UK Asset Resolution Limited
Annual Report
& Accounts 2011

UK Asset Resolution

Registered in England and Wales no. 7301961

Our Mission is:

‘maximising value for the taxpayer’

Contents

Chairman's statement

2011 is the first full financial year of UK Asset Resolution Limited ('UKAR') and the first year in which we have produced consolidated results for the Group which comprises Bradford & Bingley plc ('B&B') and Northern Rock (Asset Management) plc ('NRAM'). UKAR's aim is to maximise value for the taxpayer and our objectives in integrating the two businesses are to reduce costs by combining business infrastructure and sharing best practice in customer service.

We achieved the targets we set ourselves for 2011. The underlying profit of the combined businesses increased from £444m in 2010 to £1,089m in 2011. This was achieved after the interest rate we pay on some of our Government funding increased to more commercial levels. Total remittances to the taxpayer including repayments, interest, fees and corporation tax increased from £1.6bn to £2.8bn.

The number of customers in arrears by 3 months or more reduced from 38,500 to 33,200 contributing to the new provisions for loan impairment falling from £1,089m to £390m. We reduced customer balances from £83.5bn to £75.3bn which enabled us to repay £2.15bn of Government loans but we still remain the 6th largest mortgage provider in the UK. Operating expenses fell from £278m to £221m.

Over the last two years we have undertaken liability management programmes which have resulted in the majority of the original subordinated debt of B&B and NRAM being purchased for an average of 46% of the face value of the securities, generating total gains of over £2.1bn. This fulfils the principle that private debt holders should bear some of the cost of the past failure and nationalisation of the two firms.

It is encouraging that over 90% of our customers are fully up to date with their payments, a similar level to last year. We work sympathetically with customers in financial difficulty and seek to contact them at the earliest opportunity to help them manage their financial affairs and ensure a satisfactory outcome for both parties. When appropriate we guide customers to the 'free to customers' debt advice sector, which we financially support. Looking forward, the progress of the business will be determined by the impact of national economic conditions on our customers' stretched budgets and, for some, uncertain employment.

Making calls to customers in financial difficulties is a demanding role which many people would choose not to fulfil in their careers and I would like to give a big thank you to those colleagues who contact customers with payment problems and seek to work with them to resolve complex financial problems together.

As our customer numbers reduce due to the run off of the mortgage book, our need for staff and premises will reduce and it was with regret that we announced our intention to close our operations at Gosforth in Newcastle by mid 2013. The main activities of the business in the future will be run from Doxford in Sunderland and Crossflatts in West Yorkshire. We are looking to relocate as many people from Gosforth as are able to do so.

Looking further into the future, as the run off progresses, there will inevitably be further contraction of employment but we are putting a lot of effort into encouraging a healthy and positive working environment to enable colleagues to benefit from the time they are working at UKAR. We put great emphasis on training which not only helps colleagues fulfil their current roles better but also provides skills for future employment.

I was delighted that Phillip McLelland who has been Finance Director since the inception of UKAR in October 2010 was appointed a full member of the Board with effect from 1 July 2011. He has been a major player in the creation of UKAR and this promotion recognises his increased contribution.

Richard Banks, our CEO, and everyone at UKAR have done a good job integrating the old B&B and NRAM operations and this major project will conclude during the first half of 2012. UKAR has a unique role of running down two large mortgage firms, a path that has not been travelled in the UK before. The team has found solutions to many of the complex issues that have arisen and applied themselves with great determination and professionalism. I thank everyone involved with UKAR for their efforts in 2011 and look forward to continuing our progress in 2012.

We are very conscious that we currently owe HM Treasury directly and indirectly £46.6bn and it is our expectation and our determination to repay that debt in full without loss to the taxpayer.

Richard Pym
Chairman
1 March 2012

Chief Executive Officer's review

Introduction/Financial Performance

In the first full year under the management of UKAR, I am pleased to report that both B&B and NRAM continue to make good progress against their business objectives. The businesses met all of the financial targets agreed with UK Financial Investments ('UKFI'), for 2011 with pre-tax profit of £1,375.1m (2010: £1,487.1m) achieved and £2.15bn (2010: £1.1bn) repaid to the taxpayer.

Business and Objectives

The objectives of UKAR remain unchanged and are:

- to optimise the Balance Sheet;
- to minimise impairment and losses; and
- to reduce costs,

with the overall aim of maximising value for the taxpayer. This is being achieved by managing the businesses effectively as the Balance Sheet is reducing, whilst treating customers and creditors fairly.

Optimise the Balance Sheet

UKAR has repaid £2.15bn of government funding. In addition £1.2bn of capital instruments have been bought back and £9.6bn other funding repaid on maturity. These repayments have been funded largely from a 10% reduction in lending balances (£8.2bn) reflecting £6.5bn of secured residential redemptions, £0.4bn of unsecured redemptions, £0.2bn of commercial redemptions and £1.1bn of ongoing repayments. As a result, lending balances stand at £75.3bn as at 31 December 2011 (2010: £83.5bn). In total, the Balance Sheet has reduced from £110.9bn in 2010 to £95.2bn.

HM Treasury have the right to vary the interest rates on the B&B Working Capital Facility ('WCF') and NRAM Government Loan. In August 2011 UKFI and HM Treasury requested an increase in the margin over Bank Base Rate on the WCF, from 1.50% to 5.00%, reflecting the improved balance sheet strength of the Company. This resulted in an additional £125m of interest paid during the year, equivalent of over £250m in a full year. In addition, the terms of this WCF have been restructured enabling lower levels of liquidity to be held on the Balance Sheet.

In November, tender offers were made to repurchase up to £1.2bn of B&B and NRAM capital instruments. As a result, £1,159.4m of notes have been repurchased, generating a pre-tax gain of £382.3m.

Minimise impairment and losses

Absolute arrears levels for both B&B and NRAM are lower than the 2010 year end as a direct consequence of proactive arrears management coupled with the continued benign interest rate environment in 2011.

The total number of mortgage cases 3 or more months in arrears, including those in possession, reduced by 14% year on year to 33,216 cases as at 31 December 2011 (2010: 38,515). The total value of arrears owed by customers has reduced year on year by £39.7m to £233.9m at 31 December 2011.

During 2011, we have continued to invest in improvements to our technology and staff resources in the UKAR debt management functions, particularly at NRAM. We have also delivered considerable improvements in operational efficiency. As a result of our actions, we have seen arrears in NRAM fall for eight consecutive months after the peak in April 2011.

In total, UKAR has almost 722,000 customers (2010: 850,000), they have 657,000 mortgage accounts (2010: 726,000) and 278,000 unsecured personal loan accounts (2010: 351,000). The majority of these loans continue to perform well but we do have a significant number of customers who are finding it difficult to meet their repayments and we work closely with them to offer a range of solutions to help them manage their circumstances. During the year we made 37,000 mortgage arrangements and account modifications (2010: 44,000) to assist customers with their repayments and continue their existing mortgage.

In seeking to support customers through periods of financial difficulty, we actively work with a range of non-fee charging debt advice agencies including Payplan, the Consumer Credit Counselling Service ('CCCS'), Citizens Advice Bureau, the National Debt Line and Money Advice Service to help customers reorganise their finances and ensure, wherever possible, that they can continue as homeowners.

Chief Executive Officer's review (continued)

In some circumstances, however, the most appropriate course of action is for customers to sell their homes and we support this process, where suitable, through assisted voluntary sales.

Repossession proceedings for customers in arrears are always viewed as a last resort; regrettably, in some situations, this is inevitable. The number of properties in possession increased from 2,607 in 2010 to 2,705 at the end of 2011.

Where a buy-to-let landlord is in arrears we endeavour to protect tenants by honouring the terms of all valid Assured Shorthold Tenancy agreements and instructing a Law of Property Act receiver to collect rent directly from the tenant, thereby enabling the tenant to stay in the property for the duration of any agreement.

Reduce costs

Costs are being well controlled with ongoing administrative expenses £56.9m lower than 2010 at £220.6m, and we have successfully integrated many of the B&B and NRAM operations in 2011 including telephony, financial systems and the commercial loan books. Since the year end we have completed the migration of the NRAM mortgages to the UKAR mortgage platform. The advantage of the vast majority of mortgages being on a single mortgage system will give us reduced costs and operational flexibility. In addition, we have started the process of transferring our main computer operations to a new outsource provider, HCL, which will also provide a lower cost and more flexible platform for the future. The integration programme and the outsourcing of IT will deliver very substantial annual cost savings of around £50m once complete.

In December, we announced the plan to withdraw from our Gosforth site in Newcastle by mid 2013. By the end of that year the mortgage portfolio is expected to have declined by around 25% since 2010 and the decision to focus the business in our remaining two sites in the North East and West Yorkshire will improve efficiency and control and also reduce costs. We remain committed to providing comprehensive training and development for colleagues throughout UKAR, and will be offering outplacement and other support for those who will be leaving the business.

Colleagues

The decision to move from three to two main sites by the middle of 2013 has an impact on over 700 colleagues at UKAR. We announced this decision as soon as it was made to ensure all individuals are fully consulted and have time to consider their options. We hope as many colleagues who are able to transfer to one of our other sites will do so.

Since UKAR was formed towards the end of 2010 we have seen many changes. The professionalism of colleagues in rising to the challenges this has caused whilst continuing to serve our customers has been impressive.

Community

During the year colleagues raised over £80,300 for our corporate charities including Business Action on Homelessness, Shelter, Samaritans, the Cystic Fibrosis Trust and two local hospices - Sue Ryder Manorlands and St Benedict's. In 2012, we will be supporting NSPCC and three charities voted for by our staff and all based near our main offices: Sue Ryder Manorlands Hospice in West Yorkshire, The Sir Bobby Robson Foundation and Tiny Lives Special Care Babies in the North of England.

Outlook

In early 2011, we described the outlook for the UK economy as 'uncertain, with further contraction a possibility'. A year later, in early 2012, the outlook can be described in similar terms as the sovereign debt crisis in the Eurozone has severely weakened confidence amongst businesses and consumers alike. While we continue to expect a gradual recovery, the UK economy could contract in the short term and the global economic outlook remains uncertain. We will, therefore, continue to focus on helping our customers who experience financial difficulties.

House price movement at a national level has been small, reflecting the subdued nature of the economy although there are some significant regional variations. Uncertainty over the outlook is likely to weaken demand further and as a consequence we expect house prices to ease back by the end of 2012. Mortgage lending remains subdued despite improvements in availability and pricing over the last 12 months and we expect weakness in house prices to limit lenders' appetites further. These factors will combine to make it harder for our customers to switch providers and we expect the pace of redemptions from our book to continue to slow.

While interest rates remain lower than previously anticipated, higher inflation and rising unemployment continue to put pressure on disposable incomes, reducing 'affordability' for many households and limiting their ability to cope with higher interest rates in future. So, although impairments have improved over the last year, there is a risk that more customers may experience financial difficulties during 2012 and this would result in rising arrears and repossessions across UKAR.

Conclusion

It has been a year of rapid change, considerable progress in integrating the two businesses and delivering on our objectives. I have a great team of senior managers and colleagues who work very hard to help our customers and repay the taxpayer. I would like to thank all my colleagues for their efforts over the past 12 months and for their continued commitment to UKAR and I also wish to thank the Board and Executive management team for their personal support.

Richard Banks
Chief Executive Officer
1 March 2012

> "Payplan have taken the stress out of my situation....they score 20 out of 10 - they are the best people I have dealt with"

Since 2010 UKAR has actively engaged with the free to consumer debt advice industry. A strong partnership with Payplan – a leader in the field of free debt help – has emerged, founded on a mutual trust and understanding.

UKAR understands the benefits for all concerned of promoting free and independent debt support for those customers who are in a vulnerable financial position. Helping them to continue with their mortgage payments can be no less than life-changing – as you can see here…

Miss C

Miss C is aged 38 and single. She lives alone in her mortgaged property and has unsecured debts of £23,950 to 4 creditors with monthly contractual obligations of £547. Before talking to Payplan she had a surplus of £37 after paying her priority outgoings, which she was distributing in an adhoc way to her creditors. After completing a Payplan assessment her expenditure reduced to establish a surplus of £339 rising to £473 in 13 months time (when HP ends).

Here's Miss C's response following her referral:

> **"I just felt compelled to send you this email. I was in hideous financial trouble and spent the whole day with butterflies in my tummy over this call. Not at any point did the payplan advisor make me feel stupid or foolish for being in my current situation. She explained everything fully and was so helpful and incredibly patient with me, she didn't rush, stress or make me feel embarrassed. Full credit to you for having an excellent member of staff on your team."**

We conducted a survey amongst 50 NRAM customers who had been directly referred to Payplan between Jan-Mar 2011.

Key results included:

- None of the customers surveyed were aware of the availability of free independent and impartial debt advice before being signposted by UKAR.
- 100% of customers surveyed would recommend Payplan to others.
- 100% of customers found Payplan to be sympathetic in dealing with their situation.

Due to the uncertain economic outlook UKAR will continue to proactively approach and contact customers to offer help and support when they are experiencing financial difficulties. Focus will be on customer education, budget guidance and referring customers for professional independent advice, whether free debt advice or mortgage advice.

Key performance indicators ('KPIs') - UKAR

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

Strategic priorities	Financial measures	2011	2010*	Commentary
Optimise the Balance Sheet	Total lending balances £bn Secured £bn Unsecured £bn	**75.3** **72.8** **2.5**	83.5 80.4 3.1	Lending balances reduced by 10% during the year due to £6.5bn of secured residential redemptions, £0.4bn of unsecured loan redemptions, £0.2bn of commercial loan redemptions and £1.1bn of other capital repayments.
	Residential mortgage redemption rate % Residential redemptions £bn	**8.1** **6.5**	7.2 6.3	Although redemptions are stable year on year at c £7bn the increase in the redemption rate reflects a lower opening book and the decision to waive early redemption charges earlier in the year.
	Government loan repayments £bn Government loan balance £bn	**2.15** **46.6**	1.10 48.7	£2bn repaid against the NRAM Government Loan and repayments have commenced on the B&B Working Capital Facility ('WCF') with £150m repaid in December.
	Total cash payments to HM Treasury £m	**2,838**	1,627	Total cash paid to HM Treasury during the year. This includes principal and interest repayments, State guarantee fees and tax paid. The main driver of the increase year on year is £1.1bn higher principal repayments.
Minimise impairment and losses	Residential arrears balance : total residential mortgage balance % Residential payments overdue £m	**0.33** **233.9**	0.34 273.6	This represents the value of customers' missed payments as a proportion of the total balance of all residential mortgages.
	Residential arrears 3 months and over and possessions as % of the book: - by value - by number of accounts Number of residential arrears 3 months and over and possessions cases	 **6.61** **5.21** **33,216**	 6.94 5.46 38,515	The reduction in arrears reflects both the improvement in collections performance and continued low interest rates.
	Impairment provisions: Residential secured £m Cover % Unsecured £m Cover % Commercial/other £m Cover % Residential provision balance: residential loans in arrears %	 **1,644.5** **2.24** **501.6** **16.58** **102.2** **10.65** **19.5**	 1,845.1 2.27 542.3 14.83 88.6 7.90 20.0	The level of residential impairment Balance Sheet provision reduced by £200.6m. The provision reflects improved arrears performance and a reduction in the level of impaired assets. Coverage on the unsecured book has increased to 16.58% (2010: 14.83%) and on commercial loans this increased to 10.65% (2010: 7.90%).
Reduce costs	Total costs £m Ongoing costs £m** Ratio of costs to average interest-earning assets: - statutory % - ongoing %**	**285.8** **220.6** **0.30** **0.23**	430.0 277.5 0.40 0.26	The reduction in 2011 ongoing costs primarily reflects the restructuring undertaken in 2010, as part of the transfer of NRAM to UKAR and also the clear focus on cost management to reduce costs as the size of the Balance Sheet runs down. In addition total costs were lower year on year due to lower spend on the integration of the two companies which, in 2010, included the cost of separation from Northern Rock.

* 2010 has been restated reflecting the changes to EIR policy. Details of the change are provided in note 3.

** 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 12.

Financial review

Performance

In addition to the statutory measure of profit, the Board continues to believe 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 of B&B and NRAM, and certain gains such as the repurchase of capital instruments. 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 profit and the underlying profit of UKAR is provided below. Underlying profit before tax of £1,089.1m was £645.0m higher than 2010 (2010: £444.1m) mainly due to lower loan impairment charges. The number of mortgage accounts 3 or more months in arrears reduced by 14% compared to 2010.

Underlying net operating income was 3% lower in the year at £1,758.9m (2010: £1,811.5m), partly due to average interest-earning assets falling by 11%. Underlying net interest income fell £46.2m to £1,722.4m (2010: £1,768.6m). Ongoing administrative expenses fell £56.9m (21%) to £220.6m (2010: £277.5m). Impairment on loans and advances to customers reduced by £699.0m to £390.4m (2010: £1,089.4m).

We have restated our 2010 results reflecting a change in the policy adopted for mortgage interest recognition, leading to the reduction of the asset previously established under IAS 39 'Financial Instruments: Recognition and Measurement', (for details of the impact refer to note 3). Continuing with the previous policy with updated redemption projections would have resulted in an increase in the UKAR effective interest rate ('EIR') asset of the order of £500m, increasing reported profits by this amount and increasing the EIR asset to approximately £900m. This amount would then need to be amortised as an interest expense in the Income Statement over the remaining life of the mortgages. The Board considered this inappropriate for an organisation in run down and concluded on a revised approach, which both complies with IAS 39 and better reflects the particular nature of the UKAR business. Integral fees and charges are now amortised over a shorter period being the period to which the product reprices to a standard or product variable rate. Whilst the numbers involved are material in any one period, over the life of the assets no difference arises.

Income Statement

	UKAR		B&B		NRAM	
For the year ended 31 December	2011 £m	2010* £m	2011 £m	2010* £m	2011 £m	2010* £m
Underlying net interest income**	**1,722.4**	1,768.6	**458.4**	594.8	**1,264.0**	1,173.8
Underlying net non interest income***	**36.5**	42.9	**17.6**	32.4	**18.9**	10.5
Underlying net operating income	**1,758.9**	1,811.5	**476.0**	627.2	**1,282.9**	1,184.3
Ongoing administrative expenses	**(220.6)**	(277.5)	**(103.9)**	(112.3)	**(116.7)**	(165.2)
Impairment on loans and advances to customers	**(390.4)**	(1,089.4)	**(79.4)**	(276.6)	**(311.0)**	(812.8)
Net impairment on investment securities	**(58.8)**	(0.5)	**6.5**	14.5	**(65.3)**	(15.0)
Underlying profit before taxation	**1,089.1**	444.1	**299.2**	252.8	**789.9**	191.3
Unrealised fair value movements on financial instruments	**79.2**	446.9	**68.3**	29.2	**10.9**	417.7
Hedge ineffectiveness	**(85.2)**	(62.0)	**(59.0)**	3.0	**(26.2)**	(65.0)
Other net administrative expenses	**(65.2)**	(152.5)	**(25.0)**	(14.1)	**(40.2)**	(138.4)
Discounting of capital instruments	**-**	104.3	**-**	104.3	**-**	-
Gain on repurchase of capital instruments	**338.1**	845.7	**151.0**	786.0	**187.1**	59.7
Profit on disposal of credit linked notes	**15.6**	-	**-**	-	**15.6**	-
Gain on sale of insurance business	**-**	11.5	**-**	11.5	**-**	-
Provision for customer redress	**-**	(160.0)	**-**	-	**-**	(160.0)
Defined benefit pension scheme gains	**3.5**	9.1	**-**	-	**3.5**	9.1
Statutory profit before taxation	**1,375.1**	1,487.1	**434.5**	1,172.7	**940.6**	314.4

* 2010 has been restated (see note 3) as B&B and NRAM align accounting treatment.

** Underlying net interest income in B&B in 2010 reflects an adjustment of £104.3m for the discounting of capital instruments, and both companies restated for a change in policy relating to EIR (see note 3).

*** Underlying net non interest income includes net fee and commission income, net realised gains less losses on investment securities and other operating income. Net realised gains less losses in B&B have been restated in 2010 as B&B aligns accounting methodology with NRAM, with a reclassification to the unrealised fair value movements on financial instruments line (see note 3).

Financial review (continued)

Net interest income

Underlying net interest income was 3% lower at £1,722.4m (2010: £1,768.6m). There were a number of drivers of the decrease in the year. Across both books there was a reduction in income due to the decrease in average interest-earning assets of £11.7bn (NRAM: £7.9bn, B&B: £3.8bn) and, additionally in B&B, the introduction of an increased interest rate payable on the WCF, partly offset by an increase in underlying margins.

Underlying net interest margin was higher at 1.81% (2010: 1.66%) at UKAR level, the increase in NRAM margin outweighing the fall in B&B margin.

On the B&B book the main driver of the 0.21% reduction in the underlying net interest margin to 1.16% (2010: 1.37%) was the increased rate on the WCF, which was increased from Bank Base Rate + 1.50% to Bank Base Rate + 5.00% with effect from 1 August 2011. This was partly offset by the benefit of maturing fixed rate swaps relating to fixed rate mortgages reverting to a product variable rate, at the end of the deal period.

In NRAM, net interest margin increased to 2.28% (2010: 1.85%) mainly due to the higher margins achieved when fixed rate mortgages revert to standard variable rate, in the same way as referred to above on the B&B book.

UKAR's statutory net interest margin grew by 0.05% to 1.81% (2010: 1.76%) due to the 0.15% increase in the underlying margin, partly offset by the prior year having benefited from the one-off discounting of B&B capital instruments.

Net interest income

For the year ended 31 December	UKAR 2011 £m	UKAR 2010* £m	B&B 2011 £m	B&B 2010* £m	NRAM 2011 £m	NRAM 2010* £m
Interest receivable and similar income						
On secured advances	**2,472.5**	2,389.9	**922.1**	938.5	**1,550.4**	1,451.4
On other lending	**143.7**	131.0	**-**	-	**143.7**	131.0
On investment securities and deposits	**116.8**	158.6	**38.9**	87.6	**80.0**	73.3
Underlying interest receivable and similar income	**2,733.0**	2,679.5	**961.0**	1,026.1	**1,774.1**	1,655.7
Interest expense and similar charges						
On other deposits including loans from HM Treasury	**(475.6)**	(359.1)	**(295.3)**	(167.0)	**(180.3)**	(191.1)
State guarantee fee	**(74.9)**	(108.3)	**(74.9)**	(108.3)	**-**	-
Other	**(460.1)**	(443.5)	**(132.4)**	(156.0)	**(329.8)**	(290.8)
Underlying interest expense and similar charges	**(1,010.6)**	(910.9)	**(502.6)**	(431.3)	**(510.1)**	(481.9)
Underlying net interest income	**1,722.4**	1,768.6	**458.4**	594.8	**1,264.0**	1,173.8
Average balances						
Interest-earning assets ('IEA')	**94,929**	106,598	**39,570**	43,321	**55,501**	63,425
Financed by:						
- Interest-bearing funding	**71,610**	83,840	**18,528**	22,701	**53,239**	61,314
- Interest-free funding	**23,319**	22,758	**21,042**	20,620	**2,262**	2,111
Average rates %	**%**	%	**%**	%	**%**	%
Gross yield on IEA	**2.88**	2.51	**2.43**	2.37	**3.20**	2.61
Cost of interest-bearing funding	**(1.31)**	(0.96)	**(2.31)**	(1.42)	**(0.96)**	(0.79)
Interest spread	**1.57**	1.55	**0.12**	0.95	**2.24**	1.82
State guarantee fee	**(0.08)**	(0.10)	**(0.19)**	(0.25)	**-**	-
Contribution of interest-free funding	**0.32**	0.21	**1.23**	0.67	**0.04**	0.03
Underlying net interest margin on average IEA	**1.81**	1.66	**1.16**	1.37	**2.28**	1.85
Annual average Bank Base Rate	**0.50**	0.50	**0.50**	0.50	**0.50**	0.50
Annual average 1-month LIBOR	**0.65**	0.56	**0.65**	0.56	**0.65**	0.56
Annual average 3-month LIBOR	**0.88**	0.70	**0.88**	0.70	**0.88**	0.70
	£m	£m	**£m**	£m	**£m**	£m
Underlying net interest income	**1,722.4**	1,768.6	**458.4**	594.8	**1,264.0**	1,173.8
Add back: discounting of capital instruments	**-**	104.3	**-**	104.3	**-**	-
Statutory net interest income	**1,722.4**	1,872.9	**458.4**	699.1	**1,264.0**	1,173.8
	%	%	**%**	%	**%**	%
Statutory net interest margin on average IEA	**1.81**	1.76	**1.16**	1.61	**2.28**	1.85

* 2010 has been restated reflecting the changes to EIR policy. Details of the change are provided in note 3.

Financial review (continued)

Underlying net non interest income

Underlying net non interest income of £36.5m (2010: £42.9m) represents a £6.4m reduction compared to 2010, mainly due to the gains experienced in 2010 in B&B on a number of maturing investment assets purchased prior to nationalisation not repeating in 2011.

In NRAM, net non interest income grew by £8.4m mainly as a result of lower fees payable due to the disposal of credit linked notes, higher income from the Treasury Service Level Agreements with Northern Rock as 2011 reflected a full year of income, and higher income from redemption fees as the volume of redemptions has increased.

Net non interest income

	UKAR		B&B		NRAM	
For the year ended 31 December	2011 £m	2010* £m	2011 £m	2010* £m	2011 £m	2010* £m
Total net fee and commission income	**28.8**	24.3	**17.3**	21.1	**11.5**	3.2
Net realised gains less losses on investment securities*	**(1.2)**	8.6	**-**	8.4	**(1.2)**	0.2
Other operating income	**8.9**	10.0	**0.3**	2.9	**8.6**	7.1
Underlying net non interest income	**36.5**	42.9	**17.6**	32.4	**18.9**	10.5
Unrealised fair value movements on financial instruments*	**79.2**	446.9	**68.3**	29.2	**10.9**	417.7
Hedge ineffectiveness	**(85.2)**	(62.0)	**(59.0)**	3.0	**(26.2)**	(65.0)
Provision for customer redress	**-**	(160.0)	**-**	-	**-**	(160.0)
Statutory net non interest income	**30.5**	267.8	**26.9**	64.6	**3.6**	203.2

* Realised gains less losses on investment securities and unrealised fair value movements on financial instruments have been restated in B&B to align accounting methodology with NRAM.

Accounting volatility on derivative financial instruments

NRAM and B&B use derivative financial instruments for economic hedging purposes. Some of these are designated and accounted for as IAS 39 compliant fair value or cash flow hedge relationships. Where effective hedge relationships can be established, the movement in the fair value of the derivative is offset in full or in part either by opposite movements in the fair value of the instrument being hedged or by being taken to reserves. Any ineffectiveness arising from different movements in fair value will offset over time.

Unrealised fair value movements were a gain of £79.2m in the year (2010: a gain of £446.9m) generally relating to derivatives that act as an economic hedge but cannot be treated as an accounting hedge under IAS 39. Specifically these movements are due to changes in the value of swaps held to hedge equity instruments, the Covered Bond and securitisation programmes and basis swaps used to hedge the overall interest rate risk on the Balance Sheet.

In NRAM, the significant reduction in unrealised fair value movement reflects a stabilisation in valuations of derivatives hedging currency floating rate securitised notes. The credit in 2010 was a reversal of prior year losses.

In B&B, the £39.1m year on year improvement in unrealised fair value movements is mainly due to the impact on the valuation of basis swaps of the widening of LIBOR over Bank Base Rate in the year. In addition, the maturity in 2010 of remaining legacy swaps relating to the savings business, which reduced in value in that year, has a year on year benefit.

Provision for customer redress

As at 31 December 2010 UKAR held a provision in respect of customer compensation of £223.7m, of which £199.1m related to claims for compensation regarding payment protection insurance ('PPI'), and £24.6m related to claims for other mis-sold products such as endowments and wealth products. During 2011, £45.0m of the overall PPI compensation provision was utilised leaving £154.1m remaining at the end of 2011. We continue the proactive past business review of unsecured loan PPI sales and have written to over 90,000 customers so far. The provision in respect of other mis-sold products fell to £19.6m with £5.4m being utilised in the year. We believe these provisions remain adequate.

Ongoing administrative expenses

Ongoing administrative expenses were lower at £220.6m (2010: £277.5m) with the ratio of costs to average interest-earning assets decreasing to 0.23% (2010: 0.26%).

The reduction in 2011 costs and improvement in the cost to average interest-earning assets ratio primarily reflect the restructuring undertaken in 2010, as part of the transfer of NRAM to UKAR and also the clear focus on cost management to reduce costs as the size of the Balance Sheet runs down.

The UKAR Group has incentive schemes in place which have been agreed with UKFI. These enable staff to earn awards which are aligned to UKAR Group and individual performance. For 2011, the total of all incentives earned by employees of all UKAR Companies, including those of the Executive Directors, was £5.6m (2010: £5.5m) and is included in ongoing administrative expenses. Of these £4.9m (2010: £4.7m) will be paid in 2012, and the remainder will be deferred and paid in future years. All deferred amounts are subject to clawback terms.

Financial review (continued)

Administrative expenses

	UKAR		B&B		NRAM	
For the year ended 31 December	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Wages and salaries	**65.6**	33.7	**31.1**	28.4	**34.5**	5.3
Social security costs	**6.8**	3.5	**3.2**	3.1	**3.6**	0.4
Defined benefit pension costs	**(0.9)**	4.8	**(0.4)**	2.9	**(0.5)**	1.9
Defined contribution pension costs	**3.5**	1.8	**1.3**	1.5	**2.2**	0.3
Other retirement benefit costs	**0.5**	0.5	**0.5**	0.5	**-**	-
Total staff costs	**75.5**	44.3	**35.7**	36.4	**39.8**	7.9
IT costs	**57.9**	39.8	**27.2**	33.7	**30.7**	6.1
Outsourced and professional services	**29.6**	20.5	**16.2**	19.1	**13.4**	1.4
Depreciation and amortisation	**5.5**	3.4	**1.8**	0.4	**3.7**	3.0
Service level agreement with Northern Rock plc	**-**	115.5	**-**	-	**-**	115.5
Other administrative expenses	**52.1**	54.0	**23.0**	22.7	**29.1**	31.3
Ongoing administrative expenses	**220.6**	277.5	**103.9**	112.3	**116.7**	165.2
Other net administrative expenses:						
- Transformation costs	**40.0**	64.7	**19.4**	8.8	**26.1**	55.9
- Accelerated depreciation	**25.2**	51.8	**5.6**	-	**14.1**	51.8
- Impairment of goodwill	**-**	30.7	**-**	-	**-**	30.7
- Independent share valuation charges	**-**	5.3	**-**	5.3	**-**	-
Total other net administrative expenses	**65.2**	152.5	**25.0**	14.1	**40.2**	138.4
Total administrative expenses	**285.8**	430.0	**128.9**	126.4	**156.9**	303.6

Other net administrative expenses

Other net administrative expenses in 2011 of £65.2m (2010: £152.5m) mainly reflect one-off costs in establishing common systems across UKAR, together with expected redundancy costs and the write down of the value of buildings following the announcement of the UKAR restructure and the phased exit from the Gosforth site.

