



Bradford & Bingley plc
Annual Report & Accounts 2010

Our Mission is:

‘maximising value
for the taxpayer’

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Chairman's statement

On 1 October 2010 UK Asset Resolution Ltd ('UKAR') was established as the holding company for Northern Rock (Asset Management) plc ('NRAM') and Bradford & Bingley plc ('B&B'), bringing together the two companies under shared management and a common Board of Directors.

This is the first annual report of B&B since its combination with NRAM under the ownership of UKAR. There is no legal requirement to produce consolidated UKAR accounts this year due to the short accounting period covered so we have only produced separate accounts for NRAM and B&B, saving taxpayers' money. However, my report and the Chief Executive Officer's ('CEO') report, and a number of other sections of these accounts, cover both companies.

UKAR and its two component firms share a common Board of Directors. This is an efficient and cost effective way of working but we have to ensure that each firm operates independently as there are two distinct and separate pools of creditors. We are managing an orderly wind-down, so we have to be very careful to maintain the correct hierarchy of creditors and ensure conflicts of interest are properly managed.

In addition to myself, the Board of UKAR comprises three Non-Executive Directors from NRAM – Kent Atkinson, Sue Langley and Keith Morgan together with three Non-Executive Directors from B&B – Michael Buckley, Louise Patten and John Tattersall. There is one Executive Director, Richard Banks, our Chief Executive. Richard, assisted by a management team drawn from the two firms, has done a good job setting up UKAR. The new Board comprises strong banking, risk and operational expertise which will be essential to oversee the activities of the Company.

Bob Davies, previously a NRAM Non-Executive Director, stood down from the Board on 31 December 2010 and I thank him for his contribution to the businesses throughout the year. On 1 October 2010 Philip Remnant, who served as a Non-Executive Director of NRAM, stood down together with the Chief Executive, Gary Hoffman, and Chief Operating Officer, Andy Tate. I would like to take this opportunity to thank all three for their efforts in leading the NRAM business during the year.

UKAR has, in total, an £80bn book of residential mortgage assets and running this down will take many years. The NRAM book comprises mainly residential mortgages and has a faster run-off rate than B&B which comprises a majority of buy-to-let mortgages. Very few of our mortgages would be written on their current terms by any financial institution today. Either the loan to value or earnings multiple would be considered too high, or the pricing would be viewed as too cheap.

However, the vast majority of customers are up to date with their payments – in NRAM 87% and in B&B 91%. In terms of 3+ months arrears, B&B has made good progress during the year. This reflects tight management of collection activity and, for buy-to-let customers the advantageous borrowing rate is less than the rental yield. Customers more than 3 months in arrears including possessions fell from 5.5% to 4.1%. In NRAM, arrears increased from 4.7% to 6.6% reflecting the transfer of £10.3bn mortgages to Northern Rock plc ('NR') on 1 January 2010, the declining total book and the nature of the mortgages in the book, which have high loan to value ratios and do not have the benefit of the lower interest rates applicable to the majority of B&B buy-to-let customers.

Some of our customers have many challenges to face and the role of our customer service teams is to treat them fairly and take account of their individual circumstances. We employ around 2,400 colleagues in total of which around 1,000 are engaged in dealing with customers in arrears or facing payment difficulties.

The faster redemption rate of NRAM mortgages enabled our Government loan balances to be reduced by £1.1bn by the year end. B&B did not draw any additional borrowing from the Government. In total the two firms either directly or indirectly owe the taxpayer £48.7bn and repaying this in full is the major focus of the UKAR team.

Both firms benefited from the low cost of funding provided by the Government and this enabled profits to be achieved. Underlying profits at NRAM were £277.4m and at B&B were £200.1m. In addition, profits were generated from liability management exercises whereby debt capital instruments issued by both companies were purchased back from holders at a market value below their par value. This generated extra shareholder equity of £951m for NRAM and £566m for B&B which together with the retained profits has left both firms with high quality capital resources at the year end.

Chairman's statement (continued)

2010 was a year of progress for NRAM and B&B and, looking forward to 2011, there are some challenging targets to achieve. These include NRAM's final separation from NR which is a project involving the transfer of around 400,000 mortgage accounts and 150,000 associated unsecured loan accounts to the B&B IT platform and the integration of NRAM and B&B operations, which will provide opportunities for significant cost savings benefiting the taxpayer and creditors of both organisations.

In line with the commitment made when NRAM was first taken into public ownership, £15m was paid by NRAM to The Northern Rock Foundation in 2010. However, given our focus on repayment of our Government loans we feel that it is inappropriate for the Company to continue to make such substantial donations to a single charity. For 2011, UKAR has a modest budget that enables us to support our colleagues in carrying out charitable and volunteer work in the communities in which they live and work. In addition, we will be maintaining our focus on preventing and alleviating the causes of homelessness through continued support to both the Business Action on Homelessness programme, part of Business in the Community, and the debt advice agencies.

UKAR is a unique institution involved in a complex run-off. The team of colleagues assembled to undertake this task are seasoned and mature professionals conscious of their responsibilities to taxpayers, creditors and customers. I would like to thank everyone for their efforts in 2010 and the Board looks forward to the continued successful implementation of our strategies in 2011.

Richard Pym

Chairman

30 March 2011

Chief Executive Officer's review

Introduction

I am pleased to report that both B&B and NRAM made good progress against their business objectives and met all of the financial objectives agreed with our Shareholder for 2010. Throughout the year we worked closely with UK Financial Investments ('UKFI') and the Financial Services Authority ('FSA') in preparation for NRAM's separation from NR and the integration of NRAM and B&B into UKAR. This has gone extremely well and I thank the UKAR executive team and all our colleagues for their tremendous efforts and support throughout the year.

Business and objectives

The combination of NRAM and B&B under the UKAR holding company brings together two businesses with combined assets of £112bn. Included within this total are £80bn of residential mortgages, £1bn of commercial mortgages and £3bn of unsecured loans. The business is now operating over three main sites in the North of England with around 2,400 employees. We have a unique opportunity to deliver value to the Shareholder, the UK's taxpayers, by managing this business effectively as the assets wind-down, or are recovered.

Since bringing the UKAR companies together we have focused on developing a clear sense of direction. Objectives for the business were agreed by the Board in October 2010 with the overall aim to maximise value for the taxpayer. This will be achieved by focusing on key activities and themes based on each of the following four objectives:

- Reduce, protect and optimise the Balance Sheet;
- Integrate our operations in NRAM and B&B and minimise unit costs through continuous improvement;
- Maintain and develop excellence in debt management; and
- Create a great place to work.

These objectives will be underpinned by the need to treat customers and creditors fairly.

Customers

In total, UKAR has almost 850,000 customers, 726,000 mortgage accounts and 351,000 unsecured personal loan accounts. In the main, these loans are performing well and our operating activities are focused on providing effective and straightforward services to these customers. Given the current economic circumstances we are also dealing with a significant number of customers with difficulties meeting their repayments. We continue to work closely with those customers offering a wide range of solutions to help them manage their finances.

In 2009, arrears in both NRAM and B&B increased significantly and this rate of increase has been arrested in 2010 with the number for B&B actually falling. Whilst arrears at NRAM have continued to increase, this is at a slower rate. As at the end of 2010 there were 13,096 cases of B&B mortgages 3 or more months in arrears including possessions, a fall of 32% compared to the end of 2009. For NRAM, the equivalent figure was 25,419, up by 3%, but a much reduced rate of increase compared to the 18% experienced in 2009.

In dealing with customers in arrears, we seek to exhaust all reasonable efforts to repair and recover the loans rather than resorting to repossession proceedings, which we use only as a last resort. Unfortunately, in some cases, this is the only outcome. During 2010, UKAR made over 44,000 mortgage arrangements and account modifications to assist customers with their repayments and continue their existing mortgage.

The number of properties in possession for B&B has fallen from 962 in 2009 to 623 at the end of 2010. For NRAM the numbers of properties in possession fell from 2,061 in 2009 to 1,984 at the end of 2010.

Community

We support a number of charities and are particularly concerned to focus this support on organisations that assist people in financial difficulties.

In the North East in 2010, we have adopted Samaritans as our corporate charity and many of our colleagues have staged events to raise funds and provide practical support for this vital service. From April 2011, we will be adopting Shelter as our chosen charity. In West Yorkshire, in particular the Aire Valley, we continue to support organisations such as Business Action on Homelessness, part of Business in the Community.

Chief Executive Officer's review (continued)

Colleagues

We are extremely conscious of the huge task that lies ahead for UKAR as we fully integrate the operations of B&B and NRAM in order to minimise unit costs. We are committed to ensuring that UKAR is a great place to work, and that all our colleagues have the training and development they need to do their jobs well and to give them the confidence and skills to adapt to the changing needs of the business.

Outlook

The outlook for the UK economy remains uncertain with further contraction a possibility.

The current low level of the Bank of England base rate means that loan repayments remain affordable for many, therefore, increases in interest rates could be detrimental to the performance of both B&B and NRAM given the focus of our business on mortgage loans.

The level of loan impairments remains largely driven by the performance of the economy and in particular, the rates of unemployment and households' disposable incomes. We expect that dealing with arrears and poor performing loans will remain a significant focus of our activities during the coming year given the uncertain economic outlook.

The NRAM book in particular is continuing to prove challenging with many customers being more vulnerable to changes in environmental factors. The impact of higher taxation and increases in unemployment combined with the prospect of higher interest rates and higher inflation, is likely to mean that more customers will fall into arrears during 2011.

In these somewhat gloomy circumstances we will maintain our strong relationships with debt advisory agencies. We will continue to help our customers through short term difficulties wherever possible and assist those with more fundamental problems to make an orderly sale of their property.

Mortgage market

The attention to risk management across the sector and consequent tightening of mortgage lending conditions is likely to continue to dampen activity in the housing and mortgage markets. We expect demand to remain subdued with house prices flat at best but more likely to fall slightly in the coming year. As a result, the number of our customers that are able to find alternative mortgage providers will remain limited and we expect redemption rates to continue at the current low levels.

Conclusion

It has been an extremely challenging but rewarding year for me, both as Managing Director ('MD') of B&B and now as CEO of UKAR, NRAM and B&B. I have been impressed by the professionalism and dedication of all my colleagues at our offices in the North East, Yorkshire and London who have risen to the challenges we have faced whilst continuing to look after our customers well. In particular, I thank the Chairman, Richard Pym, the Board of Directors and my executive management team for their support to me personally and for their continued commitment to ensuring UKAR is successful.

Looking forward, I believe we have the right strategic plans and people in place to achieve our mission of maximising value for the taxpayer.

Richard Banks

Chief Executive Officer

30 March 2011

Overview of 2010

During 2010, B&B has continued to focus on its key strategic objectives and implementing its Business Plan, whilst also progressing the integration with NRAM. The Company's primary objective remains unchanged, to repay the public funding as soon as market conditions allow and protect and create value for taxpayers, whilst treating customers and creditors fairly.

In January, the European Commission ('EC') ratified our Business Plan by approving the application from the UK Government for the State aid given to B&B at the time of its nationalisation. In February, consistent with the conditions attached to the EC State aid approval, the Company announced a blanket payment deferral of coupons and principal on subordinated liabilities until completing the full repayment of the Statutory Debt.

Another condition attached to the State aid approval was the requirement to dispose of B&B's home and contents insurance business and on 9 April, contracts were exchanged for the sale of the general insurance open book. The remaining home insurance books were sold in August, September and November.

Following a review of the Balance Sheet hedging policy, a balance sheet simplification exercise was progressed from April onwards. As a result, fixed rate interest derivatives were disposed of such that the Balance Sheet was positioned to fully benefit from future interest rate rises.

In June, as part of the programme to manage the wind-down of the Balance Sheet, B&B made a tender offer to repurchase £1,150m of its issued subordinated debt instruments. An 84% acceptance of the offer was achieved, resulting in the buy-back of £971m notes and a profit before tax of £712m, further protecting the taxpayer by strengthening B&B's Shareholder equity.

The results of the independent valuation of B&B at the date of nationalisation were released on 5 July 2010. The Assessment Notice determined that no compensation was payable by HM Treasury to former shareholders and bondholders of B&B. The cost of this assessment has been charged to B&B. A revised Assessment Notice in respect of the valuation was published on 14 March 2011 and records the Independent Valuer's determination to uphold the original Assessment Notice of 5 July 2010, namely that no compensation is payable by HM Treasury to either former shareholders nor bondholders.

In July, contracts were exchanged for the sale of the former Company head office site in Bingley, with completion being on 23 July.

In August, the FSA approved our application for MIPRU regulatory status, in recognition that B&B was a provider of mortgage services rather than a bank.

During the second half of the year B&B have, along with UKFI, focused on the merger and integration of the operations of the two Government owned mortgage books in wind-down. The new holding company, UKAR, was created on 1 July and on 1 October the shares of each of NRAM and B&B were transferred into UKAR.

A second liability management exercise was launched in November, through a tender offer to repurchase a further £255m of subordinated debt. A 52% acceptance of offer was achieved, resulting in the repurchase of £131m notes, generating a further £74m profit before tax.

The statutory profit before tax for 2010 was £1,081.5m (2009: £196.0m loss). There were two items that significantly affected 2010's income positively; namely the one-off £104.3m gain on discounting deferred interest payments on subordinated liabilities and £786.0m profit on the repurchase of subordinated liabilities.

The Board believes it is appropriate to assess performance based on the underlying profit of the business, which excludes non-recurring costs, particularly those associated with the integration with NRAM, and other one-off items including the subordinated debt discounting and repurchase of subordinated liabilities.

Overview of 2010 (continued)

Also excluded are movements in fair value and hedge ineffectiveness relating to financial instruments which are expected to be held to maturity as opposed to being traded. The commentary on the results in this statement uses underlying profits and its components as the measure of performance.

Analysis of the difference between the statutory accounting measure of profit and the underlying profit of B&B is provided on page 11. Underlying profit before tax of £200.1m was £366.6m higher than 2009 (2009: £166.5m loss) mainly due to lower loan impairment losses resulting from a significant reduction in arrears and also the fact that there has been a minimal increase in new cases of suspected fraud. The number of 3+ months arrears cases reduced by 32% compared to 2009, and the size of the suspected fraud book was reduced by 36% year-on-year.

The ongoing cost : assets ratio reduced to 0.25% (2009: 0.29%) whilst the statutory cost : assets ratio reduced to 0.28% (2009: 0.29%).

Total capital resources are £798.7m lower than 2009, although equity attributable to the Shareholder is £787.4m higher. Both these movements are largely due to the buyback of subordinated liabilities that generated profits after tax of £565.9m. B&B remains well capitalised and the liability management exercise has strengthened B&B's Shareholder equity.

Key performance indicators ('KPIs')

In addition to the primary Financial Statements, we have adopted the following KPIs in managing the business performance in the context of its strategic priorities.

Strategic priorities	Financial measures	2010	2009	Commentary
Financial performance	Underlying profit/(loss) before tax £m*	200.1	(166.5)	The underlying profit of the business excludes non-recurring gains and costs, particularly costs associated with the integration of NRAM, and gains relating to discounting and repurchase of subordinated liabilities. The underlying year-on-year improvement is mainly due to reduced residential impairment provisions.
	Statutory profit/(loss) before tax £m	1,081.5	(196.0)	The year-on-year movement in statutory profit/(loss) before tax is mainly due to the repurchase of subordinated liabilities at a discounted price.
	Net interest margin % Underlying %*	1.36 1.13	1.29 1.29	Underlying margin was 0.16% lower, largely due to the reduction in fixed interest rate swaps through maturities and disposals as part of the Balance Sheet simplification exercise. This was more than reversed on a statutory basis due to the discounting of deferred interest on subordinated liabilities.
Run-down the Balance Sheet	Wholesale asset balances £bn	5.7	6.3	The reduction in wholesale assets reflects maturities, sales and reductions in the value of the assets in the investment book.
	Lending balances £bn	36.4	39.0	Lending balances reduced by 7% during the year due to £2.1bn of redemptions and £0.5bn of other movements.
	Residential mortgage redemption rate %	5.2	6.0	The slower redemption rate reflects the low interest rate environment and a lack of available alternatives for customers to move mortgages as the market has tightened.
	Total redemptions £bn	2.1	2.5	Redemptions of residential and commercial loans totalled £2.1bn. Whilst lower than 2009, redemptions were in line with our plan set at the start of the year.
	Working Capital Facility £bn	8.5	8.5	No draw-downs were made in the year from the Working Capital Facility arranged with HM Treasury. The balance of £8.5bn, excluding accrued interest, is within the £11.5bn maximum facility level currently agreed with HM Treasury.
Minimise impairment and losses	Residential arrears balance : total mortgage balance %	0.23	0.33	This represents the value of customers' missed payments as a proportion of the total balance of all mortgages. Arrears balances owing at the end of 2010 of £80.7m were 35% lower than the equivalent £124.5m at the end of 2009.
	Residential arrears over 3 months and possessions as % of the book: - by value - by number of accounts	5.52 4.09	7.58 5.54	The number of cases in arrears at the end of 2010 of 13,096 was 32% lower than the equivalent 19,159 cases as at the end of 2009 reflecting improved collections performance and a reduction in possession stock.
	Loan impairment charge £m	276.6	593.7	The reduction in the annual charge reflects the lower number of arrears cases and also a considerable reduction in the size of the provision for fraudulent loans.
	Residential impairment Provisions £m Cover%	832.1 2.28	884.1 2.26	The level of the residential impairment balance sheet provision reduced by £52m although the level of cover improved from 2.26% to 2.28% reflecting the improved arrears performance and reduction in the level of impaired assets.
Restructure and realign the business	Total costs £m Ongoing costs £m**	126.4 112.3	137.1 137.1	The reduction in ongoing costs mainly reflects the lower investment spend in 2010 and the benefits of the 2009 investments in strategic projects to right-size the business infrastructure in IT, telephony and arrears management. Disposal of the general insurance businesses also contributed to year-on-year cost reduction.
	Cost : assets ratio - statutory % - ongoing %**	0.28 0.25	0.29 0.29	The reduction to the ongoing cost assets ratio was driven by initiatives to improve efficiency through lower costs.

*Underlying results excludes certain items that are not expected to recur on an ongoing basis. An analysis of the difference between statutory and underlying profit/ (loss) is provided on page 11. An analysis of the difference between statutory and underlying net interest income is provided on page 12.

**Ongoing costs exclude certain items that are not expected to recur on an ongoing basis, an analysis of items excluded from ongoing costs is provided on page 14.

Financial review

Performance

Underlying net operating income was 12.6% lower in the year at £574.5m (2009: £657.6m), mean interest-earning assets falling by 6.5%. Underlying net interest income fell £108.8m to £503.6m (2009: £612.4m). Ongoing administrative expenses fell £24.8m, or 18.1%, to £112.3m (2009: £137.1m). Impairment on loans and advances to customers reduced by £317.1m to £276.6m (2009: £593.7m) and investment impairment was a net credit for the year of £14.5m (2009: £93.3m charge). Net realised gains less losses on investment securities of £46.9m were £55.4m higher than last year (2009: £8.5m loss).

Income Statement

For the year ended 31 December	2010 £m	2009 £m
Underlying net interest income	503.6	612.4
Underlying non interest income*	70.9	45.2
Underlying net operating income	574.5	657.6
Ongoing administrative expenses	(112.3)	(137.1)
Impairment on loans and advances to customers	(276.6)	(593.7)
Net impairment on investment securities	14.5	(93.3)
Underlying profit / (loss) before taxation	200.1	(166.5)
Unrealised fair value movements on financial instruments	(9.3)	(79.1)
Hedge ineffectiveness	3.0	44.1
Other net expenses	(14.1)	–
Gain on repurchase of subordinated liabilities	786.0	–
Discounting of subordinated liabilities	104.3	–
Gain on sale of insurance business	11.5	–
FSCS levy on retail deposits	–	(7.9)
Defined benefit pension scheme curtailment	–	13.4
Statutory profit / (loss) before taxation	1,081.5	(196.0)

*Underlying non interest income includes total fee and commission income, net realised gains less losses on investment securities and other operating income.

Net interest income

Underlying net interest income was 17.8% lower at £503.6m (2009: £612.4m).

Interest-earning assets decreased by £3.1bn to £44.6bn (2009: £47.7bn), the average level of interest-bearing funding fell to £22.7bn (2009: £27.5bn).

The yield on interest-earning assets fell 0.47% to 2.10% (2009: 2.57%), mainly reflecting a full year of Bank Base Rate at 0.50% and average 3 month LIBOR being 0.51% lower than 2009.

In 2010, the underlying average interest rate payable on interest-bearing funding was 1.90% (2009: 2.23%). The reduction in average 3 month LIBOR in 2010 flows directly through to the cost of funds with the majority of funding being priced relative to LIBOR. In addition, State guarantee fees reduced by £67.6m from £175.9m in 2009 to £108.3m in 2010, as unsecured balances matured, benefitting interest payable. However, these two factors were partly offset by lost margin on the maturity and disposal of fixed rate swaps as part of the Balance Sheet simplification exercise.

Financial review (continued)

Statutory net interest income benefited from a £104.3m discount on subordinated liabilities, a direct result of the Board's decision not to make any payments of principal or interest in respect of the Company's subordinated liabilities before it fully repays the Statutory Debt. The discount reflects the diminution in carrying value of these notes, particularly those which are not eligible for interest on the deferred coupons.

Net interest income	2010	2009
For the year ended 31 December	£m	£m
Interest receivable and similar income		
On secured advances	847.3	1,045.1
On investment securities and deposits	87.6	182.3
Underlying interest receivable and similar income	934.9	1,227.4
Interest expense and similar charges		
On other deposits including loans from HM Treasury and State guarantee fee	(276.3)	(242.7)
Other	(155.0)	(372.3)
Underlying interest expense and similar charges	(431.3)	(615.0)
Underlying net interest income	503.6	612.4
Average balances		
Interest-earning assets ('IEA')	44,589	47,706
Financed by:		
– Interest-bearing funding	22,701	27,509
– Interest-free funding	21,888	20,197
Average rates %	%	%
Gross yield on average IEA	2.10	2.57
Cost of interest-bearing funding	(1.90)	(2.23)
Interest spread	0.20	0.34
Contribution of interest-free funding	0.93	0.95
Underlying net interest margin on average IEA	1.13	1.29
Annual average Bank Base Rate	0.50	0.65
Annual average 3-month LIBOR	0.70	1.21
Annual average 3-year swap rate	1.93	2.63
Underlying net interest income	503.6	612.4
Add back: discounting of subordinated liabilities	104.3	–
Statutory net interest income	607.9	612.4
Statutory net interest margin on average IEA	1.36	1.29

In 2010 the Company has amended its presentation of interest on derivatives, impacting the allocation of amounts between interest income and expense, but not total net interest income. This change aligns the presentation with that adopted by UKAR. 2009 has been restated onto the same basis.

Financial review (continued)

Fee and commission income

Fee and commission income of £21.1m (2009: £52.6m) represents a £31.5m reduction compared to 2009, mainly due to the disposal of the Company's general insurance businesses. This was a condition of the EC's approval of the State aid application. In addition, the completion, in September 2009, of transitional services provided by B&B to Abbey, for which fees of £13.6m were received in 2009, contributed to the overall reduction.

Lending related fees reduced by £5.7m, primarily due to the reduced volume of arrears fees charged as arrears volumes have reduced this year.

Investment income reduced due to the normal ongoing maturity and attrition of investment renewal policies.

Non interest income

For the year ended 31 December	2010 £m	2009 £m
Lending related	7.3	13.0
Investment	8.6	9.6
General insurance	4.9	16.0
Other	0.3	14.0
Total fee and commission income	21.1	52.6
Net realised gains less losses on investment securities	46.9	(8.5)
Other operating income	2.9	1.1
Underlying non interest income	70.9	45.2
Unrealised fair value movements on financial instruments	(9.3)	(79.1)
Hedge ineffectiveness	3.0	44.1
Statutory non interest income	64.6	10.2

Net realised gains less losses on investment securities

Net realised gains less losses on investment securities totalled £46.9m (2009: £8.5m loss). After a year of worsening global economic conditions in 2009 impacting the prices on our structured finance investment portfolio, markets rallied early in 2010. The opportunity was taken to dispose of the few remaining commercial asset backed securities held and exposures to Portugal and Spain. Losses incurred were more than offset by gains achieved on previously impaired credit funds reaching maturity and a net gain of £8.4m (2009: £11.6m loss) was generated on cash received of £57.3m. The remaining £38.5m of reported gains was due to the amortisation of gains made on disposal of derivatives previously held in hedge accounting relationships. Under IAS 39 'Financial Instruments: Recognition and Measurement' such gains are written back to the Income Statement over the remaining term of the underlying instrument that was previously hedged.

Other operating income

Other operating income in 2010 primarily represents the book profit of £2.8m from the sale of the former head office building in Bingley. 2009 income predominately represented property rental income.

Unrealised fair value movements

B&B started the year with £2.8bn of interest rate swaps which were not in a designated hedge relationship, which either matured in the year or were disposed of as we simplified the Balance Sheet. Interest accretion on these derivatives resulted in a £15.9m negative movement in the period until their maturity/disposal. This adverse movement was partly offset by gains of £9.0m on £2bn LIBOR/Bank Base Rate swaps as forward spreads have widened, resulting in a total net loss of £9.3m (2009: £79.1m loss).

Financial review (continued)

Ongoing administrative expenses

Ongoing administrative expenses were lower at £112.3m (2009: £137.1m) with the ratio of costs to assets improving to 0.25% (2009: 0.29%).

The reduction in 2010 costs and improvement in the cost : assets ratio were mainly the result of:

- non repeat of 2009 investments in strategic projects which have also improved the efficiency and effectiveness of the IT and telephony infrastructure;
- lower premises costs following site rationalisation in London and Bingley; and
- other expenses primarily reflect the disposal of the general insurance businesses and renegotiation of third party contracts.

The UKAR Group has incentive schemes in place which have been agreed with UKFI. These enable staff to earn bonuses which are aligned to Company and individual performance. For 2010, bonuses, including those of the Executive Director, of £5.5m were earned. £4.7m of these will be paid in 2011, and the remainder will be deferred and paid in future years. All deferred bonuses are subject to clawback terms.

Administrative expenses	2010	2009
For the year ended 31 December	£m	£m
Staff costs	36.4	38.7
IT and telephony	33.7	46.8
Ongoing administrative expense	41.8	51.2
Depreciation and amortisation	0.4	0.4
Ongoing (underlying) administrative expenses	112.3	137.1
Other net administrative expenses:		
– Independent share valuation charges and associated fees	5.3	–
– Transformation project	8.8	–
Total administrative expenses	126.4	137.1
Ratio of ongoing costs to assets %	0.25	0.29
Ratio of costs to assets %	0.28	0.29

Other net administrative expenses

Other net administrative expenses include residual costs associated with nationalisation of the Company and also the establishment of UKAR in October 2010. The latter reflect costs incurred on the integration of NRAM in November 2010, and also investment required in the new organisation to further integrate systems and processes and hence become a more cost effective business.

During 2010, B&B was required to reimburse HM Treasury £4.3m relating to the costs of the independent valuation of the organisation as at 29 September 2008, the date on which it was nationalised. HM Treasury independently selected and appointed the valuer, Mr Peter Clokey of PricewaterhouseCoopers LLP. Additionally, further work in this respect, not yet billed, amounted to £1.0m which has been reflected in these Financial Statements.

Should former shareholders appeal against the findings of the independent valuation, the Company may face further charges in 2011.

Financial review (continued)

Arrears and loan impairment : Residential loans

We continue to work closely with customers either experiencing difficulty in meeting their mortgage commitments or likely to default on their payments in the future and we offer a range of forbearance options depending on individual customer circumstances and affordability. We adhere to the FSA's regulatory requirement of Treating Customers Fairly.

As a result of the proactive management of arrears, aided by a benign interest rate environment in 2010, our arrears levels continued to fall steadily throughout the year on both our residential and buy-to-let mortgage books. The total number of cases three months or more in arrears, including those in possession, reduced by 32% year-on-year to 13,096 as at 31 December 2010 (2009: 19,159).

As a result of our actions, the total value of payments in arrears was reduced by £43.8m (35%) to £80.7m (2009: £124.5m) at the end of 2010. The total value of the Company's arrears is now 0.23% of mortgage balances compared to 0.33% in 2009, a reduction of 30%.

Arrears and possessions	2010	2009
For the year ended 31 December	£m	£m
Arrears over 3 months		
– number of cases	12,473	18,197
– % of total cases	3.90	5.26
– value of cases in arrears (£m)	1,873.7	2,736.4
– % of book	5.25	7.17
Possessions		
– number of cases	623	962
– % of total cases	0.19	0.28
– value (£m)	97.1	156.7
– % of book	0.27	0.41
Total arrears over 3 months and possessions		
– number of cases	13,096	19,159
– % of total cases	4.09	5.54
– value (£m)	1,970.8	2,893.1
– % of book	5.52	7.58
Payments overdue		
– total value of payments overdue (£m)	80.7	124.5
– % of total book	0.23	0.33
Residential loan impairment allowance		
– Impairment allowance (£m)	832.1	884.1
– % of residential assets	2.28	2.26
– % of arrears and possessions	42.22	30.56

Financial review (continued)

Loan provisions

The year end provision for residential loan impairment held on the Balance Sheet reduced by £52.0m in the year to £832.1m (2009: £884.1m), reflecting the reduction in arrears cases and also a significant reduction in the volume of cases identified as potentially fraudulent or suspicious. In a benign interest rate environment, we also reviewed our provisioning levels to cater for the inherent risk in the book should interest rates rise.

We continue to hold a separate provision for potential fraud and professional negligence cases. Investigations during the year, confirmed by external specialist solicitors, have resulted in a significant number of cases being cleared of suspicion. The total value of cases remaining under investigation has reduced by 36% during the year, and total provisions for these have reduced by £35.0m to £353.4m (2009: £388.4m).

We continue to include a prudent provision for the impact of losses on cases in arrears expected to result from future house price deflation.

As a proportion of balances, the residential impairment provision was 2.28% (2009: 2.26%) and the charge to the Income Statement was £259.7m (2009: £572.2m).

Losses

Whilst the number of possession sales fell slightly compared to 2009, we experienced an increase in the number of cases sold under management by receiver appointed under the Law of Property Act ('LPA'), following on from a review of serious arrears cases conducted during 2009. In total, during the year, 2,332 cases (2009: 2,426) were sold following possession, and a further 2,600 cases (2009: 245) sold which were under LPA receiver management.

Realised losses on properties sold following possession were £199.1m (2009: £134.4m). In addition, our losses on fraudulent and professional negligence cases amounted to £114.3m compared to £20.4m in 2009.

Arrears and loan impairment : commercial and housing loan book

A charge of £16.9m was made during 2010 (2009: £21.5m) mainly reflecting an additional provision against one loan where the security property has been taken into receivership and an updated valuation undertaken. At 31 December 2010, the Balance Sheet provision stood at £58.6m (2009: £52.2m). We continually review the level of provisions against each individual loan based on current and future property valuations, future rental income projections, tenant quality and general market conditions.

Net impairment on investment securities

Markets stabilised in 2010 after a year of worsening global economic conditions in 2009. Reviews have not identified any additional asset impairments in 2010, having sold any remaining commercial asset backed securities and exposures to the more troubled areas within the Eurozone. The £14.5m gain (2009: £93.3m loss) mainly reflected steady gains on the previously impaired Principal Protected Notes portfolio over the first half of the year.

Gain on repurchase of subordinated liabilities

The two tenders to repurchase subordinated liabilities in 2010 resulted in the repurchase of £1,102m of subordinated debt. Total profit before tax on these transactions amounted to £786m, largely resulting from the discounted bid price.

Gain on disposal of business

A condition of the EC State aid approval was the disposal of the B&B general insurance businesses. This was completed during the year with a net gain of £11.5m, which partly compensates the business for the loss of renewal income in future years.

FSCS levy

In 2010, B&B was not required to pay FSCS levy as the business is no longer a retail deposit taking institution (2009: £7.9m).

Defined benefit pension scheme curtailment

The closure of the defined benefit pension scheme in 2009 resulted in a one-off £13.4m curtailment gain in 2009.

Financial review (continued)

Taxation

The total amount of tax payable for the year was £262.3m (2009: credit £97.7m). Based on a statutory profit of £1,081.5m (2009: loss £196.0m) this equates to an effective tax rate charge of 24.3% (2009: 49.8% rebate). The difference between this rate and the standard rate of 28% is caused primarily by the recognition of prior year tax losses.

Balance Sheet

Balance Sheet summary

At 31 December

	2010 £m	2009 £m
Loans and advances to customers:		
– Residential mortgages	35,683.1	38,167.3
– Commercial and other secured loans	718.7	818.9
Wholesale assets	5,652.3	6,321.2
Fair value adjustments on portfolio hedging	223.2	294.2
Derivative financial instruments	2,929.1	3,660.6
Fixed and other assets	152.1	132.4
Total assets	45,358.5	49,394.6
Statutory Debt	18,416.2	18,416.2
HM Treasury Working Capital Facility	8,564.2	8,537.8
Wholesale funding	14,702.6	18,400.6
Derivative financial instruments	531.9	665.6
Other liabilities	543.2	425.8
Interest-bearing capital	393.9	1,554.5
Equity	2,206.5	1,394.1
Total liabilities and equity	45,358.5	49,394.6

Assets

Lending balances reduced by 7% during the year to £36.4bn (2009: £39.0bn). This reflected £2.1bn of redemptions and £0.5bn of other repayments. Redemptions in 2010 were 5.2% (2009: 6.0%) of opening balances. The slower redemption rate reflects the low interest rate environment and a lack of available alternatives for customers to move mortgages as the market has tightened. The decrease in value of derivative financial instruments to £2.9bn (2009: £3.7bn) mainly reflects the impact of the increase in the value of sterling relative to the Euro and US Dollar on the cross-currency interest rate swaps that hedge our foreign currency wholesale borrowings.

Wholesale asset balances were £0.6bn lower at £5.7bn (2009: £6.3bn) primarily reflecting disposals and maturities.

Liabilities

The Statutory Debt and the working capital facility ('WCF') remained static over the year at £18.4bn and £8.6bn respectively; no additional draw down of WCF has been necessary. Wholesale funding decreased to £14.7bn (2009: £18.4bn) reflecting maturing wholesale debt being financed by profits and the wind-down of assets. As a result of the repurchase of subordinated liabilities and other capital instruments during the year, interest-bearing capital decreased to £0.4bn (2009: £1.6bn).

Financial review (continued)

Capital

The Company met its capital requirements in full throughout the year, and has received no additional capital from HM Treasury on nationalisation, or subsequently.

On 18 August 2010, the Company's application for a change of regulatory status, from being a BIPRU regulated firm to the MIPRU regime, was approved by the FSA. This brought B&B into line with NRAM for regulatory purposes, facilitating the combination of the two companies under UKAR ownership. The composition of capital is different under MIPRU, and the concepts of tier 1 and tier 2 capital are not recognised. The Board considers shareholder equity, formerly tier 1 capital, of pre-eminent importance in the capital structure of the business and continues to monitor this, in addition to the total level of capital, closely.

The table below sets out B&B's capital resources as at 31 December.

Capital Resources – Company	2010	2009
At 31 December	£m	£m
Equity attributable to the equity shareholder	1,542.9	755.5
Available-for-sale reserve adjustments	587.6	715.3
Cash flow hedge reserve adjustments	26.5	39.6
Net pension deficit adjustments	56.6	59.7
Subordinated liabilities	277.0	1,374.2
Less: deductions (capital invested in subsidiary companies and intangible assets)	(478.3)	(133.3)
Total capital resources	2,012.3	2,811.0

Total capital resources are £798.7m lower than 2009, although equity attributable to the Shareholder is £787.4m higher. Both these movements are largely due to the buyback of subordinated liabilities that generated profits after tax of £565.9m. Although the reduced level of total capital marginally increased risk to the taxpayer, B&B remains well capitalised and the liability management exercise has strengthened B&B's Shareholder equity.

Under the MIPRU regulatory regime, the minimum capital resource requirement is set at 1% of total Balance Sheet assets and any undrawn commitments. However, this requirement is set at the B&B level as opposed to the B&B Group consolidated position.

For the B&B Company, the total value of Balance Sheet assets and off-Balance Sheet commitments as at 31 December 2010 amounted to £58,507m and £146m respectively, totalling £58,653m of which 1% is £587m.

The MIPRU rules, as indicated, require a minimum capital resource of 1% of total assets and undrawn commitments, and there is no provision within the MIPRU rules to extend regulatory requirements above this amount. However, for prudential reasons, the Board consider that the assessment of capital adequacy requirements should include the full range of material risks that each legal entity faces. Consequently, and in agreement with the FSA, the Board maintains capital levels above the 1% minimum requirement.

Corporate governance

Introduction

On 24 March 2010 the then Chancellor announced the Government's intention to integrate B&B and NRAM under a single holding company and the Shareholder asked Richard Pym, Chairman of the two companies, to chair the new holding company. A Committee comprising Richard Pym together with a Non-Executive Director of NRAM, a Non-Executive Director of B&B and two representatives from UKFI was formed to recruit a Chief Executive. Following a selection process, the Committee's recommendation to appoint Richard Banks was ratified by the Shareholder and received Ministerial approval on 31 March 2010.

On 9 April 2010 UKFI announced the appointment of Richard Pym as Chairman designate and Richard Banks as Chief Executive designate of the single holding company. It was agreed that the three companies would share a common board of Directors comprising Executive and Non-Executive Directors from both the B&B and NRAM boards and a representative from UKFI. These Non-Executive Directors formed designate Board, Nominations and Remuneration Committees and met at various times from May 2010 to review and agree the progress of establishing the holding company, the structure and senior management appointments for the three companies.

