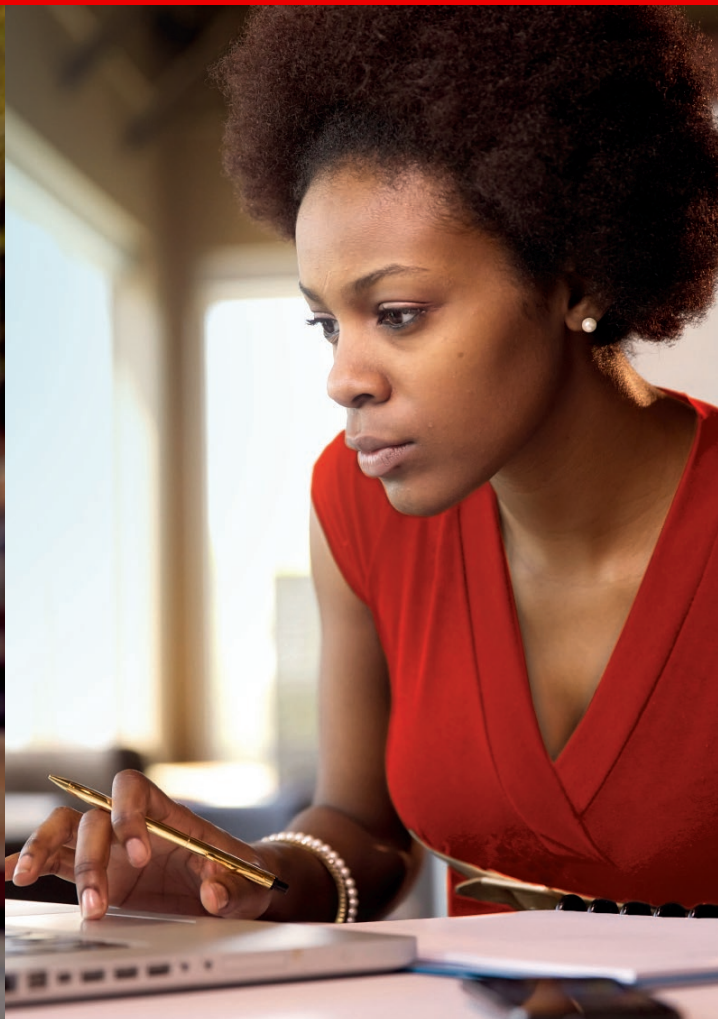




Annual Report 2020

Becoming a digital bank with a human touch



Santander UK

We help our customers at the moments that matter most.

We champion British businesses and help them to grow sustainably. Our customer focus helps us to develop more loyal and lasting relationships.

About this report

The Strategic Report outlines the key elements of the Annual Report and provides context for the related financial statements. It is also designed to help members of the company assess how the Directors have performed their duty under section 172 of the Companies Act 2006. The report highlights key financial and non-financial metrics which help to explain our performance over the past year. It also highlights the external environmental factors affecting the business along with Santander UK's position in the UK banking market.

At all times we try to treat our stakeholders fairly and meet our environmental responsibilities. Sustainability and our strategic direction are inseparable, and we continue to embed sustainability across our business. We have included information to demonstrate this within our Strategic Report and further information is also available in our ESG Supplement.

By order of the Board.

William Vereker
Chair, 2 March 2021

2020 highlights



£5.1bn

Customer loan growth
(2019: £5.4bn)



£13.9bn

Customer deposit growth
(2019: £5.7bn)



£552m

Profit before tax
(2019: £981m)



£710m

Adj. profit before tax
(2019: £1,300m)



6.3m

Digital customers
(2019: 5.8m)



1.63%

Adj. Banking Net Interest Margin
(2019: 1.64%)



59%

Adj. cost-to-income ratio
(2019: 59%)



31bps

Cost of risk
(2019: 11bps)



15.2%

CET1 capital ratio
(2019: 14.3%)



64%

mortgage loans refinanced online
(2019: 60%)

Important information for readers

Santander UK Group Holdings plc (the Company) and its subsidiaries (collectively Santander UK or the Santander UK group) operate primarily in the UK, and are part of Banco Santander (comprising Banco Santander SA and its subsidiaries). Santander UK plc and Santander Financial Services plc are regulated by the UK Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Certain other companies within the Santander UK group are regulated by the FCA and the PRA. This Annual Report contains forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in such forward-looking statements. See Forward-looking statements on page 277.

The Company is the immediate parent company of Santander UK plc. The two companies operate on the basis of a unified business strategy, albeit the principal business activities of the Santander UK group are carried on by Santander UK plc and its subsidiaries (the Santander UK plc group). The Board and Committees of the two companies run substantially simultaneously to ensure efficiency and effectiveness, whilst ensuring the independence and autonomy of Santander UK plc, our ring-fenced bank, are appropriately protected. The Company's Corporate Governance and Risk Frameworks have been adopted by its subsidiaries to ensure consistency of application. As a result, the review of the business and principal risks and uncertainties facing the Company, and the description of the Company's Corporate Governance, including the activities of the Board and risk management arrangements, are integrated with those of Santander UK plc and are reported in this document as operating within the Company for all periods presented.



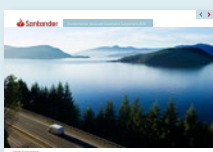
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C-19

Throughout the report look out for this symbol for Covid-19 stories

Our reporting suite



ESG Supplement

To read more visit santandersustainability.co.uk



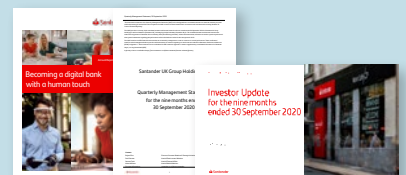
Sustainability microsite

To read more, visit santandersustainability.co.uk



Gender Pay Gap Report

To read more, visit santanderjobs.co.uk



Financial reports and presentations

To read more, visit santander.co.uk/about-santander/investor-relations

Access the full reporting suite at santander.co.uk

Santander UK at a glance

We are uniquely placed as a leading scale challenger bank.

Our business model focuses on customer loyalty in our core business franchise.

We provide high quality, seamless service across our branch, digital and telephony channels



14 million
active UK customers



c22,000
Full time equivalent employees



564
branches



3rd
largest retail mortgage provider⁽¹⁾



Top 5
largest current account provider⁽²⁾



5th
largest commercial lender⁽¹⁾

We offer innovative products and services to help people and businesses prosper

Santander UK is a large customer-focused bank and possesses the scale and breadth of proposition to challenge the big four UK banks. We serve our customers through digital channels, alongside a network of branches.

We play an important role in the UK economy and in the communities in which we operate. We help people purchase their home and save for the future, and support business growth. We employ 21,900 people and we paid £161m of corporation tax and £74m through the UK Bank Levy in 2020.

Our innovative international proposition facilitates access to a range of markets and offers invaluable expertise and insight.

We operate through three customer business segments, supported by central functions

Retail Banking

Offers a wide range of products and financial services to individuals and small businesses through a network of branches and ATMs, as well as through telephony, digital and intermediary channels. It includes business banking customers, small businesses with an annual turnover up to £2m, and Santander Consumer Finance, predominantly a vehicle finance business.

Corporate & Commercial Banking

Offers a wide range of financial services and solutions to more complex businesses across multiple sectors, typically with annual turnovers of between £2m and £500m. Our service is provided by relationship managers and product specialists who cover clients' UK and overseas needs.

Corporate & Investment Banking⁽³⁾

Offers specially tailored solutions and value-added services to corporate clients with an annual turnover of over £500m. We provide products to manage currency fluctuations and protect against interest rate risk and also arrange capital markets finance and specialist trade finance solutions.

Corporate Centre

Mainly includes Treasury, which is responsible for capital, funding, liquidity, pensions and balance sheet management. It also includes our Jersey and Isle of Man businesses as well as our non-core corporate and legacy portfolios.

(1) Santander UK industry analysis of latest available bank and building society reports. Mortgage provider: UK mortgage stock, Retail Banking divisions. Commercial lender: UK commercial lending stock, Corporate and/or Commercial Banking divisions (excludes investment banking).

(2) CACI's CSDB, Current Account Stock, Volume, November 2020.

(3) Subject to court approval, we are proposing to transfer substantially all of the CIB business to the London Branch of Banco Santander, S.A. in H221 by way of a banking business transfer scheme under Part VII of the Financial Services and Markets Act 2000.

Our stakeholders





We live our values of **Simple, Personal and Fair** through great behaviours and our people leaders:

Great Behaviours:

 Embrace Change	 Show Respect	 Talk Straight
 Keep Promises	 Bring Passion	 Actively Collaborate
 Give Support	 Speak Up	 Truly Listen

Our People Leaders:

 Being open and inclusive	 Encouraging the team to prosper
 Leading by example	 Inspiring and executing transformation



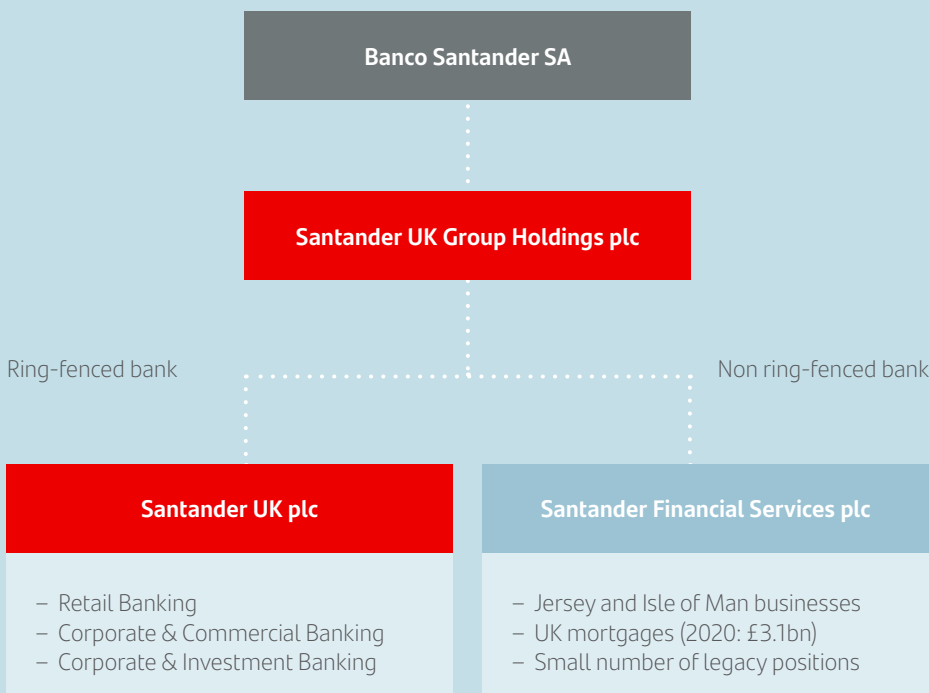
C-19

Operational response

We implemented a number of operational changes to ensure the safety of our customers and our people and to continue to provide essential services to the UK.

-  Branch staff supported call centre colleagues by taking 246,000 core retail customer calls.
-  Branches largely open during lockdown to provide essential banking services.
-  Back office systems and processes rapidly updated to enable payment holidays and government lending schemes
-  90% head office staff enabled to work safely and flexibly from home

We are an autonomous subsidiary which benefits from being an integral part of a global banking group



Chair's statement



William Vereker

I am proud of the commitment our people have shown in 2020 and am excited by the opportunities for us to continue to support our customers and communities in the future.

Introduction

The UK economy, banking sector and Santander UK have faced unprecedented challenges in 2020. Our business and our people have risen to those challenges and have been able to adapt and deliver for our customers throughout the year. I am proud to have joined Santander UK and am looking forward to the opportunities ahead. The technological changes accelerated over the last year will enable more rapid transformation of our business allowing us to serve our customers better. Our business has performed well throughout the year and as a core part of one of the largest financial services groups we have the opportunity to work more closely together across the group and work more efficiently as a business.

Our Covid-19 response

Since the onset of the Covid-19 pandemic, Nathan Bostock, our CEO and his leadership team, supported by the extraordinary hard work and commitment of all our colleagues, have done an amazing job in adapting to the fast and unprecedented changes in our operating environment and in all our lives while continuing to support our customers. Within a week of the first national lockdown, over 16,000 of our colleagues were enabled to work from home safely and productively, an increase of more than ten times pre pandemic levels and while managing through substantial operational and personal challenges for everyone involved.

Our main focus has been on providing vital support to our customers, colleagues and communities during these incredibly challenging times. We have supported

thousands of people and businesses with a range of measures, including over 373,000 payment holidays, and granted £4.6bn through Government loan schemes, which were rolled out to customers very quickly, a huge effort of which I am very proud. I would like to pay tribute to all our colleagues for their dedication and hard work in 2020.

Delivering on our strategy

We continued to deliver on our strategy, with a focus on our customers, simplification, improved efficiency and sustainable growth.

In 2020, we grew our mortgage lending by £4.4bn, despite the market being effectively closed in the second quarter of 2020. We also supported over 150,000 of our business and corporate customers via various Government backed support schemes, more than a 20 fold increase in customer volumes, all accomplished in a matter of a few short weeks. We did all this with our usual prudent approach to risk and while maintaining exceptionally strong capital and liquidity, both significantly above regulatory requirements.

Covid-19 materially impacted our 2020 results, with profit before tax down 44% to £552m. The main driver of the decline was the increase in credit impairment losses to £645m, up from £220m in 2019, driven by Covid-19 related provision for expected credit losses, as a result of the impact on many small and medium businesses all over the UK. The decisive actions we have taken have helped to deliver a very resilient performance, with notable income recovery through the second half of the year. Our net

interest margin improved significantly during the year as a result of actions that were taken on current account pricing.

Our strategic priorities remain aligned to Banco Santander's One Europe strategy, and this year we also welcomed António Simões as the Regional Head of Europe. I, and the rest of my UK based colleagues, look forward to working more closely with him, and his One Europe team, taking advantage of the further opportunities and synergies from being one of Europe's largest financial services groups.

Transforming for Success

We maintained focus on our multi-year transformation programme, to make us simpler and more efficient as we reshape the bank to support our customers better. Two years into the programme, we have invested £332m and realised £244m of savings.

The speed of change during the Covid-19 crisis has been extraordinary and transformed the way we operate. During 2020, customer engagement through contact centres and digital channels increased sharply, with digital financial transactions up 18% over the year. Branch counter transactions reduced by 18% and branch ATM transactions reduced by 55%. However, the role of the Branch evolved, with Voice in Branch (introduced in May 2020) receiving over 100,000 calls during December 2020. To facilitate this, branch staff were trained to respond to core Retail Banking calls and as at 31 December 2020, 14% of incoming customer calls were taken by branch staff to support their colleagues in call centres.

Another area of significant focus for us has been financial or economic crime. We continued to make significant investment in enhancements to our control framework, as well as key controls such as anti-bribery and corruption measures, customer risk assessment, screen and transaction monitoring.

The pace of change in banking has accelerated in 2020, and I am confident that we have the right strategy and the team to continue to adapt our business to meet the rapidly changing needs of our customers.

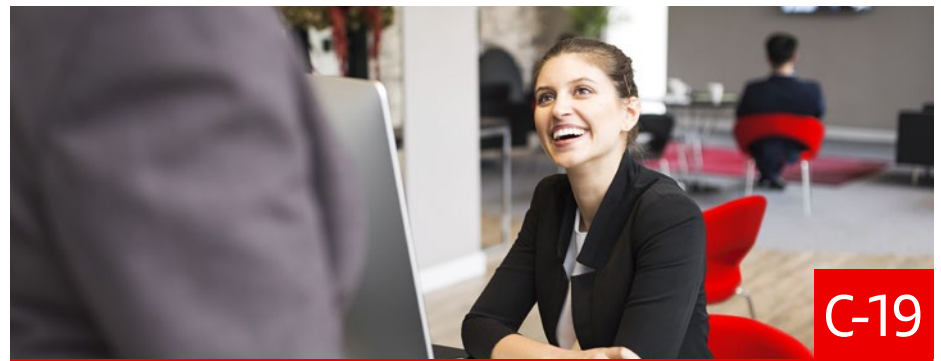
Board changes

As I begin my tenure as Chair I would like to pay tribute to Shriti Vadera for her sure-footed stewardship of the Company and leadership of the Board since her appointment in 2015. Santander UK has benefited from her guidance and I have greatly appreciated her sound advice and support in the handover of the Chair's duties. I would also like to thank Scott Wheway who stepped down from the Board at the end of September 2020 after being on the Board since October 2013. Scott had been the Senior Independent Director since May 2015 and the Board has benefited greatly from his advice. In August 2020 Gerry Byrne, a Banco Santander nominated Non-Executive Director of Santander UK plc stepped down from the Santander UK plc Board after serving since December 2017. The Board appreciated his contribution during his tenure.

We were delighted to welcome Tony Prestedge to the Board of Santander UK plc as a Deputy CEO and an Executive Director in December 2020. Tony has an outstanding track record of delivering complex transformation programmes to meet the changing needs of customers and he will be a real asset to the business. We also welcomed Mark Lewis to the Board of Santander UK plc in December 2020 as an Independent Non-Executive Director. Mark is the former CEO of Moneysupermarket.com Group plc and his experience in consumer digital businesses and leading recent digital change will enable him to make a crucial contribution to the Board.

Board focus for 2021

Although much of the Board time in 2020 has been focused on our response to the Covid-19 pandemic and preparation for the end of the Brexit transition period, we also continued



C-19

Supporting our customers through a crisis

“

The commitment of our people during the Covid-19 pandemic meant that we were able to continue to serve our customers when they most needed our support



373,000

Payment holidays provided



£4.6bn

Government backed business loans granted



82,000

Vulnerable customers contacted to offer support



£20m

Overdraft fees and interest waived

with our transformation programme to better serve our customers. This will continue to be our focus in 2021, alongside refining our strategic priorities to embed New Ways of Working as part of our evolved customer and employee proposition.

The Board recognises that we have an important role to play not just in our economy but in promoting sustainability and diversity. Our culture of Simple, Personal and Fair places fair treatment at the heart of everything we do, underpinned by our well established nine behaviours. We will continue to ensure that our culture supports the delivery of the transformation objectives and our purpose to help people and business prosper.

Finally, being part of the Banco Santander group, will provide opportunities for us to find even more ways to benefit our customers and grow the business sustainably and responsibly.

Thank you and looking forward

I am incredibly impressed and humbled by the lengths our colleagues have gone to in support of our customers and communities,

and I want to personally thank them for their enormous dedication and effort during this time.

The start of 2021 is looking challenging, but I am confident in the resilience of our business and the commitment of our colleagues to continue to achieve our transformation, whilst supporting our customers and ensuring the right outcomes for all.

I am also very excited about the future, the opportunity for Santander UK and how we can continue to play a key role in the UK economy in supporting our customers.

William Vereker

Chair, 2 March 2021

Responding to the Covid-19 crisis

The Covid-19 crisis has been a huge challenge for all of us and our top priority throughout has been the welfare of our people, our customers and the communities in which we operate. The crisis has also had a material impact on our business operations and our financial results.

Despite these challenges we have continued to play an active role in supporting our stakeholders and the wider UK economy.



People

Covid-19 has had a significant impact on our people as well as how and where they work. They put in a huge effort to quickly adapt to substantial operational changes to provide essential banking services for our customers.

Around 90% of non-branch staff worked from home during 2020. From our engagement surveys we know that the majority of our people appreciate

the flexibility of working from home but miss social interaction at the office. We intend to take this into account when we begin a phased safe return to offices.

We are acutely aware of the personal and professional stress our people have been under. To help them deal with these, we implemented a range of support measures and wellbeing events.

For more see page 29



Customers

We understand how hard it has been for our customers and we have supported half a million people and businesses with a range of measures. These included payment holidays, waived fees, reduced interest payments and lending through Government guaranteed loan schemes which were rolled out to customers very quickly.

During lockdown, we necessarily restricted opening times and transactions in branches but did our utmost to continue to provide important banking services face to face, especially for our more vulnerable customers. Customer engagement through contact centres and digital channels increased sharply which we supported through reassignment of branch staff.

For more see page 31



Communities

Older people and those affected by dementia have been disproportionately impacted by Covid-19 and so we donated £1.5m to each of our charity partners, Age UK and Alzheimer's Society, to enable them to increase capacity in their contact centres and online services.

In addition, more than 2,500 of our colleagues volunteered in the Santander 'QuaranTea' telephone call campaign

to support the most vulnerable and isolated people during the pandemic, working alongside Alzheimer's Society and Age UK.

We also contributed over £5m to university initiatives, which included a £300k donation to Oxford UCL and Imperial College to support Covid-19 research and vaccine development.

For more see page 36



C-19

Read more

The Covid-19 crisis has impacted all areas of our business and so is discussed in multiple locations throughout this report. We have also highlighted discrete Covid-19 related information in the following sections which can be identified by the C-19 indicator above.

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Shareholders

Like all banks, we have taken significant provisions against future credit losses as we anticipate the likely impact the Covid-19 crisis will have on our customers' ability to repay their loans to us.

Despite this we remained in profit for each quarter of 2020 while continuing to build resilience in the form of higher capital and liquidity.

Following PRA guidance in early 2020, we temporarily suspended ordinary dividend payments. Following further guidance, an interim dividend of £103m for 2020 was paid in December 2020.

In response to continuing pressure on our earnings, we have taken actions to mitigate some of the impact, including deposit repricing and an ongoing focus on our transformation programme.



For more see page 33

Market overview

Five major forces continue to shape the UK banking market



1



2

C-19

Changing customer behaviour

3.7 million users

Exclusively using mobile app (2019: 3.1 million)

What we have seen

The change in customer behaviour accelerated in 2020 as the move away from traditional in-branch banking towards online services stepped up as a result of the Covid-19 pandemic.

As essential services, bank branches remained largely open throughout the lockdowns but, despite this, more customers used remote channels such as digital and telephone banking services.

Digital banks have gained some traction in 2020 attracting more than their market share of current account switchers in the UK. Younger customers in particular put a greater emphasis on better digital tools, convenience, and a simpler purchasing process, characteristics often associated with digital-only banks.

Our response and looking ahead

During 2020, customer engagement through contact centres and digital channels increased sharply, with digital financial transactions up 18% over the year. Branch counter transactions reduced by 18% and branch ATM transactions reduced by 55%. In response, we adapted our operating model to meet the changing needs of our customers and to increase remote banking capacity.

During the lockdown period we trained branch staff to be redeployed to online chat and telephone services. We also moved many services online, such as the ability for our customers to request a payment holiday on a mortgage.

Strong market competition

New digital banks

In January 2021, two new entrants announced plans for UK launch

What we have seen

While the UK banking sector remains very competitive, customer rates have fallen in both lending and deposits in 2020. Mortgage rates increased in the second half of 2020 as demand recovered strongly following the Covid-19 lockdown and the temporary reduced rates of stamp duty for house purchases. However, although new business margins have improved they still tend to be below back book levels, and competition could increase as demand eases in 2021.

In recent years, some retail banks have exited mortgages or ceased new mortgage lending. In particular, several non-banks who diversified into financial services in recent years announced plans to divest and have put their books up for sale.

Our response and looking ahead

In line with the market, we increased mortgage lending rates as we managed our risk appetite and new lending flow. We also repriced our 11213 Current Account and change in benefits in light of the lower rate environment and competitor actions.

We expect our net mortgage lending to be in line with market growth, as we focus on quality customer service, retention and our comprehensive proposition for first-time buyers.

UK government and regulatory authorities response

The response by the UK government and regulatory authorities was unprecedented, with a wide range of fiscal, monetary and regulatory measures implemented. These measures included:

For consumers

- Loan payment holidays
- Interest and fee waivers on banking products
- Stamp duty waived for house purchases

For businesses

- Coronavirus Job Retention Scheme (CJRS) to pay wages for employees who cannot work due to Covid-19
- Lending schemes for business with government guarantees for lenders, most notably the Bounce Back Loan Scheme (BBLs)
- Business rates relief

For the economy

- Bank rate reduced 65bps to 0.10% from 0.75%
- Cheap funding for banks to support lending through the Term Funding SME scheme

For banking market resilience

- Reduced bank capital buffers
- Ordinary dividends and executive bonuses suspended



3

Rapid technological change

+18%

Increase in financial transactions carried out on Santander UK digital platforms⁽¹⁾

What we have seen

Technology continues to evolve rapidly across all areas of the financial services sector as people demand to be able to do more digitally. Over recent years the banking sector has evolved to offer more and more services that were once only possible to do in a branch, online or through apps.

Over recent years, new challenger banks entered the UK banking sector, disrupting the market with innovative propositions and competitive pricing to grow their business. This has helped to further influence customers' expectations of digital banking interactions in particular.

While the Covid-19 crisis highlighted the need for banks to offer essential services remotely, it has also reinforced that a high street presence has a part to play.

Our response and looking ahead

We have continued to invest heavily in improving our digital platforms to ensure our customers have a reliable, innovative and full banking service. By focusing on the customer experience, we have been able to reduce duplication from back office processes and streamline customer outcomes.

During lockdown, having branches available for small teams to work from has been a real benefit. They have provided flexibility and technology has enabled them to support both their contact centre colleagues as well as our customers.



4

Demanding regulatory agenda

64

Regulatory initiatives introduced by regulators in 2020

What we have seen

Despite the initial pause at the onset of Covid-19 pandemic, the regulatory policy and change agenda became intense heading into year-end. This was driven by the regulators continued guidance on Covid-19 financial support measures, preparation for Brexit, innovation and technological developments, and beginning the design process for the post-Brexit regulatory landscape.

Covid-19 guidance implementation at short notice put a considerable strain on technology and operations as well as programme management resources. Alongside this, there was a significant increase in the volume and frequency of supervisory information and data requests. Significant business line, Risk, Finance, Compliance, and Regulatory Affairs resources were dedicated through the year to deliver these.

Our response and looking ahead

The Government is undertaking a series of reviews of the Financial Services sector, looking at the future regulatory framework in the UK, the regulatory regime for overseas firms coming into the UK, the UK Funds regime, Ringfencing, and the UK Listings rules among others.

We are proactively engaging with the regulators, government, and industry trade associations on these and other significant policy initiatives, including a 2021 focus on Operational Resilience and Climate Risk Stress Testing, on-shored CRR II, and possibly the Basel 3.1 package of capital framework reforms.



