who might fall into arrears on their mortgage.

Our stress testing models are subject to a formal review, independent validation and approval process. We highlight the key weaknesses and related model assumptions in the approval process for each stress test. In some cases, we overlay expert judgement onto the results of our models. Where this is material to the outcome of the stress test, the approving governance committee reviews it. We take a multi-layered approach to stress testing to capture risks at various levels. This ranges from sensitivity analysis of a single factor to a portfolio, to wider exercises that cover all risks across our entire business. We use stress test outputs to design plans that aim to mitigate damaging effects.

We also conduct reverse stress tests. These are tests in which we identify and assess scenarios that are most likely to cause our business model to fail.

Board oversight of stress testing

The Santander UK ERCC approves the design of the scenarios in our ICAAP and ILAAP. The Santander UK Board Risk Committee approves the stress testing framework. The Santander UK Board reviews stress test outputs as part of the approval processes for the ICAAP, ILAAP, our Risk Appetite and regulatory stress tests.

Regulatory stress tests

We take part in a number of external stress testing exercises. These can include stress tests of the UK banking system conducted by the PRA. We also contribute to stress tests of Banco Santander conducted by the European Banking Authority (EBA).

For more on capital and liquidity stress testing, see the 'Capital risk' and 'Liquidity risk' sections.

CREDIT RISK

Overview

Credit risk management
In this section, we set out how our exposures arise and our approach to credit risk across the credit risk lifecycle. We also discuss our ECL approach and the key inputs to our ECL model.

Credit risk review
In this section, we analyse our maximum and net exposures to credit risk, including their credit quality and concentrations of risk.

CREDIT RISK MANAGEMENT

Exposures

Exposures to credit risk arise in our business from:

- Loans and advances to customers (residential mortgages to individuals)
- Loans and advances to banks

Our approach to credit risk

We manage our portfolios across the credit risk lifecycle, from drawing up our risk strategy, plans, budgets and limits to making sure the actual risk profile of our exposures stays in line with our business plans and within our Risk Appetite. We further tailor the way we manage risk across the lifecycle to the type of product.

1. Risk strategy and planning
All relevant areas of the business work together to create our business plans. We aim to balance our strategy, goals, and financial and technical resources with our Risk Appetite. To do this, we focus on economic and market conditions and forecasts, regulations, conduct matters, profitability, returns and market share. The result is an agreed set of targets and limits that help us direct our business.

2. Assessment and origination
Managing credit risk begins with lending responsibly. That means only lending to customers who can afford to pay us back, even if things get tighter for them, and are committed to paying us back. We perform a thorough risk assessment to make sure customers can meet their obligations before we approve a credit application. We make these decisions with authority from the Board and we consider:

- The credit quality of the customer
- The underlying risk – and how we can mitigate it, such as through netting or collateral
- Our risk policy, limits and appetite
- Whether we can balance the amount of risk we face with the returns we expect, and
- Assessment of customer affordability.

We also use stress testing, for example to estimate how a customer might be able to cope if interest rates rise.

Affordability
For residential mortgages, we take proportionate steps to make sure that the customer will be able to make all the repayments on the loan over its full term. As part of this, we assess the risk that they will not pay us back. We do this by a series of initial affordability and credit risk assessments. We assess affordability by reviewing the customer's income and spending, their other credit commitments, and what would happen if interest rates went up. We regularly review the way we calculate affordability and refine it when we need to. This can be due to changes in regulations, the economy or our risk profile.

Credit profile
For residential mortgages, we look at each customer's credit profile and signs of how reliable they are at repaying credit. When they apply, we use the data they give us, and:
- **Credit policy:** these are our rules and guidelines. We review them regularly to make sure our decisions are consistent and fair and align to the risk profile we want. We look at the property and the LTV as well as the borrower
- **Credit scores:** based on statistics about the reasons people fail to pay off debt. We use them to build models of what is likely to happen in the future. These models give a credit score to the customer for the loan they want, to show how likely it is to be repaid. We regularly review them
- **Credit reference agencies:** data from credit reference agencies about how the borrower has handled credit in the past
- **Other Santander accounts:** we look at how the customer is using their other accounts with us.

How we make the decision

For residential mortgages, our portfolio is maintained on a third-party supplier platform independently from the Santander UK system, and origination and decisioning is undertaken by the third-party supplier. Every application is fully manually underwritten, with a full range of checks, including obtaining a property valuation from an approved surveyor.

Credit risk mitigation

The types of credit risk mitigation, including collateral, across each of our portfolios is:

Portfolio	Description
Residential mortgages	Collateral is in the form of a first legal charge over the property. Before we grant a mortgage, we have the property valued. We have our own guidelines for surveyor valuations, which build on guidance from the Royal Institution of Chartered Surveyors (RICS). But we also make use of automated valuation methodologies where our confidence in the accuracy of this method is high.
Loans and advances to banks	Collateral – We use the Credit Support Annex with the ISDA Master Agreement. This gives us collateral for our net exposures.

3. Monitoring

We measure and monitor changes in our credit risk profile on a regular and systematic basis against our budgets, limits and benchmarks. We monitor credit performance by portfolio, segment, customer or transaction. If our portfolios do not perform as we expect, we investigate to understand the reasons. Then we take action to mitigate it as far as possible and bring performance back on track. We monitor and review our risk profile through formal governance forums and committees across our business. These agree and track any steps we need to take to manage our portfolios, to make sure the impact is prompt and effective. This structure is a vital feedback tool to coordinate issues, trends and developments across each part of the credit risk lifecycle.

Credit concentrations

We give the Santander UK ERCC a detailed analysis of our credit exposures and risk trends every month. We also report our larger exposures and risks to the Board Risk Committee every month.

For residential mortgages, our risk assessment does not end once we have made the decision to lend. We continue to monitor credit risk across the credit risk lifecycle, ensuring that early arrears are highlighted, and customers contacted to discuss potential problems. For residential mortgages, our monitoring also takes account of changes in property prices. We estimate the property's current value every three months. In most cases, we use statistical models based on recent sales prices and valuations in that local area. Use of this model is subject to Model Risk Governance. Where a lack of data means the model's valuation is not available, we use the original surveyor valuation with a House Price Index (HPI) adjustment as appropriate.

Our Watchlist

For loans and advances to banks, we use a Watchlist to help us identify potential problem debt early. Just because a customer is on our Watchlist does not mean they have defaulted. It just means that something has happened that has increased the probability of default. There are several reasons we might put customers on this list. For example, if they suffer a downturn in trade, breach a covenant, lose a major contract, slip into early arrears, or their key management resign. Whatever the trigger, we review the case to assess the potential financial impact.

We classify Watchlist cases as:
- **Enhanced monitoring**: for less urgent cases. If they are significant, we monitor them more often
- **Proactive management:** for more urgent or serious cases. We may take steps to restructure debt including extending the term, taking more collateral, agreeing a lower credit limit or seeking repayment of the loan through refinancing or other means.

We assess cases on the Watchlist for impairment in accordance with IFRS 9 as explained in 'Significant Increase in Credit Risk (SICR)' in the 'Credit risk management' section.

When a customer is included in enhanced monitoring, we do not consider that it has suffered a SICR for ECL purposes, so it remains in Stage 1 for purposes of our loss allowance calculations. When a customer is included in proactive management, we consider that it has suffered a SICR. This means we transfer it to Stage 2 and subject it to a lifetime ECL assessment to calculate the new loss allowance. We take into account any forbearance we offer. This includes whether any extra security or guarantees are available, the likelihood of more equity and the potential to enhance value through asset management.

4. Arrears management

Sometimes our customers face financial difficulty and may fall into payment arrears or breach the conditions of their credit facility. If this happens, we work with them to get their account back on track. We aim to support our customers and keep our relationship with them. To do this, we:
- Find affordable and sustainable ways of repaying to fit their circumstances
- Monitor their finances and use models to predict how they will cope. This helps us put in place the right strategy to manage their debt
- Work with them to get their account back on track as soon as possible in a way that works for them and us
- Monitor agreements we make to manage their debt, so we know they are working.

For residential mortgages, we have several strategies for managing arrears and these can be used before the customer has formally defaulted, or as early as the day after a missed payment. We assess the problems a customer is having, so we can offer them the right help to bring their account up to date as soon as possible. The most common way to bring an account up to date is to agree an affordable repayment plan with the customer. The strategy we use depends on the risk and the customer's circumstances. We have a range of tools to help customers to reach an affordable and acceptable solution. This could mean visiting the customer or offering debt counselling by a third party.

For loans and advances to banks, we identify problem debt by close monitoring, supported by our Watchlist process. When there is a problem, our relationship managers are the first to act, supported by the relevant credit risk expert. If a case becomes more urgent or needs specialist attention, and if it transfers to Stage 3, we transfer it to our Restructuring & Recoveries team.

We aim to act before a customer actually defaults (to prevent it, if possible). The strategy we use depends on the type of customer, their circumstances and the level of risk. We use restructuring and rehabilitation tools to try to help our customers find their own way out of financial difficulty and agree on a plan that works for both of us. We aim to identify warning signs early by monitoring customers' financial and trading data, checking to make sure they are not breaching any covenants, and by having regular dialogue with them. We hold regular Watchlist meetings to agree a strategy for each portfolio.

Our Restructuring & Recoveries are engaged as appropriate on Watchlist cases and we may hand over more serious cases to them.

5. Debt recovery

Sometimes, even when we have taken all reasonable and responsible steps we can to manage arrears, they are not effective. If this happens, we have to end our agreement with the customer and try to recover the whole debt, or as much of it as we can.

For residential mortgages, when a customer cannot or will not keep to an agreement for paying off their arrears, we consider recovery options. We only do this once we have tried to get the account back in order. To recover what we are owed, we may initiate legal action that could ultimately lead to the customer facing court action for possession of the property. For retail mortgage loans, we can delay legal action. That can happen if the customer shows that they will be able to pay off the loan or the arrears. We aim to repossess only as a last resort or, if necessary, to protect the property from damage or third-party claims. We make sure our estimated losses from repossessed properties are realistic by getting two independent valuations on each property, as well as the estimated cost of selling it. These form the basis of our loss allowances calculations. Where we do enforce the possession of properties held as collateral, we use external agents to realise the value and settle the debt. During this process we do not own the property, but we do administer the sale process. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with insolvency regulations.

Consensual arrangements

For loans and advances to banks, where we cannot find a solution through arrears management, we look for an exit. If we can, we aim to do this by agreeing with the borrower that they will sell some or all of their assets on a voluntary basis or agreeing to give them time to refinance their debt with another lender.

Enforcement and recovery

For loans and advances to banks, where we cannot find a way forward or reach a consensual arrangement, we consider recovery options. This can be through:

- The insolvency process
- Enforcing over any collateral
- Selling the debt on the secondary market
- Considering other legal action available to recover what we are owed from debtors and guarantors.

If there is a shortfall, we write it off against loss allowances we hold. In certain very rare instances, we may act as mortgagee in possession of assets held as collateral against non-performing commercial lending. In such cases the assets are carried on our balance sheet and are classified according to our accounting policies.

Risk measurement and control

We measure and control credit risk at all stages across the credit risk lifecycle. We have a range of tools, processes and approaches, but we rely mainly on:

- **Credit control:** as a core part of risk management we generate, extract and store accurate, comprehensive and timely data to track credit limits. We do this using internal data
- **Review:** we use formal and informal forums to approve, validate, review and challenge our risk management. We do this to help predict if our credit risk will worsen.

The residential mortgage portfolio involves managing approximately 2,000 accounts. This allows us to analyse the portfolio in detail at an individual account level in order to measure the risk. We assess and review our loss allowances regularly. We look at a number of factors, including the cash flow available to service debt. We also use an agency to value the collateral.

Key metrics

We use a number of key metrics to measure and control credit risk, as follows:

Metric	Description
Expected credit losses (ECL)	ECL tells us what credit risk is likely to cost us 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 (SICR) since origination. We explain how we calculate ECL below.
Stages 1, 2 and 3	We assess each facility's credit risk profile to determine which stage to allocate them to, and we monitor where there is a SICR and transfers between the stages. We explain how we allocate a facility to Stage 1, 2 or 3 below.
Stage 3 ratio	The Stage 3 ratio is total Stage 3 exposure as a percentage of customer loans plus undrawn Stage 3 exposures. Following the *introduction of IFRS 9 in 2018, the Stage 3 ratio became the main indicator of credit quality performance and replaces the NPL ratio* which is no longer reported.
Expected Loss (EL)	EL is based on the regulatory capital rules of CRD IV and gives us another view of credit risk. It is the product of the probability of default (PD), exposure at default and loss given default. We calculate each factor in accordance with CRD IV and include direct and indirect costs. We base them on our risk models and our assessment of each customer's credit quality. There are differences between regulatory EL and IFRS 9 ECL, which we set out below. For the rest of our Risk review, impairments, losses and loss allowances refer to calculations in accordance with IFRS, unless we specifically say they relate to CRD IV. For our IFRS accounting policy on impairment, see Note 1 to the Financial Statements.

We also assess risks from other perspectives, such as geography, business area, product and process to identify areas we need to focus on. We also use stress testing to establish vulnerabilities to economic deterioration. Our business segments tailor their approach to credit risk to their own customers, as we explain later on.

Recognising ECL

The ECL approach estimates the credit losses arising from defaults in the next 12 months on qualifying exposures, or defaults over the lifetime of the exposure where there is evidence of a SICR since the origination date. The ECL approach takes into account forward-looking data, including a range of possible outcomes, which should be unbiased and probability-weighted in order to reflect the risk of a loss being incurred even when it is considered unlikely.

Multiple economic scenarios and probability weights

We use five forward-looking economic scenarios. They consist of a central base case, two upside scenarios and two downside scenarios. We use five scenarios to reflect a wide range of possible outcomes in the performance of the UK economy.

Base case

Our base case assumes that the UK will negotiate a trade deal with the EU and that there will be an orderly exit.

Base case key macroeconomic assumptions for 2019

- **House price growth**: House price growth is forecast to remain at 1% for 2020 with growth pushing up over the subsequent years to 2%. This reflects the subdued nature of the housing market over the last few years, which has led, on average, to low levels of house price growth.
- **GDP**: GDP is forecast to follow a similar growth path to last year over 2020 as uncertainty over the UK's future trading relationship with the EU continues. However, moving forward growth is expected by 2021 to follow a stronger growth path as the uncertainties from Brexit start to fall away and the economy adjusts to its new position.
- **Unemployment rate**: Unemployment is expected to continue its current trend at approximately 4% over the forecast period, in line with the consensus view.
- **Bank of England Base Rate (Base Rate)**: For Bank of England base rate forecast, the base case currently assumes a flat profile of 75bps for our planning horizon. This is based on the view that we have a deal and a smooth transition providing some stability to the economy. With inflation expected to remain near target the Monetary Policy Committee will wait to understand how the economy responds to the new economic environment before changing the Bank Rate.

In the medium-term, the projections assume that current demographic and productivity trends will continue, causing a reduction in the UK's growth potential. This is reflected in an average growth expectation of less than 1.6% pa, the OBR's latest estimate of the UK's long run average growth rate.

We expect the low value of sterling to continue into 2020. However, we would expect some improvement if the economic data continues to recover and there is constructive dialogue between the UK and the EU on agreeing the terms of a future trade deal. Even though the continuing Brexit negotiations on a future trade deal are likely to result in some increased trade costs between the EU and UK, these are not expected to significantly impact the downwards trend in the share of UK exports going to the EU.

CPI inflation is forecast to remain around the 2% target rate and nominal earnings growth of approximately 3% is expected to continue over the forecast horizon. This implies positive real earnings growth, which in turn will support household spending power. However, the effect of limited business investment on growth will continue until the final outcome of Brexit is known. Furthermore, with the household savings ratio stabilising and consumer credit growth slowing, consumer demand will be driven increasingly by the fundamentals of household income growth.

In summary, the base case assumes that activity will continue to run at a relatively slow pace as we move through 2020 but will pick up further in subsequent years.

Key changes to our base case in 2019

The key changes to our base case assumptions in 2019 were that we lowered our GDP forecasts for 2019, 2020 and 2021 to reflect the slower growth we have been seeing given the continuing Brexit uncertainty and the decline in global growth. We also reduced house price growth slightly for 2020 and 2021.

Our forecasting approach
We derive our scenarios in part by using a set of parameters in GDP fan charts published by the Office for Budget Responsibility (OBR) twice a year. To avoid major changes to the scenarios due to changes in the OBR fan charts, we place more weight on what the long-run outlook of the fan charts are rather than relying solely on each individual release as this can create large swings in the scenarios which may not be appropriate. We use the OBR fan charts to calculate our GDP paths for each scenario. These fan charts reflect the probability distribution of a deviation from the OBR's central forecast to illustrate the uncertainty regarding the outcome of a variable, in this case GDP.