UKAR was formally incorporated on 1 July 2010 and on 1 October UKFI announced the establishment of UKAR as the new holding company for B&B and NRAM. Richard Pym was formally appointed as Chairman of UKAR and Richard Banks as Chief Executive. UKAR's Non-Executive Directors comprised Keith Morgan, Head of Wholly-Owned Investments at UKFI and Non-Executive Directors from B&B (Michael Buckley, Louise Patten and John Tattersall) and NRAM (Kent Atkinson, Bob Davies and Sue Langley). These Board appointments were also made at each of B&B and NRAM in order to achieve a common composition of Directors for the three companies.

The wholly-owned subsidiary companies of B&B and NRAM remain as separate legal entities with their own Balance Sheets and Government support arrangements whilst having the same Directors.

B&B intends to operate a governance structure which, as far as practicable, takes appropriate account of best practice for a company listed on the Official List, including where practicable complying with the requirements of the listings rules and the UK Corporate Governance Code of the United Kingdom Listing Authority and the guidance on corporate governance of the Financial Reporting Council.

This corporate governance section summarises:

- The composition of the Board at the date of this report; and
- The governance regime in place at the date of this report.

The Financial Review on pages 11 to 18 also addresses certain governance matters in relation to events in 2010.

Our Board

On 1 October 2010 UKAR was established as the holding company for B&B and NRAM, bringing together the two companies under shared management and a common Board of Directors. The individual profiles included in this section therefore set out the Directorships each of UKAR, and NRAM as well as B&B at 31 December 2010.

Richard Pym - Non-Executive Chairman

Richard became Chairman of UKAR in July 2010 having been appointed Chairman of B&B in November 2008 and NRAM in January 2010. He also chairs the Nominations Committees of all three companies.

Richard is a Non-Executive Director of The British Land Company PLC and Non-Executive Chairman of BrightHouse Group Ltd and Nordax Finans AB. He was Group Chief Executive of Alliance & Leicester plc until July 2007, and prior to that he held a number of financial and general management roles at The Burton Group plc, BAT Industries plc, British Gas and Thomson McLintock & Co. Formerly a Vice President of the British Bankers' Association, a Non-Executive Director of Old Mutual plc and Selfridges plc, and Chairman of Halfords Group plc. Richard is a Fellow of the Institute of Chartered Accountants in England and Wales and a physics graduate of the University of Warwick.

Corporate governance (continued)

Kent Atkinson - Senior Independent Director

Kent joined the Boards of UKAR and B&B in October 2010, and has been a Non-Executive Director of NRAM (previously NR) since August 2008. He is the Senior Independent Director, Chairman of the Audit Committees and a member of the Risk Committees of all three companies.

Kent was previously Group Finance Director of Lloyds TSB Group plc, and subsequently a Non-Executive Director. He is the Senior Independent Director and Chairman of the Audit Committee of Coca-Cola HBC SA. He is a Non-Executive Director, Chairman of the Group Audit and Compliance Committee, and a member of the Risk and Capital Committee and the Investment Committee of Standard Life plc. He is a Non-Executive Director and a member of the Audit Committee and the Strategy and M&A Committee of Gemalto NV. He was formerly the Senior Independent Director and Chairman of the Audit Committees of Cookson Group plc and Telent plc (previously Marconi Corporation plc), and a Non-Executive Director of Millicom International Cellular S.A.

Richard Banks - Chief Executive Officer

Richard became Chief Executive Officer of UKAR in July 2010 and was appointed Chief Executive Officer of B&B and NRAM in October 2010.

Before joining the Board of B&B as Managing Director in May 2009, Richard's career has been in retail and commercial banking; he was previously a Director of Alliance & Leicester plc where he was Group Risk Director and before that Managing Director of Commercial Banking. He is also a Non-Executive Director of ICICI Bank UK PLC and a Non-Executive Director of Liverpool Compact, which provides work experience for 14-19 year olds. Richard has a BA in Business Studies, and is an Associate of the Chartered Institute of Banking.

Michael Buckley - Non-Executive Director

Michael has been a Non-Executive Director of B&B since July 2007 and joined the Boards of UKAR and NRAM in October 2010. He is a member of the Audit, Risk and Nominations Committees of all three companies.

Michael is Non-Executive Chairman of DCC plc and a Non-Executive Director of M&T Corporation in the USA. He is also a senior adviser to a number of privately held Irish and US based companies, serves on McKinsey and Company's European Banking Practice Advisory Board and is an Adjunct Professor at the Department of Economics at NUI University College, Cork. He was Group Chief Executive of Allied Irish Banks plc from 2001 to 2005 having earlier served as Managing Director of AIB Capital Markets and AIB Poland. Previously, he was Managing Director of the NCB Group, and a senior public servant in Ireland and the EU.

Sue Langley - Non-Executive Director

Sue joined the Boards of UKAR and B&B in October 2010, having joined the Board of NRAM in January 2010. She is Chairman of the Remuneration Committee and a member of the Nominations Committee of all three companies.

Sue is currently Director of Market Operations for Lloyd's of London, joining in July 2007, and Chairman of Lloyd's Japan. Previously, she was Chief Operating Officer and a member of the Executive team for the Hiscox Group and Board member for Hiscox Syndicates and Hiscox Insurance. Sue is currently a Director of ACORD and Trustee of the Lloyd's Charities Trust. Prior to joining Hiscox, Sue worked for Thomson Tour Operations and PricewaterhouseCoopers LLP, where she was a Principal Consultant specialising in change management.

Keith Morgan - Non-Executive Director

Keith joined the Boards of UKAR and B&B in October 2010, having joined the Board of NRAM in January 2010. He is a member of the Risk and Remuneration committees of all three companies.

Keith is Head of Wholly-Owned Investments at UKFI, responsible for managing the Government's shareholdings in UKAR, B&B, NRAM and NR.

Keith joined UKFI from Banco Santander. Until July 2009, he was a Director of Sovereign Bancorp in the U.S.A. focusing on the integration of Sovereign into Santander. He was previously Director of Strategy & Planning at Abbey National, where he was a member of the Executive Committee, and was also Chairman of Santander's Asset Management and Credit Card businesses in the UK. Before joining Abbey in 2004, Keith spent 18 years at L.E.K. consulting, where he was a partner specialising in financial services.

Corporate governance (continued)

Louise Patten - Non-Executive Director

Louise joined the Boards of UKAR and NRAM in October 2010, and has been a Non-Executive Director of B&B since December 2003. She is a member of the Remuneration Committee and the Nominations Committee of all three companies.

Louise is a Non-Executive Director of Marks and Spencer Group plc as well as senior adviser to Bain & Co. She began her career at Citibank and remained in financial services until 1993, when she joined the management consultancy, Bain & Co, as a partner. Her previous experience as a Non-Executive Director includes the Hilton Group, Brixton plc, Great Universal Stores and Somerfield.

John Tattersall - Non-Executive Director

John joined the Boards of UKAR and NRAM in October 2010, having joined the Board of B&B in April 2010. He is Chairman of the Risk Committees and a member of the Audit Committees of all three companies.

John retired as a partner in PricewaterhouseCoopers LLP in 2009, where he had worked since 1975, latterly as leader of the firm's Financial Services Regulatory Practice and a senior client relationship partner. He started his career in the financial services sector with Kleinwort Benson Limited in 1973. Until 2009 he was Chairman of the Risk and Regulation Committee of the Financial Services Faculty of the Institute of Chartered Accountants in England and Wales, and a member of the faculty board. He is currently a Non-Executive Director of R Raphael & Sons PLC (Raphael's Bank), CCLA Investment Management Limited and the South East Institute for Theological Education and a member of the Independent Commission on Equitable Life payments. He is also a board member of the Gibraltar Financial Services Commission, a member of the court of the Royal Foundation of St Katharine, and a non-stipendiary priest in the Church of England. He acted as Consultant Editor and joint author of two recent books 'A Practitioner's Guide to the Basel Accord' and 'A Practitioner's Guide to FSA Regulation of Banking'.

Details of Board appointments and retirements during 2010 are as follows:

Richard Pym	Non-Executive Chairman for the whole year
Kent Atkinson	Appointed 1 October 2010
Richard Banks	Director for the whole of 2010
Michael Buckley	Director for the whole of 2010
Bob Davies	Appointed 1 October 2010, resigned 31 December 2010
Sue Langley	Appointed 1 October 2010
Keith Morgan	Appointed 1 October 2010
Louise Patten	Director for the whole of 2010
John Tattersall	Appointed 1 April 2010

Corporate governance (continued)

Board and Committee meetings

During 2010, the number of meetings attended by each Director was as follows.

	Board	Audit	Remuneration	Risk
Number of meetings held	12	5	5	4
R A Pym – Chairman	12/12		2/3	
M K Atkinson	4/4	1/1		0/1
R L Banks	12/12			
M D Buckley	12/12	4/5	3/3	3/4
R J Davies – resigned 31 December 2010	2/4		2/2	
S C Langley	4/4		2/2	
K C W Morgan	4/4		2/2	1/1
L A V C Patten	11/12	3/4	5/5	3/3
J H Tattersall	10/10	4/4		3/3

In addition there were three Board Committee meetings which dealt with specific issues where only a restricted number of Directors attended.

There were no meetings of the Nominations Committee in 2010 with all appointment related matters being considered by the Board.

During 2010, the Chairman of each Committee was as follows:

Audit Committee	Michael Buckley	1 January 2010 to 30 September 2010
	Kent Atkinson	1 October 2010 to 31 December 2010
Risk Committee	Michael Buckley	1 January 2010 to 30 September 2010
	John Tattersall	1 October 2010 to 31 December 2010
Remuneration Committee	Louise Patten	1 January 2010 to 30 September 2010
	Bob Davies	1 October 2010 to 31 December 2010
Nominations Committee	Richard Pym	1 January 2010 to 31 December 2010

The current membership of the Committees is set out on pages 25 to 26.

Corporate governance (continued)

Governance structure

Since the transfer to public ownership, the governance structure has been determined by a framework document ('the Framework Document') agreed between the Company and its ultimate Shareholder, HM Treasury. The Framework Document has been updated periodically to reflect changing circumstances and most recently was amended to reflect the establishment of UKAR.

UKAR, as the Company's Parent is responsible for ensuring that it adopts and adheres to the provisions of the Framework Document, where such provisions relate to or refer to it.

The Company operates in accordance with the terms of the latest revision to the Framework Document 'UK Asset Resolution Limited and UK Financial Investments Limited: Relationship Framework Document', which sets out how the relationship between the Company and UKFI, acting on behalf of the HM Treasury, will work in practice. The terms of this agreement are reflected below and throughout this report

The Framework Document is intended to ensure that the relationship between the companies in the UKAR Group, UKFI, HM Treasury (as ultimate Shareholder and the provider of financial support), and the FSA (as regulator), operates in the context of the over-arching objective of maximising value for the taxpayer, whilst paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. The Framework Document requires the UKAR Group to deliver a strategic and funding business plan to achieve these objectives.

The principles of the Framework Document

The relationship between UKAR, the Company and UKFI operates according to the following principles under which UKFI:

- Appoints the Chairman of the Board and is entitled to appoint one or more Non-Executive Directors;
- Is required to consent to the appointment of other members of the Board proposed for appointment by the Nominations Committee and agrees the terms on which the Directors are appointed and incentivised;
- Agrees with the Board the high level objectives of the business plan ('the Plan') and any revisions to it;
- Reviews with the Board from time to time the Company's strategic options;
- Requires that the Board is accountable to it for delivering the agreed Plan;
- Gives the Board the freedom to take the action necessary to deliver the Plan;
- Monitors the Company's performance to satisfy itself that the Plan is on track; and
- Is required to give its consent for certain significant actions.

Board structure and governance

Under the terms of the Framework Document the Board operates the following committees:

- Audit Committee;
- Risk Committee;
- Remuneration Committee, and
- Nominations Committee.

Further details about the Board Committees, and their roles, are provided on pages 25 and 26.

During 2010 and early 2011 the Board reviewed and updated its governance processes in light of changes to the corporate structure, emerging best practice and the requirements of the Plan.

Corporate governance (continued)

Board appointments and composition

UKFI considers that the composition of the Board is a critical factor and seeks to secure an environment in which it shares a common view about Board composition and succession with the Chairman, including size and balance of experience and background. To achieve this and ensure that a common governance approach is applied across the UKAR Group, UKAR and its subsidiary companies (B&B and NRAM) operate under the following principles:

- The Chairman and either the Chairman of UKFI or a senior employee nominated by the Chairman of UKFI (the Nominated Officer), will discuss and confirm Board composition and succession regularly in the light of performance and the requirements of the Plan;
- UKFI will be entitled to appoint to the Board one or more Non-Executive Directors nominated by UKFI (the 'Shareholder Directors'): Mr Morgan is currently appointed as such a Director. The Company acknowledges that the Shareholder Directors intend to liaise with and report to representatives of UKFI from time to time in relation to the business of the Company and decisions made, or to be made, by the Board in order to assist with the exercise of their powers and duties as Directors of the Company;
- One or more senior representatives of UKFI will, if so requested by UKFI, attend meetings of the Board in an observer capacity;
- The Chairman will discuss with the Nominated Officer any impending changes to Board membership;
- The Chairman of the Nominations Committee will meet with the Nominated Officer as necessary to obtain UKFI's approval to any proposed Board changes before they become subject to the formal appointment/consent procedure. The Company's Articles of Association require that at every Annual General Meeting each Director, other than the Shareholder Directors who are expressly exempt from this provision, shall retire from office and may offer themselves for re-appointment.
- Non-Executive Directors are appointed for a specified term, normally one year, subject to re-appointment in accordance with the above procedures; and
- The Board will ensure that suitably rigorous appraisals are made of the effectiveness of the Chairman and the Board.

Board responsibilities

During 2010, the Board was responsible for developing and delivering the Plan to restructure the Company in order to meet the State aid requirements of the European Commission.

The Board is responsible for:

- Setting the Company's strategic aims and for developing and recommending revisions to the Plan to deliver the over-arching objective of protecting and creating value for the taxpayer, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. Any proposed revisions to the Plan will be subject to review and approval by UKFI;
- Delivering the Plan in accordance with the requirements of the Framework Document. In this respect, decisions on the day-to-day running of the Company, subject to the Framework Document and the Company's Articles of Association, rest with the Board in accordance with the Directors' statutory, common law and fiduciary responsibilities. UKFI is committed to giving the Board the freedom necessary to deliver the agreed Plan and will not interfere in day-to-day operational and commercial matters; and
- Ensuring that the necessary financial and human resources are in place for the Company to deliver the agreed Plan, set the Company's values and standards and ensure that its obligations to HM Treasury as ultimate Shareholder are understood and met.

The Board has a written schedule of those matters reserved for its determination and those matters reserved for UKFI, in accordance with the Framework Document.

Balance of Executive and Non-Executive Directors

More than half of the Board comprises Non-Executive Directors, all of whom have experience in a range of commercial or banking activities.

Corporate governance (continued)

Monitoring performance

UKFI will regularly monitor the Company's performance against the Plan by means of the following main mechanisms:

- Meetings between the Company and UKFI to review performance to date against the Plan; and
- Monthly (or, at UKFI's request, more frequent) financial and business performance monitoring to track the progress of the Plan and the Company's performance against agreed objectives on a timely, regular and appropriate basis.

In addition, UKFI has certain monitoring and information access rights and its approval must be obtained for certain material actions and transactions.

Board Committees

The Board operates a number of Committees, each of which has detailed terms of reference setting out its remit and authority. Details of the membership and role of each Committee are set out below.

Audit Committee

The Audit Committee currently comprises Kent Atkinson (Chairman), Michael Buckley and John Tattersall, all of whom are Non-Executive Directors.

The Audit Committee met five times in 2010. Two of these meetings were held as a combined Audit, Risk & Compliance Committee.

The Committee monitors, reviews and advises the Board on:

- All regulatory, prudential and accounting requirements that may affect the Company;
- The integrity of the Financial Statements and external reporting responsibilities;
- The Company's whistleblowing policy; and
- The results of the external audit and any significant matters identified.

The Committee approves the terms of reference for Internal Audit and reviews the adequacy and effectiveness of the activities carried out by the function. In addition, the Committee reviews the effectiveness of the system of internal control annually in accordance with the UK Corporate Governance Code.

The Committee receives reports at each meeting (other than meetings held specifically to consider the Company's results) from the managers responsible for Audit. These reports highlight existing and emerging matters of significance, areas of concern, planned actions, monitoring procedures and any other matters which are likely to impact on internal controls and financial reports.

The Committee is responsible for recommending the appointment, re-appointment and removal of the external auditors. It reviews the scope and results of the annual external audit, its cost effectiveness and the independence and objectivity of the external auditors. The Committee also reviews the nature and extent of non-audit services provided by the external auditor to ensure that these do not impair the auditor's independence or objectivity.

The external auditors may attend all meetings of the Committee and they have direct access to the Committee and its Chairman at all times. The Head of Internal Audit provides further assurance that the significant risks identified by the business are properly managed. The Head of Internal Audit also has direct access to the Audit Committee and its Chairman. The Committee regularly receives reports of reviews conducted throughout the Company by the Internal Audit function.

In 2010, the Committee reviewed the effectiveness of the external auditors and made a recommendation that they be re-appointed for a further 12 months. The Board accepted this recommendation and an appropriate resolution was passed at the 2010 Annual General Meeting.

Corporate governance (continued)

Risk Committee

The Risk Committee currently comprises John Tattersall (Chairman), Kent Atkinson, Michael Buckley and Keith Morgan, all of whom are Non-Executive Directors.

The Risk Committee met four times in 2010. Two of these meetings were held as a combined Audit, Risk & Compliance Committee.

The main role of the Risk Committee is to review, on behalf of the Board, the key risks inherent in the business, the systems of control necessary to manage such risks, and to present its findings to the Board.

This responsibility requires the Risk Committee to keep under review the effectiveness of the Company's risk management frameworks and systems of internal control, which include financial, operational, compliance and risk management controls and to foster a culture that emphasises and demonstrates the benefits of a risk-based approach to internal control and management of the Company. The Risk Committee fulfils this remit through its oversight of the embedding of a supportive culture in relation to the management of risk and by making appropriate recommendations to the Board on all significant matters relating to the Company's risk appetite, strategy and policies.

To assist the Board in discharging its responsibilities for the setting of risk policy, the Risk Committee periodically reviews the Company's material risk exposures in relation to the Board's risk appetite and the Company's capital adequacy.

The Risk Committee also ensures that the public disclosure of information regarding the Company's risk management policies and key risk exposures is in accordance with statutory requirements and financial reporting standards.

Remuneration Committee

The Remuneration Committee currently comprises Sue Langley (Chairman), Louise Patten and Keith Morgan, all of whom are Non-Executive Directors.

The Remuneration Committee met five times in 2010.

The Committee has regard to recommendations from the UKAR Remuneration Committee and subject to compliance with the requirements of the Framework Document, the Committee is responsible for advising the Board on the remuneration arrangements for FSA Code employees including Executive Directors. The Committee also reviews and recommends to the Board the remuneration arrangements and policies for those executives directly below Board level and the remuneration policies for all other staff.

The Committee takes internal and external professional advice where necessary to discharge its obligations.

Nominations Committee

The Nominations Committee currently comprises Richard Pym (Chairman), Michael Buckley, Sue Langley and Louise Patten all of whom are Non-Executive Directors. The Committee did not meet during 2010 with all nominations related matters being considered by the Board.

Subject to compliance with the requirements of the Framework Document and oversight by UKFI, the Committee is responsible for reviewing the composition of the Board and preparing succession plans. The Committee is also responsible for identifying potential Executive and Non-Executive Directors and making recommendations to the Board concerning the appointment or re-appointment of Directors, having regard to the requirement for the Board to have the appropriate range of skills and experience.

The Committee also reviews the leadership needs of the Company and succession plans for key executive roles.

Management Committees

The Company operates a number of Management Committees, including an Executive Committee, details of which are set out on page 30.

Relationship between the Chairman and the Chief Executive Officer

A clear division of responsibility exists between the Chairman, who is responsible for running the Board, and the CEO, who has responsibility for running the business. This division is set out in writing and has been approved by the Board.

Corporate governance (continued)

Induction and training

The Board requires all newly appointed Directors to undergo a formal induction training programme appropriate to their skills and experience, to ensure that they:

- Are fully aware of their role, duties and responsibilities as a Director; and
- Have a good understanding of the operation of the business, so as to contribute effectively.

The Board also requires Non-Executive Directors to undertake relevant ongoing training and development to improve their capabilities and thereby contribute more effectively to Board decision making.

The Board has a comprehensive thematic training programme.

Board evaluation

Following numerous Board changes in 2010 and with a Shareholder representative Director present at Board meetings, it was agreed by the Board that a thorough evaluation process would be deferred until 2011.

Board procedures

To ensure that the Board functions effectively, Directors have full and timely access to all information which may be relevant to the discharge of their duties and obligations. All Directors have access to the advice and services of the Company Secretary, who is responsible for ensuring that Board procedures and applicable rules are followed. Where necessary, Directors are able to take independent professional advice at the Company's expense.

Internal control and risk management

The Board is responsible for the Company's system of internal control and seeks regular assurance to satisfy itself that the system is functioning effectively in managing risks in the manner which it has approved. Such a system can only provide reasonable, and not absolute, assurance against material misstatement or loss, as it is designed to manage, rather than eliminate the risk of failure to achieve business objectives. Throughout the year ended 31 December 2010, the Company has operated a system of internal control, which includes an ongoing risk management process for identifying, evaluating and managing the significant risks faced by the Company. During the year, the Board has continued to review the effectiveness of the Company's system of financial and non-financial controls including, operational and compliance controls, risk management and the Company's most significant risks and mitigating actions.

In addition, as part of the process of preparing this statement, the Board has also performed its annual assessment of the effectiveness of internal controls. The Board of Directors is not aware of any significant failures in internal control that arose in the business of the Company during 2010 that are not being addressed in accordance with the internal control procedures of the Company. Management regularly takes action to improve internal controls, either as a result of its own initiative or in response to reports from Internal Audit and other oversight review functions.

Changes in financial regulation continue within the industry. The Company's risk management processes are kept under regular review to ensure that the Company responds appropriately to both implemented and proposed regulatory changes.

The Company operates a risk management process, producing a Company-wide risk profile. This identifies the Company's significant risks, the probability of those risks occurring and their impact should they occur, and has the prime responsibility for the design and operation of suitable controls and mitigating actions. The risk management process is complemented by a formalised reporting and escalation process for control issues. Internal Audit has a key role in maintaining the control environment by providing independent assurance on the effectiveness of the Company's internal control systems. The Risk Committee and the Audit Committee oversee the risk management process, regularly consider the Company-wide risk profile, and receive monitoring reports to update it on progress.

The Company is committed to developing and maintaining an appropriate risk management framework and culture with the aim of continuing to ensure that management understand the key risks that the business faces. This is achieved through an organisational structure with clear reporting lines and governed by appropriate business monitoring mechanisms, codes of conduct and policy statements.

Corporate governance (continued)

Internal control and risk management (continued)

The system of internal control has been in place throughout 2010 and up to the date of approval of the Annual Report and Accounts.

In reviewing the effectiveness of this system, the Board takes into account the work of the Risk Committee which reviews the Company's significant risks and how these are being managed. The Risk Committee also considers reports from Compliance and management on the system of internal control, adherence to regulatory requirements and material control weaknesses, where these exist, together with actions taken to address them. The Audit Committee considers reports from Internal Audit and External Audit on the system of internal control and material control weaknesses, where these exist, together with actions taken to address them.

The Chairmen of the Risk Committee and the Audit Committee report on the outcome of each meeting to the Board, where appropriate, and the Board also receives minutes of these Committee meetings.

Going concern

As set out in note 1 to the Financial Statements, HM Treasury has provided various on-demand facilities to the Company and provided confirmation to the Directors that it is its intention to continue to fund the Company so as to maintain the Company as a going concern, and enable the Company to meet its debts as and when they fall due, for a period up to at least 31 December 2012. Accordingly, the Directors are satisfied at the time of approval of the Financial Statements that the B&B Group and the Company have adequate resources to continue in business for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the Financial Statements.

Risk management and control

Pages 29 to 35 form an integral part of the audited Financial Statements

Introduction

In accordance with the requirements in the Framework Document referred to on pages 23 to 24, B&B's approach to risk management is built on formal governance processes and relies on individual responsibility and collective oversight, informed by comprehensive reporting. The following sections describe the approach to risk management. The first section covers the risk governance structure. The second section explains the way in which the Company identifies, categorises and manages the risks it faces.

Other factors could also affect B&B results, including economic factors. Therefore, the risks described below should not be considered to represent all of the potential risks and uncertainties which could impact B&B.

Risk governance

The responsibility for the strategy and approach to risk governance and management lies with the Board. The Board is responsible for determining risk strategy, setting risk appetite and reviewing the effectiveness of risk and control processes in support of B&B's strategy. The Board is also responsible for establishing a clearly defined risk management structure with distinct roles and responsibilities. Under that structure, the Risk Committee and Internal Audit provide 'third line of defence' challenge and review of the management risks within the business. Management committees and the Risk function provide 'second line of defence' oversight, challenge and review, and line managers have 'first line of defence' responsibility for the identification, measurement and management of the risks within their business areas.

The management of the risk framework including oversight and challenge to the business on the effectiveness of their risk management activity, and reporting of Operational and Financial Risk, is performed by specialist teams in the Risk Function. Second line of defence monitoring of the risk management framework is also performed by Risk Function.

The Board and Management Committees, under the authority delegated by the Board are described below. During the year, the terms of reference and composition of the management committees have changed to align with the organisational and structural changes within B&B.

Risk Committee ('RC')

The RC was known as the Audit, Risk & Compliance Committee up to April 2010, and the Risk & Compliance Committee up to the establishment of UKAR in November 2010. In 2010 the establishment of a separate Audit Committee and RC was undertaken in accordance with the Framework Document and recommendations of the Walker Review.

The main role of the RC is to keep under review the effectiveness of B&B's risk management framework and systems of internal control, which include financial, operational, compliance and risk management controls and to foster a culture that emphasises and demonstrates the benefits of a risk-based approach to internal control and management of B&B. The RC fulfils this remit through its oversight of the embedding of a supportive culture in relation to the management of risk and by making appropriate recommendations to the Board on all significant matters relating to the Board's risk appetite, strategy and policies.

To assist the Board in discharging its responsibilities for the setting of risk policy, the RC periodically reviews B&B's material risk exposures in relation to the Board's risk appetite and B&B's capital adequacy. The RC also ensures that the public disclosure of information regarding B&B's risk management policies and key risk exposures is in accordance with statutory requirements and financial reporting standards.

Risk management and control (continued)

Pages 29 to 35 form an integral part of the audited Financial Statements

Executive Committee ('EXCO')

EXCO is an advisory committee which supports the CEO in managing the business to achieve its strategic objectives.

The following sub-committees of the Executive Committee have been established:

- Executive Risk Committee
- Integration & Change Committee
- Fraud & Professional Negligence Committee

Executive Risk Committee

The executive Risk Committee is a management sub-committee of EXCO with a reporting line to the RC. The primary objective of the executive Risk Committee is to provide technical oversight of the key financial and operational risk and governance issues including review of the adequacy of risk mitigating actions and cost and capital effectiveness. The Committee supports, advises and make recommendations to the RC.

Integration & Change Committee

The Integration & Change Committee (formerly the Change Committee) monitors and reviews major projects to ensure the appropriate returns are received from investment in change and prioritises change projects and initiatives.

Fraud & Professional Negligence Committee

The Fraud & Professional Negligence Committee determines and oversees the implementation of the strategy to mitigate the impacts of fraud and or/professional negligence and ensures that recoveries are maximised.

The following are sub-committees of the executive Risk Committee.

Asset & Liabilities Committee ('ALCO')

The primary objectives of ALCO are to support, advise and make recommendations to the executive Risk Committee on asset and liability management (including interest rate and currency risk management, basis risk, margin compression and investment assets), related wholesale credit, and capital and liquidity adequacy risks and issues.

Operational Risk Committee ('ORC')

ORC was established from January 2010 in response to the FSA's recommendations under their review in 2009 of B&B's Risk Management Framework. The ORC is a management sub-committee of the executive Risk Committee. Principally, ORC supports the executive Risk Committee in its oversight of the business' adherence to the Operational Risk Framework, Operational Risk Strategy and Policy, and provides challenge to the business on the accuracy, robustness and reliability of operational risk information and reports.

Group Risk

The Group Risk function comprises a team of risk management specialists with responsibility for the embedding and oversight of operational, financial and strategic risk management across the business, and analysis and reporting of risk matters to the Board, and the Board and Management Committees. Key functional responsibilities comprise:

- Development of a Company strategy, framework and policies for financial, strategic and operational risk;
- Operational risk management, aligned with business requirements;
- Provision of support to B&B business line management in the implementation of the Framework;
- Aggregate analyses of risk concentrations and sensitivities across the Company;
- Act as a point of reference for risk and control matters, providing advice to management, sharing best practice and carrying out special reviews as directed by the executive Risk Committee and ALCO; and
- Provision of independent assessment of, and challenge to, the business areas' risk management and profiles to ensure that they are maintained in a robust manner.

Risk management and control (continued)

Pages 29 to 35 form an integral part of the audited Financial Statements

Compliance

The role of Compliance is to:

- Provide assurance to the Board and Executive, through the RC, that control processes are in operation to manage all non-prudential regulatory risks across the business;
- Contribute to the continuous improvement of the regulatory environment through provision of advice to the business; and
- Oversee and co-ordinate liaison with the FSA on a day to day basis to promote open and co-operative relationships.

Internal audit

Ernst & Young LLP is contracted to provide internal audit services, including the provision of a seconded Head of Internal Audit. This person is required to be approved for the position by the UK's FSA and by the Board. However, the oversight of the Internal Audit function remains firmly with B&B. The Head of Internal Audit reports through to the Chairman of the Audit Committee and to the CEO.

The prime objective of the Internal Audit department is to provide reliable, valued and timely assessment to the Board and Executive Management on the effectiveness of the system of internal controls mitigating current and evolving key risks and in doing so, assist the organisation in enhancing the effectiveness of the approach to risk management culture within the organisation.

Business and support activities of B&B are included in the scope of Internal Audit's responsibility and are subject to regular and appropriate internal audit review in accordance with Internal Audit's risk based Audit Plan.

Risk categorisation

B&B categorises risk under the following headings:

(i) Credit risk

Credit risk is the potential financial loss caused by a retail customer or wholesale counterparty failing to meet their obligations to the Company as they become due. As the Company is no longer making any material loans, the absolute level of credit risk is expected to decline as the current assets mature.

Credit risk is the largest risk the Company faces and the monitoring of the recoverability of loans and amounts due from counterparties is inherent across most of the Company's activities. The Company is firmly committed to the management of credit risk in both its retail and wholesale loan books. The Company employs credit behaviour scoring and fraud detection techniques to support loss minimising strategies. As no new lending is now being undertaken, the focus of credit risk activities is on:

- A proactive approach to the identification and control of loan impairment in the Residential and Commercial Credit Risk and Credit Control areas;
- Fraud and professional negligence investigation; and
- The use of credit behaviour scoring and other techniques to monitor the risk profile of the existing book.

Adverse changes in the credit quality of borrowers or a general deterioration in UK economic conditions could affect the recoverability and value of the Company's assets and therefore its financial performance. As credit risk is the main risk to the Company, a credit risk framework has been established as part of the overall governance framework to measure, mitigate and manage credit risk within the Company's risk appetite. To a lesser degree, the Company is exposed to other forms of credit risk such as those arising from settlement activities where the risk is a consequence of a transaction, rather than a driver of it.

Risk management and control (continued)

Pages 29 to 35 form an integral part of the audited Financial Statements

The extent to which credit risk in the Company's Balance Sheet is mitigated is shown by the following table of provisions for mark-downs on impaired assets:

At 31 December

	Balance Sheet value 2010 £m	Provision 2010 £m	Balance Sheet value 2009 £m	Provision 2009 £m
Advances secured on residential property	35,683	832	38,167	884
Other secured advances	719	59	819	52
Treasury assets	5,652	333	6,321	363

The Company's ability to influence the structure of its credit risk profile, in the absence of asset sales, is largely restricted to the degree of control which it has over risk strategy, loan redemptions and credit collections activity. With the composition of the loan portfolio largely fixed in the short to medium term, the Company's credit risk profile is now determined by the credit quality of the existing portfolio alone. Changes in credit quality will arise either from changes in the underlying economic environment, our assumptions about the future trends in the economy, changes in the specific characteristics of individual loans and the credit risk strategies developed to add value to the book while mitigating credit risk.

It is the Company's policy to monitor the profile of its lending exposure on a quarterly basis. Changes in the risk profile are reported as part of the Company's stress tests. The stress tests forecast losses, impairment and capital requirements at a portfolio and product level over a 10 year horizon given a range of economic scenarios.

The Board receives a monthly update on changes in the key drivers of the lending credit risk profile, with more detailed information on the factors underlying these key drivers being reported monthly to the executive Risk Committee.

The Company also holds a structured finance portfolio that primarily consists of investments in asset backed securities ('ABS'). The credit risk is determined by the quality of the underlying securitised assets and this drives the market demand for these investments. Credit limits have been set for the structured finance portfolios. No new structured finance investments were made in 2010.

Credit related policies and limits are developed and maintained within Credit Risk and are reviewed and approved annually by the Board or when significant changes to policies are recommended. The executive Risk Committee ensures that any exposure to credit risk remains within overall risk exposure levels as agreed by the Board. Authorised credit risk limits for wholesale money market counterparties reflect the size, depth and quality of each counterparty's capital base and, where published, credit ratings assigned by the major credit rating agencies.

(ii) Market risk

Market risk is the potential adverse change in Company income or Company net worth arising from movements in interest rates, exchange rates or other market prices. Effective identification and management of market risk is essential for maintaining stable net interest income. B&B does not trade or make markets in any areas and market risk arises only as a consequence of carrying out and supporting core business activities.

Risk management and control (continued)

Pages 29 to 35 form an integral part of the audited Financial Statements

Interest rate risk

The most significant form of market risk to which the Company is exposed is interest rate risk. This arises from the interest rate characteristics of its assets and liabilities. The principal exposure is caused by variable rate mortgage balances of £18.4bn and LIBOR linked assets of £3.1bn, which in total are funded by fixed rate liabilities. A secondary exposure is caused by the mismatches between the repricing dates of the floating rate assets and liabilities. As the mortgage book declines the extent of interest rate risk will decline.

Group Treasury is responsible for managing this exposure within the risk exposure limits set out in the Treasury Policy Framework and the Interest Rate and Foreign Exchange Risk Policy, as approved by the Board. These policies set out the nature of the market risks that may be taken, along with aggregate risk limits, and stipulates the procedures, instruments and controls to be used in managing market risk.

It is ALCO's responsibility to recommend strategies to the executive Risk Committee for managing market risk exposures and to ensure that Group Treasury implements the strategies within the Company's approved Board policy limits.

The Company's results are also affected by the change in market value of interest rate derivatives that do not meet the hedge accounting requirements of IAS 39 (as set out in note 33). In 2010, the loss to the Income Statement was £9.3m (2009: £79.1m) and the net nominal value of such derivatives at 31 December 2010 was £5.1bn (2009: £5.4bn).

The Company assesses its exposure to interest rate movements using a number of techniques. There are, however, two principal methods:

- A static framework that considers the impact on the current Balance Sheet of an immediate movement of interest rates; and
- A dynamic modelling framework that considers the projected change to both the Balance Sheet and mortgage product rates over the following year under various interest rate scenarios.

The results of these analyses are presented to ALCO monthly, in order to identify, measure and manage the Company's exposure to interest rate risk.

Limits are placed on the sensitivity of the Company Balance Sheet to movements in interest rates. Exposures are reviewed by senior management and the Board with a frequency between daily and monthly, related to the granularity of the position. For example, the overall Company Balance Sheet interest rate risk exposure position is monitored monthly whilst specific portfolios within the Balance Sheet are reviewed on a daily basis. This reflects the dynamics and materiality of the various portfolios.

Interest rate risk exposure is predominantly managed through the use of interest rate derivatives, principally interest rate swaps which are over-the-counter arrangements with highly rated banking counterparties. The Company also takes advantage of the natural offset of its asset and liability positions to minimise the costs and risks of arranging transactions external to the Company.

Foreign exchange risk

Prior to nationalisation, the Company raised and invested funds in currencies other than sterling. Accordingly, foreign exchange risk arises from activities related to the Company managing borrowing costs and investment returns (the underlying asset and liability balances are set out in note 35e). As with interest rate risk, Group Treasury is responsible for managing this exposure within the limits set out in the Company's policies.

The Company does not actively seek foreign exchange exposures and any that arise naturally from its net interest income streams denominated in the foreign currencies are subject to limits set out in the Interest Rate and Foreign Exchange Risk Policy that is approved by ALCO and the Board. The Company will remain exposed to foreign exchange risk until all assets and liabilities denominated in foreign currencies have matured or been sold.

Foreign currency exposure is measured daily by Group Finance taking into consideration all non-sterling assets and liabilities. This exposure position is broken down by individual foreign currency and the net exposure circulated daily to senior managers with an overall summary position provided to ALCO on a monthly basis.

Risk management and control (continued)

Pages 29 to 35 form an integral part of the audited Financial Statements

Residual foreign exchange risk is managed through the use of foreign exchange contracts.