5

Uncertain economic environment

-3% to 6%

Range of HM Treasury consensus for 2021 growth in annual GDP⁽²⁾

What we have seen

The UK economy, along with other global economies, experienced a significant downturn in 2020. As the Covid-19 pandemic unfolded, a number of regional and national lockdowns were announced to control the virus and reduce pressure on the NHS. During lockdown, non-essential businesses, schools and workplaces were closed and economic activity and consumer spending fell dramatically as a consequence. Alongside the uncertainty caused by the Covid-19 crisis there was also increased focus on preparation for the end of the Brexit transition period.

In response, the UK government implemented a range of support programmes to protect jobs and help businesses survive and eventually support economic recovery.

The Bank of England reduced the bank rate twice in March 2020, from 0.75% to 0.25% and then down to 0.10%, the lowest interest rate the UK has ever seen.

Our response and looking ahead

At Santander UK, we implemented a number of support measures, including offering payment holidays for business and retail customers, along with participating in various government lending schemes for businesses.

Securing a Brexit deal has provided some welcome certainty and the chance to consider the opportunities inside the EU under the new arrangements, and new markets which we can support through our overseas links to the Banco Santander group.

(2) HM Treasury Forecasts for the UK economy: a comparison of independent forecasts January 2021.

(1) 2020 compared to 2019

CEO review



Nathan Bostock

To say 2020 has been a challenge for our customers, our colleagues and the economy would be an understatement. In the space of several weeks, the Covid-19 pandemic completely changed how we live our lives and how we work.

In previous years, I would use this space to review the last twelve months and reflect upon our successes, opportunities and challenges, but looking back on 2020, that would not do justice to the impact the Covid-19 pandemic has had on all of us: from our customers and our colleagues to the wider economy.

We have all had to adapt

It has resulted in a fundamental change to how we live and work. It seems remarkable to think that just twelve months ago, we were still operating in what would be considered a normal environment. But since the first UK lockdown in March 2020, we have all had to adapt in ways that would seem unimaginable and I have been incredibly proud of how Santander UK has responded to that challenge. It has been a reminder of the role we play in the lives of our customers and how our purpose, to help people and business prosper, was never more important than in 2020. We have come together, to put in place the support and assistance needed for these unprecedented times. We also had to be there for our people – focusing on their safety and well being, helping them with new ways of working. And all of this at an unbelievable pace, with situations changing on a daily basis. Whilst it has underlined how important a service we are to our customers, especially in times of crisis and difficulties, it has highlighted the commitment of our colleagues, whether in branch, contact centres or the wider business, to provide that extra help and to go the extra mile to be there when we are needed.

Our commitment to sustainability became even more relevant during the Covid-19 pandemic, not only in how we supported our stakeholders, but in our longer-term response. The pandemic reinforces the need to build more sustainable and resilient systems, to 'build back better', and we want to be part of that.

The pandemic has presented the financial sector with an opportunity to rebuild trust with our customers, and to show that we understand the difficulties they're facing, but importantly, that we can also provide the right help and support.

We had to act and to act swiftly

For our business customers, those difficulties have been stark and immediate. Almost overnight, viable, thriving businesses and their local economies were having to face up to a very different and uncertain future. Our customers were understandably looking to us and we had to act, and act swiftly. Working alongside government and regulators a series of support programmes were put in place in a matter of days, providing businesses with essential capital to help them navigate months of uncertainty. The impact has been real, with businesses telling us they have faced cash flow issues, reduced sales, decreased revenues, declining orders and for those reliant on physical customer engagement, such as retail, hospitality and leisure, the results are more acute still. SMEs faced particular challenges, and we went beyond traditional banking support with our 'Survive and Revive' initiative, offering resources and trading support to small businesses through the crisis.

Given the sheer scale of the issues facing our customers and the economy, it was understandable that the government wanted to provide real financial help, and the best means of doing so was through the banking sector. We had the means of delivering that liquidity direct to the businesses that needed it and I am extremely proud of not only our response, but that of the banking sector as a whole, where we worked with HM Treasury to put this ambitious support package into action. The numbers are incredible. In a matter of months, we granted £4.6bn of Government-backed loans to over 150,000 customers: £4.0bn through the Bounce Back Loan Scheme, £0.4bn via the Coronavirus Business Interruption Loan Scheme and £0.2bn through the Coronavirus Large Business Interruption Loan Scheme. This enabled businesses to survive and to become Covid-secure or to evolve their business to meet their customers' different needs and expectations.

It is clear that, despite the approved vaccines and their roll out, a form of normality is still some distance away, so we must remain ready to help in whatever way we can.

Straightening our relationship with our customers

Our response to the pandemic has helped strengthen and deepen our relationship with many of our business customers, and I believe the same can be said for our retail customers. Their issues are different, but no less important. Many find themselves in positions of real insecurity for the first time in their lives. So we acted quickly to offer practical support via a payments holiday

package across mortgages, unsecured personal loans and credit cards. Of the 373,000 payment holidays we provided, 251,000 of our mortgage customers benefited from a 3-6 month mortgage payment deferral. This helped reassure customers who found themselves furloughed or suddenly out of work. But it was vital that we continued to provide access to our essential day-to-day services. At the height of the pandemic, our branch network and contact centres remained operational, prioritising access for our most vulnerable customers and those with urgent needs. Over 1,100 of our branch colleagues were trained to provide support for the contact centres or live chat when they were not serving customers in the branches. Today, our branch colleagues continue to provide these services during the third national lockdown.

Inevitably, the pandemic has accelerated changes in how our customers choose to bank with us. The pace of digital adoption across the economy has been a notable trend and we have seen the number of financial transactions carried out on our digital platforms reflect this with a 18% year-on-year increase. This included a 32% increase in current account digital openings as well as 64% of online mortgage retention.

In April 2020, we launched 'Reaching Out', an initiative focused on calling some of our potentially vulnerable older customers, who typically would have visited a branch and may not have access to online or mobile banking. We provided these calls from frontline colleagues through to November 2020, reaching over 82,000 customers to check on their wellbeing and provide support where needed.

A decade of change

The priority for myself and for my leadership team was to provide colleagues with the support they would need so they could provide the services our customers needed. For those in branches and in our offices, we put in place measures to make their workplace Covid-secure. It was vital people could come to work with confidence and I was extremely proud of how quickly we moved to adapt our premises, and the understanding and fortitude of colleagues who continued to keep our face-to-face services running. On the other side, we have seen a remarkable change in how the rest of the business operates. It is astonishing to think that in the space of a handful of months,



Supporting our people remains our top priority

“
I am immensely proud of the way in which my colleagues have responded to the pandemic

Day in, day out our colleagues' passion, resolve and support for each other has meant that we have been able to continue providing the best customer experience possible. I have been humbled by the humanity and kindness within our organisation, and the perseverance and resilience of our people continues to be a great source of pride and inspiration. Our key focus throughout the crisis has been to prioritise our colleagues'

wellbeing. Many of our colleagues are now entirely working from home for the first time, whereas others continue to come into their workplace under very different and challenging circumstances. We have responded to this with various measures to help our colleagues feel reassured and safe, continuously listening and responding to their needs.

The support we have provided each other has meant that we have been able to adapt to new ways of working and manage busy workloads to respond to the rapidly changing needs of our customers. We have embraced this change, collaborating across teams to break down silos and leverage technology to help us deliver crucial support to vulnerable people and a service that is second-to-none.

For more on how we are supporting our people see page 29

we enabled 90% of our head office colleagues to work remotely. A combination of utilising our digital infrastructure to give them the confidence to work effectively, and everyone's adaptability and resilience has meant we have been able to provide customers with the support they need. In the last ten months, we have seen ten years' worth of change in how we work.

Supporting our communities

We must, as a sector, take forward lessons learned from this crisis, so we can offer the best possible working environment with the right resource to enable real flexibility and responsiveness to the needs of individual colleagues.

Throughout the pandemic, we remained committed to supporting our communities up and down the country with our sustainability strategy. Charities and their community organisations have been severely affected so I wanted to note the work of the Santander Foundation who donated £3m to our charity partners Age UK and Alzheimer's Society. This donation enabled their contact centres and online services to increase capacity, and better serve those in need. Older people and those with dementia were disproportionately impacted by Covid-19, so the work of these charities is more important than ever.

CEO Review continued

I was proud that colleagues were keen to play their part and that is why we doubled the amount of time they could undertake volunteering activities at work to 70 hours, in order to support our charity partners, local community groups and the NHS volunteering appeal. Over 2,600 Santander UK employees volunteered with Age UK and Alzheimer’s Society to make phone calls to people who may be lonely or vulnerable, deliver shopping and become a ‘Dementia Friend’.

Through Santander Universities, we’ve provided £4.5m of funding to our 85 university partners to support the array of initiatives launched to contribute to the national effort to combat the outbreak of Covid-19. With the pandemic presenting many new challenges for students, universities and the local community, we announced we were both repurposing and providing additional funding to ensure immediate support to alleviate health and educational challenges caused by the crisis. We provided £300k to Oxford, UCL and Imperial College to support Covid-19 research and vaccine development. This supported a variety of initiatives including assisting universities who were providing additional protective equipment for NHS staff as well as supporting university emergency hardship funds which provide grants to students who require financial support for living costs or resources for the transition towards a digital learning environment. This included IT equipment and support, such as laptops and broadband connectivity, which would normally be accessed on campus, to ensure students were able to continue their studies.

The funding also went towards offering vital support for student mental health and wellbeing during this challenging time. Covid-19 and Brexit understandably dominated the agenda throughout 2020, but this cannot be at the expense of our ongoing commitment to support the transition to a low-carbon economy and tackle climate change. We remain utterly committed to the objectives of the Paris Agreement and Banco Santander has participated in renewable energy finance deals totalling €32bn during 2010-19, making it one of largest financiers of renewables both globally and in the UK. Looking ahead, Banco Santander has committed to raise and facilitate €120bn by 2025, and €220bn by 2030, in green finance globally. During 2020 the Board and Executive Committee (ExCo) undertook a deep dive on climate change, with external expert support, and agreed to further increase our ambition to address the urgent need for climate action. There is always more to do and we are working hard to manage climate-related financial risks in our portfolio, support customers to transition by developing green products and services, and reduce the emissions within our operations and supply chain. However, we recognise this is only part of the solution. Supporting renewables must be complemented by a reduction in the carbon emissions across our wider lending portfolio which is why we have tightened our policies on lending to carbon-intensive sectors. As a result, we will not provide financial products or services to new coal-fired power plants worldwide, or oil and gas drilling projects north of the Arctic Circle.

programme to improve career progression and social mobility. Our gender pay gap has continued to narrow as we implement our comprehensive action plan to improve gender representation across the organisation. Our mean average gender pay gap in 2020 was 29.3% a reduction of 0.5 percentage points year on year, while the median pay gap was 27.4%, a reduction of 0.8 percentage points year on year. We are focused on our Board and leadership gender diversity but know there is still more work to do.

Although Covid-19 materially impacted our results, with statutory profit before tax of £552m, down 44% year-on-year; the decisive actions we have taken have helped to deliver a very resilient performance despite the difficult environment. We have achieved strong lending growth, particularly in mortgages, grown customer deposits, delivered further efficiency savings and a notable improvement in income in the second half of the year. In 2020, 11213 Current Account repricing actions linked to bank rate reductions, led to a fall in the number of our loyal customers and retail NPS rank. Customer loyalty and NPS remain integral to our strategy and will be a key area of focus for management in 2021.

Supporting ‘OneEurope’

Thanks to the extraordinary hard work and commitment of my colleagues, we have been able to continue providing essential banking services throughout the pandemic, alongside tailored help to customers who are facing challenges.

Of course the ongoing pandemic is not the only challenge we face in 2021, as we embark upon a new relationship with the European Union that will have a considerable impact on how our business customers operate. Securing a deal has provided some welcome certainty and the chance to consider the opportunities inside the European Union under the new arrangements, and new markets.

Regardless of the deal, how customers trade with the European Union is changing and it will involve more friction, but our Corporate and Commercial Banking team has been advising our business customers about how they can prepare for these new rules and requirements and will continue to support them in these formative weeks. In this context, Banco Santander’s ‘OneEurope’ initiative could not be better

CET1 capital ratio



UK leverage ratio



Reflecting our customers and their experiences

The last twelve months serve to remind us that regardless of the challenges we face, we must continue to promote inclusion and diversity. There is no doubt that for us to serve our customers effectively, our workplace we must reflect our customers and their experiences. Throughout the summer we held a number of events in response to the Black Lives Matter movement, listening to colleagues’ experiences and looking at the ways in which we, as a leadership team, can support colleagues and accelerate the pace of change within the bank. In response to what colleagues have been telling us we have developed our Black Inclusion Plan which will seek to double our black more senior population by 2023 and launched a black talent and sponsorship

Transforming for Success programme - integral part of OneEurope strategy



£332m

Investment since end 2018

Banco Santander's goal for OneEurope is to create a better bank where our customers and our people feel a deep connection with Santander while delivering sustainable value for shareholders.

We are building an even better bank that puts our customers at the heart of everything we do. This starts with understanding them better, so we build customer loyalty by giving them more reasons to join, stay with and recommend Santander.



£244m

Savings since end 2018

Santander UK is an integral part of this strategy and fully aligned purpose of wanting to help people and businesses prosper and to do it in a Simple, Personal and Fair way.

As part of the OneEurope family, we will continue to innovate and transform our businesses. To do this, we will work even harder and better with our European colleagues, as there is much more that unites us and our customers than what sets us apart.

timed. By working more closely with our colleagues in Spain, Portugal and Poland, we will be able to align ourselves more closely with our European colleagues and leverage their skills, knowledge and resources to the benefit of our customers. Taken alongside Banco Santander's global footprint, we are able to offer our customers access to expertise that will help them grow their business opportunities in Europe and beyond. In turbulent times, we have benefited from having a senior leadership team with the experience to help us navigate our way.

So I would like to take this opportunity to thank our outgoing Chair of six years, Shriti Vadera. She has supported us through significant transformation and cultural change whilst her experience and insight has been invaluable. Our new Chair, William Vereker, brings a wealth of expertise both in the financial and political sectors and I look forward to working closely with him.

I also want to thank Vicky Wallis and Patricia Halliday for their contributions to Santander UK and the Executive Committee as they leave for new challenges and welcome Christine Palmer and Tony Prestedge as our Chief Risk Officer and new Deputy Chief Executive Officer of Santander UK plc, respectively. Tony brings with him wide experience from his time at Nationwide and Barclays and will help drive forward the continued transformation of the business as we continue to put digital at the heart of how we operate and push forward our change programme. We plan to use our experience from the last twelve months to make Santander UK the best place to work for colleagues and a beacon for new talent and innovators.

2020 has been a year unlike any I can remember, but I am proud of how we have responded, providing our customers with the help and support they have needed. I hope that 2021 will present our customers and businesses with the sort of change they can relish with new opportunities to prosper, knowing we will be with them every step of the way.

Nathan Bostock
Chief Executive Officer,

2 March 2021

Our business model

Our purpose is to help people and businesses prosper

Our resources

People

Bringing the skills, expertise and drive to deliver enhanced customer loyalty and experience

Infrastructure

Branch and online presence, operating centres and innovative technology

Banco Santander family

Technology, shared management experience and brand benefits as part of well-diversified global bank with

Financial

Strong capital, liquidity and a prudent approach to risk

Our competitive advantage

Leading scale challenger bank in the UK

Scale in our core banking businesses combined with an innovative mindset

Resilient balance sheet

Demonstrated by the lowest CET1 drawdown in the 2019 BoE stress tests

International expertise for UK companies

20 trade corridors to help UK companies expand into overseas markets

What we do

We provide financial products and services

Mortgages, consumer auto finance, unsecured loans, credit cards, banking and savings accounts, investment and insurance products for individuals and growth-focused support and services for companies

How we do it

Build strong customer relationships

Offer a differentiated proposition

Take a prudent approach to risk

Do things The Santander Way

Our culture is built on doing things The Santander Way

Simple

Our products are easy to understand and we offer a service which is convenient, no matter when or how our customers want to engage with us

Personal

We treat our customers as valued individuals, with a professional service they can trust. We support our colleagues to achieve their ambitions

Fair

We are open, honest and treat others as we would like to be treated. We earn our investors a sustainable return and do our part to support our communities

Our aim is to be the best open financial services platform by acting responsibly and earning the lasting loyalty of our people, customers, shareholders and communities

Creating value for our stakeholders

Customers



Delivering customer loyalty and outstanding customer experience

Read more on page 31

People



Providing a thriving workplace for engaged, motivated and diverse individuals and teams

Read more on page 34

Shareholders



Aiming to improve efficiency and returns through simplification and digitalisation

Read more on page 33

Communities



Supporting communities in which we operated with our sustainability strategy

Read more on page 36

Applying Covid-19 learnings - New Ways of Working

During 2020 we all changed habits, we interacted differently, we shopped differently and we travelled less. Some of these changes are temporary but some will be more structural. The Covid-19 crisis also brought forward a digital change in our society and it will inevitably change how we operate, interact with customers, and how our employees will work going forward.

It is incredible to think that in the space of a handful of months, we enabled nearly 85% of our colleagues to work remotely. This was not just about providing the correct IT (although it was part of it) and a digital infrastructure that could support this move, but it was also about individuals willing to change and adapt to this new environment and new demands. It was not just about working from home either. We were better able to utilise more of the talent within the organisation, with branch staff now able to assist our contact centres or chat facility from the branches outside of their opening hours.

The post Covid-19 strategic operating model will leverage on the swift adoption of digital channels. Digital will encompass all levels of the organisation, including customer interactions, operations and support functions.

For many customers who were previously wary of online banking, they have now discovered it is as easy as the online shop. We cannot pretend they will go back to their previous habits. The pandemic has accelerated the trend of customers using branches less, and digital transactions are ever more important. We will further our digital transformation, making digital the primary channel for sales and servicing. We will also enhance our digital capabilities to improve customer service and adapt to what customers are now expecting.

Employees are also looking for more flexible ways of working, and the new environment will allow us to do so. There is a new challenge for many businesses, how do we give people the flexibility they want, whilst ensuring we retain a clear corporate sense of purpose?

The pandemic has forced us to communicate more frequently with our colleagues to understand what their experiences from this new way of working and what they want in the future.

Our internal surveys showed that 91% of colleagues felt more, or as productive working from home and 76% said they wanted to be in the office on average 4 days a month. We will be able to provide more flexible hours, while improving our customer service and employee value proposition. Additional flexibility will also create opportunities in how we access talent. We are confident these changes will enhance both productivity and our long-term growth potential.

As we embrace this new operating model, consistently review and adapt our risk controls and governance frameworks to ensure that these are aligned with the latest regulatory requirements.

Our continued culture of transparency and collaboration will be a key pillar for the successful implementation of our New Ways of Working strategy and that our re-defined operating model will allow for a more agile, responsive and resilient franchise, resulting in long-term value creation.



Our strategic priorities

Our refined strategic priorities are aligned to Banco Santander's One Europe strategy, with a focus on customer loyalty and experience, simplification, improved efficiency and sustainable growth, while aiming to be the best bank for all our stakeholders.

1

Deliver growth through customer loyalty and outstanding customer experience

- Deliver outstanding propositions to meet more of our customers needs
- Connect physical and digital channels for seamless customer experience
- Profitable growth in retail banking and sustainable returns in corporate banking
- New and evolving revenue sources including global group projects

2

Simplify and digitise the business for improved efficiency and returns

- Simplify, digitise and automate our processes
- Improve our technology and operations through innovation and optimisation
- Remove complexity and siloes to increase productivity
- Capital discipline and RWA management
- Maintain a prudent approach to risk

3

Engage, motivate and develop a talented and diverse team

- Enable our people to meet their full potential
- Implement new and flexible ways of working
- Provide training and development to deliver a workforce for the future
- Ensure all aspects of diversity remain front of mind

Be a responsible and sustainable business

Focus on five pillars for a thriving workplace, while meeting all our regulatory requirements and expectations:

- Sustainable economic growth and financial inclusion
- Climate change
- Inclusive digitalisation
- Ethics
- Fighting financial crime

Transforming for Success



Being new to the bank, I am impressed by Santander's ambition, the scale of the bank globally, and the talent that is available to drive through the transformation. But more than that, I am captured by the engrained belief that the customer comes first.

Tony Prestedge

Santander UK plc Deputy Chief Executive Officer

We are transforming the business for success in order to meet the changing needs of our customers and deliver improved returns over the medium-term.

Since commencing the multi-year transformation programme in 2019, we maintained a strong focus on digitalisation, automation and restructuring initiatives across the business.

We have done so at an even faster pace in 2020, and with real urgency in order to continue to meet the changing needs of all our stakeholders, and despite significant uncertainties and operational challenges caused by the onset of the Covid-19 pandemic.

2020 was also all about breaking down silos and working across teams to deliver real change, while leveraging technology to help all our colleagues in the service of our customers.

Our systems were also key enablers of this change, and through the launch of a new digitally integrated credit end-to-end platform, we have been able to reduce cycle times by 20-30%, delivering a faster and improved customer experience.

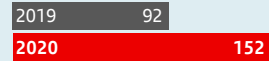
The need for change is not a new concept for our organisation. Our plans to adapt and transform started well before the pandemic, and the transformation of our organisation will continue at a pace.

Transformation programme highlights

Spend



Savings



Planned investment spend split:

Customers

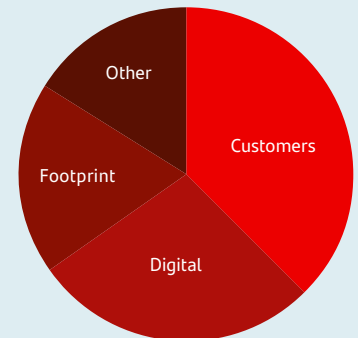
Serving our customers better with more efficient network use and digital service model development

Digital

Digitising the back office with end-to-end IT processes and automation, leveraging technology such as the cloud and big data

Footprint

Repositioning our corporate footprint while supporting agile working and collaboration and optimising how and where we work.



Our Commitment to the UN Sustainable Development Goals (SDGs)

Our business activities deliver on targets set out in the UN SDGs, which we have mapped against our Sustainability strategy. Specific SDG targets that we delivered on in 2020 are those in Goal 4, Goal 8, Goal 10, and Goal 13. To read more about our contribution and see the full mapping, please see our ESG Supplement 2020.



Our performance and KPIs

We have taken further decisive steps in 2020 to mitigate the material impact Covid-19 has had on our business operations and performance.

We are confident in our ability to transform the business through a relentless focus on improved customer outcomes, strengthened business efficiency and proven resilience of the business, while continuing to deliver on our strategic priorities.

	KPI	2020 result
1  Customers	Loyal customers	4.4 million
	Digital customers	6.3 million
	Retail NPS ⁽²⁾	8th
	Business and corporate NPS ⁽²⁾	1st
2  Shareholders	Adjusted RoTE ⁽³⁾	4.3%
	Adjusted cost-to-income ratio ⁽³⁾	59%
	Cost of risk	31bps
	Leverage ratio	5.1%
3  People	Top 10 company to work for	Medium-term aim
4  Communities	Financially empowered people	500,000

(1) See Glossary for KPI definitions.

(2) NPS measure became a KPI during 2019, replacing customer satisfaction to incorporate a broader measure of advocacy.

(3) Non-IFRS measure. See 'Alternative Performance Measures' for details and reconciliation to the nearest IFRS measure for return on ordinary shareholders' equity (RoE) and cost-to-income ratio. 2020 RoE was 2.9% (2019: 4.9%) and cost-to-income ratio was 63% (2019: 61%).

Why it matters and how we performed

Loyal customers measures the number of our customers who have a primary banking relationship with us alongside another product. Loyal customers stay with us longer and their current account usage gives us in-depth insight which allows us to tailor our services to their needs. This metric decreased in 2020, following 11213 Current Account repricing actions linked to bank rate reductions, and now represent 32% of our active customer base. Customer loyalty remains at the heart of our strategy and will be a key area of focus in 2021.

Digital customers are increasingly important given the benefits that mobile and digital can bring to the customer experience alongside more efficient operational delivery of 24/7 service. Customers in the UK are increasingly moving towards mobile and digital banking, a trend that exponentially increased in 2020 due to the Covid-19 lockdowns.

Retail net promoter score is a widely-used measure of customer experience and customer advocacy. As expected, during 2020 we slipped from the Top 4 position we achieved in 2019 following 11213 Current Account repricing actions linked to bank rate reductions. However, balances have increased over the year and overall account numbers have remained broadly stable. Improvement in customer satisfaction will be a key area of focus in 2021.

Business and corporate net promoter score is a widely-used measure of customer experience and advocacy. In 2020 we maintained our first place ranking, a testament to the comprehensive proposition and our strong support for our small and medium-sized business customers during the Covid-19 pandemic.

Adjusted RoTE is a measure of income generation on shareholder investment. The adjusted RoTE of 4.3% in 2020 was materially impacted by the Covid-19 pandemic credit impairment charges for future losses, partially offset by improvements in income driven by decisive management actions on liability repricing and continued focus on making the business more efficient. We are focused on improving returns through our 'Transforming for Success' multi-year transformation programme. Statutory RoTE was 2.9% (2019: 4.9%).

Adjusted cost-to-income ratio is an efficiency measure to capture the amount spent to generate income. Adjusted cost-to-income remained stable at 59% in 2020 with income pressure in the lower interest rate environment and the significantly lower banking and transaction fees driven by implementation of regulatory changes to overdrafts, offset by realised efficiency savings. We are focused on cost transformation through digitalisation, automation and restructuring activities. Statutory cost-to-income ratio was 63% (2019: 61%).

Cost of risk is a measure of credit impairment charge for the 12 month period as a percentage of average customer loans. In 2020 our cost of risk increased to 31bps, driven by £448m Covid-19 related provision for expected credit losses. This drove an increase of c.22bps, with portfolio performance remaining resilient with low write-offs and deterioration seen only on a few single name corporate cases.

All major UK banks and banking groups, us included, are required to hold enough Tier1 capital to satisfy a minimum Leverage ratio requirement of 3.25% and enough CET1 capital to satisfy a countercyclical leverage ratio buffer of 35% of each bank's institution-specific countercyclical capital buffer rate. Leverage ratio of 5.1% in 2020 was up 40bps, primarily through improvement in CET1 capital and active management of leverage exposures. It remains 1.5p.p. above the regulatory requirement.