We use the 0.6 and 0.7 fan chart paths for our Upside scenarios, and the 0.3 path for Downside 1. However, for Downside 2 we use a blend of the Downside 1 scenario and the recession of the early 1980s. We believe that a recession of that order of magnitude is more likely than a repeat of the 2008/09 recession. This means that in the longer run the GDP levels in our Downside 1 and 2 scenarios converge. To ensure that Downside 2 is kept consistent with any changes to the OBR fan charts, we calculate the Downside 2 GDP by taking the percentage difference between Downside 2 and Downside 1 GDP in the original forecast and applying this difference to the new Downside 1.

Our use of five scenarios is designed to reflect different possible outcomes to the base case forecast highlighting the upside and downside risks associated with the central scenario. The downside risks include unfavourable developments for Brexit, a further and sharper downturn in global growth, continuation of the very low productivity growth seen in the UK, and a move to a more protectionist agenda for trade. The upside risks are more muted at present and include the quick implementation of a new free trade agreement with the EU and an upturn in global growth, coupled with a move to more open trade.

The two upside scenarios are based on a faster global recovery and the UK quickly concluding trade agreements with a number of countries after leaving the EU, along with minimum effective tariffs. It is also based on productivity growth recovering. If this is combined with a strong supply side response, interest rate normalisation can occur in a gradual and well managed fashion. The difference between the two scenarios is how quickly the recovery happens and the strength of global recovery.

Regarding the two downside scenarios, Downside 1 reflects slower growth for longer, representing a period of continued uncertainty as the Brexit process continues to mute expectations. It also assumes 'lower for longer' global growth. With sterling under continuing pressure, this causes the Monetary Policy Committee (the MPC) to raise rates to quell further inflation even though a looser stance would be more beneficial to growth. Business and household confidence continue to be negative and business investment struggles. In terms of trade, the UK defaults to WTO rules with the EU but maintains an open trade policy pursuing bilateral trade agreements with countries rather than pure free trade agreements. Downside 2 assumes the UK economy goes into outright recession. Here global growth is undermined by further weakness among the advanced economies and the emerging markets slowing more markedly than expected. This scenario also assumes that the UK leaves the EU without a trade deal and that business investment contracts further given the continued uncertainty over future trading arrangements. There is also widespread and substantial capital flight as overseas investors sell UK assets, which in turn leads to a tightening in domestic financial conditions. As overseas investors' appetite for UK assets diminishes, this causes a sell-off in sterling and pushes up inflation, with the MPC forced to raise rates to mitigate this. Rising interest rates trigger an increase in debt-servicing costs for households with variable rate mortgages. This combined with the additional negative shock of higher unemployment leads to rising impairments, with some borrowers forced to sell their properties which leads to a fall in property values. The UK continues to negotiate trade deals with other countries, including the EU, and the successful implementation of these goes some way to restoring stability and business confidence with the UK returning to trend growth in the outer years.

Given the above, our scenarios and weights reflect the range of possible outcomes that the UK may face in 2020 and beyond.

Once we have established the GDP paths for each scenario, we run them through the Oxford Global Economic Model (OGEM) to derive the other macroeconomic variables, such as unemployment and house prices. These variables are the product of the GDP growth paths we have forecast and the output of the OGEM for these particular growth paths. We then impose a Bank Rate profile for each scenario using expert judgement. We determine the Bank Rate by using the base case Bank Rate profile and adjusting this for each of the four scenarios. To do this, we firstly consider what each of the scenarios is trying to achieve.

For the upside scenarios which have a higher growth path and rising productivity growth, a strengthening of sterling keeps CPI inflation low and allows for a managed tightening of the monetary stance. In contrast, the downside scenarios show monetary policy forced into a reactive stance to contain CPI inflation at a time of weakening output growth, so we assume the Bank of England would raise rates in this scenario in order to bring the inflation rate back to its target rate. The rising Bank Rate profiles are based on forward guidance from the Bank of England where increases are assumed to be gradual and incremental.

We update the baseline in our economic scenarios at least twice a year in line with our annual budgeting and three-year planning processes, or sooner if there is a material change in current or expected economic conditions. We refresh all our economic scenarios each quarter to reflect the latest data and OBR fan charts if these have changed, which are then reviewed and approved by ALCO. ALCO also assess the probability weights at least once a quarter. We avoid embedding new economic scenarios into our models on a quarter-end month. Instead, we aim to run the model with the new scenarios for two months before the quarter-end to ensure that we can fully validate the output.

We do not use consensus forecasts as inputs to our models, but we do compare the outputs of our models against consensus views for the base case, to make sure that we understand any significant differences and address them, where needed. In 2019, there were no significant differences between our base case forecasts and the consensus views.

Key changes to our forecasting approach in 2019
In 2019, there were no significant changes in our forecasting approach, except that for the two upside scenarios we have changed the Bank Rate profiles. Initially, we had a falling Bank Rate profile for the upside scenarios to maintain symmetry with the downside scenarios, which showed a rising Bank Rate. However, it was later decided that symmetrical outcomes were no longer required for the upside and downside scenarios; rather it was more logical to have Bank Rate rising when the economy is growing strongly, and inflation is picking up.

Scenario weights
To determine our initial scenario weights, we give the highest weight to the base case, whilst the outer scenarios typically attract lower weights than the more moderate ones. We also consider how the GDP five-year average growth rates for each scenario fits with the average growth rates over the last 10 years in helping to determine the weights to apply. We use a 10-year period as we consider this more reflective of the current UK economic environment. For example, our recent analysis shows that the likelihood that growth is positive occurs 90% of the time, so there could be negative growth 10% of the time. Therefore, using this approach would suggest we apply a 10% weight to the scenario with negative growth, in this case Downside 2. We also consider changes in the economic and political environment and whether such forces suggest further small changes to the weights would be appropriate. For example, due to the current economic position both in the UK and globally and policy concerns around securing a trade deal with the EU by the end of 2020, we have applied a higher weight to the downside scenarios than focusing on historical experience as a guide would suggest. We consider this appropriate in light of the consensus view of the future performance of the UK economy and the balance of risks, which are currently more heavily weighted to the downside.

As part of our review of the scenarios and weights that we use, we perform statistical analysis to assess whether their use ensures that we capture the non-linearity of losses implied by the results. The outcome of this analysis, which modelled several additional scenarios, showed that there is a non-linear relationship between the ECLs based on the GDP growth paths for the individual scenarios for mortgages. In addition, the trend line modelled showed that our Base case, Downside 1 and Downside 2 scenarios provided a good fit for the loss distribution profile. For example, the base case scenario provides a good fit for losses in distribution for GDP between 1-2%; that Downside 1 does this for 0-1% and Downside 2 does this for less than 0%. In terms of applying scenario weights to this for, say, Downside 1 we consider how much weight should be attached to an outcome where GDP is between 0-1%. To determine this, we run the GDP five-year average growth rates, as discussed above. Taking this approach and applying it to Downside 1, where GDP is between 0-1%, would be considered to happen between 20-40% of the time. Then using the actual GDP five-year average growth rate for the Downside 1 scenario (0.70%) this fits with a 30% likelihood which aligns with the current weight. However, as discussed above, we then review the outcome of the analysis against the global and domestic economic back drop which may mean making small changes to the weights profile to encompass the upside or downside risks associated with these events.

The scenario weights we applied for 2019 and 2018 were:

Scenario weights	Upside 2 %	Upside 1 %	Base case %	Downside 1 %	Downside 2 %
2019	**5**	**10**	**40**	**30**	**15**
2018	5	15	40	30	10

Key changes to our scenario weights in 2019

The key changes to our scenario weights were made in Q3 2019 to reduce the Upside 1 weight by 5% to reflect the lower upside risk to the base case forecast from global economic conditions and increase the Downside 2 weight by 5% to reflect the higher downside risks relating to Brexit and the risk of global recession.

Our macroeconomic assumptions and their evolution throughout the forecast period

Our macroeconomic assumptions and their evolution throughout the forecast period for 2019 and 2018 were:

2019		Upside 2 %	Upside 1 %	Base case %	Downside 1 %	Downside 2 %
House price growth	5-year average increase/decrease	**4.90**	**3.70**	**1.60**	**(1.20)**	**(9.30)**
	Peak/(trough) [1] at	**8.10**	**5.80**	**2.00**	**(2.80)**	**(13.50)**
GDP	5-year average increase/decrease	**2.40**	**2.00**	**1.60**	**0.70**	**0.20**
	Cumulative growth/(fall) to peak/(trough) [2]	**1.50**	**1.00**	**0.70**	**(1.10)**	**(5.60)**
Unemployment rate	5-year end period	**1.90**	**2.70**	**4.00**	**5.60**	**7.40**
	Peak/(trough) at	**1.88**	**2.73**	**4.10**	**5.64**	**7.84**
Bank of England base rate	5-year end period	**2.00**	**2.00**	**0.75**	**2.00**	**2.25**
	Peak/(trough) at	**2.00**	**2.00**	**0.75**	**2.00**	**3.00**

2018						
House price growth	5-year average increase/decrease	3.40	2.30	2.00	(2.00)	(9.50)
	Peak/(trough) at	7.40	4.60	2.00	(5.80)	(15.60)
GDP	5-year average increase/decrease	2.50	2.10	1.60	0.70	0.30
	Cumulative growth/(fall) to peak/(trough)	1.60	1.10	0.60	(0.60)	(6.10)
Unemployment rate	5-year end period	2.80	3.80	4.30	6.90	8.60
	Peak/(trough) at	2.58	3.71	4.39	7.30	8.65
Bank of England base rate	5-year end period	1.00	1.25	1.50	2.50	2.25
	Peak/(trough) at	2.00	2.00	1.50	2.50	3.00

(1) Peak/(trough) refers to the peak that the variable will reach in the upside scenario and the trough that the variable will reach in the downside scenario.
(2) Cumulative growth/(fall) refers to the cumulative change from the last historical data point for GDP growth to the peak (for Upside scenarios) or to the trough (for Downside scenarios).

Significant Increase in Credit Risk (SICR)

Loans which have suffered a SICR since origination are subject to a lifetime ECL assessment which extends to a maximum of the contractual term of the loan, or the behavioural term for a revolving facility. Loans which have not experienced a SICR are subject to 12 month ECL. We assess the credit risk profile of each facility to determine which of three stages to allocate them to:

- Stage 1: when there has been no SICR since initial recognition. We apply a loss allowance equal to a 12 month ECL i.e. the proportion of lifetime expected losses that relate to that default event expected in the next 12 months
- Stage 2: when there has been a SICR since initial recognition, but no credit impairment has materialised. We apply a loss allowance equal to the lifetime ECL i.e. lifetime expected loss resulting from all possible defaults throughout the residual life of a facility
- Stage 3: when the exposure is considered credit impaired. We apply a loss allowance equal to the lifetime ECL. Objective evidence of credit impairment is required. For more, see the section 'Definition of default (Credit impaired)' that follows.

We use a range of quantitative, qualitative and backstop criteria to identify exposures that have experienced a SICR. The Santander UK Credit Risk Provisions Forum (CRPF) reviews and approves our SICR thresholds periodically. The Santander UK Board Audit Committee reviews and challenges the appropriateness of them each year, or more often if we change them.

Quantitative criteria

We use quantitative criteria to identify where an exposure has increased in credit risk. The criteria we apply are based on whether any increase in the lifetime PD since the recognition date exceeds a set threshold both in relative and absolute terms. We base the value anticipated from the initial recognition on a similar set of assumptions and data to the ones we used at the reporting date, adjusted to reflect the account surviving to that date. The comparison uses either an annualised lifetime PD, where the lifetime PD is divided by the forecast period, or the absolute change in lifetime PD since initial recognition.

For each portfolio, the quantitative criteria we used for 2019 were:

Residential mortgages	Loans and advances to banks[1]
30bps	400bps

(1) Loans and advances to banks use the comparison of lifetime PDs to determine Stage allocation, unlike other products which first turn the lifetime PD into an average yearly PD (annualised) and then do the comparison.

Qualitative criteria

We also use qualitative criteria to identify where an exposure has increased in credit risk, independent of any changes in PD. For each portfolio, the criteria we used for 2019 and 2018 were:

Residential mortgages	Loans and advances to banks
In forbearance	In forbearance
Default in last 24m	Watchlist – proactive management
£100+ arrears	>30 Days past due (DPD) in last 12m
Bankrupt	Default at proxy origination

Backstop criteria

As a backstop, we classify all exposures more than 30 or 90 DPD in at least Stage 2 or in Stage 3, respectively. This means that we do not rebut the backstop presumptions in IFRS 9 (i.e. credit risk has significantly increased if contractual payments are more than 30 DPD) relating to either a SICR or default.

Definition of default (Credit impaired)

We define a financial instrument as in default (i.e. credit impaired) for purposes of calculating ECL if it is more than three months past due, or if we have data to make us doubt the customer can keep up with their payments i.e. they are unlikely to pay. The data we have on customers varies across our business. It typically includes where:

Residential mortgages

- They have been reported bankrupt or insolvent. This excludes accounts which are up to date and are not defaulted.
- Their loan term has ended, but they still owe us money more than three months later
- They have had forbearance while in default, but have not caught up with the payments they had missed before that, or they have had multiple forbearance
- We have suspended their fees and interest because they are in financial difficulties
- We have repossessed the property.

Loans and advances to banks

- They have had a winding up notice issued, or something happens that is likely to trigger insolvency – such as, another lender calls in a loan
- Something happens that makes them less likely to be able to pay us – such as they lose an important client or contract
- They have regularly missed or delayed payments, even though they have not gone over the three-month limit for default
- Their loan is unlikely to be refinanced or repaid in full on maturity
- Their loan has an excessive LTV that is unlikely to be resolved, such as by a change in planning policy, pay-downs, or increase in market value.

Where we use the advanced internal ratings-based basis for a portfolio in our capital calculations, we use the same default definitions for ECL purposes. The CRPF reviews and approves the definition of default at least annually. The Santander UK Board Audit Committee reviews and challenges the appropriateness of the definition each year, or more often if we change it.

Measuring ECL

For accounts not in default at the reporting date, we estimate a monthly ECL for each exposure and for each month over the forecast period. The lifetime ECL is the sum of the monthly ECLs over the forecast period, while the 12-month ECL is limited to the first 12 months. We calculate each monthly ECL as the discounted value for the relevant forecast month of the product of the following factors:

Factor	Description
Survival rate (SR)	The probability that the exposure has not closed or defaulted since the reporting date.
PD	The likelihood of a borrower defaulting in the following month, assuming it has not closed or defaulted since the reporting date. For each month in the forecast period, we estimate the monthly PD from a range of factors. These include the current risk grade for the exposure, which becomes less relevant further into the forecast period, as well as the expected evolution of the account risk with maturity and factors for changing economics. We support this with historical data analysis.
EAD	The amount we expect to be owed if a default event was to occur. We determine EAD for each month of the forecast period by the expected payment profile, which varies by product type. For amortising products, we base it on the borrower's contractual repayments over the forecast period. We adjust this for any expected overpayments on Stage 1 accounts that the borrower may make and for any arrears we expect if the account was to default. For revolving products, or amortising products with an off-balance sheet element, we determine EAD using the balance at default and the contractual exposure limit. We vary these assumptions by product type and base them on analysis of recent default data.
LGD	Our expected loss if a default event were to occur. We express it as a percentage and calculate it as the expected loss divided by EAD for each month of the forecast period. We base LGD on factors that impact the likelihood and value of any subsequent write-offs, which vary according to whether the product is secured or unsecured. If the product is secured, we take into account collateral values as well as the historical discounts to market/book values due to forced sales type.

We use the original effective interest rate as the discount rate. For accounts in default, we use the EAD as the reporting date balance. We also calculate an LGD to reflect the default status of the account, considering the current DPD and loan to value. PD and SR are not required for accounts in default.

Forecast period

We base the forecast period for amortising facilities on the remaining contract term. For revolving facilities, we use an analytical approach based on the behavioural, rather than contractual, characteristics of the facility type. In some cases, we shorten the period to simplify the calculation. If we do this, we apply a post model adjustment to reflect our view of the full lifetime ECL.

Forward-looking information

Our assessments of a SICR and the calculation of ECL both incorporate forward-looking data. We perform historical analysis and identify the key economic variables that impact credit risk and ECL for each portfolio. These can include the house price growth, GDP, unemployment rate and Bank of England base rate. Where applicable, we incorporate these economic variables and their associated impacts into our models.