(iii) Liquidity risk

Liquidity risk management within the Company considers both the overall Balance Sheet structure and projected daily liquidity requirements, measuring the combined effect of asset and liability maturity mismatches across the Company, undrawn commitments and other contingent obligations. The day-to-day management of liquidity is the responsibility of Company Treasury.

The Liquidity risk management policies are set out in the Liquidity and Wholesale Funding Policy and the Liquidity Contingency Policy; these policies are approved by the Board. The policies consider the quality of liquidity assets as well as projected funding requirements. The Company obtains any sterling funds required from a sterling denominated facility provided by HM Treasury. This facility enables sufficient sterling liquidity to be available even in extreme circumstances. The Company remains dependent on the markets, as it principally generates liquidity in foreign currencies by converting funds from sterling with foreign exchange swap transactions in the financial markets. Thus, whilst liquidity risk in sterling is low, that in foreign currencies remains.

The impact of liquidity risk is monitored by liquidity stress tests, the results of which are considered by ALCO and reported to the Board.

(iv) Operational risk

The most common definition of operational risk draws on the Basel Committee definition:

'The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events'.

The following are major sources of operational risk:

- Human Resource;
- Internal Theft and Fraud;
- Process Execution / Transaction;
- Documentation;
- Change / Project Management;
- System Availability / Suitability;
- Information Security;
- External Theft and Fraud;
- Regulatory and Legal;
- Loss of Assets / Facilities Management;
- Third Parties;
- Business Continuity; and
- Environmental.

Operational risk will remain an important part of the Company's risk profile throughout the wind-down process.

B&B invested significant resources in the development of a robust and fit for purpose Operational Risk Framework throughout 2010 which will continue to be embedded throughout 2011.

The Company's business areas manage Operational Risk through execution of the Operational Risk Framework. The Framework includes a balance of policies, appropriate procedures and internal controls to ensure that Operational Risks are identified, managed, mitigated and reported upon and includes:

- Operational Risk Committee ('ORC');
- Risk and Control Self Assessment ('RCSA');
- Operational Risk Events; and
- Operational Risk Stress and Scenario.

Risk management and control (continued)

Pages 29 to 35 form an integral part of the audited Financial Statements

At a detailed level, the Operational Risk Framework as noted above is facilitated by the Operational Risk function, in conjunction with business Managers and Directors with key objectives as follows:

Risk and control self assessment

- Provision of a consistent framework for the identification, assessment, monitoring and reporting of significant risks and key controls across B&B;
- Transparency with regard to ownership and accountability for the significant risks and key controls across the organisation;
- Enabling a strong level of understanding with regard to the design and operating effectiveness of controls in place to manage significant risks; and
- Embedding a risk and control 'culture' throughout the organisation.

Operational risk events

- Provide a consistent framework for the identification, investigation, capture and reporting of Operational Risk Events (losses, gains, recoveries and near misses).
- Generate sufficient data to enable B&B to understand the root cause of Operational Risk Events that are reported. This is key to enabling B&B to understand the weaknesses within its control environment and how such incidents can be prevented in the future.
- Enable a strong understanding of risk exposures and weaknesses with regard to the design and operating effectiveness of controls.
- Provide quantitative data to enable detailed comparison and tracking against the Company's capital requirements.
- Provide a platform in which to proactively avoid future operational losses.
- Ensure regulatory requirements are met as per FSA directives.

Operational stress and scenario

- Stress – comparison of potential operational risk financial exposure to the capital allocation as made under capital adequacy planning for Operational Risks (High Risk, High Likelihood).
- Scenario – comparison of the impact of severe but remote operational risks on capital allocation as made under the capital adequacy planning for Operational Risks (High Risk, Remote Likelihood).

In addition, specialist support functions provide expertise in risk areas such as information security, health and safety, compliance, fraud management, security and business continuity management.

Developments in risk management

During 2010, significant investment has been made in relation to the re-engineering the Risk Management Framework. A key development was the design and implementation of a new Operational Risk Framework during 2010 in line with FSA recommendations.

Developments under the Risk Management framework structure in 2010 include:

- Re-organisation and increased senior resourcing within the Group Risk team in order to augment the function's specialist risk management services, including the recruitment of a Group Risk Manager and Credit Risk Manager, and the recruitment of senior and experienced resource into the Operational Risk team;
- Re-organisation of the risk governance and committee structure, including the implementation of an Operational Risk Committee reporting into the executive Risk Committee; and
- Re-development and roll-out of Risk Management induction training for new employees and annual Risk Management training to all B&B employees to embed and reinforce a risk management culture at B&B.

Directors' remuneration report

This section of the Annual Report outlines the role and responsibilities of both the B&B and NRAM Remuneration Committees, summarises the key focus for the year and provides details of the remuneration for the Directors. This remuneration report does not form part of the Financial Statements and is not audited. It also outlines the overarching reward policy covering all colleagues. Given the current structure and commonality of the Directors in the two organisations, it is appropriate to provide one Directors' Remuneration Report for the UKAR Group.

As outlined in the Relationship Framework Document, the ongoing relationship between the Company and UKFI ensures the Company operates in the context of the agreed business plan and the overarching strategic objectives. In addition, the Company will seek to ensure that remuneration policy and practices are appropriate and both incorporate, and are reflective of, sound risk management principles.

This report covers the overarching principles of remuneration for UKAR and its subsidiary companies, B&B and NRAM, since they were transferred to UKAR ownership on 1 October 2010 and the UKAR Group was established. The report also references both B&B and NRAM during the period prior to UKAR establishment (1 January - 30 September 2010). There were no Directors or colleagues directly employed by NRAM during 2010. The remuneration and fees of the Executive Director, Non-Executive Directors and all employees were recharged from NR to NRAM under the terms of the service agreement between the two companies, which for Directors was up to 30 September 2010 from when they were paid by B&B and recharged to NRAM under a new service agreement.

FSA Code of practice on remuneration

UKAR does not need to comply with the FSA's code of practice on remuneration as non-banks are not in scope, but UKAR and its subsidiary companies will continue to ensure the principles of the Code underpin its remuneration policies and practices.

Advisers

PricewaterhouseCoopers LLP were independent advisers to the Remuneration Committee of B&B for the year. They provided external advice on market data, structure and design of incentives across all levels of the organisation and a review of compliance against the FSA Code of Practice on Remuneration. In addition, Hewitt New Bridge Street advised the companies on incentive scheme design. As NRAM had no employees, its Remuneration Committee did not seek any external advice.

Remuneration policies

UKAR and its subsidiary companies operate aligned reward and incentivisation policies that aim to support the achievement of our overall business strategy by establishing objective, consistent and fair schemes to support the consistent application and management of remuneration policies in order to provide a competitive, yet cost-effective, salary and benefits package to all employees.

Remuneration Committees

During the year the CEO, HR Director, Risk Director and Head of Reward were invited to attend B&B Remuneration Committee meetings for those items other than their own arrangements and to provide advice. UKFI representatives also attended meetings to represent the interests of the Shareholder.

Service agreements

The Company's policy is to employ Executive Directors on one-year rolling contracts. It is not the Company's policy to make non-contractual payments to Executive Directors on termination of their service agreement and no such payments were made in 2010. Executive Directors are entitled to pay in lieu of notice, should their contract be terminated, and statutory redundancy only. Since 1 October 2010 Richard Banks has been the only Executive Director of the Company.

Pre-UKAR establishment: 1 January 2010 – 30 September 2010

Remuneration Committees

The NRAM Remuneration Committee met twice during this time to consider its Terms of Reference.

The B&B Remuneration Committee met three times and, amongst other items, considered Company-wide annual bonus payments for 2009 and 2010 salary review and bonus scheme proposals. The scope of the Committee was to focus on remuneration policy across all levels of the organisation.

Directors' remuneration report (continued)

The Remuneration Committees of both companies were composed entirely of Non-Executive Directors as outlined below:

Table 1 – Remuneration Committee membership up to 30 September 2010 (pre-UKAR)

B&B	NRAM
Louise Patten (Chairman)	Robert Davies (Chairman)
Michael Buckley	Sue Langley
Richard Pym	Richard Pym

Table 2 – Executive Directors' service contracts (pre-UKAR)

	Date of service contract	Company	Company's notice period	Director's notice period
Richard Banks	27/04/2009	B&B	12 months	6 months

Gary Hoffman was Co-CEO of NRAM and NR, and Andrew Tate was Chief Operating Officer ('COO') of NRAM. Both were Executive Directors of NRAM for the period 1 January - 30 September 2010. They both resigned from the Board of NRAM on 30 September 2010.

Table 3 – Non-Executive Directors' terms of appointment (pre-UKAR)

	Date of appointment	Company	Company's notice period	Director's notice period
Richard Pym	01/07/2009	B&B	1 day	1 month
	01/01/2010	NRAM	3 months	3 months
Michael Buckley	26/07/2007	B&B	Nil	Nil
Louise Patten	17/12/2003	B&B	Nil	Nil
John Tattersall	01/04/2010	B&B	3 months	3 months
Robert Davies	01/01/2010	NRAM	3 months	3 months
Sue Langley	01/01/2010	NRAM	3 months	3 months
Kent Atkinson	01/01/2010	NRAM	3 months	3 months
Keith Morgan	01/01/2010	NRAM	3 months	3 months
Philip Remnant	01/01/2010	NRAM	3 months	3 months

Non-Executive Chairman and Non-Executive Directors' fees (pre-UKAR)

Richard Pym's total fees for Chairing both B&B and NRAM from 1 January 2010 remain unchanged at £250,000 p.a. Between 1 January and 30 September 2010, 25% (equivalent to £62,800 p.a.) of this was paid by NRAM, 75% (equivalent to £187,200 p.a.) by B&B.

Fee levels for NRAM Non-Executive Directors were determined by NR before the legal separation of NRAM and NR. Fees comprised a basic fee of £50,000, with additional sums of £20,000 paid to the Chair of the Risk Committee, £15,000 to the Chairs of the Audit and Remuneration Committees and £5,000 for membership of a Board Committee. Non-Executive Directors did not participate in any incentive arrangements, did not have service contracts and did not receive any other benefits.

Fee levels for B&B Non-Executive Directors were determined by a committee, which had a membership of the Managing Director, HR Director and Finance Director. At the beginning of the year fees comprised a basic fee of £48,000, with additional sums of £22,000 paid to the Chair of the Audit, Risk and Compliance Committees and £10,000 paid to the Chair of the Remuneration Committee. On 1 July 2010, following a review of committee structures and the splitting of Audit and Risk into two committees, these additional sums changed to £15,000 for the Audit Committee Chair, and £10,000 for both the Risk and Remuneration Committee Chairs. Non-Executive Directors did not participate in any incentive arrangements, did not have service contracts and did not receive any other benefits.

The emoluments of the Non-Executive Chairman and Non-Executive Directors for the year are detailed in table 7.

Directors' remuneration report (continued)

Components of Executive Director remuneration (pre-UKAR)

Remuneration frameworks were structured to place appropriate importance on fixed pay and short term bonus – there were no share schemes and no long-term incentive opportunities have existed since nationalisation.

- **Basic salary**

NRAM did not have any employees but did have two Executive Directors pre establishment of UKAR - Gary Hoffman, Co-CEO for NR and NRAM and Andrew Tate, COO of NRAM. They were both employed by NR and their services were provided and charged under the service level agreement between these two companies. Gary Hoffman was a Director of NR and his total remuneration is disclosed in the Annual Report & Accounts of NR. Andrew Tate was seconded to NRAM and was not a Director of NR and therefore his total remuneration is not disclosed in the Annual Report & Accounts of NR. His salary and emoluments attributable to NRAM totalling £250,152, whilst a Director of NRAM, were recharged to NRAM so are not disclosed in table 7 of this Report.

Richard Banks, Managing Director, was the only Executive Director of B&B and his basic salary was the only element of pay that pension was calculated from. He received a remuneration package determined by the Board and the Remuneration Committee. His salary increased from £250,000 p.a. at the beginning of the year to £256,000 p.a. from 1 April 2010.

- **Annual bonus arrangements**

Although NRAM did not have any employees, an accrual for bonus payments is included in that company's Financial Statements. This is to cover any bonus payments for all those colleagues who transferred from NR post UKAR establishment, as it was agreed that all colleagues would participate in the NR annual bonus scheme for all of 2010.

B&B senior employees participated in an annual bonus scheme which was aligned to targets derived directly from the Business Plan and individual payments linked to achievement of personal objectives. A maximum of 30% annual bonus was awarded, with 60% of any bonus earned payable in March 2011, and the remaining 40% deferred and payable in three equal instalments over three years. Where bonus payments have been deferred, they will be paid provided that there are no material adverse issues regarding personal and/or business performance which, in the opinion of the Remuneration Committee, were not evident at the time of making the award. Richard Banks falls into the scope of this bonus arrangement.

- **Pensions and other benefits**

Richard Banks received an annual supplement of 30% of basic salary in lieu of any company pension benefit. In line with typical market practice, other executive benefits are provided in the form of a company car allowance, housing allowance, private medical insurance, life assurance, permanent disability insurance and accident insurance.

The emoluments for the year of the Executive Director who was in place at the year end are detailed in table 7.

Post-UKAR establishment: 1 October 2010 – 31 December 2010

The information below details any changes that were made as part of the establishment of UKAR when the Remuneration Committees for UKAR, B&B and NRAM were aligned with common membership.

Appointment of Chief Executive Officer

Richard Banks, previously Managing Director of B&B, was appointed as Designate CEO of UKAR in April 2010 and this appointment was confirmed on 1 October 2010. His salary of £340,000 p.a. was determined by the 'Designate' Members of the Board and Remuneration Committee of UKAR taking into account the increased size and scope of the new role encompassing both NRAM and B&B. External advice was sought as to the appropriate salary range for this role.

The Remuneration Committee

The primary objective of the UKAR Remuneration Committee is to have oversight of the remuneration policy of the UKAR Group Companies. It is responsible for recommending to the Boards of B&B and NRAM all aspects of the remuneration arrangements for Executive Directors, Senior Executives, Approved Persons and Code Employees (as defined by the FSA Code of Practice on Remuneration) across the Companies regardless of whether such appointments are on a permanent or an interim basis. The UKAR Remuneration Committee monitors the targets for any performance-related pay schemes operated by the Companies. The Committee is also responsible for reviewing proposals as to the remuneration policies of the Companies for all staff and monitors and advises on any major changes in employee benefit structures throughout the Companies.

The full Terms of Reference for the Committees are available on the B&B corporate website.

Directors' remuneration report (continued)

The Remuneration Committee met twice between 1 October and 31 December 2010 and, amongst other items, considered changes to relevant regulations and best practice approaches within remuneration, and 2011 incentive arrangements.

The Remuneration Committees of UKAR, B&B and NRAM are composed entirely of Non-Executive Directors as follows.

Table 4 – Remuneration Committee membership (post-UKAR)

Robert Davies (Chairman) *	1 October 2010 to 31 December 2010
Sue Langley (Chairman) *	From 1 October 2010
Keith Morgan	From 1 October 2010
Louise Patten	From 1 October 2010

*Robert Davies resigned on 31 December 2010 and Sue Langley took over Chairmanship of the Remuneration Committee from that date.

Components of Executive Director remuneration

Executives and senior management are eligible for an annual bonus of up to 60% of basic salary. For 2010 this will be pro-rated as appropriate; 40% will be payable in March 2011, and the remaining 60% deferred and payable in three equal instalments over three years.

Service agreements

Service agreements following UKAR's establishment are shown below.

Table 5 – Executive Directors' service contracts (post-UKAR)

	Date of service contract	Company's notice period	Director's notice period
Richard Banks	01/10/2010	12 months	6 months

There was no change to Richard Banks' notice period post UKAR establishment.

Table 6 – Non-Executive Directors' terms of appointment (post-UKAR)

	Date of appointment**	Initial term end date	Company's notice period	Director's notice period
Richard Pym	1 October 2010	31 December 2011	3 months	3 months
Kent Atkinson	1 October 2010	31 December 2011	3 months	3 months
Michael Buckley	1 October 2010	31 December 2011	3 months	3 months
Sue Langley	1 October 2010	31 December 2011	3 months	3 months
Keith Morgan	1 October 2010	31 December 2011	3 months	3 months
Louise Patten	1 October 2010	31 December 2011	3 months	3 months
John Tattersall	1 October 2010	31 December 2011	3 months	3 months
Robert Davies*	1 October 2010	31 December 2011	3 months	3 months

* Robert Davies resigned on 31 December 2010.

** Represents the date of appointment to the Board of UKAR: the Directorships of B&B and NRAM continued unchanged but all notice periods have been aligned to the UKAR notice periods.

Directors' remuneration report (continued)

Non-Executive Chairman and Non-Executive Directors' fees

With effect from 1 October 2010 the basic fee for Non-Executive Directors was set at £50,000 p.a. to cover directorships of all three companies, UKAR, B&B and NRAM. In addition, the members of the Audit, Risk, Remuneration and Nomination Committees receive a fee of £5,000 p.a. per membership, which increases to £15,000 for the Chairs of the Audit, Risk and Remuneration Committees.

Richard Pym's total annual fees for chairing all three companies was unchanged at £250,000 p.a.

There were no further changes to fee levels for Non-Executive Directors post UKAR establishment.

Non-Executive Directorships

Executive Directors who hold Non-Executive Directorships in other companies are permitted to retain their earnings from these posts. Richard Banks is the only Executive Director for the Company and he has held two external directorships during the year, in each case for the whole of 2010. One was with Liverpool Compact Education Business Partnership for which he received no fees (2009: £nil) and the second was with ICICI Bank UK plc for which he received fees of £50,000 (2009: £4,166).

Pensions

There were no NRAM employees during the year and therefore no disclosure relating to pensions. For Gary Hoffman and Andrew Tate, pension salary supplements were paid by NR and 50% recharged through to NRAM under the terms of a service agreement.

The final salary-based Bradford & Bingley Staff Pension Scheme closed to future accrual with effect from 31 December 2009. No Director who served during the year had any accrued pension entitlements under any UKAR Company pension scheme.

In 2010, pension payments due to former Bradford & Bingley Building Society Directors, paid directly by B&B and not connected to the Bradford & Bingley plc Staff Pension Scheme, amounted to £23,714 (2009: £23,073). For NRAM, pension payments due to former Directors, paid directly by NRAM and not connected to the Northern Rock Staff Pension Scheme, amounted to £277,306 (2009: £210,565).

Directors' remuneration report (continued)

Table 7 – Directors' Emoluments for the year ended 31 December 2010

The table below sets out the total emoluments paid to those directors who were directors of UKAR Group companies at 31 December 2010 in respect of their services in 2010 to companies within the UKAR Group. This table also sets out the total emoluments paid to those individuals who were directors of NR for the year ended 31 December 2009 before the legal separation of NRAM from NR and the total emoluments paid to those individuals who were directors of B&B for the year ended 31 December 2009.

Executive Directors	Basic salary/fees*	Non-cash benefits	Allowances	Payment in lieu of pension	Bonus**	Total emoluments 2010	B&B Total emoluments 2009	NR*** Total emoluments 2009
Richard Banks ¹	£275,500	£1,061	£22,800	£82,650	£170,000	£552,011	£261,799	–
Chris Willford ⁹	–	–	–	–	–	–	£946,297	–
Roger Hattam ⁹	–	–	–	–	–	–	£651,442	–
Gary Hoffman ⁸	–	–	–	–	–	–	–	£1,487,166
Anne Godbehere ²	–	–	–	–	–	–	–	£85,641
Andrew Tate ³	–	–	–	–	–	–	–	–
Total	£275,500	£1,061	£22,800	£82,650	£170,000	£552,011	£1,859,538	£1,572,807
Non-Executive Directors								
Richard Pym ⁴	£250,000	–	–	–	–	£250,000	£454,913	–
Kent Atkinson	£70,000	–	–	–	–	£70,000	–	£80,000
Michael Buckley	£67,000	–	–	–	–	£67,000	£70,000	–
Robert Davies	£68,750	–	–	–	–	£68,750	–	£70,000
Sue Langley ⁵	£60,000	–	–	–	–	£60,000	–	–
Keith Morgan ⁶	–	–	–	–	–	–	–	–
Philip Remnant ¹⁰	£45,000	–	–	–	–	£45,000	–	£70,000
Louise Patten	£58,500	–	–	–	–	£58,500	£58,000	–
John Tattersall	£44,000	–	–	–	–	£44,000	–	–
Ron Sandler ⁷	–	–	–	–	–	–	–	£350,000
Laurie Adams ⁷	–	–	–	–	–	–	–	£85,000
Richard Coates ⁷	–	–	–	–	–	–	–	£70,000
John Devaney ⁷	–	–	–	–	–	–	–	£80,000
Tom Scholar ^{6&7}	–	–	–	–	–	–	–	–
Total	£663,250	–	–	–	–	£663,250	£582,913	£805,000
Grand Total	£938,750	£1,061	£22,800	£82,650	£170,000	£1,215,261	£2,442,451	£2,377,807

* The only element of pay that pension is calculated on.

** Payment is subject to the same rules around deferral and clawback as outlined earlier in this report.

*** NR was renamed as NRAM on 1 January 2010.

- As MD of B&B, Richard Banks was entitled to receive an annual bonus award which was capped upon his appointment at a maximum of £30,000 for 2009. The Remuneration Committee awarded Richard the maximum amount of £30,000 in early 2010. Scheme rules meant any bonus was deferred over three years, therefore Richard was entitled to receive £10,000 in 2010, 2011 and 2012 but he deferred his entitlement to receive the first payment in 2010 as the business had not made a profit. In 2011 the Remuneration Committee agreed to award Richard this deferred payment of £10,000 for 2009 together with the second tranche of £10,000 for 2010. In addition £73,100 will be paid in respect of 2010 performance with £96,900 deferred to future periods.
- Anne Godbehere remuneration relates to the period of service from 1 January to 31 January 2009.
- Andrew Tate was COO and a director of NRAM for the period from 1 January to 30 September 2010 during which time he was employed by NR and seconded to NRAM. His remuneration was paid by NR and charged to NRAM under the terms of a service agreement. He was not an Executive Director of either NR or NRAM during 2009, and therefore no comparative information is included. The remuneration paid to him in respect of his service to NRAM was £250,512 representing 50% of the total of his remuneration for the period to 30 September 2010.
- Richard Pym was Executive Chairman of B&B for the period up to 1 July 2009 for which he was paid £361,313 and became Non-Executive Chairman from that date for which he received fees of £93,600.

Directors' remuneration report (continued)

5. Sue Langley's fees are not paid directly to her. The fees shown in table 7 were paid to Lloyd's of London during 2010 for her services.
6. Keith Morgan, as the representative of UKFI, waived all fees for the year, as did Tom Scholar who was the representative for HM Treasury.
7. Ron Sandler, Laurie Adams, Richard Coates, John Devaney and Tom Scholar all stood down as Non-Executive Directors with effect from 1 January 2010. 2009 information is included as individuals were Non-Executive Directors of NR in 2009.
8. Gary Hoffman's emoluments in 2010 were paid by NR and he received no direct remuneration from NRAM or other UKAR companies during his period as Co-CEO of NRAM and NR. His remuneration was approved by the NR Remuneration Committee and NRAM was charged 50% of his employment costs and expenses under a service agreement and is not included in the total emoluments in table 7 above.
9. As stated in the B&B 2009 Annual Report & Accounts, two Executive Directors, Chris Willford and Roger Hattam, stood down and their notice expired on 4 June 2010.
10. Philip Remnant stood down with effect from 1 October 2010.

Table 7 disclosures do not reflect what has been charged in the accounts in 2010 as the emoluments shown relate to the UKAR Non-Executive Chairman, Executive Directors and Non-Executive Directors in total and these have been charged to NRAM and B&B in accordance with the service agreements between these companies. The emoluments of both Andrew Tate and Gary Hoffman are not included for 2010 in table 7 as they were paid through NR being recharged to NRAM under the service agreement in place at that time.

Details of the emoluments of the highest paid Director and of total Directors' remuneration for the Company may be found within note 31 to the Financial Statements. These differ from the values disclosed in table 7 above, as the values in this table relate to services to all UKAR Group companies.

Corporate social responsibility report

B&B aims to conduct its business in a socially responsible manner in respect of employees, customers, local communities and the environment.

Workplace and employees

B&B's employment practices reflect international and national standards covering areas such as minimum working age, working hours, health and safety and discrimination.

The Company promotes diversity and equality across all aspects of working life and believes it is important to share best practice and success.

Opportunities are provided for all employees to develop their skills and knowledge.

The Company recognises that the health and well-being of employees is vital to the business.

The recognised union for employees is Unite.

Customers

B&B has around 238,000 mortgage customers (2009: 260,000) to serve and manage and endeavours to treat each customer as an individual, with openness, honesty and integrity. The Company adheres to the FSA's formal framework for Treating Customers Fairly.

B&B works closely with those customers experiencing payment difficulties to exhaust all reasonable efforts before commencing repossession proceedings, which is viewed as a last resort.

Community

During 2010, B&B continued its investment into the community especially in Bradford and the Aire Valley, where the majority of our employees live and work.

In 2010, B&B focused community support on preventing and alleviating the causes of homelessness. Business Action on Homelessness ('BAOH') is the flagship programme of Business in the Community. BAOH is a unique partnership between leading businesses, homelessness agencies and the government, which aims to help homeless people to find employment and achieve independent living.

Employees at our offices in Bingley and Crossflatts voted for Sue Ryder Care at Manorlands to be B&B's charity of the year in 2010 and fundraising activities and sponsorship helped to raise over £8,000 for the charity. The Community Action Team, which consists of volunteers from across all functions of the business, assisted five other local charities and many community groups with funding and support.

B&B supports other fundraising activities by matching the first £250 of funds raised per employee and by matching employee donations through a payroll-giving programme. During the year, B&B matched employee fundraising to the total of £7,312 and payroll-giving totalled £7,323.

During 2010, 350 employees took part in volunteering events in the Bradford area, organised through 'Be Involved' and employees have supported a local primary school through the 'Better Reading' programme.

The environment

During 2010, B&B sought to continue to improve its environmental performance through a number of initiatives.

B&B is a member of the West Yorkshire Metro Travel Network and promotes its commitment to environmentally friendly travel by offering employees discounted annual travel tickets for the West Yorkshire area.

The main waste streams produced by B&B consist of general office waste, confidential paper waste and IT equipment.

There are procedures in place to recycle paper, plastic, aluminium, toners, metals, IT components and mobile phones.

Corporate social responsibility in 2011

The Company will continue its support of homeless charities and local community involvement in 2011. The corporate social responsibility strategies for B&B and NRAM will be aligned.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report & Accounts in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company Financial Statements for each financial year. Under that law they have elected to prepare both the Group and the Parent Company Financial Statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union ('EU') and applicable law.

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 Group and Parent Company and of their profit or loss for that period. In preparing each of the Group and Parent Company Financial Statements, the Directors are required to.

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether they have been prepared in accordance with IFRS as adopted by the EU; and
- Prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its Financial Statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

Other matters

Principal activities

The principal activities of the UKAR Group are explained in the CEO's review on page 6.

Review of business, future developments, principal risks and uncertainties

A review of the business, future developments, principal risks and uncertainties is set out in the CEO's review on page 6.

Property, plant and equipment

Land and buildings, which are included in the Balance Sheet at cost less accumulated depreciation, amounted to £8.9m at 31 December 2010. In the Directors' opinion, based on valuations carried out by the Company's external qualified Chartered Surveyors, the total market value of those assets at that date was not significantly different to the Balance Sheet amount.

Dividends

The Directors do not propose the payment of any dividend in respect of the year ended 31 December 2010.

Shares

On 29 September 2008, pursuant to the terms of The Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008, all shares were transferred to the Treasury Solicitor as nominee for HM Treasury.

On 1 October 2010, the shares of B&B were transferred to UKAR, the newly formed holding company into which the ownership of NRAM was also transferred. UKAR is wholly owned by HM Treasury, with the shares of the Company being held by the Treasury Solicitor as nominee for HM Treasury.

There has been no change in the issued share capital since the Company was taken into public ownership and the number of ordinary shares of 25 pence each in issue throughout 2010 and as at 31 December 2010 was 1,445,344,774.

The Company has one class of shares: ordinary shares of 25 pence each. Further details concerning the rights and obligations attaching to the shares, including voting rights, can be found in the Company's Articles of Association.

Directors' interests

Following the Transfer on 29 September 2008, no Director has any interests in shares in the Company.

No Director had any material interest during the year in any contract of significance to the Company's business.

Major Shareholders

As at the date of this Report, all shares are held by UKAR, which is wholly owned by HM Treasury.

Compensation Scheme Order

In June 2009, in accordance with the B&B plc Compensation Scheme Order 2008, HM Treasury appointed an independent valuer to assess what compensation is due, if any, to former shareholders and other interested parties following the Transfer. Further details about the Valuer can be found at his website, www.bandbvaluer.org.uk.

Employee involvement

During the year we have continued to maintain and develop policies and approaches which enable:

- Sharing information with employees;
- Consultation with employees about decisions affecting employees' interests;
- Involving employees in defining our new Company values;
- Encouraging employee involvement in the Company's performance; and
- Achieving a common awareness on the part of all employees of the financial and economic factors affecting the performance of the Company.

Other matters (continued)

Charitable and political donations

Details of the Company's charitable donations and corporate social responsibility activity can be seen on page 43.

No contributions were made for political purposes in 2010 or 2009. The Group does not make any payments that might be deemed to be political in nature.

Creditor payment policy

It is the policy of the Company to pay creditor invoices within 30 days of the invoice date. The Company is willing to consider requests by small suppliers for a shorter settlement period. The average number of creditor days in 2010 was 30 days (2009: 12 days).

Events after the reporting period

Details of events after the reporting period are shown in note 37 to the Financial Statements.

Directors' indemnities

The Company's Articles of Association provide the power to indemnify any Director against liabilities incurred as a result of their office.

UKAR, the holding company, has also provided each Director with a Deed of Indemnity indemnifying them to the fullest extent permitted by law against all losses suffered or incurred in respect of acts and omissions arising as a result of holding office. The indemnities also extend to the reimbursement of each Director with the costs of defending all claims, actions and proceedings including regulatory investigation arising out of or connected with the exercise of, or failure to exercise, any of the Director's powers, duties or responsibilities as an officer, director, trustee, agent or employee of UKAR Group and any of its subsidiaries. Reimbursement is subject to the Director's obligation to repay the Company in accordance with the provisions of the Companies Act 2006. The payment obligations of the Company under each Deed of Indemnity are backed by a specific guarantee in favour of the Director entered into between each Director and HM Treasury.

The Company has also arranged Director's and Officer's Insurance on behalf of the Directors in accordance with the provisions of the Companies Act 2006.

Annual General Meeting ('AGM')

It is proposed that the AGM of the Company will be held on 28 April 2011.

Auditor

A resolution to appoint the Company's auditors, following a competitive tendering process, will be put to the Shareholder at the forthcoming AGM.

Disclosure of information to the Auditor

As at the date of this report, each person who is a Director confirms that:

- So far as each Director is aware there is no relevant audit information of which the Company's auditor is unaware; and
- Each Director has taken such steps as he or she ought to have taken as a Director in order to make him 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 (2) of the Companies Act 2006.

Paul Hopkinson

Company Secretary, on behalf of the Board

30 March 2011

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Independent Auditor's report to the members of Bradford & Bingley plc

We have audited the Group and Parent Company Financial Statements of Bradford & Bingley plc for the year ended 31 December 2010 set out on pages 49 to 117. The Company reporting framework that has been applied in their preparation is applicable law and IFRS as adopted by the EU and, as regards the Parent Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 44, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's ('APB's') Ethical Standards for Auditors.

Scope of the audit of the Financial Statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2010 and of the Group's profit for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with IFRS as adopted by the EU;
- the Parent Company Financial Statements have been properly prepared in accordance with IFRS as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

J L Ellacott (Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants

1 The Embankment

Neville Street

Leeds LS1 4DW

30 March 2011

Consolidated Income Statement

For the year ended 31 December

	Note	2010 £m	Restated* 2009 £m
Interest receivable and similar income		934.9	1,227.4
Interest expense and similar charges		(327.0)	(615.0)
Net interest income	3	607.9	612.4
Fee and commission income		21.1	52.6
Net realised gains less losses on investment securities	33e	46.9	(8.5)
Unrealised fair value movements on financial instruments	33e	(9.3)	(79.1)
Hedge ineffectiveness	33e	3.0	44.1
Other operating income		2.9	1.1
Net operating income		672.5	622.6
Administrative expenses:			
- Ongoing	4	(112.3)	(137.1)
- Other net expenses	4	(14.1)	-
FSCS levy on retail deposits	5	-	(7.9)
Impairment on loans and advances to customers	10	(276.6)	(593.7)
Net impairment on investment securities	11	14.5	(93.3)
Defined benefit pension scheme curtailment	25d	-	13.4
Gain on sale of insurance business	6	11.5	-
Gain on repurchase of subordinated liabilities	7	786.0	-
Profit / (loss) before taxation		1,081.5	(196.0)
Taxation	8	(262.3)	97.7
Profit / (loss) for the financial year		819.2	(98.3)

The notes on pages 55 to 117 form an integral part of these Financial Statements.

The Company's profit after tax for the financial year was £727.7m (2009: £2.3m). As permitted by Section 408 of the Companies Act 2006, the Company's Income Statement has not been presented in these Financial Statements.

The Group's business and operations comprise one single activity, principally within the United Kingdom. The results above arise from continuing activities and are attributable to the equity shareholder.

*For 2010, the Group has amended its presentation of certain types of interest receivable and interest expense, with no effect on net interest income, as detailed in note 3. As a result, the 2009 interest receivable and similar income and the 2009 interest expense and similar charges shown above have been changed from the amounts previously presented in the Group's 2009 Income Statement.

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2010

	Gross of tax £m	Tax £m	Net of tax £m
Profit for the financial year	1,081.5	(262.3)	819.2
Available-for-sale instruments:			
- Net gains / (losses) recognised in available-for-sale reserve during the year	60.8	(17.0)	43.8
- Amounts transferred from available-for-sale reserve and recognised in profit during the year	24.2	(6.8)	17.4
Cash flow hedges:			
- Net gains / (losses) recognised in cash flow hedge reserve during the year	42.7	(12.2)	30.5
- Amounts transferred from cash flow hedge reserve and recognised in profit during the year	(24.1)	6.7	(17.4)
Actuarial gains on post-retirement benefit obligations	7.8	(2.0)	5.8
Effect of funding plan for post-retirement benefit obligations	(117.6)	30.7	(86.9)
Other comprehensive expense	(6.2)	(0.6)	(6.8)
Total comprehensive income for the financial year	1,075.3	(262.9)	812.4

For the year ended 31 December 2009

	Gross of tax £m	Tax £m	Net of tax £m
Loss for the financial year	(196.0)	97.7	(98.3)
Available-for-sale instruments:			
- Net gains / (losses) recognised in available-for-sale reserve during the year	228.9	64.4	293.3
- Amounts transferred from available-for-sale reserve and recognised in profit during the year	10.5	(2.9)	7.6
Cash flow hedges:			
- Net gains / (losses) recognised in cash flow hedge reserve during the year	154.4	(43.3)	111.1
- Amounts transferred from cash flow hedge reserve and recognised in profit during the year	(3.1)	0.9	(2.2)
Actuarial losses on post-retirement benefit obligations	(105.0)	29.5	(75.5)
Other comprehensive income	285.7	48.6	334.3
Total comprehensive income for the financial year	89.7	146.3	236.0

Balance Sheets

At 31 December

	Note	Group		Company	
		2010 £m	2009 £m	2010 £m	2009 £m
Assets					
Cash and balances at central banks		308.0	323.0	300.0	316.6
Loans and advances to banks		3,671.2	3,442.3	2,347.8	1,436.2
Loans and advances to customers	9	36,401.8	38,986.2	48,283.3	54,343.7
Fair value adjustments on portfolio hedging	33e	223.2	294.2	223.2	294.2
Investment securities	11	1,673.1	2,555.9	5,441.1	10,269.1
Derivative financial instruments	33e	2,929.1	3,660.6	483.2	902.3
Prepayments and accrued income		8.1	11.5	6.8	6.5
Investments in Group undertakings	13	–	–	1,111.2	1,037.2
Other assets		1.5	–	0.8	–
Deferred tax assets	14	120.4	105.9	287.6	305.7
Property, plant and equipment	15	18.8	15.0	18.4	13.8
Intangible assets	16	3.3	–	3.3	–
Total assets		45,358.5	49,394.6	58,506.7	68,925.3
Liabilities					
Deposits by banks		2,154.9	2,809.5	878.0	1,092.6
Other deposits	17	–	457.5	20,177.3	28,257.4
HM Treasury Working Capital Facility	18	8,564.2	8,537.8	8,564.2	8,537.8
Statutory Debt	19	18,416.2	18,416.2	18,416.2	18,416.2
Derivative financial instruments	33e	531.9	665.6	647.6	725.2
Debt securities in issue:					
- Securitised notes	20	5,272.9	6,021.9	–	–
- Covered Bonds	21	4,977.6	5,768.2	4,977.6	5,768.2
- Other	22	2,297.2	3,343.5	2,297.2	3,343.5
Other liabilities	23	66.6	88.2	63.3	80.4
Accruals and deferred income	24	32.9	119.3	30.1	119.8
Current tax liabilities		215.1	67.8	211.9	48.7
Post-retirement benefit obligations	25d	194.1	97.7	194.1	97.7
Provisions	26	34.5	52.8	34.5	52.8
Subordinated liabilities	27	337.9	1,309.2	471.8	1,629.5
Other capital instruments	28	56.0	245.3	–	–
Total liabilities		43,152.0	48,000.5	56,963.8	68,169.8
Equity					
Issued capital and reserves attributable to equity holder of the parent:					
- Share capital	29	361.3	361.3	361.3	361.3
- Share premium reserve		198.9	198.9	198.9	198.9
- Capital redemption reserve		29.2	29.2	29.2	29.2
- Available-for-sale reserve		14.0	(47.2)	(587.6)	(715.3)
- Cash flow hedge reserve		(26.5)	(39.6)	(26.5)	(39.6)
- Retained earnings		1,629.6	891.5	1,567.6	921.0
Share capital and reserves		2,206.5	1,394.1	1,542.9	755.5
Total equity and liabilities		45,358.5	49,394.6	58,506.7	68,925.3

The notes on pages 55 to 117 form an integral part of these Financial Statements.