Top 10 company to work for is an important measure of employee satisfaction and our participation forms part of a wider Banco Santander goal. We participated in an industry-wide ranking survey in 2020 and gained accreditation as a Great Place to Work alongside Excellence in Wellbeing. The ranking will be announced in April 2021 to check our progress towards our over-arching global medium-term target. Alongside this, Santander UK was again accredited in the Top Employers Survey for 2020 for both the UK and Europe.

Financially empowered people are those unbanked, underbanked or vulnerable people who we support by promoting access to finance, tailored products and financial education initiatives. In 2020 we adapted our support to help people through the Covid-19 pandemic, with financial aid, access initiatives and advice services. This contributes to Banco Santander's target to financially empower 10 million people by 2025.

Result

2018	4.4m
2019	4.6m
2020	4.4m

2018	5.5m
2019	5.8m
2020	6.3m

8th out of 9 competitors

1st out of 6 competitors

2018	10.2%
2019	7.8%
2020	4.3%

2018	54%
2019	59%
2020	59%

2018	8bps
2019	11bps
2020	31bps

2018	4.5%
2019	4.7%
2020	5.1%



2019	248,100
2020	500,000

Risk management overview



Santander UK is a great business with considerable opportunity, backed by a strong global brand. I want to thank all my colleagues who are actively managing risk across the organisation, keeping focused and supporting each other, while delivering for all our stakeholders.

Christine Palmer,
Chief Risk Officer



Meeting operational challenges

The Covid-19 pandemic has resulted in a number of significant challenges, which were met during the course of 2020.

We transitioned effectively to a sustained working from home environment, underpinned by robust remote access technology, and continuous communications and support measures for all of our colleagues. At the same time, the risk team's resources were mobilised to implement new processes and procedures to facilitate the delivery of Covid-19 government support measures for our retail, business and corporate customers, whilst maintaining operational resilience. Interactions and communications with our customers were also increased in order to better understand their individual needs.

Credit and operational risk impacts

During the year, we managed the evolution of both our credit and operational risk profiles across all of our businesses and loan portfolios. We initiated targeted retail customer out-reach to assess requirements for ongoing support and re-rated substantial segments of our corporate credit portfolios, also supplemented by proactive client

engagement. Financial Support activities have been re-engineered to ensure our customers obtain the best individual outcomes. We continue to focus on increased fraud and cyber risks seen across the financial services sector to ensure we maintain a robust operational environment. We have prioritised monitoring and oversight of these and other key operational risks with enhanced reporting and input to IT strategy, data management and business transformation.

Strategic risk management actions

Our teams supported the analysis of net credit loss modelling through ongoing reviews of inputs to our IFRS9 models, which determine the level and timing of the provision of credit losses in our financial accounts. Regular risk assessments of our business plans were undertaken throughout the year, under a range of economic stress scenarios. This enabled us to view our medium to longer term financial forecasts and the setting of our risk appetite to support the business plan. We also identified management actions that will assist us in mitigating cost and revenue pressures, including the phased delivery of our cost transformation programme.

C-19

Main impact on risk management

The Covid-19 pandemic had a material impact on our business and financial performance, as well as our risk profile.

Net credit losses increased materially during the 2020 financial year to £645m. However, these charges were mainly driven by management judgement overlays with regards to expected future losses and reserve build, rather than loan performance deterioration. Various government support measures, especially the furlough schemes, have delayed the full impact on our customers and in turn on us. The outlook for the credit impairment charge

remains uncertain, with future outcomes dependent upon the performance of the UK economy, especially unemployment.

Operational risks have increased, along with the technology required to support a significantly larger staff cohort working from home, and employee communications and policies to mitigate the potential risk of staff health impacts materialising into capacity constraints. We have prioritised and focused risk resources in these areas to facilitate the implementation of enhanced controls, processes and technological solutions.

Reputational and conduct risks also increased in the year, as we focused on ensuring that all customers were treated promptly and fairly under the various government backed schemes, whilst managing within risk appetite. We engaged, and continue to engage, closely with the government and regulators in the implementation and operation of the various schemes.

Top risks

Our top risks outlined below are monitored monthly at the Executive Risk Control Committee (ERCC) and Board Risk Committee (BRC).

Covid-19 first and second order risks

During 2020 our top risks have been re-focused to incorporate two new top risks; the credit and operational (first order risks) and cost and revenue (second order risks) impacts of Covid-19. These are covered in more detail in separate case studies in this section and throughout the document, being clearly labelled with the C-19 indicator.

Financial crime

Financial crime activities can have significant impact on our customers. Criminals are increasingly using the financial system to launder the profits of illegal activity such as human trafficking and terrorism. We continued to make significant investment in ongoing enhancement to our financial crime control framework, and to key controls including anti-bribery and corruption measures, customer risk assessment, screening and transaction monitoring. Our Money Laundering Reporting Officer continues to reinforce the importance to Senior Management of focusing on; continuous enhancements to data quality, Key Risk Indicators and treatment strategies to sustainably control risk; ensuring proportionate capacity and investment across due diligence processes for higher risk customer segments; and promoting the embedding of an anti-financial crime culture framework. Covid-19 has also provided an opportunity for fraudsters to take advantage of vulnerable customers through a range of fraud attacks and scams. We have increased our fraud messaging and scam education to assist our customers. We have also continued to build on existing controls and develop new control environments to address fraud attacks.

Brexit

Whilst our contingency plans were based on a worst-case 'no deal' scenario, the risks associated with Brexit remain substantially the same, as the Trade and Cooperation Agreement deal does not cover financial services in any significant detail, as expected. Our plans are described more fully in the separate case study later in this section.

Conduct and Regulatory

We are operating in an environment where conduct and regulatory risks are elevated, reflecting the challenges posed by Covid-19 and the continuing need for customer support following the extension of support and forbearance measures in relation to mortgage repayments and government lending schemes for SMEs. Regulatory engagement continues to be high as a result of these issues, as well as with respect to other key developments such as Brexit, Negative Rates and Libor Transition. Robust processes have been put in place to provide assurance that risks are being managed and actions monitored across the various government sponsored schemes, and also other conduct related issues, in order to ensure fair customer outcomes.

Managing a complex change agenda

We continue to face a challenging change agenda into 2021 with respect to our operating model and also supporting a range of initiatives required to deliver our business strategy. These include increased agile transformation across the organisation; significant IT infrastructure projects; bedding down of new centres of excellence; and implementation of regulatory projects. This places more importance on our management of change, which is underpinned by our established risk project prioritisation processes and change oversight governance.

Building and maintaining capital strength

Regulatory uncertainty on the implementation and interpretation of capital rules continues and impacts on both our capital management and capital position. We continuously review our capital position on a forward-looking basis, which remains subject to the Bank of England's stress testing regime. The 2020 CET1 capital ratio of 15.2% (2019: 14.3%)

and UK leverage ratio of 5.1% (2019: 4.7%) were both significantly above regulatory requirements, despite higher Covid-19 related credit impairment losses. This includes the impact of a 2020 ordinary share dividend.

Pension

There was substantial volatility in the funding position and IAS 19 accounting position during 2020, particularly in the first half year. AA UK corporate credit spread volatility has been a major driver of the accounting position which impacts capital, along with equity and interest rate markets, with the Bank of England cutting the bank rate to 10bps and increasing quantitative easing. The de-risking actions we have taken during the past two years, including executing various hedging strategies and strategic asset reallocation have reduced exposure to pro-cyclical assets and improved the fund's resilience.

Cyber attacks

In 2020, threats from the external cyber environment continued to increase, placing even more importance on our internal controls. We monitor a range of cyber risks and have taken mitigating actions including; deployment of a cyber threat intelligence platform; increased intelligence through industry co-operation; and actions to increase staff awareness. Implementation of our Cyber Security Plans is proving effective, with no significant disruption experienced to date.

Third party risk management

The complexity and criticality of services provided by third-parties is a key operational risk that has been recognised by us, our peers, and the regulators. We have established a robust Third Party Supplier Risk Framework, which ensures that those with whom we intend to conduct business, meet our risk and control standards throughout the life of our relationship with them.

Ring-fencing implementation

Ring-fencing has resulted in significant change to our structure, people and operations and we have retained it as a top risk to ensure continued focus on the ongoing embedding of ring-fencing culture throughout our governance and operations.

Key risk types

Risk is any uncertainty which could affect our ability to achieve our objectives or impact our results and financial resources. See Risk Review for more information.

Key risk types	Description	Mitigants	Key metric						
Credit 1 2 4	<p>The risk of financial loss due to the default or credit quality deterioration of a customer or counterparty to whom we have provided credit, or for where we have assumed a financial obligation.</p>	<p>We manage our exposures carefully, thorough credit checking and approval processes, to ensure we stay within our risk appetite and agreed concentration limits. We closely monitor the economy and where we see signs of stress we take action to reduce our exposure or adapt our pricing to adequately reflect risk.</p>	Stage 3 ratio (%) <table border="1"> <tr> <td>2018</td> <td>1.15</td> </tr> <tr> <td>2019</td> <td>1.29</td> </tr> <tr> <td>2020</td> <td>1.42</td> </tr> </table>	2018	1.15	2019	1.29	2020	1.42
2018	1.15								
2019	1.29								
2020	1.42								
Market 1 4	<p>Banking market risk – the risk of loss of income or economic value due to changes to interest rates in the banking book or to changes in other market risk factors, where such changes would affect our net worth through a change to revenues, assets, liabilities and off-balance sheet exposures in the banking book.</p> <p>Trading market risk – the risk of changes in market factors that affect the value of positions in the trading book.</p>	<p>We use a variety of approaches to protect the bank. These include using financial instruments, by matching fixed rate deposits with fixed rate loans of a similar term. Stress testing helps us to measure and evaluate the potential impact of extreme events or market moves.</p>	NIM sensitivity +50bps (£m) <table border="1"> <tr> <td>2018</td> <td>207</td> </tr> <tr> <td>2019</td> <td>99</td> </tr> <tr> <td>2020</td> <td>225</td> </tr> </table>	2018	207	2019	99	2020	225
2018	207								
2019	99								
2020	225								
Liquidity 2 4	<p>The risk that we do not have sufficient liquid financial resources to meet our obligations when they fall due, or we can only secure such resources at excessive cost.</p>	<p>We aim to ensure our balance sheet remains resilient at all times. We hold sufficient liquidity to ensure we will survive three plausible but severe stress scenarios, by maintaining a prudent balance sheet structure and approved liquid resources.</p>	LCR (%) <table border="1"> <tr> <td>2019</td> <td>142</td> </tr> <tr> <td>2020</td> <td>150</td> </tr> </table>	2019	142	2020	150		
2019	142								
2020	150								
Capital 2 4	<p>The risk that we do not have an adequate amount or quality of capital to meet our internal business needs, regulatory requirements and market expectations.</p>	<p>We utilise a capital risk framework that informs and monitors our capital risk appetite. We also undertake a wide-range of stress testing analysis to confirm our capital adequacy under various adverse scenarios.</p>	CET 1 capital ratio(%) <table border="1"> <tr> <td>2018</td> <td>13.2</td> </tr> <tr> <td>2019</td> <td>14.3</td> </tr> <tr> <td>2020</td> <td>15.2</td> </tr> </table>	2018	13.2	2019	14.3	2020	15.2
2018	13.2								
2019	14.3								
2020	15.2								

Strategic priority key:

- 1** Grow customer loyalty by providing an outstanding customer experience
- 2** Simplify and digitise the business for improved efficiency and returns
- 3** Invest in our people and ensure they have the skills and knowledge to thrive
- 4** Further embed sustainability across our business

Key risk types	Description	Mitigants	Key metric						
Pension 2 4	<p>The risk caused by our statutory, contractual or other liabilities with respect to a pension scheme (whether set up for our employees or those of a related company or otherwise). It also refers to the risk that we will need to make payments or other contributions with respect to a pension scheme due to a moral obligation or for some other reason.</p>	<p>We monitor both the accounting and funding position against the overall risk appetite, and use a range of investment and hedging strategies to mitigate the inflation and rates impact.</p>	<p>Funded DB pension scheme accounting surplus (£m)</p> <table border="1"> <tr><td>2018</td><td>766</td></tr> <tr><td>2019</td><td>431</td></tr> <tr style="background-color: #e91e63; color: white;"><td>2020</td><td>135</td></tr> </table>	2018	766	2019	431	2020	135
2018	766								
2019	431								
2020	135								
Conduct and regulatory 1 2 3 4	<p>Conduct risk – the risk that our decisions and behaviours lead to a detriment or poor outcomes for our customers. It also refers to the risk that we fail to maintain high standards of market behaviour and integrity. Regulatory risk – the risk of financial or reputational loss, or imposition of conditions on regulatory permission, as a result of failing to comply with applicable codes, regulator’s rules, guidance and regulatory expectations.</p>	<p>Our culture places the fair treatment of customers at the heart of everything we do. We continuously improve processes and training in order to integrate this fair treatment into our product and service design reviews.</p>	<p>Remaining conduct provision (£m)</p> <table border="1"> <tr><td>2018</td><td>276</td></tr> <tr><td>2019</td><td>214</td></tr> <tr style="background-color: #e91e63; color: white;"><td>2020</td><td>84</td></tr> </table>	2018	276	2019	214	2020	84
2018	276								
2019	214								
2020	84								
Operational 1 2 3 4	<p>The risk of loss due to inadequate or failed internal processes, people and systems, or external events. We maintain a particular focus on Cyber & IT; Change and transformation and People risks, which we mitigate through our management of operational risk.</p>	<p>Operational risk is inherent in our business. Our approach is to mitigate this risk as far as possible, rather than to eliminate it entirely. We have a programme to enhance existing operational resilience practices and to deliver against recent joint regulatory consultation papers and new requirements expected in early 2021.</p>	<p>Operational risk losses trend (excluding PPI and losses below £10,000) (%)</p> <table border="1"> <tr><td>2018</td><td>3%</td></tr> <tr><td>2019</td><td>-63%</td></tr> <tr style="background-color: #e91e63; color: white;"><td>2020</td><td>51%</td></tr> </table>	2018	3%	2019	-63%	2020	51%
2018	3%								
2019	-63%								
2020	51%								
Other key risks:	<p>Financial crime - the risk that we are used to enable financial crime. Legal risk - the risk of loss from legal causes or actions or omissions with legal consequences. Strategic and business - the risk of significant loss or under-performance against planned strategic objectives. Reputational - the risk of damage to the way our reputation and brand are perceived by our stakeholders. Model - the risk that predictions made by our models might be inaccurate.</p>	<p>Of these risks, financial crime is a top and high priority risk for us. We are committed to conducting business in accordance with regulatory and legal requirements and the highest ethical standards. We believe that having a comprehensive and effective financial crime framework through policies, procedures and systems and controls to prevent and detect financial crime is a business imperative.</p>	<p>£83m Incremental investment in the financial crime transformation programme to enhance systems and controls in 2020</p>						

Emerging risks

Six new emerging risks have been introduced to our risk radar during 2020. These are reviewed and discussed regularly at both ERCC and BRC.

Negative rates

Central Banks wish to retain as wide a range of policy tool options in order to mitigate economic and financial market risks. In early 2021 we were involved in roundtable discussions with the PRA, along with our industry peers, to provide feedback on the issues facing the banking sector in the event of a negative rate environment. Although we do not have material structural balance sheet exposure to negative rates, we have revisited our plans for readiness including systems capabilities (both tactical and strategic), legal and documentation issues, and how negative rates may impact our customers as well as implications for margin management. We will continue to develop and enhance our strategy during 2021, through a coordinated bank-wide approach led by our CFO.

Extended government involvement in the banking industry

There is the potential for adverse impacts on financial performance and investor perceptions of the banking industry, that could arise inadvertently as a result of

the governments ongoing responses to Covid-19 (e.g. implementation risks related to government backed loan schemes, and IFRS9 loan loss guidance). However, to a certain extent, these risks have been balanced by other government actions such as the furlough scheme and the Term Funding Scheme for SMEs (TFSME), which have delayed peak unemployment and reduced funding costs respectively. These issues are considered as part of our forward financial business planning and by our Capital Committee and Assets and Liability Committee (ALCO) regularly. We are further evaluating the potential impacts of this risk, as government lending schemes unwind and the credit impacts of the crisis crystallise further.

Extended period of economic contraction

Negative multiplier effects from the economic shock caused by Covid-19 could materialise such as delayed spending and investment, and a larger surge in business failures and unemployment than anticipated. Coupled with deflation and lower or negative rates, this would prove even more challenging for banks' profitability. We regularly undertake stress tests on our future business plans, under a range of economic scenarios.

High inflation

The injection of significant government and central bank stimulus, could over the medium to longer-term result in the emergence

of higher inflation that detrimentally impacts the UK economy. Similar to other economic risks our regular analysis of stress scenarios that we run across our business plans ensures that we fully understand the potential impacts and any mitigating actions that we might need to take.

Disruption of macro-economic factors

Changes to GDP, unemployment, and house prices from longer term structural shifts in income and wealth could have a material impact on the inputs to our economic scenario analysis. As part of this analysis we review changes in key underlying drivers which aids our forward business planning and risk appetite setting.

Other environmental and social issues

Extreme weather, natural disasters, biodiversity loss, human made environmental disasters, health impacted by pollution, water crisis, other infectious diseases, and social unrest, are other risks we are taking into consideration. Whilst, we have an ongoing focus on maintaining and enhancing our operational resilience, these risks have the potential to have unpredictable impacts on global businesses and economies, including us, and our suppliers, similar to the wide ranging impacts of Covid-19. These risks were highlighted and discussed at the World Economic Forum in January 2020.

Managing post-Brexit outcomes

With a "no deal" outcome being avoided a significant source of disruption has been removed from the first quarter outlook.

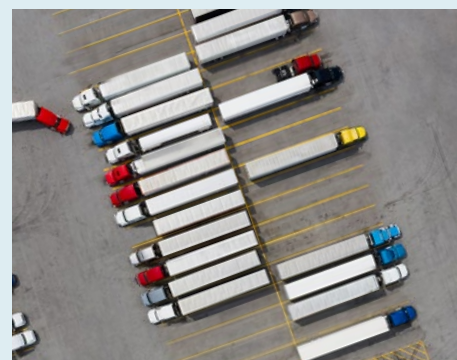
Impacts on our customers in both the retail and corporate sectors will become more apparent later during 2021. We undertake activities to support our corporate clients and maintain regular dialogue to aid our understanding of Brexit impacts on their business.

With respect to assessment of the sensitivity of our forward business projections to Brexit, we currently see the potential for more material impacts in 2022, once key effects such as Foreign Direct Investment

become clearer. We anticipated some initial Brexit related disruptions such as import and export delays in our current forecasts, consistent with the current limited trade arrangements.

For Financial Services, impacts of regulatory alignment/divergence, and how these are resolved for equivalence assessments and mutual market access, may emerge later in 2021. Our existing relationships with EEA customers are managed by each business area, with restrictions on new business underpinned by controls re-enforced through a compliance monitoring framework.

We are however able to leverage the benefits of being part of the wider Group in ensuring that we continue to serve these customers to ensure they receive the best financial outcomes.



Previously identified and monitored emerging risks and our management actions

Changing customer behaviour

We consider that the strong trends towards customer digital adoption have been further accelerated during the Covid-19 crisis. Our multi-year transformation programme is regaining momentum, with a renewed focus on investment in digitalisation and automation, and implementing solutions which meet our customers demands

Rapid technological change

The increasing availability of a wide range of online product solutions for customers requires incumbent banks to enhance their offerings in order to retain and attract customers.

We have continued to increase the number of our digital customers, develop new digital channels, improve existing digital services, and automate existing physical channels. At the same time, we also place a high priority on IT risk management, especially cyber security, in order to protect our customers and our reputation

Intense market competition

We expect competitive pressure to continue and intensify post the Covid-19 crisis, as market participants look to further reduce costs, improve productivity and services. Whilst we have been responding to these pressures as part of our business strategy, we remain focused on delivering sustainable, predictable growth, and achieving consistent profitability through balance sheet strength.

Demanding regulatory agenda

We continue to face a complex regulatory change agenda and engage in regular dialogue and interactions with regulatory bodies, particularly in the area of customer support. Covid-19 has further added to this complexity as the banking industry has responded to customer and client needs in a more challenging economic environment. We continue to manage regulatory risks, coordinated and prioritised through specific project groups with both risk and regulatory oversight.

Uncertain economic and geopolitical environment

Elevated economic and geopolitical tensions can lead to periods of elevated market volatility and stresses in funding and lending markets.

Our interest rate and foreign exchange hedging programmes are designed to limit income statement volatility arising from short-term market movements, providing resilience to our business model.

Libor transition

In January 2020, the Working Group on Sterling Risk-Free Reference Rates set targets to cease sterling LIBOR publication by the end of 2021. We continue to make good progress towards our transition to alternative rates ahead of the end of 2021, supported by our well established Project Governance structure.

Climate change

In April 2019, Supervisory Statement SS3/19 was issued by the PRA setting out its expectations of how banks and insurers should approach managing the financial risks from climate change. We are addressing climate change related risk issues through ongoing engagement across our business and support functions, coordinated and led by the Risk Division. Our continued focus is on the implementation of our plans to fully embed climate change risk assessment in risk management processes. We have set out further details of our activities in the separate call out box in this section of the report.

C-19

Impact on our economic forecasts

During 2020 we changed our forecast economic scenarios to reflect the current uncertain environment caused by Covid-19. These capture a range of recovery paths for the UK economy and take account of possible further lockdown restrictions and the impact of the UK government responses.

The changes to scenarios and associated revisions to the weights applied to those scenarios represent a significant shift to the downside. As an example, the current base case for unemployment is more severe than the worst case scenario in 2019. In addition, we moved to one upside and three downside scenarios in 2020, a change from two upside and two downside scenarios in 2019.

The scenarios include forecasts for a number of economic variables including house price growth, GDP, unemployment and bank rate.

Given the makeup of our balance sheet, the most significant driver of our expected credit losses (ECL) is unemployment, which held up through 2020 given government support measures such as the furlough scheme. We saw some noticeable impacts in ECL from changes in house prices in late 2020 as pent-up demand and the stamp duty waiver supported the housing market. The significant deterioration in GDP seen due to lockdown measures is a driver of ECL in our corporate portfolios.

While lower bank rate helps borrowers with affordability of repayments it has a significant impact on our ability to generate returns and impacts rates paid to depositors.

£164m

Impact on credit impairment losses from changes to economic scenarios and weights

Task Force on Climate-related Disclosures

Climate risks and our mortgage portfolio

We are rapidly expanding our understanding of climate-related risks to our balance sheet. With more than 1.2 million loans, mortgages are our most material portfolio. In 2020, we completed a review of the physical and transition risks of climate change to our mortgages using scenarios from the UK Climate Programme. Working with property-level data, we assessed the most visible physical risk – flooding – for every Santander UK mortgage.

Almost 95% of our mortgage lending is on properties with negligible or very low risk of flooding. Flood risk is expressed as a ratio, where a 1 in 30 year (1:30) flood event refers to the likelihood of flooding occurring in a given year.

Flood Risk	Number of properties
High: >1:30	2,906 (>1%)
Medium: between 1:30 and 1:100	10,021 (1%)
Low: >1:1000	49,678 (4%)
Very Low: >1:10,000	69,523 (6%)
Negligible: <1:10,000	1,102,435 (89%)
Total properties	1,234,563

We are implementing the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and taking action to meet the expectations set by the PRA, BoE and FCA. This requires wide-ranging collaboration both within the bank and externally to develop the tools and methodologies needed.

1

Governance

The Chief Risk Officer (CRO) is responsible for climate-related financial risks with oversight from the Board Risk Committee (BRC) and the Responsible Banking Committee (RBC). A climate change working group is managing our TCFD implementation and reports climate risks to the CRO and progress updates to the Executive Risk Control Committee and BRC. A separate working group has been set up to lead our preparation for the Bank of England 2021 Biennial Exploratory Scenario climate stress test and a steering committee provides management oversight.

We actively contribute to Banco Santander's newly-established sustainable finance working groups, which draw on global expertise to identify new business opportunities in renewable energy, green buildings, clean mobility and sustainable agriculture .

To support the Board, management, and business we delivered a range of training across the bank:

- Board-level climate change workshop covering climate science and regulations, and TCFD recommendations
- Online climate change training, available to all staff
- Sector-specific climate change training for Corporate and Commercial Banking.

In addition, we are preparing a Climate Dashboard to highlight portfolio-relevant risks and opportunities using internal portfolio level data, and external market and policy data.

2

Strategy

We are committed to the objectives of the Paris Agreement and our ambition is to help the UK transition to a low-carbon economy and tackle climate change. We are a leader in financing renewable energy projects and in 2020 we were the number one lender to the renewable energy sector by deal number, and number two by value.¹

We also aim to deliver carbon reductions across our wider lending portfolio. We have tightened our policies on lending to carbon intensive sectors and do not fund new coal-fired power plants worldwide, or oil and gas drilling projects north of the Arctic Circle.

Banco Santander is a member of the UN Collective Commitment on Climate Action, which requires banks to set sector-specific targets for the most material sectors in their portfolios. In the UK, we have assessed our most material portfolio, mortgages, against the physical and transition risks of different climate scenarios.

Following a review by the Board and ExCo, we have also repositioned climate change to be a standalone pillar within our broader sustainability agenda and increased our level of ambition. More information is available in our ESG Supplement.

In preparation for the Bank of England BES climate stress test, we are reviewing our financial exposure to climate-related risks. We have developed and are stress testing a Target Operating Model, including scenario modelling, process map and data flows. We will include stress testing results in our ICAAP in Q1 2021 ahead of the BES in Q2 2021.

(1) Source: Inframation League Tables 2020

3

4

Risk management

Climate change is integrated into Santander UK's risk framework. We have introduced minimum standards requiring each business area and risk type to consider the risks posed by climate change. The risk framework outlines the CRO's responsibility to "embed the approach to managing the financial and strategic risks associated with climate change."

The Board has also approved a qualitative statement within the bank's risk appetite statement relating to climate change. We will develop a quantitative expression for climate change risk in 2021. The key inputs for setting this limit(s) will be our climate change strategy and the outputs of the 2021 BES. We contributed to the Banco Santander risk taxonomy in 2020 using the outputs of our 2019 Climate Portfolio Screen. A UK-relevant taxonomy that is aligned with the Banco Santander taxonomy will be completed in Q1 2021.