Grouping of instruments for losses measured on a collective basis

We measure ECL at the individual financial instrument level. However, where we have used internal capital or similar models as the basis for our ECL models, this typically results in a large number of relatively small homogenous groups. We typically group instruments where they share risk characteristics using one or more statistical models and assess them for impairment collectively. We use this approach for the Crown Dependencies mortgage portfolio.

We calculate separate collective provisions for instruments in Stages 1, 2 and 3 where the instrument is not individually assessed. As described above, for all our portfolios (whether we assess them for impairment individually or collectively) we use five forward-looking economic scenarios.

Management judgement applied in calculating ECL

IFRS 9 recognises that expert management judgement is an essential part of calculating ECL. Specifically, where the historical data that we use in our models does not reflect current or future expected conditions or the data we have does not cover a sufficient period or is not robust enough. We consider the significant management judgements in calculating ECL to be:

- Definition of default: We define a financial instrument as in default (i.e. credit impaired) for purposes of calculating ECL if it is more than three months past due, or if we have data to make us doubt they can keep up with their payments. The data we have on customers varies across our business segments.
- Forward-looking multiple economic scenarios: We use five scenarios, consisting of a central base case, two upside scenarios and two downside scenarios. This symmetry meets the 'unbiased' requirement and we consider these scenarios sufficient to account for any non-linear relationships.
- Probability weights: In determining the initial scenario probability weights, we assign the highest probability to the base case, whilst the outer scenarios typically attract lower probabilities than the more moderate ones.
- SICR thresholds: We use a combination of quantitative (both absolute and relative), qualitative and backstop criteria to identify exposures that we consider have shown a SICR since initial recognition.

Governance around ECL impairment allowances

Our Risk Methodology team developed our ECL impairment models (except for the external models we use, such as OGEM which we described earlier in 'Our forecasting approach'), and our Independent Validations Team independently reviews all material models. As model owners, the Santander UK Risk Provisioning & Forecasting team run the models to calculate our ECL impairment allowances each month. The models are sensitive to changes in credit conditions and reflect various management judgements that give rise to measurement uncertainty in our reportable ECL as set out above. The following Santander UK committees and forums review the provision drivers and ensure that the management judgements we apply remain appropriate:

- **Model Risk Control Forum** (MRCF) reviews and approves new models and required model changes. It also reviews the use of OGEM as a reliable model on which to base our other forecast macroeconomic variables. It is used across all stress testing and planning, so it is subject to model risk criteria. MRCF will delegate responsibility of approvals to Model Risk Management Forum (MRMF) for changes of low risk materiality or less complex changes.
- **ALCO** reviews and approves the economic scenarios and probability weights we use to calculate forward-looking scenarios.
- **CRPF** reviews management judgements and approves ECL impairment allowances.
- **Board Audit Committee** reviews and challenges the appropriateness of the estimates and judgements made by management.

For more on the governance around specific elements of the ECL impairment allowances, including the frequency of, and thresholds for, reviews, including by these committees and forums, see the detailed sections above.

How we assess the performance of our ECL estimation process

We assess the reasonableness of our ECL provisions and the results of our Staging analysis using a range of methods. These include:

- **Benchmarking**: we compare our coverage levels with our peers.
- **Stand-back testing**: we monitor the level of our coverage against actual write-offs.
- **Back-testing**: we compare key drivers periodically as part of model monitoring practices.
- **Monitoring trends**: we track ECL and Staged assets over time and against our internal budgets and forecasts, with triggers set accordingly.

CREDIT RISK REVIEW

Our maximum and net exposure to credit risk
The tables below show the main differences between our maximum and net exposure to credit risk. The tables only show the financial assets that credit risk affects and to which the impairment requirements in IFRS 9 are applied.

For balance sheet assets, the maximum exposure to credit risk is the carrying value after impairment loss allowances. Off-balance sheet exposures are mortgage offers, guarantees, formal standby facilities, credit lines and other commitments. For off-balance sheet guarantees, the maximum exposure is the maximum amount that we would have to pay if the guarantees were called on. For formal standby facilities, credit lines and other commitments that are irrevocable over the life of the facility, the maximum exposure is the total amount of the commitment.

	Maximum exposure				
	Balance sheet asset				
2019	**Gross amounts £bn**	**Loss allowances £bn**	**Net amounts £bn**	**Off-balance sheet £bn**	**Net exposure £bn**
Cash and balances at central banks	**5.2**	–	**5.2**	–	**5.2**
Financial assets at amortised cost:					
- Loans and advances to customers[2]	**0.4**	–	**0.4**	–	**0.4**
- Loans and advances to banks	**0.7**	–	**0.7**	–	**0.7**
Total financial assets at amortised cost	**1.1**	–	**1.1**	–	**1.1**
Total	**6.3**	–	**6.3**	–	**6.3**
2018					
Cash and balances at central banks	4.4	–	4.4	–	4.4
Financial assets at amortised cost:					
- Loans and advances to customers[2]	0.5	–	0.5	–	0.5
- Loans and advances to banks	0.7	–	0.7	248.8[1]	249.5
Total financial assets at amortised cost	1.2	–	1.2	248.8	250.0
Total	5.6	–	5.6	248.8	254.4

(1) 2018 off-balance sheet exposure includes the guarantee of the liabilities of Santander UK plc which was terminated with effect from 1 January 2019 as set out in Note 19 to the Financial Statements. There is no ECL provision on the off-balance sheet exposure.
(2) Balances include interest we have charged to the customer's account and accrued interest that we have not charged to the account yet.

The tables below show the main differences between our maximum and net exposure to credit risk on the financial assets that credit risk affects and to which the impairment requirements in IFRS 9 are not applied.

	Maximum exposure				
	Balance sheet asset				
2019	**Gross amounts £bn**	**Loss allowances £bn**	**Net amounts £bn**	**Off-balance sheet £bn**	**Net exposure £bn**
Financial assets at FVTPL:					
- Other financial assets at FVTPL	**0.5**	–	**0.5**	–	**0.5**
Total	**0.5**	–	**0.5**	–	**0.5**
2018					
Financial assets at FVTPL:					
- Other financial assets at FVTPL	0.4	–	0.4	–	0.4
Total	0.4	–	0.4	–	0.4

Single credit rating scale (unaudited)

In the table below, we have used a single rating scale to ensure we are consistent across all our credit risk portfolios in how we report the risk of default. It has eight grades for non-defaulted exposures, from 9 (lowest risk) to 2 (highest risk). We define each grade by an upper and lower PD value and we scale the grades so that the default risk increases by a factor of ten every time the grade number drops by two steps. For example, grade 9 has an average PD of 0.010%, and grade 7 has an average PD of 0.100%. We give defaulted exposures a grade 1 and a PD value of 100%. In the final column of the table we show the approximate equivalent credit rating grade used by Standard & Poor's Ratings Services (S&P).

	PD range			
SFS risk grade	Mid %	Lower %	Upper %	S&P equivalent
9	0.010	0.000	0.021	AAA to AA+
8	0.032	0.021	0.066	AA to AA-
7	0.100	0.066	0.208	A+ to BBB
6	0.316	0.208	0.658	BBB- to BB
5	1.000	0.658	2.081	BB-
4	3.162	2.081	6.581	B+ to B
3	10.000	6.581	20.811	B-
2	31.623	20.811	99.999	CCC to C
1 (Default)	100.000	100.000	100.000	D

The PDs in the table above are based on Economic Capital (EC) PD mappings which are calculated based on the average probability of default over an economic cycle. This is different to the IFRS 9 PDs which are calculated at a point in time using forward looking economic scenarios. Where possible, the EC PD values are largely aligned to the regulatory capital models however any regulatory floors are removed and PDs are defined at every possible rating rather than categorised into rating buckets.

Rating distribution

The tables below show the credit rating of our financial assets to which the impairment requirements in IFRS 9 are applied.

	SFS risk grade								
2019	**9 £bn**	**8 £bn**	**7 £bn**	**6 £bn**	**5 £bn**	**4 £bn**	**3 to 1 £bn**	**Other[1] £bn**	**Total £bn**
Cash and balances at central banks	**5.2**	–	–	–	–	–	–	–	**5.2**
Financial assets at amortised cost:									
Loans and advances to customers[2]	–	–	–	–	–	–	–	**0.4**	**0.4**
Loans and advances to banks	–	–	**0.7**	–	–	–	–	–	**0.7**
Total on balance sheet	**5.2**	–	**0.7**	–	–	–	–	**0.4**	**6.3**
Total off-balance sheet	–	–	–	–	–	–	–	–	-
Total	**5.2**	–	**0.7**	–	–	–	–	**0.4**	**6.3**
2018									
Cash and balances at central banks	4.4	–	–	–	–	–	–	–	4.4
Financial assets at amortised cost:									
Loans and advances to customers[2]	–	0.1	0.1	0.1	–	–	–	0.2	0.5
Loans and advances to banks	0.1	–	0.6	–	–	–	–	–	0.7
Total on balance sheet	4.5	0.1	0.7	0.1	–	–	–	0.2	5.6
Total off-balance sheet	–	–	248.8	–	–	–	–	–	248.8
Total	4.5	0.1	249.5	0.1	–	–	–	0.2	254.4

(1) Include smaller cases in the commercial mortgages portfolios. We use scorecards for these items, rather than rating models.
(2) Include interest we have charged to the customer's account and accrued interest we have not charged to the account yet.

Credit quality

The following tables analyse the credit risk exposure of financial instruments for which an ECL allowance is recognised, and the corresponding ECL at 31 December 2019 and 2018.

2019	Stage 1 £m	Total £m
Exposures		
Loans and advances to customers	352	352
Loans and advances to banks	662	662
Total exposures	1,014	1,014
Total ECL	–	–

2018		
Exposures		
Loans and advances to customers	453	453
Loans and advances to banks	718	718
Total exposures	1,171	1,171
Total ECL	–	–

There are no material balances in Stage 2 and Stage 3.

Reconciliation of exposures, loss allowance and net carrying amounts

The table below shows the relationships between the disclosures in the Credit risk review section which refer to drawn exposures and the associated ECL, and the total assets as presented in the Balance Sheet.

	On-balance sheet			Off-balance sheet	
2019	Exposures £m	Loss allowance £m	Net carrying amount £m	Exposures £m	Loss allowance £m
Loans and advances to customers	352	–	352	–	–
Loans and advances to banks	662	–	662	–	–
Total exposures	1,014	–	1,014	–	–
Assets classified at FVTPL			490		
Non-financial assets			5,229		
Total assets per the Balance Sheet			6,733		
2018					
Loans and advances to customers	453	–	453	248,758	–
Loans and advances to banks	718	–	718	–	–
Total exposures	1,171	–	1,171	248,758	–
Assets classified at FVTPL			462		
Non-financial assets			4,455		
Total assets per the Balance Sheet			6,088		

Concentrations of credit risk exposures

Country risk exposures

We manage our country risk exposure under our global limits framework. Within this framework, we set our Risk Appetite for each country, taking into account factors that may affect its risk profile. These can include political events, macroeconomics and the nature of the risk. We actively manage exposures if we think we need to. We consider Banco Santander related risk separately.

The tables below show our total exposures, which are the total of balance sheet and off-balance sheet values. We calculate balance sheet values in accordance with IFRS (i.e. after netting allowed under IAS 32) except for credit provisions which we add back. Off-balance sheet values are undrawn facilities and letters of credit. We classify location by country of risk – the country where each client has its main business or assets. That is unless there is a full risk transfer guarantee in place, in which case we use the guarantor's country of domicile. If a client has operations in many countries, we use their country of incorporation. The tables below exclude balances with other Banco Santander companies. We show them separately in the 'Balances with other Banco Santander companies' section.

	2019					2018				
		Financial institutions					Financial institutions			
	Governments	Banks[1]	Other	Corporate	Total[2]	Governments	Banks[1]	Other	Corporate	Total[2]
Country	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
UK	5.2	0.5	0.5	–	6.2	4.4	0.5	0.4	–	5.3
US	–	–	–	–	–	–	0.1	–	–	0.1
Isle of Man	–	–	–	0.3	0.3	–	–	–	0.3	0.3
Other	–	–	–	–	–	–	–	–	–	–
	5.2	0.5	0.5	0.3	6.5	4.4	0.6	0.4	0.3	5.7
Total	5.2	0.5	0.5	0.3	6.5	4.4	0.6	0.4	0.3	5.7

(1) Excludes balances with central banks.
(2) Excludes cash at hand, interests in other entities, intangible assets, property, plant and equipment, tax assets, retirement benefit assets and other assets. Loans are included gross of credit provisions.

Balances with other Banco Santander companies

We deal with other Banco Santander companies in the ordinary course of business. We do this where we have a particular business advantage or expertise and where they can offer us commercial opportunities. These transactions also arise where we support the activities of, or with, larger multinational corporate clients and financial institutions which may deal with other Banco Santander companies. We conduct these activities on the same terms as for similar transactions with third parties, and in a way that manages the credit risk within limits acceptable to the PRA.

At 31 December 2019 and 2018, we had gross balances with other Banco Santander companies as follows:

	2019	2018
	£bn	£bn
Assets:		
Spain	0.2	0.2
UK	–	0.1
Liabilities:		
Spain	0.3	0.2

Industry concentrations

As part of our approach to credit risk management and the Santander UK Risk Appetite, we set concentration limits by industry sector. These limits are set based on the industry outlook, our strategic aims and desired level of concentration, but also take into account any relevant limit set by Banco Santander SA. For more industry information, see 'Concentrations of credit risk exposures' above.

Credit performance

The customer loans in the table below are presented differently from the balances in the Balance Sheet. The main difference is that the customer loans below exclude inter-company balances. We disclose inter-company balances separately in the Notes to the Financial Statements. In addition, customer loans below are presented on an amortised cost basis.

	Customer loans	Stage 3[1][2]	Stage 3 ratio	Gross write-offs	Loss allowances
	£bn	£m	%	£m	£m
2019	0.4	–	–	–	–
2018	0.5	2	–	141	–

(1) We define Stage 3 in the 'Credit risk management' section.
(2) Interest on Stage 3 exposures is derecognised in line with the requirements of IFRS 9.

MARKET RISK

Market risk comprises banking market risk and trading market risk. Following the implementation of our ring-fencing plans in 2018, all material trading market risk exposures of the Company are hedged using derivatives.

BANKING MARKET RISK MANAGEMENT

Risk appetite

Our framework for dealing with market risk is part of the overall Santander UK Risk Framework. The banking market risk framework sets out our high-level arrangements and standards to manage, control and oversee banking market risk. The Santander UK Risk Appetite sets the controls, risk limits and key risk metrics for banking market risk. We articulate risk appetite by the income and value sensitivity limits we set in the Santander UK Risk Appetite, at both Santander UK and Banco Santander group levels.

BANKING MARKET RISK REVIEW

Interest rate risk

Yield curve risk

The table below shows how our base case income and valuation would be affected by a 50 basis point parallel shift (both up and down) applied instantaneously to the yield curve at 31 December 2019 and 2018. Sensitivity to parallel shifts represents the amount of risk in a way that we think is both simple and scalable. 50 basis points is the stress we typically focus on for banking market risk controls, although we also monitor sensitivities to other parallel and non-parallel shifts as well as scenarios.

	2019		2018[1]	
	+50bps £m	**-50bps £m**	+50bps £m	-50bps £m
Net interest margin sensitivity	**19**	**(14)**	207	(23)
EVE sensitivity (unaudited)	**23**	**(22)**	162	(124)

(1) 2018 data i.e. before the implementation of our ring-fencing plans, reflects the Santander UK plc group sensitivity due to the effect of the guarantee given by the Company in respect of certain liabilities of Santander UK plc. As part of our ring-fencing plans, this guarantee was terminated and was of no further force and effect such that, with effect from 1 January 2019, the Company was released and discharged from all related present and future obligations and liabilities.

LIBOR

The use of LIBOR, which is expected to cease in 2021, and its transition to (near) Risk Free Reference Rates (RFR) is also a significant issue across the industry. The Santander UK group has put in place appropriate plans to address the potential risks and will update and implement in this Company as necessary.

LIQUIDITY RISK

Overview

From 1 January 2019, following the implementation of ring-fencing, we monitor and manage liquidity risk for the Santander UK plc group and SFS separately. Under this model, SFS meets regulatory requirements for the purpose of managing liquidity risk on an individual basis.

Prior to 1 January 2019, Santander UK plc, SFS and Cater Allen Limited formed the Domestic Liquidity Sub-group (the DoLSub), which allowed those entities to collectively meet regulatory liquidity requirements.