The Financial Statements were approved by the Board of Directors and authorised for issue on 30 March 2011 and signed on its behalf by:

Richard Pym
Chairman

Richard Banks
Chief Executive Officer

Bradford & Bingley plc is registered in England and Wales under Company Number No. 3938288.

Statements of Changes in Equity

For the year ended 31 December

Group	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Available- for-sale reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total capital and reserves £m
At 1 January 2010	361.3	198.9	29.2	(47.2)	(39.6)	891.5	1,394.1
Net change in available-for-sale reserve	-	-	-	61.2	-	-	61.2
Net change in cash flow hedge reserve	-	-	-	-	13.1	-	13.1
Actuarial losses on post-retirement benefit obligations	-	-	-	-	-	(81.1)	(81.1)
Net gains / (losses) not recognised in the Income Statement	-	-	-	61.2	13.1	(81.1)	(6.8)
Profit for the financial year	-	-	-	-	-	819.2	819.2
Total comprehensive income	-	-	-	61.2	13.1	738.1	812.4
At 31 December 2010	361.3	198.9	29.2	14.0	(26.5)	1,629.6	2,206.5

Group	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Available- for-sale reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total capital and reserves £m
At 1 January 2009	361.3	198.9	29.2	(348.1)	(148.5)	1,065.3	1,158.1
Net change in available-for-sale reserve	-	-	-	300.9	-	-	300.9
Net change in cash flow hedge reserve	-	-	-	-	108.9	-	108.9
Actuarial losses on post-retirement benefit obligations	-	-	-	-	-	(75.5)	(75.5)
Net gains / (losses) not recognised in the Income Statement	-	-	-	300.9	108.9	(75.5)	334.3
Loss for the financial year	-	-	-	-	-	(98.3)	(98.3)
Total comprehensive income / (expense)	-	-	-	300.9	108.9	(173.8)	236.0
At 31 December 2009	361.3	198.9	29.2	(47.2)	(39.6)	891.5	1,394.1

Company	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Available- for-sale reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total capital and reserves £m
At 1 January 2010	361.3	198.9	29.2	(715.3)	(39.6)	921.0	755.5
Net change in available-for-sale reserve	-	-	-	127.7	-	-	127.7
Net change in cash flow hedge reserve	-	-	-	-	13.1	-	13.1
Actuarial losses on post-retirement benefit obligations	-	-	-	-	-	(81.1)	(81.1)
Net gains / (losses) not recognised in the Income Statement	-	-	-	127.7	13.1	(81.1)	59.7
Profit for the financial year	-	-	-	-	-	727.7	727.7
Total comprehensive income	-	-	-	127.7	13.1	646.6	787.4
At 31 December 2010	361.3	198.9	29.2	(587.6)	(26.5)	1,567.6	1,542.9

Company	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Available- for-sale reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total capital and reserves £m
At 1 January 2009	361.3	198.9	29.2	(1,087.9)	(148.5)	994.2	347.2
Net change in available-for-sale reserve	-	-	-	372.6	-	-	372.6
Net change in cash flow hedge reserve	-	-	-	-	108.9	-	108.9
Actuarial losses on post-retirement benefit obligations	-	-	-	-	-	(75.5)	(75.5)
Net gains / (losses) not recognised in the Income Statement	-	-	-	372.6	108.9	(75.5)	406.0
Profit for the financial year	-	-	-	-	-	2.3	2.3
Total comprehensive income / (expense)	-	-	-	372.6	108.9	(73.2)	408.3
At 31 December 2009	361.3	198.9	29.2	(715.3)	(39.6)	921.0	755.5

The share premium reserve represents the excess of the consideration received for issued shares over the nominal value of those shares, net of transaction costs. The capital redemption reserve was created on the sale of surplus conversion shares and to maintain the total amount of capital when shares were repurchased by the Company.

The available-for-sale reserve represents cumulative fair value movements on assets which are still held at the Balance Sheet date and are classified as available-for-sale.

The cash flow hedge reserve represents cumulative fair value movements on financial instruments which are still held at the Balance Sheet date and are effective cash flow hedges.

Cash Flow Statements

For the year ended 31 December

	Note	Group		Company	
		2010 £m	2009 £m	2010 £m	2009 £m
Cash flows from operating activities					
Profit / (loss) for the financial year		819.2	(98.3)	727.7	2.3
Adjustments to reconcile net profit / (loss) to cash flows from operating activities:					
- Income tax charge / (credit)	8	262.3	(97.7)	271.7	(60.1)
- Depreciation and amortisation	15,16	0.4	0.4	0.4	0.4
- Loan impairment	10	278.4	592.7	205.2	319.6
- Recoveries of loans and advances previously written off	10	(1.8)	1.0	0.4	1.2
- Net impairment on investment securities	11	(14.5)	93.3	(14.5)	93.3
- Impairment of investments in subsidiary undertakings	13	-	-	-	8.5
- Defined benefit pension scheme curtailment	25d	-	(13.4)	-	(13.4)
- Gain on sale of insurance business	6	(11.5)	-	(9.5)	-
- Gain on repurchase of subordinated liabilities	7	(786.0)	-	(823.8)	-
- Interest on subordinated liabilities and other capital instruments	27,28	59.9	92.5	62.9	96.1
- Net profit on sale of property, plant and equipment and intangible assets	15,16	(2.9)	-	(2.9)	-
- Gains less losses on sale of investment securities		24.2	10.5	24.2	10.5
Cash flows from operating activities before changes in operating assets and liabilities					
		627.7	581.0	441.8	458.4
Net decrease / (increase) in operating assets:					
- Loans and advances to banks and customers	9	1,479.2	2,577.9	5,661.6	4,024.1
- Acquisitions of mortgage portfolios		-	(291.3)	-	-
- Investment securities	11	854.2	485.0	4,798.9	1,056.8
- Derivative financial instruments	33e	731.5	2,362.3	419.1	832.6
- Prepayments and accrued income		7.9	6.8	4.8	2.3
- Other assets		(1.5)	2.7	(0.8)	1.4
Net (decrease) / increase in operating liabilities:					
- Deposits by banks and other deposits	17	(1,110.5)	(6,796.1)	(8,294.8)	(9,006.1)
- Derivative financial instruments	33e	(133.7)	(564.6)	(77.6)	(584.2)
- Debt securities in issue	20,21,22	(482.0)	(3,252.3)	(435.6)	(2,835.4)
- Other liabilities	23	74.7	109.3	79.3	116.1
- Accruals and deferred income	24	6.3	(148.0)	5.4	(167.9)
- Provisions	26	(18.3)	(30.8)	(18.3)	(30.8)
- Income taxes paid	8	(130.1)	(49.4)	(128.2)	(42.6)
- Other non-cash items		(16.4)	490.4	122.1	590.2
Net cash generated by / (used in) operating activities					
		1,889.0	(4,517.1)	2,577.7	(5,585.1)
Cash flows from investing activities:					
- Proceeds of sale of insurance business	6	11.5	-	9.5	-
- Purchase of property, plant and equipment and intangible assets	15,16	(11.6)	(0.9)	(11.6)	(0.9)
- Proceeds from sale of property, plant and equipment and intangible assets	15,16	7.0	2.6	6.2	-
- Realisation of investment in subsidiary undertaking	13	-	-	1.0	199.0
- Capital injection into subsidiary undertaking	13	-	-	(75.0)	-
Net cash from / (used in) investing activities					
		6.9	1.7	(69.9)	198.1

The notes on pages 55 to 117 form an integral part of these Financial Statements.

Cash Flow Statements (continued)

For the year ended 31 December

	Note	Group		Company	
		2010 £m	2009 £m	2010 £m	2009 £m
Cash flows from financing activities:					
- Amounts paid to repurchase subordinated liabilities and other capital instruments	7	(434.2)	-	(434.2)	-
- HM Treasury Working Capital Facility	18	-	6,262.1	-	6,262.1
- Statutory Debt	19	-	2.3	-	2.3
- Repayments of secured funding	20,21	(2,081.1)	(2,197.5)	(1,376.5)	(1,342.0)
- Interest paid on subordinated liabilities and other capital instruments	27,28	-	(40.2)	-	(41.0)
- Amounts paid under the guarantee to the holders of other capital instruments	28	(9.7)	-	(9.7)	-
Net cash (used in) / from financing activities		(2,525.0)	4,026.7	(1,820.4)	4,881.4
Net increase / (decrease) in cash and cash equivalents		(629.1)	(488.7)	687.4	(505.6)
Cash and cash equivalents at beginning of year		3,705.8	4,194.5	1,750.6	2,256.2
Cash and cash equivalents at end of year		3,076.7	3,705.8	2,438.0	1,750.6
Represented by cash and assets with original maturity of three months or less within:					
- Cash and balances at central banks		308.0	306.4	300.0	300.0
- Loans and advances to banks		2,768.7	3,385.0	2,138.0	1,436.2
- Investment securities	11	-	14.4	-	14.4
		3,076.7	3,705.8	2,438.0	1,750.6
Balances maintained with the Bank of England excluded from cash and cash equivalents		-	16.6	-	16.6

As shown above, at 31 December 2009 the Group maintained balances with the Bank of England which were not included in cash and cash equivalents for the purposes of the Cash Flow Statement because the Group was not free to use these funds.

The notes on pages 55 to 117 form an integral part of these Financial Statements.

Notes to the Financial Statements

1. Principal accounting policies

Bradford & Bingley plc ('the Company') is a public limited company which was incorporated in the United Kingdom under the Companies Act 1985 and is registered in England and Wales.

These Financial Statements were authorised for issue by the Directors on 30 March 2011 and will be put to the shareholder for approval at the Company's Annual General Meeting to be held on 28 April 2011.

(a) Statement of compliance

Both the Company Financial Statements and the Group Financial Statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU. In publishing the Company Financial Statements here together with the Group Financial Statements, the Company has taken advantage of the exemption in s408 of the Companies Act 2006 not to present its individual Income Statement and related notes.

For these 2010 Financial Statements, including the 2009 comparative financial information where applicable, the Group and Company have adopted for the first time the following statements:

- The January 2008 amendment to IFRS 3 'Business Combinations'. This amendment does not change the treatment of business combinations which occurred in prior years and has had no impact on the Group's or Company's Income Statements, Balance Sheets or Cash Flow Statements.
- The May 2008 amendment to IAS 27 'Consolidated and Separate Financial Statements'. This amendment has had no impact on the Group's or Company's Income Statements, Balance Sheets or Cash Flow Statements.
- The July 2008 amendment to IAS 39 'Financial Instruments: Recognition and Measurement' relating to eligible hedged items. This amendment has had no impact on the Group's or Company's Income Statements, Balance Sheets or Cash Flow Statements.

For these 2010 Financial Statements the Group and Company have not adopted the following statement:

- IFRS 9 'Financial Instruments', issued in October 2010 as part of the International Accounting Standards Board's ('IASB's') project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. This is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.

(b) Basis of preparation

The Financial Statements have been prepared on a going concern basis and using the historical cost convention except:

- (i) the following assets and liabilities are carried at their fair value:
 - derivative financial instruments;
 - financial instruments categorised under IAS 39 as 'at fair value through profit or loss'; and
 - financial instruments categorised under IAS 39 as 'available-for-sale'; and
- (ii) where fair value hedge accounting has been applied, the carrying value of hedged items has been adjusted to take account of the fair value of the risk which has been hedged.

The validity of the going concern basis of accounting is dependent upon the funding position of the Company. At the date of approval of these Financial Statements, the Group and Company are reliant upon the financing facilities and also upon the guarantee arrangements provided to the Company by HM Treasury. Withdrawal of the financing facilities or the guarantee arrangements would have a significant impact on the Group's and Company's operations and their ability to continue as a going concern, in which case adjustments may have to be made to reduce the carrying value of assets to recoverable amounts and to provide for further liabilities that might arise. At the signing date, HM Treasury has confirmed its intentions to continue to provide funding until at least 31 December 2012.

The Directors consider that the accounting policies set out in this note are the most appropriate to the Group's and the Company's circumstances, have been consistently applied to both the Group and the Company in dealing with items which are considered material, and are supported by reasonable and prudent estimates and judgements. The accounting policies have been applied to all periods presented in these Financial Statements and are consistent with the accounting policies used by the Group in preparing its Interim Financial Information for the six months ended 30 June 2010.

The Company is regulated by the FSA as a mortgage administration company and the Directors believe that it has appropriate and adequate levels of capital to support these activities subject to the continuing support of HM Treasury.

The Financial Statements have been prepared in accordance with EU endorsed IFRS, International Financial Reporting Interpretations Committee ('IFRIC') interpretations and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. A summary of the more important accounting policies is set out below. The preparation of the Financial Statements in conformity with these accounting policies and generally accepted accounting principles requires the use of estimates and assumptions that affect the reported values of assets and liabilities at the date of the Financial Statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates (see note 2).

The Directors consider the business to comprise one operating and geographical segment due to the similarity of risks faced within its UK based residential and commercial portfolios.

Notes to the Financial Statements (continued)

1. Principal accounting policies continued**(c) Basis of consolidation**

The Group's Financial Statements incorporate on a fully consolidated line-by-line basis the Financial Statements of the Company and those entities (including special purpose structures) which are controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. Where subsidiaries have been acquired during a period, their results are consolidated into the Group's Financial Statements from the date control is transferred to the Group. Where subsidiaries have been disposed of, their results are consolidated to the date of disposal. On the acquisition of a business, fair values are attributed to the assets, liabilities and contingent liabilities acquired. Any difference between the consideration given and the fair value of the net assets acquired is capitalised as goodwill, which is subject to impairment testing in accordance with IAS 36 'Impairment of Assets'.

The Group has securitised various residential mortgage loans, generally by sale or transfer to Special Purpose Vehicles ('SPVs') which in turn issue securities to investors. The SPVs are consolidated line-by-line into the Group Financial Statements if they are, in substance, controlled by the Company. The Group presently receives substantially all of the post-tax profits of all the SPVs and hence retains substantially all of the risks and rewards of the securitised loans, and consequently all of the SPVs are fully consolidated.

(d) Interest income and expense

For all interest-bearing financial instruments except derivatives, interest income and expense are recognised in the Income Statement on an Effective Interest Rate ('EIR') basis.

The EIR method calculates the amortised cost of a financial asset or financial liability and spreads the resulting interest income or interest expense on a level yield basis over the expected life of the instrument. The EIR is the rate which at the inception of the instrument exactly discounts expected future cash flows over the expected life of the instrument to the initial carrying amount. When calculating the EIR, future cash flows are estimated, considering all contractual terms of the instrument (for example prepayment options), but potential future credit losses are not considered. The calculation includes all directly attributable incremental fees and costs, premia on acquisition of mortgage portfolios and all other premia and discounts as well as interest.

When a financial asset or a group of similar financial assets is written down as a result of an impairment loss, interest income continues to be recognised by applying the applicable EIR to the reduced balance.

(e) Fee and commission income

Where Value Added Tax ('VAT') is charged, income is stated net of VAT.

Commission receivable from the renewal of third party Regulated Financial Services products is recognised as income within 'fee and commission income' when the renewal policy goes 'on risk', net of any provision for repayment in the event of early termination by the customer. If the commission is receivable on deferred terms, a deemed interest element of the commission is separated and recognised on an EIR basis over the deferred payment period.

Fee and commission income also arises on various other activities and where they are not included within the EIR calculation, they are generally recognised on an accruals basis when the service has been provided, or as cash is received, and are accounted for within 'fee and commission income' in the Income Statement.

(f) Bonuses payable

An accrual is made for all bonuses which have been earned by the Balance Sheet date, even though these may not subsequently be payable due to clawback or the employee leaving the Group.

(g) Financial instruments

In accordance with IAS 39 each financial asset is classified at initial recognition into one of four categories:

- (i) Financial assets at fair value through profit or loss;
- (ii) Held-to-maturity investments;
- (iii) Loans and receivables; or
- (iv) Available-for-sale;

and each financial liability into one of two categories:

- (v) Financial liabilities at fair value through profit or loss; or
- (vi) Other liabilities.

The Fair Value Option within IAS 39 permits designation of a financial asset or financial liability as being at fair value through profit or loss under wider circumstances than had previously been allowed. The Company uses this option to prevent technical accounting mismatches between the Company and other Group entities in respect of accounting for certain swap arrangements; use of this option has had no impact on the results or Balance Sheet of the Group.

Notes to the Financial Statements (continued)

1. Principal accounting policies continued

Where the Directors believe it appropriate to do so, financial assets may be reclassified out of the 'fair value through profit or loss' and 'available-for-sale' categories to 'loans and receivables' or 'held to maturity' in accordance with the revisions to IAS 39 issued by the IASB in October 2008 and effective from July 2008. Reclassification is permitted only under certain restricted circumstances, including that there is no active market for the asset. The asset is reclassified using its fair value at the point of transfer, and from that point on is accounted for on an EIR basis. The difference between the carrying value at the point of reclassification and the expected value at the redemption date is recognised in profit or loss on an EIR basis over the expected life of the asset, and the asset's carrying value accretes to the redemption amount over that period. The balance in the available-for-sale reserve which related to the asset is amortised to profit or loss over the expected life of the asset; in the Income Statement the amortisation of the difference between value at reclassification and at redemption and the amortisation out of the available-for-sale reserve exactly offset each other.

Measurement of financial instruments is either at amortised cost (categories (ii), (iii) and (vi) above) or at fair value (categories (i), (iv) and (v) above), depending on the category of financial instrument.

Amortised cost is the amount measured at initial recognition, adjusted for subsequent principal and other payments, less cumulative amortisation calculated using the EIR method; the amortisation is taken to interest income or expense depending on whether the instrument is an asset or a liability. For assets, the amortised cost balance is reduced where appropriate by an allowance for amounts which are considered to be impaired or uncollectible.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Where an active market is considered to exist, fair values are based on quoted prices or lead manager prices. For instruments which do not have active markets, fair value is calculated using present value models, which take individual cash flows together with assumptions based on market conditions and credit spreads, and are consistent with accepted economic methodologies for pricing financial instruments. Interest income and interest expense on instruments carried at fair value are included in the Income Statement in 'interest receivable and similar income' or 'interest expense and similar charges'. Movements in fair value are recognised in the 'unrealised fair value movements on financial instruments' line in the Income Statement, except in the case of instruments categorised as 'available-for-sale', in which case the fair value movements are taken to the 'available-for-sale' reserve. On sale or derecognition of an available-for-sale instrument the accumulated fair value movements are transferred from the 'available-for-sale' reserve to the 'net realised gains less losses on investment securities' line of the Income Statement.

Certain certificates of deposit, fixed and floating rate notes and mortgage-backed securities are classified as available-for-sale.

(h) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the Balance Sheet only where there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(i) Derivative financial instruments and hedge accounting

All of the Group's derivative contracts are used for commercial management of exposures to interest rate risks, foreign currency risks and risks arising from forecast transactions.

For most of the Group's derivative contracts hedge accounting is applied. However, in some cases natural offsets apply and, as explained in note 1(g), the Company has used the provisions of the Fair Value Option amendment to IAS 39 to prevent technical accounting mismatches in respect of certain swap arrangements.

All derivatives are carried at fair value in the Balance Sheet, as assets when the fair value is positive and as liabilities when the fair value is negative. The fair value of a derivative includes any interest accrued on that derivative. Changes in the fair value of derivatives are charged to the Income Statement; however by applying the hedge accounting rules set out in IAS 39 the changes in fair value of derivatives which are used to hedge particular risks can either be mitigated in the Income Statement (fair value hedging) or deferred to reserves (cash flow hedging). The Group has adopted cash flow hedge accounting and fair value hedge accounting.

(i) Cash flow hedges

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in equity, and recycled to the Income Statement in the periods when the hedged item will affect profit and loss. The fair value gain or loss relating to the ineffective portion is recognised immediately in the Income Statement.

(ii) Fair value hedges

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the Income Statement over the period to maturity. The Group uses hedge accounting on one to one relationship and portfolio hedging bases, as described below.

If derivatives are not designated as hedges then changes in fair values are recognised immediately in the Income Statement.

(iii) One-to-one fair value hedges

Where one or more specific derivative financial instruments hedge the changes in fair value of a specific asset or liability, provided that the hedge arrangement meets the requirements of IAS 39 to be classed as 'highly effective', the associated hedged item is carried on the Balance Sheet at fair value in respect of the hedged risk. Fair value gains and losses are recognised in the Income Statement, mitigating the fair value movements on the associated derivative financial instruments. Hence profit volatility is mitigated. The Income Statement immediately recognises any hedge accounting 'ineffectiveness', that is any difference between the fair value movement on the hedging instrument and that on the hedged item. Where a fair value hedge relationship is terminated or deemed not to be highly effective (other than as a result of the hedged item being derecognised from the Balance Sheet due to sale or other reason), the fair value adjustment relating to the terminated hedge relationship is amortised to the Income Statement over the period to the date of maturity of the hedged item. The derivative continues to be carried at fair value.

Notes to the Financial Statements (continued)

1. Principal accounting policies continued

(iv) Portfolio fair value hedges

Where a group of derivative financial instruments hedges the interest rate exposure of a group of assets or liabilities, and the hedge meets the requirements of IAS 39 to be classed as 'highly effective', the hedge relationship is accounted for in the same way as a one-to-one fair value hedge except that the Balance Sheet carrying value of the hedged items is not adjusted; instead the difference between the carrying value and the fair value in respect of the hedged risk is carried on the Balance Sheet in 'fair value adjustments on portfolio hedging'.

(v) Hedge effectiveness

At the inception of each hedging arrangement, the relationship between the hedging instruments and the hedged items is documented, as well as the risk management objective and strategy. Also documented is an assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in the hedging arrangement are highly effective in offsetting changes in fair values or cash flows of the hedged items.

Under IAS 39 a hedge is deemed to be highly effective if effectiveness is forecast to fall, and is actually found to fall, within the 80% to 125% range. Any hedge relationship falling outside these limits is deemed to be ineffective and hedge accounting is discontinued.

(vi) Embedded derivatives

Certain financial instruments have embedded within them derivative features. Where the economic characteristics and risks of the embedded derivative are not closely related to those of the host instrument, and where changes in value in the host instrument are not reflected in the Income Statement, the embedded derivative is separated from the host and carried on the Balance Sheet at fair value, with gains and losses on the embedded derivative being recognised in the Income Statement. In accordance with IFRIC 9 'Reassessment of Embedded Derivatives' the decision as to whether to separate and value an embedded derivative is reassessed when and only when the terms of the host contract are significantly modified.

(j) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') continue to be reported as originally classified within the Group's Balance Sheet, as the risks and rewards associated with that asset remain with the Group. The counterparty liability is included in 'deposits by banks' or 'other deposits'. Securities purchased under agreements to resell ('reverse repos') are recorded as 'loans and advances to banks'. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the EIR method.

(k) Impairment losses

Financial assets which are not held at fair value through profit or loss are reviewed for indications of possible impairment throughout the year and at each published Balance Sheet date.

An impairment loss is recognised if, and only if, there is objective evidence that a loss event (or events) has occurred after initial recognition and before the Balance Sheet date and has a reliably measurable impact on the estimated future cash flows of the financial asset or group of financial assets. Losses that are incurred as a result of events occurring after the Balance Sheet date are not recognised.

(i) Financial assets held at amortised cost

For each individual loan which exhibits indications of impairment (which for mortgages includes all loans 12 or more months in arrears, those in possession or held for sale with a Law of Property Act ('LPA') receiver and others which management consider to be individually impaired) the carrying value of the loan at the Balance Sheet date is reduced to the net present value of the expected future cash flows associated with the loan, calculated at the loan's original EIR. These cash flows include, where appropriate, estimated amounts recoverable by possession and sale of the secured property taking into account a discount on property value to reflect a forced sale. All loans that have been assessed as having no individual impairment are then assessed collectively, grouped by loans with similar characteristics.

Assessment is made of impairment arising due to events which are believed to have occurred by the Balance Sheet date but have not yet been reported, taking into account the economic climate in the market. This collective impairment is reflected by reducing the carrying value of total loans. The impairment of the loans is charged in the Income Statement in the 'impairment on loans and advances to customers' line.

Interest income is recognised on impaired loans by applying the original EIR of the loan to the impaired balance.

A loan is written off and any associated impairment allowance released when and only when the property has been taken into possession and sold or sold by an LPA receiver. Any subsequent proceeds are recognised on a cash basis and offset against 'impairment on loans and advances to customers' in the Income Statement.

(ii) Possessions and LPAs

Where a property has been taken into possession, or an LPA receiver has been appointed to collect rental income on the property, the loan continues to be carried within 'loans and advances to customers'.

(iii) Available-for-sale financial assets

Investment securities classified as available-for-sale are carried at fair value or amortised cost, net of impairment. Impairment is recognised when the investment security exhibits objective evidence of impairment or is uncollectible. Such evidence may include:

- Significant financial difficulty;
- Payment defaults;
- Renegotiation of terms due to borrower difficulty;
- Sustained fall in credit rating or creditworthiness;
- Significant restructuring;
- Disappearance of an active market;
- Significant and sustained fall in market price; or

Notes to the Financial Statements (continued)

1. Principal accounting policies continued

- Observable data indicating measurable decrease in the estimated future cash flows from a group of financial assets, although the decrease cannot yet be identified within individual assets in the group.

Movements in the fair value which are a reflection of impairment of the long term value of the investment security are charged to 'net impairment on investment securities' in the Income Statement. Investment impairment losses recognised against investment securities are reversed through 'net impairment on investment securities' in the Income Statement if the improvement relates to an event occurring after the initial impairment was recognised.

If there is a sustained increase in the fair value of an investment security where an impairment loss has previously been recognised, but no improvement can be attributed to a subsequent credit event, then the increase in value may be treated as a revaluation and recognised through the Consolidated Statement of Comprehensive Income in the available-for-sale reserve.

(l) Recognition and derecognition of financial instruments

Purchases and sales of mortgage portfolios are accounted for on the completion date. All other purchases and sales of financial assets are accounted for on the date of commitment to buy or sell (the 'trade date'). The initial carrying amount of an acquired mortgage portfolio is the purchase price; this is considered to be equivalent to the portfolio's fair value at the point of purchase. Any difference between this portfolio purchase price and the total amount outstanding on the acquired loans is amortised on an EIR basis in accordance with note 1(d).

A financial asset is derecognised (i.e. removed from the Balance Sheet) only when substantially all of the risks and rewards associated with that asset have been transferred to another party and control is lost. In respect of the Company's secured funding structures, the Company sells to another entity the right to receive the cash flows arising on the loans which have been securitised. However, the Company receives substantially all of the post-tax profit of that entity, and hence retains substantially all of the risks and rewards of the securitised loans. Consequently both the debt securities in issue and the loans and advances to customers remain on the Group Balance Sheet within the appropriate balance sheet headings.

The Group derecognises financial liabilities only when the contractual obligation is discharged, cancelled or has expired.

(m) Debt and equity securities in issue

Issued securities are classified as liabilities where the contractual arrangements result in the Group having an obligation to deliver either cash or another financial asset to the security holder, or to exchange financial instruments under conditions that are potentially unfavourable to the Group. Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the Group's assets on the holder of the securities. On initial recognition, debt issued is measured at its fair value net of directly attributable issue and transaction costs. Subsequent measurement is at amortised cost using the EIR method to amortise attributable issue and transaction costs, premia and discounts over the life of the instrument. These costs are charged along with interest on the debt to 'interest expense and similar charges'. Unamortised amounts are added to or deducted from the carrying value of the instrument.

(n) Foreign currencies

The presentational and functional currency of the Group and Company is pounds sterling.

Transactions which are not denominated in pounds sterling are translated into sterling at the spot rate of exchange on the date of the transaction. Monetary assets and liabilities which are not denominated in pounds sterling are translated into pounds sterling at the closing rate of exchange at the Balance Sheet date.

Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the Income Statement.

(o) Intangible assets

(i) Goodwill

Goodwill arising on the acquisition of subsidiary companies, which is represented by the excess of fair value of the purchase consideration over the fair value of the assets acquired, is capitalised and shown as an asset in the Balance Sheet. It is reviewed annually for impairment and any impairment is recognised immediately in the Income Statement and is not subsequently reversed.

(ii) Computer software

Computer software licences are capitalised as intangible assets where it is probable that future benefits will flow to the Group. Thereafter they are carried at cost less accumulated amortisation. Amortisation is provided on a straight line basis over their useful economic lives, which may be up to five years. Those which have a life expectancy at the outset of less than two years are not capitalised but instead their costs are charged to the Income Statement as they arise.

Costs that are directly associated with developing identifiable computer software systems are capitalised if the criteria in IAS 38 'Intangible Assets' are satisfied; the main criteria are that the successful completion of the development project is reasonably certain and that the software is expected to generate future economic benefits. Each item of capitalised developed computer software is carried at cost less accumulated amortisation; amortisation is provided on a straight line basis over its estimated useful life. Costs that do not qualify for capitalisation or are associated with maintaining software are charged to the Income Statement as they arise.

All items of intangible assets are reviewed annually for impairment. If any item is considered to be impaired, it is written down to the impaired value. In addition, the estimated useful lives are also reassessed annually, and if they are judged to have changed then the rate of amortisation charged in periods after the date of the change reflects the revised estimates.

(p) Cash and cash equivalents

For the purposes of the Cash Flow Statement, cash and cash equivalents comprise balances which are highly liquid and have an original maturity of three months or less.

Notes to the Financial Statements (continued)

1. Principal accounting policies continued**(q) Taxation****(i) Current tax**

The charge for taxation is based on the result for the year and takes into account taxation deferred or accelerated arising from temporary differences between the carrying amounts of certain items for taxation and for accounting purposes. Tax relating to items which are taken directly to reserves is also taken directly to reserves.

(ii) Deferred tax

Deferred tax is calculated using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. Deferred tax is determined using tax rates and laws that have been enacted or substantially enacted by the Balance Sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled. The principal temporary differences arise from depreciation of property, plant and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits; rolled over gains on disposal of property, plant and equipment; unremitted earnings from overseas subsidiaries; tax losses carried forward; and changes in accounting basis on adoption of IFRS.

Deferred tax assets are recognised when it is probable that future taxable profit will be available against which these temporary differences can be utilised.

Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are recognised in other comprehensive income, is also recognised in other comprehensive income and subsequently in the consolidated Income Statement together with the deferred gain or loss.

(r) Post-retirement benefits

The Group operates a number of post-retirement benefit plans for its employees, including defined contribution plans, defined benefit plans and other post-retirement benefits (principally medical). The costs of these plans are charged to the Income Statement and retained earnings in accordance with IAS 19 'Employee Benefits'.

A defined contribution plan is a pension arrangement where the employer pays fixed contributions into a separate fund. The contributions are charged to the Income Statement when employees have rendered the related services, which is generally in the year of contribution.

A defined benefit plan is a pension arrangement that defines an amount of pension benefit that an employee will receive during retirement, usually dependent on one or more factors such as age, years of service and salary. The net deficit or surplus on the plan is carried on the Balance Sheet, comprising the present value of the defined benefit obligation at the Balance Sheet date less the fair value of plan assets. The defined benefit obligation is calculated semi-annually by independent qualified actuaries using the projected unit credit method. Details of the actuarial assumptions made are provided in note 25. Actuarial gains and losses are charged to retained earnings in full in the period in which they occur, and pass through the Consolidated Statement of Comprehensive Income rather than the Income Statement. The Company, being the sponsoring company of the plans, carries on its Balance Sheet the net deficit or surplus on each plan.

The Company is committed to a funding plan to address the deficit on the defined benefit plan. In accordance with IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', the net pension deficit which is recognised on the Balance Sheet is the higher of the deficit calculated as above and the net value of the committed funding. However, to the extent that the Company has a clear unconditional right to a refund of future surpluses which may arise in the plan, the carrying value of the deficit should be reduced to take account of the anticipated future available funds. As detailed in note 25(d), at 31 December 2010 the Company had no clear unconditional right to the refund of future surpluses, but as detailed in note 37 on 29 March 2011 the Trustees finalised a resolution granting such a right.

As previously reported the defined benefit pension schemes were closed to future accrual in 2009 which gave rise to a curtailment gain that was recognised in the Income Statement at the time.

Post-retirement medical benefits are accounted for in the same way as pension benefits, with the present value of the defined benefit obligation being carried as a liability on the Balance Sheet.

(s) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. All other expenditure is regarded as repairs and maintenance and is charged to the Income Statement in the period in which it is incurred.

Depreciation is provided so as to write off the cost less the estimated residual value of each significant component of each item of property, plant and equipment over that component's estimated useful life, as follows:

- Freehold land is not depreciated
- Freehold buildings 1% - 2% pa on a straight line basis
- Leasehold properties over the shorter of the lease period and 50 years on a straight line basis
- Motor vehicles 25% pa on a straight line basis
- Computer equipment 20% - 33% pa on a straight line basis
- Fixtures and fittings 20% pa on a straight line basis
- Other equipment and major alterations to buildings 10% pa on a straight line basis

Notes to the Financial Statements (continued)

1. Principal accounting policies continued

All items of property, plant and equipment are reviewed annually for impairment. If any item is considered to be impaired, it is written down to the higher of value in use and estimated net proceeds of sale. In addition, the estimated useful lives and estimated residual values are also reassessed annually, and if they are judged to have changed then the rate of depreciation charged in periods after the date of the change reflects the revised estimates.

Assets in the course of construction are not depreciated until they have been completed and transferred to the appropriate category of property, plant and equipment. The costs of financing assets in the course of construction are not included in the costs of the assets. Assets in the course of construction are included within the impairment test referred to above where appropriate.

A previously recognised impairment charge on a fixed asset may be reversed in full or in part where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value of the fixed asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

(t) Leases

Rentals under operating leases are charged to 'administrative expenses' on a straight line basis to the date of change in the rental amount. Typically operating leases have rent review dates in their terms, several years apart, and between those dates the annual rent remains constant. Any initial rent-free period and any lease premia paid are amortised over the full lease period on a straight line basis.

If a lease agreement in which the Group is a lessee transfers the risks 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 is depreciated over the estimated useful life. The lease obligations are recorded as borrowings. If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to the Income Statement in the period in which termination is made.

When the Group enters into a sale and leaseback arrangement, the leaseback is accounted for as a finance lease or an operating lease, according to its terms. If it is a finance lease, and the sale and leaseback gives rise to a profit, the profit is not recognised immediately but is deferred and amortised over the lease term. If it is an operating lease, any profit or loss is accounted for in the period of disposal.

(u) Provisions and contingent liabilities

Provisions are recognised when, and only when, the following criteria are all met:

- there is a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

Provisions are discounted to net present value using rates which reflect the risks specific to the provision, if the effect of discounting is material.

Provisions are reviewed at each Balance Sheet date and are released if they no longer meet the above criteria.

Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the Balance Sheet but are disclosed unless they are remote.

(v) Investment securities held

Investment securities intended for use on a continuing basis in the Group's activities are categorised either as 'available-for-sale' or as 'loans and receivables'; for each instrument, the Directors adopt the category which they consider to be the most appropriate.

Investment securities categorised as available-for-sale are carried at fair value, with movements in fair value, excluding impairment provisions, being taken to the available-for-sale reserve. If an investment security which has been categorised as available-for-sale becomes impaired, the impairment is charged to the Income Statement in the 'net impairment on investment securities' line.

Investment securities categorised as loans and receivables are carried at amortised cost, less any impairment, with any impairment being charged to the Income Statement in the 'net impairment on investment securities' line.

Where the Directors believe it appropriate to do so, investment securities may be initially categorised as 'at fair value through profit or loss' or 'available-for-sale' and subsequently re-categorised to 'loans and receivables' or 'held to maturity' in accordance with the revisions to IAS 39 issued by the IASB in October 2008 and effective from July 2008.

At 31 December 2010 and 31 December 2009, investment securities included investments in structured investment vehicles ('SIVs') principal protected notes ('PPNs') and collateralised debt obligations ('CDOs'). The Group had no entitlement to board or management representation in respect of its investment in any SIV, PPN or CDO, and could not exert influence, and therefore the instruments were considered to fall outside the scope of IAS 27 'Consolidated and Separate Financial Statements', IAS 28 'Investments in Associates' and IAS 31 'Interests in Joint Ventures'.

(w) Investments in Group undertakings

In the Financial Statements of the Company, investments in Group undertakings are carried at cost less any impairment. Investments are reviewed at each published Balance Sheet date for any indications of impairment. If there is indication of impairment of any investment, the carrying value of the investment is reviewed, and any impairment identified is charged immediately to the Company's Income Statement.

(x) Subordinated liabilities and other capital instruments

'Other capital instruments' comprise perpetual preferred securities and a Limited Partnership Share issued by subsidiary undertakings of the Company. These instruments are carried on an EIR basis, and the carrying amount includes hedge accounting adjustments.

Notes to the Financial Statements (continued)

1. Principal accounting policies continued**(y) Financial guarantees**

The Company applies insurance accounting to financial guarantee contracts, and provides against any claims arising under such contracts.