Banco Santander provides guidance and tools to analyse potential credit risk impacts relating to climate change, including identifying, assessing, managing and reporting climate-related risks. This guide is for Corporate and Investment Banking and Corporate and Commercial Banking, and is supported by the following documents:

- Banco Santander climate briefing paper and climate finance risk and opportunity briefings for oil & gas, power, mining and metals, and steel
- Santander Corporate and Investment Banking environment, social and climate change assessment procedure sector questionnaires and Q&A documents

In 2020, we updated policies in line with our PRA plan commitments. The Environmental Operations Policy Statement now includes reference to the bank's risk framework, which requires that climate change risks are considered. We also adopted the general sustainability policy from Banco Santander, which now incorporates the previously separate climate change policy. All UK processes and policies have been updated to reflect this, for example, integrating our commitment to a low-carbon transition into our Supplier Code of Conduct.

Targets and metrics

Banco Santander has increased the number of climate-related performance metrics it discloses. These include market position for number of deals, total financing of most relevant climate financial services, and emissions avoided by financing renewables. Details can be found in the Banco Santander Climate Finance Report.

Below we provide metrics for Santander UK Group Holding plc portfolio exposure by sector, and green finance. The table outlines the largest exposures to both physical and transition climate risks for sectors on our balance sheet. The percentage represents the sector contribution to total assets. Details of our operational carbon emissions can be found on page 37 or page 10 of our ESG Supplement 2020.

Sector	Amount £bn	Exposure percentage
Total assets	299.1	
Mortgages	169.8	57%
Real Estate	10.7	4%
Consumer Finance	8.0	3%
Electricity & Gas	0.6	0.2%

In 2020, Banco Santander was the top lender in the UK renewable energy sector by number of transactions (2nd by deal amount), exclusive of energy from waste assets.¹ As part of this, Santander UK originated £1,268m of debt financing to renewable energy projects in 2020. This includes financing originated in Santander UK by our Corporate & Commercial Banking and Corporate & Investment Banking teams.

£1,268m
total investment in 2020 in renewable energy projects

(1) Source: Inframation League Tables 2020

Financial overview



2020 was defined by the Covid-19 pandemic. While the health crisis has sadly affected large numbers of people across the globe it also highlighted there is much to recognise and applaud about how we responded. I was particularly heartened by the resilience and commitment of our people who quickly transitioned to new working arrangements and I'm extremely proud of all their efforts.

Duke Dayal,
Chief Financial Officer

A year of change

The Finance team has played an important role supporting our colleagues to help our customers with payment holidays and lending to businesses guaranteed by government schemes. These measures alongside the reduction in bank rate, introduction of the TFSME and easing of prudential capital requirements have helped us to continue supporting the UK economy, without any deterioration in the resilience of our balance sheet. Returns are lower, but we have been able to absorb the necessary Covid-19 ECL provision build and report a net profit for each quarter of 2020. This has been possible thanks to our resilient balance sheet and decisive management actions.

Our resilience is underpinned by several factors. Firstly, we have a prudent approach to risk and growth as well as a focus on prime residential mortgage lending with low LTV. Over recent years, we also chose to limit growth in our unsecured lending portfolios and actively managed down our exposure to commercial real estate.

Secondly, we entered the crisis with strong capital and liquidity alongside a good track record in the Bank of England stress tests. We were well-positioned in an environment which was highly uncertain, even before the Covid-19 pandemic.

Finally, we were quick to take mitigating and decisive actions which are beginning to come through our results and have partially offset higher impairment provisions. These actions include deposit repricing which stabilised our Banking NIM and ongoing transformation programme activities which have contributed to quarterly costs trending downward this year.

Financial Highlights

1.65%

Banking NIM
(2019:1.64%)

63%

Cost-to-income ratio
(2019:61%)

£169.8bn

UK mortgage loans
(2019:£165.4bn)

£75.6bn

Retail Banking current account balances
(2019:£68.7bn)

£7.5bn

MREL eligible senior unsecured debt
(2019:£7.9bn)

£72.9bn

Risk-weighted assets (RWAs)
(2019:£73.2bn)

An uncertain operating environment

The UK banking market is very competitive and intensely regulated. We continue to face additional challenges from the Covid-19 pandemic and the impact of the new trading arrangements with the EU, both of which we expect to continue into the medium term.

Like all banks, we have taken significant credit impairment charges this year – largely as we build provisions for expected credit losses rather than because of realised losses. We expect losses will start to be realised as unemployment rises. However, to date jobs have largely been protected by significant government measures to support businesses and individuals.

Actively supporting the UK economy

We granted 373,000 payment holidays to customers with a value of more than £40bn. Of these less than £3bn were still on payment holiday as at 31 December 2020 and we have seen less arrears among this cohort of customers than we expected.

Summarised consolidated income statement

For the years ended 31 December	2020 £m	2019 £m
Net interest income	3,437	3,295
Non-interest income ⁽¹⁾	521	875
Total operating income	3,958	4,170
Operating expenses before impairment losses, provisions and charges	(2,487)	(2,526)
Credit impairment losses	(645)	(220)
Provisions for other liabilities and charges	(274)	(443)
Profit before tax	552	981
Adjusted profit before tax ⁽²⁾	710	1,300

(1) Comprises of 'Net fee and commission income' and 'Other operating income'.

(2) The financial results were impacted by a number of specific income, expenses and charges with an aggregate impact on profit before tax of £158m in 2020 and £319m in 2019. See 'Alternative Performance Measures' for details and reconciliation to the nearest IFRS measure.

We have also lent £4.6bn to our business and corporate customers, through government schemes. The vast majority has been through the Bounce Back Loan Scheme which is 100% government guaranteed. We have also seen our business and corporate customers holding more deposits as they position themselves for the uncertain operating environment.

Our financial results

Our 2020 results have been materially impacted by the Covid-19 pandemic. Profit before tax of £552m was 44% lower than in 2019. Adjusted profit before tax of £710m was 45% lower, see the Financial review for an explanation of the adjustments and the impact on adjusted profit.

Net interest income was 4% higher than 2019 largely due to deposit repricing. Banking NIM of 1.65% was up 1bp from last year and improved sequentially in the second, third and fourth quarters of 2020. As in previous years, higher margin mortgage back book lending has continued to reprice onto lower margin new business products, although the rate of attrition on our Standard Variable Rate book has slowed and the balance in our Follow on Rate book has increased. In addition, new mortgage lending rates

started to increase during the second half of 2020, alongside good mortgage applications following the easing of Covid-19 restrictions.

Banking NIM improved during the second half of the year, largely due to deposit repricing. This was seen most significantly with our 11213 Current Account where we reduced the customer rate by 90 basis points during the year, linked to bank rate reductions. Despite two rate changes, balances on this account have increased to £57bn. In addition, other deposit repricing actions across all our businesses and stronger margins on new mortgage originations have also helped improve net interest income.

Non interest income was down 40% year-on-year following regulatory changes to overdraft fees and a slow-down in transactions during Covid-19 restrictions.

Operating expenses were down 2% year-on-year as efficiency improvements continued. These offset underlying inflationary pressure and increased depreciation related to investment projects.

Summarised segmental balance sheet⁽¹⁾

31 December	2020 £bn	2019 £bn
Customer loans		
Retail Banking	186.5	178.8
Corporate & Commercial Banking	17.6	18.4
Corporate & Investment Banking	2.8	4.0
Corporate Centre	3.5	4.1
Total customer loans	210.4	205.3
Other assets	88.7	83.2
Total assets	299.1	288.5
Customer deposits		
Retail Banking	152.2	142.7
Corporate & Commercial Banking	25.0	20.5
Corporate & Investment Banking	6.5	6.1
Corporate Centre	8.0	6.1
Total customer deposits	191.7	177.8
Total wholesale funding	63.2	65.3
Other liabilities	28.0	29.1
Total liabilities	282.9	272.2
Shareholders' equity	15.8	15.9
Non-controlling interest ⁽¹⁾	0.4	0.4
Total liabilities and equity	299.1	288.5

(1) The segmental basis of presentation in this Annual Report has been changed. See Note 2 for more information.



C-19

Covid-19 related IFRS 9 model overlays

We made significant adjustments to our economic assumptions and scenario weightings in 2020 to reflect the impact of the Covid-19 pandemic. Our five economic scenarios were updated and weighted to the downside, to reflect the longer path to recovery for the UK. See the call out box on page 25 for more.

We also reclassified the staging of a number of corporate loans based on a review of the sector exposures and lending most at risk due to Covid-19, while also considering those customers who have been granted some form of concession. In addition, we provided for unexpected defaults from large single name exposures arising as a result of the Covid-19 pandemic from non-retail portfolios.

We made management judgment overlays with regards to payment holidays offered on a range of products. The granting of a payment holiday on its own was not considered to be a Significant Increase in Credit Risk (SICR) event, nor was it considered a default under regulatory definitions.

We also made other Covid-19 management judgement overlays, predominantly relating to mortgage and unsecured personal loan model risk refinement, including delay in repossessions.

Financial overview continued

Credit impairment losses were up £425m to £645m, of this £448m related to Covid-19 provisions for expected credit losses. See the call out box on the previous page for more. Portfolio performance remains resilient with low write-offs and material deterioration seen only on a few single name corporate cases during the year.

Despite significant credit impairment losses, the loan book is relatively low risk and prudently positioned. Our loan portfolios are well collateralised and focused on prime UK mortgage lending which accounts for 80% of the customer loan balance and has an average loan-to-value of 42%.

Our consumer (auto) finance book makes up a small part of our loan book with only 4% of total customer loans – more than 80% of the book is secured. Other unsecured retail lending including credit cards makes up only 2% of the book. We have materially deleveraged our commercial real estate portfolio over recent years and this now totals £4.7bn, down from £5.1bn in 2019.

Provisions for other liabilities and charges were 38% lower year-on-year, primarily due to additional PPI charges in 2019 which were not repeated.

Balance sheet resilience from strong capital and liquidity

CET1 capital increased to £11.1bn, with capital accretion through retained profits, a change in treatment of software assets and a lower deduction from the excess of regulatory expected loss amounts over credit provisions. These increases were partially offset by adverse market driven movements in the defined benefit pension schemes.

The CET1 capital ratio increased 90bps to 15.2%, with a 5.4p.p. buffer to Maximum Distributable Amount (MDA) restrictions. The UK leverage ratio increased 40bps to 5.1%, it remains 1.5p.p. above the regulatory requirement. The change in treatment of software assets led to a benefit of c30bps for the CET1 capital ratio and c10bps for the UK leverage ratio.

Amendments to Capital Requirements Regulation (CRR), which were published in the Official Journal on 26 June 2020, contributed 17bps to the CET1 capital ratio, through the implementation of the RWA reduction factors for certain SME and infrastructure exposures.

LCR was strong at 150%, up 8 percentage points on 2019, reflecting higher customer deposits and a transfer of £3.2bn of mortgage assets to Santander Financial Services plc, as we continue to optimise the funding structure of the group.

Looking ahead

Our operating environment remains very challenging for our customers, people and communities. Our base case assumes that there are continued local and regional lockdowns. Growth in GDP is also expected to be disrupted by the change in trading arrangements with the EU.

The mortgage market has been particularly active due to pent up demand from the lockdown period and the temporarily reduced rates of stamp duty. This has led to improved new mortgage pricing and increased mortgage applications which will likely continue into the first quarter of 2021. We expect our net mortgage lending to be in line with market growth in 2021.

We expect Banking NIM to remain broadly in line with the Q420 exit rate, predicated on stable mortgage margins, 11213 Current Account repricing announced in Jan21 and no change to the Bank of England bank rate. Operating expenses should continue their downward trend, through transformation programme cost savings. We expect credit impairment charges to be lower in 2021 driven by UK economic recovery in the second half of the year.

The actions we have taken have enabled us to continue working effectively throughout the crisis and will act to stabilise returns going into 2021. Our prudent approach to risk and capital and liquidity strength make us resilient in the face of ongoing uncertainty.

Factors affecting our Banking NIM outlook

Spreads improved in 2020

Our product spreads at the end of 2020 were noticeably higher than at the start of the year and marked a change in trend after some years of decline. The improvement was largely due to significant deposit repricing throughout 2020 which was fully embedded in the margin by the fourth quarter.

The mortgage market is strong and customer rates have increased

Following the easing of lockdown restrictions and the announcement of the temporary reduction in Stamp Duty, the mortgage market recovered strongly. This led to significant mortgage applications in the second half of the year and an increase in customer rates which is likely to continue into 2021 when the stamp duty reduction is expected to end.

Deposit rates have fallen with the lower rate environment

Savings and corporate deposits rates have fallen in the market and with bank rate close to zero there is little scope for further declines.

We reduced the 11213 Current Account rate twice in 2020 and in Jan21 announced a further reduction to pay 0.30% AER.

Wholesale funding rates are low

TFSME provides banks with significant funding capacity at close to bank rate.

To date we have drawn £11.7bn through TFSME, well below the total allowable given the support we have provided to SME customers. We expect to replace almost all bank level funding maturities with TFSME during 2021.

Sustainability

We strive to create value for all our stakeholders, engaging others to help us deliver our commitment to be a more responsible bank.

Our Sustainability strategy became even more relevant during Covid-19, as the pandemic reinforced the need to build more sustainable and resilient systems. This section is designed to be read together with our Environmental, Social and Governance Supplement.



Customers

We want to help people and businesses prosper and aim to do so by being Simple, Personal and Fair in everything we do.

Support measures

During the Covid-19 pandemic, we offered unprecedented support to our customers, while ensuring the safety of our colleagues. We provided a full package of support measures for business and retail customers, including over 373,000 payment holidays, and £4.6bn of lending to our business and corporate customers through government schemes including Bounce Back Loans (BBLs), and Coronavirus Business Interruption Loan Scheme (CBILS). We paid particular attention to supporting our more vulnerable customers, providing flexibility with support options, and the rapid adaptation of our systems and processes to respond to the crisis.

Inclusive digitalisation

During the pandemic, we continued to offer a full banking service to our customers in branch, over the phone and online.

We provided the opportunity for customers to self-serve where possible, and prioritised services for those unable to do so. We launched a Financial Support phone line and online hub to help customers dealing with financial difficulties. We introduced Chat, a new digital channel providing 24/7 service via a chatbot and access to colleagues via Live Chat. Since April 2020, we have seen over 3.7 million conversations through Chat, with volumes growing from 1,000 per day to over 25,000. To ensure capacity, we trained 4,000 colleagues to speak through live chat and introduced a continuous optimisation model for chatbot. We tested more decisions with customers than ever before, checking close to 500 customer journeys across digital channels, communications and online experiences.

To help customers access information most relevant to them, we launched a dedicated home page and support sections for all Covid-19 tools and assistance. This was across Personal and Business, Mortgages, Current Accounts, Loans, Credit Cards & Investments. Between March and October 2020, over 1.3 million customers visited one of these support pages.

Protecting customers from fraud

Santander UK anticipated significant impacts on the fraud landscape due to the Covid-19 pandemic, through changes in social behaviour and criminal activity. In preparation, we adapted our controls and 2020 awareness campaigns, which covered remote access fraud, investment scams, safe account scams, financial fraud, and Covid-19-linked scams.

We adapted our in-branch Scam Awareness sessions to virtual events for customers, colleagues and communities, open for all to attend. Following a June 2020 trial with 543 attendees, we implemented their feedback to develop 'phase two' – totalling 73 events with 1,783 attendees and an 89% satisfaction score.

Cyber security

As a result of Covid-19 and the UK lockdown we have seen an increase in customers adapting to a more digital banking experience, and in parallel, we have ensured they can place full trust in our online and mobile services.

Our global, multi-layered and agile resilience framework has allowed us to respond quickly and securely to ensure the protection of our customers and their data at a time where the industry has faced extraordinary change.

Awareness is at the core of our cyber defence; we see the protection of our customers and their data as the responsibility of every employee. We focus on educating our colleagues by hosting training sessions to enhance their cyber capabilities and ultimately bolster the bank's security. We also continue to invest in emerging cyber security talent; the first cohort of our Digital Apprentices graduated in 2020 with key skills to secure the bank's next generation of cyber experts.

'Survive and Revive' for SMEs

In 2020, Santander Breakthrough re-aligned its support to SMEs with a focus on digital delivery. Designed to provide beyond-banking support to businesses from start-up to growth, we launched Survive and Revive, a bank-wide proposition delivering a suite of resources to help SMEs manage the crisis.

Survive and Revive evolved during the year to respond to the changing economic environment and will continue into 2021. The first phase included our new resource hub, providing access to webinars, overseas opportunities, a part-funded e-commerce package, thought leadership and insights. This included a Sustainability module developed together with B Lab UK, the charity behind the B Corporation movement. Through a five-part webinar, it introduces SMEs to emerging trends in Sustainability and provide guidance for business leaders to make their companies more sustainable.

Sustainability continued

Over 50 webinars and 140 pages of content were delivered, reaching over 16,000 site visitors.

The second phase of Survive and Revive focused on helping businesses trade as restrictions across the country changed. We secured digital advertising space online and in our branches for 50 SMEs and helped those wanting better digital engagement through social media and PR toolkits. Our freelancers campaign provided £250k to fund 250 SMEs projects delivered by freelancers across the country.

We are signatories of the Investing in Women Code, and in 2020 continued a remote Women Business Leaders' Mentoring Programme for 180 participants. We improved access to support and funding to under-represented entrepreneurs, focused on women of colour as part of Santander UK's Black Inclusion Plan.

In 2020 we supported over 880 businesses through international and sector trade activity, adapting our model to deliver 69 digital activities since March 2020 to a total 867 attendees. In 2020, we added 143 members to the Trade Club Alliance and supported 36 companies who faced Covid-19 challenges with supplier matchmaking, as well as referring 59 companies to the government for a PPE matchmaking scheme.

Supporting our vulnerable customers

With the backdrop of the Covid-19 pandemic, we responded to the needs of our most vulnerable customers, from 'access to cash' solutions to providing mechanisms for help from a trusted third party.

One key initiative is our Supported Banking proposition, providing a flexible level of support from the customer's chosen third party. In addition to a Power of Attorney, we now provide a Third Party Access facility and Carer's Card option, for customers who need support but not a full Power of Attorney. Compared to other 'workarounds' where people were giving their own debit card to their carer to do their shopping, the Carer's Card and Third Party mandate are safe and legal alternatives.

For people who needed cash, but who couldn't leave their homes, we enabled secure access via the Post Office network,



C-19

Reaching out calls to customers

In April 2020, we launched 'Reaching Out', an initiative focused on calling some of our potentially vulnerable older customers, who typically would have visited a branch and may not have a cash card or access to online or mobile banking. Above all, the calls are about customer wellbeing, with informal conversations supporting the customer to cope during the Covid-19 pandemic. This might cover financial wellbeing, such as explaining how to still access cash when needed, or other elements of the customer's wellbeing where we are able to make a difference, such as liaising with our charity partners

to provide additional support to those in need. We provided these calls from frontline colleagues from April-November 2020, reaching 81,859 customers.

"One customer was 80 years old and had tried to get out to the local shop but it was closed. I asked him if he had enough food and he said he had enough for today only. I spoke to Age UK and rang him back to confirm he was happy for them to call him. They are now going to arrange to do his shopping so he does not have to go out." - Sharon Field, Community Hub Director, Stratford

meaning a customer could place an order for a limited amount of cash and allow a trusted third party to collect it.

With our focus also on building capability across our colleagues, we introduced a dedicated online Vulnerability Hub. Colleagues visited the hub over 6,000 times in 2020, raising awareness and understanding about challenges faced by some customers and how this can impact their banking. The vulnerability hub is complimented with specific training sessions for all colleagues (including specialist teams), to continually broaden knowledge and develop our ability to recognise and support our vulnerable customers.

During 2020 our bereavement service saw a number of improvements. We now offer an online chat facility to support customers and their representatives who may have questions about the bereavement process. We have also simplified the information required from customer representatives and we continue to be part of the Death Notification Service allowing a customer's representatives to notify different organisations of a death through a

centralised service. To support our colleagues, and to raise awareness and improve levels of confidence in this area, we have developed a series of tailored training videos on the bereavement process and how to support customers impacted by a bereavement.

Supporting mental health

Working with the mental health charity Mind, we provided colleagues with targeted, practical tools and guidance so that they can more confidently manage difficult conversations with customers, and manage any impact these conversations can have on their own wellbeing.

Through in-depth workshops reaching over 100 colleagues, this training helps to ensure our customers – who may be dealing with financial or non-financial related stress, anxiety and other mental health issues – are aware and have access to avenues of mental health support. These initiatives are being complemented by the provision of additional tools, e-learning guidance and support for all colleagues on mental health through our internal wellbeing hub.



Shareholders

We aim to deliver a long-term, sustainable return for our shareholders while helping people and businesses prosper.

Part of a global bank

We are a subsidiary of Banco Santander SA and part of the Banco Santander group, a leading retail and commercial bank headquartered in Spain. Our ordinary shares are all held by Banco Santander group companies and are not listed, although our preference shares are listed on the London Stock Exchange. We also have other equity instruments in the form of AT1 securities issued in 2014, 2015, 2017 and 2019.

Under the subsidiary model operated by Banco Santander, autonomous subsidiaries are responsible for their own liquidity, capital management and funding. This not only mitigates the risk of difficulties in one subsidiary affecting another, it allows local market knowledge and expertise to be utilised and provides considerable operational flexibility.

We benefit from the strong Santander brand along with experience and expertise from a global banking group. Systems development capacity can be shared along with common technology platforms and innovations, creating a significant competitive advantage.

Consistent shareholder returns

Our consistent profitability has enabled us to pay a dividend every year between 2008 and 2019. In early 2020, as the Covid-19 crisis began to unfold, the PRA announced that regulated firms should not pay dividends and instead should conserve capital. In response to this, Santander UK temporarily suspended dividend payments. This guidance was later eased and dividends payments allowed within certain guidelines, following this we paid a dividend of £103m in December 2020.



ESG investor engagement

In 2019, the Investor Relations and Sustainability teams started to directly engage a targeted selection of our investors in discussions on ESG issues, with support from Banco Santander colleagues. This year we continued our structured engagement, holding individual ESG-focused meetings with our investors.

Through these discussions, we aim to respond directly to heightened investor interest in ESG that comes as sustainability topics such as climate change are increasingly recognised as financially material to business success and resilience. In a two-way dialogue, we also gain important insight of investor needs and expectations, which we use to improve our ESG strategy and disclosure. Our ESG Supplement, for example, is a succinct data-driven report aligned to our annual report timeline and governance, developed with consideration of investors as a main audience and published on our Investor Relations webpage. These discussions can also help us navigate the many ESG guidelines and standards to ensure our reporting is useful and relevant.

In 2021 we will continue to build on our engagement, including further development of our quarterly investor updates with decision-useful ESG information.

In 2019, we began a multi-year transformation programme to reshape the bank to support our customers better. By focusing on simplification, digitisation and customer experience, we aim to improve returns in the medium term.

Investor engagement

Our UK Investor Relations team actively engages with institutional investors across the globe, working alongside our funding and capital teams for new issuances and building and maintaining relationships with fixed income investors and analysts. The UK Investor Relations team provides a two-way link between investors and senior management, focusing on both external messaging and communication whilst providing feedback from investors to the Board.

Sustainability continued



People

Supporting our colleagues to deliver for our customers is our priority.

Culture

We are on a journey to embed our culture. Making all that we do Simple, Personal and Fair, underpinned by our nine behaviours, is critical to our effort to build a more responsible bank. We want to create a thriving workplace that promotes inclusion and diversity, prioritises wellbeing and develops the skills of our people. Our goal to be a high-performing and responsible business is reflected in the 2020 Global Pulse Survey with 88% of colleagues feeling “We act responsibly and make a positive contribution to society” up 3pts vs 2019.

Our announcement that we will form part of the One Europe business model, alongside our ongoing transformation programme, will further develop our culture driving collaboration between our teams to better serve our customers in a Simple, Personal, Fair way. It presents an exciting opportunity and the Global Pulse Survey showed that our people have positive attitudes to change - 86% feel managers lead effectively through change and 85% believe their teams support our transformation.

In 2020, we were again recognised as a Top Employer in UK and Europe by the Top Employers Institute alongside being accredited as a Great Place to Work. In 2021, our cultural priorities will continue to focus on being an inclusive and responsible organisation alongside continuously improving our culture to become more Simple, Personal, Fair in order to enable our colleagues to deliver great customer outcomes.

Ways of working during the pandemic

With the backdrop of the pandemic, we responded to the rapidly changing needs of our customers at pace and with efficiency, leveraging technology to enable over 15,000 colleagues to work remotely. Our response to Covid-19 has been well received with 88% of colleagues in agreement that “Santander is taking the appropriate steps to ensure employees stay safe and healthy at this stage of the pandemic” in the Global Pulse survey.

Our top priority is to support the wellbeing and safety of our colleagues. We made a commitment that whatever a colleague’s personal situation, we will continue to pay contracted hours as normal, including throughout any periods of self-isolation. This applies to colleagues who are both permanent and on fixed term contracts. Our commitment continues to provide colleagues who have primary caring responsibilities with paid leave. We did not furlough any colleagues.

We introduced a new always-on pulse survey called ‘Your Say’ to enable colleagues to provide regular feedback, share ideas and seek support. The survey focused on wellbeing, communication and our response to Covid-19. To help maintain social connections, we launched a ‘Stay in Touch, Keep Calm & Connect’ website to enable colleagues to remain connected through activities including stories and quizzes.

We introduced a new module to our mandatory training suite to help people work from home effectively. Topics include preparing yourself, setting up your environment and managing your time, as well as how best to stay connected. Our survey on working from home continues to show positive feedback in terms of how we have managed this process. 91% of colleagues stated they are as or more productive working from home, an increase of 7 points from when the survey was first run earlier in the year.

Inclusion and belonging

Our commitment is to be a truly inclusive organisation reflective of our customer and communities. In 2020, we set out our next three year inclusion and belonging strategy “everyday inclusion” that prioritises the themes of respect, balance, leadership, advocacy, allyship, transparency and accountability.