LIQUIDITY RISK MANAGEMENT

Risk appetite

From 1 January 2019, separate Liquidity Risk Appetites (LRAs) for Santander UK plc and for the Company have been approved. These are appropriate to their individual business models and consistent with the strategy of Santander UK Group Holdings plc.

Our LRA statement is based on the principles of liquidity management we use to manage our balance sheet. It also supports our need to meet or exceed the rules of our regulators.

The Company has adopted the Santander UK Risk Management framework and the CFO and Risk Divisions within Santander UK manage and control liquidity risk on behalf of the Company. The relevant policy frameworks and procedures within Santander UK Group Holdings plc therefore also apply to the Company.

Our LRA is proposed to the Risk division, and reviewed and approved by the Board each year, or more often if needed.

The Company's Board approved the Internal Liquidity Adequacy Assessment Process (ILAAP) in November 2019.

Risk measurement (unaudited)

We use a number of metrics to manage liquidity risk. These include metrics that show the difference between cash and collateral inflows and outflows in different periods. We have a liquidity stress test framework in place which is central to our LRA measurement and monitoring. It includes three severe but plausible stress test scenarios. To fit with our risk appetite, the liquidity outflows that come from these stress tests must be fully covered with high-quality liquid assets, other liquid assets and management actions sanctioned at the right level of governance.

Our Risk division runs a range of stress tests. Our LRA stress test is a combination of three tests that cover idiosyncratic, market-wide and combined scenarios.

We monitor our Liquidity Coverage Ratio (LCR) to ensure we continue to meet the requirements. Although the Basel Committee published its final Net Stable Funding Ratio (NSFR) standards in October 2014, the NSFR has not yet been implemented within the EU (unlike the LCR). As such there is no formal NSFR requirement applicable to UK or other EU banks until such time as the European Commission adopts appropriate regulatory and technical standards. Nonetheless, we monitor our NSFR on an ongoing basis and will be ready to comply with the standards once agreed.

Risk mitigation (unaudited)

The Board aims to make our balance sheet resilient at all times and for it to be perceived as such by stakeholders. This preserves our short and long-term viability. The Board recognises that as we are involved in maturity transformation, we cannot hold enough liquidity to cover all possible stress scenarios. The Board requires us to hold enough liquidity to make sure we will survive three plausible but severe stress scenarios (our LRA stress). We do this by maintaining a prudent balance sheet structure and approved liquid resources.

Risk monitoring and reporting (unaudited)

We monitor liquidity risk daily, weekly and monthly. We do this through different committees and levels of management, including the Santander UK ALCO and the Board Risk Committee.

LIQUIDITY RISK REVIEW (unaudited)

From 1 January 2019, following implementation of ring-fencing, liquidity risk for the Company has been monitored and managed separately from the rest of the Santander UK group.

Liquidity Coverage Ratio
This table shows our LCR and LRA at 31 December 2019. We only present data for 2019 reflecting the fact that we monitor and manage liquidity risk for SFS separately from the rest of the Santander UK group from 1 January 2019. The LRA data reflect the stress testing methodology in place at that time.

	LCR £bn	LRA £bn
Eligible liquidity pool (liquidity value)	5.7	5.7
Net stress outflows	(1.2)	(1.1)
Surplus	4.5	4.6
Eligible liquidity pool as a percentage of anticipated net cash flows	471%	518%

LCR eligible liquidity pool
This table shows the carrying value and liquidity value of our eligible liquidity pool assets at 31 December 2019. It also shows the weighted average carrying value in the year. We only present data for 2019 reflecting the fact that we monitor and manage liquidity risk for SFS separately from the rest of the Santander UK group from 1 January 2019.

	Carrying value £bn	Liquidity value[1] £bn	Weighted average carrying value in the year £bn
Cash and balances at central banks	5.2	5.2	4.4
Government bonds	0.5	0.5	0.5
Total	5.7	5.7	4.9

(1) Liquidity value is the carrying value with the applicable LCR haircut applied

Currency analysis
This table shows the carrying value of our eligible liquidity pool by major currencies at 31 December 2019. The composition of the pool is consistent with the currency profile of our net liquidity outflows. We only present data for 2019 reflecting the fact that we monitor and manage liquidity risk for SFS separately from the rest of the Santander UK group from 1 January 2019.

	US Dollar £bn	Euro £bn	Sterling £bn	Other £bn	Total £bn
2019	-	-	5.7	-	5.7

Composition of the eligible liquidity pool
This table shows the allocation of the carrying value of the assets in our eligible liquidity pool for LRA and LCR purposes at 31 December 2019. We only present data for 2019 reflecting the fact that we monitor and manage liquidity risk for SFS separately from the rest of the Santander UK group from 1 January 2019.

	2019				
	LCR eligible liquidity pool				
	Level 1 £bn	Level 2A £bn	Level 2B £bn	Total £bn	Of which LRA eligible £bn
Cash and balances at central banks	5.2	-	-	5.2	5.2
Government bonds:					
- AAA to AA-	0.5	-	-	0.5	0.5
	5.7	-	-	5.7	5.7

FUNDING RISK MANAGEMENT

Deposit funding
The Company is primarily funded through Crown Dependency deposits and has access to internal wholesale funding from Santander UK Group Holdings plc.

Wholesale funding
Wholesale funding was £nil at 31 December 2019 (2018: £0.6bn), all of which was classified as Deposits by banks.

CAPITAL RISK

THE SCOPE OF OUR CAPITAL ADEQUACY

Regulatory supervision

For capital purposes, we are subject to prudential supervision by the PRA, as a UK bank, and by the European Central Bank (ECB) as part of the Banco Santander group. The ECB supervises Banco Santander as part of the Single Supervisory Mechanism (SSM). Although we are part of the Banco Santander group, we do not have a guarantee from our ultimate parent Banco Santander SA. As we are regulated by the PRA, we have to meet the PRA capital requirements on a standalone basis. We also have to show the PRA that we can withstand capital stress tests without the support of our ultimate parent. Reinforcing our corporate governance framework, the PRA exercises oversight through its rules and regulations on the Board and senior management appointments.

Santander UK Group Holdings plc is the holding company of Santander Financial Services plc and is the head of the Santander UK group (including SFS) for regulatory capital and leverage purposes.

CAPITAL RISK MANAGEMENT

The Board is responsible for capital management strategy and policy and ensuring that we monitor and control our capital resources within regulatory and internal limits. We operate within the capital risk framework and appetite approved by the Santander UK Board. This reflects the business environment we operate in, our strategy for each material risk and the potential impact of any adverse scenarios or stresses on our capital position.

Management of capital requirements

Our capital risk appetite aims to maintain capital levels appropriate to the level of stress applied, and the expected regulatory response. In:

- An adverse economic stress, which we might expect to occur once in 20 years, the firm should remain profitable and exceed all regulatory capital minimums at all times
- A very severe economic stress, which we might expect to occur once in 100 years, and which has been designed to test any specific weaknesses of a firm's business model, the firm should meet all regulatory capital minimums at all times. This is subject to the use of regulatory buffers designed to absorb losses in such a stress.

Management of capital resources

We use a mix of regulatory and economic capital (EC) ratios and limits, internal buffers and restrictions to manage our capital resources. We also take account of the costs of differing capital instruments and capital management techniques. We also use these to shape the best structure for our capital needs. We decide how to allocate our capital resources as part of our strategic planning process. We base this in part on the relative returns on capital using both EC and regulatory capital measures. We plan for severe stresses and we set out what action we would take if an extremely severe stress threatened our viability and solvency. This could include not paying dividends, selling assets, reducing our business and issuing more capital.

Risk measurement (unaudited)

We apply Banco Santander's approach to capital measurement and risk management for CRD IV. For more on the CRD IV risk measurement of our exposures, see Banco Santander's Pillar 3 report.

The main metrics we use to measure capital risk are CET1 capital and total regulatory capital.

Risk mitigation (unaudited)

Santander UK has designed its capital risk framework, policies and procedures to ensure that we operate within our Risk Appetite. Santander UK manages capital transferability between its subsidiaries in line with its business strategy, its risk and capital management policies, and UK laws and regulations. There are no legal restrictions on Santander UK moving capital resources promptly, or repaying liabilities, between Santander UK and its subsidiaries except for distributions between Santander UK entities in the ring-fenced bank sub-group and Santander UK entities that are not members of the ring-fenced bank sub-group (such as the Company), where the PRA is required to assess the impact of proposed distribution prior to payment.

From 1 January 2019, as a result of ring-fencing, Santander UK Group Holdings plc, SFS and Santander Equity Investments Limited entered into a capital support deed dated 13 November 2018 (the NRFB Capital Support Deed) which expires on 31 December 2021. The purpose of the NRFB Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties breached or was at risk of breaching its capital resources requirements or risk concentrations requirements.

Prior to 1 January 2019, Santander UK plc, SFS and Cater Allen Limited, which are the PRA-regulated entities within the Santander UK group, were party to a capital support deed dated 23 December 2015 (the Capital Support Deed 2015) with Santander UK Group Holdings plc and certain other non-regulated subsidiaries of Santander UK plc. The core UK group permission as supported by the Capital Support Deed 2015 expired on 31 December 2018.

Other than the change of the entities in scope, the purpose of the NRFB Capital Support Deed is the same as the previous Capital Support Deed 2015.

Risk monitoring and reporting (unaudited)

We monitor and report regularly against our capital plan. We do this to identify any change in our business performance that might affect our capital. Each month, we also review the economic assumptions we use to create and stress test our capital plan. We do this to identify any potential reduction in our capital.

CAPITAL RISK REVIEW

Regulatory capital resources

This table shows our regulatory capital.

	2019 £m	2018 £m
CET1 capital before regulatory adjustments	319	346
CET1 regulatory adjustments	(2)	(3)
CET1 capital	**317**	343
Total regulatory capital	**317**	343

CET1 regulatory adjustments

These are adjustments required by CRD IV.

Independent auditors' report to the members of Santander Financial Services plc

Report on the audit of the financial statements

Opinion

In our opinion, Santander Financial Services plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2019 and of its loss 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, which comprise: the balance sheet as at 31 December 2019; 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.

Our opinion is consistent with our reporting to the Board Audit Committee.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the financial statements, the Company, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion, the financial statements have been properly prepared in accordance with IFRSs as issued by the IASB.

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

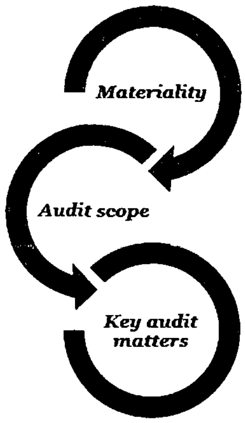
We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance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

Other than those disclosed in note 6 to the financial statements, we have provided no non-audit services to the company in the period from 1 January 2019 to 31 December 2019.

Our audit approach

Overview



- Overall materiality: £31 million (2018: £13.3 million), based on 0.5% of total assets.

- The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment and other qualitative factors (including history of misstatement through fraud or error).
- We performed audit procedures over components considered to be financially significant in the context of the company.

- We have key audit matters on credit impairment loss allowances and Covid-19

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.

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 breaches of the rules of the Financial Conduct Authority, Prudential Regulatory Authority, Jersey Financial Services Commission and Isle of Man Financial Services Authority, 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. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls). The engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the engagement team and/or the component auditors included:

- Discussions with management and those charged with governance in relation to known or suspected instances of non-compliance with laws and regulation and fraud;
- Evaluation and testing of the operating effectiveness of management's controls designed to prevent and detect fraud and errors in financial reporting;
- Assessment of matters reported on the Santander UK group's whistleblowing helpline and the results of management's investigation of such matters;
- Attendance at key governance forums and reviewing management information presented at these meetings;
- Identifying and testing journal entries, in particular any journal entries posted by senior management, unusual account combinations and period end adjustments; and
- Incorporated unpredictability into the nature, timing and/or extent of our testing.

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***
Credit impairment loss allowances The determination of credit impairment loss allowances can be subjective and judgmental. As at 31 December 2019, the company has recognised credit impairment loss allowances on loans and advances to customers of less than £1m against loans and advances to customers of £352m and loans and advances to banks of £662m. The loans and advances to customers are primarily comprised of residential mortgages in the Isle of Man (IoM) which have a low history of arrears. The majority (over 98%) of loans are classified as stage 1 at 31 December 2019. Loans and advances to banks primarily comprise a cash collateralised loan with a credit institution. We have focussed our procedures on the valuation of the credit loss impairment allowance.	To test the valuation of the credit impairment loss allowance, we have: • Understood and assessed the appropriateness of the methodology used by management to calculate the loss allowance on the IoM residential mortgages, recalculated the loss allowance and tested the inputs back to underlying sources; • Tested the arrears monitoring controls operated by management over of the underlying IoM book to verify the low arrears; • Where loans matured shortly after the year end, we have obtained evidence to confirm they were repaid in full; and • Tested the cash collateral available to evidence recoverability of loans and advances to banks. Based on the evidence obtained, we consider the methodology and data used within the allowance calculation to be appropriate, and that the arrears monitoring controls are effective. In addition, we have considered the impact of Covid-19. As included in the key audit matter below, this is considered a non-adjusting post balance sheet event and therefore has no impact on the credit impairment loss allowance as at 31 December 2019. We have concluded that the credit impairment loss allowance as at 31 December 2019 is not materially misstated.
Covid-19 Since the balance sheet date, there has been a global pandemic of Covid-19 which has also impacted the UK. This has been disruptive to the financial markets and normal patterns of human behaviour, and is anticipated to translate into an adverse impact on the UK economy. Management have considered the impact of this on the financial statements, including its impact on the going concern assessment and post balance sheet event disclosures. The directors have concluded that the matter is a non-adjusting post balance sheet event, the financial effect of which cannot be reliably measured at this stage.	We have assessed management's conclusion that the matter be treated as a non-adjusting post balance sheet event and that the impact cannot be measured reliably at this stage. In particular we considered: • The timing of the development of the outbreak across the world and in the UK; and • The timing and nature of UK government advice to UK citizens. We are satisfied that the pandemic is a non-adjusting post balance sheet event. In forming our conclusions over going concern, we evaluated whether management's assessment considered impacts arising from Covid-19. Our procedures in respect of going concern included: • Evaluating the impact of the events on the company's capital and liquidity positions; and • Testing the company's access to funding from its parent, Santander UK Group Holdings plc. This included assessing the parent's ability to provide funding. Based on the work performed, we are satisfied that matter has been appropriately evaluated and reflected in the financial statements, and that there is no material uncertainty that the company will continue as a going concern for at least 12 months following the date of this report. We also assessed the adequacy of disclosures related to Covid-19 included in the financial statements and assessed these to be appropriate.

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.

We identified Jersey and Isle of Man Branches of the company as components which, in our view, required an audit of specific financial statement line items based on their size or their risk characteristics, in the context to the company's financial statements. We used component auditors within PwC who are familiar with the relevant businesses to audit its components.

Processes and controls supporting the company's operations are also undertaken by Banco Santander S.A. in Spain, including the hosting and monitoring of certain IT systems. As part of the planning and execution of the audit, we worked closely with the component auditors throughout the year to ensure that the procedures performed on our behalf were sufficient for our purposes and we reviewed the results of their work.

The procedures which we performed accounted for 88% of interest and similar income, 93% of interest expense and similar charges, 99% of net trading and other income and 99% of total assets of the company.

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	£31 million (2018: £13.3 million).
How we determined it	0.5% of total assets.
Rationale for benchmark applied	Banking reform migrations have had a significant impact on the company and it now has a much reduced and simplified balance sheet. We will continue using a total assets based benchmark as we did in 2018 as we believe this is most appropriate for an entity of this nature and in consideration of the users of the financial statements. The balances from the Jersey and Isle of Man branches were excluded from the materiality calculation in 2018 as the transfers occurred close to year end, however these branches have been in the company for a full year in 2019 and are therefore included in the materiality calculation.

We agreed with the Board Audit Committee that we would report to them misstatements identified during our audit above £1,500,000 (2018: £665,000) 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.

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 Directors' report, 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.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2019 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 Directors' Report.

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 13, 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 the Board Audit Committee, we were appointed by the members 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 4 years, covering the years ended 31 December 2016 to 31 December 2019.