Costs in 2010 reflected the combination of the £138.4m costs in NRAM and £14.1m costs in B&B. NRAM costs in 2010 related to the costs of the separation of NRAM from Northern Rock of £55.9m, together with a £30.7m write down of goodwill on an acquired mortgage business and £51.8m in respect of a revaluation of a proportion of the office complex in Gosforth which was reclassified as an investment property during that year.

B&B costs in 2010 included residual costs associated with nationalisation of the Company and also the establishment of UKAR in October 2010.

Arrears and loan impairment: residential loans

We have invested in both technology and staff resources in the UKAR debt management functions, particularly in the NRAM operation based in the North East. As a result of our actions, we have seen arrears in both Companies fall. In B&B, arrears levels are now below the Council of Mortgage Lenders average having been double this figure 2 years ago and in NRAM, they have fallen for eight consecutive months following the peak in April 2011. At UKAR level, the number of mortgage accounts 3 months or more in arrears reduced in the first half of the year by just over 1% but fell in the second half by 13%. We have also delivered considerable improvements in operational efficiency and exercised tighter control over customer requests for financial concessions resulting in a reduction in loan modifications compared to 2010.

We adhere to the FSA's regulatory guidance regarding Treating Customers Fairly and continue to work closely with customers experiencing, or likely to experience, financial difficulty in maintaining their mortgage payments. We offer a range of measures to support these customers depending upon their individual circumstances and ability to pay with the long term aim of sustaining their mortgage commitments and remaining in their homes. Possession continues to be a last resort.

Our absolute arrears levels for both companies are lower than 2010 year end as a direct consequence of proactive arrears management coupled with a continued benign interest rate environment in 2011.

The total number of cases 3 or more months in arrears, including those in possession, reduced by 14% year on year to 33,216 cases as at 31 December 2011 (2010: 38,515). The total value of debt owed by customers has reduced year on year by £39.7m to £233.9m at 31 December 2011 (2010: £273.6m) equivalent to 0.33% of mortgage balances (2010: 0.34%).

Financial review (continued)

Arrears and loan impairment: residential and unsecured loans

Arrears and possessions

At 31 December		UKAR 2011 Residential	UKAR 2011 Unsecured	UKAR 2010 Residential	UKAR 2010 Unsecured
Arrears 3 months and over					
Number of cases	No.	**30,511**	**34,282**	35,908	26,274
Proportion of total cases	%	**4.79**	**12.33**	5.09	7.48
Asset value	£m	**4,358.8**	**466.1**	5,158.1	397.9
Proportion of book	%	**6.06**	**18.47**	6.50	12.78
Total value of payments overdue	£m	**170.4**	**56.0**	210.4	42.5
Proportion of total book	%	**0.23**	**2.22**	0.26	1.36
Possessions					
Number of cases	No.	**2,705**	**-**	2,607	-
Proportion of total cases	%	**0.42**	**-**	0.37	-
Asset value	£m	**395.9**	**-**	351.2	-
Proportion of book	%	**0.55**	**-**	0.44	-
Total value of payments overdue	£m	**27.1**	**-**	23.4	-
Proportion of total book	%	**0.04**	**-**	0.03	-
Total arrears 3 months and over and possessions					
Number of cases	No.	**33,216**	**34,282**	38,515	26,274
Proportion of total cases	%	**5.21**	**12.33**	5.46	7.48
Asset value	£m	**4,754.7**	**466.1**	5,509.3	397.9
Proportion of book	%	**6.61**	**18.47**	6.94	12.78
Total value of payments overdue	£m	**197.5**	**56.0**	233.8	42.5
Proportion of total book	%	**0.27**	**2.22**	0.29	1.36
Payments overdue					
Total value of payments overdue	£m	**233.9**	**58.5**	273.6	46.6
Proportion of total book	%	**0.33**	**2.32**	0.34	1.50
Loan impairment provision					
As % of total balances	%	**2.24**	**16.58**	2.27	14.83
As % of arrears 3 months and over and possessions	%	**34.59**	**107.62**	33.49	136.29

Financial review (continued)

Arrears and loan impairment: residential and unsecured loans (continued)

Arrears and possessions

		B&B		NRAM			
At 31 December		2011	2010	2011		2010	
		Residential	Residential	Residential	Unsecured	Residential	Unsecured
Arrears 3 months and over							
Number of cases	No.	**8,180**	12,473	**22,331**	**34,282**	23,435	26,274
Proportion of total cases	%	**2.74**	3.90	**6.57**	**12.33**	6.07	7.48
Asset value	£m	**1,212.3**	1,873.7	**3,146.5**	**466.1**	3,284.4	397.9
Proportion of book	%	**3.62**	5.31	**8.19**	**18.47**	7.44	12.78
Total value of payments overdue	£m	**38.6**	64.3	**131.8**	**56.0**	146.1	42.5
Proportion of total book	%	**0.11**	0.18	**0.34**	**2.22**	0.33	1.36
Possessions							
Number of cases	No.	**587**	623	**2,118**	**-**	1,984	-
Proportion of total cases	%	**0.20**	0.19	**0.62**	**-**	0.51	-
Asset value	£m	**96.0**	97.1	**299.9**	**-**	254.1	-
Proportion of book	%	**0.29**	0.28	**0.78**	**-**	0.57	-
Total value of payments overdue	£m	**6.1**	6.8	**21.0**	**-**	16.6	-
Proportion of total book	%	**0.02**	0.02	**0.06**	**-**	0.04	-
Total arrears 3 months and over and possessions							
Number of cases	No.	**8,767**	13,096	**24,449**	**34,282**	25,419	26,274
Proportion of total cases	%	**2.94**	4.09	**7.19**	**12.33**	6.58	7.48
Asset value	£m	**1,308.3**	1,970.8	**3,446.4**	**466.1**	3,538.5	397.9
Proportion of book	%	**3.91**	5.59	**8.97**	**18.47**	8.01	12.78
Total value of payments overdue	£m	**44.7**	71.1	**152.8**	**56.0**	162.7	42.5
Proportion of total book	%	**0.13**	0.20	**0.40**	**2.22**	0.37	1.36
Payments overdue							
Total value of payments overdue	£m	**52.6**	80.7	**181.3**	**58.5**	192.9	46.6
Proportion of total book	%	**0.16**	0.23	**0.47**	**2.32**	0.44	1.50
Loan impairment provision							
As % of total balances	%	**2.10**	2.31	**2.35**	**16.58**	2.24	14.83
As % of arrears 3 months and over and possessions	%	**54.89**	42.22	**26.88**	**107.62**	28.63	136.29

Loan provisions

Total UKAR loan impairment provisions as at 31 December were £2,248.3m (2010: £2,476.0m) comprising residential mortgages £1,644.5m (2010: £1,845.1m), unsecured loans £501.6m (2010: £542.3m) and commercial property of £102.2m (£88.6m).

Residential loan impairment

The year end provisions for residential loan impairment held on the Balance Sheet reduced by £200.6m in the year to £1,644.5m (2010: £1,845.1m) reflecting the 14% reduction in arrears cases, minimal new fraud cases identified during 2011 and possession sales.

Within the B&B book, our fraud and professional negligence provisions have reduced by £53.6m to £299.8m (2010: £353.4m) mainly as a result of cases written off which were fully provided for. Investigations during the year have resulted in a significant number of cases being cleared of suspicion. As a result, the total value of the B&B fraud and professional negligence cases remaining under investigation has reduced by 39% to £744m (2010: £1,218m).

In a benign interest rate environment, we continue to review our provisioning levels to cater for mortgage affordability and inherent credit risk in the book which may be masked by current low interest rates. We continue to include a provision for the impact on losses of current arrears to result from future house price deflation.

As a proportion of balances, the residential impairment provision was 2.24% (2010: 2.27%). The loan impairment charge was £245.3m (2010: £872.3m) as the 2010 charge included a number of UKAR alignment adjustments and the 2011 charge benefited from lower arrears volumes and minimal new fraud cases.

Financial review (continued)

Losses

The number of properties in possession for UKAR increased from 2,607 in 2010 to 2,705 at the end of 2011. Within B&B, possession stock reduced from 623 cases in 2010 to 587 in 2011 whereas in NRAM possession stock increased from 1,984 cases in 2010 to 2,118 at the end of 2011.

In addition to residential property possessions, we also have a number of buy-to-let properties within B&B managed by a Law of Property Act ('LPA') receiver. Our LPA 'for sale' stock reduced from 1,378 cases in 2010 to 785 in 2011.

During the year, 8,749 cases (2010: 8,402) were sold following possession and a further 1,533 cases (2010: 2,600) sold which were under LPA management. Realised losses on properties sold following possession or sold by an LPA were £454.5m (2010: £512.4m). Within these losses were fraudulent and professional negligence losses within B&B which amounted to £65.1m (2010: £114.3m).

Loan impairment: unsecured loans

The number of unsecured loans 3 months or more in arrears increased by 30% to close the year at 34,282 cases. However, the charge for unsecured loan impairment was 31% lower at £124.9m (2010: £181.3m), mainly reflecting that many of these new arrears cases were fully provided against prior to 2011, having previously been identified as being in financial difficulty. Asset coverage has naturally increased from 14.8% in 2010 to 16.6% in 2011 reflecting the reduction in overall size of the performing book.

The year end provision for unsecured loans reduced by £40.7m to £501.6m. Realised losses were £179.0m (2010: £214.0m).

Arrears and loan impairment: commercial loan book

The year end provision for the commercial book has increased to £102.2m (2010: £88.6m) and realised losses were £6.6m compared to £12.0m in 2010. The increase in provision was mainly due to updated property valuations on the NRAM book and alignment of provisioning methodology across UKAR. 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

Conditions in the wholesale markets have remained difficult in 2011, with growing fears over the stability of the Eurozone leading to further illiquidity and widening spreads in the bond markets and the threat of recession throughout much of Europe. Against this background, and with the evidence of poor performance of underlying collateral in some of the asset backed securities held by NRAM, we have identified a number of our remaining bonds that we believe to be impaired, partly offset by gains on previously impaired B&B assets, giving a net charge in the year of £58.8m (2010: £0.5m).

Gain on repurchase of capital instruments

The liability management exercise launched in November tendered for £1,347.3m of capital instruments. As a result, £1,159.4m of notes have been repurchased, generating £382.3m of pre-tax profit, £338.1m of which is recognised in statutory profit with the balance being recognised in reserves. The profit on disposal of credit linked notes in NRAM also generated a gain of £15.6m, giving a combined profit of £353.7m for these Balance Sheet management items (2010: £845.7m).

Gain on disposal of business

In 2010 a condition of the EC State Aid approval was the disposal of the B&B general insurance businesses. This completed in 2010 with a net gain of £11.5m.

Defined benefit pension scheme

The closure of the NRAM defined benefit pension scheme in 2010 resulted in a £9.1m curtailment gain in 2010. A further gain of £3.5m arose in 2011 resulting from a transfer in of certain assets and obligations from the scheme set up to replace NRAM's closed scheme.

Taxation

The effective tax rate in the Group for 2011 is 15.5%. This is below the standard rate based on current corporation tax rates of 26.5% for two main reasons. Firstly, within NRAM there are tax losses brought forward which have been fully utilised in 2011, meaning that the profit on which tax is payable is lower than the accounting profit. This results in a lower tax rate being reflected in the Financial Statements. Secondly, within B&B we made a provision in 2008 as we believed that it was possible that HMRC may take the view that the costs associated with nationalisation did not qualify for tax relief. We have established in 2011 that there will be no disallowance for such costs, and therefore we have released the provision. This also has the effect of lowering the effective tax rate in the Group.

Financial review (continued)

Balance Sheet

Balance Sheet summary

At 31 December	UKAR 2011 £m	UKAR 2010* £m	B&B 2011 £m	B&B 2010* £m	NRAM 2011 £m	NRAM 2010* £m
Loans and advances to customers:						
-Residential mortgages	**71,913.3**	79,397.4	**33,491.3**	35,244.5	**38,422.0**	44,152.9
-Commercial and other secured loans	**857.2**	1,033.4	**588.5**	718.7	**268.7**	314.7
-Unsecured lending	**2,523.9**	3,113.8	**-**	-	**2,523.9**	3,113.8
Wholesale assets	**11,765.3**	16,832.0	**3,214.4**	5,652.3	**8,685.4**	11,330.4
Fair value adjustments on portfolio hedging	**597.5**	762.8	**362.6**	223.2	**234.9**	539.6
Derivative financial instruments	**7,369.1**	9,471.6	**2,318.0**	2,929.1	**5,051.1**	6,542.5
Other assets	**203.6**	263.4	**127.4**	179.0	**138.3**	102.0
Total assets	**95,229.9**	110,874.4	**40,102.2**	44,946.8	**55,324.3**	66,095.9
Statutory Debt and HM Treasury loans	**46,582.2**	48,707.7	**26,855.8**	26,980.4	**19,726.4**	21,727.3
Wholesale funding	**42,137.4**	55,486.4	**9,899.2**	14,702.6	**32,387.2**	40,954.2
Derivative financial instruments	**965.4**	1,358.3	**577.9**	531.9	**387.5**	826.4
Other liabilities	**518.1**	792.3	**197.0**	454.9	**379.6**	349.7
Other capital instruments	**350.4**	1,494.6	**131.1**	393.9	**219.3**	1,100.7
Equity	**4,676.4**	3,035.1	**2,441.2**	1,883.1	**2,224.3**	1,137.6
Total equity and liabilities	**95,229.9**	110,874.4	**40,102.2**	44,946.8	**55,324.3**	66,095.9

* The 2010 Balance Sheets have been restated to reflect the change in EIR accounting policy and accounting reclassifications (refer to note 3 for further details of the restatement).

The Balance Sheet has decreased by £15.6bn to £95.2bn from £110.9bn since December 2010.

Lending balances were £8.2bn (10%) lower, reducing to £75.3bn (2010: £83.5bn) during the year, reflecting £6.5bn of secured residential redemptions, £0.2bn of commercial redemptions, £0.4bn unsecured loan redemptions and £1.1bn of other capital repayments.

Wholesale asset balances were £5.0bn lower at £11.8bn (2010: £16.8bn) primarily reflecting disposals and lower core liquidity requirement as the Balance Sheet runs off.

Liabilities

Statutory Debt and HM Treasury loans reduced by £2.15bn to £46.6bn (2010: £48.7bn) due to repayments having been made in the year (NRAM: £2.0bn, B&B: £0.15bn). UKAR did not draw down on any facility during the year. In addition, £9.6bn of other funding was repaid in the year. Capital instruments have also reduced as a result of the exercise which repurchased £1,159.4m of subordinated liabilities and other issued capital.

Cash repayments

At the start of the year, UKAR had £33.0bn of funding from HM Treasury, plus a further £15.7bn owed to the Financial Services Compensation Scheme ('FSCS'). Repayment of this debt remains a primary objective of UKAR. In the year £2.15bn of HM Treasury debt was repaid, and, in addition, other cash flows were generated for Her Majesty's Government in the form of State guarantee fees, interest and taxes. The Board considers the total of all these cash flows paid to HM Treasury to be an important measure. Total cash repayments to HM Treasury in 2011 were £2.8bn (2010: £1.6bn).

Financial review (continued)

Capital

The regulated Group companies met their capital requirements in full throughout the year and have received no additional capital from HM Treasury on nationalisation, or subsequently.

Capital resources - B&B plc

At 31 December	2011 £m	2010 £m
Share capital and reserves	**2,331.1**	1,896.4
Available-for-sale reserve adjustments	**(19.6)**	(14.0)
Cash flow hedge reserve adjustments	**(46.6)**	26.5
Net pension deficit adjustments	**(77.6)**	56.6
Less: deductions	**(508.3)**	(478.3)
Tier 1 capital	**1,679.0**	1,487.2
Subordinated liabilities	**81.5**	277.0
Total capital	**1,760.5**	1,764.2

Capital resources - NRAM plc

At 31 December	2011 £m	2010 £m
Share capital and reserves	**1,933.5**	777.0
Available-for-sale reserve adjustments	**124.6**	227.7
Cash flow hedge reserve adjustments	**(68.1)**	66.5
Pension scheme asset	**(49.8)**	(8.3)
Reserve capital instruments	**102.3**	156.2
Tier one notes	**42.9**	135.7
Less: deductions	**(1.2)**	-
Tier 1 capital	**2,084.2**	1,354.8
Subordinated notes	**23.4**	52.9
Subordinated liabilities	**150.7**	905.0
Total capital	**2,258.3**	2,312.7

The Board considers shareholder equity, formerly tier 1 capital, of pre-eminent importance in the capital structure of the business. It is in this context that the Board undertook the further buyback of capital instruments in the year. Although this resulted in total capital resources in the Group's regulated companies falling, the profits on the transactions benefit shareholder equity.

B&B plc total capital resources are £3.7m lower than 2010, the reduction being a result of the buyback of subordinated liabilities largely offset through profits generated in the year. Tier 1 capital is £191.8m higher due to the profits generated.

NRAM plc total capital resources are £54.4m lower than 2010, although tier 1 capital is £729.4m higher, mainly due to profits generated in the year net of capital instruments repurchased.

UKAR operates under a MIPRU regulatory status. Strictly the regulated companies within the Group are required to hold capital in excess of 1% of total Balance Sheet assets plus any undrawn commitments. However, the Board believes it should hold capital above 1% reflecting the increased risk in the business compared to a standard MIPRU firm, and at the year end capital in B&B plc represented 4% of B&B assets; NRAM plc capital represented 4% of NRAM assets.

Key performance indicators ('KPIs') - B&B

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

Strategic priorities	Financial measures	2011	2010*	Commentary
Optimise the Balance Sheet	Lending balances secured £bn	**34.1**	36.0	Lending balances reduced by 5% during the year due to £1.5bn of residential redemptions, £0.1bn commercial redemptions and £0.3bn of other capital repayments.
	Residential mortgage redemption rate % Residential redemptions £bn	**4.2** **1.5**	5.2 2.0	The slower redemption rate reflects the low interest rate environment and a lack of available alternatives for customers to move mortgages.
	Government loan repayments £bn Government loan balance £bn	**0.15** **26.9**	Nil 27.0	No drawdowns were made in the year from the WCF 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. The first repayment of £150m was made in December 2011.
	Total cash payments to HM Treasury £m	**654**	379	Total cash paid to HM Treasury during the year. This includes principal and interest repayments, State guarantee fees and tax paid. The main drivers of the increase year on year are £150m principal repayment and a £125m increase in interest payments on the WCF.
Minimise impairment and losses	Residential arrears balance : total residential mortgage balance % Residential payments overdue £m	**0.16** **52.6**	0.23 80.7	This represents the value of customers' missed payments as a proportion of the total balance of all residential mortgages.
	Residential arrears 3 months and over and possessions as % of the book: - by value - by number of accounts Number of residential arrears 3 months and over and possessions cases	 **3.91** **2.94** **8,767**	 5.59 4.09 13,096	The reduction in arrears reflects both the improvement in collections performance and continued low interest rates.
	Residential impairment provisions £m Cover % Residential provision balance: residential loans in arrears %	**718.1** **2.10** **28.2**	832.1 2.31 25.0	The level of the residential impairment Balance Sheet provision reduced by £114m, the level of cover reduced slightly but still remained over 2%.
Reduce costs	Total costs £m Ongoing costs £m** Ratio of costs to average interest-earning assets: - statutory % - ongoing %**	**128.9** **103.9** **0.33** **0.26**	126.4 112.3 0.29 0.26	The reduction in ongoing costs mainly reflects the benefits of investments in IT and telephony systems. Total costs in 2011 reflect the costs of integrating the two companies, 2010 included residual costs of nationalisation.

* 2010 has been restated reflecting the changes to EIR policy. Details of the change are provided in note 3.
** 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 12.

Key performance indicators ('KPIs') - NRAM

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

Strategic priorities	Financial measures	2011	2010*	Commentary
Optimise the Balance Sheet	Total lending balances £bn Secured £bn Unsecured £bn	**41.2** **38.7** **2.5**	47.6 44.5 3.1	Lending balances reduced by 13% during the year due to £5.0bn of residential redemptions, £0.4bn of unsecured loan redemptions and £1.0bn of other capital repayments. Unsecured balances include both the Together and Standalone unsecured loan books.
	Residential mortgage redemption rate % Residential redemptions £bn	**11.2** **5.0**	8.7 4.3	The increased rate reflects a higher level of redemptions partly driven by waiving Early Redemption Charges coupled with a lower opening book.
	Government loan repayments £bn Government loan balance £bn	**2.0** **19.7**	1.1 21.7	£2.0bn of repayments have been made since the end of 2010, increasing total repayments to the Government to £3.1bn since 1 January 2010.
	Total cash payments to HM Treasury £m	**2,184**	1,248	Total cash paid to HM Treasury during the year. This includes principal and interest repayments, State guarantee fees and tax paid. The main driver of the increase year on year is £0.9bn higher principal repayments on the Government loan.
Minimise impairment and losses	Residential arrears balance : total residential mortgage balance % Residential payments overdue £m	**0.47** **181.3**	0.44 192.9	This represents the value of customers' missed payments as a proportion of the total balance of all residential mortgages.
	Residential arrears 3 months and over and possessions as % of the book: - by value - by number of accounts Number of residential arrears 3 months and over and possessions cases	 **8.97** **7.19** **24,449**	 8.01 6.58 25,419	The reduction in arrears reflects both the improvement in collections performance and continued low interest rates.
	Residential impairment provisions £m Cover % Residential provision balance: residential loans in arrears %	**926.4** **2.35** **15.7**	1,013.0 2.24 17.2	The level of the residential impairment Balance Sheet provision reduced by £86.6m although the level of cover increased from 2.24% to 2.35%.
Reduce costs	Total costs £m Ongoing costs £m** Ratio of costs to average interest-earning assets: - statutory % - ongoing %**	**156.9** **116.7** **0.28** **0.21**	303.6 165.2 0.48 0.26	The reduction in ongoing costs reflects the full year impact of the restructuring undertaken in 2010 as part of the transfer of NRAM to UKAR, and the benefit of access to UKAR services and contracts. This has been partly offset by investment in supporting customers in financial difficulty. In addition, total costs were lower year on year due to lower spend on the integration into UKAR which, in 2010, included the cost of separation from Northern Rock.

* 2010 has been restated reflecting the changes to EIR policy. Details of the change are provided in note 3.
** 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 12.

Directors' remuneration report

This section of the Annual Report outlines the role and responsibilities of the UKAR Remuneration Committee (which covers the UKAR, B&B and NRAM businesses), summarises the key areas of focus for the year and provides details of the remuneration for Directors. This remuneration report does not form part of the Financial Statements and is not audited, although the Directors' emoluments figures are audited. It also outlines the overarching reward policy covering all colleagues. The Non-Executive Directors have service contracts with UKAR. All Executive Directors and colleagues were employed by B&B (the legal employer) during 2011.

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

FSA Remuneration Code

UKAR is not required to comply with the FSA's Remuneration Code as non-banks are not in scope, but continues to ensure the principles of the Code underpin its remuneration policies and practices.

Advisors

PricewaterhouseCoopers LLP were independent advisors to UKAR's Remuneration Committee until September 2011. Following PricewaterhouseCoopers' ('PwC') appointment as UKAR auditors, New Bridge Street were appointed as independent advisors to the Remuneration Committee in September 2011. New Bridge Street is a trading name of Aon Hewitt Limited.

During the year, advice was received from the advisors on market practice together with updates on legislative and regulatory changes.

Remuneration policies

UKAR operates reward and incentivisation policies that aim to support the achievement of our overall business strategy and promote sound risk management. Levels of remuneration are set so as to be sufficient to attract, retain and motivate employees of the quality required to run UKAR successfully but without paying more than is necessary for this purpose. A significant proportion of the remuneration for the senior management team is linked to corporate and individual performance. The Committee takes into account the pay and employment conditions in other companies when setting the remuneration policy for the senior team.

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 Board all aspects of the remuneration arrangements for Executive Directors, Senior Executives, Approved Persons and Code Employees (as defined by the FSA Remuneration Code) across the Group 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 colleagues and monitors and advises on any major changes in employee benefit structures throughout the Companies. The full Terms of Reference for the Committee are available on the corporate website.

The Remuneration Committee met eight times during 2011 to consider, amongst other items, deferred incentive payments for previous years, incentive schemes, salary reviews and best practice approaches to remuneration.

During the year the Chairman, the CEO, HR Director, Risk Director and Head of Reward were invited to attend Remuneration Committee meetings for those items other than their own arrangements, and to provide advice.

The Remuneration Committee was composed entirely of Non-Executive Directors as outlined in Table 1 below.

Table 1 - Remuneration Committee membership for 2011

Sue Langley (Chair)
Louise Patten
Keith Morgan

Executive Directors

Appointment of Finance Director

Phillip McLelland, Finance Director, was appointed to the Board with effect from 1 July 2011.

Directors' remuneration report (continued)

Service agreements

Table 2 - Executive Directors' service contracts

	Date of appointment to UKAR*	Company's notice period	Director's notice period
Richard Banks	01/10/2010	12 months	6 months
Phillip McLelland	01/07/2011	12 months	6 months

* Prior to this appointment Richard Banks was a Director of B&B.

Components of Executive Remuneration

Remuneration frameworks are structured to place appropriate importance on fixed pay and short to medium-term incentives.

- **Basic salary**

  Base salaries for individual Executive Directors are set on appointment and then reviewed annually by the Committee. Salaries are set with reference to individual performance, experience and contribution, together with developments in the relevant employment market and internal relativities. The Committee gives due consideration to the current economic climate and current market practice regarding Executive salary reviews and the broader employee salary review policy in UKAR.

  Richard Banks was appointed as Chief Executive Officer in October 2010 on a salary of £340,000 p.a. The Committee reviewed his salary during the year and awarded him a 2% increase (to £346,800 p.a.) effective from 1 October 2011.

  Phillip McLelland's salary of £250,000 p.a. was set on appointment in July 2011.

- **Short term incentive plan ('STIP')**

  The annual STIP incentive is linked to achievement of both UKAR targets and personal performance. There are five Key Performance Indicators ('KPIs'). These are pre-tax profit, costs, redemptions, impairment provisions and a balanced scorecard of other measures, aligned to internal controls and people management. As stated earlier, the FSA Remuneration Code does not apply to UKAR. However, UKAR seeks to follow the principles of the Code, wherever possible. Under the FSA Remuneration Code, for senior colleagues a minimum of 40% of variable pay is required to be deferred for a period covering not less than three years. The deferral percentage increases to 60% for larger firms and where an individual's variable pay is at least £500,000, substantially higher than at UKAR. However, UKAR has chosen to voluntarily apply deferral to all bonuses for the senior management population, and to apply the highest level of deferral of 60% of the bonus. Therefore, the first 40% of any incentive due is paid in March following the relevant year-end, with the remaining 60% deferred and payable in three equal instalments over the subsequent three years.

  The corporate KPIs were chosen to drive both financial and operational performance, aligned to the delivery of value for the tax-payer. They include targets for profit, redemptions, arrears and costs.

  Where incentive payments have been deferred, they will be paid subject to a malus provision, which enables the Committee to make downward adjustments in the event of a significant deterioration in performance or failure of risk management. Payment of each deferred tranche is subject to achievement of at least 75% of the previous year's profit target, (e.g. March 2013 payment is subject to achievement of 75% of the 2012 profit target).

  The range of metrics used to determine performance under the annual STIP and the deferral and malus provisions ensure that the annual STIP is aligned with UKAR's risk strategy. Together, these provisions ensure that incentives can and will be scaled back in the event of poor corporate or individual performance. Both Richard Banks and Phillip McLelland are eligible for this incentive arrangement and received the following awards for 2011.

Table 3 - Executive Directors' STIP awards

	Type of award	Amount	Date of payment
Richard Banks	2011 STIP	£49,938	March 2012
		£24,970	March 2013
		£24,970	March 2014
		£24,970	March 2015
	Total	**£124,848**	
Phillip McLelland	2011 STIP	£46,000	March 2012
		£23,000	March 2013
		£23,000	March 2014
		£23,000	March 2015
	Total	**£115,000***	

* Note this award covers the full year to 31 December 2011, including the 6 months prior to his appointment.

Directors' remuneration report (continued)

- **Medium term incentive plan ('MTIP')**

During the year a new medium term incentive plan was established to incentivise senior management to accelerate the delivery of shareholder value over and above the STIP targets. The MTIP is based on increasing shareholder value and faster repayment of the government loans with targets set for a three year period, 2011-2013. The maximum payment for the MTIP over three years is up to 60% of 2011 salary based on the achievement of an overall three year stretch target set in 2011. Incentive milestones are set over a three year period 2011-2013 and payments may be made in 2013 and 2014. Both Richard Banks and Phillip McLelland are eligible for this incentive arrangement subject to achievement of the targets.

- **Payment of deferred STIP**

Details of the deferred remuneration of the Executive Directors relating to previous years' annual STIP are shown in Table 4. In 2011, the Remuneration Committee determined that business and individual performances were sufficient to allow the relevant tranches of the deferred awards to vest in full.

- **Senior Executives' Scheme**

In 2010, Phillip McLelland was a member of the Bradford & Bingley Senior Executives' Scheme.