A member of our Executive Committee sponsors each diversity strand of gender, LGBT+, ethnicity, disability, families and carers, social mobility, and mental wellbeing. We hold a quarterly Everyday Inclusion Forum to provide guidance and direction to our strategy attended by our Executive Committee Sponsors, our Chief HR Officer and our Employee Led Network Leads.

Our eight employee-led diversity networks collectively have over 11,000 members. They consider intersectionality, providing a safe space for colleagues to share their lived experiences, and receive targeted communications within a digital community space that is a vital source of support during the pandemic. We made enhancements to

our people policies, including increasing our maternity, adoption and shared parental leave, offering a new paid sabbatical and developing ground breaking work to support menopause.

Over the summer, we held a number of colleague listening events in response to the Black Lives Matter movement, looking at the ways to support colleagues to accelerate the pace of change. In September, we put in place a Black Inclusion plan, alongside an analysis of our own data. Three areas of focus were identified: Leadership, Allyship and Networks with supporting measures and targets to shape our activity to build Black Inclusion and amplify Black Voices. Additional actions include no longer using the term BAME, publishing our ethnicity workforce data and voluntarily publishing our ethnicity pay gap and action plan in December.

We again featured in The Times Top 50 for Women List, commended for being in the top ten per cent of organisations that featured regularly during the ten years the list has been published. In the Social Mobility Employer Index, we were the highest placed Retail Bank (26th). The Social Mobility Employers’ Index, created by the Social Mobility Foundation (SMF), ranks UK employers on the actions they are taking to ensure they are open to accessing, developing and progressing talent from all backgrounds.

Our Global Pulse survey results show that 87% of colleagues believe that Santander UK has created an environment where people of diverse backgrounds can succeed, 9 points above the external benchmark.⁽¹⁾

(1) Financial sector benchmarks taken from the survey provider Mercer Sirota. The financial services sector norms are based on more than one million employees answering 114 surveys over the last five years.



Key people statistics

77%

Engagement Index Score, 7 points above external benchmark.

(2019: 70%)

82%

Pride in being part of Santander, 5 points above external benchmark.

(2019: 75%)



Prioritising wellbeing

The launch of our Wellbeing Strategy and Wellbeing Hub in January 2020 provided a solid foundation for the significant focus and speed at which support is in place to help colleagues through the pandemic. In recognition of our strategy we achieved "Excellence in Wellbeing" accreditation from Great Places to Work.

Our focus on wellbeing covers physical, mental, financial and social wellbeing. Our Wellbeing Hub reflects the new working environment including information on looking after your mental wellbeing when working at home, wellbeing webinars and a direct link to our Employee Assistance Programme. Since its launch, the Wellbeing Hub has been used by colleagues over 95,000 times.

Thrive, our Mental Wellbeing app, is available to all colleagues and has multiple features to help maintain mental wellbeing, including meditation, breathing exercises and a mood meter. Importantly, the app allows all colleagues to access a live text chat with qualified psychologists at the touch of a button Monday to Friday, 8am to 8pm, with responses typically received within 30 seconds. We also enhanced our Employee Assistance programme to offer virtual counselling for more complex mental wellbeing support.



79%

of our colleagues feel we care about wellbeing, 20 points above the external benchmark, and 13 points increase since 2019.

Skills development

Investing in our people allows us to be fit for the future with skilled and engaged colleagues who can truly thrive. In 2020, our people undertook 61,398 training days and we invested £7.9m, equipping them with the skills they need for now and in the future, including digital skills. Our Digital Learning Platform, MIO, saw 328,950 hits throughout 2020. The platform is focused on both development and providing support through internal communities and networks. MIO provides a variety of training styles, from 2-3 minute bursts to themed box set content.

In 2021, we will launch a number of colleague upskill academies through the new global academy offer via Dojo (Banco Santander skills platform). This will include academies on Cloud and Agile, Digital Fluency, Global Engineering, Leadership and Global Financial Crime Academy.

Employee engagement

We foster an open dialogue between employees and our senior leaders. Colleagues joined virtual "In Conversation" events this year with the Santander UK plc Employee Designated Director on topics of simplification, wellbeing and inclusion. Our CEO and members of the Executive Committee participated in quarterly virtual events, with all colleagues invited to participate in the conversation and submit their questions in the live forum. The topics included sharing Santander UK's financial results, recognition and celebrating success and providing insight into the future strategy.

The Global Pulse Survey results improved in 24 of the 26 questions where we had a historical trend from the Global Engagement Survey (GES) 2019.

Our Engagement Index score increased from 2019 by 7 points to 77%, and is 7 points above the external benchmark. Pride in being part of Santander increased by 7 points to 82% and is 5 points above the external benchmark. Drivers of increased engagement with the most positive trends compared with 2019 were questions around wellbeing, communication, innovative working practices and collaboration. Areas of improvement included continuing our simplification to improve colleague enablement and addressing ineffective ways of working.

Working in partnership

During 2020, we continued to work in partnership with our recognised trade unions Advance and Communication Workers Union (CWU) on our approach to support colleagues through the pandemic. We have also continued consultation with representatives on changes associated with transformation.

Fair pay

Our Reward Framework is reviewed annually against the external marketplace. We are proud to have been an accredited Real Living Wage employer since 2015. Salary reviews, and changes to reward policies, are assessed for any adverse impacts on a particular group. Salary ranges and Pay Progression arrangements are visible to all colleagues. We embrace transparent reporting, evidenced by our detailed Diversity Pay Report which includes voluntarily publishing our ethnicity pay gap, and the voluntary disclosure of our CEO pay ratio in our Remuneration Implementation Report.



Sustainability continued



Communities

We support and invest in communities across the UK to foster sustainable economic growth.

Becoming the UK's best dementia-friendly bank

In 2020, we entered the second year of our partnership with Alzheimer's Society by focusing on how to better support customers with dementia. This included developing an online Dementia Guide, and launching a bespoke e-learning module, 'Dementia Friends,' encouraging our colleagues to improve their awareness of, and commit to a social action to support people affected by the disease. At the end of 2020, 54% of our workforce were Dementia Friends and 129 contact centre and branch staff completed a Dementia Ambassador training course, aimed at empowering colleagues to share information and promote internal dementia-friendly initiatives in their areas.

We also launched the Dementia Steering Group, made up of carers and people living with dementia to ensure our products and services, (such as the ATM journey), are dementia friendly.

Despite the challenges of Covid-19, we raised over £655,000 for Alzheimer's Society in 2020, equating to over £1.4m since the partnership began in 2019.

Santander Foundation

Older people and those affected by dementia were disproportionately impacted by Covid-19. In response, the Santander Foundation postponed the launch of its new grants programme until 2021 to concentrate on supporting Alzheimer's Society and Age UK. Each charity received a £1.5m donation enabling their contact centres and online services to increase capacity and continue providing support for those in need.

The Foundation did however, further continue its support of charities through the Matched Donations programme, approving 577 employee requests totalling £509,319.



Employee volunteers provide lockdown lift

The Santander 'QuaranTea' campaign, aimed to support the most vulnerable and isolated people during the pandemic. Supporting Alzheimer's Society and Age UK, Santander colleagues volunteered to; make weekly companion phone calls to isolated individuals, provide direct support to local Age UK centres, become Digital Champions and Dementia Friends, and distribute support guides to older people in their local communities. To encourage colleagues to join the campaign, the

Santander Foundation donated £1,000 for each volunteer that took part, split equally between Alzheimer's Society and Age UK (up to £1m), and also doubled the time colleagues could dedicate to volunteering, offering 70 hours of time, compared to 35. The response to the campaign far exceeded the original ambition to recruit 1,000 volunteers and 2,591 colleagues signed up to support 5,472 vulnerable people.

Financial inclusion

Confidence with numbers is a key skill that underpins financial inclusion and in 2019 we established a three-year partnership with National Numeracy aimed at helping children and parents build confidence with numbers, using the magic of football and our sponsorship of the Champions League. To support the partnership during school closures, we enlisted Twinkl (the world's largest online education hub), the F2 Freestylers (the world's biggest football influencers), and Rio Ferdinand, former England and Manchester United Captain to create a series of free online football-themed maths challenges. The content received over 119,000 unique downloads.

Confidence in money matters is another key skill which our partnership with Young Enterprise (YE) addresses through in-school activity. Due to school closures, YE adapted their programmes, and took My Money Week (MMW) and the Fiver challenge online. For MMW, a free resource hub was created for teachers, parents and carers to share with children, and the Fiver 'at Home' challenge encouraged students to develop a product or service over four weeks using £5 start-up money. Even with schools closed, over 110,000 young people took part in activities.

Digital inclusion

Wanting to improve digital skills for older people, we partnered with Age UK to launch GoDigital in 2020. Through digital awareness events 21,716 people were reached and a further 462 people received one-to-one support.

In addition to supporting older people, we worked with We Are Digital to create content aimed at keeping 11-17 year-olds safe online. Through this programme, 1,513 young people were trained on topics such as captology, fraud and scams and sextortion.

Santander Universities

In response to Covid-19, Santander UK contributed £5.1m to university initiatives, which included a £300k donation to Oxford, UCL and Imperial College to support Covid-19 research and vaccine development. The contribution also went towards the production of PPE for the NHS and IT equipment for students.

We also supported more than 10,200 students and graduates in 2020. 490 start-ups and SMEs benefited from the Santander Universities Internship Scheme, totalling 558 internships and founderships, with 45% of the internships going on to employment with the SME.



Ethics & Environment

We are committed to upholding the highest ethical standards.

Responsible lending

As part of the Banco Santander group, we comply with the Equator Principles, factoring social, ethical and environmental impacts into our risk analysis and decision making process for financial transactions. These principles address climate change, prevention of pollution and toxic waste emissions, biodiversity, indigenous peoples and human rights.

Our policy on Aerospace and Defence, Energy, Mining & Metals and Soft Commodities and our Sensitive Social and Ethical Sectors policy continue to define our approach towards creating long-term value while managing reputational, social and environmental risks. We have in place a number of prohibitions restrictions on a range of activities. Prohibited activities now include the provision of products or services for new Coal Fired Power Plant (CFPP) projects and taking on new clients with existing CFPPs. Restricted activities include transactions specific to CFPPs for existing clients which do not significantly improve environmental impacts, such as a significant reduction of CO₂.

Environmental and Social Risk Champions and the Reputational Risk Forum reviews and approves all restricted activities to ensure that they fall within our risk appetite. This forum reviews, monitors and escalates key decisions around financial and non-financial reputational risks to the Board.

Renewable financing

In 2020, Santander was the top UK lender in the renewable energy sector by number of transactions (2nd by deal amount), exclusive of energy from waste assets. As part of this, Santander UK originated £1.27bn of debt financing to renewable energy projects. We provide advisory and financing solutions for renewable and alternative energy clients across a range of technologies and renewable energy support schemes, including onshore and offshore wind and solar projects.

In 2020 we funded renewable energy in new markets and continued to expand our service offering by developing innovative new funding structures for the sector. We advised on two onshore wind portfolio financings across the UK and Ireland, which will allow clients to secure long-term financing and assure their future growth in this sector.

We also lent to an offshore wind project in a new Asian market for that technology.

In Corporate and Commercial Banking, we continue to support traditional mid-market renewable generation technologies, with tailored project finance solutions and flexible portfolio level facilities. In addition, we delivered funding solutions for a diverse range of projects and technologies, including batteries, energy efficiency and subsidy-free renewables. In 2020 we launched an innovative "Environmental and Social Growth Funding" solution, aiming to unlock high quality projects which deliver clear sustainability benefits.

Ethical supply chain

We want to do business with companies who share our values. Our standard supplier contracts include specific requirements to respect human rights and ethical labour practice based on the principles of the UN Global Compact.

In 2020 we improved our Third-Party Risk Management framework, processes and policies. The Third Party Supplier Control Questionnaire was reviewed and updated in Q2 2020 with support from EY, aligning to market best practice and including a review of the supplier's approach to ensure compliance with human rights standards and support of the Real Living Wage. Covid-19 disrupted our planned on-site assessments, and we adapted to deliver remote assessments to suppliers.

We launched our Third Party Code of Conduct in 2019, which we ask all suppliers to accept on our platform. We updated this in 2020 to include reference to climate change, inviting suppliers to join our commitment to a low carbon economy. We also improved our Procurement controls in review with a consultancy.

Anti-Financial Crime, Anti-Bribery and Corruption

Our Anti Financial Crime (AFC) strategy is set around the three principles of 'Deter, Detect and Disrupt'. In 2020 we continued to promote our AFC Culture and Strategy, including through senior leadership briefings and colleague events or communications.

We continue to develop external partnerships including through participation on the Economic Crime Action Plan. We're a proactive member of the Joint Money Laundering Intelligence Taskforce and supported work to reform the Suspicious Activity Reporting regime. In addition, our partnership with the NGO "Stop the Traffik" strengthens how we tackle human trafficking and modern slavery.

In 2020, AFC Strategy held a virtual three-day conference with over 400 colleagues in attendance and external speakers from the National Economic Crime Committee and Stop the Traffik.

Carbon neutrality in our operations

At Santander UK, we are committed to reducing our operational impact on the environment. Banco Santander set an ambition to be carbon neutral across its operations by 2020, and the UK has achieved this. In 2020, we created the working group 'Forum for Environmental Change' to drive and coordinate our efforts. Our energy strategy enables annual reductions in carbon emissions across the UK estate. In 2020, Covid-19 amplified these reductions, with emissions of 6,452 tCO₂e and total energy use of 123,152,495 kWh.

With significant disruptions to typical working across the UK, our teams responded by monitoring the energy-related impacts of these disruptions. We have an employee network of over 1,800 Green Champions. Our engagement programme 'Go Green' is evolving to consider the environmental aspects of home working. Annual water use across our estate decreased by 27% and rainwater collection units have also been in place at our Carlton Park data centres since 2019. We have taken steps to meet our net zero ambitions with the offsetting of 6,452 verified carbon units in 2020 and 100% procurement of electricity via green sources, bringing our net carbon emissions to zero.

Our offices and data centres successfully retained our ISO 14001 (environmental) and ISO 50001 (energy) management system certifications. In 2020 we started construction of our new head office building, Unity Place. Aligning with rigorous efficiency and environmental criteria, Unity Place is set to rank in the top 10% of buildings with regards to BREEAM sustainability, demonstrating best practice.

Stakeholder voice in the boardroom

Section 172(1) Statement

This section sets out how the directors have regard to their duties in section 172 of the Companies Act, to promote the long-term success of the Company for the benefit of its shareholder and other stakeholders.

This s.172 statement reflects our Company's position as the holding company for the Santander UK group. The Company does not have employees, customers or suppliers. However, in the spirit of complying with the requirement, we have instead used the activities of our subsidiaries to complete this statement where appropriate.

During the year, the directors considered the views of all stakeholders insofar as is possible and practical when making decisions for the Company, mindful of our primary purpose to help people and businesses prosper. Inevitably there are times where a decision has required a trade-off to be made between stakeholder groups and, where this is the case, we sought to do this in a clear and transparent manner in line with our strategic priorities.

More information on our stakeholders is set out in the Sustainability section of the Strategic Report, which also identifies why we consider these stakeholders to be key to our business model and strategy.

The likely consequences of any decision in the long term

Covid-19 had an immediate and significant impact on the financial position of the Company as well as its stakeholders. However, it also reaffirmed the importance of our ongoing transformation programme, with its focus on Technology, Procurement, Digital Capability and Omni-channel service provision. The Board remained focused on providing oversight of the programme's delivery and balanced this with the interests of stakeholders including our customers in light of the current trading environment. In the face of unprecedented challenges posed by Covid-19 we maintained our strategic priority to simplify and digitise the business for improved efficiency and returns. Our engagement with stakeholders is described below.

To ensure continuity of service for our customers, we accelerated technological change with employees reskilling to strengthen the support provided to customers during lockdown and restricted branch opening hours. We supported the swift development and roll out of various initiatives intended to provide additional support to customers who were unable to access services in branch (further details in the Our response to Covid-19). The Board received regular updates on the initiatives as well as feedback from customers.

We devoted significant time to the long-term profitability of the business, which included considering product pricing of our 11213 account. The Directors balanced the future viability of our business against the impact on customers and sought to remain competitive in the market, ensure fair outcomes for customers on pricing as well as protect customers adversely impacted, by moving some customers to other products if appropriate. We also put in place additional support for customers identified as vulnerable.

The interests of our employees

As the Company has no direct employees there is currently no employee NED representation at the Board level. However, the Company oversees certain aspects of employee relations in subsidiaries, one of which, Santander UK plc, a designated Non-Executive Director to represent the views of the workforce and if the number of employees in other entities increases, employee representation at subsidiary or at Board level will be reviewed. For the time being, these other entities make their own arrangements for ensuring engagement with their employees and this is reported in their respective s.172 statements. The Global Pulse Survey included these employees in its scope.

Covid-19 had a significant impact on our employees with the majority moving to remote working for their safety and wellbeing. The Board considered reports on steps taken to protect colleagues working in branches from Covid-19 infection as well as from physical or verbal abuse from a minority of customers. We supported proposals for keeping branches open wherever possible, given their importance to the communities they serve, especially for our most vulnerable customers without access to digital services.

Considering the needs of our employees, we reduced opening hours but balanced this with a significant increase in contact centre and digital support - both online and via mobile banking. We were mindful of the operational risks this presented and the mitigating actions that were being implemented and would evolve over time in response to our experience operating remotely. The Chief HR Officer regularly reported to the Board on the results of frequent employee wellbeing surveys and initiatives to support employees through these challenging times. There was positive feedback on our rapid response to the pandemic that enabled most colleagues to work remotely within a few weeks of lockdown and colleagues felt there was a genuine interest in their wellbeing. The pandemic provided a reminder that employee wellbeing is an important element of organisational resilience and efficiency and the Board and the Board Responsible Banking Committee paid close attention to employee metrics that seek to quantify well-being.

We considered significant proposals impacting large numbers of colleagues at both national and local levels. We received assurance that our two recognised unions, Advance and CWU, had been actively consulted and engaged to ensure that employees' views were represented in those proposals.

In addition to responding to these challenges, the Board Remuneration Committee worked with management to align executive pension contributions, in line with best practice, with the wider workforce, and we provided strong challenge to ensure that the Company-wide remuneration policy remains Simple, Personal and Fair. We continued to support initiatives and investment in our people to ensure they have the skills and knowledge to thrive - a key strategic priority - this is covered in more detail in the People section of the Sustainability Report and we have been in active dialogue during the year about revising our Employee Value Proposition to reflect the experience of Covid-19, the aspirations of our colleagues and the needs of the business.

The need to foster the company's business relationships with suppliers, customers and others

Covid-19 has impacted all of our customers, both individuals and businesses. It has challenged the delivery of our strategic purpose of providing our customers with an exceptional customer experience, and details of our efforts are provided in the Covid section and the Sustainability section.

As a Board we paid close attention to our business relationships across our Retail, Corporate & Commercial Banking and Corporate Investment Banking businesses. At the outset of the lockdown we held several ad hoc Board meetings to understand how continuity of service and additional support would be provided to individual customers and businesses both large and small. We noted several improvements including upskilling of colleagues to empower them to resolve customer concerns at the First Point of Contact and the introduction of a 'Digital Accelerator' to improve the digital experience of customers.



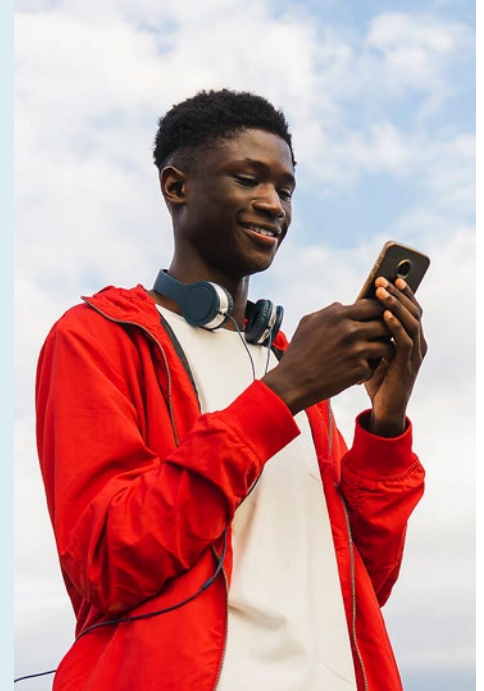
Branch Staff at the Vanguard

Alert employees working in our branch network have been instrumental in caring for our customers in these challenging times: whether spotting exceptional withdrawals of cash to pay rogue builders, signs of human trafficking or unapproved withdrawals of cash by carers of vulnerable customers, their service on the front line has had a tremendous impact. We recognised their achievements on our intranet and this was also reported to the Board. Really Knowing Your Customer means more than account opening forms!

Responding to Black Lives Matter

We held a number of events in response to the Black Lives Matter movement, listening to colleagues about their experiences, analysing our own data then looking at ways to support colleagues and accelerate the pace of change within the bank. Disparities between the experiences of employees from different ethnic groups raised in these discussions were considered by members of our Executive and the Santander UK plc Employee Designated NED, who reported her feedback to the Santander UK plc Board.

We responded by developing a Black Inclusion plan. Three areas of focus were identified: Leadership, Allyship and Networks, with supporting measures and targets to shape our activity to Build Black Inclusion and amplify Black Voices. We will also now use Asian, Black, other Minority Ethnic and White ethnic group identities rather than BAME in our analysis and reporting, publishing our ethnicity workforce data and our Ethnicity Pay Gap.



Extensive customer testing helps shape new customer journeys such as the Business Bounce Back Loan digital journey, and we have developed an holistic Net Promoter Score tracking programme to understand what are the key factors that drive 'promoters' and 'detractors' of our brand. We have used this data to inform our discussions about prioritisation such as the mobile development backlog, and to understand the customer impact of key strategic decisions such as the 11213 current account pricing changes.

We worked closely with the Government and industry to make funds available to businesses to limit the impact of Covid-19. We provided challenge to the initial design of the schemes and also their implementation, impact on capital, liquidity, colleagues and customers. We accepted that fraud risk and operational risk might increase as a result of our participation in these government schemes but concluded that the interests of our customers would outweigh these negatives and we sought assurance on the controls and workarounds that would be put in place to mitigate these risks. We regularly received management information on loan applications and release of funds and associated risk issues.

As part of the Board Risk Committee's consideration of third party suppliers, we noted plans to work closely with our suppliers, ensuring their business continuity plans were in place and capable of providing continuity of service to the Company whilst adjusting to the new operating conditions under Covid-19. We have continued to uphold the standards expected of them including reviewing how we assess and mitigate the risk of human trafficking or slavery in our supply chains, and ensuring our UK Supplier Code of Conduct explicitly references the supplier contribution we expect towards a low-carbon economy. Our procurement proposition is under review as part of the transformation programme, which is considered regularly at Board level.

The impact of our operations on the community and the environment

As a result of Covid-19, many people in the communities in which we operate have been left feeling isolated or vulnerable. We have taken a particular interest in the many instances where employees have made a difference in their local communities and welcomed and acknowledged two colleagues receiving British Empire Medals for services to the community.

Stakeholder voice in the boardroom continued

Sustainability is one of our four strategic priorities and we are determined to further embed sustainability into the way we do business. Climate change is considered as a key financial risk as well as a reputational risk, and the Board is actively considering the long-term effect of our operations on the environment including its lending decisions. In accordance with our PRA implementation plan, the implemented governance is that reputational risk aspects are considered at the Board Responsible Banking Committee while other risk (financial) is considered at Board Risk Committee. In addition to both of these Committees considering climate change in 2020, the Board also received a training workshop on climate change in September 2020.

As a Board, we adopted locally the Banco Santander Responsible Banking policies on Sustainability, Human Rights and Culture, as part of a Banco Santander-wide exercise to ensure consistent standards and simplification.

Maintaining a reputation for high standards of business conduct

High standards of business conduct are a regulatory and communal imperative. Without trust in our services and our brand, we cannot serve our customers or the wider community. As a Board of a recognised and

trusted high street brand, we are deeply aware of what Santander means to our customers and the risks that could damage its reputation. We therefore maintain oversight through our Board Risk Committee and Board Responsible Banking Committee of improvements in our technology, data capture and structure as well as ensuring that we are treating customers fairly, putting in extra support for those considered vulnerable. We expect all employees to take individual accountability for our reputation and protecting our licence to operate.

Although Covid-19 has changed some of the challenges faced, both in implementing government financial support schemes and changing fraudster tactics, Financial Crime has been a focus of our attention. Clear oversight and close supervision is managed by the Board Responsible Banking Committee with relevant issues escalated to the full Board. This approach is supported by comprehensive Anti-Financial Crime training for all Board members. Further to this, a centralised Anti Financial Crime Academy was launched in 2020, which builds on enhanced, role specific training for colleagues managing controls and processes as part of the financial crime compliance framework.

We continue to uphold high ethical standards in our fight against financial crime and have taken forward a number of projects with external stakeholders. These include work with 'Stop the Traffik', the global leading Human Trafficking prevention charity. We have created a bespoke awareness training package, supported by the Modern Slavery Statement. We are also prominent members of the Joint Money Laundering Intelligence Taskforce (JMLIT), an industry and law enforcement framework for successful intelligence sharing. Overall, we are increasing our Private Public Partnerships to manage and respond to significant financial crime threats.

The need to act fairly as between members of the company

We have a single shareholder that is Banco Santander SA. The Board ensures that the shareholder's interests are balanced against those of other stakeholders, including by the analysis of capital contributions and group-wide employee incentives, and ensuring individual remuneration scorecards include non-financial KPIs to measure positive actions in stakeholders' interests.

Board dives deep into Sustainability

In November 2020 the Board Responsible Banking Committee had a two-hour workshop on Sustainability, in order to gain a detailed understanding of current sustainability macro trends and material issues for the bank, such as diversity, financial inclusion and climate change, and their implications for our business. The Board Responsible Banking Committee agreed the evolution of the Sustainability strategy, our key sustainability priorities for Santander UK moving forward and the level of ambition for each of these priorities. This will support the development of medium to long-term metrics and targets, to be approved by the Board.



Non financial information statement

This section is produced to comply with s414CA and s414CB of the Companies Act 2006. The information listed is incorporated by cross-reference. Additional non-financial information can be found in our 2020 ESG Supplement.