(z) Loan commitments

Loan commitments are disclosed, but are accounted for only if there is an onerous commitment; there were no onerous loan commitments in the year or previous year. The commitment ceases to be disclosed once it is advanced or expires. Loan commitments comprise commitments to advance cash sums and also, in respect of lifetime mortgages, the commitment to continue to accrue further interest on the loan. The interest on lifetime mortgages rolls up and is not payable until redemption of the loan. For disclosure purposes, an estimate is made of the future interest which is expected to accrue on the lifetime mortgages which were outstanding as at the Balance Sheet date, up to redemption of these loans. This estimate is made using actuarial assumptions obtained from independent actuaries.

2. Critical judgements and accounting estimates**(a) Judgements:**

- (i) Financial instrument designation
Upon initial designation, judgement is required in ascertaining within which category, as prescribed in IAS 39, a financial instrument should be designated. The IAS 39 categories are detailed in the accounting policies set out in note 1 and the designation is based on the criteria specified in IAS 39.
- (ii) Qualifying hedge relationships
In designating a financial instrument as part of a qualifying hedge relationship the Group and Company have determined that the hedge is expected to be highly effective over the life of the hedging instrument. In accounting for a derivative as a cash flow hedge the Group and Company have determined that the hedged cash flow exposure relates to highly probable future cash flows.
- (iii) Impairment of investment securities
For investment securities carried at fair value, judgement is applied in determining whether any fall in value represents impairment. Factors considered in determining whether an asset is impaired, or impairment has reversed, are detailed in note 1(k).
- (iv) Securitisations
In applying the Group's policies on securitised financial assets, the Group and Company have considered both the degree of transfer of risks and rewards on assets transferred to another entity and the degree of control exercised by the Group over the other entity:
 - Where the Group, in substance, controls the entity to which financial assets have been transferred, the entity is included in these consolidated Financial Statements and the transferred assets continue to be recognised on the Group's Balance Sheet.
 - Where the Company or another Group entity has transferred financial assets to another entity, but has not transferred substantially all of the risks and rewards relating to the transferred assets, the assets continue to be recognised on the transferring entity's Balance Sheet.
- (v) Deferred tax assets
Significant management judgement is required to determine the extent to which tax losses can be offset against future taxable profits and therefore recognised in the form of deferred tax assets. This judgement is based upon examination and assessment of the business plan, and the expectation that there may be sufficient profitability in future years to utilise tax losses in the Company and certain subsidiaries. A deferred tax asset is recognised accordingly, but only to the extent to which future taxable profits are foreseen. In excess of this value any taxable losses are not recognised as deferred tax assets. Management continue to monitor closely the opportunities for the recoverability of unrecognised deferred tax assets and will reassess the appropriateness of recognition at subsequent Balance Sheet dates. Details of recognised and unrecognised deferred tax assets are contained in note 14.

(b) Estimates:

- (i) Effective interest rate
IAS 39 requires interest earned from mortgage lending to be measured under the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument, or, when appropriate, a shorter period, to the net carrying amount of the financial asset. Management must therefore use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. On a periodic basis throughout the financial reporting period, models are reviewed to re-assess expected life by portfolio of products based upon actual redemptions by product and anticipated market conditions. At 31 December 2010, if the expected average life of a loan were increased or reduced by one month, the Balance Sheet amount of loans and advances to customers would be increased by £7.8m or reduced by £8.0m respectively.
- (ii) Impairment losses on loans and advances
The Group and Company reviews its loan impairment on a monthly basis and assesses individual impairment losses by reference to an individual review of the underlying asset and utilises actual loss experience to provide both probabilities of defaults and property forced sale discounts across a portfolio of products. Collective impairment losses on loans and advances are calculated using a statistical model. The key assumptions used in this model are: the probability of any balance entering into default as a result of an event that had occurred prior to the Balance Sheet date; the probability of this default resulting in possession or write off; and the subsequent loss incurred. These key assumptions are based on observed data trends, and are updated on a regular basis within an approved methodology to ensure the impairment allowance is entirely representative of the current portfolio. The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic environment and assumptions which differ from actual outcomes. To the extent that house prices were to change by +/- 10%, the impairment allowance would be an estimated £84.5m lower or £87.2m higher respectively.

Notes to the Financial Statements (continued)

2. Critical judgements and accounting estimates continued

- (iii) Post-retirement benefit obligations
The net deficit in respect of post-retirement benefit obligations is carried on the Group's and Company's Balance Sheets. The value of these obligations is calculated by the Group's actuaries using the assumptions set out in note 25. Note 25 also discloses the impact on the benefit obligations of changes in certain key assumptions.
- (iv) Provisions
Provisions are carried in respect of certain known or forecast future expenditure, as described in note 26. Provisions are calculated using the best available information but the actual future outcomes of items provided for may differ from expectations.
- (v) Fair value calculations
Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in an arm's length transaction with a willing and knowledgeable counterparty. For the majority of instruments carried at fair value, this is determined by reference to quoted market prices. Where these are not available, fair value is based upon cash flow models, which use wherever possible independently sourced market parameters such as interest rate yield curves, currency rates and option volatilities. Other factors are also considered, such as counterparty credit quality and liquidity. Management must use judgement to arrive at estimates where not all necessary data can be externally sourced or where factors specific to the Group's and Company's holdings need to be considered. The accuracy of the fair value calculations may therefore be affected by unexpected market movements, or variations in actual outcomes when compared to estimates and assumptions used for modelling purposes.

3. Net interest income

	2010 £m	Restated** Group 2009 £m
Interest receivable and similar income		
On secured advances	847.3	1,045.1
On investment securities and deposits	87.6	182.3
Total interest receivable and similar income	934.9	1,227.4
Interest expense and similar charges		
On other deposits including loans from HM Treasury	(168.0)	(66.8)
State guarantee fee***	(108.3)	(175.9)
Other****	(50.7)	(372.3)
Total interest expense and similar charges	(327.0)	(615.0)
Net interest income	607.9	612.4
Average interest-earning assets ('IEA')	44,589	47,706
Financed by:		
- Interest-bearing funding	22,701	27,509
- Interest-free funding*	21,888	20,197
Average rates:	%	%
- Gross yield on IEA	2.10	2.57
- Cost of interest-bearing funding	(1.44)	(2.23)
Interest spread	0.66	0.34
Contribution of interest-free funding	0.70	0.95
Net interest margin	1.36	1.29
Annual average Bank Base Rate	0.50	0.65
Annual average 3-month LIBOR	0.70	1.21
Annual average 3-year swap rate	1.93	2.63

*Interest-free funding is calculated as an average over the year. Prior to the Transfer, interest-free funding was primarily share capital and reserves. Since the Transfer, interest-free liabilities also include the Statutory Debt.

**For 2010, the Group has amended its presentation of interest on derivatives, impacting the allocation of amounts between interest income and expense, but not impacting net interest income. Under the amended presentation, interest on derivatives is included in interest income where the derivative is hedging interest income, and in interest expense where the derivative is hedging interest expense. This approach aligns presentation with that adopted by UKAR. The Group's previous presentation included derivative interest in interest income or expense largely based on whether the derivative flows were income or expense, but the revised approach is considered closer to reflect asset yields. As a result of this re-presentation, the 2009 comparative interest income and expense above are each £652.6m lower than previously reported.

***At the time of the nationalisation of the Company, HM Treasury provided a guarantee with regard to certain wholesale borrowings and derivative transactions existing at that time.

****Interest expense for 2010 was reduced by £104.3m compared to 2009, being the effect of discounting liabilities (see notes 27 and 28). This discount will reverse through interest expense over the remaining life of these liabilities. In respect of liabilities repurchased (see note 7), the discount has been released in full. Total interest receivable and similar income includes interest accrued on individually impaired assets of £11.1m (2009: £32.4m).

Notes to the Financial Statements (continued)

4. Administrative expenses

The average number of persons employed during the year was as follows:

Group	Full time		Part time		Total	Full time equivalent		
	2010 Number	2009 Number	2010 Number	2009 Number		2010 Number	2009 Number	
Employed	981	817	202	152	1,183	969	1,111	917
Recharged to NRAM	(155)	–	(53)	–	(208)	–	(190)	–
Net	826	817	149	152	975	969	921	917

Company	Full time		Part time		Total	Full time equivalent		
	2010 Number	2009 Number	2010 Number	2009 Number		2010 Number	2009 Number	
Employed	934	679	185	98	1,119	777	1,052	746
Recharged to NRAM	(155)	–	(53)	–	(208)	–	(190)	–
Net	779	679	132	98	911	777	862	746

The full time equivalent is based on the average hours worked by employees in the year.

The total headcount at each year end was:

Group	Full time		Part time		Total	Full time equivalent		
	2010 Number	2009 Number	2010 Number	2009 Number		2010 Number	2009 Number	
Employed	1,772	794	469	149	2,241	943	2,081	892
Recharged to NRAM	(933)	–	(321)	–	(1,254)	–	(1,139)	–
Net	839	794	148	149	987	943	942	892

Company	Full time		Part time		Total	Full time equivalent		
	2010 Number	2009 Number	2010 Number	2009 Number		2010 Number	2009 Number	
Employed	1,761	667	469	98	2,230	765	2,070	731
Recharged to NRAM	(933)	–	(321)	–	(1,254)	–	(1,139)	–
Net	828	667	148	98	976	765	931	731

In addition to the permanent staff above, the Group employed a full time equivalent of 174 temporary staff at 31 December 2010 (2009: 47) of which 70 were recharged to NRAM (2009: nil).

Notes to the Financial Statements (continued)

4. Administrative expenses continued

	Gross cost 2010 £m	Recharged 2010 £m	Net cost 2010 £m	Net cost 2009 £m
The Group's aggregate costs of permanent staff were as follows:				
Wages and salaries	33.7	(5.3)	28.4	30.0
Social security costs	3.5	(0.4)	3.1	3.2
Defined benefit pension costs (see note 25d)	2.9	-	2.9	4.2
Defined contribution pension costs (see note 25a)	1.8	(0.3)	1.5	0.7
Other post-retirement benefits costs (see note 25d)	0.5	-	0.5	0.6
Total staff costs	42.4	(6.0)	36.4	38.7
Property operating lease rentals	0.2	-	0.2	0.6
Depreciation and amortisation (see notes 15 and 16)	0.4	-	0.4	0.4
Other legal and professional services	19.1	-	19.1	25.8
IT costs	33.7	-	33.7	46.8
Other administrative expenses	22.6	(0.1)	22.5	24.8
Ongoing administrative expenses	118.4	(6.1)	112.3	137.1
Other net expenses:				
- Independent share valuation charges and associated fees	5.3	-	5.3	-
- Transformation project	10.5	(1.7)	8.8	-
Total other net expenses	15.8	(1.7)	14.1	-
Total	134.2	(7.8)	126.4	137.1

With effect from 1 November 2010, staff previously contracted and employed by Northern Rock plc but being recharged by Northern Rock plc to NRAM, were transferred to contracts with Bradford & Bingley plc. These costs were subsequently invoiced to NRAM (£5.4m at cost), together with a proportioned charge relating to senior management (£0.6m), NRAM's share of Transformation costs (£1.7m), and other small items (£0.1m).

Staff costs in 2009 included £37,000 in respect of the Bank Payroll Tax on bonuses over £25,000, relating to 8 people. All of these bonuses include deferred elements and are subject to clawback.

	2010 £m	2009 £m
Remuneration of auditor and associates		
Statutory audit of the Company and consolidated accounts	0.4	0.4
Fees payable to the Group's auditor and its associates for other services:		
- Auditing of the Company's subsidiary undertakings	0.1	0.1
- Other services pursuant to legislation	0.1	0.4
- Other services relating to taxation	-	0.2
- Regulatory and other services	0.5	0.3
Total	1.1	1.4

5. FSCS levy on retail deposits

In 2009 the Company paid £7.9m in respect of the FSCS levy on retail deposits for the scheme year 2008/2009, which was triggered by holding retail deposits on 31 December 2007 and was calculated based on the amount of retail deposits held at that date.

As at 31 December 2008 it was believed that the Company would have no obligation, but it became clear during 2009 that this levy would be payable. On the basis that the Company did not hold any such retail deposits after the Transfer, no further amounts have been paid and it is unlikely that the Company will be subject to these levy charges going forward.

Notes to the Financial Statements (continued)

6. Gain on sale of insurance business

On 9 April 2010, contracts were exchanged for the sale of the Group's general insurance open book. The remaining insurance books were sold in August, September and November 2010. This generated a gain of £11.5m for the Group (Company: £9.5m).

7. Gain on repurchase of subordinated liabilities

	2010 £m
Principal amount of subordinated liabilities purchased	1,102.2
Amount paid to repurchase subordinated liabilities	(434.2)
Other net gains resulting from the repurchase*	118.0
Gain on repurchase of subordinated liabilities	786.0

* Principally release of deferred coupons and hedge adjustment releases, less accelerated amortisation of the discounting effect of deferral of coupons.

In June and December 2010 the Group and Company repurchased certain of their own subordinated liabilities and other capital instruments, realising a total net gain of £786.0m. Further details of the repurchases are provided in notes 27 and 28. There were no repurchases in 2009.

8. Taxation

	Group	
	2010 £m	2009 £m
Current taxation (charge) / credit:		
- UK corporation tax on profit / (loss) for the financial year	(249.5)	38.2
- Adjustments in respect of previous years	5.1	17.3
	(244.4)	55.5
Foreign taxation	(9.2)	(8.2)
Total current taxation	(253.6)	47.3
Deferred taxation (charge) / credit:		
- Origination and reversal of temporary differences (see note 14)	(6.3)	50.4
- Change in rate effective 1 April 2011 on deferred tax items	(2.4)	-
Total taxation (charge) / credit per the Income Statement	(262.3)	97.7

	2010 £m	Group 2009 £m
The following current tax was recognised directly in equity during the year:		
- Relating to available-for-sale investment securities	(23.8)	(97.8)
The following tax was recognised in equity during the year in deferred tax:		
- Relating to cash flow hedge reserve	(5.5)	(42.4)
- Relating to available-for-sale investment securities	-	159.3
- Relating to actuarial losses on post-retirement benefit obligations	28.7	29.5
Net (charge) / credit to equity	(0.6)	48.6

Notes to the Financial Statements (continued)

8. Taxation continued

The total taxation (charge)/credit differs from the theoretical amount that would be derived by applying the weighted average standard UK corporation tax rate to the Group's results as follows:

	Group	
	2010 £m	2009 £m
Profit / (loss) before taxation	1,081.5	(196.0)
UK corporation tax at 28.0%	(302.8)	54.9
Effects of:		
- Expenses not deductible for taxation	-	(1.2)
- Deferred tax previously unrecognised	30.1	(3.9)
- Overseas tax rates	1.1	4.7
- Change in rate effective 1 April 2011 on deferred tax items	(2.4)	-
- Adjustments in respect of previous years	11.7	43.2
Total taxation (charge) / credit per the Income Statement	(262.3)	97.7
Effective tax rate (%)	24.3	49.8

The weighted average standard rate of UK corporation tax for 2010 was 28.0% (2009: 28.0%).

The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate would reduce from 28% to 27% on 1 April 2011 and would further reduce by 1% each year for the next 3 years, ultimately reducing to 24% on 1 April 2014. The Budget on 23 March 2011 amended this to a reduction of 2% to 26% on 1 April 2011, further reducing by 1% each year ultimately to 23% on 1 April 2014. The Group's and Company's deferred taxation reflect the changes which had been substantively enacted by 31 December 2010, i.e. a reduction to 27% on 1 April 2011. Further details of the expected impact of the changes are provided in note 14.

9. Loans and advances to customers

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Net of impairment (see note 10):				
- Residential mortgages	35,683.1	38,167.3	27,074.7	29,153.1
- Housing association loans	20.5	20.6	20.5	20.6
Total secured on residential loans	35,703.6	38,187.9	27,095.2	29,173.7
- Commercial property loans	698.2	798.3	698.2	798.3
	36,401.8	38,986.2	27,793.4	29,972.0
- Amounts due from Group undertakings	-	-	20,489.9	24,371.7
Total	36,401.8	38,986.2	48,283.3	54,343.7

Balances include accounting adjustments in respect of EIR and provisioning requirements, which account for the calculated difference of opening and closing balances when adding new mortgages and subtracting redemptions.

Loans and advances to customers include advances secured on residential properties amounting to £12,383.9m (2009: £14,673.5m) for the Group and Company which have been sold to bankruptcy remote special purpose vehicles whereby substantially all of the risks and rewards of the portfolio are retained by the Group/Company. Accordingly, all these loans and advances are retained on the Group's/Company's Balance Sheets. Further details are provided in notes 20 and 21.

Notes to the Financial Statements (continued)

9. Loans and advances to customers continued

Loans and advances to customers comprise the following product types:

Group	Balances		Redemptions		Balances		Redemptions	
	At 31 December 2010 £m	%	2010 £m		At 31 December 2009 £m	%	2009 £m	
Residential								
Organic								
Buy-to-let	20,512.7	73	(757.4)		21,527.3	72	(602.1)	
Self-cert	4,659.8	16	(232.9)		4,951.8	16	(363.6)	
Standard and other specialist	3,020.0	11	(441.3)		3,507.1	12	(817.7)	
Total	28,192.5	100	(1,431.6)		29,986.2	100	(1,783.4)	
Acquired								
Buy-to-let	2,476.0	33	(150.5)		2,673.9	33	(113.9)	
Self-cert	2,772.3	37	(227.3)		3,033.3	37	(331.6)	
Standard and other specialist	2,242.3	30	(161.0)		2,473.9	30	(227.9)	
Total	7,490.6	100	(538.8)		8,181.1	100	(673.4)	
Buy-to-let	22,988.7	64	(907.9)		24,201.2	63	(716.0)	
Self-cert	7,432.1	21	(460.2)		7,985.1	21	(695.2)	
Standard and other specialist	5,262.3	15	(602.3)		5,981.0	16	(1,045.6)	
Total residential	35,683.1	100	(1,970.4)		38,167.3	100	(2,456.8)	
Residential	35,683.1	98	(1,970.4)		38,167.3	98	(2,456.8)	
Commercial property	698.2	2	(93.2)		798.3	2	(13.9)	
Housing associations	20.5	-	-		20.6	-	(0.9)	
Total	36,401.8	100	(2,063.6)		38,986.2	100	(2,471.6)	

Company	Balances		Redemptions		Balances		Redemptions	
	At 31 December 2010 £m	%	2010 £m		At 31 December 2009 £m	%	2009 £m	
Residential								
Buy-to-let	18,325.5	68	(655.9)		19,262.3	66	(572.5)	
Self-cert	5,705.3	21	(347.3)		6,179.8	21	(508.8)	
Standard and other specialist	3,043.9	11	(443.2)		3,711.0	13	(850.1)	
Total	27,074.7	100	(1,446.4)		29,153.1	100	(1,931.4)	
Residential	27,074.7	97	(1,446.4)		29,153.1	97	(1,931.4)	
Commercial property	698.2	3	(93.2)		798.3	3	(13.9)	
Housing associations	20.5	-	-		20.6	-	(0.9)	
Total	27,793.4	100	(1,539.6)		29,972.0	100	(1,946.2)	

Notes to the Financial Statements (continued)

10. Impairment on loans and advances to customers

Group 2010	On residential mortgages £m	On commercial property and housing association loans £m	Total £m
Allowances for credit losses against loans and advances to customers have been made as follows:			
Opening provision at 1 January 2010	884.1	52.2	936.3
Movements during the year:			
- Write-offs	(313.4)	(10.6)	(324.0)
- Loan impairment charge	262.9	17.0	279.9
- Discount unwind	(1.5)	-	(1.5)
Net movements during the year	(52.0)	6.4	(45.6)
Closing provision at 31 December 2010	832.1	58.6	890.7
The Income Statement charge comprises:			
- Loan impairment charge	262.9	17.0	279.9
- Recoveries net of costs	(1.7)	(0.1)	(1.8)
- Discount unwind	(1.5)	-	(1.5)
Total Income Statement charge	259.7	16.9	276.6

Group 2009	On residential mortgages £m	On commercial property and housing association loans £m	Total £m
Allowances for credit losses against loans and advances to customers have been made as follows:			
Opening provision at 1 January 2009	467.7	30.7	498.4
Movements during the year:			
- Write-offs	(154.8)	-	(154.8)
- Loan impairment charge	579.3	21.5	600.8
- Discount unwind	(8.1)	-	(8.1)
Net movements during the year	416.4	21.5	437.9
Closing provision at 31 December 2009	884.1	52.2	936.3
The Income Statement charge comprises:			
- Loan impairment charge	579.3	21.5	600.8
- Net cost of recoveries	1.0	-	1.0
- Discount unwind	(8.1)	-	(8.1)
Total Income Statement charge	572.2	21.5	593.7

Notes to the Financial Statements (continued)

10. Impairment on loans and advances to customers continued

Company 2010	On residential mortgages £m	On commercial property and housing association loans £m	Total £m
Allowances for credit losses against loans and advances to customers have been made as follows:			
Opening provision at 1 January 2010	491.3	52.2	543.5
Movements during the year:			
- Write-offs	(152.7)	(10.6)	(163.3)
- Loan impairment charge	188.9	17.0	205.9
- Discount unwind	(0.7)	-	(0.7)
Net movements during the year	35.5	6.4	41.9
Closing provision at 31 December 2010	526.8	58.6	585.4
The Income Statement charge comprises:			
- Loan impairment charge	188.9	17.0	205.9
- Recoveries net of costs	0.5	(0.1)	0.4
- Discount unwind	(0.7)	-	(0.7)
Total Income Statement charge	188.7	16.9	205.6

Company 2009	On residential mortgages £m	On commercial property and housing association loans £m	Total £m
Allowances for credit losses against loans and advances to customers have been made as follows:			
Opening provision at 1 January 2009	241.3	30.7	272.0
Movements during the year:			
- Write-offs	(48.1)	-	(48.1)
- Loan impairment charge	301.9	21.5	323.4
- Discount unwind	(3.8)	-	(3.8)
Net movements during the year	250.0	21.5	271.5
Closing provision at 31 December 2009	491.3	52.2	543.5
The Income Statement charge comprises:			
- Loan impairment charge	301.9	21.5	323.4
- Net cost of recoveries	1.2	-	1.2
- Discount unwind	(3.8)	-	(3.8)
Total Income Statement charge	299.3	21.5	320.8

In the Balance Sheet the carrying values of the impaired assets are presented net of these impairment allowances.

Notes to the Financial Statements (continued)

10. Impairment on loans and advances to customers continued

In respect of loans and advances to residential customers, the Group and Company hold collateral in the form of mortgages over residential properties. The fair value of this collateral was as follows:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Neither past due nor impaired	46,237.6	49,967.7	36,626.8	40,122.6
Past due but not impaired	2,768.5	3,285.4	1,832.7	2,173.4
Individually impaired	892.6	1,863.5	460.9	1,061.7
Total	49,898.7	55,116.6	38,920.4	43,357.7

If the collateral amount on each individual loan were capped at the amount of the balance outstanding, and any surplus of collateral values over balances outstanding ignored, the fair value of collateral held would be as follows:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Neither past due nor impaired	32,171.5	33,495.2	24,959.0	26,237.9
Past due but not impaired	2,329.6	2,745.2	1,479.3	1,739.0
Individually impaired	832.8	1,733.8	419.5	967.9
Total	35,333.9	37,974.2	26,857.8	28,944.8

The individually impaired balances above include the following carrying amount of assets in possession.

	77.0	131.0	43.7	69.6
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The fair value of the collateral is estimated by taking the most recent valuation of the property and adjusting for positive or negative house price inflation.

The indexed average loan to value (LTV) of residential loans and advances to customers was as follows:

	Group		Company	
	2010 %	2009 %	2010 %	2009 %
At 31 December				
Neither past due nor impaired	71.7	68.8	70.8	66.9
Past due but not impaired	87.2	85.6	83.0	81.5
Individually impaired	105.3	99.4	102.3	96.0
Total book	73.2	70.9	71.7	68.4
Buy-to-let LTV	79.9	82.4		
Self-cert LTV	85.8	88.6		
Standard LTV	85.1	86.9		
Lifetime LTV	43.6	41.7		
Total book	73.2	70.9		

Further details of the lifetime mortgage product are provided in note 30.

After a property has been taken into possession, the process for sale is designed to mitigate any loss or maximise any potential surplus for the borrower. Typically the property is sold by private treaty, via a locally appointed agent, as quickly as possible and for the best price attainable, taking into consideration market, property and general economic conditions. If it becomes apparent that the property will not sell by private treaty, consideration is given to submitting the property to an auction, following an auction appraisal and a recommendation by the Group's appointed Asset Manager.

During 2010, the number of cases three months or more in arrears has decreased to 13,096 cases at 31 December 2010 from 19,159 cases at 31 December 2009. In percentage terms, these numbers equate to 4.10% of the mortgage book compared to 5.54%. The total balances of these loans at 31 December 2010 was £1,970.8m (2009: £2,893.1m).

Notes to the Financial Statements (continued)

10. Impairment on loans and advances to customers continued

Further information regarding the credit quality of loans and advances to customers:

Group	At 31 December 2010			At 31 December 2009		
	On residential mortgages £m	On commercial property and housing association loans £m	Total £m	On residential mortgages £m	On commercial property and housing association loans £m	Total £m
Neither past due nor impaired	33,162.4	464.4	33,626.8	34,388.0	447.9	34,835.9
Past due but not impaired:						
- up to 3 months	1,320.7	-	1,320.7	1,390.1	-	1,390.1
- 3 to 6 months	594.7	-	594.7	746.9	-	746.9
- 6 to 12 months	497.6	-	497.6	674.6	-	674.6
Individually impaired	939.8	312.9	1,252.7	1,851.8	423.2	2,275.0
	36,515.2	777.3	37,292.5	39,051.4	871.1	39,922.5
Impairment allowances	(832.1)	(58.6)	(890.7)	(884.1)	(52.2)	(936.3)
Loans and advances to customers net of impairment allowances	35,683.1	718.7	36,401.8	38,167.3	818.9	38,986.2
Impairment allowances:						
- individual	362.2	58.6	420.8	479.0	52.2	531.2
- collective	469.9	-	469.9	405.1	-	405.1
Total impairment allowances	832.1	58.6	890.7	884.1	52.2	936.3

Company	At 31 December 2010			At 31 December 2009		
	On residential mortgages £m	On commercial property and housing association loans £m	Total £m	On residential mortgages £m	On commercial property and housing association loans £m	Total £m
Neither past due nor impaired	25,607.9	464.4	26,072.3	26,854.2	447.9	27,302.1
Past due but not impaired:						
- up to 3 months	886.7	-	886.7	934.6	-	934.6
- 3 to 6 months	360.2	-	360.2	463.7	-	463.7
- 6 to 12 months	275.0	-	275.0	372.9	-	372.9
Individually impaired	471.7	312.9	784.6	1,019.0	423.2	1,442.2
	27,601.5	777.3	28,378.8	29,644.4	871.1	30,515.5
Impairment allowances	(526.8)	(58.6)	(585.4)	(491.3)	(52.2)	(543.5)
Loans and advances to customers net of impairment allowances	27,074.7	718.7	27,793.4	29,153.1	818.9	29,972.0
Impairment allowances:						
- individual	175.8	58.6	234.4	226.0	52.2	278.2
- collective	351.0	-	351.0	265.3	-	265.3
Total impairment allowances	526.8	58.6	585.4	491.3	52.2	543.5

The above table includes loans and advances to customers within 'neither past due nor impaired' which would have been shown as past due or impaired other than due to renegotiation; these were loans where arrears were capitalised during 2010 and 2009. These loans amounted to £187.1m for Group (2009: £95.2m) and £111.1m for Company (2009: £72.8m). A loan is eligible for capitalisation of arrears only once the borrower has complied with stringent terms for a set period.

The Group also offers other forbearance methods to borrowers, subject to compliance with loan terms, including extension of repayment date and switching to interest-only products, the aim of these being to assist the borrower to reduce the levels of arrears. Management have taken into consideration the forbearance options in applying loan default probabilities and in their overall assessment of the total impairment provision.

Notes to the Financial Statements (continued)

10. Impairment on loans and advances to customers continued

Arrears and possessions are monitored for the Group as a whole, and also split by type of product, and split between the loans which the Group originally advanced to customers and the loans which the Group acquired from other lenders.

Residential arrears and possessions – total Group		At 31 December 2010	At 31 December 2009
Over 3 months			
Number of cases	Number	12,473	18,197
Proportion of total	%	3.90	5.26
Asset value	£m	1,873.7	2,736.4
Proportion of book	%	5.25	7.17
Total value of payments overdue	£m	64.3	102.3
Proportion of total book	%	0.18	0.26
Possessions			
Number of cases	Number	623	962
Proportion of total	%	0.19	0.28
Asset value	£m	97.1	156.7
Proportion of book	%	0.27	0.41
Total value of payments overdue	£m	6.8	10.9
Proportion of total book	%	0.02	0.03
Total arrears and possessions			
Number of cases	Number	13,096	19,159
Proportion of total	%	4.09	5.54
Asset value	£m	1,970.8	2,893.1
Proportion of book	%	5.52	7.58
Total value of payments overdue over 3 months	£m	71.1	113.2
Proportion of total book over 3 months	%	0.20	0.29

In respect of all arrears (including those which are less than 3 months in arrears) together with possessions, the total value of payments overdue as at 31 December was:

Total value of payments overdue	£m	80.7	124.5
Proportion of total book	%	0.23	0.33
Residential loan impairment balance			
As % of residential balances	%	2.28	2.26
As % of residential arrears and possessions	%	42.22	30.56

Analysis of residential accounts 3+ months in arrears by product		At 31 December 2010	At 31 December 2009
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Arrears**Buy-to-let**

Number of cases	Number	6,882	11,316
Proportion of total	%	3.63	5.72
Asset value	£m	1,042.8	1,722.9
Proportion of book	%	4.54	7.12
Asset value of arrears and possessions	£m	1,095.6	1,781.0
Proportion of total book	%	4.77	7.36

Self-cert

Number of cases	Number	2,897	3,521
Proportion of total	%	6.09	6.95
Asset value	£m	510.3	623.3
Proportion of book	%	6.87	7.81
Asset value of arrears and possessions	£m	533.7	675.8
Proportion of total book	%	7.18	8.47

Other

Number of cases	Number	2,694	3,360
Proportion of total	%	3.27	3.45
Asset value	£m	320.6	390.2
Proportion of book	%	6.09	6.52
Asset value of arrears and possessions	£m	341.5	436.3
Proportion of total book	%	6.49	7.29

Notes to the Financial Statements (continued)

10. Impairment on loans and advances to customers continued**Analysis of residential accounts 3+ months in arrears:
Organic loans**

At 31 December 2010 At 31 December 2009

Arrears**Total**

Number of cases	Number	8,009	12,423
Proportion of total	%	3.01	4.31
Asset value	£m	1,152.4	1,802.6
Proportion of book	%	4.09	6.01
Asset value of arrears and possessions	£m	1,208.5	1,869.5
Proportion of total book	%	4.29	6.23

Buy-to-let

Number of cases	Number	5,686	9,389
Proportion of total	%	3.35	5.31
Asset value	£m	866.3	1,430.7
Proportion of book	%	4.22	6.65
Asset value of arrears and possessions	£m	904.3	1,468.7
Proportion of total book	%	4.41	6.82

Self-cert

Number of cases	Number	1,223	1,569
Proportion of total	%	4.10	5.00
Asset value	£m	216.3	280.3
Proportion of book	%	4.64	5.66
Asset value of arrears and possessions	£m	229.3	303.0
Proportion of total book	%	4.92	6.12

Other

Number of cases	Number	1,100	1,465
Proportion of total	%	1.65	1.83
Asset value	£m	69.8	91.6
Proportion of book	%	2.31	2.61
Asset value of arrears and possessions	£m	74.9	97.8
Proportion of total book	%	2.48	2.79

**Analysis of residential accounts 3+ months in arrears:
Acquired loans**

At 31 December 2010 At 31 December 2009

Arrears**Total**

Number of cases	Number	4,464	5,774
Proportion of total	%	8.38	10.06
Asset value	£m	721.3	933.8
Proportion of book	%	9.63	11.42
Asset value of arrears and possessions	£m	762.3	1,023.6
Proportion of total book	%	10.18	12.51

Buy-to-let

Number of cases	Number	1,196	1,927
Proportion of total	%	6.07	9.15
Asset value	£m	176.5	292.2
Proportion of book	%	7.13	10.93
Asset value of arrears and possessions	£m	191.3	312.4
Proportion of total book	%	7.73	11.68

Self-cert

Number of cases	Number	1,674	1,952
Proportion of total	%	9.41	10.12
Asset value	£m	294.0	343.0
Proportion of book	%	10.60	11.31
Asset value of arrears and possessions	£m	304.4	372.8
Proportion of total book	%	10.98	12.29

Other

Number of cases	Number	1,594	1,895
Proportion of total	%	10.12	11.14
Asset value	£m	250.8	298.6
Proportion of book	%	11.18	12.07
Asset value of arrears and possessions	£m	266.6	358.4
Proportion of total book	%	11.89	13.68

Notes to the Financial Statements (continued)

11. Investment securities

At 31 December	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Investment securities issued by public bodies:				
- Government securities	156.5	261.6	156.5	261.6
Investment securities issued by other issuers:				
- Other investment securities	1,516.6	2,294.3	5,284.6	10,007.5
Total	1,673.1	2,555.9	5,441.1	10,269.1

All investment securities held are listed.

Investment securities are financial instruments such as bonds or notes issued by governments, supranational public organisations or private corporations which represent ownership or a debt agreement. An investment security represents an investment in, or loan to, the issuer with the expectation of profits and/or interest receipts, earned through the efforts of the issuer, and the ultimate repayment at maturity of the principal investment (or loan). Investment securities are held by the Group for investment purposes, as liquidity or as collateral pledged to raise wholesale funding.

Investment securities are categorised either as available-for-sale or as loans and receivables. Investment securities categorised as available-for-sale are carried at fair value, which is calculated through reference to a market price. Where no reliable market price exists, an assessment is made as to the value of the investment security, based on the net present value of the future expected cash flows. As detailed in note 33(a), certain investment securities categorised as loans and receivables within the Company Balance Sheet were initially categorised as available-for-sale, but were recategorised as loans and receivables during 2009 because there was no active market in these assets and the Company intended to hold them until their maturity. These were recategorised using their fair value immediately prior to recategorisation, and subsequently have been carried on an amortised cost basis; their carrying amounts will accrete up to their redemption amount over their expected lives. During 2010 some of these assets were redeemed, at par, as part of the wind-up of funding structures.

Where there are indicators of potential impairment (for example ratings downgrades, significant or prolonged decline in market price, or a failure of the vehicle to meet contractual liquidity requirements) impairment is assessed. Any reduction that is considered to be permanent is then taken as a charge through 'net impairment on investment securities' in the Income Statement.

At 31 December 2010, the Group and Company held no investment securities issued by the governments of Portugal, the Republic of Ireland, Italy, Greece or Spain.

The risks in the Group's portfolio are managed on a Group basis. An analysis of the Group's and Company's liquidity and structured investment portfolio is provided in note 12.