Steven Linnegar

Steven Linnegar (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
27 March 2020

INCOME STATEMENT

For the years ended 31 December

	Notes	2019 £m	2018 £m
Interest and similar income		59.6	13.8
Interest expense and similar charges		(51.8)	(12.0)
Net interest income	2	7.8	1.8
Net fee and commission income	3	2.0	0.1
Net trading and other income	4	5.1	2.6
Total operating income		14.9	4.5
Operating expenses before credit impairment losses, provisions and charges	5	(18.0)	(2.7)
Credit impairment losses	7	-	-
Provisions for other liabilities and charges		(1.0)	-
Total operating credit impairment losses, provisions and charges		(1.0)	-
(Loss)/profit on continuing operations before tax		(4.1)	1.8
Tax on (loss)/profit on continuing operations	8	(2.6)	(0.4)
(Loss)/profit on continuing operations after tax		(6.7)	1.4
Profit in respect of discontinued operations after tax	9	-	17.8
(Loss)/profit after tax		(6.7)	19.2
Attributable to:			
Equity holders of the parent		(6.7)	19.2
(Loss)/profit after tax		(6.7)	19.2

STATEMENT OF COMPREHENSIVE INCOME

For the years ended 31 December

		2019 £m	2018 £m
(Loss)/profit after tax on continuing operations		(6.7)	1.4
Other comprehensive (expense)/income on continuing operations that may be reclassified to profit or loss subsequently:			
Currency translation on foreign operations		(10.0)	-
Total comprehensive (expense)/income in respect of continuing operations		(16.7)	1.4
Profit after tax in respect of discontinued operations	9	-	17.8
Total other comprehensive income in respect of discontinued operations	9	-	3.2
Total comprehensive income in respect of discontinued operations		-	21.0
Total comprehensive (expense)/income		(16.7)	22.4
Attributable to:			
Equity holders of the parent		(16.7)	22.4
Total comprehensive (expense)/income		(16.7)	22.4

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

BALANCE SHEET

At 31 December

	Notes	2019 £m	2018 £m
Assets			
Cash and balances at central banks		**5,215**	4,433
Financial assets at fair value through profit or loss:			
– Derivative financial instruments	11	**37**	36
– Other financial assets at fair value through profit or loss	12	**453**	426
Financial assets at amortised cost:			
– Loans and advances to customers	13	**352**	453
– Loans and advances to banks		**662**	718
Intangible assets	15	**2**	3
Property, plant and equipment		**3**	3
Deferred tax assets	8	**6**	13
Other assets		**3**	3
Total assets		**6,733**	6,088
Liabilities			
Financial liabilities at fair value through profit or loss:			
– Derivative financial instruments	11	**251**	222
Financial liabilities at amortised cost:			
– Deposits by customers	16	**6,121**	4,825
– Deposits by banks	17	**2**	606
Other liabilities		**9**	36
Provisions	18	**5**	6
Current tax liabilities		**26**	47
Total liabilities		**6,414**	5,742
Equity			
Share capital	20	**250**	250
Retained earnings		**69**	86
Other reserves		**-**	10
Total shareholders' equity		**319**	346
Total liabilities and equity		**6,733**	6,088

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

The Financial Statements were approved and authorised for issue by the Board on 27 March 2020 and signed on its behalf by:

Madhukar Dayal
Director

Company Registered Number: 2338548

CASH FLOW STATEMENT

For the years ended 31 December

	2019 £m	2018 £m
Cash flows from operating activities		
(Loss)/profit after tax	(7)	19
Adjustments for:		
Non-cash items included in profit:		
– Depreciation and amortisation	2	9
– Provisions for other liabilities and charges	1	12
– Impairment losses	-	22
– Corporation tax charge	3	7
– Other non-cash items	(3)	13
	3	63
Net change in operating assets and liabilities		
– *Cash and balances held at central banks*	(12)	42
– Trading assets	-	24,143
– Derivative assets	(2)	19,817
– Other financial assets at fair value through profit or loss	(27)	875
– Loans and advances to banks and customers	178	10,353
– Other assets	-	212
– Deposits by banks and customers	688	(11,252)
– Derivative liabilities	29	(20,750)
– Trading liabilities	-	(31,101)
– Other financial liabilities at fair value through profit or loss	-	(656)
– Debt securities in issue	-	(6,680)
– Other liabilities	(24)	(203)
	830	(15,200)
Corporation taxes paid	(17)	(55)
Effects of exchange rate differences	(8)	164
Net cash flows from operating activities	801	(15,009)
Cash flows from investing activities		
Proceeds from disposal of subsidiaries[1]	-	40
Purchase of property, plant and equipment and Intangible assets	-	(5)
Proceeds from sale and redemption of financial assets at amortised cost and financial assets at fair value through other comprehensive income	-	1
Net cash flows from investing activities	-	36
Cash flows from financing activities		
Dividends paid on ordinary shares	(10)	(3,546)
Net cash flows from financing activities	(10)	(3,546)
Change in cash and cash equivalents	791	(18,519)
Cash and cash equivalents at beginning of the year	4,625	23,016
Effects of exchange rate changes on cash and cash equivalents	(2)	128
Cash and cash equivalents at the end of the year	5,414	4,625
Cash and cash equivalents consist of:		
Cash and balances at central banks	5,215	4,433
Less: regulatory minimum cash balances	(13)	-
	5,202	4,433
Net non-trading other cash equivalents	212	192
Cash and cash equivalents at the end of the year	5,414	4,625

(1)In 2018, a number of subsidiaries were sold for a cash consideration of £40m, which was equivalent to the carrying value of the assets and liabilities.

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

STATEMENT OF CHANGES IN EQUITY

For the years ended 31 December

	Share capital £m	Other reserves: Fair value £m	Other reserves: Currency translation £m	Retained earnings £m	Total £m
At 1 January 2019	**250**	-	**10**	**86**	**346**
Other comprehensive expense in respect of continuing operations:					
Currency translation reserve	-	-	(10)	-	(10)
Total comprehensive expense net of tax in respect of continuing operations	-	-	(10)	(7)	(17)
Dividends on ordinary shares	-	-	-	(10)	(10)
At 31 December 2019	**250**	-	-	**69**	**319**
At 31 December 2017	250	-	10	3,622	3,882
Adoption of IFRS 9[1]	-	1	-	(13)	(12)
At 1 January 2018	250	1	10	3,609	3,870
Total comprehensive income net of tax in respect of continuing operations	-	-	-	1	1
Total comprehensive income net of tax in respect of discontinued operations	-	(1)	-	22	21
Total comprehensive income	-	(1)	-	23	22
Dividends on ordinary shares	-	-	-	(3,546)	(3,546)
At 31 December 2018	250	-	10	86	346

(1) The adoption of IFRS 9 decreased shareholders' equity at 1 January 2018 by £12m (net of tax) comprised of a £22m decrease arising from the application of the new classification and measurement requirements for financial assets and a £5m increase arising from the application of the new ECL impairment methodology, these amounts being partially offset by the resulting deferred tax asset of £5m.

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

1. ACCOUNTING POLICIES

These financial statements are prepared for Santander Financial Services plc (the Company or SFS) under the Companies Act 2006. Santander Financial Services plc is a public company, limited by shares and incorporated in England and Wales having a registered office at 2 Triton Square, Regent's Place, London, NW1 3AN. The Company is an operating company whose principal activity is to undertake banking and financial services transactions to customers in Jersey and the Isle of Man. It also holds a small pool of residual assets and liabilities, which is intended to be run down and/or managed for value.

Basis of Preparation

The financial statements have been prepared on the going concern basis using the historical cost convention, except for financial assets and liabilities that have been measured at fair value. An assessment of the appropriateness of the adoption of the going concern basis of accounting is disclosed in the statement of going concern in the Directors' Report.

Compliance with International Financial Reporting Standards

The financial statements have been prepared in accordance with IFRSs as issued by the IASB, including interpretations issued by the IFRS Interpretations Committee (IFRS IC) of the IASB (together IFRS) as adopted by the European Union and the Companies Act 2006 applicable to companies reporting under IFRS.

Disclosures required by IFRS 7 'Financial Instruments: Disclosure' relating to the nature and extent of risks arising from financial instruments, and IAS 1 'Presentation of Financial Statements' relating to objectives, policies and processes for managing capital, can be found in the Risk review. Those disclosures form an integral part of these financial statements.

Recent accounting developments

IFRS 16 'Leases' (IFRS 16)

On 1 January 2019 the Company adopted IFRS 16 and the revised accounting policies as lessee which have been applied from 1 January 2019 are set out below. Comparatives have not been restated. The impact of applying IFRS 16 is disclosed in section (ii):

IFRS 16 impacted property and equipment leases where the company is the lessee.

i) Accounting policy change

SFS as lessee

The Company assesses whether a contract is or contains a lease at the inception of the contract and recognises 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, except for short-term leases, being those with a term of 12 months or less, or leases for which the underlying asset is of low value which are expensed in the income statement on a straight-line basis over the lease terms. Lease payments exclude irrecoverable VAT which is expensed in the income statement as lease payments are made.

The lease liability, which is included within Other liabilities on the balance sheet, is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the incremental borrowing rate appropriate to the lease term. The lease liability is subsequently measured at amortised cost using the effective interest rate method. Remeasurement of the lease liability occurs if there is a change in the lease payments (when a corresponding adjustment is made to the ROU asset), the lease term or in the assessment of an option to purchase the underlying asset.

At inception, the ROU asset, which is included within Property, plant and equipment on the balance sheet, comprises the lease liability, initial direct costs and the obligations to restore the asset, less any incentives granted by the lessor. The ROU asset is depreciated over the shorter of the lease term or the useful life of the underlying asset and is reviewed for indications of impairment as for owned assets. The obligation to restore the asset is included within Provisions on the balance sheet.

ii) Impact of adoption

The Company elected to apply the modified retrospective approach whereby the ROU asset at the date of initial application was measured at an amount equal to the lease liability. The ROU asset was adjusted for any prepaid lease payments and incentives relating to the relevant leases that were recognised on the balance sheet at 31 December 2018 and included an estimate of the costs of restoring the underlying assets to the condition required by the terms of the lease. In addition, the following practical expedients permitted by the standard were applied:

- a single discount rate being the incremental borrowing rate was applied to a portfolio of leases with reasonably similar characteristics; and
- operating leases with a remaining lease term of less than 12 months as at 1 January 2019 were treated as short term leases.

The application of IFRS 16 at 1 January 2019 increased property, plant and equipment by £1.5m (being the net increase in ROU assets referred to above) and increased other liabilities by £1.4m from recognising lease liabilities. In addition, we also increased provisions by £0.1m (see Note 18). There was no impact on shareholders' equity. There was no material difference between the amount of the lease liabilities and the amount of operating lease commitments at 31 December 2018 (see Note 19).

In addition to the choice of transition approach, the determination of the discount rate an area of judgement. The Company applies an incremental borrowing rate (based on 3-month GBP LIBOR plus a credit spread to reflect the cost of raising unsecured funding in the wholesale markets) appropriate to the relevant remaining lease term.

Future accounting developments

At 31 December 2019 there were no significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective.

Discontinued operations

A discontinued operation is a component of the Company that has been disposed of or is classified as held for sale and that represents a separate major line of business or geographical area of operations, is part of a single co-ordinated plan to dispose of such a line of business or area of operations, or is a subsidiary acquired exclusively with a view to resale. The results of discontinued operations are presented separately in the statement of profit or loss.

Revenue recognition

a) Interest income and expense

Interest and similar income comprises interest income on financial assets measured at amortised cost, investments in debt instruments measured at FVOCI and interest income on hedging derivatives. Interest expense and similar charges comprises interest expense on financial liabilities measured at amortised cost, and interest expense on hedging derivatives. Interest income on financial assets measured at amortised cost, investments in debt instruments measured at FVOCI (2017: available-for-sale) 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). For more information on stage allocations of credit risk exposures, see 'Significant increase in credit risk' in the 'Credit risk management' section of the Risk review.

b) Fee and commission income and expense

Fees and commissions that are not an integral part of the effective interest rate are recognised when the service is performed. Most fee and commission income is recognised at a point in time. Certain commitment, upfront and management fees are recognised over time but are not material Fee and commission income which forms an integral part of the effective interest rate of a financial instrument (for example certain loan commitment fees) is recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.

c) Dividend income

Except for equity securities classified as trading assets or financial assets held at fair value through profit or loss, described below, dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for equity securities.

d) Net trading and other income

Net trading and other income includes all gains and losses from changes in the fair value of financial assets and liabilities held at fair value through profit or loss (comprising financial assets and liabilities held for trading, trading derivatives and other financial assets and liabilities at fair value through profit or loss), together with related interest income, expense, dividends and changes in fair value of any derivatives managed in conjunction with these assets and liabilities. Changes in fair value of derivatives in a fair value hedging relationship are also recognised in net trading and other income. Net trading and other income also includes income from operating lease assets, and profits and losses arising on the sales of property, plant and equipment and subsidiary undertakings.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, including computer software, which are assets that necessarily take a substantial period of time to develop for their intended use, are added to the cost of those assets, until the assets are substantially ready for their intended use. All other borrowing costs are recognised in profit or loss in the period in which they occur.

Intangible assets

Software development costs are capitalised when they are direct costs associated with identifiable and unique software products that are expected to provide future economic benefits and the cost of those products can be measured reliably. These costs include payroll, materials, services and directly attributable overheads. Internally developed software meeting these criteria and externally purchased software are classified in intangible assets on the balance sheet and amortised on a straight-line basis over their useful life of three to seven years, unless the software is an integral part of the related computer hardware, in which case it is treated as property, plant and equipment as described below. Capitalisation of costs ceases when the software is capable of operating as intended. Costs of maintaining software are expensed as incurred.

Property, plant and equipment
Property, plant and equipment include owner-occupied properties (including leasehold properties), office fixtures and equipment and computer software. Property, plant and equipment also includes right-of-use assets where the Company is the lessee, as described further in the 'Leases' accounting policy below. Property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. A review for indications of impairment is carried out at each reporting date. Gains and losses on disposal are determined by reference to the carrying amount and are reported in net trading and other income. Repairs and renewals are charged to the income statement when the expenditure is incurred. Internally developed software meeting the criteria set out in 'Intangible assets' above and externally purchased software are classified in property, plant and equipment where the software is an integral part of the related computer hardware (for example operating system of a computer). Classes of property, plant and equipment are depreciated on a straight-line basis over their useful life, as follows:

Owner-occupied properties	Not exceeding 50 years
Office fixtures and equipment	5 to 8 years
Computer software	3 years
Right-of-use assets (see 'Leases – SFS as lessee' below)	Shorter of the lease term or the useful life of the underlying asset

Depreciation is not charged on freehold land and assets under construction.

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. The Company does not hold any held to maturity financial assets.

A regular way purchase is a purchase of a financial asset under a contract whose terms require delivery of the asset within the timeframe established generally by regulation or convention in the market place concerned. Regular way purchases of financial assets classified as loans and receivables, issues of equity or financial liabilities measured at amortised cost are recognised on settlement date; all other regular way purchases and issues are recognised on trade date.

b) Financial assets and liabilities

i) Classification and subsequent measurement
The Company 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 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. 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 13. 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.
- 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'. 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' in the period in which it arises.

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 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 other comprehensive income (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 Company recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments.

d) Day One profit adjustments

The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, sometimes the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Company recognises a trading gain or loss at inception (Day One gain or loss), being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire Day One gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable or an offsetting transaction is entered into.

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 FVOCI and with the exposure arising from financial guarantee contracts and loan commitments. 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.

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

a) Write-off
For secured loans, a write-off is only made when all collection procedures have been exhausted and the security has been sold or from claiming on any mortgage indemnity guarantee or other insurance. There may be occasions where a write-off occurs for other reasons, such as following a consensual restructure or refinancing of the debt or where the debt is sold for strategic reasons into the secondary market at a value lower than its face value.

There is no threshold based on past due status beyond which all secured or unsecured loans are written off. The write-off policy is regularly reviewed. Write-offs are charged against previously established credit impairment 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. Recoveries of credit impairment losses are classified in the income statement as 'Credit impairment losses'.

iii) Modifications of financial assets
The treatment of a renegotiation or modification of the contractual cash flows of a financial asset normally depends upon whether the renegotiation or modification is due to financial difficulties of the borrower or for other commercial reasons.

- Contractual modifications due to financial difficulties of the borrower: where the Company modifies the contractual conditions to enable the borrower to fulfil their payment obligations, the asset is not derecognised. The gross carrying amount of the financial asset is recalculated as the present value of the renegotiated/modified contractual cash flows that are discounted at the financial asset's original EIR and any gain or loss arising from the modification is recognised in the income statement.
- Contractual modifications for other commercial reasons: such modifications are treated as a new transaction resulting in derecognition of the original financial asset, and the recognition of a 'new' financial asset. Any difference between the carrying amount of the derecognised asset and the fair value of the new asset is recognised in the income statement as a gain or loss on derecognition.