Table 4 - Executive Directors' deferred annual STIP and Senior Executives' Scheme awards

	Type of award	**Amount granted**	Date of payment	Amount	Paid during 2011	Amount outstanding at 31 December 2011
Richard Banks[1]	2009 Annual STIP	**£30,000**	2010[1]	£10,000	£10,000	-
			2011	£10,000	£10,000	-
			2012	£10,000	-	£10,000
	2010 Annual STIP	**£170,000**	2011	£73,100	£73,100	-
			2012	£32,300	-	£32,300
			2013	£32,300	-	£32,300
			2014	£32,300	-	£32,300
Phillip McLelland[2]	2009 Scheme		2012	£11,333	-	£11,333
	2010 Scheme		2012	£12,075	-	£12,075
			2013	£12,075	-	£12,075
			2014	£12,075	-	£12,075

1 Richard Banks elected to defer receipt of the first deferred payment of the 2009 STIP which would have been due in 2010 as the business had not yet made a profit.
2 In respect of Phillip McLelland, the table shows deferred elements of awards granted before his appointment as a Director.

- **Pensions and other benefits**

Richard Banks receives a cash supplement of 30% of basic salary in lieu of UKAR pension benefit.

Phillip McLelland, who became a UKAR Director on 1 July 2011, is a member of the UKAR Pension Plan, a stakeholder plan. He receives a 15% of salary employer contribution into the Plan. From 1 July 2011 to 31 December 2011, he contributed £3,750 into the Plan.

In line with typical market practice, other executive benefits are provided in the form of a company car allowance, private medical insurance, life assurance, income protection and accident insurance. Richard Banks also receives a housing allowance.

In 2011, 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 £1,944 (2010: £23,714). NRAM pension payments due to former Directors, paid directly by NRAM and not connected to the NR Staff Pension Scheme, amounted to £289,623 (2010: £277,306).

Phillip McLelland is eligible to be considered for redundancy payments in line with UKAR's redundancy policy. Richard Banks is not entitled to such payments.

The emoluments for Richard Banks and Phillip McLelland are detailed in Table 6 on page 24.

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 of UKAR who held external directorships during 2011. One was with Liverpool Compact Education Business Partnership for which he received no fees (2010: £nil) and the second was with ICICI Bank UK plc for which he received fees of £50,000 (2010: £50,000). In both cases, he held these appointments for all of 2011.

Directors' remuneration report (continued)

Non-Executive Chairman and Non-Executive Directors' fees

The Chairman Richard Pym's total annual fees were unchanged at £250,000 p.a. during the year. However, recognising the business is one in wind-down Mr Pym has offered to reduce his fees by 5% with effect from 1 January 2012 and this reduced level will apply throughout 2012.

There has been no change to the fee structure for Non-Executive Directors since the 2010 report, with the basic fee set at £50,000 p.a. plus £15,000 for each Chair held, and £5,000 for each Committee membership. The Non-Executive Directors have also volunteered to reduce their fees by 5% and this will take effect from 1 October 2012.

Non-Executive Directors did not participate in any incentive arrangements, did not have employment contracts and did not receive any other benefits. Table 5 outlines the Non-Executive Directors' terms of appointment and the emoluments of the Non-Executive Chairman and Non-Executive Directors for the year are detailed in Table 6.

Table 5 – Non-Executive Directors' terms of appointment

	Date of appointment	Contract end date	Company's notice period	Director's notice period
Richard Pym	1 October 2010	31 December 2013	3 months	3 months
Kent Atkinson	1 October 2010	31 December 2013	3 months	3 months
Michael Buckley	1 October 2010	31 December 2013	3 months	3 months
Sue Langley	1 October 2010	31 December 2013	3 months	3 months
Keith Morgan	1 October 2010	31 December 2013	3 months	3 months
Louise Patten	1 October 2010	31 December 2012	3 months	3 months
John Tattersall	1 October 2010	31 December 2013	3 months	3 months

Directors' remuneration report (continued)

Table 6 - Directors' Emoluments for the year ended 31 December 2011

Table 6 below sets out the total emoluments paid to those Directors who were Directors of UKAR Group companies at 31 December 2011 in respect of their services in 2011 to companies within the UKAR Group.

Executive Directors	Basic salary/ fees[1]	Non-cash benefits	Allowances	Payment in lieu of pension/ pension contributions	STIP non-deferred[2]	STIP deferred[2]	Total emoluments 2011	Total emoluments 2010
Richard Banks[3]	£341,700	£1,239	£26,400	£102,510	£49,938	£74,910	**£596,697**	£552,011
Phillip McLelland[4]	£125,000	£650	£3,660	£18,750	£46,000	£69,000	**£263,060**	-
Gary Hoffman[5]	-	-	-	-	-	-	-	£604,300
Andrew Tate[6]	-	-	-	-	-	-	-	£250,200
Total	**£466,700**	**£1,889**	**£30,060**	**£121,260**	**£95,938**	**£143,910**	**£859,757**	**£1,406,511**
Non-Executive Directors								
Richard Pym	£250,000	-	-	-	-	-	**£250,000**	£250,000
Kent Atkinson	£70,000	-	-	-	-	-	**£70,000**	£70,000
Michael Buckley	£65,000	-	-	-	-	-	**£65,000**	£67,000
Sue Langley[7]	£70,000	-	-	-	-	-	**£70,000**	£60,000
Keith Morgan[8]	-	-	-	-	-	-	-	-
Louise Patten	£60,000	-	-	-	-	-	**£60,000**	£58,500
John Tattersall	£70,000	-	-	-	-	-	**£70,000**	£44,000
Robert Davies[9]	-	-	-	-	-	-	-	£68,750
Philip Remnant[10]	-	-	-	-	-	-	-	£45,000
Total	**£585,000**	-	-	-	-	-	**£585,000**	**£663,250**
Grand Total	**£1,051,700**	**£1,889**	**£30,060**	**£121,260**	**£95,938**	**£143,910**	**£1,444,757**	**£2,069,761**

1 The only element of pay that pension salary supplement/pension contributions were calculated on.

2 STIP payment is subject to the rules on deferral and malus as outlined earlier in this report.

3 The increase reflects Richard Banks' appointment as CEO of UKAR and NRAM in addition to his role as Managing Director of B&B in 2010.

4 Phillip McLelland was appointed as an Executive Director with effect from 1 July 2011 at an annual salary of £250,000. The emoluments shown in the table reflect his remuneration in the period from appointment to 31 December 2011. The STIP amounts shown represent the amount awarded for the full year to 31 December 2011, including the 6 months prior to his appointment.

5 Gary Hoffman was Chief Executive and a Director of both Northern Rock plc and NRAM for the period from 1 January 2010 to 30 September 2010. During this period his remuneration was agreed by the Remuneration Committee of Northern Rock plc. The emoluments shown in Table 6 represent 50% of his total remuneration for that period and is the amount paid by NRAM to Northern Rock plc under the terms of a service agreement.

6 Andrew Tate was employed and paid by Northern Rock plc and was a Director of NRAM for the period 1 January 2010 to 30 September 2010. During this period his remuneration was agreed by the Remuneration Committee of Northern Rock plc. The emoluments shown in Table 6 represent 50% of his total remuneration for that period and is the amount paid by NRAM to Northern Rock plc under the terms of a service agreement.

7 Sue Langley's fees are not paid directly to her. The fees shown in Table 6 were paid to Lloyd's of London during 2011 for her services.

8 Keith Morgan, as the representative of UKFI, does not receive any fees in respect of his services as a Director.

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

10 Philip Remnant stood down with effect from 30 September 2010.

Corporate governance

Introduction

UKAR is the holding company established on 1 October 2010 to bring together the businesses of B&B and NRAM.

UKAR itself is 100% owned by the UK Government which exercises control through UK Financial Investments ('UKFI') which was set up on 3 November 2008 to manage the Government's investments in Royal Bank of Scotland, Lloyds TSB, Northern Rock and B&B.

UKAR governs and controls NRAM and B&B, as their sole shareholder.

Although managed under a common board and management structure, NRAM and B&B (the 'Principal Subsidiaries') remain separate legal entities and continue to operate as individual companies with their own individual brands and balance sheets.

This corporate governance section summarises the governance regime applicable to UKAR including its Principal Subsidiaries (the 'Group') at the date of this report.

Our Board

UKAR, B&B and NRAM share a common Board of Directors. The individual profiles included in this section therefore set out the Directorships of all three companies.

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. Formerly, he was a Vice President of the British Bankers' Association, a Non-Executive Director of Old Mutual plc, Selfridges plc, and Chairman of Halfords Group plc. Richard is a Fellow of the Institute of Chartered Accountants in England and Wales.

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 since January 2010. He is our 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 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 and a member of the Audit and Risk Committees of the Bank of Ireland as well as being a Non-Executive Director and a member of the Audit Committee and Mergers & Acquisition Committee of Gemalto NV. Until recently he was a Non-Executive Director and Chairman of the Group Audit and Compliance Committee and a member of the Risk and Investment Committees of Standard Life plc. He was formerly a Non-Executive Director, Chairman of the Audit Committee and a member of the Risk Committee of Northern Rock plc, 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 and a member of the Audit Committee 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 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 is an Associate of the Chartered Institute of Banking.

Michael Buckley - Non-Executive Director

Michael joined the Boards of UKAR and NRAM in October 2010, and has been a Non-Executive Director of B&B since July 2007. 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 advisor to a number of privately held Irish and US based companies, 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.

Corporate governance (continued)

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 Development for Lloyd's of London, joining in July 2007, and a Director of Lloyd's Asia 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.

Phillip McLelland - Finance Director

Phillip joined the Boards of UKAR, NRAM and B&B in July 2011, having been Finance Director of the latter since June 2009. He is responsible for all aspects of reporting and financial control across the business.

Prior to joining B&B in 2000, Phillip worked at KPMG Consulting, Coopers & Lybrand and National & Provincial Building Society. He is a member of the Chartered Institute of Management Accountants.

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 and NRAM.

Keith was a Non-Executive Director of Northern Rock plc until its sale to Virgin Money on 1 January 2012. Keith joined UKFI from Banco Santander where 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.

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 and the Nominations Committees of all three companies.

Louise is a Non-Executive Director of Capital Shopping Centres Group plc and Control Risks Group Holdings Limited as well as the senior advisor to management consultants Bain & Co. She began her career at Citibank and remained in financial services until 1993, when she joined Bain & Co, as a partner. Her previous experience as a Non-Executive Director includes the Hilton Group, Brixton plc, Great Universal Stores, Marks and Spencer Group plc 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 Committee and a member of the Audit Committee 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 UBS Limited, 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 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 2011 are as follows:

Richard Pym	Chairman for the whole of 2011
Kent Atkinson	Director for the whole of 2011
Richard Banks	Director for the whole of 2011
Michael Buckley	Director for the whole of 2011
Sue Langley	Director for the whole of 2011
Phillip McLelland	Appointed Director from 1 July 2011
Keith Morgan	Director for the whole of 2011
Louise Patten	Director for the whole of 2011
John Tattersall	Director for the whole of 2011

Corporate governance (continued)

Board and Committee meetings

During 2011, the number of meetings attended by each Director was as follows:

	Board	Audit	Nominations	Remuneration	Risk
Number of meetings held	**11**	**4**	**4**	**8**	**6**
Richard Pym	11/11		4/4		
Kent Atkinson	10/11	4/4			5/6
Richard Banks	11/11				
Michael Buckley	10/11	4/4	3/4		6/6
Sue Langley	11/11		4/4	8/8	
Phillip McLelland	5/5				
Keith Morgan	10/11			8/8	6/6
Louise Patten	10/11		4/4	8/8	
John Tattersall	11/11	4/4			6/6

During 2011, the Chairman of each Committee was as follows:

Audit Committee	Kent Atkinson
Risk Committee	John Tattersall
Nominations Committee	Richard Pym
Remuneration Committee	Sue Langley

The current membership of the Committees is set out on pages 29 and 30.

Governance structure

Since the transfer to public ownership, the governance structure has been determined by a framework document ('the Framework Document') agreed between UKAR and its Shareholder, HM Treasury. The Framework Document has been updated periodically to reflect changing circumstances and the Group 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 Group and UKFI, acting on behalf of 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 Group, UKFI, HM Treasury (as 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 Group to deliver a strategic and funding business plan to achieve these objectives.

The principles of the Framework Document

The relationship between the Group 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 Group'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 Group's performance to satisfy itself that the Plan is on track; and
- Is required to give its consent for certain significant actions.

Corporate governance (continued)

Board structure and governance

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 29 and 30.

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, balance of experience and diversity. To achieve this and ensure that a common governance approach is applied, the Group operates 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 Group 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 Group and decisions made, or to be made, by the Board in order to assist with the exercise of their powers and duties as Directors;
- 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 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, 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 2011, the Board was responsible for developing and delivering the Plan to restructure the Group in order to meet the State Aid requirements of the European Commission.

The Board is responsible for:

- Setting the Group's strategic aims and 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 Group, 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 Group to deliver the agreed Plan, set the Group's values and standards and ensure that its obligations to HM Treasury as 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.

Monitoring performance

UKFI monitors the Group's performance against the Plan by means of the following main mechanisms:

- Meetings between the Group 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 Group'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.

Corporate governance (continued)

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 four times in 2011.

The Committee monitors, reviews and advises the Board on:

- All regulatory, prudential and accounting requirements that may affect the Group;
- The integrity of the Financial Statements and external reporting responsibilities;
- The 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 Group'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 Group by the Internal Audit function.

In 2011, the Committee put out a tender for the external auditor's service and made a recommendation that PricewaterhouseCoopers LLP ('PwC') be appointed for the entire Group. The Board accepted this recommendation and an appropriate resolution was passed at the 2011 Annual General Meeting.

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 six times in 2011.

The main role of the Risk Committee is to review the key risks inherent in the business, the systems of control necessary to manage such risks, and to present its findings to the Board. The Head of Internal Audit and external auditors regularly attend the meetings.

This responsibility requires the Risk Committee to keep under review the effectiveness of the Group'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 Group. 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 Group'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 Group's material risk exposures in relation to the Group's risk appetite and capital adequacy.

The Risk Committee also ensures that the public disclosure of information regarding the Group'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 eight times in 2011.

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.

Corporate governance (continued)

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 Nominations Committee met four times in 2011.

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 Group and succession plans for key executive roles.

Management Committees

The Group operates a number of Management Committees, including an Executive Committee ('EXCO'), details of which are set out on pages 32 and 33.

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.

Induction and training

The Group 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 Group 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.

A comprehensive thematic training programme is in existence.

Board evaluation

During 2011, a Board evaluation exercise was conducted by the Chairman with assistance from the Company Secretary.

All Executive Directors, Non-Executive Directors and the Chairman participated in the appraisal of the Board and its Committees to ensure that their operation continued to be of the highest standard. The appraisal process consisted of a questionnaire and meetings with Directors that canvassed their views on a wide range of matters including the effectiveness of the Board, its Committees and the Chairman. In addition, the evaluation also considered the Board meeting process, the composition of the Board and the interaction between the Board and its Committees.

The Company Secretary reported to the Chairman on the outcome of the evaluation exercise, which showed that the Board and its Committees are discharging their responsibilities effectively. The appraisal produced a number of recommendations to further improve effectiveness of the Board which are to be implemented during the course of 2012.

Board procedures

To ensure that the Group 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 Group's expense.

Internal control and risk management

The Board is responsible for the Group'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 2011, the Group 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 Group. During the year, the Board has continued to review the effectiveness of the Group's system of financial and non-financial controls including operational and compliance controls, risk management and the Group'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 risk management and internal controls. The Board of Directors is not aware of any significant risk events or internal control failures that arose across the Group during 2011 that are not being addressed in accordance with the internal control procedures of the Group.

The Group 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)

Under the risk management framework, the Group operates a risk management process, producing an enterprise-wide risk profile. This identifies the Group's significant risks, the probability of those risks occurring and their impact should they occur. Management regularly takes action to improve the design and operation of suitable controls, either as a result of its own initiative, or in response to reports from Internal Audit and other oversight review functions.

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 Group's internal control systems. The Risk Committee and the Audit Committee oversee the risk management process, regularly consider the enterprise-wide risk profile, and receive monitoring reports to update them on progress.

The system of risk management and internal control has been in place throughout 2011 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 Group's significant risks and how these are being managed. The Risk Committee also considers reports from Compliance and from 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

The Directors have assessed, in the light of current and anticipated economic conditions, the Company's and the Group's ability to continue as a going concern. As set out in the Annual Reports and Accounts of B&B and NRAM, HM Treasury has provided various on-demand facilities to each of those companies, and has provided confirmation to the Directors of those two companies that it is HM Treasury's intention to fund those companies so as to maintain them as a going concern, and to enable those companies to meet their debts as and when they fall due, for a period up to at least 1 October 2013. Accordingly, the Directors of B&B and NRAM are satisfied at the time of approval of these Financial Statements that the B&B and NRAM companies and groups have adequate resources to continue in business for the foreseeable future. The Directors of the Company confirm that, therefore, they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future, and for this reason they continue to adopt the going concern basis in preparing the Financial Statements.

Risk management and control

Pages 32 to 36 form an integral part of the audited Financial Statements

Introduction

In accordance with the requirements in the Framework Document referred to on page 27, the Group'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 Group's approach to risk management, including the major risk categories under management. Other factors could also affect Group results, including economic factors. Therefore, the categories of risk described below should not be considered to represent all of the potential risks and uncertainties which could impact the Group.

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 the Group'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 the Risk Function.

Risk Committees

The Board and management committees, under the authority delegated by the Board are described below:

Risk Committee ('RC')

The main role of the RC is to review the key risks inherent in the business, the systems of control necessary to manage such risks, and to present its findings to the Board. The Head of Internal Audit regularly attends the meetings.

This responsibility requires the RC to keep under review the effectiveness of the Group'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 Group. 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 Group's risk appetite, strategy and policies.

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

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

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 EXCO have been established:

- Executive Risk Committee; and
- Fraud & Professional Negligence Committee

Executive Risk Committee ('ERC')

The ERC is a management sub-committee of EXCO with a reporting line to the RC. The primary objective of the ERC 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 makes recommendations to EXCO and the RC.

Fraud & Professional Negligence Committee ('FPNC')

The FPNC is a management sub-committee of EXCO. The FPNC 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 FPNC supports risk oversight of key fraud and professional negligence matters through reporting into the ERC.

The following are sub-committees of the ERC.

Asset & Liabilities Committee ('ALCO')

The primary objectives of ALCO are to support, advise and make recommendations to the ERC 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.

Risk management and control (continued)

Pages 32 to 36 form an integral part of the audited Financial Statements

Operational Risk Committee ('ORC')

The ORC is a management sub-committee of the ERC. Principally, ORC supports the EXCO in its oversight of the principal subsidiaries' 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.

Risk management oversight

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 advisory and management committees. Key functional responsibilities comprise:

- Development of a Group strategy, framework and policies for financial, strategic and operational risk;
- Operational risk management, aligned with business requirements;
- Provision of support to the Group business line management in the implementation of the risk management framework;
- Aggregate analyses of risk concentrations and sensitivities across the principal subsidiaries;
- 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 Board, EXCO, the RC, ERC 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.

Compliance

The role of Compliance is to:

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

Internal audit

Internal Audit responsibilities reside with Ernst & Young LLP, including the provision of a seconded Head of Internal Audit. This person is approved for the position by the FSA and by the Board. However, the oversight of the Internal Audit function remains with the Group. 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 in mitigating current and evolving key risks and in so doing, assist the organisation in enhancing the effectiveness of the approach to risk management within the organisation.

Business and support activities of the Group 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

(i) Credit risk

Credit risk is the potential for financial loss caused by a retail or commercial customer, or wholesale counterparty, failing to meet their obligations to the principal subsidiaries as they become due. As the principal subsidiaries are no longer making any new retail loans, the absolute level of retail credit risk is expected to decline as the current assets mature and wholesale credit risk will decline in line with the maturity profile of financial instruments and investments. Credit risk is the largest risk the principal subsidiaries face and the monitoring of the recoverability of loans and amounts due from counterparties is inherent across most of the principal subsidiaries' activities.

The principal subsidiaries employ 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 principal subsidiaries' assets and therefore the financial performance of each subsidiary.

As credit risk is the main risk to the principal subsidiaries, a credit risk framework has been established as part of the overall governance framework to measure, mitigate and manage credit risk within risk appetite. To a lesser degree, the Group 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 32 to 36 form an integral part of the audited Financial Statements

Risk categorisation (continued)

(i) Credit risk (continued)

The extent to which credit risk in the Group'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 2011 £m	Provision 2011 £m	Balance Sheet value 2010 £m	Provision 2010 £m
Advances secured on residential property	**71,913**	**1,645**	79,397	1,845
Other secured advances	**857**	**102**	1,033	89
Unsecured personal loans	**2,524**	**502**	3,114	542
Wholesale assets	**11,765**	**768**	16,832	776

The principal subsidiaries' ability to influence the structure of their credit risk profiles, in the absence of asset sales, is largely restricted to the degree of control which they have 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 principal subsidiaries' credit risk profiles are now determined by the credit quality of the existing portfolio. Changes in credit quality will arise 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 whilst mitigating credit risk.

It is Group policy to monitor the profile of the principal subsidiaries' lending exposure on a quarterly basis. Changes in the risk profile are reported as part of the subsidiaries' 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 ERC.

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 ERC 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. Wholesale Credit related policies and limits are developed and maintained within Wholesale Risk and Finance with Treasury related credit policies approved by the Board at least annually, or when significant changes to policies are recommended.

The principal subsidiaries each hold 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 2011.

Risk management and control (continued)

Pages 32 to 36 form an integral part of the audited Financial Statements

(ii) Market risk

Market risk is the potential for 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. The principal subsidiaries do not trade or make markets in any areas and market risk arises only as a consequence of carrying out and supporting core business activities.

Interest rate risk

Interest rate risk within the principal subsidiaries can be subdivided into the following:

- Mismatch risk. The effect that variations in the relationship between different points on the yield curve indices have on the value of fixed rate assets and liabilities.
- Prepayment risk. The effect that variations in early repayment have on expected run-off profiles of fixed rate loans and, therefore, on the effectiveness of hedging transactions.
- Basis risk. Created where balance sheet assets and liabilities are sensitive to different underlying interest rates or indices.
- Reset risk. Exposure to the timing of repricing of assets and liabilities or to a sudden spike in a key underlying floating rate index on a particular day.

The most significant form of market risk to which the principal subsidiaries are exposed is interest rate risk. This arises from the interest rate characteristics of their assets and liabilities. The principal subsidiaries have legacy mortgage products with varying interest rate features and maturities which create potential interest rate risk exposures which arise as a result of timing differences on the repricing of assets and liabilities. As the mortgage book declines, the extent of interest rate risk will decline.

Treasury is responsible for managing these exposures within the risk exposure limits set out in the UKAR Market Risk Policy, as approved by the Board and managed by ALCO. These policies set out the nature of the market risks that may be taken, along with aggregate risk limits, and stipulate the procedures, instruments and controls to be used in managing market risk.

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

Risk exposures are controlled by limits which require Treasury to manage proactively, expected interest margins and market value to within pre-defined limits. In addition, the impact of specific stress scenarios on portfolio exposures are analysed to ensure that unexpected events do not carry unacceptable risk levels. The results of these analyses are presented to ALCO monthly, in order to identify, measure and manage the principal subsidiaries' exposure to interest rate risk.

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 rated banking counterparties. The principal subsidiaries also take advantage of the natural offset of their asset and liability positions to minimise the costs and risks of arranging transactions externally to the subsidiaries.

Foreign exchange risk

Foreign exchange risk can result in volatility in earnings resulting from movements in exchange rates altering the sterling value of unmatched foreign currency income streams, assets and liabilities (principally US$ and Euro positions).

Prior to nationalisation, the principal subsidiaries raised and invested funds in currencies other than sterling. Accordingly, foreign exchange risk arises from activities related to the principal subsidiaries' managing borrowing costs and investment returns (the underlying asset and liability balances are set out in note 37e). As with interest rate risk, Treasury is responsible for managing this exposure within the limits set out in the Group's policies.

The principal subsidiaries do not actively seek foreign exchange exposures and any that arise naturally from their net interest income streams denominated in the foreign currencies, are subject to limits set out in the Group Market Risk Policy that is approved by the Board and managed by ALCO. The principal subsidiaries will remain exposed to foreign exchange risk until all assets and liabilities denominated in foreign currencies have matured or been sold.

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

(iii) Liquidity risk

Liquidity risk represents the risk of being unable to pay liabilities as they fall due and arises from the mismatch in cash flows generated from current and expected assets, liabilities and derivatives.

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

Liquidity risk management is set out in the UKAR Liquidity Policy as approved by the Board and managed by ALCO. The policy considers the quality of liquidity assets as well as projected funding requirements. The principal subsidiaries obtain 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 Group remains dependent on the markets, as it principally generates liquidity in foreign currencies by converting funds from sterling. Thus, whilst liquidity risk in sterling is very 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.

Risk management and control (continued)

Pages 32 to 36 form an integral part of the audited Financial Statements

(iv) Operational risk

Operational Risk is defined as:

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

The Operational Risk Framework includes a balance of policies, appropriate procedures and internal controls to enable effective identification, assessment, mitigation and reporting of key Operational Risks. The framework is overseen and reported on by the Operational Risk Function. The key objectives of the framework are 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 the Group. Where controls are assessed as ineffective in design or operation, a defined Corrective Action Plan process is in place to develop, track and implement control improvements.

Operational Risk Event Reporting

Provision of a consistent framework for the identification, investigation, assessment and reporting of Operational Risk Events (losses, gains and near misses) across the Group. Root cause analysis performed as part of Operational Risk Event Reporting enhances the control environment by directing control improvement effort where there is a risk of event recurrence.

Operational Risk Stress Testing and Scenario Analysis

We undertake operational risk stress testing and scenario analysis to calculate the financial impact of both expected and unexpected operational risk events. This analysis facilitates a comparison between operational risk, financial exposure and the operational risk capital allocation derived under the Group's capital adequacy assessment process.

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

Corporate social responsibility report

UKAR aims to conduct its business in a socially responsible manner in respect of our customers, the workplace, the communities we operate in and the environment.

Customers

Our subsidiary businesses have some 722,000 customers, making us the sixth largest mortgage service provider in the UK.

We are committed to:

- Ensuring that simplicity, integrity and truth applies to everything we do;
- Supporting vulnerable customers; and
- Supporting customers in financial difficulty.

Workplace and employees

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

UKAR runs an apprenticeship scheme in conjunction with Shipley College at our Crossflatts (West Yorkshire) site and the North East Chamber of Commerce at our Doxford (Sunderland) site. There have been 29 members of the scheme over this period and 12 have gone on to secure roles in the business. All apprentices are offered the opportunity to obtain a National Vocational Qualification ('NVQ') in Business Administration or Customer Service as well as valuable on the job training.

We are committed to:

- Developing our colleagues' skills;
- Enabling colleagues to improve their health and wellbeing; and
- Encouraging a diverse workforce with equal opportunities for all.

The recognised union for employees is Unite.

Community

We are committed to:

- Using the skills of the business to support education in our communities;
- Building the skills of our colleagues through community engagement; and
- Supporting colleagues with their own community and charity initiatives.

During 2011, UKAR supported charities tackling homelessness through Business Action on Homelessness in Crossflatts (West Yorkshire), and Shelter in both Doxford (Sunderland) and Gosforth (Newcastle upon Tyne). In total, £47,674 was donated to homeless charities.

At each site we also supported a local charity chosen by our colleagues. These were Sue Ryder - Manorlands in Crossflatts, St Benedict's Hospice in Sunderland and the Cystic Fibrosis Trust in Gosforth. The following amounts were raised for these charities in 2011:

- Sue Ryder - Manorlands £11,398;
- St Benedict's Hospice £11,150; and
- Cystic Fibrosis Trust £7,563.

£2,552 was also donated to the Samaritans in 2011.

UKAR supports other charitable fundraising activities by adding up to £250 to funds raised per employee and by matching employee donations to charity through a payroll giving programme. During the year, UKAR matched employee fundraising to the total of £12,789 and payroll giving totalled £18,762.

During 2011, 478 employees took part in team volunteering events.

UKAR is now working with Young Enterprise to give colleagues the opportunity to have a positive impact on young people in the local communities by volunteering to deliver their programmes in local schools.

Young Enterprise is a charity set up to work with schools to inspire young people with the confidence, ability and ambition to succeed in a challenging and changing economy.

Corporate social responsibility report (continued)

The environment

We are committed to:

- Reducing environmental impact wherever possible;
- Increasing recycling programmes; and
- Creating awareness of environmental programmes and engaging colleagues in these activities.

We seek to improve our environmental performance through a range of initiatives and in 2011 we achieved the following:

Recycling	90.1% of waste recycled
Landfill	9.9% of waste sent to landfill
Carbon*	reduced by 21% in the year

* Carbon produced from utilities (gas/electric consumption).

Wherever possible surplus furniture and equipment is donated to charitable organisations or is recycled in other ways.

Corporate social responsibility in 2012

UKAR's corporate charity in 2012 is NSPCC. We will also support the following local charities:

Crossflatts	Sue Ryder - Manorlands
Doxford	Tiny Lives Special Care Babies
Gosforth	The Sir Bobby Robson Foundation

Statement of Directors' responsibilities

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

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

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

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRS as adopted by the EU have been adopted, subject to any material departures disclosed and explained in the Financial Statements; and
- prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom 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 pages 5 and 6.

Review of business, future developments and uncertainties

A review of the business, future developments and uncertainties is set out in the CEO's review on pages 5 and 6.

Principal risks

Principal risks of the UKAR Group are covered on pages 32 to 36.

Property, plant and equipment

Land and buildings, which are included in the Balance Sheet at cost less accumulated depreciation, amounted to £29.0m at 31 December 2011 (2010: £40.8m). In the Directors' opinion, based on valuations carried out by the Group'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 2011.

Directors' interests

No Director has any interests in shares in the Group.

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

Major Shareholders

As at the date of this Report, all shares in UKAR are held by HM Treasury and all shares in B&B and NRAM are held by UKAR.

Employee involvement

UKAR is committed to providing employment practices and policies which recognise the diversity of our workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief.

Employees are kept closely involved in major changes affecting them through measures such as: team meetings, briefings, internal communications and engagement surveys. There are well established procedures, including regular meetings with our recognised union, to ensure that the views of employees are taken into account in reaching decisions.

UKAR is committed to providing employees with comprehensive coverage of the economic and financial issues affecting the Group. We have established a full suite of communication channels, including an extensive face-to-face briefing programme which allows us to update our employees on our performance and any financial issues throughout the year.