Investment impairment	Net impairment reversal 2010 £m	Impairment balance 2010 £m	Net impairment charge 2009 £m	Impairment balance 2009 £m
Group				
Liquidity portfolio	0.5	33.4	(40.1)	45.7
Structured investment portfolio	14.0	299.6	(53.2)	317.2
Total investment securities	14.5	333.0	(93.3)	362.9

Group	Liquidity portfolio £m	Structured investment portfolio £m	Total £m
At 1 January 2010	45.7	317.2	362.9
Charged in the year	0.6	0.8	1.4
Released in the year	(1.1)	(14.8)	(15.9)
Utilised in the year	(11.8)	(3.6)	(15.4)
At 31 December 2010	33.4	299.6	333.0

Group	Liquidity portfolio £m	Structured investment portfolio £m	Total £m
At 1 January 2009	5.8	348.0	353.8
Charged in the year	40.1	67.0	107.1
Released in the year	-	(13.8)	(13.8)
Utilised in the year	(0.2)	(84.0)	(84.2)
At 31 December 2009	45.7	317.2	362.9

Notes to the Financial Statements (continued)

12. Wholesale assets

Group						
Wholesale assets At 31 December	2010 £m	AAA %	AA %	A %	BBB %	CCC and below %
Cash and balances at central banks	308.0	100	–	–	–	–
Loans and advances to banks:						
- Reverse repos	1,599.1	100	–	–	–	–
- Bank and time deposits	413.4	–	93	7	–	–
- Cash and other collateral	1,658.7	42	20	38	–	–
Total loans and advances to banks	3,671.2	63	19	18	–	–
Investment securities:						
Liquidity portfolio:						
- UK Government securities	156.5	100	–	–	–	–
- Bank and supranational bonds	846.5	94	6	–	–	–
- UK and European AAA mortgage backed securities	497.9	100	–	–	–	–
- Other asset backed securities	70.2	–	60	24	16	–
Total liquidity portfolio	1,571.1	92	6	1	1	–
Structured investment portfolio:						
- Principal protected notes	81.7	29	44	27	–	–
- Credit funds	20.3	6	–	–	–	94
Total structured investment portfolio	102.0	23	35	22	–	20
Total investment securities	1,673.1	88	8	2	1	1
Total wholesale assets	5,652.3	72	15	12	1	–

Group						
Wholesale assets At 31 December	2009 £m	AAA %	AA %	A %	BBB %	CCC and below %
Cash and balances at central banks	323.0	100	–	–	–	–
Loans and advances to banks:						
- Reverse repos	605.0	100	–	–	–	–
- Bank and time deposits	284.0	22	16	51	11	–
- Cash and other collateral	2,553.3	20	42	38	–	–
Total loans and advances to banks	3,442.3	34	33	32	1	–
Investment securities:						
Liquidity portfolio:						
- UK Government securities	261.6	100	–	–	–	–
- Bank and supranational bonds	956.5	97	3	–	–	–
- UK and European AAA mortgage backed securities	889.7	100	–	–	–	–
- Other asset backed securities	85.3	50	27	18	5	–
Total liquidity portfolio	2,193.1	97	2	1	–	–
Structured investment portfolio:						
- Principal protected notes	328.4	53	17	30	–	–
- Credit funds	34.4	–	–	57	43	–
Total structured investment portfolio	362.8	48	15	33	4	–
Total investment securities	2,555.9	90	4	5	1	–
Total wholesale assets	6,321.2	60	19	20	1	–

Notes to the Financial Statements (continued)

12. Wholesale assets continued

Company						
Wholesale assets At 31 December	2010 £m	AAA %	AA %	A %	BBB %	CCC and below %
Cash and balances at central banks	300.0	100	–	–	–	–
Loans and advances to banks:						
- Reverse repos	1,599.1	100	–	–	–	–
- Bank and time deposits	413.4	–	93	7	–	–
- Cash and other collateral	335.3	22	68	10	–	–
Total loans and advances to banks	2,347.8	71	26	3	–	–
Investment securities:						
Liquidity portfolio:						
- UK Government securities	156.5	100	–	–	–	–
- Bank and supranational bonds	846.5	94	6	–	–	–
- UK and European AAA mortgage backed securities	3,235.6	100	–	–	–	–
- Other asset backed securities	680.2	–	25	2	73	–
- Bonds issued by Group undertakings	420.3	100	–	–	–	–
Total liquidity portfolio	5,339.1	87	4	–	9	–
Structured investment portfolio:						
- Principal protected notes	81.7	29	44	27	–	–
- Credit funds	20.3	6	–	–	–	94
Total structured investment portfolio	102.0	23	35	22	–	20
Total investment securities	5,441.1	85	5	–	9	1
Total wholesale assets	8,088.9	81	11	1	6	1

Company						
Wholesale assets At 31 December	2009 £m	AAA %	AA %	A %	BBB %	CCC and below %
Cash and balances at central banks	316.6	100	–	–	–	–
Loans and advances to banks:						
- Reverse repos	605.0	100	–	–	–	–
- Bank and time deposits	284.0	22	16	51	11	–
- Cash and other collateral	547.2	–	86	14	–	–
Total loans and advances to banks	1,436.2	46	37	15	2	–
Investment securities:						
Liquidity portfolio:						
- UK Government securities	261.6	100	–	–	–	–
- Bank and supranational bonds	956.5	97	3	–	–	–
- UK and European AAA mortgage backed securities	8,488.5	79	5	–	16	–
- Other asset backed securities	85.3	50	27	18	5	–
- Bonds issued by Group undertakings	114.4	100	–	–	–	–
Total liquidity portfolio	9,906.3	81	5	–	14	–
Structured investment portfolio:						
- Principal protected notes	328.4	53	17	30	–	–
- Credit funds	34.4	–	–	57	43	–
Total structured investment portfolio	362.8	48	15	33	4	–
Total investment securities	10,269.1	80	5	1	14	–
Total wholesale assets	12,021.9	76	9	3	12	–

Notes to the Financial Statements (continued)

12. Wholesale assets continued

Additional analysis of the underlying collateral within the structured finance portfolio by geographic region and by type of exposure is provided in the tables below:

Group	Analysis of investment by geographic region						Analysis of investment by type			
	£m	UK %	Europe %	US %	Other %	Total %	Asset backed securities %	Corporate loans %	Other %	Total %
At 31 December 2010										
Principal protected notes	81.7	8	56	28	8	100	–	100	–	100
Credit funds	20.3	1	74	25	–	100	–	100	–	100
Total	102.0	7	59	28	6	100	–	100	–	100

Group	Analysis of investment by geographic region						Analysis of investment by type			
	£m	UK %	Europe %	US %	Other %	Total %	Asset backed securities %	Corporate loans %	Other %	Total %
At 31 December 2009										
Principal protected notes	328.4	10	42	45	3	100	2	74	24	100
Credit funds	34.4	29	58	3	10	100	–	84	16	100
Total	362.8	12	44	41	3	100	2	75	23	100

Company	Analysis of investment by geographic region						Analysis of investment by type			
	£m	UK %	Europe %	US %	Other %	Total %	Asset backed securities %	Corporate loans %	Other %	Total %
At 31 December 2010										
Principal protected notes	81.7	8	56	28	8	100	–	100	–	100
Credit funds	20.3	1	74	25	–	100	–	100	–	100
Total	102.0	7	59	28	6	100	–	100	–	100

Company	Analysis of investment by geographic region						Analysis of investment by type			
	£m	UK %	Europe %	US %	Other %	Total %	Asset backed securities %	Corporate loans %	Other %	Total %
At 31 December 2009										
Principal protected notes	328.4	10	42	45	3	100	2	74	24	100
Credit funds	34.4	29	58	3	10	100	–	84	16	100
Total	362.8	12	44	41	3	100	2	75	23	100

Notes to the Financial Statements (continued)

13. Investments in Group undertakings

Company	2010 £m	2009 £m
At 1 January	1,037.2	1,244.7
Investments	75.0	–
Disposals	–	(8.5)
Repayment of capital	(1.0)	(199.0)
At 31 December	1,111.2	1,037.2
Investments comprise:		
Shares	308.7	234.7
Loans	802.5	802.5
Total	1,111.2	1,037.2

During 2010 the Company provided a capital contribution of £75.0m to its indirect subsidiary undertaking Mortgage Express, and Bradford & Bingley Treasury Services (Ireland) repaid share capital of £1.0m.

The Company's principal subsidiary undertakings at 31 December 2010 held directly or indirectly, all of which are fully consolidated into the Group Financial Statements are listed below:

	Country of incorporation	Major activity	Class of shares held	Interest
Direct				
Bradford & Bingley Investments	England	Holding company	Ordinary	100%
Bradford & Bingley Treasury Services (Ireland)	England	Treasury activities	Ordinary	100%
Indirect				
Mortgage Express	England	Residential mortgage lending	Ordinary	100%

SPVs

The following entities are SPVs established in connection with the Group's securitisation and secured funding programmes (see notes 20 and 21). The Company is a partner in Bradford & Bingley Warehousing No. 1 LLP and Bradford & Bingley Covered Bonds LLP, and has no ownership interest in the other entities but they are regarded as subsidiaries as they are, in substance, controlled by the Company.

	Country of incorporation	Major activity
Aire Valley Mortgages 2004-1 plc	England	Debt issuance
Aire Valley Mortgages 2005-1 plc	England	Debt issuance
Aire Valley Mortgages 2006-1 plc	England	Debt issuance
Aire Valley Mortgages 2007-1 plc	England	Debt issuance
Aire Valley Mortgages 2007-2 plc	England	Debt issuance
Aire Valley Mortgages 2008-1 plc	England	Debt issuance
Bowler Finance plc	England	Debt issuance
Bradford & Bingley Warehousing No. 1 LLP	England	Mortgage funding
Bradford & Bingley Covered Bonds LLP	England	Mortgage funding

Bradford & Bingley Investments, Bradford & Bingley Treasury Services (Ireland) and Mortgage Express are all unlimited companies.

Notes to the Financial Statements (continued)

14. Deferred taxation

The net deferred taxation asset is attributable to the following:

Group	Assets		Liabilities		Net	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December						
Change in accounting basis on adoption of IFRS	8.5	10.3	(11.5)	(14.3)	(3.0)	(4.0)
Cash flow hedges	9.8	15.3	–	–	9.8	15.3
Accelerated tax depreciation	6.0	10.9	–	–	6.0	10.9
Available-for-sale reserve and fair value	222.5	259.0	(229.0)	(266.5)	(6.5)	(7.5)
Employee benefits	53.0	39.3	–	(10.2)	53.0	29.1
Taxation value of losses carried forward	61.1	62.1	–	–	61.1	62.1
	360.9	396.9	(240.5)	(291.0)	120.4	105.9
Offset	(240.5)	(291.0)	240.5	291.0	–	–
Total	120.4	105.9	–	–	120.4	105.9

£2.8m (2009: £35.5m) of deferred tax assets have not been recognised, relating to unused tax losses of £10.3m (2009: 126.7m). £61.1m (2009: £62.1m) of deferred tax assets have been recognised in respect of tax losses carried forward; based upon detailed business plans, there will be sufficient taxable profits in future years to utilise the losses on which deferred tax has been recognised.

Company	Assets		Liabilities		Net	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December						
Change in accounting basis on adoption of IFRS	5.1	6.2	(8.8)	(11.0)	(3.7)	(4.8)
Cash flow hedges	9.8	15.3	–	–	9.8	15.3
Accelerated tax depreciation	6.0	6.3	–	–	6.0	6.3
Available-for-sale reserve and fair value	222.5	259.8	–	–	222.5	259.8
Employee benefits	53.0	39.3	–	(10.2)	53.0	29.1
Taxation value of losses carried forward	–	–	–	–	–	–
	296.4	326.9	(8.8)	(21.2)	287.6	305.7
Offset	(8.8)	(21.2)	8.8	21.2	–	–
Total	287.6	305.7	–	–	287.6	305.7

There were no deferred tax assets unrecognised at 31 December 2010 or 31 December 2009.

The movements in the Group's temporary differences during the year and previous year were as follows:

Group	At 1 January 2010 £m	Recognised in income £m	Recognised in equity £m	At 31 December 2010 £m
Change in accounting basis on adoption of IFRS	(4.0)	1.0	–	(3.0)
Cash flow hedges	15.3	–	(5.5)	9.8
Accelerated tax depreciation	10.9	(4.9)	–	6.0
Available-for-sale reserve and fair value	(7.5)	1.0	–	(6.5)
Employee benefits	29.1	(4.8)	28.7	53.0
Taxation value of losses carried forward	62.1	(1.0)	–	61.1
Total	105.9	(8.7)	23.2	120.4

Group	At 1 January 2009 £m	Recognised in income £m	Recognised in equity £m	At 31 December 2009 £m
Change in accounting basis on adoption of IFRS	(4.5)	0.5	–	(4.0)
Cash flow hedges	57.7	–	(42.4)	15.3
Accelerated tax depreciation	5.7	5.2	–	10.9
Available-for-sale reserve and fair value	(297.7)	0.2	290.0	(7.5)
Employee benefits	(0.3)	(0.1)	29.5	29.1
Taxation value of losses carried forward	148.2	44.6	(130.7)	62.1
Total	(90.9)	50.4	146.4	105.9

Notes to the Financial Statements (continued)

14. Deferred taxation continued

The movements in the Company's temporary differences during the year and previous year were as follows:

Company	At 1 January 2010 £m	Recognised in income £m	Recognised in equity £m	At 31 December 2010 £m
Change in accounting basis on adoption of IFRS	(4.8)	1.1	–	(3.7)
Cash flow hedges	15.3	–	(5.5)	9.8
Accelerated tax depreciation	6.3	(0.3)	–	6.0
Available-for-sale reserve and fair value	259.8	–	(37.3)	222.5
Employee benefits	29.1	(4.8)	28.7	53.0
Taxation value of losses carried forward	–	–	–	–
Total	305.7	(4.0)	(14.1)	287.6

Company	At 1 January 2009 £m	Recognised in income £m	Recognised in equity £m	At 31 December 2009 £m
Change in accounting basis on adoption of IFRS	(5.5)	0.7	–	(4.8)
Cash flow hedges	57.7	–	(42.4)	15.3
Accelerated tax depreciation	2.2	4.1	–	6.3
Available-for-sale reserve and fair value	(1.7)	(1.3)	262.8	259.8
Employee benefits	(0.3)	(0.1)	29.5	29.1
Taxation value of losses carried forward	130.7	–	(130.7)	–
Total	183.1	3.4	119.2	305.7

Deferred tax appropriately reflects a change to the standard rate of UK corporation tax from 28% to 27% with effect from 1 April 2011. This change was substantively enacted on 20 July 2010. The announced further rate reductions by an additional 1% on 1 April 2011 and a further 3% by 1 April 2014, as described in note 8, would have the maximum potential impact of reducing the Group's deferred tax assets by approximately £53.5m (Company £43.9m).

Notes to the Financial Statements (continued)

15. Property, plant and equipment

Group	Land and buildings £m	Equipment fixtures and vehicles £m	Total £m
Cost			
At 1 January 2010	29.8	51.4	81.2
Additions	–	8.3	8.3
Disposals	(6.7)	(6.5)	(13.2)
At 31 December 2010	23.1	53.2	76.3
Depreciation			
At 1 January 2010	17.7	48.5	66.2
Depreciation charge for the year	0.1	0.3	0.4
Disposals	(3.6)	(5.5)	(9.1)
At 31 December 2010	14.2	43.3	57.5
Net book value			
At 1 January 2010	12.1	2.9	15.0
At 31 December 2010	8.9	9.9	18.8

Group	Land and buildings £m	Equipment fixtures and vehicles £m	Total £m
Cost			
At 1 January 2009	29.8	63.1	92.9
Additions	–	0.9	0.9
Disposals	–	(12.6)	(12.6)
At 31 December 2009	29.8	51.4	81.2
Depreciation			
At 1 January 2009	17.6	58.2	75.8
Depreciation charge for the year	0.1	0.3	0.4
Disposals	–	(10.0)	(10.0)
At 31 December 2009	17.7	48.5	66.2
Net book value			
At 1 January 2009	12.2	4.9	17.1
At 31 December 2009	12.1	2.9	15.0

Sale proceeds from asset disposals were £7.0m (2009: £2.6m) resulting in a profit on sale of £2.9m (2009: £nil). Cumulatively, work in progress of £9.2m (2009: £0.9m) has been capitalised and is not being depreciated at the year end. £8.5m (2009: £0.9m) relates to an IT investment programme to simplify the infrastructure and reduce ongoing costs which is currently expected to complete in mid 2011. £0.7m (2009: £nil) relates to the Group's part of an IT investment programme to transform the infrastructure of NRAM and integrate it into B&B's infrastructure; this programme is currently expected to complete at the end of 2011.

Notes to the Financial Statements (continued)

15. Property, plant and equipment continued

Company	Land and buildings £m	Equipment fixtures and vehicles £m	Total £m
Cost			
At 1 January 2010	27.9	49.6	77.5
Additions	–	8.3	8.3
Transfer from subsidiary undertaking	–	0.6	0.6
Disposals	(4.8)	(5.7)	(10.5)
At 31 December 2010	23.1	52.8	75.9
Depreciation			
At 1 January 2010	15.8	47.9	63.7
Depreciation charge for the year	0.1	0.3	0.4
Transfer from subsidiary undertaking	–	0.6	0.6
Disposals	(1.7)	(5.5)	(7.2)
At 31 December 2010	14.2	43.3	57.5
Net book value			
At 1 January 2010	12.1	1.7	13.8
At 31 December 2010	8.9	9.5	18.4

Company	Land and buildings £m	Equipment fixtures and vehicles £m	Total £m
Cost			
At 1 January 2009	27.9	58.1	86.0
Additions	–	0.9	0.9
Disposals	–	(9.4)	(9.4)
At 31 December 2009	27.9	49.6	77.5
Depreciation			
At 1 January 2009	15.7	57.0	72.7
Depreciation charge for the year	0.1	0.3	0.4
Disposals	–	(9.4)	(9.4)
At 31 December 2009	15.8	47.9	63.7
Net book value			
At 1 January 2009	12.2	1.1	13.3
At 31 December 2009	12.1	1.7	13.8

Sale proceeds from asset disposals were £6.2m (2009: £nil) resulting in a profit on sale of £2.9m (2009: £nil). Cumulatively, work in progress of £9.2m (2009: £0.9m) has been capitalised and is not being depreciated at the year end. £8.5m (2009: £0.9m) relates to an IT investment programme to simplify the infrastructure and reduce ongoing costs which is currently expected to complete in mid 2011. £0.7m (2009: £nil) relates to the Group's part of an IT investment programme to transform the infrastructure of NRAM and integrate it into B&B's infrastructure; this programme is currently expected to complete at the end of 2011.

Notes to the Financial Statements (continued)

16. Intangible assets

	Group	Company
	£m	£m
Cost		
At 1 January 2010	43.2	31.9
Additions	3.3	3.3
Transfer from subsidiary undertaking	–	9.6
Disposals	(16.6)	(16.6)
At 31 December 2010	29.9	28.2
Amortisation		
At 1 January 2010	43.2	31.9
Transfer from subsidiary undertaking	–	9.6
Disposals	(16.6)	(16.6)
At 31 December 2010	26.6	24.9
Net book value		
At 1 January 2010	–	–
At 31 December 2010	3.3	3.3

	Group	Company
	£m	£m
Cost		
At 1 January 2009	46.6	35.3
Disposals	(3.4)	(3.4)
At 31 December 2009	43.2	31.9
Amortisation		
At 1 January 2009	46.6	35.3
Disposals	(3.4)	(3.4)
At 31 December 2009	43.2	31.9
Net book value		
At 1 January 2009	–	–
At 31 December 2009	–	–

Intangible assets comprise capitalised software.

Sale proceeds from asset disposals were £nil (2009: £nil) resulting in a loss on sale of £nil (2009: £nil). Cumulatively, work in progress of £3.3m (2009: £nil) has been capitalised and is not being amortised at the year end. £0.2m (2009: £nil) of this relates to an IT investment programme to simplify the infrastructure and reduce ongoing costs which is currently expected to complete in mid 2011, and £3.1m (2009: £nil) relates to the Group's part of an IT investment programme to transform the infrastructure of NRAM and integrate it into B&B's infrastructure; this programme is currently expected to complete at the end of 2011.

17. Other deposits

	Group		Company	
At 31 December	2010	2009	2010	2009
	£m	£m	£m	£m
Amounts due to subsidiary undertakings	–	–	19,576.7	27,654.3
Cash collateral received	–	457.5	–	–
Amounts due to other depositors	–	–	600.6	603.1
Total	–	457.5	20,177.3	28,257.4

Notes to the Financial Statements (continued)

18. HM Treasury Working Capital Facility

The Company has an interest-bearing Working Capital Facility ('WCF') provided by HM Treasury. At 31 December 2010 the Company had drawn £8,550.0m of this facility; £8,564.2m including accrued interest (2009: £8,537.8m). HM Treasury has indicated that its current intention is to continue to fund the Company as a going concern, and to enable the Company to meet its debts as and when they fall due, until at least 31 December 2012.

HM Treasury has indicated that it expects the WCF to be repaid out of the cash flows generated by the Company and the Group during their wind-down. These cash flows will principally comprise interest and redemptions arising on loans to customers. The redemption profile of loans to customers is uncertain; many of these loans have contractual maturities of 25 years or more from the date of advance, but experience has been that most loans to customers redeem earlier than their contractual maturity dates. Consequently, the timing of the repayment of the WCF is uncertain.

As described in note 27, on 25 January 2010 the EC announced its approval under the State aid rules of the financing facilities and guarantee arrangements provided by HM Treasury.

19. Statutory Debt

The Company has an interest-free Statutory Debt due to the FSCS of £18,416.2m as at 31 December 2010 and 31 December 2009. This replaced the Group's savings-related assets and liabilities which were transferred to Abbey on 29 September 2008.

It is expected that the Statutory Debt will be repaid out of the cash flows generated by the Company and the Group during their wind-down. These cash flows will principally comprise interest and redemptions arising on loans to customers. The redemption profile of loans to customers is uncertain; many of these loans have contractual maturities of 25 years or more from the date of advance, but experience has been that most loans to customers redeem earlier than their contractual maturity dates. Consequently, the timing of the repayment of the Statutory Debt is uncertain.

As described in note 27, on 25 January 2010 the EC announced its approval under the State aid rules of the financing facilities and guarantee arrangements provided by HM Treasury.

20. Securitised notes

	Group
	£m
2010	
Balance at 1 January 2010	6,021.9
Repayments	(704.6)
Exchange rate movements and hedge accounting adjustments	(44.4)
Balance at 31 December 2010	5,272.9
Securitisied assets	6,045.7
	Group
	£m
2009	
Balance at 1 January 2009	8,264.6
Repayments	(855.5)
Exchange rate movements and hedge accounting adjustments	(1,387.2)
Balance at 31 December 2009	6,021.9
Securitisied assets	8,179.6

The Group issued debt securities to securitise loans and advances to customers through SPVs, the amounts of which are shown above. These are subject to fair value hedge designation and the carrying values of these instruments are adjusted to reflect the fair values of the risks being hedged. In addition to the Group numbers above, the Company holds investment securities issued by Group SPVs as detailed in note 31.

Notes to the Financial Statements (continued)

21. Covered Bonds

2010	Group	Company
	£m	£m
Balance at 1 January 2010	5,768.2	5,768.2
Repayments	(1,376.5)	(1,376.5)
Exchange rate movements and hedge accounting adjustments	585.9	585.9
Balance at 31 December 2010	4,977.6	4,977.6
Securitised assets	6,338.2	6,338.2
	Group	Company
2009	£m	£m
Balance at 1 January 2009	8,004.0	8,121.9
Repayments	(1,342.0)	(1,342.0)
Exchange rate movements and hedge accounting adjustments	(893.8)	(1,011.7)
Balance at 31 December 2009	5,768.2	5,768.2
Securitised assets	6,493.9	6,493.9

The Group issued debt securities to securitise loans and advances to customers through Covered Bonds, the amounts of which are provided above. These are subject to fair value hedge designation, and the carrying values of these instruments are adjusted to reflect the fair values of the risks being hedged.

HM Treasury has provided a guarantee with regard to certain wholesale borrowings existing at the time of the nationalisation of the Company. The Company pays a fee for this guarantee, as shown in note 3.

22. Other debt securities in issue

2010	Group	Company
	£m	£m
Balance at 1 January 2010	3,343.5	3,343.5
Repayments	(640.3)	(640.3)
Exchange rate movements and hedge accounting adjustments	(406.0)	(406.0)
Balance at 31 December 2010	2,297.2	2,297.2
	Group	Company
2009	£m	£m
Balance at 1 January 2009	4,397.7	5,242.1
Repayments	(1,295.5)	(1,295.5)
Exchange rate movements and hedge accounting adjustments	241.3	(603.1)
Balance at 31 December 2009	3,343.5	3,343.5

The Group issued debt securities, the amounts of which are shown above. These are subject to fair value hedge designation and the carrying values of these instruments are adjusted to reflect the fair value of the risks being hedged.

HM Treasury has provided a guarantee with regard to certain wholesale borrowings existing at the time of the nationalisation of the Company. The Company pays a fee for this guarantee, as shown in note 3.

Notes to the Financial Statements (continued)

23. Other liabilities

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Surplus conversion shares	13.5	14.9	13.5	14.9
Other creditors	53.1	73.3	49.8	65.5
Total	66.6	88.2	63.3	80.4

24. Accruals and deferred income

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Accrued interest on subordinated liabilities (see note 27)	–	84.8	–	93.2
Accrued interest on other capital instruments (see note 28)	–	5.7	–	–
Deferred income	–	1.3	–	1.3
Other	32.9	27.5	30.1	25.3
Total	32.9	119.3	30.1	119.8

At 31 December 2009 accrued interest on subordinated liabilities and other capital instruments was carried within accruals and deferred income. At 31 December 2010, this accrued interest is carried within the carrying amount of the amortised liabilities, as detailed further in notes 27 and 28. This change in presentation has been made because, since the reduction of the carrying amount of the associated liabilities in February 2010, the interest accrued on an EIR basis no longer represents amounts payable in the short term.

25. Post-retirement benefit obligations**(a) Pension schemes**

The Group operated a defined benefit staff pension scheme, the Bradford & Bingley Staff Pension Scheme ('the principal scheme'), which was administered by 'the Trustees'. On 31 December 2009 the scheme was closed to future service accrual and all members became deferred members and were given the option to transfer to the Group defined contribution scheme from 1 January 2010. The funds are independent from those of the Group. The normal pension age of employees in the scheme is 65.

The Group also operates a defined contribution scheme, the Bradford & Bingley Group Pension Plan. The funds of this scheme are independent from those of the Group. The Group and Company had no liabilities or prepayments associated with the defined contribution scheme at 31 December 2010 (2009: £nil). The cost in the year to the Group of the defined contribution scheme was £1.5m (2009: £0.7m) and the cost to the Company was £1.1m (2009: £0.4m).

(b) Other post-retirement benefits

The Group provides healthcare benefits to some of its pensioners. The healthcare benefits are provided through a post-retirement medical scheme into which the Company contributes 100% towards the cost of providing medical expense benefits for members who retired before 1 January 1996 and 50% for members who retired after this date. The total number of members of the scheme at 31 December 2010 was 355 (2009: 393). Private medical costs are assessed in accordance with the advice of a qualified actuary.

(c) Accounting treatment

The Group accounts for post-retirement benefit costs in accordance with IAS 19 and IFRIC 14. The full net deficit is carried on the Group and Company Balance Sheets, and gains and losses arising due to actuarial revaluations and adjustments to reflect the funding plan commitments are taken to Group and Company retained earnings rather than being charged or credited in the Income Statement. The Company is committed to a funding plan to address the deficit on the defined benefit plan. In accordance with IFRIC 14 'IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', the net pension deficit which is recognised on the Balance Sheet is the higher of the deficit calculated under IAS 19 and the net present value of the committed funding. However, to the extent that the Company has a clear unconditional right to a refund of future surpluses which may arise in the plan, the carrying value of the deficit should be reduced to take account of the anticipated future available refunds. The actuarial gain recognised in the Group and Company retained earnings during the year was £7.8m (2009: loss £105.0m) and the funding plan reduced retained earnings by £117.6m (2009: £nil).

More than one employing Group entity contributes to the post-retirement benefit schemes. As there is no contractual agreement or stated policy for charging the net defined benefit cost to individual Group entities, the net defined benefit cost is recognised in the Financial Statements of the Company (being the sponsoring entity). Other Group entities, in their individual financial statements, recognise a cost equal to their contributions payable for the period.

Notes to the Financial Statements (continued)

25. Post-retirement benefit obligations continued**(d) Employee benefit obligations**

The amounts carried on the Group and Company Balance Sheets are as follows:

	Defined benefit pension plans		Post-retirement medical benefits		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Present value of funded obligations	650.7	615.1	9.0	7.8	659.7	622.9
Fair value of plan assets	(583.2)	(525.2)	–	–	(583.2)	(525.2)
Effect of agreed funding plan	117.6	–	–	–	117.6	–
Net liability	185.1	89.9	9.0	7.8	194.1	97.7
Amounts carried on the Balance Sheet:						
- Liabilities	185.1	89.9	9.0	7.8	194.1	97.7

In July 2010 the Company committed to address the deficit on the defined benefit plan by making contributions of £16m per annum increasing at 10% pa for 10 years; the first payment of £16m was made in 2010. The Company's net liability above reflects the full commitment under the funding plan, with the Company having no unconditional right to the refund of future surpluses as at 31 December 2010. The Trustees agreed in November 2010 to pass a resolution under section 251(3) of the Pensions Act 2004 for the refund of any future surpluses to the Company. As detailed in note 37, this resolution was finalised on 29 March 2011 and consequently the net pension liability carried on the Balance Sheet reduced at that time.

The amounts recognised in the Group Income Statement were as follows:

	Defined benefit pension plans		Post-retirement medical benefits		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Current service cost	–	1.6	–	0.1	–	1.7
Interest on plan obligations	33.6	30.7	0.5	0.5	34.1	31.2
Expected return on plan assets	(30.7)	(28.1)	–	–	(30.7)	(28.1)
	2.9	4.2	0.5	0.6	3.4	4.8
Gain on curtailment (i)	–	(13.4)	–	–	–	(13.4)
Total	2.9	(9.2)	0.5	0.6	3.4	(8.6)

All amounts above have also been recognised in the Company Income Statement with the exception of £nil (2009: £0.8m) of the current service cost, which has been recognised within other Group companies.

The actual return on defined benefit plan assets for the year was £61.9m (2009: £49.9m).

Notes to the Financial Statements (continued)

25. Post-retirement benefit obligations continued**(d) Employee benefit obligations** continued

Changes in the present value of defined benefit obligations were as follows:

	Defined benefit pension plans		Post-retirement medical benefits		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Opening defined benefit obligations	615.1	480.5	7.8	9.2	622.9	489.7
Current service cost	–	1.6	–	0.1	–	1.7
Contributions by employees	–	0.3	–	–	–	0.3
Interest on plan obligations	33.6	30.7	0.5	0.5	34.1	31.2
Actuarial loss / (gain)	22.4	132.6	1.0	(1.4)	23.4	131.2
Gain on curtailment (i)	–	(13.4)	–	–	–	(13.4)
Benefits paid	(20.4)	(17.2)	(0.3)	(0.6)	(20.7)	(17.8)
Closing defined benefit obligations	650.7	615.1	9.0	7.8	659.7	622.9

Changes in the fair value of plan assets were as follows:

	Defined benefit pension plans		Post-retirement medical benefits		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Opening fair value of plan assets	525.2	485.3	–	–	525.2	485.3
Expected return on plan assets	30.7	28.1	–	–	30.7	28.1
Contributions by employing entities	16.4	7.3	0.3	0.6	16.7	7.9
Contributions by employees	–	0.3	–	–	–	0.3
Actuarial gain	31.2	21.3	–	–	31.2	21.3
Benefits paid	(20.3)	(17.1)	(0.3)	(0.6)	(20.6)	(17.7)
Closing fair value of plan assets	583.2	525.2	–	–	583.2	525.2

(i) Gain on curtailment

As of 31 December 2009 the scheme was closed to future service accrual and all members became deferred members and were given the option to transfer to the Group defined contribution scheme from 1 January 2010. The curtailment gain arising as a result of this event was £13.4m. Curtailment gains have been calculated in accordance with IAS 19.

The Group expects to contribute £17.6m to its defined benefit pension plan in 2011.

The major categories of plan assets as a percentage of total plan assets at 31 December were as follows:

	2010	2009
Equities	40%	37%
Property	8%	7%
Bonds	30%	33%
Gilts	13%	12%
Cash and other	9%	11%
Total	100%	100%

Notes to the Financial Statements (continued)

25. Post-retirement benefit obligations continued**(d) Employee benefit obligations** continued

The principal actuarial assumptions (expressed as weighted averages) were as follows:

	2010	2009
To determine benefit obligations		
Discount rate at 31 December	5.3%	5.7%
Future pension increases	3.3%	3.5%
Rate of salary increase	n/a	5.5%
To determine the net pension cost		
Expected return on plan assets	6.0%	6.1%
Discount rate	5.6%	6.4%
Rate of salary increase	n/a	5.0%
For post-retirement medical plan		
Discount rate	5.3%	5.7%
Inflation	3.3%	3.5%
Medical cost trend for duration of liability	6.0%	4.5%

In determining the expected long-term return on plan assets, the Company considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns on each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term return for the portfolio.

The Trustees have announced their intention that, with effect from 1 January 2011, the Consumer Prices Index will be used for the revaluation of the benefits accrued by deferred members. At 31 December 2010 management and the Trustees were working to implement the change. There are certain conditions which need to be fulfilled before the change comes into effect, and so the year ended 31 December 2010 the inflation assumption used to determine benefit obligations as shown above continues to be based on the Retail Prices Index.

The table below shows the life expectancy assumptions from age 60 (based on a 1945 year of birth for retired members and 1965 for non-retired members):

	Retired members	2010 Non-retired members	Retired members	2009 Non-retired members
Male	26.6	28.8	26.6	28.8
Female	29.5	31.7	29.5	31.7

Sensitivity

The following table illustrates the sensitivity of the pension scheme defined benefit obligation to three key assumptions: the discount rate, the rate of inflation and the mortality assumption:

Assumption	Change in assumption	Impact on benefit obligation
Discount rate	Decrease by 0.5%	Increase by 11%
Inflation	Increase by 0.5%	Increase by 11%
Mortality	Decrease by 1 year	Increase by 2%

If the assumptions were to change by the same amount in the opposite direction to those illustrated, the benefit obligation would decrease by a similar percentage to those shown in the table in each case.

Assumed healthcare cost trend rates have an effect on the amounts recognised in staff costs. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	2010 £m	2009 £m
Effect on the aggregate of service cost and interest cost	0.1	0.1
Effect on defined benefit obligations	1.2	1.1

Notes to the Financial Statements (continued)

26. Provisions and contingent liabilities

Group and Company	Empty leasehold premises £m	Compensation claims £m	Restructuring costs £m	Total £m
At 1 January 2010	6.7	23.8	22.3	52.8
Charged in the year	–	2.0	–	2.0
Released in the year	–	(0.6)	–	(0.6)
Utilised in the year	(1.3)	(4.6)	(13.8)	(19.7)
At 31 December 2010	5.4	20.6	8.5	34.5

Group and Company	Empty leasehold premises £m	Compensation claims £m	Restructuring costs £m	Total £m
At 1 January 2009	6.1	25.5	52.0	83.6
Charged in the year	1.3	3.8	13.3	18.4
Released in the year	–	–	(8.4)	(8.4)
Utilised in the year	(0.7)	(5.5)	(34.6)	(40.8)
At 31 December 2009	6.7	23.8	22.3	52.8

Empty leasehold premises

The empty leasehold premises provision relates to properties which, as at the Balance Sheet date, were no longer used by the business but were subject to a lease agreement. The rental payments are due to be made during the period 2011 to 2017.

Compensation claims

Compensation claims relate to potential payments to customers relating to endowment and other products sold in the past by the Group's independent advisory business. This business was sold in December 2004 following a strategic review. The provision is calculated on the basis of a reasonable estimate of the size and expected timing of claims. It is not possible to give a precise indication of the timing or amount of future payments as external factors such as the performance of the stock market and market agitation could have a significant impact. The provision includes £2.0m in respect of payment protection insurance and this provision is considered to be sufficient to cover the anticipated levels of claims.

Restructuring costs

Restructuring costs were incurred as a consequence of certain strategic changes made during 2008 and include employee contract termination costs. The provision represents amounts expected to be paid in 2011.

Contingent liabilities

On 20 January 2009 a solicitor's letter was received notifying the Company and certain present and former Directors of a potential claim by former individual shareholders who subscribed for additional shares in the £401m rights issue approved on 17 July 2008. These former shareholders claim to have suffered loss through having been induced to subscribe for shares in the rights issue by allegedly materially misleading and/or incomplete statements made in the associated prospectus dated 24 June 2008 as revised and supplemented by the supplementary prospectus dated 11 July 2008. Should such a claim result in proceedings which are pursued through the courts and which succeed, the defendant Directors and/or the Company could be liable in damages to certain former shareholders in the Company who subscribed for shares in the rights issue. The Company together with its legal advisers has responded to the allegations raised. It is not possible at this stage to determine the outcome or timing of any conclusion to this matter. No provision has been made in respect of these allegations.

The Company has provided a number of financial guarantees to other Group companies. The Directors do not expect any claims to be made against the Company under these guarantees and hence no provision has been made.

As described in note 28, the Company has provided a subordinated guarantee to the holders of 6.462% guaranteed, non-voting, non-cumulative, perpetual preferred securities, Series A issued by Bradford & Bingley Capital Funding L.P., whereby, if Bradford & Bingley Capital Funding L.P. fails to make a distribution to the holders of the securities when due, then the Company will be obliged to make such payment, subject to certain conditions. In June 2010 the Company made a payment under this guarantee, and it is expected that the Company will continue to make annual payments for a period of time. The Company carries this guarantee at fair value within subordinated liabilities.

Notes to the Financial Statements (continued)

27. Subordinated liabilities

Group	At 31 December 2010					At 31 December 2009	
	Initial interest rate	First due or callable	Transfer Order classification	Carrying amount £m	Principal £m	Carrying amount £m	Principal £m
Dated securities:							
- Subordinated notes	7.625%	2010	Dated	31.6	27.7	124.8	125.0
- Fixed rate step-up subordinated notes	5.500%	2018	Dated	20.2	17.3	266.6	250.0
- Fixed rate step-up subordinated notes	5.750%	2022	Dated	37.2	30.8	213.8	200.0
- Subordinated notes	6.625%	2023	Dated	36.7	30.5	127.8	125.0
- Subordinated notes	LIBOR + 1.300%	2054	Dated	77.6	75.0	-	-
				203.3	181.3	733.0	700.0
Callable perpetual securities:							
- Perpetual subordinated notes	5.625%	2013	Undated	43.7	39.5	261.5	250.0
- Perpetual subordinated notes	6.000%	2019	Undated	34.6	33.5	209.7	200.0
- Perpetual subordinated notes	6.462%	2032	Undated	-	-	-	-
				78.3	73.0	471.2	450.0
Undated perpetual securities:							
- Perpetual subordinated bonds	13.000%	Perpetual	Undated	29.2	41.5	55.0	55.0
- Perpetual subordinated bonds	11.625%	Perpetual	Undated	27.1	35.7	50.0	50.0
				56.3	77.2	105.0	105.0
Total subordinated liabilities				337.9	331.5	1,309.2	1,255.0

Company	At 31 December 2010					At 31 December 2009	
	Initial interest rate	First due or callable	Transfer Order classification	Carrying amount £m	Principal £m	Carrying amount £m	Principal £m
Dated securities:							
- Subordinated notes	7.625%	2010	Dated	31.6	27.7	124.8	125.0
- Fixed rate step-up subordinated notes	5.500%	2018	Dated	20.2	17.3	266.6	250.0
- Fixed rate step-up subordinated notes	5.750%	2022	Dated	37.2	30.8	213.8	200.0
- Subordinated notes	6.625%	2023	Dated	36.7	30.5	127.8	125.0
- Subordinated notes	LIBOR + 1.300%	2054	Dated	155.5	150.0	150.0	150.0
				281.2	256.3	883.0	850.0
Callable perpetual securities:							
- Perpetual subordinated notes	5.625%	2013	Undated	43.7	39.5	261.5	250.0
- Perpetual subordinated notes	6.000%	2019	Undated	34.6	33.5	209.7	200.0
- Perpetual subordinated notes	6.462%	2032	Undated	56.0	46.3	170.3	150.0
				134.3	119.3	641.5	600.0
Undated perpetual securities:							
- Perpetual subordinated bonds	13.000%	Perpetual	Undated	29.2	41.5	55.0	55.0
- Perpetual subordinated bonds	11.625%	Perpetual	Undated	27.1	35.7	50.0	50.0
				56.3	77.2	105.0	105.0
Total subordinated liabilities				471.8	452.8	1,629.5	1,555.0

Notes to the Financial Statements (continued)

27. Subordinated liabilities continued

The subordinated liabilities are all denominated in sterling.