Any other contractual modifications, such as where a regulatory authority imposes a change in certain contractual terms or due to legal reasons, are assessed on a case-by-case basis to establish whether or not the financial asset should be derecognised.

iv) Derecognition other than on a modification
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.

Financial liabilities are derecognised when extinguished, cancelled or expired.

c) Financial guarantee contracts and loan commitments
Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of the amount of the loss allowance, and the premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

Loan commitments are measured as the amount of the loss allowance. The Company has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For financial guarantee contracts and loan commitments, the loss allowance is recognised as a provision and charged to credit impairment losses in the income statement. The loss allowance in respect of revolving facilities is classified in loans and advances to customers to the extent of any drawn balances. The loss allowance in respect of undrawn amounts is classified in provisions. When amounts are drawn, any related loss allowance is transferred from provisions to loans and advances to customers.

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. Transactions are undertaken in interest rate, cross currency, equity, residential property and other index-related swaps, forwards, caps, floors, swaptions, as well as credit default and total return swaps, equity index contracts and exchange traded interest rate futures, and equity index options.

Derivatives are held for risk management purposes and classified as held for trading.

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.

Certain 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 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.

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. 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.

Offsetting financial assets and liabilities

Financial assets and liabilities including derivatives are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. The Company is party to a number of arrangements, including master netting arrangements under industry standard agreements which facilitate netting of transactions in jurisdictions where netting agreements are recognised and have legal force. The netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis.

Impairment of non-financial assets

At each balance sheet date, or more frequently when events or changes in circumstances dictate, property plant and equipment (including operating lease assets) and intangible assets are assessed for indicators of impairment. If indications are present, these assets are subject to an impairment review. 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 fair value 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. 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 values of property, plant and equipment, and intangible assets are written down by the amount of any impairment and the loss is recognised in the income statement in the period in which it occurs. A previously recognised impairment loss relating to property, plant and equipment may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the property, plant and equipment's recoverable amount. The carrying amount of the property, plant and equipment will only be increased up to the amount that would have been had the original impairment not been recognised.

Leases - SFS as lessee

The Company assesses whether a contract is or contains a lease at the inception of the contract and recognises 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, except for leases with a term of 12 months or less which are expensed in the income statement on a straight-line basis over the lease terms. Lease payments exclude irrecoverable VAT which is expensed in the income statement as lease payments are made.

The lease liability, which is included within Other liabilities on the balance sheet, is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the incremental borrowing rate appropriate to the lease term. The lease liability is subsequently measured at amortised cost using the effective interest rate method. Remeasurement of the lease liability occurs if there is a change in the lease payments (when a corresponding adjustment is made to the ROU asset), the lease term or in the assessment of an option to purchase the underlying asset.
At inception, the ROU asset, which is included within Property, plant and equipment on the balance sheet, comprises the lease liability, initial direct costs and the obligations to restore the asset, less any incentives granted by the lessor. The ROU asset is depreciated over the shorter of the lease term or the useful life of the underlying asset and is reviewed for indications of impairment as for owned assets. The obligation to restore the asset is included within Provisions on the balance sheet.

If the lease agreement transfers the risk and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and depreciated over the lower of the estimated useful life and the life of the lease. The corresponding rental obligations are recorded as borrowings. The aggregate benefit of incentives, if any, is recognised as a reduction of rental expense over the lease term on a straight-line basis.

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 income statement 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. A current tax liability for the current or prior period is measured at the amount expected to be paid to the tax authorities. Where the amount of the final tax liability is uncertain or where a position is challenged by a taxation authority, the liability recognised is the most likely outcome. Where a most likely outcome cannot be determined, a weighted average basis is applied.

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 liabilities are not recognised if the temporary difference arises from the initial recognition of 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.

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. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Company is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future. The Company reviews the carrying amount of deferred tax assets at each balance sheet date and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax relating to fair value re-measurements of financial instruments accounted for at FVOCI is charged or credited directly to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

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, loans and advances to 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 benefits will be necessary to settle the obligation, and it can be reliably estimated.

Conduct provisions are made for the estimated cost of making redress payments with respect to the past sales of products, using conclusions such as the number of claims, the number of those that will be upheld, the estimated average settlement per case and other related costs. Provision is made for the anticipated cost of restructuring, including redundancy costs, when an obligation exists. An obligation exists when the Company has a detailed formal plan for restructuring a business, has raised valid expectations in those affected by the restructuring, and has started to implement the plan or announce its main features.

When a leasehold property ceases to be used in the business, 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.

Loan commitments are measured as the amount of the loss allowance (determined in accordance with IFRS 9 as described in Credit risk section of the Risk review).

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 they are remote.

Share capital

a) Share issue costs

Incremental external costs directly attributable to the issue of new shares are deducted from equity net of related income taxes.

b) Dividends

Dividends on ordinary shares are recognised in equity in the period in which the right to receive payment is established.

Accounting policies relating to comparatives - IAS 17

On 1 January 2019, the Company adopted IFRS 16, which replaced IAS 17. Having chosen to apply the modified retrospective approach, in accordance with the transition requirements of IFRS 16, comparatives were not restated. The accounting policies for the Company as lessee applied in accordance with IAS 17 for periods before the adoption of IFRS 16 are set out below:

The Company enters into operating leases for the rental of equipment or real estate. Payments made under such leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

If the lease agreement transfers the risk and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and depreciated over the lower of the estimated useful life and the life of the lease. The corresponding rental obligations are recorded as borrowings. The aggregate benefit of incentives, if any, is recognised as a reduction of rental expense over the lease term on a straight-line basis.

CRITICAL JUDGEMENTS AND ACCOUNTING ESTIMATES

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, no significant judgements have been made in the process of applying the Company's accounting policies.

2. NET INTEREST INCOME

	2019 £m	2018 £m
Interest and similar income:		
Loans and advances to Santander UK group undertakings	**1.3**	2.5
Other loans and advances	**58.3**	11.3
Total interest and similar income:	**59.6**	13.8
Interest expense and similar charges:		
Deposits by Santander UK group undertakings	**(2.9)**	(10.4)
Other deposits and borrowings	**(48.9)**	(1.6)
Total interest expense and similar charges	**(51.8)**	(12.0)
Net interest income	**7.8**	1.8

3. NET FEE AND COMMISSION INCOME

	2019 £m	2018 £m
Current account and debit card fee income	**2.0**	0.1

4. NET TRADING AND OTHER INCOME

	2019 £m	2018 £m
Net trading and funding of other items by the trading book	**4.3**	-
Net gains/(losses) on other financial assets at fair value through profit or loss	**40.6**	(1.6)
Net (losses)/gains on derivatives managed with assets/liabilities held at fair value through profit or loss	**(39.9)**	4.2
Other	**0.1**	-
	5.1	2.6

5. OPERATING EXPENSES BEFORE CREDIT IMPAIRMENT LOSSES, PROVISIONS AND CHARGES

	2019 £m	2018 £m
Staff costs:		
Wages and salaries	**4.4**	2.2
Performance-related payments	**1.1**	-
Social security costs	**0.2**	0.1
Pensions costs – defined contribution plans	**0.2**	-
Other personnel costs	**0.4**	-
	6.3	2.3
Other administration expenses	**9.7**	0.4
Depreciation, amortisation and impairment	**2.0**	-
	18.0	2.7

The Company uses staff who have employment contracts with Santander UK plc. The cost of their services is recharged by Santander UK plc to the Company. For 2018, these recharges are classified in the table above as staff costs and are included in the average number of full-time equivalent staff. In 2019 and following the completion of the Santander UK group's ring-fence structure on 1 January 2019, these recharges are now classified as other administrative expenses and are excluded from the average number of full-time equivalent staff.

The average number of full-time equivalent staff, including in respect of discontinued operations in 2018, was 131 (2018: 667).

6. AUDIT AND OTHER SERVICES

	2019 £m	2018 £m
Audit fees:		
Fees payable to the Company's auditor and its associates for the audit of the annual accounts	**0.4**	0.3
Total audit fees[1]	**0.4**	0.3
Non-audit fees:		
Audit-related assurance services	**0.1**	-
Other assurance services	**-**	-
Total non-audit fees[2]	**0.1**	-

(1) The 2019 audit fees included £0.2m (2018: £nil) which related to the prior year.

(2) Total non-audit fees comprised audit-related assurance services of £54,000 (2018: £36,000) and other assurance services of £26,000 (2018: £12,000).

7. CREDIT IMPAIRMENT LOSSES AND PROVISIONS

There were no material credit impairment losses on loans and advances to banks.

8. TAXATION

	2019 £m	2018 £m
Current tax:		
UK corporation tax on (loss)/profit on continuing operations for the year	**0.8**	0.4
Adjustments in respect of prior years	**(5.1)**	-
Total current tax	**(4.3)**	0.4
(Credit)/charge for the year	**(0.1)**	-
Adjustments in respect of prior years	**7.0**	-
Total deferred tax	**6.9**	-
Tax on (loss)/profit on continuing operations	**2.6**	0.4

The standard rate of UK corporation tax was 27% for banking entities (2018: 27%) following the introduction of an 8% surcharge to be applied to banking companies from 1 January 2016. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions. The Finance Act 2016 introduced a further reduction in the standard rate of corporation tax rate to 17% from 2020. The effects of the changes in tax rates are included in the deferred tax balances at both 31 December 2019 and 2018.

The effective tax rate for continuing operations in 2019 and 2018, based on (loss)/profit before tax, was (63.4)% (2018: 22.2%). The tax on (loss)/profit before tax differs from the theoretical amount that would arise using the basic corporation tax rate of the Company as follows:

	2019 £m	2018 £m
(Loss)/profit before tax on continuing operations	**(4.1)**	1.8
Tax calculated at a tax rate of 19% (2018: 19%)	**(0.8)**	0.3
Bank surcharge on profits	**(0.3)**	0.1
Foreign tax paid	**1.7**	-
Other disallowable items	**0.1**	-
Adjustment to prior year provisions	**1.9**	-
Tax charge on continuing operations	**2.6**	0.4

Current tax assets and liabilities

Movements in current tax assets and liabilities during the year were as follows:

	2019 £m	2018 £m
Liabilities at 1 January	**(47)**	(101)
Income statement (including discontinued operations)	**4**	(7)
Corporate income tax paid	**17**	55
Other movements	**-**	6
Liabilities at 31 December	**(26)**	(47)

Other movements include current tax amounts relating to amounts settled by intercompany group relief.

The amount of corporation income tax paid differs from the tax charge for the period as a result of the timing of payments due to the tax authorities together with the effects of movements in temporary differences and adjustments to prior period current tax provisions.

The Company proactively engages with HM Revenue & Customs to resolve tax matters relating to prior years. The accounting policy for recognising provisions for such matters are described in Note 1 to the Financial Statements. It is not expected that there will be any material movement in such provisions within the next 12 months.

The Company adopted the Code of Practice on Taxation for Banks in 2010.

Deferred tax

The table below shows the deferred tax assets and liabilities including the movement in the deferred tax account during the year. Deferred tax balances are presented in the balance sheet after offsetting assets and liabilities where the Company has the legal right to offset and intends to settle on a net basis.

	Accelerated tax depreciation £m	Other temporary differences £m	Total £m
At 1 January 2019	2	11	13
Income statement charge	(1)	(6)	(7)
At 31 December 2019	1	5	6
At 31 December 2017	2	7	9
Adoption of IFRS 9	-	5	5
At 1 January 2018	2	12	14
Charged to other comprehensive income (including discontinued operations)	-	(1)	(1)
At 31 December 2018	2	11	13

The deferred tax assets scheduled above have been recognised 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 within the Santander UK group as they reverse.

9. DISCONTINUED OPERATIONS

Following Court approval of our Ring-Fence Transfer Scheme (RFTS) on 11 and 12 June 2018, the Company was emptied of most assets and liabilities, except for a small pool of residual assets and liabilities, and became a wholly-owned direct subsidiary of Santander UK Group Holdings plc, outside the ring-fenced bank. The prohibited business of the Company, which principally included our derivatives business with financial institutions, certain corporates and our short term markets business, was either transferred to Banco Santander SA (mainly Banco Santander London Branch) or, in the case of the majority of our short term markets business, was run down. The majority of the permitted business of the Company transferred to Santander UK plc, with a small amount of the permitted business of the Company transferring to Banco Santander London Branch.

In 2018, the RFTS transfers, asset sales and the run-down of certain short-term positions met the requirements for presentation as discontinued operations. The financial performance and cash flow information relating to the discontinued operations in 2018 were as follows:

	2018 £m
Total operating income	216.9
Operating expenses before credit impairment losses, provisions and charges	(158.1)
Total operating credit impairment losses, provisions and charges	(34.0)
Profit in respect of discontinued operations before tax	24.8
Tax on profit in respect of discontinued operations	(7.0)
Profit in respect of discontinued operations after tax	17.8

There were no gains or losses recognised on the measurement to fair value less costs to sell or on the disposal of the asset groups constituting the discontinued operations.

In 2018 other comprehensive income in respect of discontinued operations was as follows:

	2018 £m
Fair value reserves	(1.0)
Currency translation reserves	0.4
Retained earnings	3.8
Other comprehensive income, net of tax, in respect of discontinued operations	3.2

In 2018, the net cash flows attributable to the operating activities, investing activities and financing activities in respect of discontinued operations were £14,958m outflow, £35m inflow and £3,546m outflow respectively.

There were no discontinued operations in 2019 as all related assets and liabilities had been sold by the end of 2018.

10. DIVIDENDS ON ORDINARY SHARES

Dividends on ordinary shares declared and paid during the year were as follows:

	2019 Pence per share	2018 Pence per share	**2019 £m**	2018 £m
In respect of current year – first interim	**4.00**	240.00	**10**	600
– second interim	**-**	1,178.41	**-**	2,946
	4.00	1,418.41	**10**	3,546

The dividends that were made in 2018 related to the ring-fencing transfers to Banco Santander London Branch and Santander UK plc.

11. DERIVATIVE FINANCIAL INSTRUMENTS

a) Use of derivatives

The Company undertook derivative activities primarily to provide customers with risk management solutions, and to manage and hedge its own risks. The derivative balances are being run down and/or managed for value.

The Company's derivative activities do not give rise to significant open positions in portfolios of derivatives. Any residual position is managed to ensure that it remains within acceptable risk levels, with matching deals being used to achieve this where necessary. When entering into derivative transactions, the Company employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

b) Analysis of derivative financial instruments

The contract/notional amounts of derivatives in the tables below indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent actual exposures.

	2019			2018		
		Fair value			Fair value	
	Notional amount £m	**Assets £m**	**Liabilities £m**	Notional amount £m	Assets £m	Liabilities £m
Derivatives held for trading:						
Exchange rate contracts	**147**	**1**	**-**	335	1	-
Interest rate contracts	**481**	**36**	**251**	484	35	222
	628	**37**	**251**	819	36	222
Netting		**-**	**-**		-	-
Total derivatives financial instruments	**628**	**37**	**251**	819	36	222

Derivative assets and liabilities are reported on a gross basis on the balance sheet unless there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously. For more information on offsetting, see Note 26.

Net gains or losses arising from fair value hedges

The table below analyses the net gains or losses from fair value hedges that were held during the year:

	2019 £m	2018 £m
Fair value hedging:		
Gains on hedging instruments	-	33
Losses on hedged items attributable to hedged risks	-	(31)
Fair value hedging ineffectiveness	-	2

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

	2019 £m	2018 £m
Loans and advances to customers	**448**	414
Debt securities	**5**	12
	453	426

At 31 December 2019 and 2018, all other financial assets at fair value through profit or loss were designated as such.

Loans and advances to customers principally represented other loans, being deferred consideration that is managed, and has its performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about it is provided on that basis to management. Since 2009, the Company's policy has been not to designate similar new loans at fair value through profit or loss.

13. LOANS AND ADVANCES TO CUSTOMERS

	2019 £m	2018 £m
Loans and advances to customers	**352**	**453**
Credit impairment loss allowances on loans and advances to customers	-	-
Net loans and advances to customers	**352**	**453**

14. INTERESTS IN OTHER ENTITIES

The movement in interests in subsidiaries was as follows:

	Cost £m	Impairment £m	Net book value £m
At 1 January 2018	57	-	57
Disposal	(57)	-	(57)
At 31 December 2018, 1 January 2019 and 31 December 2019	-	-	-

The Company is incorporated and domiciled in the UK and has no subsidiaries, associates or joint ventures. The Company has branch offices in Jersey and the Isle of Man, following the transfer of the businesses of the Crown Dependency branches of Santander UK to the Company on 17 December 2018.