The Non-Executive Directors have service contracts with UKAR. All Executive Directors and colleagues were employed by B&B (the legal employer) during 2011.

Charitable and political donations

Details of the Company's charitable donations and corporate social responsibility activity can be seen on pages 37 and 38.

No contributions were made for political purposes in 2011 or 2010. The Group does not make any payments that might be deemed to be political in nature.

Creditor payment policy

The Company has no creditors other than other Group Companies. It is the policy of the Group to aim to pay creditor invoices within 30 days of the invoice date. The Group is willing to consider requests by small suppliers for a shorter settlement period. The UKAR Group's average number of creditor days in 2011 was 26 days (2010: 30 days).

Other matters (continued)

Directors' indemnities

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

UKAR 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 the 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.

UKAR has also arranged Directors' and Officers' 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 29 March 2012.

Auditor

A resolution to re-appoint PwC as the Group's auditor 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
1 March 2012

The Accounts

Notes to the Financial Statements

UKAR Limited Company Accounts

Notes to the Financial Statements

Independent Auditor's report to the Shareholder of UK Asset Resolution Limited

We have audited the Group Financial Statements (the 'Financial Statements') of UK Asset Resolution Limited for the year ended 31 December 2011 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Balance Sheet, the Consolidated Statement of Changes in Equity, the Consolidated Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRS') as adopted by the European Union.

Respective responsibilities of Directors and Auditors

As explained more fully in the Statement of Directors' Responsibilities on page 39, 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 Ethical Standards for Auditors.

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

Scope of the audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the Financial Statements. In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited Financial Statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group's affairs as at 31 December 2011 and of the Group's profit and cash flows for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the Group Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006, and Article 4 of the IAS Regulation.

Opinion on other matters 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.

Mark Hannam (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds
1 March 2012

Consolidated Income Statement

For the year ended 31 December	Note	2011 £m	2010 £m*
Interest receivable and similar income	4	**2,733.0**	2,679.5
Interest expense and similar charges	4	**(1,010.6)**	(806.6)
Net interest income	4	**1,722.4**	1,872.9
Fee and commission income		**43.1**	40.2
Fee and commission expense		**(14.3)**	(15.9)
Net fee and commission income		**28.8**	24.3
Net realised gains less losses on investment securities	5	**(1.2)**	8.6
Unrealised fair value movements on financial instruments	6	**79.2**	446.9
Hedge ineffectiveness	6	**(85.2)**	(62.0)
Provision for customer redress	27	**-**	(160.0)
Other operating income		**8.9**	10.0
Non-interest income		**30.5**	267.8
Net operating income		**1,752.9**	2,140.7
Administrative expenses:			
- Ongoing	7	**(220.6)**	(277.5)
- Other net expenses	7	**(65.2)**	(152.5)
Impairment on loans and advances to customers	16	**(390.4)**	(1,089.4)
Net impairment on investment securities	13	**(58.8)**	(0.5)
Defined benefit pension scheme gains	20	**3.5**	9.1
Gain on sale of insurance business	8	**-**	11.5
Gain on repurchase of capital instruments	9	**338.1**	845.7
Profit on disposal of credit linked notes	10	**15.6**	-
Profit before taxation		**1,375.1**	1,487.1
Taxation	11	**(213.8)**	(277.2)
Profit for the financial year		**1,161.3**	1,209.9

* Restated - see note 3.

The notes on pages 49 to 102 form an integral part of these Financial Statements.

The Group's business and operations comprise one single activity, principally within the United Kingdom, and the Group has only one operating segment for the purposes of IFRS 8 'Operating Segments'. The results above arise from continuing activities and are attributable to the equity shareholder.

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2011	Gross of tax £m	Tax £m	Net of tax £m
Profit for the financial year	**1,375.1**	**(213.8)**	**1,161.3**
Available-for-sale instruments:			
- net gains recognised in available-for-sale reserve during the year	**128.8**	**(21.2)**	**107.6**
- amounts transferred from available-for-sale reserve and recognised in profit during the year	**(3.5)**	**0.7**	**(2.8)**
Cash flow hedges:			
- net gains recognised in cash flow hedge reserve during the year	**83.6**	**(22.4)**	**61.2**
- amounts transferred from cash flow hedge reserve and recognised in profit during the year	**267.7**	**(25.5)**	**242.2**
Actuarial gains on retirement benefit obligations	**51.3**	**(15.5)**	**35.8**
Effect of funding plan for retirement benefit obligations	**117.6**	**(30.7)**	**86.9**
Total other comprehensive income	**645.5**	**(114.6)**	**530.9**
Total comprehensive income for the financial year	**2,020.6**	**(328.4)**	**1,692.2**

For the year ended 31 December 2010	Gross of tax £m	Tax £m	Net of tax £m
Profit for the financial year	1,487.1	(277.2)	1,209.9
Available-for-sale instruments:			
- net gains recognised in available-for-sale reserve during the year	176.1	(12.0)	164.1
- amounts transferred from available-for-sale reserve and recognised in profit during the year	32.1	(6.8)	25.3
Cash flow hedges:			
- net gains recognised in cash flow hedge reserve during the year	86.2	(12.2)	74.0
- amounts transferred from cash flow hedge reserve and recognised in profit during the year	(8.3)	6.7	(1.6)
Actuarial gains on retirement benefit obligations	1.6	(2.0)	(0.4)
Effect of funding plan for retirement benefit obligations	(117.6)	30.7	(86.9)
Total other comprehensive income	170.1	4.4	174.5
Total comprehensive income for the financial year	1,657.2	(272.8)	1,384.4

Consolidated Balance Sheet

	Note	31 December 2011 £m	31 December 2010* £m	1 January 2010* £m
Assets				
Cash and balances at central banks	12	**6,170.7**	7,291.8	7,828.3
Loans and advances to banks		**2,746.5**	5,615.6	5,611.5
Investment securities and unsecured investment loans	13	**2,848.1**	3,924.6	5,075.7
Loans and advances to customers	15	**75,294.4**	83,544.6	92,290.5
Fair value adjustments on portfolio hedging	15	**597.5**	762.8	1,265.5
Derivative financial instruments	35	**7,369.1**	9,471.6	11,134.4
Other assets	19	**42.7**	25.7	37.2
Current tax assets		**-**	-	45.4
Deferred tax assets	18	**0.8**	138.8	121.4
Retirement benefit assets	20	**49.8**	8.3	-
Investment property	21	**26.6**	26.6	-
Property, plant and equipment	22	**49.2**	60.7	136.9
Intangible assets	23	**34.5**	3.3	30.7
Total assets		**95,229.9**	110,874.4	123,577.5
Liabilities				
Deposits by banks		**4,075.9**	7,057.7	8,598.4
Other deposits		**-**	-	457.5
Statutory Debt and HM Treasury loans	24	**46,582.2**	48,707.7	49,784.9
Derivative financial instruments	35	**965.4**	1,358.3	2,339.4
Debt securities in issue	25	**38,061.5**	48,428.7	57,095.5
Other liabilities	26	**163.9**	228.3	304.5
Current tax liabilities		**114.6**	120.2	-
Retirement benefit obligations	20	**24.6**	194.1	102.6
Provisions	27	**215.0**	249.7	140.6
Capital instruments	28	**350.4**	1,494.6	2,762.4
Total liabilities		**90,553.5**	107,839.3	121,585.8
Equity				
Issued capital and reserves attributable to equity holder of the parent:				
- Share capital	29	**1.2**	1.2	1.2
- Reserves	30	**1,226.1**	817.9	556.1
- Retained earnings		**3,323.4**	2,006.9	(6.7)
Share capital and reserves		**4,550.7**	2,826.0	550.6
Non-shareholders' funds	31	**125.7**	209.1	1,441.1
Total equity		**4,676.4**	3,035.1	1,991.7
Total equity and liabilities		**95,229.9**	110,874.4	123,577.5

* Restated - see note 3.

The notes on pages 49 to 102 form an integral part of these Financial Statements.

The Financial Statements were approved by the Board of Directors and authorised for issue on 1 March 2012 and signed on its behalf by:

Richard Banks
Chief Executive Officer

Phillip McLelland
Finance Director

UK Asset Resolution Limited is registered in England and Wales under company number 7301961.

Consolidated Statement of Changes in Equity

For the year ended 31 December 2011	Share capital £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Merger reserve £m	Retained earnings £m	Total share capital and reserves £m	Non-shareholders' funds £m	Total equity £m
At 1 January 2011	**1.2**	**(211.7)**	**(93.0)**	**1,122.6**	**2,006.9**	**2,826.0**	**209.1**	**3,035.1**
Other comprehensive income:								
- Net movement in available-for-sale reserve	-	125.3	-	-	-	125.3	-	125.3
- Net movement in cash flow hedge reserve	-	-	351.3	-	-	351.3	-	351.3
- Actuarial gains and losses	-	-	-	-	51.3	51.3	-	51.3
- Effect of funding plan for retirement benefit obligations	-	-	-	-	117.6	117.6	-	117.6
- Tax effects of the above	-	(20.5)	(47.9)	-	(46.2)	(114.6)	-	(114.6)
Total other comprehensive income	-	104.8	303.4	-	122.7	530.9	-	530.9
Profit for the financial year	-	-	-	-	1,161.3	1,161.3	-	1,161.3
Gain on repurchase of capital instruments	-	-	-	-	32.5	32.5	(83.4)	(50.9)
At 31 December 2011	**1.2**	**(106.9)**	**210.4**	**1,122.6**	**3,323.4**	**4,550.7**	**125.7**	**4,676.4**

For the year ended 31 December 2010	Share capital £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Merger reserve £m	Retained earnings £m	Total share capital and reserves £m	Non-shareholders' funds £m	Total equity £m
At 1 January 2010	1.2	(401.1)	(165.4)	1,122.6	(6.7)	550.6	1,441.1	1,991.7
Other comprehensive income:								
- Net movement in available-for-sale reserve	-	208.2	-	-	-	208.2	-	208.2
- Net movement in cash flow hedge reserve	-	-	77.9	-	-	77.9	-	77.9
- Actuarial gains and losses	-	-	-	-	1.6	1.6	-	1.6
- Effect of funding plan for retirement benefit obligations	-	-	-	-	(117.6)	(117.6)	-	(117.6)
- Tax effects of the above	-	(18.8)	(5.5)	-	28.7	4.4	-	4.4
Total other comprehensive income	-	189.4	72.4	-	(87.3)	174.5	-	174.5
Profit for the financial year	-	-	-	-	1,209.9	1,209.9	-	1,209.9
Gain on repurchase of capital instruments	-	-	-	-	891.0	891.0	(1,232.0)	(341.0)
At 31 December 2010	1.2	(211.7)	(93.0)	1,122.6	2,006.9	2,826.0	209.1	3,035.1

Consolidated Cash Flow Statement

For the year ended 31 December	2011 £m	2010 £m
Cash flows from operating activities		
Profit before taxation for the financial year	**1,375.1**	1,487.1
Adjustments to reconcile profit to cash flows used in operating activities:		
- Provision for customer redress	**-**	160.0
- Impairment of goodwill	**-**	30.7
- Depreciation and amortisation	**24.6**	55.2
- Net profit on sale of property, plant and equipment and intangible assets	**-**	(3.0)
- Impairment on loans and advances to customers	**390.4**	1,089.4
- Net impairment on investment securities	**58.8**	0.5
- Gain on repurchase of capital instruments	**(338.1)**	(845.7)
- Income taxes paid	**(207.8)**	(124.9)
- Fair value adjustments on financial instruments	**331.1**	751.4
- Other non-cash movements	**(78.1)**	517.5
Cash flows from operating activities before changes in operating assets and liabilities	**1,556.0**	3,118.2
Net (increase)/decrease in operating assets:		
- Deposits held for regulatory or monetary control purposes	**-**	80.4
- Loans and advances to banks and customers	**8,754.6**	17,095.0
- Derivative financial instruments receivable	**2,102.5**	1,662.8
- Other assets	**(35.0)**	31.0
Net increase/(decrease) in operating liabilities:		
- Deposits by banks and other deposits	**(2,979.2)**	(2,232.0)
- Amounts due to customers	**-**	(20,556.9)
- HM Treasury loans	**(1,999.6)**	7,397.9
- Derivative financial instruments payable	**(392.9)**	(981.1)
- Debt securities in issue	**(9,920.5)**	(8,840.9)
- Provisions	**(36.7)**	(50.1)
- Other liabilities	**(177.7)**	(98.4)
Net cash used in operating activities	**(3,128.5)**	(3,374.1)
Cash flows from investing activities		
- Purchase of property, plant and equipment and intangible assets	**(44.8)**	(13.5)
- Proceeds from sale of property, plant and equipment and intangible assets	**0.5**	63.4
- Purchase of investment securities	**(231.7)**	(91.3)
- Proceeds from sale and redemption of investment securities	**1,308.8**	1,383.7
Net cash from investing activities	**1,032.8**	1,342.3
Cash flows used in financing activities		
- Repayment of Working Capital Facility	**(150.0)**	-
- Repurchase of capital instruments	**(843.4)**	(826.5)
Net cash used in financing activities	**(993.4)**	(826.5)
Net decrease in cash and cash equivalents	**(3,089.1)**	(2,858.3)
Cash and cash equivalents at beginning of year	**12,001.5**	14,859.8
Cash and cash equivalents at end of year	**8,912.4**	12,001.5
Represented by cash and assets with original maturity of three months or less within:		
- Cash and balances at central banks	**6,168.2**	7,288.8
- Loans and advances to banks	**2,741.2**	4,712.7
- Investment securities and unsecured investment loans	**3.0**	-
Total	**8,912.4**	12,001.5

Notes to the Financial Statements

1. Principal accounting policies

UK Asset Resolution Limited ('UKAR') is a private limited company incorporated on 1 July 2010 and domiciled in the United Kingdom. UKAR acquired B&B and NRAM by a share-for-share exchange on 1 October 2010. These Financial Statements are the first to be issued by UKAR, though unaudited summary information was provided in the Group's Interim Financial Report to 30 June 2011. These consolidated Financial Statements are prepared under the 'predecessor accounting' method. Under the predecessor accounting method the Group has the option of presenting the UKAR consolidated results prospectively from the date of the acquisition of B&B and NRAM or retrospectively as if the Group had been in existence in its present form for the whole of 2010 and 2011. The latter option has been selected as it is deemed to be the most appropriate policy for the Group. Therefore the 2010 UKAR Group information presented in these Financial Statements reflects the combined results of both B&B and NRAM even though the UKAR Company was not incorporated until 1 July 2010. Where such prior periods have been restated from the information previously presented in the prior period consolidated financial statements of B&B and NRAM the restatement has been included in these UKAR consolidated Financial Statements (see note 3). The Financial Statements of the UKAR Company are presented on pages 104 to 106, and form an integral part of these Financial Statements.

These Financial Statements were authorised for issue by the Directors on 1 March 2012 and will be put to the shareholder for approval at UKAR's Annual General Meeting to be held on 29 March 2012.

(a) Statement of compliance

Both the UKAR Company Financial Statements and the Group (comprising UKAR and its subsidiaries) 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 UKAR Company Financial Statements here together with the Group Financial Statements, UKAR 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 2011 Financial Statements, including the 2010 comparative financial information where applicable, the Group and Company have adopted for the first time the following statements, none of which had any significant impact on the Financial Statements.

- The November 2009 technical amendment to IFRIC 14 'IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'. This amendment merely removed an unintended consequence of IFRIC 14.
- The November 2009 amendments to IAS 24 'Related Party Disclosures', which clarified the disclosure requirements for Government-related entities and was effective from 1 January 2011.
- The October 2010 amendments to IFRS 7 'Financial Instruments: Disclosures' regarding enhancement of disclosures of transfers of financial assets.
- The 2010 Annual Improvements to IFRS, which were effective from 1 January 2011.

For these 2011 Financial Statements the Group and Company have not adopted the following statements; the Group and Company are assessing whether these statements will have any impact on their Financial Statements.

- IFRS 9 'Financial Instruments', sections of which have been issued as part of the International Accounting Standard Board's ('IASB's') project to replace IAS 39 'Financial Instruments: Recognition and Measurement', and the associated amendments to IFRS 7. These statements are expected to be mandatory for 2015 Financial Statements, with 2014 comparative information, but have not yet been adopted for use in the EU. The Group continues to monitor developments.
- IFRS 10 'Consolidated Financial Statements'. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.
- IFRS 11 'Joint Arrangements'. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.
- IFRS 12 'Disclosure of Interests in Other Entities'. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.
- IFRS 13 'Fair Value Measurement'. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.
- IAS 27 'Separate Financial Statements' (revised 2011). This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.
- IAS 28 'Investments in Associates' (revised 2011). This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.
- The December 2010 amendments to IAS 12 'Income Taxes' relating to 'Deferred Tax: Recovery of Underlying Assets'. This amendment is expected to be mandatory for 2012 Financial Statements, with 2011 comparative information, but has not yet been adopted for use in the EU.
- The June 2011 amendments to IAS 1 'Presentation of Financial Statements' relating to 'Presentation of Items of Other Comprehensive Income'. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(a) Statement of compliance (continued)

- The June 2011 amendments to IAS 19 'Employee Benefits'. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.
- The December 2011 amendments to IFRS 7 and IAS 32 'Financial Instruments: Presentation' relating to the offsetting of financial assets and financial liabilities. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.

All other new standards, amendments to standards and interpretations are not considered relevant to, and have no impact upon, the Financial Statements of the Group and UKAR company.

(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';
- financial instruments categorised under IAS 39 as 'available-for-sale'; and
- investment property; 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 UKAR Company, B&B and NRAM. At the date of approval of these Financial Statements, the Group is reliant upon the financing facilities and also upon the guarantee arrangements provided to B&B and NRAM by HM Treasury. Withdrawal of the financing facilities or the guarantee arrangements would have a significant impact on the Company's operations and its 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 of these Financial Statements, HM Treasury has confirmed its intentions to continue to provide funding until at least 1 October 2013. It has also committed to convert up to £1.6bn of its loan to NRAM to meet regulatory capital requirements if so required.

The Directors consider that the accounting policies set out in this note are the most appropriate to the Group's and the UKAR 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 B&B Group and the NRAM Group in preparing their Interim Financial Reports for the six months ended 30 June 2011, with one exception. The accounting policy in respect of Effective Interest Rate accounting was changed during the year. Further detail is provided in note 1(d).

B&B and NRAM are regulated by the Financial Services Authority ('FSA') as mortgage administration companies and the Directors believe that those companies have 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-adopted IFRS, IFRIC interpretations issued by the IFRS Interpretations Committee (formerly the International Financial Reporting Interpretations Committee) and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. A summary of 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, commercial and unsecured portfolios.

(c) Basis of consolidation

The UKAR Group's Financial Statements incorporate on a fully consolidated line-by-line basis the Financial Statements of the UKAR Company and those entities (including special purpose structures) which are controlled by UKAR (its subsidiaries); the Group Financial Statements primarily comprise the transactions and balances of the B&B Group and the NRAM Group. The UKAR Company's acquisition of the entire issued share capital of B&B and NRAM in a share-for-share exchange has been accounted for under 'predecessor accounting' and the UKAR Group's Financial Statements cover the year ended 31 December 2011 and the comparative year ended 31 December 2010. The UKAR Company's Financial Statements cover the 18 month period from incorporation to 31 December 2011. The difference between the UKAR Company's carrying value of investments and merger reserves, and the share capital and non-distributable reserves of the B&B Group and the NRAM Group, has been accounted for in the UKAR Group as a 'merger reserve'.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(c) Basis of consolidation (continued)

Control is achieved where UKAR 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 UKAR Group's Financial Statements from the date control is transferred to UKAR. 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 UKAR Group has securitised various residential mortgage loans, generally by sale or transfer to Special Purpose Vehicles ('SPVs') which in turn have issued securities to investors. The SPVs are consolidated line-by-line into the UKAR Group Financial Statements if they are, in substance, controlled by UKAR. The UKAR 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, or an appropriate shorter period. 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.

In these 2011 Financial Statements, the Group has restated the 2010 comparative financial information to reflect a change in the policy adopted for mortgage interest recognition. During the preparation of the first set of UKAR consolidated Financial Statements, we have considered the appropriateness of the previous accounting policy adopted by B&B and NRAM. Following the review we have shortened the period over which integral fees and charges are amortised. Such amounts are now amortised over the period to which the product reprices to a standard or product variable rate, which has resulted in the reduction of the EIR asset previously recognised. This has been treated as a change in accounting policy and consequently net interest income for 2011 has increased by £225.9m. As shown in note 3, net interest income for 2010 has been restated to increase it by £5.1m. Loans and advances to customers as at 31 December 2010 have been restated to reduce the balance by £619.4m.

Interest on derivatives is included in interest income where the derivative is hedging interest income, and interest expense where the derivative is hedging interest expense.

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.

Fees charged to existing borrowers, including arrears and redemption fees, are recognised in fee and commission income as they arise.

(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;

(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.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(g) Financial instruments (continued)

Certain Group companies use the Fair Value Option within IAS 39 to designate certain financial assets and financial liabilities as being at fair value through profit or loss. This approach is taken to prevent technical accounting mismatches in respect of accounting for certain intercompany swap arrangements; use of this option has had no impact on the results or Balance Sheet of the Group.

Where the Directors believed it appropriate to do so, financial assets have been reclassified out of the 'available-for-sale' category to 'loans and receivables' in accordance with the revisions to IAS 39 issued by the IASB in October 2008. Such reclassifications are 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, except where the asset has become impaired. 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.

(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 many of the Group's derivative contracts hedge accounting is applied. However, in some cases natural offsets apply. Also, as explained in note 1(g), certain Group companies use 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 hedge accounting) or recognised in other comprehensive income (cash flow hedge accounting). The Group has adopted cash flow hedge accounting and fair value hedge accounting.

(i) Cash flow hedge accounting
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 the cash flow hedge reserve component of 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 hedge accounting
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. The Group uses fair value hedge accounting on one-to-one relationship and portfolio hedging bases, as described below.

Where hedge accounting is not applied, changes in fair values are recognised immediately in the Income Statement.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(i) Derivative financial instruments and hedge accounting (continued)

(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. 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.

(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) Termination of hedges

Where a 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 adjustment relating to the terminated hedge relationship is amortised to the Income Statement over the period that the hedged item affects profit and loss.

(vii) Embedded derivatives

Certain financial instruments have derivative features embedded within them. 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 they were 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 asset an assessment is made as to whether an impairment provision should be made on either an individual or a collective basis. Loans where an individual assessment is made include all loans in possession or held for sale with a Law of Property Act ('LPA') receiver and others which management consider to be individually impaired, for example where a fraud has been uncovered. The carrying value of the loan at the Balance Sheet date is reduced, by applying an impairment allowance, 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 by applying an impairment allowance.

The impairment of loans is charged in the Income Statement in the 'impairment on loans and advances to customers' line.

For impaired loans, interest is accrued for accounting purposes on the loan amount after any impairment adjustments, in accordance with IAS 39, using the original EIR of the loan. However, for the purposes of the amount legally due from the borrower, interest continues to accrue on the full outstanding balance, and it is this full balance plus full interest which is pursued for collection.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(k) Impairment losses (continued)

A loan is written off and any associated impairment allowance released when and only when the property is sold or the account is redeemed. Any subsequent proceeds are recognised on a cash basis and offset against 'impairment on loans and advances to customers' in the Income Statement.

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'.

(ii) Available-for-sale financial assets

Investment securities classified as available-for-sale are carried at fair value, which appropriately reflects any 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
- 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 other 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.

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, including capital instruments, 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. Issued securities include ordinary and preference share capital. Preference shares are classified as equity instruments where dividend payments and redemptions are discretionary.

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.

Equity instruments (including share capital) are initially recognised at net proceeds, after deducting transaction costs and any related income tax.

(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.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(o) Intangible assets

(i) Goodwill

NRAM's goodwill arising on acquisitions before the date of transition to IFRS was retained at the previous UK GAAP amount, having been tested for impairment at 31 December 2003. This goodwill was impaired in 2010 (see note 23). B&B had no goodwill during 2011 or 2010.

(ii) Computer software

Purchased 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, being the higher of value in use and estimated net proceeds of sale. 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

Cash and cash equivalents comprise balances which are highly liquid and have an original maturity of three months or less.

(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 substantively 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 profits 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) Retirement benefits

The Group operates a number of retirement benefit plans for its employees, including defined contribution plans, defined benefit plans and post-retirement healthcare benefits. The costs of these plans are charged to the 'administrative expenses' line of the Income Statement and other comprehensive income 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.

As at 31 December 2011 and 31 December 2010 the B&B defined benefit scheme was in deficit. The NRAM defined benefit scheme was in surplus on an accounting basis, but in deficit on a trustees funding basis. As these are separate schemes, a surplus on one scheme cannot be used to offset a deficit on the other.

A full actuarial valuation of the Group's defined benefit sections of the existing schemes is undertaken every three years with interim reviews in the intervening years; these valuations are updated to 30 June and 31 December each year by qualified independent actuaries. For the purpose of these

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(r) Retirement benefits (continued)

updates, scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method. Liabilities are discounted using rates equivalent to the market yields at the Balance Sheet date on high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Details of the actuarial assumptions made are provided in note 20. The resulting net surplus or deficit is included in the Group's Balance Sheet. Actuarial gains and losses are charged to retained earnings in full in the period in which they occur, and pass through other comprehensive income rather than the Income Statement. The Group's Income Statement includes, for each scheme, the current service cost of providing pension benefits, the expected return on the scheme's assets, net of administration costs, and the interest cost on the scheme's liabilities. Following closure of the schemes, the current service cost for 2010 and subsequent years is nil.

At 31 December 2010 the inflation assumption used to determine B&B's benefit obligations was based on the Retail Prices Index ('RPI'), pending fulfilment of conditions which would need to be satisfied in order for the proposed change to a Consumer Prices Index ('CPI') basis to come into effect in respect of deferred members. These conditions were satisfied during 2011, and consequently CPI has been applied with effect from 1 January 2011. Consequently the net pension liability carried on the Balance Sheet reduced at that time by a credit to other comprehensive income. The inflation assumption used to determine NRAM's benefit obligations is RPI.

Surpluses are only recognised on the Balance Sheet to the extent that they are recoverable through reduced contributions in the future or through refunds from the scheme; the surplus on the NRAM scheme is recognised on this basis. The Group is committed to funding plans to address the deficits on the schemes. In accordance with IFRIC 14, the net pension deficit on the B&B scheme 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 Group has a clear unconditional right to a refund of future surpluses which may arise in the plans, the carrying value of the deficit should be reduced to take account of the anticipated future available funds. As detailed in note 25 to B&B's 2011 Financial Statements, as at 31 December 2010 B&B had no clear unconditional right to the refund of such surpluses, but on 29 March 2011 the Trustees finalised a resolution granting such a right and consequently the net pension liability carried on the Balance Sheet reduced at that time by a credit to other comprehensive income.

For defined contribution plans, the Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

In B&B, post-retirement healthcare 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 Group's Balance Sheet. In the event of a defined benefit plan surplus exceeding the value of post-retirement medical benefits, these benefits will be offset against the defined benefit asset. NRAM does not provide post-retirement healthcare benefits.

(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 over 15 years/1% - 2% pa on a straight line basis (see below)
- 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
- Plant 3% pa on a straight line basis
- Furniture 10% pa on a straight line basis
- Other equipment and major alterations to buildings 10% pa on a straight line basis.

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. During the year the estimated useful lives of freehold buildings was reassessed, and the depreciation rate was accelerated from 1% - 2% pa to 6.7% pa (ie over 15 years).

Where a property ceases to be occupied by a Group company and it is not intended to re-occupy the property or to sell it in the ordinary course of business, the property is reclassified as an investment property and is carried at fair value. Any shortfall between the carrying amount of the property and its fair value at the date of reclassification is charged to the Income Statement, unless there is a revaluation surplus in respect of that property(s) against which to allocate any shortfall. Any surplus between the carrying amount of the property and its fair value at the date of reclassification is credited directly to other comprehensive income except to the extent that the increase reverses a previous impairment loss for that property, in which case the increase is recognised in the Income Statement.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(s) Property, plant and equipment (continued)

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 an 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 asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

(t) Investment property

Investment properties represent properties held as investments to earn rentals or for capital appreciation, or both. Investment properties are included in the Balance Sheet at fair value, with changes recognised in the Income Statement in the period of change. Fair values are determined by independent professional valuers by application of recognised valuation techniques.

(u) 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 and 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.

Where the Group leases assets out under an operating lease agreement, the asset is included in the Balance Sheet based on the nature of the asset. Lease income is recognised over the term of the lease on a straight line basis.

(v) 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.

(w) 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 which were initially categorised as 'at fair value through profit or loss' or 'available-for-sale' have subsequently been re-categorised to 'loans and receivables' in accordance with the revisions to IAS 39 issued by the IASB in October 2008.

(x) Investments in Group undertakings

In the Financial Statements of the UKAR Company, investments in Group undertakings are carried at cost less any impairment. UKAR's acquisition of the entire issued share capital of B&B and NRAM in a share-for-share exchange has been accounted for under 'predecessor accounting' and the cost of

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(x) Investments in Group undertakings (continued)

each of these investments has been deemed to be the net assets of the B&B company and the NRAM company at 30 June 2010. The difference between the deemed cost of investment and the nominal value of the shares issued in exchange by UKAR has been accounted for in the UKAR Company's Balance Sheet as a 'merger reserve'. 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 Income Statement.

(y) Financial guarantees

The Group 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, to allow drawdown of monies previously overpaid (where the terms of the loan specifically allow) and, in respect of lifetime mortgages, the commitment to continue to accrue further interest on the loan. The interest on some lifetime mortgages rolls up and is not repayable 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.

2. Critical judgements and accounting estimates

In preparing the Financial Statements, management are required to make a series of judgements and estimates. Judgements involve an interpretation of requirements to decide how to allocate, value or recognise an item. Estimates arise from using assumptions which result in a range of possible outcomes. The most important judgements and estimates used in preparing these Financial Statements are described below.

Qualifying hedge relationships

In designating a financial instrument as part of a qualifying hedge relationship the Group has 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 has determined that the hedged cash flow exposure relates to highly probable future cash flows.

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).

Securitisations

In applying the Group's policies on securitised financial assets, the Group has 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.
- Where a 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.