Reporting requirement	Policies and standards	Information necessary to understand our business and its impact
Environmental matters	Environmental Policy	Emerging risks, pages 24-25 Risk management overview: TCFD, page 26 Sustainability: Ethics and environment, page 37 Directors' report: Streamlined Energy and Carbon Reporting, page 75
Employees	People Policies Whistleblowing Policy Ethical Code of Conduct	Sustainability: Fair pay, page 35; People, pages 34-35 Board Audit Committee Chair's report: Whistleblowing, page 62 Board Responsible Banking Committee Chair's report, People and Culture, page 64 Directors' report: Ethical Code of Conduct, page 78
Human rights	Human Rights Policy	Sustainability: Ethics and environment, page 37
Social matters	Social Ethical Policy	Sustainability: Communities, page 36 Ethics and environment, page 37
Anti-corruption and anti-bribery	Anti-Bribery & Corruption Policy Ethical Code of Conduct	Sustainability: Ethics and environment, page 37 Directors' report: Ethical Code of Conduct, page 78
Principal risks and impact of business activity		Risk management overview, pages 20-25
Description of business model		Business model, page 14
Non-financial key performance indicators		Our Performance and KPIs, page 18

Governance

Our governance

The UK Corporate Governance Code 2018 (the Code) sets out the framework for premium listed companies in the UK. The Code is the corporate governance code applied by the Company, with appropriate amendments as a fully owned subsidiary, and the standard against which we measure ourselves.

This Governance section (including the Chair's report on Corporate Governance, the Committee Chair Reports and the Remuneration Policy and Remuneration Implementation reports) detail how the Company has applied and complied with the principles and provisions of the Code.

Any principles and provisions of the Code that are not precisely followed are detailed in the Directors' Report.

How our governance supports the delivery of our strategy

All Directors are collectively responsible for the success of the Company. The Non-Executive Directors exercise objective judgement in respect of Board decisions, and scrutinise and challenge management. They also have various responsibilities concerning the integrity of financial information, internal controls and risk management.

The Board is responsible for setting our strategy and policies, overseeing risk and corporate governance, and monitoring progress towards meeting our objectives and annual plans. It is accountable to our shareholder for the proper conduct of the business and our long-term success, and seeks to represent the interests of all stakeholders.

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Board of Directors

1 William Vereker

Chair

Appointed 1 November 2020 (Chair)
Previously Independent Non-Executive Director from 1 October 2020

Skills and experience

William is an experienced and well-respected Banker, previously having served as Global Head of Investment Banking for UBS (2013 – 2018), and prior to that holding a number of leadership roles at Nomura, Lehman Brothers and Morgan Stanley. From 2018 to 2019 he served as the Prime Minister's Business Envoy. He was a Vice Chairman at JP Morgan until October 2020.

Other principal appointments

Chair of Santander UK plc*.

Board Committee memberships

Board Nomination Committee

2 Ed Giera

Independent Non-Executive Director

Appointed 19 August 2015

Skills and experience

Ed is currently Principal of EJ Giera LLC, providing corporate finance advisory and fiduciary services, and the Manager of Boscobel Place Capital LLC, a private investment partnership focused on the global financial services sector. Formerly, his executive career was with JP Morgan Securities, the investment banking affiliate of JP Morgan Chase & Co.

Ed also previously served as a Non-Executive Director at Pension Corporation Group Limited, ICBC Standard Bank plc, the Renshaw Bay Structured Finance Opportunity Fund, NovaTech LLC and the Life and Longevity Markets Association.

Other principal appointments

Independent Non-Executive Director of Santander UK plc*. Non-Executive Director of the Renshaw Bay Real Estate Finance Fund.

Board Committee memberships

Board Audit Committee
Board Nomination Committee
Board Responsible Banking Committee
Board Risk Committee
Board Remuneration Committee

3 Chris Jones

Independent Non-Executive Director Whistleblower's Champion

Appointed 30 March 2015

Skills and experience

Chris was a partner at PwC from 1989 to 2014 and was a Senior Audit Partner specialising in the audit of banks and other financial services companies. He also led PwC's EMEA Financial Services practice. He is a past president of the Association of Corporate Treasurers and a former Chairman of the Advisory Board of the Association of Corporate Treasurers.

Other principal appointments

Independent Non-Executive Director of Santander UK plc*. Independent Non-Executive Director of Legal & General Investment Management (Holdings) Limited. Audit and Risk Committee member of the Wellcome Trust. Non-Executive Director of Redburn (Europe) Limited. Board member of the Audit Committee Chairs' Independent Forum.

Board Committee memberships

Board Audit Committee
Board Remuneration Committee
Board Responsible Banking Committee
Board Risk Committee
Whistleblower Champion

4 Ana Botín

Banco Santander Nominated Non-Executive Director

Appointed 10 January 2014, Non-Executive Director from 29 September 2014

Skills and experience

Ana joined the Banco Santander group in 1988 and was appointed Executive Chair of Banco Santander SA in September 2014. Ana has been a member of Banco Santander SA's Board and Executive Committee since 1989 and previously served as CEO of Santander UK plc between 2010 and 2014. Ana directed Banco Santander's Latin American expansion in the 1990s.

Other principal appointments

Non-Executive Director of Santander UK plc*. Executive Chair of Banco Santander SA* and Director. Non-Executive Director of The Coca-Cola Company. Vice-Chair of the Empresa y Crecimiento Foundation. Vice-Chair of the World Business Council for Sustainable Development. Member of the MIT's CEO Advisory Board. Appointed to the IMF external advisory Board in March 2020.

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* Part of the Banco Santander group.

Board of directors continued

For full bios visit

www.santander.co.uk/uk/about-santander-uk/about-us/non-executive-directors

5 Bruce Carnegie-Brown Banco Santander Nominated Non-Executive Director

Appointed 16 September 2019

Skills and experience

Bruce is a Vice Chairman and Lead Independent Director of Banco Santander SA* and Chairman of Lloyd's of London.

Bruce has served as Non-Executive Chairman of Moneysupermarket.com Group plc and a Non-Executive Director of JLT Group plc. He was also Non-Executive Chairman of Aon UK Ltd, and was Senior Independent Director at Close Brothers Group plc and Catlin Group Ltd. As an executive, he was co-founder and managing partner of the listed private equity division of 3i Group plc, President and CEO of Marsh Europe and a managing director of JP Morgan.

He was previously a Non-Executive Director of Santander UK plc* between 2012 and 2017, and a Non-Executive Director of Santander UK Group Holdings plc* between 2014 and 2017.

Other principal appointments

Non-Executive Director of Santander UK plc* since September 2019. Vice Chairman and Lead Independent Director of Banco Santander SA*. Chairman of Lloyd's of London and Chair of Cuvva Limited.

Board Committee memberships

Board Nomination Committee

6 Nathan Bostock Executive Director Chief Executive Officer

Appointed 19 August 2014

Skills and experience

Nathan joined Santander UK from RBS, where he was an Executive Director and Group Finance Director. He joined RBS in 2009 as Head of Restructuring and Risk, and Group Chief Risk Officer. He previously spent eight years with Abbey National plc (now Santander UK plc*) and served on the Board as an Executive Director from 2005. During his time with Abbey National plc, he held other senior positions including Chief Financial Officer.

He was also at RBS from 1991 to 2001 in a number of senior positions and spent seven years before that with Chase Manhattan Bank, having previously qualified as a Chartered Accountant at Coopers & Lybrand (now PwC).

Other principal appointments

Chief Executive Officer of Santander UK plc*. Member of the Financial Services Trade Investment Board.

7 Madhukar (Duke) Dayal Executive Director Chief Financial Officer

Appointed 16 September 2019

Skills and experience

Duke has extensive financial services experience in a wide range of areas. Before joining Santander UK*, he worked for Santander US* in Boston as CFO of Santander Holdings* (April 2016 – July 2019) and President and CEO of Santander Bank NA* (September 2017 – July 2019).

Prior to joining Santander, Duke was with BNP Paribas for six years, where he served as Chief Financial Officer for BNP Paribas USA Holdings, BancWest and Bank of the West. Before that he helped lead a private equity start-up for JP Morgan Chase & Co, Brysam Global Partners. Prior to that, he spent eight years with Citi.

Duke also served as a member of the Executive Committee on the Board of Trustees for the Institute of International Banking in New York as a Board member of the Federal Home Loan Bank of Pittsburgh and is on the Board of Governors for Nottingham Trent University.

Other principal appointments

Chief Financial Officer of Santander UK plc*.

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* Part of the Banco Santander group.

Chair's report on corporate governance

My report describes the roles, responsibilities and activities of the Board and its Committees.



The Board has been focused on supporting management during a challenging year to achieve Simple, Personal and Fair outcomes for customers.

William Vereker
Chair
2 March 2021

Board activities
Read more on **p47**

Committee membership and attendance
Read more on **p73**

Our governance

Maintaining high standards of corporate governance is an essential element underpinning the long-term sustainable success of the Company.

In addition to the UK Corporate Governance Code 2018 (the Code) (the standard against which we measure ourselves), our governance practices and rules are set out in a number of our key documents, principally:

- The UK Group Framework, which defines clearly our responsibilities and relationship with Banco Santander SA, our shareholder, taking account of our fiduciary and regulatory responsibilities. This gives us the autonomy to discharge our responsibilities in the UK in line with best practice as an independent board while giving Banco Santander SA the oversight it needs. Clarity of roles and responsibilities is key to ensuring proper accountability for decisions and outcomes; and
- The Corporate Governance Framework, which is designed to assist the Board of Directors in discharging their responsibilities and ensuring an appropriate scheme of delegation throughout the Santander UK group.

The Board's schedule and activities are planned to make sure that Directors have regard to the matters necessary to promote the success of the Company, including the broader implications of their decisions for all the Company's stakeholders including its shareholder. Details of how the Board has achieved this are set out in the Section 172 statement in the Strategic report. Our statement of compliance with the Code can be found in the Directors' report.

Ring-fencing embedding

Following the changes implemented at the end of 2019, Santander UK plc, as the ring-fenced bank, has continued to operate within the ring-fencing governance rules. As the substantive business of the Santander UK Group Holdings plc group is currently conducted by Santander UK plc, our ring-fenced bank, under our current business model, the PRA has granted certain ring-fencing governance rule modifications, subject to various safeguards.

This allows for certain overlaps of the Board and senior management of Santander UK Group Holdings plc and Santander UK plc, recognising our ownership structure and chosen ring-fencing business model.

The key ring-fencing safeguards include:

- the requirement to have at least three ring-fenced bank Independent Non-Executive Directors (INED), of whom none are employees or directors of any other member of the ring-fenced bank's group other than a ring-fenced affiliate (referred to as Double INEDs (DINEDs)); and one of whom is designated senior ringfencing director (SRD) responsible for making sure that processes to identify and manage any conflicts of interest between the ring-fenced bank group and other members of the Santander UK Group Holdings plc group are operating effectively.
- the DINEDs and SRD have certain veto rights designed to protect the interests of the ring-fenced bank.
- the requirement for an approved person who is part of the RFB risk management function and who is not a director of, employed by or has any responsibilities for any other member of the ring-fenced bank's group other than a ring-fenced affiliate (RFB Risk Officer). The RFB Risk Officer has certain specific responsibilities in relation to identifying conflict matters.
- the Board and Committees of the two companies continue to be run substantially simultaneously to ensure efficiency and effectiveness whilst guaranteeing the independence and autonomy of our ring-fenced bank are appropriately protected. However, under PRA rule modifications, the ring-fenced bank Board and Board Committees must hold separate meetings twice a year to consider matters specific to the ring-fenced bank. The separate Board and Board Committee meetings of the ring-fenced bank took place in July and December 2020.

At 31 December 2020, the four DINEDs of the ring-fenced bank were Garrett Curran, Annemarie Durbin, Mark Lewis and Genevieve Shore. In addition, Annemarie Durbin acts as the SRD of Santander UK plc. Copies of the role profiles of board members, including the SRD, are available at www.aboutsantander.co.uk.

Chair's report on corporate governance continued

Santander UK Group Holdings plc Board

William Vereker (Chair and Chair of NomCo)	Ed Giera (Chair of BRC and BRBC)	Chris Jones (Chair of BAC and RemCo)	
Ana Botín (Group Executive Chair)	Bruce Carnegie-Brown (Group NED)	Nathan Bostock (CEO)	Duke Dayal (CFO)

Key

- HoldCo/RFB INED
- Group NED
- RFB Only INED
- ED

Santander UK plc Board

William Vereker (Chair and Chair of NomCo)	Ed Giera (Chair of BRC)	Chris Jones (Chair of BAC)	Garrett Curran (Chair of BRBC)	Annemarie Durbin (SRD and Chair of RemCo)	Mark Lewis	Genevieve Shore
Ana Botín (Group Executive Chair)	Bruce Carnegie-Brown (Group NED)	Dirk Marzluf (Group Head of Technology & Operations)	Nathan Bostock (CEO)	Tony Prestedge (Deputy CEO)	Susan Allen (CEO, Retail & Business Banking)	Duke Dayal (CFO)

In addition, the Board Committees of the ring-fenced bank must comprise at least one DINED member (or two DINED members for the Board Audit Committee and the Board Risk Committee). The Company continues to benefit from the knowledge, skills and experience of the DINEDs, where appropriate, in the simultaneous Board and Committee meetings of both companies.

Board membership

As at 31 December 2020, the Board of Santander UK Group Holdings plc consisted of 3 Independent Non-Executive Directors (INEDs) including the Chair, 2 Group appointed Non-Executive Directors (GNEDs) and 2 Executive Directors (EDs). The Santander UK plc Board, as at 31 December 2020, consisted of 7 INEDs, including the Chair, 4 EDs and 3 GNEDs. The Board composition of Santander UK Group Holdings plc and Santander UK plc is detailed above. Under the UK Group Framework, in light of the fact that Santander UK Group Holdings plc is fully owned by Banco Santander and that the Chair is independent of the shareholder, the Chair is counted as an INED. This does not comply with Code provisions.

Through the Board Nomination Committee, we make sure we have the right composition of individuals on the Board, giving an appropriate balance of knowledge, skills, experience and perspectives. Our aim of ensuring orderly succession for Board positions is supported by continuous and proactive processes. We take into account our strategic priorities and the main trends and factors affecting the sustainability and success of the business. We oversee and regularly review the development of a diverse pipeline for succession

Changes to Board membership are set out in the Directors' report. These appointments maintain valuable skills and experience of financial services, digital, strategy, development and execution and transformation. On behalf of the Board, I would like to thank Shriti Vadera and Scott Wheway who stepped down during 2020 for their invaluable service to the Board and the Company.

All aspects of diversity form part of our Board succession planning process, which is explained in the Board Nomination Committee Chair's report. In 2016 we set an aspirational target of having 33% women on the Board by 2020. Due to changes to the membership of the Board that took effect from 1 January 2020, we have not achieved this target. However, despite this reduction, we remain committed to our aspirational target. The Board of Santander UK plc is significantly larger than the board of Santander UK Group Holdings plc, reflective of the size of the business of the company. Consequently, a small change in the size of the composition of the board of Santander UK Group Holdings plc, has a greater impact on the diversity of that Board. The Boards of the two companies are run largely simultaneously.

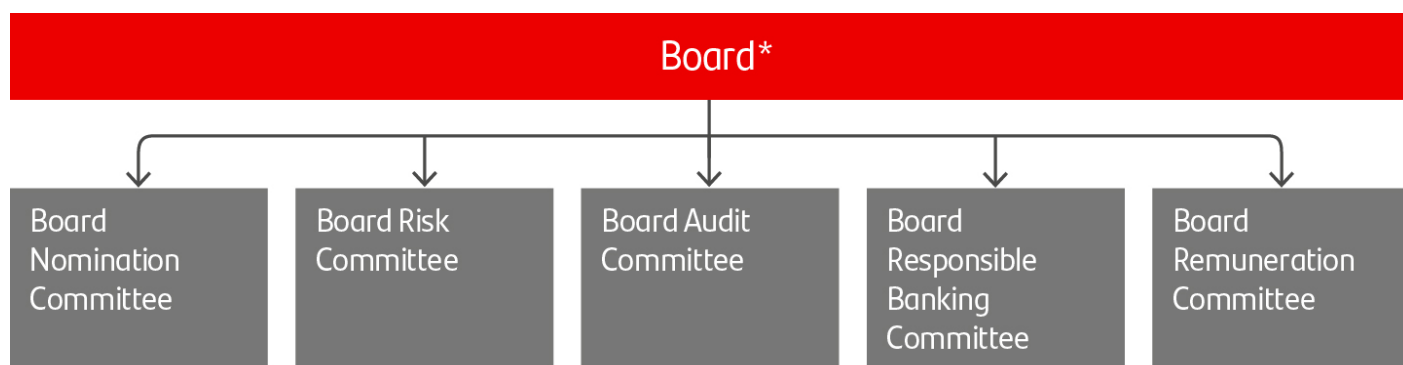
Director inductions and training

The Company Secretary supports the Chair in designing individual inductions for NEDs, which include site visits and cover topics like strategy, key risks and current issues including the legal and regulatory landscape. The delivery of our tailored NED induction programme for our new appointments continued through 2020, appropriately adapted in light of the pandemic to include a number of virtual site visits and interactions.

William Vereker benefited from tailored induction programmes phased over a period of 12 months, which includes meeting with senior management and site visits (where appropriate and in a Covid-19 safe way).

Throughout 2020, we continued to deliver workshops for all NEDs to further develop their knowledge and understanding of key business issues including major change projects and operational resilience, climate change, sustainability and financial crime.

As well as workshops, the NEDs received briefings on the governance requirements of ring-fenced banks.



*Board and Committee meetings held concurrently with Santander UK plc

Views of the workforce at the Board

As the overwhelming majority of colleagues within the Santander UK group are employed in the UK by Santander UK plc, the Board have not appointed a Non-Executive Director to represent the views of the workforce. However, the Board receives regular updates on the culture of the business and views of employees from engagement surveys feedback. The Board considers these arrangements to be invaluable in understanding the views of the workforce and providing meaningful dialogue at the Board on workforce matters.

Board Committees

The Board delegates certain responsibilities to Board Committees to help discharge its duties, as detailed in each of the individual Committee Chair's reports. The Committees play an essential role in supporting the Board, giving focused oversight of key areas and aspects of the business. The role and responsibilities of the Board and Board Committees are set out in formal Terms of Reference. These are reviewed at least annually as part of the review of the Corporate Governance Framework.

Except for the Board Nomination Committee which has one GNED, all Committees are composed of INEDs only.

The reduction in Board membership arising from implementation of ring-fencing requirements and the departure of Scott Wheway as SID has resulted in the Board Audit Committee, Board Remuneration Committee, Board Responsible Banking Committee and Board Risk Committee comprising two INEDs each.

Having assessed this in the light of Code recommendations, and as the substantive business of the Santander UK group is conducted by Santander UK plc, we are satisfied that the Committees will continue to be able to discharge their duties professionally, effectively and efficiently particularly as the Chairs of the Santander UK Group Holdings plc Board Audit Committee, Board Nomination Committee and Board Risk Committee are also chairs of the Santander UK plc Committees. As the Santander UK Group Holdings plc and Santander UK plc Committees run substantively simultaneously, they also continue to have the opportunity to benefit from the broader INED group's skills and experience.

Further details of the roles and responsibilities of the Board Committees are detailed in the Chair's reports of each of the Board Committees.

Board activities

The Chair, with the CEO and Company Secretary, supported by the Directors and senior management, make sure that the Board has an appropriate schedule, which is focused on the opportunities and risks to the future success of the business, business performance and risk mitigation, and make sure that the Company's culture is aligned with its purpose, values and strategy.

The Board regularly monitors progress against the strategic priorities and performance targets of the business.

During 2020, unlike previous years, the Board did not hold a separate Board Strategy day as the Board sought to adapt its processes due to the pandemic.

From March 2020, Board meetings were held virtually and the Board received deep dives on a number of particular areas of focus as well as undertaking a review of the overall strategy, including developing thoughts about what the new organisational operating model would look like in a post Covid-19 world.

During the course of the year, separate sessions were also held with the INEDs.

The Board has remained focused on the execution of strategy and responding to the challenges the business faced due to Covid-19, working closely with the government on the implementation of their support programmes.

To ensure the most effective use of the time at Board meetings, in addition to the delegation of certain responsibilities to the Board Committees, the Chair holds informal discussions with Board members. Complemented with external speaker workshops the Board consider important topics in depth and engage with key stakeholders. The Board ensures regular contact with management and colleagues through a number of means. These include inviting relevant business and function heads to present to the Board or its Committees on latest developments; permitting observers as part of individual senior managers' development plans; scheduling regular meetings for Committee Chairs to meet with relevant senior managers; site visits by one or more NEDs, and topical or technical workshops. Senior leaders are also available to the NEDs throughout the year.

Further details of the Board activities in 2020 are set out on the following page.

Chair's report on corporate governance continued

Summary of Board activities in 2020

The Board endeavoured to consider the views of all impacted stakeholders, whilst acting in the best interests of the Company and its members as a whole, and as described in the Section 172 statement in the Strategic report section of this Annual Report. The Board's activities in 2020 included the following themes:

Theme	Action taken by the Board and outcomes
Strategy and transformation	<ul style="list-style-type: none"> – In respect of transformation, received regular updates on the progress in driving the transformation agenda. – Received regular updates on the competitive landscape, the UK economy and banking sector including changes resulting from regulatory change requirements or in response to Covid-19. – As part of consideration of the overall strategy, considered the UK economic outlook, including financial impacts of Covid-19, and possible future operating models, together with an in depth review of Financial Crime. – Regularly considered Financial Crime, including approval of risk appetite and oversight of programmes to accelerate controls enhancement and regulatory engagement. – Considered M&A market opportunities and reviewed organic and inorganic growth opportunities. – Regularly reviewed progress in delivering the strategic priorities of Santander UK including the future Retail business model and technological journey and associated investments required. – Received regular updates from Banco Santander on the OneEurope initiative, including the benefits to Santander UK as a consequence of synergies with our ultimate parent, Banco Santander SA.
Business and customer	<ul style="list-style-type: none"> – Reviewed, challenged and remained apprised of the performance of the business divisions and functions, strategic business opportunities, developments with customer experience and the Company's transformation programme. – Reviewed and approved the response to implementing the High Cost of Credit Review and changes to current accounts. – Reviewed, challenged and approved the 3-year business plan (2021-2023) and the annual Budget, including cost efficiencies and associated risk assessments. – Conducted strategic reviews of our current account and mortgage propositions to ensure they remained competitive.
Covid-19	<ul style="list-style-type: none"> – Received regular reports on Covid-19 throughout the pandemic. – Provided support to Management in its deliberations and challenged preparedness for business dislocation. – Received regular reports on the well being of staff during the pandemic across a range of metrics. – Reviewed, challenged and remained apprised of the support being given to customers under the various Government initiatives as well as changes to overdrafts and the assistance being provided to vulnerable customers.
Regulation, Balance Sheet and Capital	<ul style="list-style-type: none"> – Reviewed, challenged and approved the ICAAP; ILAAP; adequacy and effectiveness of stress-testing and capital management; AT1 Payments and ordinary dividend payments in accordance with guidance from the PRA. – Reviewed the results of the BoE Financial Policy Committee Financial Stability Report, considering future changes to the UK bank capital framework. – Received regular updates on capital planning. – Considered asset and liability management activities and was apprised of regulatory developments. – Agreed key assumptions and capabilities. – Approved the Annual Report and other year-end related matters. – Received and discussed regular reports on ring-fencing implementation compliance including the consideration of conflict matters and the appointment of a ring-fenced bank officer. – Approved the Surplus Capital Allocation Framework and Dividend Policy.
Risk and control	<ul style="list-style-type: none"> – Received regular enterprise wide risk updates from the CRO, together with updates on specific risks, such as pensions, cyber security, financial crime, climate change and Brexit. – Approved/adopted changes to the Risk Framework as part of the annual review, including the introduction of a new minimum standard to ensure each business area and risk type considers risks posed by climate change.
People and Culture	<ul style="list-style-type: none"> – Received updates on issues including talent management and succession planning, gender pay, and diversity and inclusion. – Received updates on culture, considering our long-term strategic direction and cultural priorities following employee feedback and assessment findings from the Banking Standards Board. – Considered Succession Planning across all key control and support functions.
Governance	<ul style="list-style-type: none"> – Received regular updates on the Chair's succession, subsequently approving the appointment of the new Chair. – Approved the appointment of a new NED, Senior Independent Director, ED and the Company Secretary. – Reviewed, challenged and approved Santander UK's Annual Report. – Received regular verbal updates of Board Committee activity from their respective Committee Chairs. – Approved a revised version of the Group Subsidiary Governance Model for subsidiaries, as well as changes to certain Group Corporate Frameworks. – Approved a number of policies including a new Board level Conflicts of Interest Policy and a Group Policy for the Suitability, Selection and Succession of Board members, on the recommendation of the Board Nomination Committee. – Approved certain policies in respect of ring-fencing compliance including a Permitted Exceptions Policy and an Arms Length Policy, on the recommendation of the Board Risk Committee. – Approved any changes to directors' conflicts of interest, on the recommendation of the Board Nomination Committee.

Board Nomination Committee Chair's report



During the course of 2020, we strengthened the senior management team and will continue to do so throughout 2021, striving to achieve greater diversity.

William Vereker
Chair
2 March 2021

Committee membership and attendance

Read more on **p73**

The Committee has focused on overseeing board changes and continuing to strengthen the senior management succession pipeline

On behalf of the Committee, I am pleased to present my first Board Nomination Committee report. I would like to thank Shriti Vadera and the Committee members for their support as part of my transition to the Chairmanship of the Company and the Committee. During 2020, the Committee has undergone a number of changes in its membership as set out later in this report.

Role and responsibility

The primary responsibilities of the Committee include to:

- Review the Board's structure, size and composition, including skills, knowledge, experience and diversity;
- Consider succession planning for Directors and Senior Executives;
- Identify and nominate candidates to fill Board vacancies as they arise;
- Assess its performance and oversee the performance evaluation process for the Board and its Committees;
- Consider the annual reappointment of NEDs having regard to their performance and ability to contribute to the Board;
- Oversee the induction of new directors and ongoing training needs for the Board and individual directors; and
- Oversee the adequacy of the governance arrangements in place.