The carrying values of these liabilities are on an EIR basis which takes into account issue costs. The carrying value of individually hedged items also includes hedge accounting adjustments to reflect changes in the fair value of hedged risks. Hedge accounting of subordinated liabilities ceased during the year, and the hedge accounting adjustments which existed at the point of cessation of hedge accounting are being amortised to the Income Statement over the original expected life of the hedge arrangement on an EIR basis, with the unamortised adjustments being carried within the carrying amount of the associated subordinated liabilities. On derecognition of a subordinated liability, any remaining unamortised hedge accounting adjustment is released to the Income Statement as part of the gain or loss on derecognition.

Since mid-June 2009, the Board have deferred payment of all principal and coupons in respect of the Group's subordinated liabilities. Each decision was taken on a case-by-case basis until 23 February 2010. Following the Board meeting of 23 February 2010, the Group announced that it had resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities as listed in the table above during the period prior to the date on which it repays in full the Statutory Debt described in note 19. This Board decision followed the notification to the Group on 25 January 2010 of the EC's approval of State aid. The EC's decision set various conditions on the Group receiving State aid, one of which was that the Group should not make payments of principal or interest on its subordinated liabilities during the period prior to the date on which it repays in full the Statutory Debt. The Group announced that it had resolved to continue to make payments in full under its guarantee of the £150,000,000 6.462% guaranteed, non-voting, non-cumulative, perpetual preferred securities, Series A, issued by Bradford & Bingley Capital Funding L.P., subject to the terms of such instruments (see note 28).

As a consequence of the announcement of 23 February 2010, the carrying value of subordinated liabilities was reduced by £104.3m, with an equal gain being recognised in the Income Statement (see note 3), to reflect the revised present value of the new expected cash flows of these instruments. Following this reduction, interest, including unwind of the reduction in carrying value, accrues on the reduced liabilities on an EIR basis at the original EIR of the liability, such that the carrying value will ultimately accrete up to principal plus interest due. For subordinated liabilities where interest is compound, the interest accrual also takes into account interest on the deferred coupons, on an EIR basis.

At 31 December 2009 accrued interest was carried within accruals and deferred income (see note 24). At 31 December 2010 accrued interest is carried within the carrying amount of the associated subordinated liabilities. This change in presentation has been made because, since the reduction of the carrying amount in February 2010, the interest accrued on an EIR basis no longer represents amounts payable in the short term.

In June 2010 and in December 2010 the Group bought back its own subordinated liabilities and other capital instruments (see note 28) with a principal value of £1,102.2m (£1,097.9m net of discount on issue). These liabilities, along with associated accrued interest, have been derecognised from the Group's Balance Sheet, and a gain of £786.0m has been recognised in the Income Statement (see note 7).

The subordinated notes due 2010 are due to pay interest at a rate of 7.625% per annum annually on 16 February until their maturity. The interest and principal payments due on 16 February 2010 and 16 February 2011 were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, and interest is due on the amount of deferred coupons at the same rate as on the principal.

The fixed rate step-up subordinated notes due 2018 are due to pay interest at a rate of 5.500% per annum annually on 15 January up to but excluding 15 January 2013 when the Group may either redeem them (on that date or any subsequent interest payment date, subject to obtaining FSA consent) or pay interest at a rate of 0.830% above 3 month GBP LIBOR until redemption. The interest payments due on 15 January 2010 and 15 January 2011 were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, and interest is due on the amount of deferred coupons at the same rate as on the principal.

The fixed rate step-up subordinated notes due 2022 are due to pay interest at a rate of 5.750% per annum annually on 12 December up to but excluding 12 December 2017 when the Group may either redeem them or pay interest at a rate of 2.000% above the relevant 5 year benchmark gilt rate until redemption. The interest payments due on 12 December 2009 and 12 December 2010 were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, and interest is due on the amount of deferred coupons at the same rate as on the principal.

The subordinated notes due 2023 are due to pay interest at a rate of 6.625% per annum annually on 16 June until their maturity. The interest payments due on 16 June 2009 and 16 June 2010 were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, and interest is due on the amount of deferred coupons at the same rate as on the principal.

Of the subordinated notes due 2054 (the '2054 Notes'), £75.0m is currently held by external parties and as at 31 December 2010 £75.0m was held by the Company's subsidiary undertaking Mortgage Express (and hence eliminated from Group balances). As described in note 37, on 10 March 2011 the Company repurchased at par, and cancelled, the notes held by Mortgage Express. Previously all £150.0m of the notes were held by subsidiary undertakings of the Company. These notes are due to pay interest quarterly on 31 March, 30 June, 30 September and 31 December at a rate of 1.300% above 3 month GBP LIBOR, and can be redeemed at the option of the Group on the March 2015 interest payment date or any subsequent interest payment date until maturity, subject to obtaining FSA consent. The interest payments due on 30 June 2009 and subsequently were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, and interest is due on the amount of deferred coupons at the same rate as on the principal.

Notes to the Financial Statements (continued)

27. Subordinated liabilities continued

The perpetual subordinated notes due 2013 are due to pay interest at a rate of 5.625% per annum annually on 20 December up to but excluding 20 December 2013 and thereafter at 2.230% above the relevant 5 year benchmark gilt rate, and can be redeemed at the option of the Group on 20 December 2013 and on each fifth anniversary thereafter. The interest payments due on 20 December 2009 and 20 December 2010 were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, but no interest will be due on the deferred coupons.

The perpetual subordinated notes due 2019 are due to pay interest at a rate of 6.000% per annum annually on 10 December up to but excluding 10 December 2019 and thereafter at 1.930% above the relevant 5 year benchmark gilt rate, and can be redeemed at the option of the Group, subject to obtaining FSA consent, on 10 December 2019 and on each fifth anniversary thereafter. The interest payments due on 10 December 2009 and 10 December 2010 were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, but no interest will be due on the deferred coupons.

The perpetual subordinated notes due 2032 are currently held by the Company's subsidiary undertaking Bradford & Bingley Capital Funding L.P. These notes are due to pay interest at a rate of 6.462% annually on 2 June up to but excluding 2 June 2032 and thereafter at 2.300% above the relevant 5 year benchmark gilt rate, and can be redeemed at the option of the Group on 2 June 2032 and on each fifth anniversary thereafter subject to obtaining FSA consent. The notes can also be redeemed on other dates, subject to obtaining FSA consent, if the Group pays an additional make whole amount calculated in accordance with the terms of the instrument. The interest payment due on 2 June 2010 was deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, but no interest will be due on the deferred coupons. As a result of the deferral of interest payments, certain income distributions from Bradford & Bingley Capital Funding L.P. were not and will not be paid (see note 28). As described in note 28, the Company has provided a subordinated guarantee to holders of securities issued by Bradford & Bingley Capital Funding L.P. In June 2010 the Company made a payment under this guarantee, and it is expected that the Company will continue to make annual payments for a period of time. The Company carries this guarantee at fair value, within subordinated liabilities.

The 13.000% perpetual subordinated bonds are due to pay interest six-monthly on 7 April and 7 October each year, and have no maturity date. The interest payments due on 7 October 2009, 7 April 2010 and 7 October 2010 were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, but no interest will be due on the deferred coupons.

The 11.625% perpetual subordinated bonds are due to pay interest six-monthly on 20 January and 20 July each year, and have no maturity date. The interest payments due on 20 July 2009 and subsequently were deferred, and, as described above, the Group has announced that it has resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities, including these notes, during the period prior to the date on which it repays in full the Statutory Debt. Deferred coupons on these notes continue to be due, but no interest will be due on the deferred coupons.

Interest incurred by the Group in 2010 with respect to subordinated liabilities was £50.6m (2009: £82.1m) and by the Company was £62.9m (2009: £96.1m).

None of the subordinated liabilities can be repaid at the Group's option, except as stated above. The rights of holders of subordinated debt, including perpetual subordinated bonds, are subordinated to the claims of all depositors and senior creditors as regards the principal and interest thereon.

The Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008 modified the rights of the holders of the Group's dated subordinated notes such that a non-payment of any principal due in respect of a dated subordinated note shall not constitute an event of default under such note. Under the terms of the Bradford & Bingley plc Transfer of Securities and Property etc. (Amendment) Order 2009, which came into force on 20 February 2009, principal and interest shall not become due on any dated subordinated note until either the Group gives notice that it will become due or the Group has satisfied in full its liability to the FSCS under article 30(1) of the Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008 (the Statutory Debt described in note 19). As described above, following the Board meeting of 23 February 2010 the Group announced that it had resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities during the period prior to the date on which it repays in full the Statutory Debt.

Notes to the Financial Statements (continued)

28. Other capital instruments

	Group		Group	
	Carrying amount 2010 £m	Principal 2010 £m	Carrying amount 2009 £m	Principal 2009 £m
At 31 December				
Perpetual preferred securities	56.0	46.3	170.3	150.0
Limited Partnership Share	–	–	75.0	75.0
Total	56.0	46.3	245.3	225.0

The other capital instruments are all denominated in sterling.

The carrying values of these liabilities are on an EIR basis which takes into account issue costs. The carrying value of individually hedged items also includes hedge accounting adjustments to reflect changes in the fair value of hedged risks. Hedge accounting of these liabilities ceased during the year, and the hedge accounting adjustments which existed at the point of cessation of hedge accounting are being amortised to the Income Statement over the original expected life of the hedge arrangement on an EIR basis, with the unamortised adjustments being carried within the carrying amount of the associated liabilities. On derecognition of an instrument, any remaining unamortised hedge accounting adjustment is released to the Income Statement as part of the gain or loss on derecognition.

At 31 December 2009 accrued interest was carried within accruals and deferred income (see note 24). At 31 December 2010 accrued interest is carried within the carrying amount of the associated instruments.

On 29 May 2002, £150.0m (£148.5m net of discount on issue) 6.462% guaranteed, non-voting, non-cumulative, perpetual preferred securities, Series A, were issued by Bradford & Bingley Capital Funding L.P., a Jersey limited partnership. These securities are not subject to any mandatory redemption provisions; they are redeemable by the General Partner at its option on 2 June 2032 and on each fifth anniversary thereafter (subject to certain conditions being satisfied, including FSA consent). These securities have a fixed coupon and, if they are not redeemed in 2032, the coupon will be reset at a rate equal to the sum of the relevant 5 year benchmark gilt rate plus a margin of 2.300% per annum. Following the Board meeting of 23 February 2010 the Group announced that it had resolved not to make any payment of principal or interest in respect of the Group's subordinated liabilities as listed in the table in note 27, including the perpetual subordinated notes currently held by Bradford & Bingley Capital Funding L.P., during the period prior to the date on which it repays in full the Statutory Debt described in note 19. As a consequence, interest distributions due to be paid by Bradford & Bingley Capital Funding L.P. on the perpetual preferred securities, which would otherwise fall due during this period, will also not be paid. At the time the transaction was entered into in May 2002, the Company provided a subordinated guarantee to the holders of these securities whereby, if Bradford & Bingley Capital Funding L.P. fails to make a distribution to the holders of the securities when due, then the Company will be obliged to make such payment, unless such payment would exceed the Company's adjusted distributable reserves (as calculated under the terms of the instrument) or would cause a breach of capital adequacy requirements then applicable to the Company. Following the announcement that subordinated coupons were to be deferred at the Board meeting of 23 February 2010, the Company announced that it had resolved to continue to make payments in full under this guarantee, subject to its terms. £9.7m was paid to the holders of these securities in June 2010, under this guarantee. The carrying amount of the perpetual preferred securities includes the effect of the liability for this guarantee as well as the benefit of the non-payment of distributions from Bradford & Bingley Capital Funding L.P. In December 2010 the Group bought back some of these securities with a principal value of £103.7m (£102.8m net of discount on issue). These securities, along with associated accrued interest, have been derecognised from the Group's Balance Sheet, and a gain of £63.9m has been recognised in the Income Statement (see note 7).

On 23 March 2005, Bradford & Bingley Capital Funding II L.P., a limited partnership incorporated under the UK Limited Partnership Act 1907, issued £150.0m limited partnership interests. At 31 December 2009, £75.0m of these limited partnership interests were held by Group undertakings, with the balance being held by external parties, being the Limited Partnership Share. During the year, the external Limited Partnership Share was replaced by subordinated notes due 2054 (see note 27).

Interest incurred by the Group in 2010 with respect to other capital instruments was £9.3m (2009: £10.4m).

29. Share capital

Group and Company ordinary shares of 25p each:

	2010 Number of shares (m)	2009 Number of shares (m)	2010 £m	2009 £m
Ordinary shares issued and fully paid at 1 January and 31 December	1,445.3	1,445.3	361.3	361.3

In accordance with The Companies Act 2006, the Company no longer has 'authorised capital' other than its issued capital.

The Company has one class of shares: ordinary shares of 25p each, ranking equally in respect of rights attaching to voting, dividends and in the event of a winding-up.

Notes to the Financial Statements (continued)

30. Off Balance Sheet commitments

Group 2010	In not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
Loan commitments:				
- Lifetime mortgages	55.8	238.1	1,121.2	1,415.1
- Other mortgages	128.3	-	-	128.3
Total loan commitments	184.1	238.1	1,121.2	1,543.4
Rentals under non-cancellable operating leases	1.6	3.4	0.2	5.2
Capital commitments	8.1	-	-	8.1
Total off Balance Sheet commitments	193.8	241.5	1,121.4	1,556.7
Group 2009	In not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
Loan commitments:				
- Lifetime mortgages	53.8	238.7	1,214.8	1,507.3
- Other mortgages	104.6	-	-	104.6
Total loan commitments	158.4	238.7	1,214.8	1,611.9
Rentals under non-cancellable operating leases	1.6	4.1	0.3	6.0
Capital commitments	0.3	-	-	0.3
Total off Balance Sheet commitments	160.3	242.8	1,215.1	1,618.2
Company 2010	In not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
Loan commitments:				
- Lifetime mortgages	1.1	4.8	22.6	28.5
- Other mortgages	104.6	-	-	104.6
Total loan commitments	105.7	4.8	22.6	133.1
Rentals under non-cancellable operating leases	1.6	3.4	0.2	5.2
Capital commitments	8.1	-	-	8.1
Total off Balance Sheet commitments	115.4	8.2	22.8	146.4
Company 2009	In not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
Loan commitments:				
- Lifetime mortgages	1.1	4.8	24.3	30.2
- Other mortgages	12.2	-	-	12.2
Total loan commitments	13.3	4.8	24.3	42.4
Rentals under non-cancellable operating leases	1.6	4.1	0.3	6.0
Capital commitments	0.3	-	-	0.3
Total off Balance Sheet commitments	15.2	8.9	24.6	48.7

The operating leases relate to land and buildings.

The Group's irrevocable undrawn loan facilities in respect of lifetime mortgages reflects an estimate of the interest expected to roll up on the loans until redemption, which occurs on vacation of the property. The lifetime mortgage product involves the advance of a lump sum, on which interest then accrues but is not payable until the loan is redeemed. There is no commitment to advance further cash in respect of these loans. The loan advance is accounted for in the same way as other loans to customers. The interest is accrued for as it arises. Irrevocable undrawn facilities in respect of other mortgages reflect the cash that could be drawn down by customers in respect of further advance commitments, including the customers' rights to re-draw amounts voluntarily overpaid.

The Company has provided a number of financial guarantees to other Group companies. As at 31 December 2010 and 31 December 2009 no provision has been made because the Directors do not expect any claims to be made against the Company.

Notes to the Financial Statements (continued)

31. Related party disclosures

The Group and Company consider the Board of Directors and the members of the Executive Committee to be the key management personnel. The Group and Company have related party relationships with the key management personnel and with the Group's pension schemes. In addition, the Company has related party relationships with its subsidiary undertakings; the Company's principal subsidiaries are listed in note 13, and transactions between the Company and its subsidiaries are on 'arm's length' terms.

As discussed in note 36, on 1 October 2010 all shares in the Company were acquired by UKAR, and hence the Company has related party relationships with UKAR and its subsidiary undertaking NRAM and the subsidiary undertakings of NRAM.

A summary of the remuneration of the 19 (2009: 14) key management personnel is set out in the table below. These amounts include the Group's share of the remuneration of the Directors which is set out in more detail in the Directors' Remuneration Report on pages 36 to 42. The Directors' Remuneration Report gives details of the Company's Directors' salaries, fees, bonuses, pension entitlements, other incentives and other benefits. Included in the Group's Income Statement, the aggregate Directors' emoluments and the emoluments of the highest paid director amounted to £813,228 and £472,078 respectively reflecting the B&B related element of the total UKAR Directors' emoluments (2009: £2,442,451 and £946,297 respectively). Further details of the accounting treatment of pensions are given in note 25. The key management personnel contributed £60,000 (2009: £34,000) to Group pension schemes during the year. Their increase in transfer value of defined benefit entitlements, net of employee contributions, was £nil (2009: £178,000) due to the closure of the scheme to further benefit accrual.

Details of the Group's and Company's transactions and balances with the Group's pension schemes are given in note 25. There were no amounts due to or from the schemes at 31 December 2010 (2009: £nil).

	Key personnel	
	2010 £000	2009 £000
Group and Company		
Salaries, bonuses and other short-term benefits	2,349	3,452
Total	2,349	3,452

The balances due from related parties and value of transactions were as follows:

Group	Key personnel	
	2010 £000	2009 £000
Debtors outstanding at 1 January	78	2
Net movement over the year	(61)	76
Debtors outstanding at 31 December	17	78
Interest earned	3	4

Company	Subsidiaries		Key personnel	
	2010 £m	2009 £m	2010 £m	2009 £m
Debtors outstanding at 1 January	24,371.7	26,201.2	78	–
Net movement over the year	(3,881.8)	(1,829.5)	(61)	78
Debtors outstanding at 31 December	20,489.9	24,371.7	17	78
Interest earned	479.1	715.6	3	4

The debtors due from subsidiary undertakings bear interest at a commercial LIBOR-related rate, and are included in 'loans and advances to customers'.

The debtors due from key personnel as at 31 December 2010 are loans to purchase cars and are on commercial terms.

Notes to the Financial Statements (continued)

31. Related party disclosures continued

The balance due to related parties and value of transactions were as follows:

Company	2010 £m	2009 £m
Creditors outstanding at 1 January	27,654.3	29,509.6
Net movement over the year	(8,077.6)	(1,855.3)
Creditors outstanding at 31 December	19,576.7	27,654.3
Interest expense	150.5	303.8

The creditors due to subsidiary undertakings bear interest at a commercial LIBOR-related rate, and are included within 'other deposits'.

Neither the Group or Company had any liabilities due to key personnel at 31 December 2010 (2009: £nil).

In addition to the interest income and expense shown above, the Company had other balances and transactions with its subsidiaries as follows:

	2010 £m	2009 £m
Derivative assets net of liabilities	32.2	38.1
Dividend income	4.0	35.0
Return of capital by subsidiary undertakings (see note 13)	1.0	37.1
Capital contribution to subsidiary undertaking (see note 13)	(75.0)	–
Management charges and servicing fee income	19.0	37.0

At 31 December 2010 the Group and Company were owed £2.5m by UKAR and its subsidiary undertakings.

At 31 December 2010 the Group and Company held £114.6m of loan notes issued by the NRAM group, on which the Group earned income of £0.3m during the period 1 October 2010 to 31 December 2010.

At 31 December 2010 the Company held £3,978.9m (2009: £7,950.3m) of loan notes issued by the Group's securitisation vehicles on which it earned interest of £64.4m during 2010 (2009: £210.8m). At 31 December 2010 the Company held £1,800.0m (2009: £2,300.0m) of loan notes issued under the Covered Bond programme, on which it earned interest of £33.4m during 2010 (2009: £43.5m). No additional loans and advances to customers were securitised during the year or previous year. Further information regarding the securitisations is provided in notes 20 and 21.

As described in note 36, the Company considers Her Majesty's Government to be the ultimate controlling party. The Group's material balances with departments and bodies of Her Majesty's Government comprise deposits with the Bank of England totalling £308.0m (2009: £323.0m), the WCF (see note 18), the Statutory Debt (see note 19) and other UK Government securities held (see note 12). HM Treasury has also provided guarantee arrangements to the Company, for which the company pays a fee (see note 3). In addition to these loans and guarantees, the Group has balances and transactions with numerous Government bodies on an arm's length basis in relation to the payment of corporation tax, value added tax and employee taxes, and the payment of regulatory fees and levies. These balances and transactions are not disclosed due to their nature and volume.

As described in note 26, the Company has provided a number of financial guarantees to other Group companies. As at 31 December 2010 and 31 December 2009 no provision had been made. In February 2010, as a result of decisions regarding payments to holders of subordinated liabilities and other capital instruments as described in notes 27 and 28, the Company recognised a liability in respect of the subordinated guarantee to holders of certain loan notes issued by Bradford & Bingley Capital Funding L.P. described in note 28.

During the year the Company made recharges to NRAM as detailed in note 4. The Company was recharged £0.2m by UKAR in respect of services provided to the Company by Non-Executive Directors who are employed by UKAR.

Notes to the Financial Statements (continued)

32. Capital structure

The Company met its capital requirements in full throughout the year, and has received no additional capital from HM Treasury since nationalisation. On 18 August 2010, the Group's application for a change of regulatory status, from being a BIPRU regulated firm to the MIPRU regime, was approved by the FSA. This brought B&B into line with NRAM for reporting purposes, facilitating the combination of the two companies under UKAR ownership. MIPRU regulation is applied at individual company level, not at Group level. The composition of capital is different under MIPRU, and the concepts of tier 1 and tier 2 capital are not recognised. The Board considers core equity, formerly tier 1 capital, of pre-eminent importance in the capital structure of the business and continues to monitor this, in addition to total level of capital, closely.

The first table below sets out the Company's regulatory capital resources under MIPRU as at 31 December 2010, and the second table sets out the Group's regulatory capital resources under BIPRU as at 31 December 2009, when it was under the BIPRU regime.

	Company
	31 December 2010
	£m
Share capital and reserves	1,542.9
Available-for-sale reserve adjustments	587.6
Cash flow hedge reserve adjustments	26.5
Net pension deficit adjustment	56.6
Subordinated liabilities	277.0
Less: deductions	(478.3)
Total capital	2,012.3

	Group
	31 December 2009
	£m
Tier 1	
Share capital and reserves	1,394.1
Available-for-sale reserve adjustments	47.2
Cash flow hedge reserve adjustments	39.6
Net pension deficit adjustment	84.9
Innovative tier 1	149.0
Total tier 1 capital	1,714.8
Upper tier 2 capital	813.2
Lower tier 2 capital	651.7
Total tier 2 capital	1,464.9
Total capital	3,179.7

The primary objectives of the Company's capital management are to maintain capital resources to support the objectives of the business, to cover risks inherent in its activities and to ensure compliance with externally imposed capital requirements. The capital structure is managed in response to changes in the nature of the Company's activities and economic conditions.

The Company defines equity, subordinated liabilities and other capital instruments as capital. Capital excludes accounting reserves for available-for-sale assets and cash flow hedges. It also excludes any accounting adjustments arising from the hedging of these instruments and reflects amortisation of subordinated liabilities where appropriate. The Company's capital adequacy and capital resources are managed and monitored in accordance with the regulatory capital rules of the FSA, the UK regulator. The Company must at all times monitor and demonstrate compliance with the relevant regulatory capital requirements of the FSA.

Notes to the Financial Statements (continued)

33. Financial instruments

(a) Categories of financial assets and financial liabilities: carrying value compared to fair value

Group	Assets at fair value through profit or loss - on initial recognition	Loans and receivables	Hedging adjustments	Total carrying value	Fair value	If fair values increased by 1%
At 31 December 2010	Available for-sale					
Financial assets	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	-	308.0	-	308.0	308.0	3.1
Loans and advances to banks	-	3,671.2	-	3,671.2	3,671.2	36.7
Loans and advances to customers	-	36,401.8	-	36,401.8	36,459.5	364.6
Fair value adjustments on portfolio hedging	-	-	223.2	223.2	-	-
Investment securities	1,630.3	-	42.8	1,673.1	1,673.1	16.7
Derivative financial instruments	-	2,929.1	-	2,929.1	2,929.1	29.3
Other financial assets	-	1.5	-	1.5	1.5	-
Total financial assets	1,630.3	2,929.1	266.0	45,207.9	45,042.4	450.4

Financial liabilities	Liabilities at fair value through profit or loss - on initial recognition	Liabilities at amortised cost	Hedging adjustments	Total carrying value	Fair value	If fair values increased by 1%
	£m	£m	£m	£m	£m	£m
Deposits by banks	-	2,154.9	-	2,154.9	2,154.9	21.5
HM Treasury Working Capital Facility	-	8,564.2	-	8,564.2	8,564.2	85.6
Statutory Debt	-	18,416.2	-	18,416.2	18,416.2	184.2
Derivative financial instruments	531.9	-	-	531.9	531.9	5.3
Debt securities in issue	-	12,180.5	367.2	12,547.7	11,351.5	113.5
Subordinated liabilities	-	328.8	9.1	337.9	140.5	1.4
Other capital instruments	-	47.8	8.2	56.0	56.0	0.6
Other financial liabilities	-	86.0	-	86.0	86.0	0.9
Total financial liabilities	531.9	41,778.4	384.5	42,694.8	41,301.2	413.0

Notes to the Financial Statements (continued)

33. Financial instruments continued**(a) Categories of financial assets and financial liabilities: carrying value compared to fair value** continued

Group	Assets at fair value through profit or loss - on initial recognition	Loans and receivables	Hedging adjustments	Total carrying value	Fair value	If fair values increased by 1%
At 31 December 2009	£m	£m	£m	£m	£m	£m
Financial assets						
Cash and balances at central banks	–	323.0	–	323.0	323.0	3.2
Loans and advances to banks	–	3,442.3	–	3,442.3	3,442.3	34.4
Loans and advances to customers	–	38,986.2	–	38,986.2	39,163.0	391.6
Fair value adjustments on portfolio hedging	–	–	294.2	294.2	–	–
Investment securities	2,505.3	–	50.6	2,555.9	2,555.9	25.6
Derivative financial instruments	–	3,660.6	–	3,660.6	3,660.6	36.6
Other financial assets	–	1.4	–	1.4	1.4	–
Total financial assets	2,505.3	42,752.9	344.8	49,263.6	49,146.2	491.4

Financial liabilities	Liabilities at fair value through profit or loss - on initial recognition	Liabilities at amortised cost	Hedging adjustments	Total carrying value	Fair value	If fair values increased by 1%
	£m	£m	£m	£m	£m	£m
Deposits by banks	–	2,809.5	–	2,809.5	2,809.5	28.1
Other deposits	–	457.5	–	457.5	457.5	4.6
HM Treasury Working Capital Facility	–	8,537.8	–	8,537.8	8,537.8	85.4
Statutory Debt	–	18,416.2	–	18,416.2	18,416.2	184.2
Derivative financial instruments	665.6	–	–	665.6	665.6	6.7
Debt securities in issue	–	14,858.1	275.5	15,133.6	12,273.9	122.7
Subordinated liabilities	–	1,250.5	58.7	1,309.2	168.9	1.7
Other capital instruments	–	222.1	23.2	245.3	80.2	0.8
Other financial liabilities	–	191.3	–	191.3	191.3	1.9
Total financial liabilities	665.6	46,743.0	357.4	47,766.0	43,600.9	436.1

Notes to the Financial Statements (continued)

33. Financial instruments continued**(a) Categories of financial assets and financial liabilities: carrying value compared to fair value** continued

Company	Assets at fair value through profit or loss - on initial recognition	Loans and receivables	Hedging adjustments	Total carrying value	Fair value	If fair values increased by 1%
At 31 December 2010	£m	£m	£m	£m	£m	£m
Financial assets	Available for-sale					
Cash and balances at central banks	-	300.0	-	300.0	300.0	3.0
Loans and advances to banks	-	2,347.8	-	2,347.8	2,347.8	23.5
Loans and advances to customers	-	48,283.3	-	48,283.3	48,295.7	483.0
Fair value adjustments on portfolio hedging	-	-	223.2	223.2	-	-
Investment securities	1,662.8	3,735.5	42.8	5,441.1	5,330.2	53.3
Derivative financial instruments	-	483.2	-	483.2	483.2	4.8
Other financial assets	-	0.8	-	0.8	0.8	-
Total financial assets	1,662.8	54,667.4	266.0	57,079.4	56,757.7	567.6

Financial liabilities	Liabilities at fair value through profit or loss - on initial recognition	Liabilities at amortised cost	Hedging adjustments	Total carrying value	Fair value	If fair values increased by 1%
	£m	£m	£m	£m	£m	£m
Deposits by banks	-	878.0	-	878.0	878.0	8.8
Other deposits	18,419.2	1,758.1	-	20,177.3	20,177.3	201.8
HM Treasury Working Capital Facility	-	8,564.2	-	8,564.2	8,564.2	85.6
Statutory Debt	-	18,416.2	-	18,416.2	18,416.2	184.2
Derivative financial instruments	647.6	-	-	647.6	647.6	6.5
Debt securities in issue	-	6,894.9	379.9	7,274.8	7,141.1	71.4
Subordinated liabilities	-	454.5	17.3	471.8	200.9	2.0
Other financial liabilities	-	79.9	-	79.9	79.9	0.8
Total financial liabilities	19,066.8	37,045.8	397.2	56,509.8	56,105.2	561.1

Notes to the Financial Statements (continued)

33. Financial instruments continued**(a) Categories of financial assets and financial liabilities: carrying value compared to fair value** continued

Company	Assets at fair value through profit or loss - on initial recognition	Loans and receivables	Hedging adjustments	Total carrying value	Fair value	If fair values increased by 1%
At 31 December 2009	£m	£m	£m	£m	£m	£m
Financial assets						
Cash and balances at central banks	–	316.6	–	316.6	316.6	3.2
Loans and advances to banks	–	1,436.2	–	1,436.2	1,436.2	14.4
Loans and advances to customers	–	54,343.7	–	54,343.7	54,359.9	543.6
Fair value adjustments on portfolio hedging	–	–	294.2	294.2	–	–
Investment securities	3,022.0	7,196.5	50.6	10,269.1	9,136.3	91.3
Derivative financial instruments	–	902.3	–	902.3	902.3	9.0
Other financial assets	–	1.4	–	1.4	1.4	–
Total financial assets	3,022.0	63,294.4	344.8	67,563.5	66,152.7	661.5

Financial liabilities	Liabilities at fair value through profit or loss - on initial recognition	Liabilities at amortised cost	Hedging adjustments	Total carrying value	Fair value	If fair values increased by 1%
	£m	£m	£m	£m	£m	£m
Deposits by banks	–	1,092.6	–	1,092.6	1,092.6	10.9
Other deposits	25.7	28,231.7	–	28,257.4	28,257.4	282.6
HM Treasury Working Capital Facility	–	8,537.8	–	8,537.8	8,537.8	85.4
Statutory Debt	–	18,416.2	–	18,416.2	18,416.2	184.2
Derivative financial instruments	725.2	–	–	725.2	725.2	7.3
Debt securities in issue	–	8,814.9	296.8	9,111.7	8,136.9	81.4
Subordinated liabilities	–	1,549.1	80.4	1,629.5	324.1	3.2
Other financial liabilities	–	184.0	–	184.0	184.0	1.8
Total financial liabilities	750.9	66,826.3	377.2	67,954.4	65,674.2	656.8

Neither the Group or Company had any assets or liabilities 'at fair value through profit or loss held for trading' as at 31 December 2010 or 31 December 2009.

Cash and balances at central banks and loans and advances to banks: as none of these assets are considered to be impaired, their fair value is considered to be their carrying amount.

Loans and advances to customers: where floating rate loans and advances to customers have been issued at market rates, fair value has been assumed to approximate to book value, credit risk being considered as part of impairment review. The fair value of fixed rate mortgage balances within loans and advances to customers is calculated using discounted cash flow models, prevailing market rates, with underlying assumptions based on current market conditions. At 31 December 2010, their fair value in respect of interest rate risk is considered to be marginally higher than their carrying value. Given current market conditions, it is not known whether these fair values are reflective of prices that could be achieved on the open market.

Investment securities: the fair value has been derived through reference to market price.

Derivative financial instruments, other financial assets, deposits by banks and other financial liabilities: the fair value is considered to be their carrying amount.

Other deposits: the fair value is estimated from expected future cash flows, discounted at current market rates.

HM Treasury Working Capital Facility and Statutory Debt: the fair value is assumed to be their carrying amount because these will be repayable 'on demand' subject to timing of repayment of loans to customers (see notes 18 and 19).

Debt securities in issue: the fair value has been estimated through reference to market prices.

Subordinated liabilities and other capital instruments: the fair value has been estimated through reference to market prices. As described in notes 27 and 28, as a consequence of the deferral of coupon and principal payments the carrying value of subordinated liabilities and other capital instruments was reduced by £104.3m in February 2010.

Notes to the Financial Statements (continued)

33. Financial instruments continued**(a) Categories of financial assets and financial liabilities: carrying value compared to fair value** continued

No financial assets were reclassified during 2010 by the Group or Company between amortised cost and fair value categories, or by the Group during 2009. At 1 January 2009, the Company reclassified investment security assets valued at £7,155.8m from available-for-sale to loans and receivables, because there was no active market in these assets and the Company intended to hold them until their maturity. However, during 2010 some of these assets were redeemed, at par, as part of the wind-up of financing structures. At 31 December 2010 the remaining reclassified assets were carried at £3,315.2m (2009: £7,196.5m). The reclassified assets are carried at amortised cost, and the difference between the carrying value at the date of reclassification and the expected value at the redemption date is recognised in profit and loss on an effective interest rate basis over the expected life of the asset; their carrying amounts will accrete up to their redemption amounts over their expected lives. The amount recognised in profit and loss during the year was a gain of £59.0m (2009: £40.7m), which was exactly offset by losses transferred from the available-for-sale reserve during the year. If the assets had not been reclassified in 2009, it is estimated that fair value losses of £1,092.1m would have been reflected in the available-for-sale reserve during 2009 in respect of these assets. The expected redemption value of the remaining assets is £4,123.7m (2009: £8,063.8m). The fair value of these assets at 31 December 2010 was £3,204.3m (2009: £6,063.7m).

(b) Interest income and expense on financial instruments that are not carried at fair value through profit or loss

Total interest income and expense (calculated using the EIR method) on financial instruments that are not carried at fair value through profit or loss were as follows:

	Group	Restated Group
	2010 £m	2009 £m
Interest income	1,227.2	1,785.6
Interest expense	(559.6)	(962.3)
Net interest income	667.6	823.3

These amounts represent interest income and expense before hedging arrangements. As described in note 3, the Group has amended its presentation of interest on derivatives, with a consequent change to the 2009 presented amounts of interest income and interest expense.

(c) Impaired financial assets

Allowance accounts for credit losses in respect of impairment of loans and advances to customers are detailed in note 10 and in respect of investment securities in note 11. No impairment loss has been recognised in respect of any other class of financial asset, and no other class of financial asset includes assets that are past due.

(d) Derecognition of financial assets

The following financial assets have been sold but continue to be carried on the Balance Sheet because the sale does not qualify for derecognition; the Group/Company remains exposed to the economic risk on the assets because of the sale terms.

Group	2010		2009	
	Carrying amount of assets £m	Carrying amount of associated liabilities £m	Carrying amount of assets £m	Carrying amount of associated liabilities £m
At 31 December				
Repurchase agreements (see also note 34)	589.6	1,167.8	570.2	1,166.3
Total	589.6	1,167.8	570.2	1,166.3

Company	2010		2009	
	Carrying amount of assets £m	Carrying amount of associated liabilities £m	Carrying amount of assets £m	Carrying amount of associated liabilities £m
At 31 December				
Repurchase agreements (see also note 34)	1,473.8	1,267.8	1,416.0	1,166.3
Total	1,473.8	1,267.8	1,416.0	1,166.3

The repurchase agreements include debt securities held by the Company issued by other Group entities; these assets are consolidated out of the Group Balance Sheet.

In addition, loans to customers which have been securitised are not derecognised from the Balance Sheet as the originator of the loans retains substantially all of the risks and rewards of the securitised loans (see notes 20 and 21).