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 certain Group companies. 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 18.

Notes to the Financial Statements (continued)

2. Critical judgements and accounting estimates (continued)

Impairment losses on loans and advances

The Group 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 agreed 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 situation and assumptions which differ from actual outcomes. To the extent that house prices were to change by +/- 10%, the residential impairment allowance would be an estimated £202.3m lower (2010: £276.7m) or £222.7m higher (2010: £309.6m) respectively.

Retirement benefit obligations

The net surplus or deficit in respect of each of the Group's retirement benefit schemes is carried on the Group's Balance Sheet. The value of these obligations is calculated by the Group's actuaries using the assumptions set out in note 20. Note 20 also discloses the impact on the benefit obligations of changes in certain key assumptions.

Provisions

Provisions are carried in respect of certain known or forecast future expenditure, as described in note 27. Provisions are calculated using the best available information, but the actual future outcomes of items provided for may differ from expectations.

Fair value calculations

Fair value is defined as the value at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. 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 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. For example, if management were to use a tightening in the credit spread of 10 basis points, the fair values of liabilities (including derivatives) would increase from the reported fair values by £87.7m (2010: £109.6m).

Notes to the Financial Statements (continued)

3. Restatements and reclassifications in B&B and NRAM

During 2011 B&B and NRAM were subject to a change in accounting policy and reclassifications. Consequently, in the 2011 Financial Statements of B&B and NRAM, the comparative 2010 information was restated from that presented in their 2010 Financial Statements. Following the principles of predecessor accounting (as described in note 1) these restatements have also been applied to the UKAR Group and hence UKAR's comparative balances have been restated. The changes applied were:

(i) Effective Interest Rate ('EIR') accounting. The accounting policy of B&B and NRAM regarding EIR on loans and advances to customers was changed during 2011, as described in note 1(d). Integral fees and charges are now amortised over a shorter period, being the period to which the product reprices to a standard or product variable rate.

(ii) Reclassifications. B&B changed the Income Statement line classification of the amortisation of gains made on the disposal of derivatives. NRAM changed the Balance Sheet classification of interest accruals.

Further detail is provided in the 2011 Annual Reports and Accounts of B&B (see note 3) and NRAM (see note 3). The impact on UKAR is the aggregate of the B&B and NRAM restatements above.

Bradford & Bingley Group

Income Statement For the year ended 31 December 2010	Reported in 2010 £m	EIR adjustment £m	Reclassification £m	Restated 2010 £m
Underlying net interest income*	503.6	91.2	-	594.8
Underlying non interest income**	70.9	-	(38.5)	32.4
Underlying net operating income	574.5	91.2	(38.5)	627.2
Ongoing administrative expenses	(112.3)	-	-	(112.3)
Impairment on loans and advances to customers	(276.6)	-	-	(276.6)
Net impairment on investment securities	14.5	-	-	14.5
Underlying profit before taxation	200.1	91.2	(38.5)	252.8
Unrealised fair value movements on financial instruments	(9.3)	-	38.5	29.2
Hedge ineffectiveness	3.0	-	-	3.0
Other net administrative expenses	(14.1)	-	-	(14.1)
Gain on repurchase of capital instruments	786.0	-	-	786.0
Discounting of capital instruments	104.3	-	-	104.3
Gain on sale of insurance business	11.5	-	-	11.5
Statutory profit before taxation	1,081.5	91.2	-	1,172.7

Balance sheet At 31 December 2010	Reported in 2010 £m	EIR adjustment £m	Reclassification £m	Restated 2010 £m
Loans and advances to customers:				
-Residential mortgages	35,683.1	(438.6)	-	35,244.5
-Commercial and other secured loans	718.7	-	-	718.7
Wholesale assets	5,652.3	-	-	5,652.3
Fair value adjustments on portfolio hedging	223.2	-	-	223.2
Derivative financial instruments	2,929.1	-	-	2,929.1
Other assets	152.1	26.9	-	179.0
Total assets	45,358.5	(411.7)	-	44,946.8
Statutory Debt & HM Treasury loans	26,980.4	-	-	26,980.4
Wholesale funding	14,702.6	-	-	14,702.6
Derivative financial instruments	531.9	-	-	531.9
Other liabilities	543.2	(88.3)	-	454.9
Capital instruments	393.9	-	-	393.9
Equity	2,206.5	(323.4)	-	1,883.1
Total equity and liabilities	45,358.5	(411.7)	-	44,946.8

* Underlying net interest income in B&B in 2010 excludes an adjustment of £104.3m for the discounting of capital instruments.

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

Notes to the Financial Statements (continued)

3. Restatements and reclassifications in B&B and NRAM (continued)

Northern Rock (Asset Management) Group

Income Statement For the year ended 31 December 2010	Reported in 2010 £m	EIR adjustment £m	Reclassification £m	Restated 2010 £m
Underlying net interest income	1,259.9	(86.1)	-	1,173.8
Underlying non interest income*	10.5	-	-	10.5
Underlying net operating income	1,270.4	(86.1)	-	1,184.3
Ongoing administrative expenses	(165.2)	-	-	(165.2)
Impairment on loans and advances to customers	(812.8)	-	-	(812.8)
Net impairment on investment securities	(15.0)	-	-	(15.0)
Underlying profit before taxation	277.4	(86.1)	-	191.3
Unrealised fair value movements on financial instruments	417.7	-	-	417.7
Hedge ineffectiveness	(65.0)	-	-	(65.0)
Other net administrative expenses	(138.4)	-	-	(138.4)
Gain on repurchase of capital instruments	59.7	-	-	59.7
Provision for customer redress	(160.0)	-	-	(160.0)
Defined benefit pension scheme gains	9.1	-	-	9.1
Statutory profit before taxation	400.5	(86.1)	-	314.4

Balance sheet At 31 December 2010	Reported in 2010 £m	EIR adjustment £m	Reclassification £m	Restated 2010 £m
Loans and advances to customers:				
-Residential mortgages	44,332.3	(180.8)	1.4	44,152.9
-Commercial and other secured loans	312.4	-	2.3	314.7
-Unsecured lending	3,113.8	-	-	3,113.8
Wholesale assets	11,321.2	-	9.2	11,330.4
Fair value adjustments on portfolio hedging	539.6	-	-	539.6
Derivative financial instruments	6,542.5	-	-	6,542.5
Other assets	114.9	-	(12.9)	102.0
Total assets	66,276.7	(180.8)	-	66,095.9
HM Treasury loans	21,713.4	-	13.9	21,727.3
Wholesale funding	40,784.1	-	170.1	40,954.2
Derivative financial instruments	826.4	-	-	826.4
Other liabilities	568.1	-	(218.4)	349.7
Capital instruments	1,066.3	-	34.4	1,100.7
Equity	1,318.4	(180.8)	-	1,137.6
Total equity and liabilities	66,276.7	(180.8)	-	66,095.9

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

Notes to the Financial Statements (continued)

4. Net interest income

	2011 £m	2010* £m
Interest receivable and similar income		
On secured advances	**2,472.5**	2,389.9
On other lending	**143.7**	131.0
On investment securities and deposits	**116.8**	158.6
Total interest receivable and similar income	**2,733.0**	2,679.5
Interest expense and similar charges		
On deposits including loans from HM Treasury	**(475.6)**	(359.1)
State guarantee fee**	**(74.9)**	(108.3)
Other	**(460.1)**	(339.2)
Total interest expense and similar charges	**(1,010.6)**	(806.6)
Net interest income	**1,722.4**	1,872.9
Average balances		
Interest-earning assets ('IEA')	**94,929**	106,598
Financed by:		
- Interest-bearing funding	**71,610**	83,840
- Interest-free funding***	**23,319**	22,758
	%	%
Average rates:		
- Gross yield on IEA	**2.88**	2.51
- Cost of interest-bearing funding	**(1.31)**	(0.83)
Interest spread	**1.57**	1.68
State guarantee fee**	**(0.08)**	(0.10)
Contribution of interest-free funding***	**0.32**	0.18
Net interest margin on average IEA	**1.81**	1.76
Average Bank Base Rate	**0.50**	0.50
Average 1-month LIBOR	**0.65**	0.56
Average 3-month LIBOR	**0.88**	0.70

* Restated - see note 3.

** At the time of the nationalisation of B&B, HM Treasury provided a guarantee with regard to certain wholesale borrowings and derivative transactions existing at that time. The amount of this fee is dependent on balances outstanding, and hence it is included within 'interest expense and similar charges'.

At the time of the nationalisation of NRAM, HM Treasury provided a guarantee with regard to certain wholesale borrowings and derivative transactions existing at that time. The amount of this fee is currently £12m pa, and is not dependent on balances outstanding, and hence it is included within 'fee and commission expense'.

*** Interest-free funding is calculated as an average over the financial year, and includes the Statutory Debt and share capital and reserves.

Total interest receivable and similar income includes interest accrued on individually impaired assets of £18.1m (2010: £22.3m).

Interest expense for 2010 was reduced by £104.3m being the effect of discounting capital instruments (see note 28).

Notes to the Financial Statements (continued)

5. Net realised gains less losses on investment securities

Net realised gains less losses on investment securities recognised in the Income Statement comprised the following:

	2011 £m	2010 £m
Net realised gains on available-for-sale instruments	-	8.6
Net realised losses on instruments at amortised cost	(1.2)	-
Total net realised gains less losses on investment securities	**(1.2)**	8.6

6. Unrealised fair value movements on financial instruments & hedge ineffectiveness

	2011 £m	2010 £m
Net gain/(loss) in fair value:		
- translation gains/(losses) on underlying instruments	**160.6**	(144.0)
- fair value movements on derivatives which are economic hedges but are not in hedge accounting relationships	**(81.4)**	590.9
Unrealised fair value movements	**79.2**	446.9
Net gains on fair value hedging instruments	**228.8**	1,403.2
Net losses on fair value hedged items attributable to hedged risk	**(289.5)**	(1,443.4)
Ineffectiveness on cash flow hedges	**(24.5)**	(21.8)
Net hedge ineffectiveness losses	**(85.2)**	(62.0)
Total	**(6.0)**	384.9

7. Administrative expenses

On 1 January 2010 all employees previously employed by NRAM transferred to Northern Rock plc under the terms of the Northern Rock Transfer Order 2009, SI 2009/3226. On 1 November 2010, 1,254 of these employees transferred to B&B and staff allocated to NRAM are included in the table below. Between 1 January and 31 October 2010 Northern Rock plc charged NRAM for the services of the staff who were working for NRAM but these staff are not included in the numbers below. The costs charged by Northern Rock plc are included in the 'Service Level Agreement with Northern Rock plc' below.

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

For the year ended 31 December	2011 Number	2010 Number
Average headcount		
Full time	**1,855**	981
Part time	**538**	202
Total employed	**2,393**	1,183
Working for NRAM:		
Full time	**982**	155
Part time	**382**	53
Total working for NRAM	**1,364**	208
Working for B&B:		
Full time	**873**	826
Part time	**156**	149
Total working for B&B	**1,029**	975
Total average full time equivalent	**2,199**	1,111
Total average full time equivalent working for NRAM	**1,221**	190
Total average full time equivalent working for B&B	**978**	921

The full time equivalent is based on the average hours worked by employees in the year. Staff numbers include Directors on service contracts.

Notes to the Financial Statements (continued)

7. Administrative expenses (continued)

The number of persons employed at the end of the year was as follows:

	2011 Number	2010 Number
Full time	**1,954**	1,772
Part time	**538**	469
Total employed	**2,492**	2,241
Working for NRAM:		
Full time	**1,089**	933
Part time	**378**	321
Total working for NRAM	**1,467**	1,254
Working for B&B:		
Full time	**865**	839
Part time	**160**	148
Total working for B&B	**1,025**	987
Total full time equivalent headcount	**2,305**	2,081
Total full time equivalent headcount working for NRAM	**1,332**	1,139
Total full time equivalent headcount working for B&B	**973**	942

In addition to the permanent staff above, the Group employed a full time equivalent of 290 temporary staff and specialist contractors at 31 December 2011 (2010: 174).

The Group's aggregate costs of permanant staff were as follows:

	2011 £m	2010 £m
Wages and salaries	**65.6**	33.7
Social security costs	**6.8**	3.5
Defined benefit pension costs (see note 20)	**(0.9)**	4.8
Defined contribution pension costs (see note 20)	**3.5**	1.8
Other retirement benefit costs (see note 20)	**0.5**	0.5
Total staff costs	**75.5**	44.3
IT costs	**57.9**	39.8
Outsourced and professional services	**29.6**	20.5
Depreciation and amortisation (see notes 22 and 23)	**5.5**	3.4
Service Level Agreement with Northern Rock plc	**-**	115.5
Other administrative expenses	**52.1**	54.0
Ongoing administrative expenses	**220.6**	277.5
Other net expenses:		
- Transformation costs	**40.0**	64.7
- Accelerated depreciation	**25.2**	51.8
- Impairment of goodwill (see note 23)	**-**	30.7
- Independent share valuation charges and associated fees	**-**	5.3
Total other net expenses	**65.2**	152.5
Total administrative expenses	**285.8**	430.0

Transformation costs relate to the integration of B&B and NRAM into UKAR. The cost of £65.2m in 2011 relates to the establishment of common systems across UKAR together with expected redundancy costs and the write-down of the value of buildings following the announcement of the UKAR restructure and the phased exit from the Gosforth site.

During 2010 the majority of the administrative expenses incurred by the NRAM Group arose from the Service Level Agreement ('SLA') with Northern Rock plc. Further details are provided in note 33.

Notes to the Financial Statements (continued)

7. Administrative expenses (continued)

Services provided by the Group's auditors and network firms
During the year the Group obtained services from the Group's auditors, as detailed below:

	2011 £m	2010 £m
Fees payable to Company auditors for the audit of parent Company and consolidated accounts	**0.1**	-
Fees payable to Company auditors and its associates for other services:		
- The audit of the Company's subsidiaries pursuant to legislation	**0.8**	1.2
- Other services pursuant to legislation	**-**	0.2
- All other services (including regulatory)	**0.1**	0.5
Total	**1.0**	1.9

Amounts shown in the above analysis are exclusive of VAT.

8. Gain on sale of insurance business

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

9. Gain on repurchase of capital instruments

2011	Subordinated notes £m	Reserve capital instruments £m	Total gains taken to reserves £m	Tier one notes £m	Subordinated liabilities £m	Other capital instruments £m	Total Income Statement gains £m
Principal amount of capital instruments repurchased	**29.7**	**54.1**	**83.8**	**79.8**	**949.5**	**46.3**	**1,075.6**
Amount paid to repurchase capital instruments	**(11.8)**	**(27.0)**	**(38.8)**	**(51.9)**	**(719.6)**	**(30.8)**	**(802.3)**
Other net gains resulting from the repurchase*	**(0.3)**	**(0.5)**	**(0.8)**	**31.6**	**24.3**	**8.9**	**64.8**
Gain on repurchase of capital instruments	**17.6**	**26.6**	**44.2**	**59.5**	**254.2**	**24.4**	**338.1**

2010	Subordinated notes £m	Reserve capital instruments £m	Total gains taken to reserves £m	Tier one notes £m	Subordinated liabilities £m	Other capital instruments £m	Total Income Statement gains £m
Principal amount of capital instruments repurchased	1,101.7	143.4	1,245.1	89.5	998.5	103.7	1,191.7
Amount paid to repurchase capital instruments	(302.4)	(35.9)	(338.3)	(51.1)	(377.2)	(57.0)	(485.3)
Other net gains resulting from the repurchase*	(15.2)	(0.6)	(15.8)	21.3	100.8	17.2	139.3
Gain on repurchase of capital instruments	784.1	106.9	891.0	59.7	722.1	63.9	845.7

* The other net gains were principally release of deferred coupons and hedge adjustment releases, less accelerated amortisation of the discounting effect of deferral of coupons and fees.

The gain on repurchase of subordinated notes and reserve capital instruments is reported in reserves as these instruments are accounted for as equity; after tax of £11.7m (2010: £nil), the net gain taken to reserves was £32.5m (2010: £891.0m). The gain on repurchase of tier one notes, subordinated liabilities and other capital instruments is reported in the Income Statement as these instruments are accounted for as liabilities.

10. Profit on disposal of credit linked notes

On 24 June 2011 holders of various classes of credit linked notes issued by NRAM's subsidiary Graphite Mortgages plc were invited to tender such notes for purchase by NRAM for cash. The result of this tender was announced on 6 July 2011 and as a consequence NRAM purchased notes with a par value of €216.1m for €197.8m. On 7 July 2011 NRAM announced that it intended to exercise its right to terminate the credit default swap between NRAM and KfW to which these notes related as of the payment date scheduled to fall on 10 August 2011. As a result of this, Graphite Mortgages plc was obliged to redeem all notes in issue on that date at par with NRAM receiving €216.1m for the notes that it had acquired. The profit resulting from the sale of the notes amounted to £15.6m.

Notes to the Financial Statements (continued)

11. Taxation

	2011 £m	2010 £m
The tax charge for the year comprises:		
Current tax:		
- on profit for the year	**(186.7)**	(267.6)
- adjustments in respect of prior years	**20.9**	10.4
- foreign tax	**(2.0)**	(9.2)
Total current tax	**(167.8)**	(266.4)
Deferred tax (see note 18):		
- origination and reversal of temporary differences	**56.9**	(12.2)
- adjustments in respect of prior years	**(111.5)**	3.8
- change in rate effective 1 April 2011 on deferred tax items	**8.6**	(2.4)
Total deferred tax	**(46.0)**	(10.8)
Total taxation charge per the Income Statement	**(213.8)**	(277.2)

The following tax amounts have also been (charged)/credited directly to equity:

	2011 £m	2010 £m
Current tax:		
- Relating to available-for-sale investments	**(22.7)**	(23.8)
- Relating to repurchase of capital instruments (see note 9)	**(11.7)**	-
Deferred tax:		
- Relating to cash flow hedge reserve	**(47.9)**	(5.5)
- Relating to actuarial movements on retirement benefit obligations	**(46.5)**	28.7
- Relating to available-for-sale investments	**2.4**	5.0
Net charge to equity	**(126.4)**	4.4

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the standard weighted average rate of UK corporation tax of 26.5% (2010: 28%) as follows:

	2011 £m	2010 £m
Profit before taxation	**1,375.1**	1,487.1
Tax calculated at rate of 26.5% (2010: 28%)	**(364.4)**	(416.4)
Effects of:		
Deferred tax assets transferred to Northern Rock plc	**-**	(5.8)
Utilisation of deferred tax assets	**141.0**	84.8
Deferred tax asset arising not previously recognised	**-**	30.1
Income not subject to tax	**-**	33.6
Overseas tax rates	**-**	1.1
Change in rate effective 1 April 2011 on deferred tax items	**8.4**	(2.4)
Expenses not deductible for tax purposes	**(20.4)**	(24.6)
Adjustments in respect of prior years	**21.6**	22.4
Total taxation charge for the year	**(213.8)**	(277.2)

Taxation appropriately reflects changes in tax rates which had been substantively enacted by 31 December 2011, as detailed in note 18.

12. Cash and balances at central banks

	2011 £m	2010 £m
Balances with Bank of England for liquidity purposes	**3,374.3**	3,658.6
Collateral balances with Bank of England	**2,796.4**	3,633.2
Total	**6,170.7**	7,291.8

Notes to the Financial Statements (continued)

13. Investment securities and unsecured investment loans

	2011 £m	2010 £m
Available-for-sale securities	**970.4**	1,699.9
Investment securities held as loans and receivables	**1,536.6**	1,874.5
Unsecured investment loans	**341.1**	350.2
Total	**2,848.1**	3,924.6

In the Balance Sheet the carrying values of impaired assets are presented net of the impairment allowances shown in note 14.

Net impairment on investment securities for the year comprised:

	2011 £m	2010 £m
Net impairment reversals on available-for-sale securities	**6.3**	6.7
Net impairment losses on investment securities held as loans and receivables and unsecured investment loans	**(65.1)**	(7.2)
Total	**(58.8)**	(0.5)

a) Available-for-sale securities

	2011 £m	2010 £m
At fair value:		
Listed	**881.7**	1,612.2
Unlisted	**88.7**	87.7
Total	**970.4**	1,699.9
The movement in available-for-sale securities was as follows:		
At 1 January	**1,699.9**	2,627.9
Transferred to Northern Rock plc (see note 39)	**-**	(53.0)
Additions	**234.6**	88.5
Disposals (sales and redemptions)	**(981.2)**	(998.7)
Exchange differences	**(16.6)**	(11.6)
Net gains on changes in fair value	**33.7**	46.8
At 31 December	**970.4**	1,699.9

b) Investment securities held as loans and receivables

	2011 £m	2010 £m
Carrying value	**1,536.6**	1,874.5
Fair value	**1,340.4**	1,772.4
Listed	**1,512.6**	1,843.5
Unlisted	**24.0**	31.0
Total	**1,536.6**	1,874.5

14. Wholesale assets

The assets in the following table are of a wholesale nature as opposed to individual customer assets. The credit and concentration risk characteristics of these portfolios should therefore be considered together.

	2011 £m	2010 £m
Cash and balances at central banks (see note 12)	**6,170.7**	7,291.8
Loans and advances to banks	**2,746.5**	5,615.6
Investment securities and unsecured investment loans (see note 13)	**2,848.1**	3,924.6
Total	**11,765.3**	16,832.0

The Group had no collateral or other credit enhancements in respect of these assets.

Notes to the Financial Statements (continued)

14. Wholesale assets (continued)

a) Credit risk

The credit quality of wholesale assets is set out in the tables below:

At 31 December 2011	Cash and balances at central banks £m	Loans and advances to banks £m	Available-for-sale securities £m	Investment securities held as loans and receivables £m	Unsecured investment loans £m	Total £m
Neither past due nor impaired	**6,170.7**	**2,746.5**	**855.5**	**1,465.7**	**341.1**	**11,579.5**
Impaired	**-**	**-**	**507.6**	**196.0**	**250.5**	**954.1**
	6,170.7	**2,746.5**	**1,363.1**	**1,661.7**	**591.6**	**12,533.6**
Provisions	**-**	**-**	**(392.7)**	**(125.1)**	**(250.5)**	**(768.3)**
Total	**6,170.7**	**2,746.5**	**970.4**	**1,536.6**	**341.1**	**11,765.3**

At 31 December 2010	Cash and balances at central banks £m	Loans and advances to banks £m	Available-for-sale securities £m	Investment securities held as loans and receivables £m	Unsecured investment loans £m	Total £m
Neither past due nor impaired	7,291.8	5,615.6	1,568.7	1,826.7	350.2	16,653.0
Past due but not impaired	-	-	-	6.3	-	6.3
Impaired	-	-	596.3	102.2	250.6	949.1
	7,291.8	5,615.6	2,165.0	1,935.2	600.8	17,608.4
Provisions	-	-	(465.1)	(60.7)	(250.6)	(776.4)
Total	7,291.8	5,615.6	1,699.9	1,874.5	350.2	16,832.0

The credit quality of wholesale assets by reference to credit ratings is set out in the tables below:

At 31 December 2011	£m	AAA %	AA %	A %	BBB to B %	CCC and below %
Cash and balances at central banks	**6,170.7**	**100**	**-**	**-**	**-**	**-**
Loans and advances to banks	**2,746.5**	**-**	**50**	**50**	**-**	**-**
Investment securities and unsecured investment loans:						
- available-for-sale securities	**970.4**	**70**	**10**	**10**	**1**	**9**
- loans and receivables	**1,536.6**	**5**	**29**	**32**	**29**	**5**
- unsecured investment loans	**341.1**	**-**	**-**	**-**	**100**	**-**
Total investment securities and unsecured investment loans	**2,848.1**	**29**	**17**	**18**	**30**	**6**
Total	**11,765.3**	**60**	**16**	**16**	**7**	**1**

At 31 December 2010	£m	AAA %	AA %	A %	BBB to B %	CCC and below %
Cash and balances at central banks	7,291.8	100	-	-	-	-
Loans and advances to banks	5,615.6	46	24	30	-	-
Investment securities and unsecured investment loans:						
- available-for-sale securities	1,699.9	84	8	3	1	4
- loans and receivables	1,874.5	16	22	28	31	3
- unsecured investment loans	350.2	-	-	-	100	-
Total investment securities and unsecured investment loans	3,924.6	43	14	15	25	3
Total	16,832.0	69	11	13	6	1

Notes to the Financial Statements (continued)

14. Wholesale assets (continued)

b) Concentration risk

Wholesale assets are analysed by geographical region at their carrying amounts in the tables below:

At 31 December 2011	UK £m	Europe £m	US £m	Other countries £m	Total £m
Cash and balances at central banks	**6,170.7**	**-**	**-**	**-**	**6,170.7**
Loans and advances to banks	**2,266.5**	**449.5**	**19.8**	**10.7**	**2,746.5**
Investment securities and unsecured investment loans:					
- available-for-sale securities	**624.2**	**267.7**	**20.9**	**57.6**	**970.4**
- loans and receivables	**718.0**	**240.6**	**90.8**	**487.2**	**1,536.6**
- unsecured investment loans	**-**	**-**	**-**	**341.1**	**341.1**
Total investment securities and unsecured investment loans	**1,342.2**	**508.3**	**111.7**	**885.9**	**2,848.1**
Total	**9,779.4**	**957.8**	**131.5**	**896.6**	**11,765.3**

At 31 December 2010	UK £m	Europe £m	US £m	Other countries £m	Total £m
Cash and balances at central banks	7,291.8	-	-	-	7,291.8
Loans and advances to banks	4,376.1	965.4	72.8	201.3	5,615.6
Investment securities and unsecured investment loans:					
- available-for-sale securities	1,000.6	576.2	28.4	94.7	1,699.9
- loans and receivables	847.0	378.2	127.6	521.7	1,874.5
- unsecured investment loans	-	-	-	350.2	350.2
Total investment securities and unsecured investment loans	1,847.6	954.4	156.0	966.6	3,924.6
Total	13,515.5	1,919.8	228.8	1,167.9	16,832.0

At 31 December 2011 the Group held no investment securities issued by the governments of Portugal, the Republic of Ireland, Italy, Greece or Spain.

Notes to the Financial Statements (continued)

15. Loans and advances to customers

	31 December 2011 £m	31 December 2010* £m	1 January 2010* £m
Residential mortgages	**71,913.3**	79,397.4	87,268.9
Commercial loans	**857.2**	1,033.4	1,109.2
Total secured loans	**72,770.5**	80,430.8	88,378.1
Unsecured loans	**2,523.9**	3,113.8	3,912.4
Total	**75,294.4**	83,544.6	92,290.5

Residential mortgages include all of the Group's buy-to-let loans. Commercial loans comprise loans secured on commercial properties. The Together product, previously offered by NRAM, combines a secured and unsecured loan all at one interest rate and with flexible payments. Outstanding secured balances in respect of this product are included within total residential mortgages while outstanding unsecured balances are included within unsecured loans.

All of the Group's loans and advances to customers are to UK customers.

Balances include accounting adjustments in respect of EIR and provisioning requirements.

Loans and advances to customers include loans amounting to £50,876.2m (31 December 2010: £56,491.5m) which have been sold to bankruptcy remote SPVs whereby substantially all of the risks and rewards of the portfolio are retained by the Group. Accordingly, all of these loans and advances are retained on the Group's Balance Sheet. Further details are provided in note 25.

Fair value adjustments on portfolio hedging amounting to £597.5m (2010: £762.8m) relate to fair value adjustments to loans and advances to customers in relation to interest rate risk as a result of their inclusion in a fair value portfolio hedge relationship.

Loans and advances to customers comprise the following product types:

	Balances 31 December 2011 £m	%	Redemptions 2011 £m	Balances 31 December 2010 £m*	%	Redemptions 2010 £m	Balances 1 January 2010 £m*
Residential mortgages							
Buy-to-let	**25,799.5**	**36**	**(894.1)**	26,936.8	34	(1,080.2)	28,378.9
Self Cert	**6,902.4**	**9**	**(330.6)**	7,318.0	9	(460.2)	7,801.9
Together	**14,312.0**	**20**	**(1,183.5)**	15,974.2	20	(903.3)	17,377.4
Standard and other	**24,899.4**	**35**	**(4,042.4)**	29,168.4	37	(3,864.9)	33,710.7
Total residential mortgages	**71,913.3**	**100**	**(6,450.6)**	79,397.4	100	(6,308.6)	87,268.9
Residential loans	**71,913.3**	**96**	**(6,450.6)**	79,397.4	95	(6,308.6)	87,268.9
Commercial loans	**857.2**	**1**	**(178.6)**	1,033.4	1	(106.3)	1,109.2
Total secured loans	**72,770.5**	**97**	**(6,629.2)**	80,430.8	96	(6,414.9)	88,378.1
Unsecured loans	**2,523.9**	**3**	**(362.7)**	3,113.8	4	(514.8)	3,912.4
Total	**75,294.4**	**100**	**(6,991.9)**	83,544.6	100	(6,929.7)	92,290.5

* The 2010 balances have been restated for the impact of the accounting policy change detailed in note 3. The impact was to reduce loans and advances to customers by £619.4m at 31 December 2010 and by £624.5m at 1 January 2010.

Redemptions comprise full redemptions and voluntary partial redemptions, but exclude overpayments and regular monthly payments.

Notes to the Financial Statements (continued)

16. Impairment on loans and advances to customers

Allowances for credit losses against loans and advances to customers have been made as follows:

2011	On residential mortgages £m	On commercial loans £m	On unsecured loans £m	Total £m
At 1 January	**1,845.1**	**88.6**	**542.3**	**2,476.0**
Movements during the year:				
- Write-offs	**(454.5)**	**(6.6)**	**(179.0)**	**(640.1)**
- Loan impairment charge	**253.9**	**20.2**	**138.3**	**412.4**
Net movements during the year	**(200.6)**	**13.6**	**(40.7)**	**(227.7)**
At 31 December	**1,644.5**	**102.2**	**501.6**	**2,248.3**
The Income Statement charge comprises:				
- Loan impairment charge	**253.9**	**20.2**	**138.3**	**412.4**
- Recoveries net of costs	**(8.6)**	**-**	**(13.4)**	**(22.0)**
Total Income Statement charge	**245.3**	**20.2**	**124.9**	**390.4**

2010	On residential mortgages £m	On commercial loans £m	On unsecured loans £m	Total £m
At 1 January	1,480.2	64.7	564.3	2,109.2
Transferred to Northern Rock plc (see note 39)	(0.4)	-	(0.2)	(0.6)
Movements during the year:				
- Write-offs	(512.4)	(12.0)	(214.0)	(738.4)
- Loan impairment charge	877.7	35.9	192.2	1,105.8
Net movements during the year	365.3	23.9	(21.8)	367.4
At 31 December	1,845.1	88.6	542.3	2,476.0
The Income Statement charge comprises:				
- Loan impairment charge	877.7	35.9	192.2	1,105.8
- Recoveries net of costs	(5.4)	(0.1)	(10.9)	(16.4)
Total Income Statement charge	872.3	35.8	181.3	1,089.4

In the Balance Sheet the carrying values of loans and advances to customers are presented net of these impairment allowances.