Overview of the year

During 2020, the focus of the Committee's work was to:

- Oversee Board changes and continue to strengthen the senior management succession pipeline;
- Lead the process for new director appointments to the Board;
- Review the collective skills, knowledge and experience of the Board, taking into account independence and diversity to inform succession plans;
- Review Board Committee membership and overseeing changes;
- Consider arrangements relating to Directors including Directors' interests, time commitment, terms of employment and that they remain appropriate; and

- Oversee governance arrangements on ring-fencing rule safeguards.

In addition, the Committee considered a number of governance policies and corporate frameworks that support our internal governance systems.

Summary of 2020 outcomes Succession planning

The Committee leads the process for identification, nomination and recommendation of candidates for appointments to the Board and senior management. It also makes sure plans are in place for orderly succession to both the Board and senior management positions. In doing so, it follows a rigorous and transparent process designed to make sure the appointments are based on merit and objective criteria and they promote diversity in its broadest sense to complement and strengthen the overall Board and its Committees' skills, knowledge and experience.

As part of the Board appointments process, the Committee takes account of legal and regulatory requirements. The Board retains responsibility for and approves final decisions on these matters.

In 2020, the Committee spent significant time overseeing new Board appointments. Under the lead of the SID, the Committee undertook a search supported by Spencer Stuart for Shriti Vadera's replacement, resulting in its recommendation to the Board to appoint me as an independent Chair to the Board.

During the year, the Committee also reviewed changes to executive management talent, including a thorough assessment of the skill sets needed in light of the strategic direction of the business, together with development planning for identified talent, to ensure a diverse leadership pipeline and strong leadership team. As part of this process, Tony Prestedge joined Santander UK plc as Deputy CEO, and Christine Palmer joined as Chief Risk Officer. Both are members of the Executive Committee.

Board Nomination Committee Chair's report continued

To support orderly succession planning for Board and senior management positions, the Committee assesses the challenges and opportunities facing the Company and evaluates the skills and expertise that will be needed in the future alongside internal capabilities, including Board evaluation feedback. Increasing diversity in all respects in the boardroom and executive pipeline is a key factor we consider. Board appointments and succession planning in 2020 were consistent with this approach, tailored as appropriate in each case.

Central to the succession planning process is the Board skills and diversity matrix which is used to track the Board's strengths and identify any gaps in its desired collective skills profile.

The skills and diversity matrix was updated during 2020 to take into consideration the future strategic direction of the Company and to make sure that consideration is given to diversity in its broadest sense.

Other areas of 2020 focus Diversity, inclusion and engagement with stakeholders

In 2016, we set an aspirational target of having 33% women on the Board by 2020. Due to changes in membership of the Board in 2020, we had not achieved this aspirational target at 31 December 2020. However, we remain committed to our target. The Board of Santander UK plc is significantly larger than the Board of Santander UK Group Holdings plc, reflecting the size of the business of the company. As a result, a small change in the composition of the board of Santander UK Group Holdings plc has a greater impact on the diversity of that Board. The Boards of the two companies are run largely simultaneously for efficiency.

We will also continue to make sure that gender and all aspects of diversity remain front of mind in our succession planning. We have signed the Business in The Community 'Race at Work' Charter and made good progress, achieving four of our five actions with good progress on the final one. In February 2019, the Board confirmed our ambition to increase senior manager representation of Asian, Black, other Minority Ethnic and White ethnic group employees to 14% (+/-2%) across mid to senior manager roles by 2025.

The Board Diversity and Inclusion Policy is available at www.aboutsantander.co.uk.

Annual review of director interests, fees and conflicts of interest

In 2020, the Committee continued to review time commitment and Directors' interests and to ensure any conflicts are managed appropriately and in compliance with CRD IV and ring-fencing requirements. The Company's Articles of Association contain provisions that allow the Board to consider and, if it sees fit, to authorise situational conflicts. The Board confirms that such powers have operated effectively and that a formal system for Directors to declare their interests and for the non-conflicted Directors to authorise situational conflicts continues to be in place. Any authorisations given are recorded by the Company Secretary.

The CEO and I reviewed the level of fees paid to INEDs for Board and Board Committee chairmanship and membership, as well as certain roles including the SID, SRD and designated NED to represent the views of the workforce. In doing so, we considered whether NED fees were at an appropriate level, having regard to factors including the associated time commitments for INEDs and benchmarking against peers. In light of this, increases to the SID fee, and the introduction of a fee for the role of SRD and designated NED to represent the views of the workforce were approved. Further details are set out in the Remuneration Implementation Report.

Priorities for 2021

Over the next year we will continue to work on talent and succession planning, in particular on executive and senior management succession, ensuring we have a strong pipeline for senior management positions, as well as focusing on NEDs' continuing development. We will place particular focus on the integration and orderly transition of new Board and senior management members, ensuring that Board and senior management dynamics remain appropriate.

We will also undertake an external evaluation of the Board and Board Committees' effectiveness.

Governance Committee membership

On 28 April 2020, Bruce Carnegie-Brown replaced Ana Botin as the GNED on the Committee. Subsequently, on 30 September 2020, Scott Wheway ceased to be a member of the Committee, following his decision to step down from the Board. I joined the Committee on 1 October 2020 and became Chair of the Committee on 1 November 2020, following Shriti Vadera's departure, and Ed Giera became a member on 16 October 2020. I would like to thank Ana Botin, Shriti Vadera and Scott

Wheway for their service on behalf of the Committee and welcome Bruce Carnegie-Brown, and Ed Giera to the Committee.

I believe that the Committee retains an appropriate balance of skills and expertise to carry out its role effectively.

Details of other Board Committee chairmanship and membership changes are detailed in each of the respective Committee reports.

Effectiveness of the Committee

The Committee's performance was assessed as part of the Board's evaluation process in the year. Results were shared with the Committee Chair and then considered by the Committee. The review highlighted that the Committee continues to perform effectively, and the areas identified for enhancement have already been completed.

Board Effectiveness

In April 2020, an internal review of Board Effectiveness was facilitated by Lintstock, focused on the Board's performance in 2019 as well as capturing matters pertaining to 2020. Individual Directors' assessments were also conducted. The review concluded that the Board and its Committees continue to perform effectively. The Committee reviewed with the Board the areas for greater focus identified by the effectiveness review and recommended actions (including 2020 related actions) which are now underway. Those areas included: executive and board succession planning, transformation, dynamics between Board and executive, financial crime and customer focus. With my arrival in November 2020, the SID will undertake his twice-yearly assessment of my performance in 2021.

Following a number of Board membership changes in the year as described earlier, the Committee determined that an external evaluation of the operation of the Board and Board Committees will be conducted at the end of 2021. Whilst this is later than the normal cycle, it is designed to allow new Board members to transition and for new Board processes to be established, giving more meaningful observations for the ongoing operational effectiveness of the Board.

Terms of Reference

The Terms of Reference are regularly reviewed by the Committee to make sure they continue to be appropriate. The Committee's Terms of Reference are available at www.aboutsantander.co.uk.

Board Risk Committee Chair's report



The Committee supports the Board in ensuring that the business operates within agreed Risk Appetite while reviewing the capability to identify and manage new and emerging risks.



We counselled management on the need for a dynamic assessment of credit risk following industry or market responses to emerging risks, including Covid-19 and climate change.

Ed Giera

Board Risk Committee Chair
2 March 2021

Role and Responsibilities

Advise the Board on the enterprise wide risk profile, Risk Appetite and strategy.

- Review the enterprise wide risk profile through business updates from the First Line of Defence and regular reports and updates on each key risk type from the Second Line of Defence.
- Provide advice, oversight and challenge to embed and maintain a supportive risk culture.
- Review the Risk Framework and recommend it to the Board for approval.
- Review and approve the key risk type and risk activity frameworks identified in the Risk Framework.
- Review the capability to identify and manage new risks and risk types.
- Oversee and challenge the day-to-day risk management actions and oversight arrangements and adherence to risk frameworks and policies.

Overview of the year

2020 was an unprecedented year for the Committee mainly due to the risks facing our business from Covid-19. The Committee considered a wide range of current and emerging risks to our customers and our business including:

- Covid-19 impact on our people and operating model
- Operational risks, resilience of systems to fraud, and third party risks
- Capital and liquidity
- Conduct and Prudential risks
- Credit, both retail and commercial
- Santander Services including data integrity and security, cyber risks and risk infrastructure
- Initial development of climate change risk appetite
- Brexit.

We reviewed the top risks at each meeting and also received regular updates on key emerging risks, principally driven by the Covid-19 pandemic, such as stress testing in response to the economic recovery, rapid technology change, changing customer behaviour, climate change risk, LIBOR transition, market risk, pension risk and business risk reviews.

The Board Risk Committee maintains a holistic view of Enterprise-Wide risks and, to help achieve this, there is appropriate cross-membership between this Committee and both the Board Responsible Banking Committee and the Board Audit Committee.

Whilst the Board Responsible Banking Committee has oversight of financial crime risk, the Board Risk Committee retains ultimate oversight of risk appetite with respect to conduct, regulatory, reputational and financial crime risks.

Committee membership and attendance

Read more on **p73**

Board Risk Committee Chair's report continued

Summary of 2020 outcomes

The Committee addressed our key responsibilities relating to Risk Appetite and the Risk Framework, our oversight of capital and liquidity stress testing, and raised challenges relating to areas of focus and risk categories. Many of the risk categories had been significantly impacted by Covid-19. For more on our responsibilities relating to risk management and internal controls see the section 'Other areas of focus' that follows.

Significant areas of focus

Area of focus	Action taken by the Board Risk Committee	Outcome
Risk Appetite	<ul style="list-style-type: none"> – Considered a number of changes proposed to the Board's Risk Appetite Statement as part of the Annual Risk Appetite Review. – Challenged management on the risk appetite for Crown Dependencies, specifically concentrations for buy-to-let and interest only, were appropriate and proportionate for the size of the geography. – Reviewed management progress on the development of climate change risk appetite. – Discussed the economic downturn and the impact on risk limits. – Challenged management on the controls in place to identify and mitigate concentration risk in deposit gathering units by geography and business line. – Monitored management progress on addressing financial crime risk exposure relative to risk appetite. – Requested the development of a set of measures to improve the Committee's oversight and monitoring of and the concentration of deliverables to support prioritisation and input to change risk. 	<ul style="list-style-type: none"> – Following challenge, recommended management's proposed changes to Risk Appetite to the Board for approval. – Noted and were satisfied with the proposal to reduce the risk appetite limit for annual operational risk losses. – Continued to assess management's progress relative to Risk Appetite in the context of the Financial Crime Transformation Programme and Controls Acceleration Programme to enhance the Financial Crime control framework. <p>For more, see 'Risk Appetite' in the 'Risk governance' section of the Risk review.</p>
Risk Framework	<ul style="list-style-type: none"> – Reviewed and adopted management changes to the Risk Framework to include the broadening of the scope of climate change risk and the inclusion of the Ring-Fenced Bank Risk Officer role. – Received an update on the annual certification process and assessed the extent to which the Risk Framework had been effectively implemented and embedded across the business. – Received management's proposal for changes to the suite of Risk Type and Risk Activity Frameworks and their delineation between Santander UK Group Holdings plc and Santander UK plc. – Received management's proposal to amalgamate the Banking Market and Market Risk Frameworks into a single framework, the Structural and Market Risk Type Framework. 	<ul style="list-style-type: none"> – Noted the enhanced responsibilities to be included in the Chief Financial Officer. role profile, and discussed the measures intended to increase capital efficiency and recycling. – Received the Risk function's confirmation that the Risk Framework had embedded the ring-fencing changes. – Noted there was transparency and ownership of areas for improved compliance. – Recommended the proposed changes to the Board for approval. <p>For more, see 'Risk Framework' in the 'Risk governance' section of the Risk review.</p>
Stress testing	<ul style="list-style-type: none"> – Monitored the 2020 Bank of England Concurrent Stress Test exercise and received updates throughout the process. – Noted the development plans in place to improve existing and to develop new models. – Noted that risks associated with Santander UK's suite of stress testing models had generally improved across the last year. 	<ul style="list-style-type: none"> – Recommended the governance, process, controls and stress test results to the Board for approval and onward submission to the PRA. – Committee members were provided with greater insight to adaptations to model plans, particularly for Internal Ratings Based and IFRS 9 and response to Covid-19. – Supported management in determining the approach to climate change risk stress testing. <p>For more, see 'Stress testing' in the 'Risk governance' section of the Risk review.</p>

Area of focus	Action taken by the Board Risk Committee	Outcome
Santander Services (Technology & Operations)	<ul style="list-style-type: none"> – Challenged management to decide on how best to report on enhancements needed to improve connectivity between Santander Services and business units, specifically in relation to skills and resourcing needs. – Requested that reporting enables the Committee to have appropriate oversight on cultural change. – Received update on actions being taken by management to enhance the approach to, and capability of, Third Party Risk Management including the establishment of a centre of excellence and exploring opportunities to consolidate and streamline the certification of external suppliers, particularly those that provide services across the business. – Continued discussions with management on Data Management risk and the progress being made to identify and manage key risks such as data quality and data lineage. – Received updates on cyber risk and the strategy and risk management relating to cloud usage. – Continued discussions with management about the execution risks, and benefits, associated with a migration away from existing technology and risk infrastructure. Emphasised the need for Board-level involvement as well as alignment with Banco Santander group in the associated debate and decisions impacting data management and key systems architecture. – Received substantive updates on Bank-wide Risk Infrastructure Management and the ongoing monitoring of IT obsolescence and data. – Assessed the impact of Covid-19 on key Bank-wide Risk Infrastructure Management projects. – Received updates on third party supplier risks and supported management's efforts to ensure successful embedding and awareness of third party risk management across the workforce. – Received regular updates from the Chief Operating Officer. 	<ul style="list-style-type: none"> – Noted the progress made by management to improve risk management capability within Santander Services and the improved clarity of management's reporting to the Committee more generally. – Noted the three-year Cyber Transformation Programme and associated investment had contributed to enhancing Cyber security, including augmenting fraud detection capability across the business. – Supported the implementation of a data governance model. – Took comfort from the process by management to distribute ownership and accountability for data integrity and observed that data structure and legacy systems architecture were key areas of focus to improve data quality. – Noted the progress on the Cyber investment plan and the Bank-wide Risk Infrastructure Management programme and the overall execution risk status.
Brexit	<ul style="list-style-type: none"> – Received regular updates on management's contingency plans. – Continued to monitor the risks and potential impact to Santander UK of alternative scenarios following the transition period. – Noted management actions to enhance infrastructure, improve data and respond dynamically to reflect local regulations in overseas jurisdictions. – Reviewed and supported the decision on retaining passive servicing of EEA customer accounts. – Requested management to consider how business customers would be supported with the changes to supplier payments. – Considered the risk of greater regulatory misalignment between the UK and the EU both in the near-term and in the longer-term. – Emphasised the need for coordination with Banco Santander on any actions taken impacting customers and our employees working in the UK as EU nationals, in particular. 	<ul style="list-style-type: none"> – We continue to monitor political developments, and to review and challenge management's contingency plans and post transition control framework for Brexit. <p>For more, see the 'Operational risk' section of the Risk review.</p>
Ring-fencing	<ul style="list-style-type: none"> – Received frequent updates on the ring-fencing programme both as part of the Enterprise Wide Risk Management Reports and separately. These updates focused on the programme's top risks and mitigating actions, including operational, legal, execution and regulatory risks related to completion of the programme. – Received the annual Ring-Fenced Body Permitted Exceptions and Arm's Length policies and associated reports from Internal Audit. We noted the governance and waterfall of attestation processes and management's increasing awareness of ring-fencing related compliance obligations. 	<ul style="list-style-type: none"> – In the course of monitoring progress on the execution of the ring-fencing programme, we agreed to the appointment of a Ring-Fenced Bank Risk Officer role, subject to regulatory approval. – Recommended the Ring-Fenced Body Permitted Exceptions Policy and the Arm's Length Policy to the Board for approval.

Board Risk Committee Chair's report continued

Oversight and advice to the Board on Santander UK's current risk exposure and future risk strategy

In 2020, we reviewed Santander UK's exposure to the risks outlined below and analysed emerging themes, including regulatory, macroeconomic and global risks, which could affect Santander UK's ability to achieve its strategic goals.

Risk	Action taken by the Board Risk Committee	Outcome
Credit risk	<ul style="list-style-type: none"> – Received regular credit risk updates across Retail Banking, Corporate & Commercial Banking and Corporate Investment Banking businesses. – Examined the impact of Covid-19 on the credit and collateral quality of affected customers, including sector deep dives of our businesses. – Received updates on the retail mortgage book, including interest-only and buy-to-let mortgages. – Monitored concentration risks, reviewed growth strategies and challenged management in relation to the Consumer Finance business. – Discussed how the Covid-19 crisis was expected to accelerate structural shifts in certain industry sectors and the potential impact from a credit risk perspective, in particular the Retail and Real Estate sectors. – Reviewed the impact of Payment Holidays on credit risk and the suppression of collection activities on non-performing loan stock. – Considered the process and support for customers on Payment Holidays. – In relation to the construction and associated support sectors, we noted the progress made by management to implement risk management, including control enhancements, adjustments to limits and exposures, corporate credit monitoring and approval processes, and operational procedures for delivering supply chain financing and receivables purchase products. 	<ul style="list-style-type: none"> – Counselling management on the need for a dynamic assessment of credit risks following Covid-19 and industry or market responses to emerging risks, including climate change. <p>For more, see the 'Credit risk' section of the Risk review.</p>
Strategic risk	<ul style="list-style-type: none"> – Considered strategic risk as part of risk reports on M&A opportunities, Data, Change and Operational Risk. – Discussed the value to the Company of being part of Santander Group. – Discussed the Company's agility to be able to adapt quickly to changes in the market, including the acceleration of digital technologies. 	<ul style="list-style-type: none"> – Encouraged Management to continuously re-evaluate the strategy in order to be responsive to the changing competitive environment. <p>For more, see the 'Strategic risk' section of the Risk review.</p>
Pension risk	<ul style="list-style-type: none"> – Received regular updates on pension risk. – Discussed the volatility in both the funding position and the IAS 19 accounting position. – Noted that market uncertainty had increased volatility of credit spreads, however, the asset de-risking and hedging programme completed by management had mitigated the impacts on pension risk metrics. 	<ul style="list-style-type: none"> – Supported the enhancements of the governance arrangements with the trustees. – Encouraged management to continue working with the Trustees on a framework that would enable timely and efficient execution of asset allocation and risk management decisions. <p>For more, see the 'Pension risk' section of the Risk review.</p>
Liquidity risk	<ul style="list-style-type: none"> – Reviewed the Internal Liquidity Adequacy Assessment Process (ILAAP) and noted material enhancements to the previous process made by management. – Questioned management about material liquidity stress test assumptions, and the flexibility and timeliness of our liquidity reporting. – Received half yearly updates on asset and liability management activities and confirmed the liquid asset buffer portfolio remained within risk appetite, and appropriately hedged against duration risks and LIBOR decommissioning risks, respectively. 	<ul style="list-style-type: none"> – Agreed to recommend the 2020 ILAAP to the Board for approval following review and challenge. <p>For more, see the 'Liquidity risk' section of the Risk review.</p>

Risk	Action taken by the Board Risk Committee	Outcome
Capital risk	<ul style="list-style-type: none"> – Considered, from a capital risk perspective, dividends payable on the ordinary dividends proposed to be paid by Santander UK Group Holdings plc and Santander UK plc for the year-end. – Reviewed and approved the changes proposed to the Surplus Capital Allocation Framework which allowed for the identification of surplus capital. – Reviewed the Internal Capital Adequacy Assessment Process (ICAAP) and noted material enhancements to the previous process made by management. – Received updates on a new internal rating based (IRB) regulatory capital model for the mortgage book. 	<ul style="list-style-type: none"> – Recommended the payment of dividends to the Board for approval, subject to final determinations on capital distributions by the regulator. – Comments and challenges received from Committee members were considered by management and incorporated into the final draft ICAAP. – Agreed to recommend the ICAAP to the Board for approval following review and challenge. <p>For more, see the 'Capital risk' section of the Risk review.</p>
Operational risk	<ul style="list-style-type: none"> – Noted the emerging risk associated with Covid-19 and considered the actions being taken by management with respect to business continuity, credit sanction policy, supply chain as well as sector and single name exposures. – Discussed the operational risk & resilience challenge to the business, particularly those relating to our working from home model. – Received Operational Risk updates within Enterprise-wide Risk Management as well as Operational Resiliency, Data Centre Resilience and Change Risk. – Received regular updates on management's strategies for mitigating cyber risk and third party risk. – Reviewed steps being taken to manage the additional operational risks caused by the Covid-19 pandemic. – Discussed the current residual risks for the extended Working From Home operating model adopted as a result of Covid-19 pandemic. – Reviewed the increase in operational risk incidents and the impacts on our own customers, as well as any lessons that could be learned. – Noted the enhancements to programme management disciplines around change and considered third party risk and dependence on key suppliers. – Highlighted the elevated risk presented by the confluence of regulatory change requirements, change risk more generally and organisational capacity and capability programme. – Considered and noted good progress on the LIBOR transition. 	<ul style="list-style-type: none"> – Monitored the impacts on operational risk and key controls associated with management's execution of the high volume of significant transformation and remediation programmes. – Acknowledged management had enhanced operational resilience and implemented effective crisis management protocols. – Assessed and challenged the progress being made by management in the management of operational risk incidents. – Considered an update on the regular monitoring of capital adequacy models. – Received an update on the regulatory review of key mortgage and corporate IRB models. – Considered the implications of differing regulatory perspectives on through-the-cycle capital requirements of the Bank of England and the ECB, respectively. <p>For more, see the 'Managing LIBOR transition' case study in the 'Market risk' section of the Risk review.</p>
Model risk	<ul style="list-style-type: none"> – Considered an update on the regular monitoring of capital adequacy models. – Received an update on the regulatory review of key mortgage and corporate IRB models. – Considered the implications of differing regulatory perspectives on through-the-cycle capital requirements of the Bank of England and the ECB, respectively. – Reviewed management's short, medium, and long term approaches to model data time series and model recalibration in the wake of Covid-19 impacts. 	<ul style="list-style-type: none"> – The Committee will continue to monitor progress in respect of regulatory initiatives for IRB models, and request evidence of appropriate model types, assumptions, data integrity, and calibration. <p>For more, see the 'Model risk' section of the Risk review.</p>

Board Risk Committee Chair's report continued

Other areas of focus

Effectiveness of risk management system and internal controls

The Committee considered, as part of the Operational Risk Profile & Analysis update, the results of the 2019 year end Risk and Control Self Assessment (RCSA). This highlighted the risk and exposure issues reported through the RCSA processes.

Based on our assessments of the risk and exposure issues reported, we considered the continued increase in critical and high risks, however, we were satisfied that overall critical and high risks were well managed via risk mitigation and reassessment processes, respectively. The remaining high risks related mainly to third party provider IT disruption and making sure third party providers are contracted to meet ring-fencing requirements.

Whilst the self-assessment acknowledged a number of control weaknesses, in particular for Financial Crime, we were satisfied that appropriate actions were planned and being progressed by management to address these. Management had undertaken significant work through the Financial Crime Transformation Programme (the FCTP) and the establishment of a Controls Acceleration Programme (CAP) to enhance the financial crime control network. To mitigate risk, steps were being taken to assess the impact of integrating CAP changes into business as usual activity.

The volume of change expected to be implemented in such a concentrated period of time presented a meaningful challenge for the Financial Crime function, however, and this necessitated a review of the resources needed. We continue to monitor the exposure, including with respect to overall risk appetite.

The Committee received reports on management's strategic plan for investment prioritisation. The Committee continues to review management's reports on the execution of the overall bank-wide risk infrastructure investment programme and the effectiveness of controls and improvements driven by the programme over the investment period.

Change Programme

The Committee maintained its oversight of the changing scale, scope and critical nature of the various change initiatives undertaken by Santander UK to meet regulatory and other requirements that continued to pose significant risk in 2020. The impact of Covid-19 had necessitated some reprioritisation of change initiatives, in agreement with regulators, to ensure continuity of service support to customers.

Reports from the Chief Operating Officer's and Operational Risk identified similar themes with respect to root cause issues underpinning the execution of change programmes.

The Committee sought assurance around the aggregate risk of, as well as the capacity for delivering, the change programme.

The Committee had expressed concern at management's capacity to effectively resource and execute the number of strategic transformation programmes in progress concurrently with the execution of regulatory change requirements including Covid-19 Government initiatives.

The Committee noted the plans to improve management information to execute the implementation of complex and often time critical and interdependent deliverables.

Priorities for 2021

In 2021, we will monitor the ongoing impact of Covid-19 on the credit risk profile, capital and liquidity adequacy and conduct risk, with respect to the Government sponsored recovery loan programs.

Data, cyber, third party, operational resilience and other IT-related operational risks will continue to be a priority, including the adoption of cloud services.

We expect to review continuing developments related to Brexit and the changes to the UK's political, economic, and regulatory relationships with the EU.

We will also review and consider Santander UK's risk framework and risk appetite for financial crime and climate-related financial and strategy risks.

Governance

Committee membership

There were no changes to the membership of the Committee in the year. The Committee welcomed the appointment of a new Chief Risk Officer.

The Terms of Reference require the majority of the members to be Independent Non-Executive Directors. This criterion was met throughout the year.

Effectiveness of the Committee

I believe that the Committee has an appropriate mix of skills to enable it to operate effectively and to offer appropriate challenge and support to management.

In December 2020, we reviewed the Committee's responsibilities as set out in the Terms of Reference and confirmed that including the impacts from Covid-19, the Committee had discharged its responsibilities in full in 2020.

The Committee's performance was assessed as part of the Board's evaluation process during the year. The results were considered by the Committee, with some actions agreed as a mechanism for continuous improvement and to keep areas for development in focus.

We continued to receive regular reports on enterprise wide risk and to call risk owners to our meetings to account for their progress. We have benefited from the perspectives of each of the three lines of defence to gain assurance and confirm progress in respect of material initiatives intended to mitigate key risk exposures.

These actions are examples of how we have looked to inform our debate and decision making in the year and contribute to our effectiveness as a Committee

Terms of Reference

The Terms of Reference are regularly reviewed by the Committee to ensure they continue to be appropriate. The Committee's Terms of Reference are available at www.aboutsantander.co.uk.