During 2018, as part of the Santander UK group's ring-fencing plans, the Company sold 100% of the share capital of Santander Equity Investments Limited to Santander UK Group Holdings plc, for a consideration of £40m, which was equivalent to the book value of the associated assets and liabilities. Prior to this, Santander Equity Investments Limited acquired 100% of the share capital of a number of subsidiaries of Santander UK plc, with aggregate net assets of £9m at the acquisition date. In addition, Santander Equity Investments Limited acquired 100% of the share capital of a number of subsidiaries of the Company, with net assets of less than £1m at the acquisition date.

15. INTANGIBLE ASSETS

	Cost £m	Accumulated amortisation /impairment £m	Net book value £m
At 1 January 2019	3	-	3
Charge	-	(1)	(1)
At 31 December 2019	3	(1)	2
At 1 January 2018	62	(16)	46
Additions	4	-	4
Disposals	(63)	22	(41)
Charge	-	(6)	(6)
At 31 December 2018	3	-	3

16. DEPOSITS BY CUSTOMERS

	2019 £m	2018 £m
Current and demand accounts	1,195	1,044
Savings accounts	3,484	3,063
Time deposits	1,442	718
	6,121	4,825

17. DEPOSITS BY BANKS

	2019 £m	2018 £m
Amounts due to Santander UK subsidiaries	2	4
Amounts due to Banco Santander SA – other	-	8
Other deposits	-	594
	2	606

18. PROVISIONS

	2019 £m	2018 £m
At 1 January	**6**	18
Additional provisions	1	12
Utilisation	(2)	(24)
At 31 December	**5**	6
To be settled:		
- Within 12 months	5	6
	5	6

Isle of Man and Jersey Bank Depositor Compensation Schemes (DCSs)

The Isle of Man branch of the Company is a participant in the Isle of Man Depositors' Compensation Scheme and the Jersey branch of the Company is a participant in the Jersey Bank Depositors Compensation Scheme. These DCSs are independent statutory compensation funds for customers of Isle of Man and Jersey banks and pay compensation if a bank is unable to pay claims against it.

The DCSs are funded, if and when required, by contributions from covered banks in the Isle of Man or Jersey that are participants in the DCSs. The cost to the Company in respect of the DCSs for 2019 was £nil (2018: £nil).

Financial Services Compensation Scheme (FSCS)

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). 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. The remaining debt due to the FSCS, that related to the failure of Bradford & Bingley plc, has now been repaid. This has enabled the FSCS to make a corresponding repayment of the balance of its loan to HM Treasury. The costs to the Company in respect of the FSCS for 2019 were £nil (2018: £nil).

UK Bank Levy

In addition to changes in corporation tax rates, Finance (No.2) Act 2015 reduced the UK Bank Levy rate from 0.21% via subsequent annual reductions to 0.10% from 1 January 2021. As a result, a rate of 0.15% applies for 2019 (2018: 0.16%). The cost of the UK Bank Levy for 2019 was £1m (2018: £1m). The Company paid £nil in 2019 (2018: £34m) and provided for a liability of £2m at 31 December 2019 (2018: £1m).

Other

Other provisions comprised of £3m (2018: £5m) in respect of vacant property and restructuring charges relating to the US branch of the Company which closed in 2018.

19. CONTINGENT LIABILITIES AND COMMITMENTS

	2019 £m	2018 £m
Guarantees given on behalf of Santander UK plc, fellow subsidiaries and subsidiaries	-	248,751
Formal standby facilities, credit lines and other commitments with original term to maturity of:		
– One year or less	8	-
– Later than one year	5	5
	13	248,756

At 31 December 2019, the Company had no significant credit impairment loss provisions relating to guarantees given to third parties and undrawn loan commitments. Where the items set out below can be reliably estimated, they are disclosed in the table above.

Guarantees given on behalf of Santander UK plc

The Company had previously given a full and unconditional guarantee in respect of certain unsubordinated liabilities of Santander UK plc (excluding debt securities) incurred before 31 December 2018 under a deed poll guarantee entered into on 11 May 2017. Via this guarantee, the Company had previously also indirectly guaranteed the obligations of Cater Allen Limited incurred prior to 31 December 2018. As part of our ring-fencing plans this guarantee was terminated and was of no further force and effect such that, with effect from 1 January 2019, the Company was released and discharged from all related present and future obligations and liabilities.

Capital Support Deed

From 1 January 2019, as a result of ring-fencing, Santander UK Group Holdings plc, SFS and Santander Equity Investments Limited entered into a capital support deed dated 13 November 2018 (the NRFB Capital Support Deed). The parties to the NRFB Capital Support Deed are permitted by the PRA to form a core UK group as defined in the PRA Rulebook, a permission which will expire on 31 December 2021. Exposures of each of the regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the NRFB Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties breached or was at risk of breaching its capital resources requirements or risk concentrations requirements.

Prior to 1 January 2019, Santander UK plc, SFS and Cater Allen Limited, which are the PRA-regulated entities within the Santander UK group, were party to a capital support deed dated 23 December 2015 (the Capital Support Deed 2015) with Santander UK Group Holdings plc and certain other non-regulated subsidiaries of Santander UK plc. The core UK group permission as supported by the Capital Support Deed 2015 expired on 31 December 2018.

Other than the change of the entities in scope, the purpose of the NRFB Capital Support Deed is the same as the previous Capital Support Deed 2015.

Liquidity support arrangements

From 1 January 2019, following the implementation of ring-fencing, we monitor and manage liquidity risk for the Santander UK plc group and SFS separately. Under this model, SFS meets regulatory requirements for the purpose of managing liquidity risk on an individual basis.

Prior to 1 January 2019, Santander UK plc, SFS and Cater Allen Limited formed the Domestic Liquidity Sub-group (the DoLSub), which allowed those entities to collectively meet regulatory liquidity requirements.

Guarantees given to third parties

Guarantees given to third parties consist primarily of letters of credit, bonds and guarantees granted as part of normal product facilities which are offered to customers.

Formal standby facilities, credit lines and other commitments

Standby facilities, credit lines and other commitments are also granted as part of normal product facilities which are offered to customers. Corporate facilities can comprise standby and revolving facilities which are subject to ongoing compliance with covenants and the provision of agreed security. Failure to comply with these terms can result in the withdrawal of the unutilised facility headroom.

Isle of Man and Jersey DCSs and FSCS

As described in Note 18, the Company participates in the Isle of Man and Jersey DCSs, and the UK's national resolution scheme, the FSCS, and is thus subject to levies to fund the DCSs and the FSCS. In the event that the DCSs or the FSCS significantly increases the levies to be paid by firms the associated costs to the Company would rise.

Other legal actions and regulatory matters

The Company engages in discussion, and co-operates, with the FCA, PRA, CMA and other regulators and government agencies in various jurisdictions in their supervision and review of the Company including reviews exercised under statutory powers, regarding its interaction with past and present customers, both as part of general thematic work and in relation to specific products, services and activities. During the ordinary course of business, the Company is also subject to complaints and threatened legal proceedings brought by or on behalf of current or former employees, customers, investors or other third parties, in addition to legal and regulatory reviews, challenges and tax or enforcement investigations or proceedings in various jurisdictions. All such matters are assessed periodically to determine the likelihood of the Company incurring a liability.

In those instances where it is concluded that it is not yet probable that a quantifiable payment will be made, for example because the facts are unclear or further time is required to fully assess the merits of the case or to reasonably quantify the expected payment, no provision is made. In addition, where it is not currently practicable to estimate the possible financial effect of these matters, no provision is made. A provision established with respect to interest rate derivatives is held by Santander UK plc.

German dividend tax arbitrage transactions

In June 2018 the Cologne Criminal Prosecution Office and the German Federal Tax Office commenced an investigation in relation to the historical involvement of Santander UK plc, Santander Financial Services plc and Cater Allen International Limited (all subsidiaries of Santander UK Group Holdings plc) in German dividend tax arbitrage transactions (known as cum/ex transactions). These transactions allegedly exploited a feature of a specific German settlement mechanism through short-selling and complex derivative structuring which resulted in the German government either refunding withholding tax where such tax had not been paid or refunding it more than once. The German authorities are investigating numerous institutions and individuals in connection with alleged transactions and practices which may be found to be illegal under German law.

During 2019 we have continued to cooperate with the German authorities and, with the assistance of external experts, to progress an internal investigation into the matters in question. From the Company's perspective the investigation is focused principally on the period 2009-2011 and remains on-going. There remain factual issues to be resolved which may have legal consequences including potentially material financial penalties. These issues create uncertainties which mean that it is difficult to predict the resolution of the matter including timing or the significance of the possible impact. However, any potential losses, claims or expenses suffered or incurred by the Company in respect of these matters have been fully indemnified by Santander UK plc, as part of the Ring-Fence Transfer Scheme.

Taxation

The Company engages in discussion, and co-operates, with HM Revenue & Customs in their oversight of the Company's tax matters. The Company adopted the UK's Code of Practice on Taxation for Banks in 2010.

Other

As part of the sale of subsidiaries, businesses and other entities, and as is normal in such circumstances, the Company has given warranties and indemnities to the purchasers.

Other off-balance sheet commitments

The Company has commitments to lend at fixed interest rates which expose it to interest rate risk. For further information, see the Risk review.

Operating lease commitments

The table below shows the rental commitments under non-cancellable operating leases at 31 December 2018. Following the application of IFRS 16 at 1 January 2019, the Company now recognises a lease liability on the balance sheet to represent its obligation to make lease payments. For more information, including a reconciliation of operating lease commitments at 31 December 2018 to lease liabilities recognised at 1 January 2019, see Note 1.

Rental commitments under non-cancellable operating leases	2018 £m
Not later than one year	1
Later than one year and not later than five years	-
	1

During 2018, rental expense amounted to £0.4m in respect of minimum rentals. There was no contingent rent expense included in this rental expense.

20. SHARE CAPITAL

Issued and fully paid share capital	Ordinary shares of £1 each No.	Ordinary shares of £1 each £m	Tracker shares of £1 each No.	Tracker shares of £1 each £m	B Tracker shares of £1 each No.	B Tracker shares of £1 each £m	Total £m
At 1 January 2018, 31 December 2018, 1 January 2019 and 31 December 2019	**249,998,000**	**250**	**1,000**	**-**	**1,000**	**-**	**250**

In 2008, the Company issued 1,000 Tracker Shares of £1 each at par to its parent company for £1,000. The Tracker Shares entitled the holders to dividends related to certain cash flows that were received by the Company in the period up to 7 April 2010. The Tracker Shares are not redeemable and do not confer any rights to participate in the assets of the Company on winding up (beyond the amount subscribed). The Tracker Shares carry no voting rights.

In 2010, the Company issued 1,000 B Tracker Shares of £1 each at par to its parent company for £1,000. The B Tracker Shares entitled the holders to dividends related to certain cash flows that were received by the Company in the year up to 31 December 2011. The B Tracker Shares are not redeemable and do not confer any rights to participate in the assets of the Company on a winding up (beyond the amount subscribed). The B Tracker Shares carry no voting rights.

21. CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

The table below shows the changes in liabilities arising from financing activities:

	2019		2018		
	Balance sheet item		Balance sheet item		
	Dividends paid £m	Total £m	Debt securities in issue £m	Dividends paid £m	Total £m
At 1 January	-	-	6,043	-	6,043
Cash flows from financing activities	(10)	(10)	-	(3,546)	(3,546)
Cash flows from operating activities	-	-	(6,047)	-	(6,047)
Non-cash changes:					
– Unrealised foreign exchange	-	-	(1)	-	(1)
– Other changes	10	10	5	3,546	3,551
At 31 December	-	-	-	-	-

22. ASSETS CHARGED AS SECURITY FOR LIABILITIES AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS

The following transactions are conducted under terms that are usual and customary to collateralised transactions, including, where relevant, standard securities lending and repurchase agreements.

a) Assets charged as security for liabilities

The financial assets below are analysed between those assets accounted for on-balance sheet and off-balance sheet in accordance with IFRS.

	2019 £m	2018 £m
On-balance sheet:		
Loans and advances to customers	26	1,227
Loans and advances to banks	287	184
Total on-balance sheet	313	1,411
Total off-balance sheet	-	-

The Company provides assets as collateral in the following areas of the business.

Stock borrowing and lending agreements

Asset balances under stock borrowing and lending agreements represent stock lent by the Company. These balances amounted to £75m at 31 December 2019 (2018: £1,196m) and are offset by contractual commitments to return stock borrowed or cash received.

Derivatives business

In addition to the arrangements described above, collateral is also provided in the normal course of derivative business to counterparties. At 31 December 2019, £238m (2018: £215m) of such collateral in the form of cash had been provided by the Company and is included in the table above.

b) Collateral accepted as security for assets

The collateral held as security for assets below are analysed between those liabilities accounted for on the balance sheet and off-balance sheet in accordance with IFRS.

	2019 £m	2018 £m
Total on-balance sheet	-	-
Total off-balance sheet	**342**	237

Stock borrowing and lending agreements

Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations totalled £342m at 31 December 2019 (2018: £237m) and are offset by a contractual right to receive stock lent by the Company.

Lending activities

In addition to the above collateral held as security for assets, the Company may obtain a charge over a customer's property in connection with its lending activities. Details of our approach to credit risk mitigation, including collateral, are set out in the 'Credit risk' section of the Risk review.

23. TRANSACTIONS WITH DIRECTORS AND OTHER KEY MANAGEMENT PERSONNEL

a) Remuneration of Directors and Other Key Management Personnel

The remuneration of the Directors and Other Key Management Personnel is set out in aggregate below.

Directors' remuneration	2019 £	2018 £
Salaries and fees	**145,636**	989,232
Performance-related payments	**84,550**	1,096,114
Other fixed remuneration (pension and other allowances & non-cash pension benefits)	**37,243**	219,666
Total remuneration[1]	**267,429**	2,305,012

Directors' and Other Key Management Personnel compensation	2019 £	2018 £
Short-term employee benefits	**1,312,213**	2,093,245
Post-employment benefits	**84,306**	211,767
Total compensation[1]	**1,396,519**	2,305,012

(1) In addition to the remuneration in the table above, termination benefits of £31,613 were paid in 2018. No such payments were made to directors in 2019.

Of the Directors that served during the year, seven (2018: seven) were remunerated in relation to their services as Directors of this Company and the amounts included above are based on an estimated time allocation basis. The aggregate emoluments above exclude emoluments received by Directors in respect of their primary duties as Directors or officers of Banco Santander SA and Santander UK plc. Salaries and performance-related payments comprise payments to seven (2018: seven) Directors serving during the year.

The Company ensures that it is compliant with the mandatory deferral requirements of the PRA's Remuneration Rules and Remuneration Code for staff who meet the relevant criteria (Code Staff) and the amount of bonus to be deferred is based on the total variable pay received. The PRA Remuneration Rules and Remuneration Code prescribes that at least 40% of variable pay must be made over a period of at least three, five or seven years and, for staff earning more than £500,000 in variable remuneration, at least 60% of a bonus must be deferred over the same period.

All UK bonus awards in 2019 and 2018 are subject to deferral principles that have been set at Banco Santander group level. Such principles, as applied to the Company, are subject to ratification by the Santander UK Group Holdings Board Remuneration Committee and can be overridden by UK national requirements to meet any criteria set by the PRA or other regulator/law. However, the general deferral principles are as follows:

- Any deferred amount will be issued over a three, five or seven year period as an award comprising 50% in shares and 50% in cash
- Deferrals are subject to continued employment with the Banco Santander group in the UK and on the condition that none of the prescribed circumstances of forfeiture occur.

In 2019, the remuneration, excluding pension contributions and compensation for loss of office, of the highest paid Director was £63,074 (2018: £1,506,905) of which £32,918 (2018: £810,000) was performance-related. In 2019 and 2018 no amounts were paid with respect to a defined contribution scheme on behalf of the highest paid Director.

At 31 December 2019 and 2018, there was no accrued pension benefit for the highest paid Director and there was no lump sum accrued by the highest paid Director.

b) Retirement benefits

No Director will be receiving benefits under a defined benefit scheme (2018: none) and five Directors (2018: two) will be receiving benefits under a defined contribution scheme.

c) Transactions with Directors, Other Key Management Personnel and each of their connected persons

Directors, Other Key Management Personnel who served during the year and their connected persons have undertaken the following transactions with the Company in the ordinary course of business.