Notes to the Financial Statements (continued)

17. Credit quality of loans and advances to customers

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

At 31 December	2011 £m	2010 £m
Neither past due nor impaired	**93,503.3**	104,155.3
Past due but not impaired	**7,592.4**	8,347.5
Impaired	**1,613.9**	2,242.0
Total	**102,709.6**	114,744.8

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:

At 31 December	2011 £m	2010 £m
Neither past due nor impaired	**63,482.8**	70,255.2
Past due but not impaired	**6,477.5**	6,675.4
Impaired	**1,482.6**	2,056.6
Total	**71,442.9**	78,987.2
The impaired balances above include the following carrying amount of assets in possession, capped at the balance outstanding	**266.1**	236.2

The fair value of the collateral is estimated by taking the most recent valuation of the property and adjusting for house price inflation or deflation up to the Balance Sheet date.

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

At 31 December	2011 %	2010 %
Neither past due nor impaired	**69.5**	69.0
Past due but not impaired	**89.4**	82.9
Impaired	**109.9**	108.4
Total	**71.6**	70.8

	At 31 December 2011				At 31 December 2010			
	Residential mortgages £m	Commercial loans £m	Unsecured loans £m	Total £m	Residential mortgages £m	Commercial loans £m	Unsecured loans £m	Total £m
Neither past due nor impaired	**64,998.3**	**706.4**	**2,327.3**	**68,032.0**	71,888.2	785.8	2,986.3	75,660.3
Past due but not impaired:								
- less than 3 months	**3,668.7**	**2.7**	**207.2**	**3,878.6**	3,719.4	0.4	123.2	3,843.0
- 3 to 6 months	**1,801.7**	**1.3**	**-**	**1,803.0**	1,866.3	0.2	7.9	1,874.4
- over 6 months	**1,316.1**	**-**	**-**	**1,316.1**	1,337.3	4.0	15.3	1,356.6
Impaired	**1,773.0**	**249.0**	**491.0**	**2,513.0**	2,431.3	331.6	523.4	3,286.3
	73,557.8	**959.4**	**3,025.5**	**77,542.7**	81,242.5	1,122.0	3,656.1	86,020.6
Impairment allowances	**(1,644.5)**	**(102.2)**	**(501.6)**	**(2,248.3)**	(1,845.1)	(88.6)	(542.3)	(2,476.0)
Loans and advances to customers net of impairment allowances	**71,913.3**	**857.2**	**2,523.9**	**75,294.4**	79,397.4	1,033.4	3,113.8	83,544.6
Impairment allowances:								
- individual	**316.9**	**71.5**	**-**	**388.4**	473.0	72.3	-	545.3
- collective	**1,327.6**	**30.7**	**501.6**	**1,859.9**	1,372.1	16.3	542.3	1,930.7
Total impairment allowances	**1,644.5**	**102.2**	**501.6**	**2,248.3**	1,845.1	88.6	542.3	2,476.0

Impaired loans are those which are 12 months or more in arrears, in possession or held for sale with an LPA receiver, and others which management consider to be individually impaired.

The above table includes balances 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 the year. These loans amounted to £81.9m (2010: £2,051.7m). A loan is eligible for capitalisation of arrears only once the borrower has complied with stringent terms for a set period.

Notes to the Financial Statements (continued)

17. Credit quality of loans and advances to customers (continued)

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 level 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.

Arrears and possessions are monitored for the Group as a whole, and also split by type of product.

Arrears and possessions on residential mortgages and unsecured loans

		At 31 December 2011		At 31 December 2010	
		Residential	Unsecured	Residential	Unsecured
Arrears 3 months and over					
Number of cases	Number	**30,511**	**34,282**	35,908	26,274
Proportion of total	%	**4.79**	**12.33**	5.09	7.48
Asset value	£m	**4,358.8**	**466.1**	5,158.1	397.9
Proportion of book	%	**6.06**	**18.47**	6.50	12.78
Total value of payments overdue	£m	**170.4**	**56.0**	210.4	42.5
Proportion of total book	%	**0.23**	**2.22**	0.26	1.36
Possessions					
Number of cases	Number	**2,705**	-	2,607	-
Proportion of total	%	**0.42**	-	0.37	-
Asset value	£m	**395.9**	-	351.2	-
Proportion of book	%	**0.55**	-	0.44	-
Total value of payments overdue	£m	**27.1**	-	23.4	-
Proportion of total book	%	**0.04**	-	0.03	-
Total arrears 3 months and over and possessions					
Number of cases	Number	**33,216**	**34,282**	38,515	26,274
Proportion of total	%	**5.21**	**12.33**	5.46	7.48
Asset value	£m	**4,754.7**	**466.1**	5,509.3	397.9
Proportion of book	%	**6.61**	**18.47**	6.94	12.78
Total value of payments overdue	£m	**197.5**	**56.0**	233.8	42.5
Proportion of total book	%	**0.27**	**2.22**	0.29	1.36
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	**233.9**	**58.5**	273.6	46.6
Proportion of total book	%	**0.33**	**2.32**	0.34	1.50
Loan impairment provision					
As % of total balances	%	**2.24**	**16.58**	2.27	14.83
As % of arrears of 3 months and over and possessions	%	**34.59**	**107.62**	33.49	136.29

Notes to the Financial Statements (continued)

17. Credit quality of loans and advances to customers (continued)

Analysis of residential mortgages and unsecured loans 3 months and over in arrears by product

		At 31 December 2011		At 31 December 2010	
		Residential	Unsecured	Residential	Unsecured
Buy-to-let					
Number of cases	Number	**5,623**	-	8,332	-
Proportion of total	%	**2.63**	-	3.77	-
Asset value	£m	**870.7**	-	1,287.5	-
Proportion of book	%	**3.37**	-	4.78	-
Total value of payments overdue	£m	**31.3**	-	48.4	-
Proportion of total book	%	**0.12**	-	0.18	-
Self Cert					
Number of cases	Number	**2,080**	-	2,897	-
Proportion of total	%	**4.59**	-	6.09	-
Asset value	£m	**362.3**	-	510.3	-
Proportion of book	%	**5.25**	-	6.97	-
Total value of payments overdue	£m	**10.4**	-	15.4	-
Proportion of total book	%	**0.15**	-	0.21	-
Together					
Number of cases	Number	**10,391**	**15,149**	11,262	15,239
Proportion of total	%	**7.43**	**10.49**	7.40	9.61
Asset value	£m	**1,178.9**	**262.3**	1,281.6	272.2
Proportion of book	%	**8.24**	**13.95**	8.02	12.85
Total value of payments overdue	£m	**50.4**	**21.9**	58.5	20.4
Proportion of total book	%	**0.35**	**1.16**	0.37	0.96
Standard and other					
Number of cases	Number	**12,417**	**19,133**	13,417	11,035
Proportion of total	%	**5.20**	**14.31**	4.71	5.73
Asset value	£m	**1,946.9**	**203.8**	2,078.7	125.7
Proportion of book	%	**7.82**	**31.68**	7.13	12.64
Total value of payments overdue	£m	**78.3**	**34.1**	88.1	22.1
Proportion of total book	%	**0.31**	**5.30**	0.30	2.22

Notes to the Financial Statements (continued)

18. Deferred taxation

The net deferred taxation asset is attributable to the following:

At 31 December	Assets 2011 £m	Assets 2010 £m	Liabilities 2011 £m	Liabilities 2010 £m	Net 2011 £m	Net 2010 £m
Changes in accounting basis on adoption of IFRS	**11.7**	8.5	**(8.5)**	(19.4)	**3.2**	(10.9)
Unremitted earnings from overseas subsidiary	**-**	-	**-**	(3.4)	**-**	(3.4)
Cash flow hedges	**-**	9.8	**(38.1)**	-	**(38.1)**	9.8
Accelerated tax depreciation	**4.7**	6.0	**(0.7)**	(0.1)	**4.0**	5.9
Available-for-sale reserve and fair value	**-**	-	**(10.3)**	(13.4)	**(10.3)**	(13.4)
Employee benefits	**6.5**	53.0	**(11.0)**	(2.2)	**(4.5)**	50.8
Taxation value of losses carried forward	**46.5**	100.0	**-**	-	**46.5**	100.0
	69.4	177.3	**(68.6)**	(38.5)	**0.8**	138.8
Offset	**(68.6)**	(38.5)	**68.6**	38.5	**-**	-
Total	**0.8**	138.8	**-**	-	**0.8**	138.8

£22.6m (2010: £204.0m) of deferred tax assets have not been recognised, relating to unused tax losses of £10.3m (2010: £497.5m) and deductible temporary differences of £80.0m (2010: £258.0m). £46.5m (2010: £100.0m) 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.

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

	At 1 January 2011 £m	Recognised in income £m	Recognised in equity £m	At 31 December 2011 £m
Change in accounting basis on adoption of IFRS	**(10.9)**	**14.1**	**-**	**3.2**
Unremitted earnings from overseas subsidiary	**(3.4)**	**3.4**	**-**	**-**
Cash flow hedges	**9.8**	**-**	**(47.9)**	**(38.1)**
Accelerated tax depreciation	**5.9**	**(1.9)**	**-**	**4.0**
Available-for-sale reserve and fair value	**(13.4)**	**0.7**	**2.4**	**(10.3)**
Employee benefits	**50.8**	**(8.8)**	**(46.5)**	**(4.5)**
Taxation value of losses carried forward	**100.0**	**(53.5)**	**-**	**46.5**
Total	**138.8**	**(46.0)**	**(92.0)**	**0.8**

	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	(13.9)	3.0	-	(10.9)
Unremitted earnings from overseas subsidiary	(3.4)	-	-	(3.4)
Cash flow hedges	15.3	-	(5.5)	9.8
Accelerated tax depreciation	10.8	(4.9)	-	5.9
Available-for-sale reserve and fair value	(19.4)	1.0	5.0	(13.4)
Employee benefits	29.9	(7.8)	28.7	50.8
Taxation value of losses carried forward	105.8	(5.8)	-	100.0
Rolled over gains	(3.8)	3.8	-	-
Other temporary differences	0.1	(0.1)	-	-
Total	121.4	(10.8)	28.2	138.8

Deferred tax appropriately reflects the change to the standard rate of UK corporation tax to 25% with effect from 1 April 2012. The announced further rate reductions by an additional 1% on each of 1 April 2013 and 2014 to 23% would have the maximum potential impact of reducing the Group's deferred tax assets by approximately £5.3m.

Notes to the Financial Statements (continued)

19. Other assets

	2011 £m	2010 £m
Prepayments and accrued income	**26.6**	8.1
Other	**16.1**	17.6
Total	**42.7**	25.7

20. Retirement benefit assets and obligations

a) Pension schemes

The UKAR Group operates a number of retirement benefit plans for its employees, including defined benefit plans, defined contribution plans and other retirement benefits (principally medical). The costs of these plans are charged to the Income Statement and other comprehensive income in accordance with IFRIC 14 'IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' and IAS 19 'Employee Benefits'.

Further details in respect of the Group's schemes are given in sections (b) (B&B schemes) and (c) (NRAM schemes) below.

b) Bradford & Bingley schemes

Pension schemes
The B&B 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 B&B Group defined contribution scheme from 1 January 2010. The assets of the principal scheme are held in a separate trustee-administered fund. The normal pension age of employees in the principal scheme is 65.

The B&B Group also operates a defined contribution scheme, the Bradford & Bingley Group Pension Plan. The assets of this scheme are independent from those of the Group. The UKAR Group and Company had no liabilities or prepayments associated with the defined contribution scheme at 31 December 2011 (2010: £nil). The cost in the year to the UKAR Group of the defined contribution scheme was £3.5m (2010: £1.8m) and the cost to the UKAR Company was £nil (2010: £nil).

Other post-retirement benefits
The B&B Group provides healthcare benefits to some of its pensioners. The healthcare benefits are provided through a post-retirement medical scheme into which the UKAR Group 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 2011 was 336 (2010: 355). Private medical costs are assessed in accordance with the advice of a qualified actuary.

Accounting treatment
The B&B Group accounts for post-retirement benefit costs in accordance with IAS 19 and IFRIC 14. The full net deficit is carried on the UKAR Group Balance Sheet, and gains and losses arising due to actuarial revaluations and adjustments to reflect the funding plan commitments are taken to UKAR Group other comprehensive income rather than being credited or charged in the Income Statement.

The Group is committed to a funding plan to address the deficit on the B&B defined benefit plan and in July 2010 B&B committed to make contributions of £16m per annum increasing at 10% pa for 10 years, commencing in 2010. In accordance with IFRIC 14 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 B&B Group 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. In March 2011 the Trustees finalised a resolution under Section 251(3) of the Pensions Act 2004 for the refund of any future surpluses to B&B. At 31 December 2010, this resolution not yet being in effect, the funding plan reduced retained earnings by £117.6m.

At 31 December 2010 the inflation assumption used to determine benefit obligations was based on the Retail Prices Index ('RPI'), pending fulfilment of conditions which would need to be satisfied in order for the proposed change to a Consumer Prices Index ('CPI') basis to come into effect in respect of deferred members. The conditions were satisfied during 2011, and consequently CPI has been applied with effect from 1 January 2011. Consequently the net pension liability carried on the UKAR Group Balance Sheet reduced at that time by a credit to other comprehensive income.

The actuarial gain recognised in the UKAR Group's other comprehensive income during the year was £34.0m (2010: gain £7.8m) and retained earnings have also increased by £117.6m as a result of the passing of the resolution regarding the refund of surpluses (2010: decrease of £117.6m). The cumulative actuarial loss recognised in other comprehensive income since transition to IFRS on 1 January 2004 is £35.0m (2010: £69.0m).

Notes to the Financial Statements (continued)

20. Retirement benefit assets and obligations (continued)

b) Bradford & Bingley schemes (continued)

Defined benefit obligations

The amounts carried on the UKAR Group Balance Sheet are as follows:

	Defined benefit pension plans		Post-retirement medical benefits		Total	
	2011 £m	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m
Present value of defined benefit obligations	**(663.7)**	(650.7)	**(9.9)**	(9.0)	**(673.6)**	(659.7)
Fair value of defined benefit assets	**649.0**	583.2	**-**	-	**649.0**	583.2
Effect of agreed funding plan	**-**	(117.6)	**-**	-	**-**	(117.6)
Defined benefit liability	**(14.7)**	(185.1)	**(9.9)**	(9.0)	**(24.6)**	(194.1)

As described above, the defined benefit liability at 31 December 2011 reflected the net present value of committed funding.

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

	Defined benefit pension plans		Post-retirement medical benefits		Total	
	2011 £m	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m
Interest on defined benefit obligations	**34.0**	33.6	**0.5**	0.5	**34.5**	34.1
Expected return on defined benefit assets	**(34.4)**	(30.7)	**-**	-	**(34.4)**	(30.7)
Net (credit)/cost	**(0.4)**	2.9	**0.5**	0.5	**0.1**	3.4

The actual return on defined benefit assets for the year was £65.8m (2010: £61.9m).

Movements in the present value of defined benefit obligations during the year:

	Defined benefit pension plans		Post-retirement medical benefits		Total	
	2011 £m	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m
At 1 January	**650.7**	615.1	**9.0**	7.8	**659.7**	622.9
Interest on defined benefit obligations	**34.0**	33.6	**0.5**	0.5	**34.5**	34.1
Actuarial (gain)/loss	**(3.3)**	22.4	**0.7**	1.0	**(2.6)**	23.4
Benefits paid	**(17.7)**	(20.4)	**(0.3)**	(0.3)	**(18.0)**	(20.7)
At 31 December	**663.7**	650.7	**9.9**	9.0	**673.6**	659.7

Movements in the fair value of defined benefit assets were as follows:

	Defined benefit pension plans		Post-retirement medical benefits		Total	
	2011 £m	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m
At 1 January	**583.2**	525.2	**-**	-	**583.2**	525.2
Expected return on defined benefit assets	**34.4**	30.7	**-**	-	**34.4**	30.7
Defined benefit company contributions	**17.6**	16.4	**0.5**	0.3	**18.1**	16.7
Actuarial gain	**31.4**	31.2	**-**	-	**31.4**	31.2
Benefits paid	**(17.6)**	(20.3)	**(0.5)**	(0.3)	**(18.1)**	(20.6)
At 31 December	**649.0**	583.2	**-**	-	**649.0**	583.2

The UKAR Group expects to contribute £19.4m to the defined benefit pension plan in 2012.

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

	2011	2010
Equities	**23%**	40%
Property	**8%**	8%
Bonds	**40%**	30%
Gilts	**19%**	13%
Cash and other	**10%**	9%
Total	**100%**	100%

Notes to the Financial Statements (continued)

20. Retirement benefit assets and obligations (continued)

b) Bradford & Bingley schemes (continued)

Summary actuarial assumptions (expressed as weighted averages) were as follows:

	2011	2010
To determine benefit obligations:		
Discount rate at 31 December	**4.7%**	5.3%
Inflation (RPI)	**3.0%**	3.4%
Inflation (CPI)	**2.3%**	N/A
Future pension increases	**2.9%**	3.3%
To determine the net pension cost:		
Expected return on plan assets	**5.9%**	6.0%
Discount rate	**5.3%**	5.6%
For post-retirement medical plan:		
Discount rate	**4.7%**	5.3%
Medical cost trend for duration of liability	**5.2%**	6.0%

In determining the expected long-term return on defined benefit assets, the Group 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 table below shows the life expectancy assumptions from age 60:

	Pensioner	2011 Non-retired member	Pensioner	2010 Non-retired member
Male	**27.3**	**28.9**	26.6	28.8
Female	**30.2**	**31.8**	29.5	31.7

The table below illustrates the 5 year history of experience gains and losses for the B&B defined benefit pension plan:

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Defined benefit obligations	**(663.7)**	(650.7)	(615.1)	(480.5)	(586.8)
Fair value of defined benefit assets	**649.0**	583.2	525.2	485.3	575.8
IFRIC 14 restriction	**-**	(117.6)	-	(4.8)	-
Deficit	**(14.7)**	(185.1)	(89.9)	-	(11.0)
Experience gain/(loss) on liabilities	**3.3**	(22.4)	(132.6)	101.5	60.4
Experience gain/(loss) on assets	**31.4**	31.2	21.3	(115.7)	(6.9)

Sensitivity

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

Assumption	Change in assumption	Impact on net obligations
Discount rate	Decrease by 0.5%	Increase by 11%
Inflation	Increase by 0.5%	Increase by 10%
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 defined benefit obligations 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:

	2011 £m	2010 £m
Effect on interest cost	**0.1**	0.1
Effect on defined benefit obligations	**1.3**	1.2

Notes to the Financial Statements (continued)

20. Retirement benefit assets and obligations (continued)

c) NRAM schemes

Pension schemes

The NRAM Group operated a staff pension scheme ('the scheme'), which had both defined benefit and defined contribution sections. On 1 January 2010 all employees previously employed by the NRAM Group transferred to Northern Rock plc under the terms of the Northern Rock Transfer Order 2009. As a consequence of this, members of the scheme became members of the Northern Rock (2010) Pension Scheme (defined contribution scheme) and the existing scheme was closed. The assets of the closed scheme are held in a separate trustee-administered fund. The normal pension age of employees in this scheme is 60.

Of the employees who transferred to the Northern Rock (2010) Pension Scheme, 1,254 subsequently transferred to B&B on 1 November 2010 and were eligible to join that company's defined contribution pension scheme (the Bradford & Bingley Group Pension Plan). The NRAM Group had no liabilities or prepayments associated with the B&B defined contribution scheme as at 31 December 2011 (2010: £nil). The cost in the year to the NRAM Group arising from amounts recharged by B&B in respect of employees providing services to the NRAM Group who participate in this scheme was £2.2m (2010: £0.3m).

Accounting treatment

The ongoing costs of providing the accrued benefits earned by members of the defined benefit section of the scheme are recognised in the UKAR Group's accounts in accordance with IAS 19 and IFRIC 14. The full net surplus or deficit is carried on the UKAR Group's Balance Sheet, and gains and losses arising due to actuarial revaluations are taken to other comprehensive income rather than being credited or charged in the Income Statement. The actuarial gain recognised in the UKAR Group's other comprehensive income during the year was £19.1m (2010: loss £6.2m). The cumulative actuarial loss recognised in Group other comprehensive income since transition to IFRS on 1 January 2004 is £15.8m (2010: £34.9m).

The UKAR Group continues to determine benefit obligations under this scheme based on the Retail Prices Index (RPI).

Defined benefit section of scheme

The amounts carried on the UKAR Group Balance Sheet are as follows:

	2011 £m	2010 £m
Present value of defined benefit obligations	**(423.7)**	(371.9)
Fair value of defined benefit assets	**473.5**	380.2
Net defined benefit asset	**49.8**	**8.3**

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

	2011 £m	2010 £m
Interest on defined benefit obligations	**19.5**	21.1
Expected return on defined benefit assets	**(20.0)**	(19.2)
Defined benefit pension gain	**(3.5)**	-
Curtailment gain	**-**	(9.1)
Net credit	**(4.0)**	(7.2)

The defined benefit pension gain in 2011 has been calculated in accordance with IAS 19 and arises due to the transfer in of certain assets and obligations from the Northern Rock (2010) Pension Scheme.

The curtailment gain in 2010 has been calculated in accordance with IAS 19 and arises due to members accruing no further benefits with the scheme following its closure.

The actual return on defined benefit assets for the year was a gain of £77.9m (2010: loss of £2.8m).

Movements in the present value of defined benefit obligations during the year:

	2011 £m	2010 £m
At 1 January	**371.9**	391.4
Interest on defined benefit obligations	**19.5**	21.1
Actuarial loss/(gain)	**38.8**	(15.8)
Benefits paid	**(9.7)**	(11.9)
Curtailment gain	**-**	(9.1)
Other adjustments	**3.2**	(3.8)
At 31 December	**423.7**	371.9

Other adjustments in 2011 represent obligations arising from the transfer in from members of the Northern Rock (2010) Pension Scheme.

Other adjustments in 2010 are in respect of the transfer to the Northern Rock (2010) Pension Scheme of obligations for the money purchase guarantee reserve.

Notes to the Financial Statements (continued)

20. Retirement benefit assets and obligations (continued)

c) NRAM schemes (continued)

Movements in the fair value of defined benefit assets were as follows:

	2011 £m	2010 £m
At 1 January	**380.2**	386.5
Expected return on defined benefit assets	**20.0**	19.2
Defined benefit company contributions	**18.4**	12.2
Actuarial gain/(loss)	**57.9**	(22.0)
Benefits paid	**(9.7)**	(11.9)
Other adjustments	**6.7**	(3.8)
At 31 December	**473.5**	380.2

Other adjustments in 2011 represent obligations arising from the transfer in from members of the Northern Rock (2010) Pension Scheme. Other adjustments in 2010 are in respect of the transfer to the Northern Rock (2010) Pension Scheme of assets for the money purchase guarantee reserve.

The UKAR Group expects to contribute £15.3m to this defined benefit pension plan in 2012 under a funding plan to address the deficit on the scheme as calculated on a trustees funding basis.

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

	2011	2010
Equities	**3%**	3%
Property	**-**	3%
Bonds	**20%**	21%
Gilts	**39%**	28%
Cash and other	**38%**	45%
Total	**100%**	100%

Summary actuarial assumptions (expressed as weighted averages) were as follows:

	2011	2010
To determine benefit obligations:		
Discount rate at 31 December	**4.7%**	5.3%
Inflation (RPI)	**3.0%**	3.4%
Future pension increases	**2.9%-3.5%**	3.3% - 3.7%
To determine the net pension cost:		
Expected return on plan assets	**5.1%**	4.9%
Discount rate	**5.3%**	5.7%

In determining the expected long-term return on defined benefit assets, the UKAR Group 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 table below shows the life expectancy assumptions from age 60:

	2011 Pensioner	2011 Non-retired member	2010 Pensioner	2010 Non-retired member
Male	**27.5**	**28.5**	27.4	28.4
Female	**30.0**	**30.8**	29.9	30.8

Notes to the Financial Statements (continued)

20. Retirement benefit assets and obligations (continued)

c) NRAM schemes (continued)

The table below illustrates the 5 year history of experience gains and losses for the NRAM defined benefit pension plan:

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Defined benefit obligations	**(423.7)**	(371.9)	(391.4)	(335.8)	(354.6)
Fair value of assets	**473.5**	380.2	386.5	367.5	360.3
Surplus/(deficit)	**49.8**	8.3	(4.9)	31.7	5.7
Experience (loss)/gain on liabilities	**(6.5)**	9.3	12.2	2.8	19.5
Experience gain/(loss) on assets	**57.9**	(22.0)	(6.3)	(1.9)	6.2

Sensitivity

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

Assumption	Change in assumption	Impact on net obligations
Discount rate	Decrease by 0.5%	Increase by 12%
Inflation	Increase by 0.5%	Increase by 8%
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.

21. Investment property

At 31 December 2009 NRAM's Gosforth Head Office site was wholly occupied by NRAM and was classed as owner occupied property within property, plant and equipment. Following the completion of a legal and capital restructuring, a proportion of this site has been leased to Northern Rock plc since 1 January 2010. On 1 October 2010 NRAM was acquired by UKAR, resulting in a clearer strategy for the Group's plans in respect of the Gosforth site. Accordingly that element was reclassified as an investment property as of 1 October 2010.

The Group carries its investment property at fair value. Fair value is determined by independent professional valuers who apply recognised valuation techniques.

During the year, rental income and direct property repair and maintenance costs in respect of the property of £6.5m and £0.6m respectively have been recognised in the Income Statement (1 October to 31 December 2010: £1.7m and £0.3m respectively).

Movements in the value of investment property are analysed as follows:

	2011 £m	2010 £m
Investment properties at fair value at 1 January	**26.6**	-
Transfer from property, plant and equipment	**-**	26.6
Fair value movement	**-**	-
Investment properties at fair value at 31 December	**26.6**	26.6

Notes to the Financial Statements (continued)

22. Property, plant and equipment

2011	Land and buildings £m	Plant, equipment, fixtures, fittings and vehicles £m	Total £m
Cost			
At 1 January 2011	**63.2**	**75.9**	**139.1**
Additions	**-**	**13.5**	**13.5**
Disposals	**-**	**(0.7)**	**(0.7)**
At 31 December 2011	**63.2**	**88.7**	**151.9**
Depreciation			
At 1 January 2011	**22.4**	**56.0**	**78.4**
Charged in year	**2.7**	**2.7**	**5.4**
Accelerated depreciation	**9.1**	**10.0**	**19.1**
Disposals	**-**	**(0.2)**	**(0.2)**
At 31 December 2011	**34.2**	**68.5**	**102.7**
Net book amount:			
At 1 January 2011	**40.8**	**19.9**	**60.7**
At 31 December 2011	**29.0**	**20.2**	**49.2**

2010	Land and buildings £m	Plant, equipment, fixtures, fittings and vehicles £m	Total £m
Cost			
At 1 January 2010	143.6	217.5	361.1
Transferred to Northern Rock plc (see note 39)	(23.5)	(104.0)	(127.5)
Additions	0.2	10.0	10.2
Disposals	(7.0)	(7.1)	(14.1)
Transfers	5.8	(2.5)	3.3
Transferred to investment property (see note 21)	(55.9)	(38.0)	(93.9)
At 31 December 2010	63.2	75.9	139.1
Depreciation			
At 1 January 2010	29.6	161.9	191.5
Transferred to Northern Rock plc (see note 39)	(5.9)	(88.9)	(94.8)
Charged in year	1.0	2.4	3.4
Accelerated depreciation	29.6	22.2	51.8
Disposals	(3.6)	(5.9)	(9.5)
Transfers	3.5	(0.2)	3.3
Transferred to investment property (see note 21)	(31.8)	(35.5)	(67.3)
At 31 December 2010	22.4	56.0	78.4
Net book amount:			
At 1 January 2010	114.0	55.6	169.6
At 31 December 2010	40.8	19.9	60.7

Accelerated depreciation charges have been made of £19.1m (2010: £51.8m). The charge in 2011 related to NRAM's Head Office, and IT assets which will no longer be of use to the business following the decision to change IT service provider. The charge in 2010 represented the difference between the carrying amount and fair value of NRAM's investment property at the date of reclassification (see note 21).

Following a review of expected useful lives of freehold buildings, the rate of depreciation was changed with effect from 1 January 2011 as described in note 1(s). This change increased the depreciation charge in 2011 by £2.0m compared to the previous depreciation rates.

At 31 December 2011, cumulatively, work in progress of £8.2m (2010: £9.2m) has been capitalised and is not being depreciated. Of this, £8.2m (2010: £0.7m) relates to 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 by mid 2012.

During 2011, £8.5m which was held as work in progress at 31 December 2010 and £4.6m of additions during 2011 has begun depreciating. This relates to an IT investment programme to simplify existing infrastructure and reduce ongoing costs.

Sale proceeds from asset disposals were £0.5m (2010: £7.6m) resulting in a profit on sale of £nil (2010: £3.0m).