Notes to the Financial Statements (continued)

33. Financial instruments continued**(e) Hedge accounting**

The Group had the following types of hedges:

At 31 December 2010	Fair value hedges £m	Cash flow hedges £m	Economic hedges £m	Total £m	Nominal amounts £m
Exchange rate contracts	2,652.7	–	176.2	2,828.9	12,185.5
Interest rate contracts	20.7	10.2	69.3	100.2	25,075.2
Total asset balances	2,673.4	10.2	245.5	2,929.1	37,260.7
Exchange rate contracts	14.0	–	42.2	56.2	1,675.2
Interest rate contracts	257.7	112.3	105.7	475.7	16,532.3
Other	–	–	–	–	–
Total liability balances	271.7	112.3	147.9	531.9	18,207.5
Fair value of hedging instruments	2,401.7	(102.1)	97.6	2,397.2	19,053.2

At 31 December 2009	Fair value hedges £m	Cash flow hedges £m	Economic hedges £m	Total £m	Nominal amounts £m
Exchange rate contracts	3,254.4	–	21.3	3,275.7	13,158.1
Interest rate contracts	139.2	79.4	166.3	384.9	16,883.0
Total asset balances	3,393.6	79.4	187.6	3,660.6	30,041.1
Exchange rate contracts	20.3	–	54.4	74.7	1,052.9
Interest rate contracts	338.8	170.6	80.3	589.7	23,441.1
Other	–	–	1.2	1.2	48.9
Total liability balances	359.1	170.6	135.9	665.6	24,542.9
Fair value of hedging instruments	3,034.5	(91.2)	51.7	2,995.0	5,498.2

The Company had the following types of hedges:

At 31 December 2010	Fair value hedges £m	Cash flow hedges £m	Economic hedges £m	Total £m	Nominal amounts £m
Exchange rate contracts	344.7	–	23.0	367.7	2,436.7
Interest rate contracts	20.7	10.2	84.6	115.5	14,499.6
Total asset balances	365.4	10.2	107.6	483.2	16,936.3
Exchange rate contracts	14.0	–	42.2	56.2	1,675.2
Interest rate contracts	257.8	112.3	221.3	591.4	20,632.3
Other	–	–	–	–	–
Total liability balances	271.8	112.3	263.5	647.6	22,307.5
Fair value of hedging instruments	93.6	(102.1)	(155.9)	(164.4)	(5,371.2)

At 31 December 2009	Fair value hedges £m	Cash flow hedges £m	Economic hedges £m	Total £m	Nominal amounts £m
Exchange rate contracts	360.4	–	21.3	381.7	2,603.1
Interest rate contracts	139.2	79.4	302.0	520.6	26,192.4
Total asset balances	499.6	79.4	323.3	902.3	28,795.5
Exchange rate contracts	20.3	–	54.4	74.7	1,052.9
Interest rate contracts	338.8	170.6	139.9	649.3	19,958.6
Other	–	–	1.2	1.2	48.9
Total liability balances	359.1	170.6	195.5	725.2	21,060.4
Fair value of hedging instruments	140.5	(91.2)	127.8	177.1	7,735.1

Notes to the Financial Statements (continued)

33. Financial instruments continued**(e) Hedge accounting** continued

The Group defines an 'economic hedge' as one which effectively hedges the risk associated with the underlying asset or liability but where hedge accounting has not been applied.

All of the Group's derivative contracts are used for commercial management of exposures to interest rate risks, foreign currency risks and risks arising from forecast transactions. For most of the Group's derivative contracts, hedge accounting is applied, but in other cases natural offsets apply, and as explained in note 1(i) the Company has used the Fair Value Option provisions of IAS 39 to prevent technical accounting mismatches in respect of certain swap arrangements.

The Group and Company use fair value hedge accounting and cash flow hedge accounting in respect of those hedges that qualify within the definitions of IAS 39.

Fair value hedges are primarily used to hedge against changes in fair value of fixed rate products due to movements in market interest rates. For the year ended 31 December 2010, the Group recognised fair value gains of £3.0m (2009: £44.1m), representing the ineffective portion of the fair value hedges. In respect of loans and advances to customers, portfolio fair value hedge accounting is applied, and the fair value adjustment on that hedging was £223.2m at 31 December 2010 (2009: £294.2m).

Cash flow hedges are used to hedge the risk of exposure to variability of cash flows attributable to a particular risk associated with a recognised asset or liability, or a forecast transaction.

Any gains or losses on cash flow hedges are recorded in equity until the hedged cash flow occurs, whereupon they are transferred to profit or loss for the period. As at 31 December 2010, net losses accumulated in equity were £26.5m (2009: £39.6m).

Hedge effectiveness is measured and assessed on an ongoing basis. Changes in fair values and cash flows of the hedged items were almost fully offset by changes in fair values and cash flows of the hedging instruments, and actual effectiveness was within a range of 80% to 125%.

The Group and Company had no material embedded derivatives at 31 December 2010 or 31 December 2009.

Prior to the nationalisation of the Company, forward starting swaps were entered into, in anticipation of the take up of fixed rate mortgages. These were treated as cash flow hedges. Cash flow ineffectiveness testing incorporates testing for forecast transactions which are no longer expected to occur.

At the time of the nationalisation of the Company, HM Treasury provided a guarantee with regard to certain derivative transactions with the Company existing at that time. The Company pays a fee for this guarantee as shown in note 3. As described in note 27, on 25 January 2010 the EC announced its approval under the State aid rules of the financing facilities and guarantee arrangements provided by HM Treasury.

Fair value movements on financial instruments recognised in the Income Statement comprised the following:

	Group	
	2010	2009
	£m	£m
Net gains on fair value hedging instruments	1,090.1	328.1
Net losses on fair value hedged items	(1,087.1)	(284.0)
Net hedge ineffectiveness gains	3.0	44.1
Unrealised fair value movements on financial instruments	(9.3)	(79.1)
Total fair value losses recognised in the Income Statement	(6.3)	(35.0)

The unrealised fair value movements arose on swaps which are commercial hedges but are not part of hedge accounting ('economic hedges').

Net gains less losses on investment securities recognised in the Income Statement comprised the following:

	Group	
	2010	2009
	£m	£m
Realised gains / (losses) on available-for-sale instruments	8.4	(12.4)
Realised gains on instruments at fair value through profit or loss	38.5	3.9
Total net realised gains / (losses) on investment securities recognised in the Income Statement	46.9	(8.5)

Notes to the Financial Statements (continued)

33. Financial instruments continued**(f) Fair value measurement**

Financial assets and liabilities carried at fair value are valued on the following bases:

Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2010				
Financial assets				
Investment securities: available-for-sale	343.0	1,330.1	–	1,673.1
Derivative financial instruments	–	2,929.1	–	2,929.1
Financial liabilities				
Derivative financial instruments	–	(531.9)	–	(531.9)

Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2009				
Financial assets				
Investment securities: available-for-sale	563.0	1,992.9	–	2,555.9
Derivative financial instruments	–	3,660.6	–	3,660.6
Financial liabilities				
Derivative financial instruments	–	(665.6)	–	(665.6)

Company	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2010				
Financial assets				
Investment securities: available-for-sale	343.0	1,362.6	–	1,705.6
Derivative financial instruments	–	483.2	–	483.2
Financial liabilities				
Other deposits	–	(18,419.2)	–	(18,419.2)
Derivative financial instruments	–	(647.6)	–	(647.6)

Company	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2009				
Financial assets				
Investment securities: available-for-sale	563.0	2,509.6	–	3,072.6
Derivative financial instruments	–	902.3	–	902.3
Financial liabilities				
Other deposits	–	(25.7)	–	(25.7)
Derivative financial instruments	–	(725.2)	–	(725.2)

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as price) or indirectly (i.e. derived from the implications of prices). The Group is aware that some institutions have adopted the overnight indexed swap ('OIS') curves in the valuation of derivatives. The Group is considering the implications of moving to an OIS basis in 2011.

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

These definitions have been taken from the March 2009 amendment to IFRS 7 'Improving Disclosures about Financial Instruments'.

Notes to the Financial Statements (continued)

34. Collateral received and pledged

All loans and advances to customers made by the Group are secured on property. The secured property can be repossessed in the event of borrower default, in which case the carrying value of the loan is reduced if the estimated recoverable amount is lower than the outstanding balance owed, in accordance with the accounting policy described in note 1(k). The repossessed property is carried on the Balance Sheet within loans and advances to customers.

A credit exposure could arise in respect of derivative contracts entered into by the Group if the counterparty were unable to fulfil its contractual obligations. The Group addresses the risks associated with these activities by monitoring counterparty credit exposure and requiring additional collateral to be posted or returned as necessary. The only forms of collateral accepted by the Group are cash and Government securities. Derivatives are transacted under ISDA with CSA annexes, and as such may require collateral to be posted from time to time, as required by the specific terms and conditions of the arrangements.

Fair value of collateral which the Group/Company holds and can sell or repledge in the absence of default by the owner of the collateral:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Assets under reverse repurchase agreements	1,624.8	598.8	1,624.8	598.8
Cash collateral which we have received in respect of derivative contracts	902.5	850.8	209.8	393.3
Total	2,527.3	1,449.6	1,834.6	992.1

None of the above collateral has been sold or repledged. The liability to repay the cash collateral received is included within 'deposits by banks'.

Financial assets which the Group/Company has pledged as collateral:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Assets under repurchase agreements (see also note 33(d))	1,436.2	570.2	1,473.8	1,416.0
Cash Ratio Deposit with the Bank of England	–	16.6	–	16.6
Cash collateral which the Group / Company has provided in respect of derivative contracts	304.0	1,477.5	304.0	584.9
Total	1,740.2	2,064.3	1,777.8	2,017.5

In addition, certain loans to customers have been securitised, as detailed in notes 20 and 21. These loans, and also the other financial assets shown above which the Group/Company has pledged, are carried on the Group's and Company's Balance Sheets.

Notes to the Financial Statements (continued)

35. Financial risk management

A description of the principal risks to which the Group and Company are exposed is provided on pages 29 to 35 which form an integral part of the audited Financial Statements.

(a) Financial and market risk

The following table describes the significant activities undertaken by the Group which give rise to financial or market risk and the potential consequences associated with such activities.

Activity	Risk	Type of derivative instrument used
Funding activities in sterling involving either fixed rate instruments or instruments with embedded options	Sensitivity to changes in interest rates	Interest rate swaps and interest rate futures
Fixed and capped rate mortgage lending and investment activities involving either fixed rate instruments or instruments with embedded options	Sensitivity to changes in interest rates	Interest rate swaps and options
Variable rate mortgage products	Sensitivity to changes in interest rates	Interest rate swaps
Investment and funding in foreign currencies	Sensitivity to changes in foreign exchange rates	Cross-currency interest rate swaps and foreign exchange contracts

The accounting policy for derivatives and hedge accounting is described in note 1(j), and further details of hedge accounting are provided in note 33(e).

(b) Credit risk

Before taking account of any collateral, the maximum exposure to credit risk was:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Cash and balances at central banks	308.0	323.0	300.0	316.6
Loans and advances to banks	3,671.2	3,442.3	2,347.8	1,436.2
Loans and advances to customers	36,401.8	38,986.2	48,283.3	54,343.7
Investment securities	1,673.1	2,555.9	5,441.1	10,269.1
Derivative financial instruments	2,929.1	3,660.6	483.2	902.3
Other financial assets	1.5	1.4	0.8	1.4
Total on-Balance Sheet	44,984.7	48,969.4	56,856.2	67,269.3
Irrevocable undrawn loan facilities (off-Balance Sheet) (see note 30)	1,543.4	1,611.9	133.1	42.4
Total maximum exposure to credit risk	46,528.1	50,581.3	56,989.3	67,311.7

Loans and advances to banks include reverse repurchase agreements in support of which the Group and Company hold gilts as security (see note 34). Loans and advances to customers are secured on property. Further information regarding the credit quality of loans and advances to customers is provided in note 10, and of loans and advances to banks and investment securities in note 12.

In respect of lifetime mortgages, the irrevocable, undrawn loan facility is calculated using actuarial assumptions. There is no commitment to advance further cash; the commitment reflects interest expected to roll up on the loans until redemption. Further details of the lifetime mortgage product are provided in note 30.

(c) Liquidity risk

It should be noted that many financial instruments are settled earlier than their contractual maturity dates; in particular, many mortgage loans are repaid early in full or in part.

The Group closely monitors its liquidity position against the Board's liquidity policy. This policy sets out elements of available and required liquidity through reference to and modelling of net lending commitments, short and medium term wholesale commitments, liquidity reserves and the requirement for other payments (e.g. tax). From this, minimum and target liquidity levels are established. Furthermore, liquidity is also measured in proportion to the total Balance Sheet and is subject to trigger levels; these determine the appropriate levels of escalation in order to address any actual or forecast shortfalls. The liquidity policy also requires stress testing through modelling and assessment of any emerging and potentially extreme funding conditions.

Notes to the Financial Statements (continued)

35. Financial risk management continued**(c) Liquidity risk** continued

The contractual maturities of financial assets and liabilities were as follows:

Group	On demand £m	In not more than three months £m	In more than three months but not more than six months £m	In more than six months but not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
At 31 December 2010							
Financial assets							
Cash and balances at central banks	308.0	-	-	-	-	-	308.0
Loans and advances to banks	2,768.7	902.5	-	-	-	-	3,671.2
Loans and advances to customers	-	114.8	203.9	106.6	1,249.0	34,727.5	36,401.8
Fair value adjustments on portfolio hedging	223.2	-	-	-	-	-	223.2
Investment securities	-	102.0	0.1	21.0	877.4	672.6	1,673.1
Derivative financial instruments	-	10.6	358.2	267.0	505.4	1,787.9	2,929.1
Other financial assets	-	1.5	-	-	-	-	1.5
Total financial assets	3,299.9	1,131.4	562.2	394.6	2,631.8	37,188.0	45,207.9
Financial liabilities							
Deposits by banks	1,487.1	667.8	-	-	-	-	2,154.9
Other deposits	-	-	-	-	-	-	-
HM Treasury Working Capital Facility	8,564.2	-	-	-	-	-	8,564.2
Statutory Debt	18,416.2	-	-	-	-	-	18,416.2
Derivative financial instruments	-	25.9	16.7	28.1	165.0	296.2	531.9
Debt securities in issue	-	519.6	914.0	1,170.5	2,607.7	7,335.9	12,547.7
Subordinated liabilities	-	39.5	-	-	39.3	259.1	337.9
Other capital instruments	-	-	-	-	-	56.0	56.0
Other financial liabilities	-	86.0	-	-	-	-	86.0
Total financial liabilities	28,467.5	1,338.8	930.7	1,198.6	2,812.0	7,947.2	42,694.8
Group net liquidity gap	(25,167.6)	(207.4)	(368.5)	(804.0)	(180.2)	29,240.8	2,513.1
Group financial assets at 31 December 2009	3,542.7	764.6	614.5	598.5	4,302.9	39,440.4	49,263.6
Group financial liabilities at 31 December 2009	28,997.4	3,496.5	1,222.0	1,760.5	6,524.8	5,764.8	47,766.0
Group net liquidity gap at 31 December 2009	(25,454.7)	(2,731.9)	(607.5)	(1,162.0)	(2,221.9)	33,675.6	1,497.6

Notes to the Financial Statements (continued)

35. Financial risk management continued

(c) Liquidity risk continued

Company	On demand £m	In not more than three months £m	In more than three months but not more than six months £m	In more than six months but not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
At 31 December 2010							
Financial assets							
Cash and balances at central banks	300.0	-	-	-	-	-	300.0
Loans and advances to banks	2,138.0	209.8	-	-	-	-	2,347.8
Loans and advances to customers	20,489.9	102.2	158.6	87.4	1,062.5	26,382.7	48,283.3
Fair value adjustments on portfolio hedging	223.2	-	-	-	-	-	223.2
Investment securities	-	102.0	0.1	21.0	1,297.6	4,020.4	5,441.1
Derivative financial instruments	-	10.6	17.7	229.4	151.6	73.9	483.2
Other financial assets	-	0.8	-	-	-	-	0.8
Total financial assets	23,151.1	425.4	176.4	337.8	2,511.7	30,477.0	57,079.4
Financial liabilities							
Deposits by banks	210.2	667.8	-	-	-	-	878.0
Other deposits	19,576.7	0.6	-	-	600.0	-	20,177.3
HM Treasury Working Capital Facility	8,564.2	-	-	-	-	-	8,564.2
Statutory Debt	18,416.2	-	-	-	-	-	18,416.2
Derivative financial instruments	-	25.9	16.7	28.1	248.5	328.4	647.6
Debt securities in issue	-	519.6	914.0	1,170.5	924.4	3,746.3	7,274.8
Subordinated liabilities	-	39.5	-	-	39.3	393.0	471.8
Other capital instruments	-	-	-	-	-	-	-
Other financial liabilities	-	79.9	-	-	-	-	79.9
Total financial liabilities	46,767.3	1,333.3	930.7	1,198.6	1,812.2	4,467.7	56,509.8
Company net liquidity gap	(23,616.2)	(907.9)	(754.3)	(860.8)	699.5	26,009.3	569.6
Company financial assets at 31 December 2009	25,901.9	599.0	315.0	323.4	3,289.8	37,134.4	67,563.5
Company financial liabilities at 31 December 2009	55,032.5	1,246.9	822.5	1,330.6	3,680.2	5,841.7	67,954.4
Company net liquidity gap at 31 December 2009	(29,130.6)	(647.9)	(507.5)	(1,007.2)	(390.4)	31,292.7	(390.9)

HM Treasury has indicated that it expects the WCF provided to the Company by HM Treasury and the Statutory Debt due to the Financial Services Compensation Scheme to be repaid out of the cash flows generated by the Company and the Group during their wind-down. As explained in notes 18 and 19 it is not possible to specify the contractual maturity dates of the loans to the Company from HM Treasury and from the Financial Services Compensation Scheme, and they have been included in the table above as though repayable on demand.

Certain debt securities in issue are being repaid on a pass-through basis. In the above tables, deferred amounts are treated as though they will be paid on the next scheduled interest payment date.

Notes to the Financial Statements (continued)

35. Financial risk management continued**(c) Liquidity risk** continued

The contractual undiscounted cash flows associated with financial liabilities were as follows:

Group							
Financial liabilities At 31 December 2010	On demand £m	In not more than three months £m	In more than three months but not more than six months £m	In more than six months but not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
Deposits by banks	1,487.1	667.8	-	-	-	-	2,154.9
Other deposits	-	-	-	-	-	-	-
HM Treasury Working Capital Facility	8,564.2	-	-	-	-	-	8,564.2
Statutory Debt	18,416.2	-	-	-	-	-	18,416.2
Derivative financial instruments	-	50.7	46.6	83.2	355.8	1,014.1	1,550.4
Debt securities in issue	-	522.7	1,064.8	1,222.4	3,299.1	9,023.9	15,132.9
Subordinated liabilities	-	70.6	5.1	11.5	117.3	744.3	948.8
Other capital instruments	-	-	3.0	-	12.0	97.2	112.2
Other financial liabilities	-	86.0	-	-	-	-	86.0
Irrevocable undrawn loan facilities	128.3	-	-	-	-	-	128.3
Total	28,595.8	1,397.8	1,119.5	1,317.1	3,784.2	10,879.5	47,093.9

Included in the above are the following expected cash flows arising on cash flow hedges (positive = outflow); no impact is anticipated on the Income Statement due to hedging arrangements.

Cash flow hedges	-	15.6	12.4	20.0	73.5	16.4	137.9
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Group							
Financial liabilities At 31 December 2009	On demand £m	In not more than three months £m	In more than three months but not more than six months £m	In more than six months but not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
Deposits by banks	1,585.9	670.9	-	6.3	574.0	-	2,837.1
Other deposits	457.5	-	-	-	-	-	457.5
HM Treasury Working Capital Facility	8,537.8	-	-	-	-	-	8,537.8
Statutory Debt	18,416.2	-	-	-	-	-	18,416.2
Derivative financial instruments	-	123.3	112.2	173.4	533.5	1,194.3	2,136.7
Debt securities in issue	-	2,609.8	959.6	1,919.2	5,869.8	5,292.0	16,650.4
Subordinated liabilities	-	154.4	35.8	71.6	928.8	1,032.4	2,223.0
Other capital instruments	-	2.0	3.8	7.7	44.5	395.1	453.1
Other financial liabilities	-	98.1	-	-	-	-	98.1
Irrevocable undrawn loan facilities	104.6	-	-	-	-	-	104.6
Total	29,102.0	3,658.5	1,111.4	2,178.2	7,950.6	7,913.8	51,914.5

Included in the above are the following expected cash flows arising on cash flow hedges (positive = outflow); no impact is anticipated on the Income Statement due to hedging arrangements.

Cash flow hedges	-	38.8	39.3	41.8	116.2	30.1	266.2
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The amounts in the above tables differ from the Balance Sheet carrying values because the Balance Sheet amounts are based on discounted cash flows, and also because the above amounts include associated cash flows including interest; future interest rates have been estimated based on actual rates at the Balance Sheet date.

As described in notes 27 and 28, the Group has announced that it has resolved not to make any payment of principal or interest in respect of subordinated liabilities and other capital instruments during the period prior to the date on which it repays in full the Statutory Debt. Given the uncertainty of the timing of this, the tables above include payment of principal and interest on subordinated liabilities and other capital instruments at the earliest date that it would have become contractually payable as per the original terms, regardless of the Group's announcement.

Subordinated liabilities include perpetual instruments as detailed in note 27. The amounts above assume these instruments will be redeemed on 31 December 2055.

Notes to the Financial Statements (continued)

35. Financial risk management continued**(c) Liquidity risk** continued

The contractual undiscounted cash flows associated with financial liabilities were as follows:

Company							
Financial liabilities At 31 December 2010	On demand £m	In not more than three months £m	In more than three months but not more than six months £m	In more than six months but not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
Deposits by banks	210.2	667.8	–	–	–	–	878.0
Other deposits	19,576.7	0.6	–	–	600.0	–	20,177.3
HM Treasury Working Capital Facility	8,564.2	–	–	–	–	–	8,564.2
Statutory Debt	18,416.2	–	–	–	–	–	18,416.2
Derivative financial instruments	–	52.1	48.3	86.6	493.2	1,014.1	1,694.3
Debt securities in issue	–	509.7	1,051.8	1,196.5	1,481.2	3,748.0	7,987.2
Subordinated liabilities	–	71.0	8.5	12.3	135.3	974.7	1,201.8
Other financial liabilities	–	79.9	–	–	–	–	79.9
Irrevocable undrawn loan facilities	104.6	–	–	–	–	–	104.6
Total	46,871.9	1,381.1	1,108.6	1,295.4	2,709.7	5,736.8	59,103.5

Included in the above are the following expected cash flows arising on cash flow hedges (positive = outflow); no impact is anticipated on the Income Statement due to hedging arrangements.

Cash flow hedges	–	15.6	12.4	20.0	73.5	16.4	137.9
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Company							
Financial liabilities At 31 December 2009	On demand £m	In not more than three months £m	In more than three months but not more than six months £m	In more than six months but not more than one year £m	In more than one year but not more than five years £m	In more than five years £m	Total £m
Deposits by banks	421.1	668.8	–	0.1	5.4	–	1,095.4
Other deposits	27,657.4	2.3	–	6.8	618.0	–	28,284.5
HM Treasury Working Capital Facility	8,537.8	–	–	–	–	–	8,537.8
Statutory Debt	18,416.2	–	–	–	–	–	18,416.2
Derivative financial instruments	–	108.5	97.6	144.3	418.3	(454.3)	314.4
Debt securities in issue	–	344.9	669.0	1,337.9	2,831.1	5,292.0	10,474.9
Subordinated liabilities	–	157.7	39.3	78.5	979.0	1,502.8	2,757.3
Other financial liabilities	–	90.8	–	–	–	–	90.8
Irrevocable undrawn loan facilities	12.2	–	–	–	–	–	12.2
Total	55,044.7	1,373.0	805.9	1,567.6	4,851.8	6,340.5	69,983.5

Included in the above are the following expected cash flows arising on cash flow hedges (positive = outflow); no impact is anticipated on the Income Statement due to hedging arrangements.

Cash flow hedges	–	38.8	39.3	41.8	116.2	30.1	266.2
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The amounts in the above tables differ from the Balance Sheet carrying values because the Balance Sheet amounts are based on discounted cash flows, and also because the above amounts include associated cash flows including interest; future interest rates have been estimated based on actual interest rates at the Balance Sheet date.

As described in notes 27 and 28, the Group has announced that it has resolved not to make any payment of principal or interest in respect of subordinated liabilities and other capital instruments during the period prior to the date on which it repays in full the Statutory Debt. Given the uncertainty of the timing of this, the tables above include payments of principal and interest on subordinated liabilities and other capital instruments at the earliest date it would have become contractually payable as per the original terms, regardless of the Group's announcement.

Subordinated liabilities include perpetual instruments as detailed in note 27. The amounts above assume these instruments will be redeemed on 31 December 2055.

As described in note 26, the Company has provided a number of financial guarantees to other Group companies. No cash outflows are included in the above tables in respect of these guarantees because at 31 December 2010 and 31 December 2009 the Directors did not expect any claims to be made against the Company. As described in note 28, as a consequence of decisions taken in February 2010, the Company is obliged to make future payments to holders of certain loan notes issued by a subsidiary undertaking; these cash flows are included in the tables above.

Notes to the Financial Statements (continued)

35. Financial risk management continued**(d) Interest rate risk**

Interest rate risk typically arises from mismatches between the re-pricing dates of the interest-bearing assets and liabilities on the Group's Balance Sheet, and from the investment profile of the Group's capital and reserves. The Group's Treasury is responsible for managing this exposure within the risk exposure limits set out in the Interest Rate and Foreign Exchange Risk policy, as approved by the Board. This policy sets out the nature of the market risks that may be taken along with aggregate risk limits, and stipulates the procedures, instruments and controls to be used in managing market risk. Market risk is the potential adverse change in Group income or Group net worth arising from movements in interest rates, exchange rates or other market prices. Effective identification and management of market risk is essential for maintaining stable net interest income.

It is ALCO's responsibility to recommend to the Risk Committee strategies for managing market risk exposures and to ensure that the Group's Treasury implements the strategies so that the exposures are managed within the Group's approved Board policy limits.

The Group assesses its exposure to interest rate movements using a number of techniques. However, there are two principal methods:

- (i) a static framework that considers the impact on the current Balance Sheet of an immediate movement of interest rates; and
- (ii) a dynamic modelling framework that considers the projected change to the Balance Sheet over the following year under various interest rate scenarios.

The results of these analyses are presented to senior management in order to identify, measure and manage the Group's exposure to interest rate risk.

Limits are placed on the sensitivity of the Group Balance Sheet to movements in interest rates. Exposures are reviewed as appropriate by senior management and the Board with a frequency between daily and monthly, related to the granularity of the position. For example, the overall Group Balance Sheet interest rate risk exposure position is monitored monthly whilst several specific portfolios within the Balance Sheet are reviewed more frequently on a daily or weekly basis. This reflects the dynamics and materiality of the various portfolios.

Interest rate risk exposure is predominantly managed through the use of interest rate derivatives, principally interest rate swaps. Interest rate swaps are over-the-counter arrangements with highly rated banking counterparties. The Group also uses asset and liability positions to offset exposures naturally wherever possible to minimise the costs and risks of arranging transactions external to the Group.

In general, swaps which have been taken out to manage Group interest rate risk are held by the Company even where the related financial instruments are held by other Group entities. In these cases, the Company's interest rate risk is managed by either creating swaps between the Company and the entities which hold the instruments or by setting the interest rate terms on loan balances between the Company and those entities, in each case in order to reduce the Company's interest rate risk to an acceptable level.

Interest rate sensitivities are reported to ALCO monthly and are calculated using a range of interest rate scenarios, including non-parallel shifts in the yield curve. The main metrics used by management are:

- (i) the change in value of the Group's net worth (PV200) to a notional 2% parallel move in market and base rates.

	Group	
	2010	2009
	£m	£m
2% increase	12.7	(71.7)
2% decrease	(16.6)	62.4

- (ii) the sensitivity of the Group's interest margin over 12 months to a notional 2% parallel move in market and base rates.

	Group	
	2010	2009
	£m	£m
2% increase	421.3	306.5
2% decrease	(158.9)	(140.8)

(e) Foreign currency risk

The Group's policy is to hedge all material foreign currency exposures by use of naturally offsetting foreign currency assets and liabilities or by the use of derivatives. Consequently, at 31 December 2010 and 31 December 2009 the Group and Company had no net material exposure to foreign exchange fluctuations or changes in foreign currency interest rates. The impact on the Group's loss and equity of reasonably possible changes in exchange rates compared to actual rates would not have been material at 31 December 2010 or 31 December 2009.

The sterling equivalent amounts of the Group's and Company's financial assets and liabilities denominated in foreign currencies as at 31 December 2010 and 31 December 2009 are set out in the tables below. The net financial assets/(liabilities) in non sterling currencies largely represent currency balances held within the available-for-sale reserve on the Balance Sheet.

Notes to the Financial Statements (continued)

35. Financial risk management continued

(e) Foreign currency risk continued

Group	Sterling £m	Euro £m	US \$ £m	Other £m	Total £m
At 31 December 2010					
Financial assets					
Cash and balances at central banks	308.0	–	–	–	308.0
Loans and advances to banks	2,218.3	1,186.3	266.6	–	3,671.2
Loans and advances to customers	36,401.8	–	–	–	36,401.8
Fair value adjustments on portfolio hedging	223.2	–	–	–	223.2
Investment securities	1,055.7	498.6	118.8	–	1,673.1
Derivative financial instruments	100.1	2,015.0	271.8	542.2	2,929.1
Other financial assets	1.5	–	–	–	1.5
Total financial assets	40,308.6	3,699.9	657.2	542.2	45,207.9
Financial liabilities					
Deposits by banks	794.4	1,360.5	–	–	2,154.9
Other deposits	–	–	–	–	–
HM Treasury Working Capital Facility	8,564.2	–	–	–	8,564.2
Statutory Debt	18,416.2	–	–	–	18,416.2
Derivative financial instruments	475.8	54.3	1.8	–	531.9
Debt securities in issue	2,283.7	7,635.9	1,342.0	1,286.1	12,547.7
Subordinated liabilities	337.9	–	–	–	337.9
Other capital instruments	56.0	–	–	–	56.0
Other financial liabilities	86.0	–	–	–	86.0
Total financial liabilities	31,014.2	9,050.7	1,343.8	1,286.1	42,694.8
Notional values of derivatives affecting currency exposures	(6,790.4)	5,361.6	685.9	742.9	–
Net financial assets / (liabilities)	2,504.0	10.8	(0.7)	(1.0)	2,513.1
Group					
At 31 December 2009					
Financial assets					
Cash and balances at central banks	323.0	–	–	–	323.0
Loans and advances to banks	3,346.4	50.2	45.7	–	3,442.3
Loans and advances to customers	38,986.2	–	–	–	38,986.2
Fair value adjustments on portfolio hedging	294.2	–	–	–	294.2
Investment securities	1,306.5	975.2	274.2	–	2,555.9
Derivative financial instruments	384.8	2,566.2	326.5	383.1	3,660.6
Other financial assets	1.4	–	–	–	1.4
Total financial assets	44,642.5	3,591.6	646.4	383.1	49,263.6
Financial liabilities					
Deposits by banks	1,695.4	1,114.1	–	–	2,809.5
Other deposits	2.5	–	455.0	–	457.5
HM Treasury Working Capital Facility	8,537.8	–	–	–	8,537.8
Statutory Debt	18,416.2	–	–	–	18,416.2
Derivative financial instruments	590.9	68.2	6.5	–	665.6
Debt securities in issue	2,388.9	9,387.2	1,982.5	1,375.0	15,133.6
Subordinated liabilities	1,309.2	–	–	–	1,309.2
Other capital instruments	245.3	–	–	–	245.3
Other financial liabilities	191.3	–	–	–	191.3
Total financial liabilities	33,377.5	10,569.5	2,444.0	1,375.0	47,766.0
Notional values of derivatives affecting currency exposures	(9,693.2)	6,948.6	1,752.7	991.9	–
Net financial assets / (liabilities)	1,571.8	(29.3)	(44.9)	–	1,497.6

Notes to the Financial Statements (continued)

35. Financial risk management continued**(e) Foreign currency risk** continued

Company	Sterling £m	Euro £m	US \$ £m	Other £m	Total £m
At 31 December 2010					
Financial assets					
Cash and balances at central banks	300.0	–	–	–	300.0
Loans and advances to banks	1,587.7	493.5	266.6	–	2,347.8
Loans and advances to customers	48,283.3	–	–	–	48,283.3
Fair value adjustments on portfolio hedging	223.2	–	–	–	223.2
Investment securities	3,650.6	1,656.0	134.5	–	5,441.1
Derivative financial instruments	115.6	287.7	14.8	65.1	483.2
Other financial assets	0.8	–	–	–	0.8
Total financial assets	54,161.2	2,437.2	415.9	65.1	57,079.4
Financial liabilities					
Deposits by banks	210.2	667.8	–	–	878.0
Other deposits	20,177.3	–	–	–	20,177.3
HM Treasury Working Capital Facility	8,564.2	–	–	–	8,564.2
Statutory Debt	18,416.2	–	–	–	18,416.2
Derivative financial instruments	591.5	54.3	1.8	–	647.6
Debt securities in issue	478.3	5,426.6	83.8	1,286.1	7,274.8
Subordinated liabilities	471.8	–	–	–	471.8
Other financial liabilities	79.9	–	–	–	79.9
Total financial liabilities	48,989.4	6,148.7	85.6	1,286.1	56,509.8
Notional values of derivatives affecting currency exposures	959.2	(726.4)	(332.9)	100.1	–
Net financial assets / (liabilities)	6,131.0	(4,437.9)	(2.6)	(1,120.9)	569.6

Company	Sterling £m	Euro £m	US \$ £m	Other £m	Total £m
At 31 December 2009					
Financial assets					
Cash and balances at central banks	316.6	–	–	–	316.6
Loans and advances to banks	1,340.3	50.2	45.7	–	1,436.2
Loans and advances to customers	54,343.7	–	–	–	54,343.7
Fair value adjustments on portfolio hedging	294.2	–	–	–	294.2
Investment securities	7,781.9	2,161.6	325.6	–	10,269.1
Derivative financial instruments	520.5	329.1	8.1	44.6	902.3
Other financial assets	1.4	–	–	–	1.4
Total financial assets	64,598.6	2,540.9	379.4	44.6	67,563.5
Financial liabilities					
Deposits by banks	415.6	677.0	–	–	1,092.6
Other deposits	28,257.4	–	–	–	28,257.4
HM Treasury Working Capital Facility	8,537.8	–	–	–	8,537.8
Statutory Debt	18,416.2	–	–	–	18,416.2
Derivative financial instruments	650.5	68.2	6.5	–	725.2
Debt securities in issue	732.5	6,924.0	80.2	1,375.0	9,111.7
Subordinated liabilities	1,629.5	–	–	–	1,629.5
Other financial liabilities	184.0	–	–	–	184.0
Total financial liabilities	58,823.5	7,669.2	86.7	1,375.0	67,954.4
Notional values of derivatives affecting currency exposures	668.3	(571.9)	(374.2)	277.8	–
Net financial assets / (liabilities)	6,443.4	(5,700.2)	(81.5)	(1,052.6)	(390.9)

Notes to the Financial Statements (continued)

35. Financial risk management continued

(f) Concentrations of risk

The Group has investments in a range of investment securities issued by government bodies, banks and building societies, and in asset-backed securities, in both the UK and overseas. UK government securities, bank and supranational bonds comprise 60% (2009: 48%) of investment securities held. 62% (2009: 62%) of the asset-backed securities are backed by UK assets.

The Group operates primarily in the UK, and adverse changes to the UK economy could impact all areas of the Group's business. Residential loans and advances to customers are all secured on property in the UK. 64% (2009: 63%) of residential loans and advances to customers are concentrated in the buy-to-let market; the remaining balances are mainly secured on residential owner-occupied properties.

The residential loan book of £35.7bn (2009: £38.2bn) is geographically spread across the UK broadly in line with the country's housing stock. Consequently, there is a geographic concentration of mortgages secured on properties in London and the South-East representing 50% (2009: 51%) of the book.

Within the commercial mortgage portfolio and housing association loans, there are approximately 54 loans (2009: 70) totalling £718.7m (2009: £818.9m), the largest 10 loans accounting for 82% (2009: 84%) of the portfolio. All of these loans are secured on commercial and housing association properties.

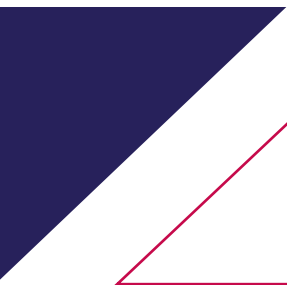
36. Controlling party

All shares in Bradford & Bingley plc were transferred to the Treasury Solicitor as nominee for HM Treasury on 29 September 2008 as a result of The Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008. On 1 October 2010 all shares in Bradford & Bingley plc were acquired via a share-for-share exchange by UK Asset Resolution Limited, a private limited company incorporated in the United Kingdom under the Companies Act 2006 and registered in England and Wales, which is wholly owned by the Treasury Solicitor as nominee for HM Treasury and is the Group's ultimate parent undertaking. The Company considers Her Majesty's Government to remain its ultimate controlling party.

37. Events after the reporting period

On 10 March 2011 the Company repurchased at par the £75.0m of its subordinated liabilities which were held by the Company's subsidiary undertaking Mortgage Express, and cancelled them.

On 29 March 2011 the Trustees of the Bradford & Bingley Staff Pension Scheme finalised the resolution described in note 25(d), which determined that the Company would have the right to refund of any future surpluses in the scheme. As a result, the liability carried on the Balance Sheet of the Group and Company reduced at that time by an amount approximating to the calculated effect of the agreed funding plan.



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