	2019		2018	
	No.	£	No.	£
Deposit, bank and instant access accounts and investments				
At 1 January	**6**	**-**	7	-
Net movements	**4**	**104,524**	(1)	-
At 31 December	**10**	**104,524**	6	-

In 2019 and 2018, no Director held any interest in, nor exercised or was granted any rights to subscribe for, the shares of the Company. In addition, in 2019 and 2018, no Directors exercised share options over shares in Banco Santander SA, the ultimate parent company of the Company.

Amounts deposited by Directors, Other Key Management Personnel and their connected persons earn interest at the same rates as those offered to the market or on the same terms and conditions applicable to other employees in the Company. Deposits, bank and instant access accounts and investments are entered into by Directors, Other Key Management Personnel and their connected persons on normal market terms and conditions, or on the same terms and conditions as applicable to other employees in the Company.

In 2019, no loans were made to any of the Directors or Key Management Persons (2018: none).

In 2019 and 2018, there were no other transactions, arrangements or agreements with the Company in which Directors, Other Key Management Personnel or their connected persons had a material interest. In addition, in 2019 and 2018, no Director had a material interest in any contract of significance with the Company other than a service contract.

24. RELATED PARTY DISCLOSURES

a) Parent undertaking and controlling party

The Company's immediate parent is Santander UK Group Holdings plc, a company incorporated in England and Wales. The ultimate parent and controlling party is Banco Santander SA, a company incorporated in Spain. The smallest and largest groups into which the Company's results are included are the group accounts of Santander UK Group Holdings plc and Banco Santander SA, respectively, copies of which may be obtained from Shareholder Relations, 2 Triton Square, Regent's Place, London NW1 3AN, on the corporate website (www.aboutsantander.co.uk) or on the Banco Santander corporate website (www.santander.com).

b) Transactions with related parties

Transactions with related parties during the year and balances outstanding at the year-end:

	Interest, fees and other income received		Interest, fees and other expense paid		Amounts owed by related parties		Amounts owed to related parties	
	2019	2018	**2019**	2018	**2019**	2018	**2019**	2018
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
Ultimate parent company	**(3)**	(32)	**40**	452	**248**	226	**(251)**	(229)
Immediate parent[1]	**-**	-	**-**	-	**-**	-	**-**	-
Fellow subsidiaries	**(3)**	(113)	**10**	466	**1**	150	**(4)**	(11)
	(6)	(145)	**50**	918	**249**	376	**(255)**	(240)

(1) In 2018, the immediate parent of the Company changed following its sale by Santander UK plc to Santander UK Group Holdings plc.

Further information on balances due from/(to) other Banco Santander companies is set out in the section 'Balances with other Banco Santander companies' in the Risk review. In addition, details of the Capital Support Deeds and the DoLSub liquidity facility, as well as guarantees previously given on behalf of Santander UK plc and fellow subsidiaries, are described in Note 19.

The above transactions were made in the ordinary course of business, except those carried out with Banco Santander SA and Santander UK plc as part of our ring-fencing plans, on substantially the same terms as for comparable transactions with third party counterparties, and within limits acceptable to the PRA. Such transactions do not involve more than the normal risk of collectability or present any unfavourable features.

In addition, in 2017 Santander UK plc, Santander Financial Services plc, Santander UK Group Holdings plc and Banco Santander SA entered into a ring-fencing transfer scheme which formalised the business transfers required to implement the planned ring-fenced structure. In 2018, the Company became a wholly owned direct subsidiary of Santander UK Group Holdings plc, outside the ring-fenced bank, and was emptied of most assets and liabilities, except for a small pool of residual assets. The prohibited business of the Company, which principally included the Santander UK group's derivatives business with financial institutions, certain corporates and the Santander UK group's short term markets business, was either transferred to Banco Santander London branch or, in the case of the majority of our short-term markets business, was run down. The majority of the permitted business of the Company transferred to Santander UK plc, with a small amount of the permitted business of the Company transferring to Banco Santander London Branch.

25. 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.

The Company manages certain groups of financial assets and liabilities on the basis of its net exposure to either market risks or credit risk. As a result it has elected to use the exception under IFRS 13 which permits the fair value measurement of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position for a particular risk exposure or paid to transfer a net short position for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions.

(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.

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

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.

c) Valuation techniques

The main valuation techniques employed in internal models to measure the fair value of the financial instruments at 31 December 2019 and 2018 are set out below. In substantially all cases, the principal inputs into these models are derived from observable market data. The Company did not make any material changes to the valuation techniques and internal models it used in 2019 and 2018.

A In the valuation of financial instruments requiring static hedging (for example interest rate, currency derivatives and property derivatives) and in the valuation of loans and advances and deposits, the 'present value' method is used. Expected future cash flows are discounted using the interest rate curves of the applicable currencies or forward house price index levels, as well as credit spreads. The interest rate curves are generally observable market data and reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cash flows and maturities of the instruments. The forward house price index levels are generally observable market data.

B 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. In limited circumstances, other inputs may be used in these models that are based on unobservable market data, such as the Halifax's UK HPI volatility, HPI forward growth, HPI spot rate, mortality, mean reversion and contingent litigation risk.

C In the valuation of financial instruments exposed to interest rate risk that require either static or dynamic hedging (such as interest rate futures, caps and floors, and options), the present value method (futures), Black's model (caps/floors) and the Hull/White and Markov functional models (Bermudan options) are used. These types of models are widely accepted in the financial services industry. The significant inputs used in these models are observable market data, including appropriate interest rate curves, volatilities, correlations and exchange rates. In limited circumstances, other inputs may be used in these models that are based on unobservable market data, such as HPI volatility, HPI forward growth, HPI spot rate, and mortality.

D In the valuation of linear instruments such as credit risk and fixed-income derivatives, credit risk is measured using dynamic models similar to those used in the measurement of interest rate risk. In the case of non-linear instruments, if the portfolio is exposed to credit risk such as credit derivatives, the probability of default is determined using the credit default spread market. The main inputs used to determine the underlying cost of credit of credit derivatives are quoted credit risk premiums and the correlation between the quoted credit derivatives of various issuers.

The fair values of the financial instruments arising from the Company's internal models take into account, among other things, contract terms and observable market data, which include such factors as bid-offer spread, interest rates, credit risk, exchange rates, the quoted market price of equity securities, volatility and prepayments. In all cases, when it is not possible to derive a valuation for a particular feature of an instrument, management uses judgement to determine the fair value of the particular feature. In exercising this judgement, a variety of tools are used including proxy observable data, historical data and extrapolation techniques. Extrapolation techniques take into account behavioural characteristics of equity markets that have been observed over time, and for which there is a strong case to support an expectation of a continuing trend in the future. Estimates are calibrated to observable market prices when they become available.

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.

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 2019 and 2018, 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. Cash and balances at central banks which consist of demand deposits with the Bank of England. There were no financial instruments carried at amortised cost whose fair values would be classified in Level 1.

	2019				2018			
	Fair value				Fair value			
	Level 2 £m	Level 3 £m	Total £m	Carrying value £m	Level 2 £m	Level 3 £m	Total £m	Carrying value £m
Assets								
Loans and advances to customers	-	352	352	352	-	453	453	453
Loans and advances to banks	233	424	657	662	271	409	680	718
	233	776	1,009	1,014	271	862	1,133	1,171
Liabilities								
Deposits by customers	1	6,120	6,121	6,121	4,825	-	4,825	4,825
Deposits by banks	-	2	2	2	594	12	606	606
	1	6,122	6,123	6,123	5,419	12	5,431	5,431

Valuation methodology for financial instruments carried at amortised cost

The valuation approach to specific categories of financial instruments is described below.

Assets:

Loans and advances to customers

The approach to estimating the fair value of loans and advances to customers has been determined by discounting expected cash flows to reflect either current market rates or credit spreads relevant to the specific industry of the borrower. The determination of their fair values is an area of considerable estimation and uncertainty as there is no observable market and values are significantly affected by customer behaviour.

The fair value of the mortgage portfolio is calculated by discounting contractual cash flows by different spreads for each LTV band, after taking account of expected customer prepayment rates. The spread is based on new business interest rates derived from competitor market information.

Loans and advances to banks

These comprise secured loans, short-term placements with banks including collateral and unsettled financial transactions. The secured loans have been valued based on a discounted spread for the term of the loans using valuation technique A as described above. 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:

Deposits by customers

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. Certain of the deposit liabilities are at a fixed rate until maturity. The deficit/surplus of fair value over carrying value of these liabilities has been estimated by reference to the market rates available at the balance sheet date for similar deposit liabilities of similar maturities. The fair value of such deposit liabilities has been estimated using valuation technique A as described above.

Deposits by banks

The fair value of deposits by banks, including repos, has been estimated using valuation technique A as described above, discounted at the appropriate credit spread.

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 2019 and 2018, analysed by their levels in the fair value hierarchy – Level 1, Level 2 and Level 3.

					2019				2018	
		Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Valuation technique
Assets										
Derivative financial instruments	Exchange rate contracts	-	1	-	1	-	1	-	1	A
	Interest rate contracts	-	36	-	36	-	35	-	35	A & C
		-	37	-	37	-	36	-	36	
Other financial assets at FVTPL	Loans and advances to customers	-	448	-	448	-	414	-	414	A
	Debt securities	2	3	-	5	5	7	-	12	A & B
		2	451	-	453	5	421	-	426	
Total assets at fair value		2	488	-	490	5	457	-	462	
Liabilities										
Derivative financial instruments	Interest rate contracts	-	251	-	251	-	222	-	222	A & C
Total liabilities at fair value		-	251	-	251	-	222	-	222	

Transfers between levels of the fair value hierarchy

Transfers between levels of the fair value hierarchy are reported regularly throughout the year. In 2019, there were no (2018: none) transfers of financial instruments between Levels 1 and 2. In 2019, there were no (2018: none) transfers of financial instruments between Levels 2 and 3.

g) Fair value adjustments

The internal models incorporate assumptions that the Company believes would be made by a market participant to establish fair value. Fair value adjustments are adopted when the Company considers that there are additional factors that would be considered by a market participant that are not incorporated in the valuation model.

The Company classifies fair value adjustments as either 'risk-related' or 'model-related'. The fair value adjustments form part of the portfolio fair value and are included in the balance sheet values of the product types to which they have been applied. The magnitude and types of fair value adjustment are listed in the following table:

	2019 £m	2018 £m
Risk-related:		
- Bid-offer and trade specific adjustments	-	5
- Uncertainty	20	19
	20	24

Risk-related adjustments

Risk-related adjustments are driven, in part, by the magnitude of the Company's market or credit risk exposure, and by external market factors, such as the size of market spreads.

(i) Bid-offer and trade specific adjustments

Portfolios are marked at bid or offer, as appropriate. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the cost that would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position. For debt securities, the bid-offer spread is based on a consensus market price at an individual security level. For other products, the major risk types are identified. For each risk type, the net portfolio risks are first classified into buckets, and then a bid-offer spread is applied to each risk bucket based upon the market bid-offer spread for the relevant hedging instrument.

(ii) Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, a range of possible values exists that the financial instrument or market parameter may assume, and an adjustment may be needed to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

Model-related adjustments

Models used for portfolio valuation purposes, may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the core revaluation models and a model limitation adjustment is no longer needed.

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

At 31 December 2019 and 31 December 2018 there were no financial instruments classified as Level 3. The following table sets out the movements in Level 3 financial instruments in 2018:

	Assets			Liabilities	
	Derivatives £m	Other financial assets at FVTPL £m	Total £m	Derivatives £m	Total £m
At 31 December 2017	63	64	127	(58)	(58)
Adoption of IFRS 9	-	55	55	-	-
At 1 January 2018	63	119	182	(58)	(58)
Total gains/(losses) recognised in profit or loss:					
– Fair value movements	14	-	14	3	3
– Foreign exchange and other movements	(5)	-	(5)	5	5
Sales	-	(119)	(119)	50	50
Settlements	(72)	-	(72)	-	-
At 31 December 2018	-	-	-	-	-
Gains recognised in profit or loss relating to assets and liabilities held at the end of the year	9	-	9	8	8

i) Maturities of financial liabilities and off-balance sheet commitments

The table below analyses the maturities of the undiscounted cash flows relating to financial liabilities and off-balance sheet commitments of the Company based on the remaining period to the contractual maturity date at the balance sheet date. Deposits by customers largely consist of retail deposits. This table is not intended to show the liquidity of the Company.

2019	On demand £m	Not later than 3 months £m	Later than 3 months and not later than 1 year £m	Later than 1 year and not later than 5 years £m	Later than 5 years £m	Total £m
Financial liabilities						
Derivative financial instruments	-	-	1	3	264	268
Deposits by customers	1,984	1,387	2,513	237	-	6,121
Deposits by banks	-	2	-	-	-	2
Total financial liabilities	1,984	1,389	2,514	240	264	6,391
Off-balance sheet commitments given	-	-	8	5	-	13
2018						
Financial liabilities						
Derivative financial instruments	-	-	-	2	242	244
Deposits by customers	1,580	1,224	1,880	141	-	4,825
Deposits by banks	594	12	-	-	-	606
Total financial liabilities	2,174	1,236	1,880	143	242	5,675
Off-balance sheet commitments given	-	-	-	5	-	5

(1) Comprises the derivative liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows.

26. OFFSETTING FINANCIAL ASSETS AND LIABILITIES

Financial assets and financial liabilities are reported on a net basis on the balance sheet only if there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The following tables show the impact of netting arrangements on:

- All financial assets and liabilities that are reported net on the balance sheet
- All derivative financial instruments and repurchase agreements and other similar secured lending and borrowing agreements that are subject to enforceable master netting arrangements or similar agreements, but do not qualify for balance sheet netting.

The table identifies the amounts that have been offset in the balance sheet and also those amounts that are covered by enforceable netting arrangements (offsetting arrangements and financial collateral) but do not qualify for netting under the requirements described above.

For derivative contracts, the 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting agreements, such as the ISDA Master Agreement or derivative exchange or clearing counterparty agreements, whereby all outstanding transactions with the same counterparty can be offset and close-out netting applied across all outstanding transaction covered by the agreements if an event of default or other predetermined events occur. Financial collateral refers to cash and non-cash collateral obtained, typically daily or weekly, to cover the net exposure between counterparties by enabling the collateral to be realised in an event of default or if other predetermined events occur.

The Company engages in a variety of counterparty credit mitigation strategies in addition to netting and collateral arrangements. Therefore, the net amounts presented in the tables below do not purport to represent the Company's actual credit exposure.

	Amounts subject to enforceable netting arrangements							
	Effects of offsetting on-balance sheet			Related amounts not offset				
2019	Gross amounts £m	Amounts offset £m	Net amounts on the balance sheet £m	Financial instruments £m	Financial collateral[1] £m	Net amount £m	Assets not subject to enforceable netting arrangements[2] £m	Balance sheet total[3] £m
Assets								
Derivative financial instruments	37	-	37	(36)	-	1	-	37
Loans and advances to customers and banks[4]	-	-	-	-	-	-	1,014	1,014
Total assets	37	-	37	(36)	-	1	1,014	1,051
Liabilities								
Derivative financial instruments	251	-	251	(36)	(210)	5	-	251
Deposits by customers and banks[4]	-	-	-	-	-	-	6,123	6,123
Total liabilities	251	-	251	(36)	(210)	5	6,123	6,374
2018								
Assets								
Derivative financial instruments	36	-	36	(34)	-	2	-	36
Loans and advances to customers and banks[4]	-	-	-	-	-	-	1,171	1,171
Total assets	36	-	36	(34)	-	2	1,171	1,207
Liabilities								
Derivative financial instruments	216	-	216	(34)	(176)	6	6	222
Deposits by customers and banks[4]	-	-	-	-	-	-	5,431	5,431
Total liabilities	216	-	216	(34)	(176)	6	5,437	5,653

(1) Financial collateral is reflected at its fair value but has been limited to the net balance sheet exposure so as not to include any over-collateralisation.
(2) This column includes contractual rights of set-off that are subject to uncertainty under the laws of the relevant jurisdiction.
(3) The balance sheet total is the sum of 'Net amounts reported on the balance sheet' that are subject to enforceable netting arrangements and 'Amounts not subject to enforceable netting arrangements'.
(4) The amounts offset within loans and advances to customers/banks or deposits by customers/banks relate to intercompany balances that are subject to netting.

27. EVENTS AFTER THE BALANCE SHEET DATE

Since the balance sheet date there has been a global pandemic arising from an outbreak of respiratory illness known as COVID-19. This is causing disruption to financial markets and business activity in the UK, Isle of Man and Jersey. While it is too early to accurately estimate the financial and business impact of the COVID-19 outbreak, we expect a negative impact on our 2020 financial results.