Notes to the Financial Statements (continued)

23. Intangible assets

2011	Goodwill £m	Software £m	Total £m
Cost			
At 1 January 2011	**30.7**	**29.9**	**60.6**
Additions	**-**	**31.3**	**31.3**
Disposals	**-**	**(2.8)**	**(2.8)**
At 31 December 2011	**30.7**	**58.4**	**89.1**
Impairment and amortisation			
At 1 January 2011	**30.7**	**26.6**	**57.3**
Amortisation charged in year	**-**	**0.1**	**0.1**
Disposals	**-**	**(2.8)**	**(2.8)**
At 31 December 2011	**30.7**	**23.9**	**54.6**
Net book amount:			
At 1 January 2011	**-**	**3.3**	**3.3**
At 31 December 2011	**-**	**34.5**	**34.5**

2010	Goodwill £m	Software £m	Total £m
Cost			
At 1 January 2010	30.7	204.3	235.0
Additions	-	3.3	3.3
Transferred to Northern Rock plc (see note 39)	-	(161.1)	(161.1)
Disposals	-	(16.6)	(16.6)
At 31 December 2010	30.7	29.9	60.6
Impairment and amortisation			
At 1 January 2010	-	181.2	181.2
Transferred to Northern Rock plc (see note 39)	-	(138.0)	(138.0)
Impairment charged in year	30.7	-	30.7
Disposals	-	(16.6)	(16.6)
At 31 December 2010	30.7	26.6	57.3
Net book amount:			
At 1 January 2010	30.7	23.1	53.8
At 31 December 2010	-	3.3	3.3

At 31 December, cumulatively, work in progress of £32.8m (2010: £3.3m) has been capitalised and is not being amortised at the year end. Of this, £32.8m (2010: £3.1m) relates to an IT investment programme to transform the infrastructure of NRAM and to integrate it into B&B's infrastructure; this programme is currently expected to complete by mid 2012.

During 2011, £0.2m of work in progress held at 31 December 2010 and £0.4m of additions in 2011 has begun amortising. This relates to an IT investment programme to simplify existing infrastructure and reduce ongoing costs.

Goodwill resulted from the acquisition of a mortgage company. The Group no longer writes new mortgage business, and the goodwill was fully impaired during 2010.

Sale proceeds from asset disposals were £nil (2010: £nil) resulting in a profit on sale of £nil (2010: £nil).

Notes to the Financial Statements (continued)

24. Statutory Debt and HM Treasury loans

	2011 £m	2010 £m
HM Treasury loan to NRAM	**19,726.4**	21,727.3
B&B Statutory Debt	**18,416.2**	18,416.2
HM Treasury Working Capital Facility to B&B	**8,439.6**	8,564.2
Total	**46,582.2**	48,707.7

The HM Treasury loan to NRAM is repayable on demand. Interest is charged at Bank of England Base Rate + 25 bps. At the signing date of these Financial Statements HM Treasury has confirmed its intentions to continue to provide funding until at least 1 October 2013. It has also committed to convert up to £1.6bn of its loan to NRAM to meet regulatory capital requirements if so required. It is expected that the HM Treasury loan will be repaid out of the cash flows generated by NRAM during its 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 HM Treasury loan to NRAM is uncertain.

B&B has an interest-free Statutory Debt of £18,416.2m as at 31 December 2011 and 31 December 2010. This replaced B&B's savings-related assets and liabilities which were transferred to Banco Santander Group on 29 September 2008. £15,654.5m of the Statutory Debt is owed to the Financial Services Compensation Scheme ('FSCS'). The remaining £2,761.7m is owed to HMT, relating to savings balances in excess of the £35,000 which was covered by the FSCS at that time. It is expected that the Statutory Debt will be repaid out of the cash flows generated by B&B during its 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.

B&B has an interest-bearing Working Capital Facility ('WCF') provided by HM Treasury. Since 1 August 2011 the rate charged has been Bank of England Base Rate + 500bps, and prior to that date the rate was Bank of England Base Rate + 150bps. HM Treasury has the option to vary the rate charged. At 31 December 2011 B&B had drawn £8,400.0m (2010: £8,550.0m) of this facility; £8,439.6m including accrued interest (2010: £8,564.2m). HM Treasury has indicated that its current intention is to continue to fund B&B as a going concern, and to enable B&B to meet its debts as and when they fall due, until at least 1 October 2013. HM Treasury has indicated that it expects the WCF to be repaid out of the cash flows generated by B&B during its 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.

25. Debt securities in issue

	Securitised notes £m	Covered Bonds £m	Other £m	Total £m
At 1 January 2011	**29,129.7**	**14,913.7**	**4,385.3**	**48,428.7**
Repayments	**(4,867.2)**	**(2,495.6)**	**(2,245.5)**	**(9,608.3)**
Other movements	**(379.0)**	**(322.1)**	**(57.8)**	**(758.9)**
At 31 December 2011	**23,883.5**	**12,096.0**	**2,082.0**	**38,061.5**
Securitised assets	**31,050.3**	**19,825.9**	**-**	**50,876.2**

	Securitised notes £m	Covered Bonds £m	Other £m	Total £m
At 1 January 2010	34,650.1	15,791.1	6,654.3	57,095.5
Repayments	(5,537.8)	(1,376.5)	(1,926.1)	(8,840.4)
Other movements	17.4	499.1	(342.9)	173.6
At 31 December 2010	29,129.7	14,913.7	4,385.3	48,428.7
Securitised assets	35,326.9	21,164.6	-	56,491.5

Other movements comprise exchange rate movements, accrued interest and hedge accounting adjustments.

The B&B and NRAM Groups issued debt securities to securitise loans and advances to customers through SPVs and Covered Bonds, 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.

HM Treasury has provided guarantees with regard to certain wholesale borrowings of the B&B and NRAM Groups; the Group pays fees for these guarantees, as detailed in note 4.

Securitised assets represent loans and advances to customers which have been used to securitise issued notes, including notes which are held by other Group companies.

Further details of debt securities in issue are provided in the Annual Reports and Accounts of B&B and NRAM, copies of which are available on the corporate website of each of these companies.

At 31 December 2011 the SPVs had cash deposits (including accrued interest) amounting to £3,371.0m, including collateral deposits of £1,311.8m (2010: £4,444.8m, including collateral deposits of £2,380.7m). This balance (excluding the collateral deposits) is restricted in use to the repayment of the debt securities issued by the SPVs and other legal obligations.

Notes to the Financial Statements (continued)

26. Other liabilities

	2011 £m	2010 £m
Surplus conversion shares	**13.2**	13.5
Accruals and deferred income	**61.7**	46.4
Other	**89.0**	168.4
Total	**163.9**	228.3

27. Provisions

	Customer redress £m	Onerous contracts £m	Restructuring £m	Total £m
At 1 January 2011	**223.7**	**17.5**	**8.5**	**249.7**
Utilised in the year	**(50.4)**	**(7.3)**	**(4.0)**	**(61.7)**
Charged in the year	**0.4**	**2.0**	**26.1**	**28.5**
Released in the year	**-**	**-**	**(1.5)**	**(1.5)**
At 31 December 2011	**173.7**	**12.2**	**29.1**	**215.0**

	Customer redress £m	Onerous contracts £m	Restructuring £m	Total £m
At 1 January 2010	96.2	22.1	22.3	140.6
Utilised in the year	(33.9)	(3.8)	(13.8)	(51.5)
Charged in the year	162.0	(0.8)	-	161.2
Released in the year	(0.6)	-	-	(0.6)
At 31 December 2010	223.7	17.5	8.5	249.7

The provision for customer redress relates to potential claims from customers in relation to Payment Protection Insurance ('PPI'), wealth and endowment products. Total customer compensation payments made during the year were £50.4m (2010: £33.9m). NRAM increased its provision in respect of unsecured lending PPI and other customer compensation by £160.0m in 2010, and in July 2011 commenced a proactive customer contact programme. Based on current evidence, the Group believes the provision for customer redress to be adequate.

The onerous contracts provision relates to empty leasehold premises 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 to 2025.

Restructuring costs of £26.1m have been provided in 2011 which relate to expected redundancy costs following the announcement of the UKAR restructure and the phased exit from the Gosforth site. A £1.5m provision for the right-sizing and removal of legacy IT systems has been released.

Notes to the Financial Statements (continued)

28. Capital instruments

	Initial interest rate	First due or callable	Final maturity	Issuer	At 31 December 2011 Carrying amount £m	At 31 December 2011 Principal £m	At 31 December 2010 Carrying amount £m	At 31 December 2010 Principal £m
Dated subordinated notes	7.625%	2010	2050	B&B	**15.2**	**12.4**	31.6	27.7
Dated fixed rate step-up subordinated notes	5.50%	2018	2018	B&B	**5.2**	**4.4**	20.2	17.3
Dated fixed rate step-up subordinated notes	5.75%	2022	2022	B&B	**-**	**-**	37.2	30.8
Dated subordinated notes	6.625%	2023	2023	B&B	**-**	**-**	36.7	30.5
Dated subordinated notes	LIBOR +1.300%	2054	2054	B&B	**-**	**-**	77.6	75.0
Callable perpetual subordinated notes	5.625%	2013	Undated	B&B	**20.8**	**18.1**	43.7	39.5
Callable perpetual subordinated notes	6.00%	2019	Undated	B&B	**21.9**	**20.0**	34.6	33.5
Undated perpetual subordinated bonds	13.00%	Perpetual	Undated	B&B	**35.8**	**41.5**	29.2	41.5
Undated perpetual subordinated bonds	11.625%	Perpetual	Undated	B&B	**32.2**	**35.7**	27.1	35.7
Subordinated bonds	5.625%	2010	2015	NRAM	**-**	**-**	309.3	300.0
Subordinated loan	11.734%	See below	2016	NRAM	**25.0**	**20.0**	25.6	20.0
Subordinated bonds	5.75%	2012	2017	NRAM	**-**	**-**	270.7	250.0
Subordinated bonds	10.375%	2018	2018	NRAM	**-**	**-**	54.4	50.0
Subordinated bonds	9.375%	2021	2021	NRAM	**-**	**-**	152.1	150.0
HM Treasury PIK interest	See below	See below	2013	NRAM	**150.8**	**150.7**	150.7	150.7
Tier one notes	7.053%	2027	Undated	NRAM	**43.5**	**30.7**	137.9	110.5
Perpetual preferred securities	6.462%	2032	2032	B&B Capital Funding L.P.	**-**	**-**	56.0	46.3
Total					**350.4**	**333.5**	1,494.6	1,409.0

The capital instruments are all denominated in sterling.

The carrying values of these instruments 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.

The 11.734% subordinated loan 2016 is repayable in five equal annual instalments from 2012 to 2016.

The HM Treasury PIK interest represents the amount of margin payable to HM Treasury which was subordinated under the terms of the HM Treasury loan to NRAM (see note 24). Repayment of this amount is due on 1 April 2013. Interest is payable on this loan at a floating rate above the Bank Base Rate.

Since mid-June 2009, the B&B Board have deferred payment of all principal and coupons in respect of B&B'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 B&B Group announced that it had resolved not to make any payment of principal or interest in respect of the B&B 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 24. This Board decision followed the notification to the B&B Group on 25 January 2010 of the EC's approval of State Aid. The EC's decision set various conditions on the B&B Group receiving State Aid, one of which was that the B&B 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 B&B Group announced that it had resolved to continue to make payments in full under its guarantee of the 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.

As a consequence of the announcement of 23 February 2010, the carrying value of B&B's subordinated liabilities was reduced by £104.3m, with an equal gain being recognised in the Income Statement, 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.

As detailed in note 9, in 2011 and 2010 the Group bought back certain of its capital instruments.

Redemptions of any capital instruments prior to their final maturity date are subject to obtaining prior consent of the FSA.

The rights of repayment of holders of capital instruments are subordinated to the claims of other creditors.

Further details of capital instruments are provided in the Annual Reports and Accounts of B&B and NRAM, copies of which are available on the corporate website of each of these companies.

Notes to the Financial Statements (continued)

29. Called up share capital

	25p Ordinary shares Number	25p Preference shares Number	25p Ordinary shares £	25p Preference shares £	Total share capital £
At 1 January 2011 and 31 December 2011	4,955,595	4,000	1,238,899	1,000	1,239,899
At 1 January 2010	-	-	-	-	-
Issued 1 July 2010	4,000	-	1,000	-	1,000
Issued 1 October 2010	4,951,595	4,000	1,237,899	1,000	1,238,899
At 31 December 2010	4,955,595	4,000	1,238,899	1,000	1,239,899

On the Company's incorporation on 1 July 2010 the Company issued 1,000 £1 ordinary shares to the Treasury Solicitor for cash. On 1 October 2010 these shares were subdivided into 4,000 25p ordinary shares.

On 1 October 2010 the Company issued 6,000 25p ordinary shares to the Treasury Solicitor in exchange for the whole issued share capital of B&B, and issued 4,945,595 25p ordinary shares and 4,000 25p non-cumulative callable preference shares to the Treasury Solicitor in exchange for the whole issued share capital of NRAM.

In accordance with the Companies Act 2006, the Company does not have authorised capital other than its issued capital.

The ordinary shares rank equally in respect of rights attached to voting, dividends and in the event of a winding up.

Dividends on preference shares are discretionary and, subject to Board approval, are payable annually on 4 July at a rate of 6.8509% based on a principal amount of £1,000 per preference share.

No dividends were declared or paid in 2011 or 2010 on the Company's ordinary or preference shares.

As described in note 1, these consolidated Financial Statements are prepared under the 'predecessor accounting' method and hence in the Balance Sheet the share capital is shown as though it had been issued prior to 1 January 2010.

30. Reserves

Reserves comprise the following:

	2011 £m	2010 £m
Available-for-sale reserve	**(106.9)**	(211.7)
Cash flow hedge reserve	**210.4**	(93.0)
Merger reserve	**1,122.6**	1,122.6
Total	**1,226.1**	817.9

Available-for-sale reserve

	2011 £m	2010 £m
At 1 January	**(211.7)**	(401.1)
Amounts recognised in equity	**107.6**	164.1
Amounts transferred to net income	**(2.8)**	25.3
At 31 December	**(106.9)**	(211.7)

The available-for-sale reserve represents cumulative fair value movements on assets classified as available-for-sale.

Cash flow hedge reserve

	2011 £m	2010 £m
At 1 January	**(93.0)**	(165.4)
Amounts recognised in equity	**61.2**	74.0
Amounts transferred to net income	**242.2**	(1.6)
At 31 December	**210.4**	(93.0)

The cash flow hedge reserve represents cumulative fair value movements on financial instruments which are effective cash flow hedges.

Merger reserve

	2011 £m	2010 £m
At 1 January and 31 December	**1,122.6**	1,122.6
Generated on acquisition of B&B	**589.3**	589.3
Generated on acquisition of NRAM	**533.3**	533.3
Total	**1,122.6**	1,122.6

Notes to the Financial Statements (continued)

30. Reserves (continued)

The merger reserve was generated on 1 October 2010 when the Company acquired all the issued shares of B&B and NRAM from the Treasury Solicitor via a share-for-share exchange. The merger reserve represents the difference between the value attributed to the Company's investment in each company and the capital and non-distributable reserves of the acquired groups. As described in note 1, these consolidated Financial Statements are prepared under the 'predecessor accounting' method, and hence the merger reserve and other reserves are treated as having been in existence at 1 January 2010.

31. Non-shareholders' funds

In accordance with the requirements of IAS 32, the following instruments are classified as equity:

	2011 £m	2010 £m
Reserve capital instruments	**102.3**	156.2
Subordinated notes	**23.4**	52.9
Total non-shareholders' funds	**125.7**	209.1

a) Reserve capital instruments

Reserve capital instruments were issued by NRAM for a value of £200.0m in September 2000 and for £100.0m in May 2001 and are undated. They carry a coupon of 8.399% payable annually in arrears on 21 September each year. At each payment date NRAM will decide whether to declare or defer the coupon. If NRAM decides to declare the coupon, the holder will receive a cash payment equivalent to the coupon which will be achieved either by the payment of cash directly, or while NRAM is in public ownership, as per the terms of Article 5 of The Northern Rock Transfer Order 2008 (the 'Transfer Order') which was made on 21 February 2008 pursuant to the Banking (Special Provisions) Act 2008. If NRAM elects to defer the coupon, it may not declare or pay a dividend on any share until the deferred coupons are satisfied. While NRAM is in public ownership, deferred coupons and any interest accruing thereon can only be satisfied in accordance with the terms of Article 5 of the Transfer Order.

NRAM has a call option after 15 years, which it can only exercise with the consent of the FSA. If the issue is not called, the coupon resets to yield 4.725% above the prevailing 5-year benchmark Gilt rate.

The full amount of reserve capital instruments is permitted for inclusion within NRAM's regulatory capital.

As detailed in note 9, in 2011 and 2010 the Group bought back certain of its capital instruments.

b) Subordinated notes

At 31 December	Interest rate	Terms	Denomination	2011 £m	2010 £m
Perpetual subordinated notes	12.625%	Not redeemable	Sterling	**13.5**	13.5
Undated subordinated notes	8.00%	Redeemable on coupon dates which fall on 15 March, 15 June, 15 September and 15 December	US$	**-**	19.0
Perpetual fixed to floating rate subordinated notes	6.594%	Not redeemable before 28/06/17	US$	**1.2**	1.2
Fixed rate step-up undated subordinated notes	6.75%	Not redeemable before 17/06/24	Sterling	**-**	10.5
Undated subordinated notes	5.60%	Not redeemable before 30/04/14	US$	**8.7**	8.7
Total				**23.4**	52.9

Redemptions of any subordinated notes are at the issuer's option only and are subject to obtaining prior consent of the FSA.

The rights of repayment of holders of subordinated notes are subordinated to the claims of other creditors.

As detailed in note 9, in 2011 and 2010 the Group bought back certain of its capital instruments.

c) Appropriations

Coupons on non-shareholders' funds are treated as appropriations.

One of the conditions resulting from NRAM's State Aid approval in October 2009 requires NRAM to withhold coupon payments on all subordinated instruments where possible. Consequently no appropriations have been made in respect of NRAM's reserve capital instruments or subordinated notes during 2011 (2010: £nil).

Notes to the Financial Statements (continued)

32. Off Balance Sheet commitments

a) Commitments payable

At 31 December 2011	Within one year £m	In one to five years £m	Over five years £m	Total £m
Loan commitments:				
- Lifetime mortgages	**57.9**	**246.3**	**1,102.2**	**1,406.4**
- Other loans	**2,160.0**	**-**	**-**	**2,160.0**
Total loan commitments	**2,217.9**	**246.3**	**1,102.2**	**3,566.4**
Operating lease commitments:				
- Land and buildings	**2.0**	**1.8**	**0.1**	**3.9**
Capital commitments	**7.9**	**-**	**-**	**7.9**
Total	**2,227.8**	**248.1**	**1,102.3**	**3,578.2**

At 31 December 2010	Within one year £m	In one to five years £m	Over five years £m	Total £m
Loan commitments:				
- Lifetime mortgages	57.0	243.3	1,140.8	1,441.1
- Other loans	2,622.5	-	-	2,622.5
Total loan commitments	2,679.5	243.3	1,140.8	4,063.6
Operating lease commitments:				
- Land and buildings	2.8	6.0	0.9	9.7
Capital commitments	8.1	-	-	8.1
Total	2,690.4	249.3	1,141.7	4,081.4

Loan commitments represent contractual amounts to which the Group is committed for extension of credit to customers. In respect of lifetime mortgages which involved the advance of a lump sum on which interest continues to accrue but is not payable until the loan is redeemed, the commitment reflects an estimate of the interest expected to roll up until redemption. In respect of monthly drawdown products, the commitment reflects an estimate of the future drawdowns to redemption. On other loans, the commitment comprises cash which could be re-drawn by customers in respect of amounts voluntarily overpaid.

Operating lease commitments represent minimum future lease payments under non-cancellable operating leases.

Capital commitments represent contractual amounts to which the Group is committed in respect of IT infrastructure investment.

b) Commitments receivable

At 31 December 2011	Within one year £m	In one to five years £m	Over five years £m	Total £m
Operating lease commitments:				
- Land and buildings	**7.0**	**7.6**	**-**	**14.6**
Total	**7.0**	**7.6**	**-**	**14.6**

At 31 December 2010	Within one year £m	In one to five years £m	Over five years £m	Total £m
Operating lease commitments:				
- Land and buildings	7.0	14.5	0.1	21.6
Total	7.0	14.5	0.1	21.6

Operating lease commitments represent minimum future lease payments receivable under non-cancellable operating leases.

Notes to the Financial Statements (continued)

33. Related party disclosures

a) Key management personnel

The Group considers the Boards of Directors and the members of the Executive Committees of UKAR, B&B and NRAM to be the key management personnel. All remaining loans to key personnel, which had all been advanced in the normal course of business, were redeemed during the year. The volumes of related party transactions, outstanding balances at the year end and related income for the year are set out below.

Loans:

	2011 £m	2010 £m
Loans outstanding at 1 January	-	1.7
Net movement over the year	-	(1.7)
Loans outstanding at 31 December	-	-
Interest charged to key management personnel	-	-

A summary of the Group's remuneration of the 15 (2010: 19) 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 20 to 24. The Directors' Remuneration Report gives details of the UKAR Group's Directors' salaries, fees, bonuses, pension benefits, other incentives and other benefits.

Remuneration of key management personnel:

	2011 £m	2010 £m
Short-term employee benefits	**3.0**	4.4
Post-employment benefits	**0.2**	0.5
Termination benefits	-	0.5
Total	**3.2**	5.4

Further details of the accounting treatment of pensions and of the Group's and Company's transactions and balances with the Group's pension schemes are given in note 20. There were no amounts due to or from the schemes at 31 December 2011 (2010: £nil). The key management personnel contributed £39,907 (2010: £60,000) to Group pension schemes during the year.

Included in the Group's Income Statement, the aggregate Directors' emoluments and the emoluments of the highest paid director amounted to £1,444,757 and £596,697 respectively (2010: £2,069,761 and £604,300 respectively).

b) Her Majesty's Government

As described in note I, 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 (see note 12), loans from HM Treasury (see note 24), the Statutory Debt (see note 24) and UK Government securities held. HM Treasury has also provided guarantee arrangements to the Group, for which the Group pays fees (see note 4). 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.

c) SLA with Northern Rock plc

NRAM had an SLA with Northern Rock plc ('NR') during the period 1 January to 31 October 2010. Under this agreement NR invoiced NRAM monthly in arrears for the cost of services rendered to NRAM plus a margin of 10%. The cost of services rendered comprised operational, non-operational, transition and real estate costs. During 2010 NRAM incurred a net cost of £160.8m under this SLA. Of this amount £115.5m was reflected within ongoing administrative expenses and £45.3m in other net administrative expenses.

34. Capital structure

The UK financial regulator the FSA regulates three of the Company's principal subsidiaries, B&B, NRAM and Mortgage Express, under the MIPRU regime, which applies to mortgage administration companies. Each of these companies manages its capital resources in order to meet the FSA's regulatory requirements. Capital adequacy is monitored on an ongoing basis by the Group's executive management and Board, based on the regulations established by the FSA. The required capital information is filed with the FSA on a quarterly basis. Each of these three companies met its capital requirements in full throughout 2011 and 2010, and has received no additional capital from HM Treasury since the nationalisation of B&B and NRAM; further information is available in the Annual Report and Accounts of B&B and NRAM, which do not form part of these Financial Statements. The Board considers core equity, formerly tier 1 capital, to be of pre-eminent importance in the capital structure of the regulated companies, and continues to monitor this, in addition to the total level of capital, closely. The Directors believe that each regulated Group company has an appropriate and adequate level of capital to support its activities, subject to the continuing support of HM Treasury. Strictly the regulated companies within the Group are required to hold capital in excess of 1% of total Balance Sheet assets plus any undrawn commitments. However, the Board believes they should hold capital above 1% and at the year end capital in B&B represented 4% of B&B assets, and NRAM capital represented 4% of NRAM assets.

The primary objectives of the Group'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 Group's activities and economic conditions.

The Group defines equity and certain other capital instruments as capital. Capital excludes accounting reserves for available-for-sale assets and cash flow hedges. The Group'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)

35. Financial instruments

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

The following tables summarise the carrying amounts and fair values of financial assets and liabilities. Assets are presented at bid prices, whereas offer prices are used for liabilities. The accounting policy note 1(g) sets out the key principles for estimating the fair values of financial instruments. This note provides some additional information in respect of the methodologies used.

At 31 December 2011	Available-for-sale £m	Assets at fair value through profit or loss £m	Loans and receivables £m	Hedging adjustments £m	Total carrying value £m	Fair value £m	If fair value increased by 1% £m
Financial assets:							
Cash and balances at central banks	-	-	6,170.7	-	6,170.7	6,170.7	61.7
Loans and advances to banks	-	-	2,746.5	-	2,746.5	2,746.5	27.5
Investment securities and unsecured investment loans	953.4	-	1,877.7	17.0	2,848.1	2,585.8	25.9
Loans and advances to customers	-	-	75,288.7	5.7	75,294.4	75,399.2	754.0
Fair value adjustments on portfolio hedging	-	-	-	597.5	597.5	-	-
Derivative financial instruments	-	7,369.1	-	-	7,369.1	7,369.1	73.7
Other financial assets	-	-	27.3	-	27.3	27.3	0.2
Total financial assets	953.4	7,369.1	86,110.9	620.2	95,053.6	94,298.6	943.0

	Liabilities at fair value through profit or loss £m	Liabilities at amortised cost £m	Hedging adjustments £m	Total carrying value £m	Fair value £m	If fair value increased by 1% £m
Financial liabilities:						
Deposits by banks	-	4,075.9	-	4,075.9	4,075.9	40.8
Statutory Debt and HM Treasury loans	-	46,582.2	-	46,582.2	46,582.2	465.8
Derivative financial instruments	965.4	-	-	965.4	965.4	9.7
Debt securities in issue	-	36,885.0	1,176.5	38,061.5	33,718.6	337.2
Capital instruments	-	331.2	19.2	350.4	209.8	2.1
Other financial liabilities	-	113.7	-	113.7	113.7	1.1
Total financial liabilities	965.4	87,988.0	1,195.7	90,149.1	85,665.6	856.7

At 31 December 2010	Available-for-sale £m	Assets at fair value through profit or loss £m	Loans and receivables £m	Hedging adjustments £m	Total carrying value £m	Fair value £m	If fair value increased by 1% £m
Financial assets:							
Cash and balances at central banks	-	-	7,291.8	-	7,291.8	7,291.8	72.9
Loans and advances to banks	-	-	5,615.6	-	5,615.6	5,615.6	56.2
Investment securities and unsecured investment loans	1,657.1	-	2,224.7	42.8	3,924.6	3,822.5	38.2
Loans and advances to customers	-	-	83,537.3	7.3	83,544.6	84,168.6	841.7
Fair value adjustments on portfolio hedging	-	-	-	762.8	762.8	-	-
Derivative financial instruments	-	9,471.6	-	-	9,471.6	9,471.6	94.7
Other financial assets	-	-	1.5	-	1.5	1.5	-
Total financial assets	1,657.1	9,471.6	98,670.9	812.9	110,612.5	110,371.6	1,103.7

Notes to the Financial Statements (continued)

35. Financial instruments (continued)

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

At 31 December 2010	Liabilities at fair value through profit or loss £m	Liabilities at amortised cost £m	Hedging adjustments £m	Total carrying value £m	Fair value £m	If fair value increased by 1% £m
Financial liabilities:						
Deposits by banks	-	7,057.7	-	7,057.7	7,057.7	70.6
Statutory Debt and HM Treasury loans	-	48,707.7	-	48,707.7	48,707.7	487.1
Derivative financial instruments	1,358.3	-	-	1,358.3	1,358.3	13.6
Debt securities in issue	-	47,426.5	1,002.2	48,428.7	44,973.2	449.7
Capital instruments	-	1,439.5	55.1	1,494.6	942.6	9.4
Other financial liabilities	-	87.0	-	87.0	87.0	0.9
Total financial liabilities	1,358.3	104,718.4	1,057.3	107,134.0	103,126.5	1,031.3

No financial assets or liabilities were reclassified during 2011 or 2010 between amortised cost and fair value categories.

At 31 December 2011 assets carried by NRAM at amortised cost which were previously carried at fair value were carried at £1,586.9m (2010: £1,927.7m). 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 lives of the assets; 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 £102.3m (2010: £133.0m), which was exactly offset by losses transferred from the available-for-sale reserve during the year. If the assets had not been reclassified, it is estimated that fair value losses of £51.1m would have been reflected in the available-for-sale reserve during 2011 in respect of these assets (2010: gains of £277.0m). The expected redemption value of the remaining assets is £1,884.0m (2010: £2,278.4m). The fair value of these assets at 31 December 2011 was £1,380.5m (2010: £1,818.0m).

Valuation methods for calculations of fair values in the tables above for those financial assets and liabilities not presented on the Balance Sheet at their fair value are set out below:

Cash and balances at central banks
Fair value approximates to carrying value because they have minimal credit losses and are either short term in nature or reprice frequently.

Loans and advances to banks
Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is their carrying amount.

Investment securities held as loans and receivables
Fair values are based on quoted prices where available or by using discounted cash flows applying market rates.

Unsecured investment loans
The fair value of unsecured investment loans approximates their carrying value due to the impairment of these assets to the value of the future expected cash flows.

Loans and advances to customers
The Group provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the rate charged on these loans varies in line with changes in market rates. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, as the Group's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Group has an exposure to this difference in value.

Deposits by banks and other deposits
Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated using discounted cash flows, applying either market rates or rates currently offered by the Group for deposits of similar remaining maturities.

Statutory Debt and HM Treasury loans
The fair value is assumed to be the carrying amount as the rate charged on these loans varies in line with changes in market rates, or the loans are considered to be repayable on demand subject to timing of repayment of loans to customers.

Debt securities in issue and capital instruments
Fair values are based on quoted prices where available, or by using discounted cash flows, applying market rates.

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

	2011 £m	2010 £m
Interest income	**3,366.3**	3,801.1
Interest expense	**(1,530.6)**	(1,441.6)
Net interest income	**1,835.7**	2,359.5

These amounts represent interest income and expense before hedging arrangements.

Notes to the Financial Statements (continued)

35. Financial instruments (continued)

c) Impaired financial assets

Allowance accounts for credit losses in respect of impairment of loans and advances to customers are detailed in note 16 and in respect of investment securities in note 14. 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 Balance Sheet because the sale does not qualify for derecognition; the Group remains exposed to the economic risk on the assets because of the sale terms.

	2011 Carrying amount of assets £m	2011 Carrying amount of associated liabilities £m	2010 Carrying amount of assets £m	2010 Carrying amount of associated liabilities £m
Repurchase agreements (see also note 36)	-	-	589.6	1,167.8
Total	-	-	589.6	1,167.8

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

e) Hedge accounting

Strategy in using derivative financial instruments

The Board has authorised the use of derivative instruments for the purpose of supporting the strategic and operational business activities of the Group and reducing the risk of loss arising from changes in interest rates and exchange rates. All use of derivative instruments within the Group is to hedge risk exposure, and the Group takes no trading positions in derivatives.

The objective when using any derivative instrument is to ensure that the risk-to-reward profile of any transaction is optimised. The intention is only to use derivatives to create economically effective hedges. However, because of the specific requirements of IAS 39 to obtain hedge accounting, not all economic hedges are designated as accounting hedges, either because natural accounting offsets are expected or because obtaining hedge accounting would be especially onerous.

i) Fair value hedges
The Group designates a number of derivatives as fair value hedges. In particular, the Group has three approaches establishing relationships for:

- Hedging the interest rate and foreign currency exchange rate risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps.
- Hedging the interest rate risk of a single currency portfolio of sterling, US Dollar or Euro non-prepayable fixed rate assets/liabilities on a one-for-one basis with vanilla fixed/floating or floating/fixed interest rate swaps.
- Hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages. The Group believes this solution is the most appropriate as it is consistent with its policy for hedging fixed rate mortgages on an economic basis.

ii) Cash flow hedges
The Group designates a number of derivatives as cash flow hedges. In particular, the Group adopts the following approaches:

- Using fixed interest rate swaps to hedge floating rate sterling liabilities.
- To address the volatility generated by floating/floating cross currency swaps, they are placed into cash flow hedges; the accounting hedge relationship is to hedge the foreign currency exchange rate risk of the foreign denominated asset/liability.
- Fixed/floating cross currency swaps are split into their separate risk components and separately designated into cash flow hedges.

iii) Net investment hedges
The Group has not designated any derivatives as net investment hedges in 2011 or 2010.

The Group had the following types of hedges:

At 31 December 2011	Fair value hedges £m	Cash flow hedges £m	Economic hedges £m	Total £m	Nominal amounts £m
Exchange rate contracts	8.6	7,075.5	138.3	7,222.4	24,562.2
Interest rate contracts	20.3	3.8	122.6	146.7	30,303.2
Total asset balances	28.9	7,079.3	260.9	7,369.1	54,865.4
Exchange rate contracts	-	-	7.9	7.9	960.9
Interest rate contracts	675.6	163.6	118.3	957.5	13,935.7
Total liability balances	675.6	163.6	126.2	965.4	14,896.6
Fair value of hedging instruments	(646.7)	6,915.7	134.7	6,403.7	39,968.8

Notes to the Financial Statements (continued)

35. Financial instruments (continued)

e) Hedge accounting (continued)

At 31 December 2010	Fair value hedges £m	Cash flow hedges £m	Economic hedges £m	Total £m	Nominal amounts £m
Exchange rate contracts	5,357.7	-	3,896.8	9,254.5	34,350.5
Interest rate contracts	68.3	10.4	138.4	217.1	27,208.5
Total asset balances	5,426.0	10.4	4,035.2	9,471.6	61,559.0
Exchange rate contracts	-	-	44.9	44.9	1,686.6
Interest rate contracts	901.4	239.5	172.5	1,313.4	48,999.4
Total liability balances	901.4	239.5	217.4	1,358.3	50,686.0
Fair value of hedging instruments	4,524.6	(229.1)	3,817.8	8,113.3	10,873.0

f) Fair value measurement

Financial assets and liabilities carried at fair value are valued on the following bases:

At 31 December 2011	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets:				
Investment securities - available-for-sale	**399.7**	**570.7**	**-**	**970.4**
Derivative financial instruments	**-**	**3,962.5**	**3,406.6**	**7,369.1**
Financial liabilities:				
Derivative financial instruments	**-**	**883.1**	**82.3**	**965.4**

At 31 December 2010	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets:				
Investment securities - available-for-sale	343.0	1,356.9	-	1,699.9
Derivative financial instruments	-	4,980.0	4,491.6	9,471.6
Financial liabilities:				
Derivative financial instruments	-	1,289.8	68.5	1,358.3

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, whether directly (ie as price) or indirectly (ie derived from the implications of prices).

Level 3: Inputs for the asset or liability that are not based on observable market data or have significant unobservable inputs.

The movement in assets and liabilities measured using a valuation technique for which any significant input is not based on observable market data (Level 3) is as follows:

	Financial assets £m	Financial liabilities £m	Total £m
At 1 January 2011	**4,491.6**	**(68.5)**	**4,423.1**
Total losses in the Income Statement	**(1,085.0)**	**(13.8)**	**(1,098.8)**
At 31 December 2011	**3,406.6**	**(82.3)**	**3,324.3**

Notes to the Financial Statements (continued)

35. Financial instruments (continued)

f) Fair value measurement (continued)

	Financial assets £m	Financial liabilities £m	Total £m
At 1 January 2010	5,145.7	(21.9)	5,123.8
Total losses in the Income Statement	(649.1)	(51.6)	(700.7)
Transfers from assets to liabilities	(5.0)	5.0	-
At 31 December 2010	4,491.6	(68.5)	4,423.1

All Level 3 financial assets and liabilities are derivative financial instruments.

Total losses in the Income Statement of £1,098.8m (2010: £700.7m) are a result of fair value losses of £1,693.7m (2010: £1,369.1m) less settlement gains of £594.9m (2010: £668.4m).

These amounts are included within ‘unrealised fair value movements on financial instruments’, and all relate to assets and liabilities which were still held at the Balance Sheet date.

The main unobservable input that affects the valuation of the Group’s derivative financial instruments is the forecast level of customer prepayments in respect of mortgage loans assigned to securitisation structures. An increase in forecast prepayments will cause interest rate and cross currency swaps associated with the notes in issue to pay down in an accelerated manner, so affecting their fair values. The following table shows the impact on reported fair values of a hypothetical 10% increase in customer prepayments.

2011	**Reported fair value £m**	**Revised fair value £m**	**Favourable changes to Income Statement £m**	**Unfavourable changes to Income Statement £m**
Financial assets:				
Derivative financial instruments	**3,406.6**	**3,404.3**	**-**	**(1.7)**
Financial liabilities:				
Derivative financial instruments	**(82.3)**	**(82.3)**	**-**	**-**

2010	Reported fair value £m	Revised fair value £m	Favourable changes to Income Statement £m	Unfavourable changes to Income Statement £m
Financial assets:				
Derivative financial instruments	4,491.6	4,494.0	2.6	0.2
Financial liabilities:				
Derivative financial instruments	(68.5)	(68.5)	-	-

36. Collateral pledged and received

	2011 £m	2010 £m
Assets placed under repurchase agreements	**-**	1,436.2
Cash collateral which the Group has provided in respect of derivative contracts	**751.4**	881.8
Total collateral pledged	**751.4**	2,318.0

	2011 £m	2010 £m
Assets held under reverse repurchase agreements	**-**	1,624.8
Cash collateral which the Group has received in respect of derivative contracts	**4,031.9**	5,674.0
Securities collateral held	**66.7**	129.6
Total collateral received	**4,098.6**	7,428.4

In addition to the collateral amounts shown above, certain loans to customers provide security in respect of securitised note and Covered Bond funding as detailed in note 25. These loans, and also cash collateral pledged shown above, are carried on the Balance Sheet. The liability to repay the collateral received is included within deposits by banks in the Balance Sheet. In the absence of counterparty default, the Group has no right to sell or re-pledge the securities, and therefore in accordance with the provisions of IAS 39 such securities are not recognised on the Balance Sheet.

Notes to the Financial Statements (continued)

37. Financial risk management

A description of the principal risks to which the Group is exposed is provided on pages 32 to 36 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, the potential consequences associated with such activities and the derivative instruments used by the Group to mitigate the risks arising.

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
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(i), and further details of hedge accounting are provided in note 35(e).

b) Credit risk

The Board has approved a framework for maximum credit counterparty limits against which total exposures are continually monitored and controlled. The credit limit structure adopts a risk based matrix whereby lower rated counterparties are afforded lower overall levels of limit. Although publicly available ratings produced by rating agencies provide a useful guide to the creditworthiness of counterparties, an internal evaluation is also used in the limit assignment process. Single counterparties are assigned maximum limits in accordance with the ratings matrix, based on the lowest rating afforded to any part of the counterparty group.

Maximum credit risk exposure at 31 December before taking account of any collateral and other credit enhancements:

	2011 £m	2010 £m
On Balance Sheet:		
Cash and balances at central banks	**6,170.7**	7,291.8
Loans and advances to banks	**2,746.5**	5,615.6
Investment securities and unsecured investment loans	**2,848.1**	3,924.6
Loans and advances to customers	**75,294.4**	83,544.6
Derivative financial instruments	**7,369.1**	9,471.6
Other financial assets	**27.3**	1.5
Total on Balance Sheet	**94,456.1**	109,849.7
Off Balance Sheet:		
Loan commitments (see note 32)	**3,566.4**	4,063.6

Loans and advances to customers includes loans which are secured on property. Additional information in respect of credit risk is provided in note 14 (for wholesale assets) and note 17 (for loans and advances to customers).

Notes to the Financial Statements (continued)

37. Financial risk management (continued)

c) Liquidity risk

The Group closely monitors its liquidity position against the Board's liquidity policy. Minimum and target liquidity levels are established through stress testing and cash flow forecasting, taking into consideration an assessment of any emerging and potentially extreme funding conditions.

The tables below analyse the Group's financial assets and liabilities into relevant maturity groupings:

At 31 December 2011	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Financial assets:							
Cash and balances at central banks	6,170.7	-	-	-	-	-	6,170.7
Loans and advances to banks	1,895.2	846.3	5.0	-	-	-	2,746.5
Investment securities and unsecured investment loans	-	74.4	40.7	251.4	662.4	1,819.2	2,848.1
Loans and advances to customers	384.9	408.6	356.2	778.3	6,983.8	66,382.6	75,294.4
Fair value adjustments on portfolio hedging	-	39.2	47.6	93.8	136.5	280.4	597.5
Derivative financial instruments	-	218.1	184.8	204.0	3,224.9	3,537.3	7,369.1
Other financial assets	9.9	7.2	-	-	10.2	-	27.3
Total financial assets	**8,460.7**	**1,593.8**	**634.3**	**1,327.5**	**11,017.8**	**72,019.5**	**95,053.6**
Financial liabilities:							
Deposits by banks	4,034.0	-	0.1	-	41.8	-	4,075.9
Statutory Debt and HM Treasury loans	46,582.2	-	-	-	-	-	46,582.2
Derivative financial instruments	-	42.7	26.0	63.0	215.2	618.5	965.4
Debt securities in issue	-	2,241.7	1,381.4	1,550.0	17,984.7	14,903.7	38,061.5
Capital instruments	-	0.1	-	5.6	170.7	174.0	350.4
Other financial liabilities	-	113.1	-	-	0.6	-	113.7
Total financial liabilities	**50,616.2**	**2,397.6**	**1,407.5**	**1,618.6**	**18,413.0**	**15,696.2**	**90,149.1**
Net liquidity gap	**(42,155.5)**	**(803.8)**	**(773.2)**	**(291.1)**	**(7,395.2)**	**56,323.3**	**4,904.5**

At 31 December 2010	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Financial assets:							
Cash and balances at central banks	7,291.8	-	-	-	-	-	7,291.8
Loans and advances to banks	3,578.8	2,036.8	-	-	-	-	5,615.6
Investment securities and unsecured investment loans	-	183.0	43.9	135.3	1,331.9	2,230.5	3,924.6
Loans and advances to customers	436.8	419.4	482.6	852.1	7,376.6	73,977.1	83,544.6
Fair value adjustments on portfolio hedging	-	51.4	76.6	143.5	348.1	143.2	762.8
Derivative financial instruments	-	470.2	339.6	989.3	2,936.4	4,736.1	9,471.6
Other financial assets	-	1.5	-	-	-	-	1.5
Total financial assets	11,307.4	3,162.3	942.7	2,120.2	11,993.0	81,086.9	110,612.5
Financial liabilities:							
Deposits by banks	6,258.7	712.3	0.3	43.3	43.1	-	7,057.7
Statutory Debt and HM Treasury loans	48,707.7	-	-	-	-	-	48,707.7
Derivative financial instruments	-	60.9	68.7	187.2	622.9	418.6	1,358.3
Debt securities in issue	-	2,217.5	1,985.4	5,060.4	17,412.7	21,752.7	48,428.7
Capital instruments	-	29.3	-	5.1	467.3	992.9	1,494.6
Other financial liabilities	-	87.0	-	-	-	-	87.0
Total financial liabilities	54,966.4	3,107.0	2,054.4	5,296.0	18,546.0	23,164.2	107,134.0
Net liquidity gap	(43,659.0)	55.3	(1,111.7)	(3,175.8)	(6,553.0)	57,922.7	3,478.5

Notes to the Financial Statements (continued)

37. Financial risk management (continued)

c) Liquidity risk (continued)

HM Treasury has indicated that it expects the loans and the WCF provided to the Group 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 Group during its wind-down. It is not possible to specify the contractual maturity dates of the loans to the Group from HM Treasury and from the Financial Services Compensation Scheme, and therefore they have been included in the table above as though repayable on demand.

Debt securities in issue include notes which securitise loans and advances to customers through SPVs. Certain of these notes are repaid on a pass-through or controlled amortisation basis. In the above table, maturities of such notes are based on the expected repayment of notes which, in turn, are derived from the expected redemption profiles of securitised loans.

In the above table, where derivatives have been entered into to hedge mortgage backed securitised notes, the timings of derivative payments are based on the expected repayment dates of the hedged notes.

As described in note 28, B&B announced in 2010 that it had resolved not to make any payment of principal or interest in respect of 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 table above includes payments of principal and interest on capital instruments at the earliest date it would have become contractually payable as per the original terms, regardless of the announcement. Capital instruments include perpetual instruments, as shown in note 28. The table above assumes these instruments will be redeemed on 31 December 2055.

Other financial assets and liabilities are included in the above table according to the earliest date that payment can be contractually demanded. It should be noted that many financial instruments are settled earlier than their contractual maturity date; in particular, many mortgage loans are repaid early, in full or in part.

Assets and liabilities with a remaining period to contractual maturity of within one year are classed as current and those with a remaining period of more than one year are classed as non-current. Non-financial assets and liabilities amount to £176.3m and £404.4m respectively (2010: £261.9m and £705.3m) of which £nil and £114.6m respectively are classed as current (2010: £nil and £120.2m) and £176.3m and £289.8m respectively are classed as non-current (2010: £261.9m and £585.1m).

Non-derivative cash flows

The table below analyses the Group's non-derivative cash flows payable into relevant periods. The assumptions used in the preparation of this table are consistent with those used in the maturity tables on pages 97 and 98. The amounts disclosed are the contractual undiscounted cash outflows. These differ from Balance Sheet values due to the effects of discounting on certain Balance Sheet items and due to the inclusion of contractual future interest flows.

At 31 December 2011	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Financial liabilities:							
Deposits by banks	**4,034.0**	**-**	**0.4**	**0.4**	**42.2**	**-**	**4,077.0**
Statutory Debt and HM Treasury loans	**46,583.0**	**-**	**-**	**-**	**-**	**-**	**46,583.0**
Debt securities in issue	**-**	**2,333.9**	**1,537.7**	**1,799.2**	**20,166.4**	**15,236.1**	**41,073.3**
Capital instruments	**-**	**0.3**	**1.5**	**7.9**	**180.5**	**600.0**	**790.2**
Other financial liabilities	**-**	**113.1**	**-**	**-**	**0.6**	**-**	**113.7**
Loan commitments	**2,160.0**	**0.3**	**0.3**	**0.6**	**4.6**	**16.1**	**2,181.9**
Total	**52,777.0**	**2,447.6**	**1,539.9**	**1,808.1**	**20,394.3**	**15,852.2**	**94,819.1**

At 31 December 2010	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Financial liabilities:							
Deposits by banks	6,260.4	711.2	0.4	43.5	44.0	-	7,059.5
Statutory Debt and HM Treasury loans	48,709.0	-	-	-	-	-	48,709.0
Debt securities in issue	-	2,299.9	2,233.4	5,336.3	19,797.3	22,585.9	52,252.8
Capital instruments	-	36.7	1.4	23.4	898.3	1,088.5	2,048.3
Other financial liabilities	-	87.0	-	-	-	-	87.0
Loan commitments	2,622.5	0.3	0.3	0.6	5.2	19.6	2,648.5
Total	57,591.9	3,135.1	2,235.5	5,403.8	20,744.8	23,694.0	112,805.1

Notes to the Financial Statements (continued)

37. Financial risk management (continued)

c) Liquidity risk (continued)

Derivative cash flows

The following table analyses cash outflows for the Group's derivative financial liabilities. The amounts are allocated into relevant periods using assumptions consistent with those used in the preparation of the maturity tables on pages 97 and 98.

At 31 December 2011	**On demand £m**	**Within three months £m**	**After three months but within six months £m**	**After six months but within one year £m**	**After one year but within five years £m**	**After five years £m**	**Total £m**
Derivative financial liabilities to be settled on a net basis	**-**	**102.4**	**67.4**	**101.7**	**420.0**	**918.5**	**1,610.0**
Derivative financial liabilities to be settled on a gross basis:							
- Outflows	**-**	**944.7**	**1.5**	**14.5**	**354.9**	**51.9**	**1,367.5**
- Inflows	**-**	**(941.7)**	**(1.8)**	**(14.9)**	**(357.8)**	**(49.5)**	**(1,365.7)**
Total	**-**	**105.4**	**67.1**	**101.3**	**417.1**	**920.9**	**1,611.8**

At 31 December 2010	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Derivative financial liabilities to be settled on a net basis	-	249.2	208.3	336.7	906.0	1,487.2	3,187.4
Derivative financial liabilities to be settled on a gross basis:							
- Outflows	-	43.7	188.4	55.0	332.6	-	619.7
- Inflows	-	(39.6)	(47.5)	(48.7)	(332.1)	-	(467.9)
Total	-	253.3	349.2	343.0	906.5	1,487.2	3,339.2

Below are the periods when the net undiscounted cash flows attributable to cash flow hedges are expected to occur and impact profit or loss (positive = outflow):

	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
At 31 December 2011	**-**	**136.6**	**98.4**	**106.7**	**1,120.4**	**484.0**	**1,946.1**
At 31 December 2010	-	45.5	38.8	68.7	210.3	64.4	427.7

Notes to the Financial Statements (continued)

37. Financial risk management (continued)

d) Interest rate risk

Interest rate risk typically arises from mismatches between the repricing dates of interest-bearing assets and liabilities on the Group's Balance Sheet, and from the investment profile of the Group's capital and reserves. Corporate Treasury is responsible for managing this exposure within the risk exposure limits set out in the Market 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.

The Group measures, monitors and controls the following interest rate risks and sensitivities:

- Mismatch risk
- Curve
- Prepayment risk
- Basis risk
- Reset risk

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.

Interest rate risk exposure is predominantly managed through the use of interest rate derivatives, principally interest rate swaps. 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.

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 due to a notional 2% parallel move in market and base rates.

	2011 £m	2010 £m
2% increase	**15.7**	18.3
2% decrease	**(2.3)**	(18.7)

(ii) the sensitivity of the Group's interest margin over 12 months to a notional 2% parallel move in market and base rates.

	2011 £m	2010 £m
2% increase	**465.7**	462.6
2% decrease	**(120.9)**	(174.4)

Notes to the Financial Statements (continued)

37. Financial risk management (continued)

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 2011 and 31 December 2010 the Group had no net material exposure to foreign exchange rate fluctuations or changes in foreign currency interest rates. The impact on the Group's profit and equity of reasonably possible changes in exchange rates compared to actual rates would not have been material at 31 December 2011 or 31 December 2010.

The table below summarises the Group's exposure to foreign currency exchange rate risk at the year end, based on the information presented to management. Included in the table are the Group's financial instruments, including those classified as equity, under the relevant currency headings. The amounts disclosed are the sterling equivalents of the notional amounts due on maturity, including interest accrued at the Balance Sheet date, less any impairment provisions. Although equity instruments denominated in foreign currency are recorded in the Balance Sheet at their original settlement rates, closing rates are used here to provide sterling equivalents of the currency amounts.

At 31 December 2011	€ £m	$ £m	Other £m	Total £m
Financial assets:				
Cash and balances at central banks	-	-	-	-
Loans and advances to banks	**1,252.0**	**37.7**	-	**1,289.7**
Investment securities and unsecured investment loans	**1,384.4**	**150.2**	-	**1,534.6**
Loans and advances to customers	-	-	-	-
Derivative financial instruments	**18,856.7**	**8,334.1**	**1,355.3**	**28,546.1**
Other financial assets	-	-	-	-
Total financial assets	**21,493.1**	**8,522.0**	**1,355.3**	**31,370.4**
Financial liabilities:				
Deposits by banks	**1,746.4**	**0.1**	-	**1,746.5**
Statutory Debt and HM Treasury loans	-	-	-	-
Derivative financial instruments	**130.5**	**96.9**	-	**227.4**
Debt securities in issue	**19,639.3**	**8,408.1**	**1,355.2**	**29,402.6**
Capital instruments	-	-	-	-
Other financial liabilities	-	-	-	-
Total financial liabilities	**21,516.2**	**8,505.1**	**1,355.2**	**31,376.5**
Non-shareholders' funds	-	**11.2**	-	**11.2**
Total	**21,516.2**	**8,516.3**	**1,355.2**	**31,387.7**
Net currency gap	**(23.1)**	**5.7**	**0.1**	**(17.3)**

At 31 December 2010	€ £m	$ £m	Other £m	Total £m
Financial assets:				
Cash and balances at central banks	-	-	-	-
Loans and advances to banks	2,350.4	311.3	-	2,661.7
Investment securities and unsecured investment loans	1,903.5	212.8	-	2,116.3
Loans and advances to customers	-	-	-	-
Derivative financial instruments	26,047.9	10,014.4	2,041.6	38,103.9
Other financial assets	-	-	-	-
Total financial assets	30,301.8	10,538.5	2,041.6	42,881.9
Financial liabilities:				
Deposits by banks	3,302.4	7.4	-	3,309.8
Statutory Debt and HM Treasury loans	-	-	-	-
Derivative financial instruments	1,123.0	242.5	-	1,365.5
Debt securities in issue	25,874.2	10,259.3	2,042.5	38,176.0
Capital instruments	-	-	-	-
Other financial liabilities	-	-	-	-
Total financial liabilities	30,299.6	10,509.2	2,042.5	42,851.3
Non-shareholders' funds	-	31.0	-	31.0
Total	30,299.6	10,540.2	2,042.5	42,882.3
Net currency gap	2.2	(1.7)	(0.9)	(0.4)

Notes to the Financial Statements (continued)

37. Financial risk management (continued)

f) Concentration 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 20% (2010: 33%) of investment securities held. 53% (2010: 55%) 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. 36% (2010: 34%) 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 £71.9bn (2010: £79.4bn) 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 43% (2010: 43%) of the book.

Within the commercial mortgage portfolio and housing association loans, there are 176 loans (2010: 194) totalling £0.9bn (2010: £1.0bn), with the largest 10 loans accounting for 63% (2010: 61%) of the portfolio. All of these loans are secured on commercial properties.

Further details in respect of concentrations in the wholesale assets portfolio are given in note 14.

38. Contingent liabilities

a) On 20 January 2009 a solicitor's letter was received notifying B&B and certain present and former B&B 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 B&B could be liable in damages to certain former shareholders in B&B who subscribed for shares in the rights issue. B&B together with its legal advisors responded to the allegations raised in May 2009. Nothing further was heard until 23 January 2012 when further correspondence was received from the solicitors representing the former shareholders, to which B&B together with its legal advisors has responded. This correspondence contained no further allegations or details of the former shareholders' potential claim. 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.

b) As part of the transfer of assets and liabilities by NRAM to Northern Rock plc on 1 January 2010 (see note 39), NRAM agreed to indemnify Northern Rock plc against potential claims arising from past business up to a maximum of £100m. The cumulative total paid to 31 December 2011 was £2.8m. This indemnity terminated on 1 January 2012 following the sale of Northern Rock plc to Virgin Money.

39. Assets and liabilities transferred to Northern Rock plc

On 1 January 2010 NRAM transferred certain assets and liabilities to Northern Rock plc under the terms of The Northern Rock Transfer Order 2009, SI 2009/3226.

There was no profit or loss associated with this transaction. The balance owed to Northern Rock plc resulting from this transaction has been paid in full in cash. This was funded by an increase in the loan to NRAM from HM Treasury of £8,506.0m.

In addition to the transfer of the assets and liabilities, all employees of NRAM transferred to Northern Rock plc on 1 January 2010. The two companies entered into various agreements under which services were provided primarily by Northern Rock plc to NRAM.

40. Events after the reporting period

The Directors are of the opinion that there have been no significant events which have occurred since 1 January 2012 to the date of this report that are likely to have a material effect on the Group's financial position as disclosed in these Financial Statements.

Independent Auditor's report to the Shareholder of UK Asset Resolution Limited

We have audited the Parent Company Financial Statements (the 'Financial Statements') of UK Asset Resolution Limited for the 18 month period ended 31 December 2011 which comprise the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRS') as adopted by the European Union, and as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of Directors and Auditors

As explained more fully in the Statement of Directors' Responsibilities on page 39, 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 Ethical Standards for Auditors.

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

Scope of the audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the Financial Statements. In addition, we read all the financial and non-financial information in the Parent Company Financial Statements to identify material inconsistencies with the audited Financial Statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of the Company's cash flows for the 18 month period then ended;
- the Parent Company Financial Statements have been properly prepared in accordance with IFRS as adopted by the European Union 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 matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial period 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.

Mark Hannam (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds
1 March 2012

Company Balance Sheet

At 31 December 2011	Note	£m
Assets		
Investments in Group undertakings	E	**2,634.1**
Total assets		**2,634.1**
Equity		
Issued capital and reserves attributable to equity holder:		
- Share capital	29	**1.2**
- Merger reserve	F	**2,632.8**
- Retained earnings		**0.1**
Share capital and reserves		**2,634.1**

The notes on pages 105 and 106 form an integral part of these Financial Statements.

The Financial Statements were approved by the Board of Directors and authorised for issue on 1 March 2012 and signed on its behalf by:

Richard Banks
Chief Executive Officer

Phillip McLelland
Finance Director

UK Asset Resolution Limited is registered in England and Wales under company number 7301961.

Company Statement of Changes in Equity

For the period ended 31 December 2011	Share capital £m	Merger reserve £m	Retained earnings £m	Total share capital and reserves £m
On incorporation	-	-	-	-
Issue of share capital	1.2	-	-	1.2
Acquisition of subsidiary undertakings	-	2,632.8	-	2,632.8
Profit for the financial period	-	-	0.1	0.1
At 31 December 2011	**1.2**	**2,632.8**	**0.1**	**2,634.1**

Company Cash Flow Statement

For the period ended 31 December 2011

During the period the Company had no material cash flows or balances. Consequently no Cash Flow Statement has been presented.

The Company's significant non-cash transactions during the period were the issue of share capital (see note 29) and the acquisition of shares in subsidiary undertakings (see note E).

Notes to the Financial Statements

A. Principal accounting policies

The Company is a private limited company incorporated on 1 July 2010 and domiciled in the United Kingdom. The Company applies the accounting policies of the UKAR Group, set out on pages 49 to 58.

B. Critical judgements and accounting estimates

In preparing the Financial Statements, management have made the following critical judgement.

Investments in Group undertakings

The Directors consider the value of the Company's investments in subsidiary undertakings to be supported by their underlying assets.

C. Profit

The Company's profit after tax for the period from incorporation to 31 December 2011 was £92,000. As permitted by s408 of the Companies Act 2006 the Company's individual Income Statement, Statement of Comprehensive Income and related notes have not been presented.

D. Taxation

The Company bears tax at the standard weighted average rate of UK corporation tax of 27%, and has no deferred tax provided or unprovided.

E. Investments in Group undertakings

The investments in Group undertakings represent the Company's holdings of the entire issued share capital of B&B and NRAM, which were acquired in a share-for-share exchange on 1 October 2010. The cost of each of these investments has been deemed to be the net assets of each of B&B and NRAM at 30 June 2010.

The Company's principal subsidiary undertakings at 31 December 2011 held directly or indirectly, all of which are wholly owned and are fully consolidated into the Group Financial Statements, are listed below. All operate in their country of incorporation.

	Nature of business	Country of incorporation	Class of shares held
Direct			
Bradford & Bingley plc ('B&B')	Mortgage administration	UK	Ordinary
Northern Rock (Asset Management) plc ('NRAM')	Mortgage administration	UK	Ordinary and preference
Indirect			
Mortgage Express	Mortgage administration	UK	Ordinary
Northern Rock Mortgage Indemnity Company Limited	Provision of mortgage indemnity insurance	Guernsey	Ordinary

F. Merger reserve

	2011 £m
On incorporation	-
Generated on acquisition of B&B	1,488.0
Generated on acquisition of NRAM	1,144.8
At 31 December 2011	**2,632.8**

The merger reserve was generated on 1 October 2010 when the Company acquired all the issued shares of B&B and NRAM from the Treasury Solicitor via a share-for-share exchange. The merger reserve represents the difference between the value attributed to the Company's investment in each company and the nominal value of the share capital issued by the Company.

Notes to the Financial Statements (continued)

G. Related party disclosures

a) Subsidiary companies

The Company had no material balances outstanding with subsidiary companies during the period.

The Company had transactions with its subsidiaries as follows:

	2011 £000
Management charges to subsidiary undertakings	**981**
Staff-related costs charged by subsidiary undertakings	**889**

b) Key management personnel

The Group considers the Boards of Directors and the members of the Executive Committees of UKAR, B&B and NRAM to be the key management personnel. The Company had no transactions or balances directly with any key management personnel during the period. The salaries and fees of the Company's Directors were paid by B&B and recharged to the Company.

c) Directors' emoluments

The aggregate emoluments of the Directors of the UKAR Company for the 18 months ended 31 December 2011 were £2,028,438, and of the highest paid Director £974,128.

H. Financial risk management

The Company has no significant financial risks.

I. Ultimate controlling party

All shares in the Company are owned by the Treasury Solicitor as nominee for HM Treasury, and the Company considers Her Majesty's Government to be its ultimate controlling party.