Board Audit Committee Chair's report



In 2020, the principal challenge for the Committee comprised the assessment of the appropriateness of significant management judgements, disclosures and financial reporting arising from Covid-19, within an environment that has seen an unprecedented shift to remote working and the associated incremental risks this entails.

Chris Jones

Board Audit Committee Chair
2 March 2021

Committee membership and attendance

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Our responsibilities include oversight of the integrity of financial reporting and controls, the effectiveness of our internal audit function, the relationship with the external auditors and the adequacy of our whistleblowing arrangements

Role and responsibility

The Committee provides oversight of the:

- integrity of the financial statements of the Company and any formal announcements relating to its financial performance, including significant financial reporting judgements.
- effectiveness of internal financial controls.
- relationship with the external auditors including their independence and objectivity, audit scope and effectiveness of the audit process in respect of the statutory audit of the annual financial statements.
- effectiveness of the internal audit function.
- whistleblowing arrangements.

In exercising this responsibility, the Committee recognises that certain matters with respect to Santander UK plc and its subsidiaries are reserved exclusively to the decision-making authority of the Santander UK plc Board of Directors and its committees.

Overview of the year

In 2020, the main activities of the Committee included:

Financial reporting:

- Assessing the appropriateness of key management judgements and estimates and related reporting each quarter.
- Monitoring our Expected Credit Loss provisioning under IFRS 9, particularly as a result of the impact of Covid-19 and Brexit on the macroeconomic scenarios and their weightings; reviewing the staging of impaired loans; assessing the impact of payment holidays, including related PRA guidance; considering any post model adjustments, particularly those designed to adjust model results in response to the unusual economic environment due to Covid-19; focusing on disclosure enhancements and reviewing plans for further tactical and strategic IFRS 9 model development.
- Monitoring the provisions for and disclosure of PPI-related matters considering a number of factors, including the run-off of claims post the

PPI deadline expiry and the potential for future Plevin/RND legal claims.

- Considering our conduct risk exposures, including any associated provisioning and contingent liability disclosures, and challenging management's estimates.
- Reviewing the actuarial assumptions of the pension scheme accounting valuation, with particular focus on discount rates impacted by stressed markets and the risk of impairment to private equity, real estate and infrastructure assets.
- Considering the assessment of goodwill due to reduced profitability in the Covid-19 impacted economic environment.

Other key areas:

- Providing oversight on the adequacy and effectiveness of internal controls over financial reporting including: overseeing the enhancement of the SOx independent testing framework; reviewing the adequacy of data lineage; and assessing potential risks arising from the Covid-19 related remote working of staff.
- Overseeing the performance of the Internal Audit function, including their consideration of the potentially enhanced risks arising from remote working as well as overseeing the succession of the incumbent Chief Internal Auditor.
- Continuing oversight of interaction with our External Auditors including rotation of the partner team, selection of a new lead engagement partner for 2021, their increasing use of IT and monitoring their ability to audit remotely.
- Overseeing Santander UK's whistleblowing arrangements including the effectiveness of a largely new team.
- Reviewing management's progress in implementing the incoming Resolvability Assessment Framework.
- Reviewing the UK taxation strategy.

We also addressed other responsibilities delegated to the Committee by the Board.

Board Audit Committee Chair's report continued

Summary of 2020 outcomes

Significant financial reporting issues and judgements

The use of assumptions or estimates and the application of management judgement is an essential part of financial reporting. In 2020, we focused on the following significant reporting matters in relation to financial accounting and disclosures:

Financial reporting issue or judgement	Action taken by the Board Audit Committee	Outcome
<p>Credit provisions Determining the appropriateness of credit provisions is highly judgemental requiring management to make a number of assumptions. This has been impacted further during the year as a result of the Covid-19 pandemic.</p>	<p>Covid-19 impact</p> <ul style="list-style-type: none"> – Noted that applying management judgements on IFRS 9 ECL provisioning was highly difficult given the unusual and unique circumstances as a consequence of Covid-19. – Noted the importance of being as alert to over provisioning as to under provisioning. – Reviewed the fully updated macroeconomic scenarios and weights on a quarterly basis which captured a wide range of potential outcomes for the UK economy since the outbreak of Covid-19. – Noted that there was model risk around the underlying economic modelling in respect of the IFRS 9 ECL provisioning models in the context of the very significant required judgements. – Considered management's compliance with both regulatory guidance in relation to the treatment of payment holidays and accounting guidance published during 2020. 	<ul style="list-style-type: none"> – Agreed additional disclosures to provide clarity on management judgements. – Satisfied ourselves that the robustness of the process used to arrive at the management judgements as well as with the management judgements themselves. – Endorsed the quarterly updates to the macroeconomic scenarios and weights. – Agreed to continue monitoring the IFRS 9 ECL models for the reasonableness of the outputs in future periods. – Agreed management's approach on applying additional Post Model Adjustments (PMAs) to supplement the IFRS 9 ECL models due to Covid-19. <p>See the 'Credit risk' section in the Risk review.</p> <p>See 'Critical judgements and accounting estimates' in Note 1 to the Consolidated Financial Statements.</p>
	<p>Retail credit provisions</p> <ul style="list-style-type: none"> – Reviewed detailed reports from management throughout the year analysing the proposed provisions by key product. – Considered management's proposals to apply a PMA to the mortgage model to transfer a proportion of Stage 1 loans into Stage 2 where our discussions with retail customers on a Covid-19 payment holiday established they may be in longer-term financial difficulties. – Considered management's proposals to apply a PMA to mitigate the risk of the mortgage model underestimating ECL. 	<ul style="list-style-type: none"> – Agreed with management's judgement on the level of retail credit provisions, concluding that provisions remain robust and assumptions were appropriate. – Agreed with management's proposals to apply PMAs to the mortgage model. – We will continue to monitor retail credit provisions. <p>See 'Critical judgements and accounting estimates' in Note 1 to the Consolidated Financial Statements.</p> <p>See Note 13 to the Consolidated Financial Statements.</p>
	<p>Corporate credit provisions</p> <ul style="list-style-type: none"> – Reviewed detailed reports from management throughout the year to satisfy ourselves that any Significant Increase in Credit Risk triggers had been correctly identified. – Considered management's proposals to apply a PMA to transfer loans for some corporate and SME sectors and clients who have been severely impacted because of Covid-19 from Stage 1 into Stage 2 or from Stage 2 into Stage 3. – Considered management's proposals to apply a PMA to mitigate against the risk of a single name exposure with an ECL requirement of greater than £10m defaulting, which has not been covered by the existing model estimate or the corporate and SME PMA above. 	<ul style="list-style-type: none"> – Agreed with management's judgement on the level of corporate credit provisions, concluding that provisions remain robust and assumptions were appropriate. – Agreed with management's proposals to apply PMAs to the corporate model. – Acknowledged management's approach of performing a significant amount of internal sector and counterparty assessments on the corporate portfolio. – We will continue to monitor corporate credit provisions. <p>See 'Critical judgements and accounting estimates' in Note 1 to the Consolidated Financial Statements.</p> <p>See Note 13 to the Consolidated Financial Statements.</p>

Financial reporting issue or judgement	Action taken by the Board Audit Committee	Outcome
<p>Conduct and regulatory provisions</p> <p>The provision for conduct and regulatory remediation activities continued to be highly judgemental and requires significant assumptions including Plevin in scope rates.</p>	<ul style="list-style-type: none"> – Continued to scrutinise the level and adequacy of conduct provisions and challenged the reasonableness of management's assumptions throughout the year. In respect of non-PPI matters, the Committee: <ul style="list-style-type: none"> – Reviewed management's judgements and estimates in respect of the level of provision. – Considered disclosures on the Cologne CPO and German FTO ongoing investigation into our historical involvement in German dividend arbitrage trades. – Considered potential risks arising from anti-money laundering and financial crime systems and controls and our regulator's focus on this area and concurred with management's proposed disclosures. In respect of PPI, mainly Plevin, the Committee: <ul style="list-style-type: none"> – Monitored the discussion and progress made with a third party over the liability under an indemnity. – Reviewed management's judgements and estimates in respect of the level of provision for potential future Plevin/RND legal claims. 	<ul style="list-style-type: none"> – Agreed with management's judgement on the level of conduct provisions and disclosures, including PPI, mainly Plevin, and other products. – Endorsed management's recommendation that no additional charges should be made for PPI BAU matters in 2020. – Endorsed the proposed year-end disclosures relating to German dividend arbitrage trades and anti-money laundering and financial crime systems and controls matters. <p>See 'Critical judgements and accounting estimates' in Note 1 to the Consolidated Financial Statements.</p> <p>See Note 29 to the Consolidated Financial Statements.</p>
<p>Pension obligations</p> <p>Significant judgement is required on the key assumptions underlying defined benefit pension obligation calculations. Outcomes remain inherently uncertain.</p>	<ul style="list-style-type: none"> – Reviewed detailed reports throughout the year on key assumptions underlying the defined benefit pension obligation calculations. We recognised that, although some assumptions are based on observable data, others continue to require significant judgement. – Noted actuaries continue to review our best estimate of pension liabilities under IAS 19. – Reviewed the approach and outcome of illiquid assets valuation. – Reviewed the proposed update to the long-term improvement mortality assumption to reflect the Continuous Mortality Investigation (CMI) 2019 projections model. – Reviewed the change proposed to the Consumer Price Index (CPI) inflation assumption. – Reviewed the regulatory capital impact of the change. – Monitored the continued appropriateness of the methodology and reviewed the inflation, discount and mortality rates applied at the year-end. 	<ul style="list-style-type: none"> – Agreed with management's conclusion on illiquid assets revaluation. – Agreed with management's approach to the assumptions applied, including changes made on long-term improvement mortality assumption and CPI inflation assumption in 2020. – Endorsed the proposed quantitative and qualitative year-end disclosures in respect of pension obligations. <p>See 'Critical judgements and accounting estimates' in Note 1 to the Consolidated Financial Statements.</p> <p>See 'Pension risk management' in the Risk Review.</p> <p>See Note 30 to the Consolidated Financial Statements.</p>
<p>Other areas</p>	<ul style="list-style-type: none"> – Reviewed the outcome of the management's going concern assessment in light of Covid-19. – Reviewed the outcome of management's assessment of any potential impairment of goodwill and investment in subsidiaries, and noted the decrease in 'headroom' arising from reduced expected future profitability in the current Covid-19 impacted economic environment. – Received regular reports on any material litigation cases and their progress, as part of our consideration of provisions and contingent liabilities and monitored the appropriateness and transparency of disclosures. 	<ul style="list-style-type: none"> – Agreed with management that the going concern basis of accounting remained appropriate at 31 December 2020. – Agreed with management no impairment to either goodwill or the carrying value of investment in subsidiaries should be recognised in 2020 and also considered the required increased sophistication of the assessment process and disclosures as a result of the lower headroom. – Endorsed management's recommended accounting and disclosure in relation to litigation. <p>See Notes 29 and 31 to the Consolidated Financial Statements.</p>

Board Audit Committee Chair's report continued

The Committee's focus continues to be on areas of significant judgement which pose the greatest risk of a material financial statement misstatement.

In addition to the areas set out in the preceding table, the Committee also considers other higher risk items. For 2020, these included the identification and assessment of risks of material misstatement due to fraud or error and the controls over calculation of risk-weighted assets. The Committee commissioned an external review of regulatory reporting, including consideration of the main controls over the completeness and accuracy of the main COREP returns and the appropriateness of key interpretations and judgements, with a focus on capital and risk-weighted assets. The Committee also reviewed the processes and governance in respect of the preparation of additional capital and risk management disclosures. The Committee monitored the increased risk arising from widespread and sustained remote working of staff due to Covid-19. We also received regular reports on any material litigation cases and their progress, as part of our consideration of provisions and contingent liabilities.

External Auditor

We continued to develop and oversee the interaction with PwC following their appointment in 2016. The independence of PwC was considered and monitored throughout the year. The Committee satisfied itself that PwC had met the independence requirements.

Jon Holloway will complete his fifth year as lead audit engagement partner and will rotate off the PwC audit engagement team in March 2021. Accordingly, during 2020, the Committee oversaw the process to select his replacement, Laura Needham. As part of our broader oversight of the PwC partner team, the Committee also considered the rotation of Hamish Anderson, a Key Audit Partner, during 2020 after four years and his replacement by Heather Varley.

Oversight of the relationship with our External Auditors

As part of our review of our relationship with PwC, our activities included:

- Consideration of their work and opinion relating to management judgements.
- Discussion of the impact of Covid-19 and remote working on their audit work and interaction with management.
- Consideration of the summary of misstatements not corrected by management. The Committee was satisfied that they were not quantitatively or qualitatively material,

either individually or in the aggregate at each quarter.

- Discussion on the level of disclosure in the Annual Report and Half Yearly Financial Report to satisfy ourselves that it is appropriate.
- Discussion of developments in financial reporting including changes to statute, accounting standards and best practice.
- Review of PwC's reports on findings and recommendations on internal control and financial reporting matters identified during their audit and their view of management's progress in resolving them.
- Received a briefing on PwC's increasing use of technology in their audit work.
- Interactions, including meetings in private session during each Committee meeting, and at other times throughout the year.
- Noted the latest results of the FRC's quality inspection, and enquired into the results of any internal and external audit quality reviews of Santander UK.
- Considered Santander UK specific independence issues, as well as the PwC firmwide transparency report.
- Considered the FRC's Audit Quality Inspection Report published in July 2020 and audit quality indicators as part of our annual assessment of PwC's performance.

Based on the above inputs, which were captured in a formalised assessment, the Committee satisfied itself as to the rigour and quality of PwC's audit process.

Non-audit fees

We have a robust policy on non-audit services provided by our External Auditors, which was updated in 2020 in the context of the Revised Ethical Standard issued by the FRC in December 2019.

Non-audit services were under continuous review throughout 2020 to determine that they were permitted by reference to their nature, assessing potential threats and safeguards to auditor independence as well as the overall ratio of audit to non-audit fees.

All assignments require advance approval, either by the Chair (or in his absence his alternate), under delegated authority for amounts under £250,000 plus VAT or, if larger, by the full Committee. This process is in addition to the requirement for all non-audit fees to be approved by the Banco Santander Audit Committee.

The fees for non-audit work performed by PwC in the year, which are disclosed in Note 7 to the Consolidated Financial Statements, mainly comprised audit-related assurance services relating to the

support of various debt issuance programmes. We ensured that these met the external and internal tests for maintaining their independence, including evidence of their professional scepticism. During 2020, Santander UK paid a fee of £1.4m to PwC in relation to incremental work undertaken in support of their audit of Banco Santander SA.

In 2020, PwC's non-audit related fees were 34% of their total audit fees, well within the internal cap of 70% approved by the Committee.

Fees for non-audit work performed by PwC in the year, other than those in relation to audit-related assurance services, were 4.3% of the average of the fees approved for Deloitte, EY and KPMG.

Internal controls

The Board Risk Committee has overall responsibility for the effectiveness of the internal control systems. However, due to the nature of internal control matters, there is a degree of overlap in responsibilities with those of this Committee, particularly regarding financial reporting controls.

Section 404 of the Sarbanes-Oxley Act requires management to report on the design and effectiveness of its internal controls over financial reporting (ICFR) framework. During 2020, the framework was further enhanced.

We considered the financial control environment in the year. Finance and our External and Internal Auditors provided regular reports to the Committee on ICFR, including key systems, and provided feedback on remediation and overall improvements required to ensure that the relevant controls were appropriately designed and operating effectively. Management also provided presentations to the Committee concerning their actions in response to External and Internal Audit recommendations. This included access management, end user computing, controls over IFRS 9 and the Client Assets control environment.

Disclosure in the Annual Report

We received reports from the Disclosure Committee in respect of each quarterly financial report, a senior executive committee chaired by the CFO. Its remit is to advise the Committee on the completeness and accuracy of disclosures in Santander UK's external reporting. This, together with other reports received in the year, and a review of best practice and the approach of our peers, enabled us to conclude that we were satisfied with the disclosures in this Annual Report.

Management also engaged the Board and Committee early on concerning the approach to the report which enabled us to provide input into the overall tone and messaging in a timely manner.

Fair, balanced and understandable

The Disclosure Committee also reports on whether the Annual Report is fair, balanced, and understandable and whether it provides the information necessary for readers to assess Santander UK's position and performance, business model and strategy. In this context, the Disclosure Committee considered and advised us whether:

- Key messages remained consistent throughout the document, relating both to financial performance and progress against strategic priorities.
- All key judgements, significant risks and issues are reported and explained clearly and adequately.
- There is a clear framework to the document with good signposting and a complete picture of performance and events.

In addition to the above review process, the Committee's assessment of fair, balanced and understandable is underpinned by the understanding it gains through the reporting made to it throughout the year of management judgements, internal control matters, Internal Audit activities and the reports of the External Auditors.

The Committee's assessment also considers the robustness and outcomes of the assurance, review and verification processes conducted by management and considers whether the key risks reflected those that were of a concern to the Committee and were consistent with those reported by management.

Following our assessment we concluded that the 2020 Annual Report is fair, balanced and understandable.

Financial Reporting Council (FRC) Annual Review of Corporate Reporting 2020/21

In November 2020, the FRC issued a report which sets out its perspective on key developments for 2020/21 annual reports. As part of our oversight of this area, we received and reviewed a report from management on its work in respect of the areas of interest to the FRC. We are satisfied that management addressed the areas identified by the FRC in the preparation of this Annual Report to the extent appropriate to our ownership structure, including the impact of Covid-19 and Brexit on the operation of the Company as well as the content and detail expected in the section 172 statement in the Strategic Report, which describes how

the Board has had regard to a number of factors when working to promote the success of the business.

Alternative Performance Measures (APMs)

This Annual Report includes a number of financial measures which are not accounting measures within the scope of IFRS. Such non-IFRS measures are APMs and include financial measures of historical or future financial performance, financial position or cash flows that exclude or include amounts that would not be adjusted in the most comparable IFRS measures.

Management reviews these APMs in order to measure Santander UK's overall performance, position and profitability, as well as to show business growth excluding ring-fence transfers, and believes that their presentation provides useful information to investors on the Santander UK group.

Definition of these APMs and, where such APMs are adjusted, reconciliations to the nearest comparable IFRS measures are presented in 'Selected financial data' in the 'Financial review' section.

We reviewed the APMs and are satisfied that they continue to provide useful information to investors, and that management has clearly identified the APMs presented in this Annual Report and, where such APMs are adjusted, reconciled them to the nearest comparable IFRS measures. In addition, we challenged the number of adjustments made, and noted that management reduced them.

Going Concern

We satisfied ourselves that it is appropriate to use the going concern basis of accounting in preparing the financial statements, supported by a detailed analysis provided to the Committee by senior finance management.

As part of the assessment, we considered whether there are sufficient financial resources, including liquidity and capital, available to continue the operations of Santander UK. We considered Santander UK's resilience in the face of potential stress and prominent events including Covid-19. In making our assessment, we considered all information of which we were aware about the future, which was at least, but not limited to, 12 months from the date that the balance sheet was signed.

Viability Statement

The going concern assessment is further enhanced by the Viability Statement, in line with the UK 2018 Corporate Governance Code. This statement requires the

Directors to explain how they have assessed Santander UK's prospects, over what period they have done so and why they consider that period appropriate.

The full disclosures are included in the Directors' report and we have satisfied ourselves that a three-year time period for the viability statement remains appropriate.

Although the determination of longer-term viability for banks is of greater inherent uncertainty, banks are already subject to extensive regulatory measures including having to meet minimum capital and liquidity requirements as well as having to carry out stress tests. A time period of three years remains consistent with our planning horizon and that covered by regulatory monitoring and is consistent with the regulatory horizon.

Internal Audit

The Internal Audit plan, based on a comprehensive risk assessment, was presented in draft and then final form for challenge and approval by the Committee. The plan has been updated at regular intervals throughout the year in response to changes in the business and the regulatory environment and at the request of the Committee.

All unsatisfactorily rated audit reports issued were subject to additional scrutiny by the Committee with the relevant business areas being required to present their action plans to the Committee. Some audit reports rated needs improvement or satisfactory were also considered by the Committee on a sample basis.

We chose to invite management to present on progress with the implementation of Internal Audit's recommendations, issues encountered, key milestones and key dependencies.

We received regular reports on audit recommendations from our Chief Internal Auditor (the Head of Internal Audit), quarterly Internal Audit reports and monitored findings as part of our oversight. We considered the total number of recommendations, the rationale for any of them becoming overdue, and broader root cause analyses. The Committee also requested that the Chief Internal Auditor highlight recommendations becoming due and any that were past due.

We noted a strong engagement between Internal Audit and the business in 2020. The Committee was also pleased to note that in January 2020, Internal Audit was the winner of the Chartered Institute of Internal Auditors Audit & Risk Awards 2019 in the category of 'Outstanding Team - Financial Services Sector'.

Board Audit Committee Chair's report continued

The Committee monitored the impact of Covid-19 and the widespread remote working of staff including Internal Audit staff on execution of the Internal Audit plan.

We also oversaw the objective setting and performance evaluation of the Chief Internal Auditor. The Chief Internal Auditor, having completed his term of assignment, is due to return to Banco Santander in early 2021. The Committee oversaw the selection process for a new Chief Internal Auditor and satisfied itself as to his qualifications, experience and suitability for the role.

Internal Audit External Quality Assessment

In early 2020, the Committee reviewed the implementation of the remaining improvement opportunities identified in the External Quality Assessment of the Internal Audit function that was conducted in 2018. This review is conducted every five years and evaluates the Internal Audit function in respect of its conformance with the standards of the Chartered Institute of Internal Auditors (CIIA), as well as its performance and effectiveness in comparison to industry peers and good practice. The outcome of the review had been favourable with the function being compliant with the CIIA's Guidance on Effective Internal Audit in Financial Services – Second Edition and also benchmarked well against peers.

Whistleblowing

Santander UK recognises the importance of a culture where colleagues feel able to speak up. In 2020, management continued to embed within Santander UK the whistleblowing framework and arrangements under our oversight. This included recruiting a number of staff resulting in a largely new whistleblowing team.

We further consolidated operating procedures and delivered targeted training to managers within the Retail Division notwithstanding that further training was impacted by Covid-19. Nevertheless, there has been significant senior management engagement as well as staff whistleblowing communications.

The Committee is responsible for reviewing and monitoring the effectiveness of Santander UK's whistleblowing procedures. It received and considered bi-annual reports on Santander UK's whistleblowing arrangements. The reporting included oversight and progress of concerns, outcomes, identifiable trends, observable risks, the regulatory environment, changes to proposed legislation and activities to promote and

enhance the arrangements to support the culture of speaking up. The Committee also reviewed the annual Whistleblowing Report prepared for the Board to consider.

In 2020, Internal Audit performed an audit of the key controls in the Whistleblowing function and rated them as satisfactory.

The Committee is satisfied that Santander UK has complied with the FCA and PRA regulations on whistleblowing in the year.

I continued to act as the Whistleblowers' Champion to oversee the integrity, independence, and effectiveness of the whistleblowing arrangements. I remained focused on procedures and governance to prevent victimisation of those employees raising a whistleblowing concern. I meet regularly with management and I have been involved in overseeing the implementation of suggested enhancements to continuously improve the arrangements.

Other areas of 2020 focus

In 2019, the Bank of England published its Resolvability Assessment Framework (RAF). This sets out how the Bank of England assesses UK financial firms' resolvability and introduces a public disclosure regime. The Bank of England expects UK firms to be resolvable by 1 January 2022 and firms must submit a self-assessment of their resolvability to the Prudential Regulation Authority on a two-yearly cycle from October 2021.

During 2020, the Committee oversaw management's progress in strengthening resolution capabilities, including with respect to valuations in resolution, and in meeting the requirements of the RAF. As in previous years the Committee also oversaw the development and updating of the recovery plan.

Priorities for 2021

Areas of focus for the Committee for 2021 will include:

- Monitoring the ongoing impact of Covid-19 on the macroeconomic scenarios and their weights which flow through to the management judgements and estimates supporting the IFRS 9 ECL provisioning.
- Reviewing our enhanced disclosures in response to recommendations of the PRA's Taskforce on Disclosure about ECL.
- Overseeing Management's proposed development of the IFRS 9 model.
- Monitoring the financial impact and disclosure consequences of historical conduct and litigation related issues including Plevin/RND.
- Monitoring the adequacy and effectiveness of internal controls over financial reporting including those in relation to IFRS 9, effective interest rate

and goodwill/impairment carrying values.

- Monitoring the potential impact of remote working by staff on financial reporting risk, the execution of the 2021 Internal Audit plan and external audit activities.
- Monitoring Management's progress implementing the Resolvability Assessment Framework.
- Monitoring the rotation of the PwC lead audit engagement partner.
- Monitoring the rotation of the Chief Internal Auditor.

Governance

Committee membership

At 31 December 2020, all members of the Committee were Independent Non-Executive Directors. The Committee also met the necessary requirements of independence throughout the year, in accordance with the requirements of Rule 10A-3 under the US Securities Exchange Act 1934.

Effectiveness of the Committee

In respect of the Revised Statutory Audit Directive, the Board satisfied itself that at least one member of the Committee had competence in accounting and auditing, and the members of the Committee as a whole had competence in the banking sector, in which we are operating.

The Board has determined that I have the necessary qualifications and skills to qualify as a Board Audit Committee financial expert as defined in Item 16A of Form 20-F and by reference to the NYSE listing standards.

In my capacity as Committee Chair, I meet with key members of the management team and the External Auditors in advance of each Committee meeting. I ensure that the Committee meets with management, the Internal Auditors and the External Auditors in private sessions. I also attend meetings with the PRA, the FCA and the FRC.

Terms of Reference

The Terms of Reference are regularly reviewed by the Committee to make sure they continue to be appropriate. The Committee's Terms of Reference are available at www.aboutsantander.co.uk.

Board Responsible Banking Committee Chair's report



We continued to challenge management on delivering appropriate financial crime controls, managing regulatory change, and supporting employees and customers during the pandemic.

Ed Giera

Responsible Banking Committee Chair
2 March 2021

Committee membership and attendance

Read more on [p73](#)

The Committee supports the Board with oversight of financial crime, reputation, conduct, sustainability, culture, diversity and inclusion, customer outcomes and employee wellbeing

Role and responsibility

The purpose of the Committee is to strengthen focus on financial crime, culture, conduct, sustainability and customer outcomes. It monitors, challenges and supports actions taken by management to ensure that the business is run in a responsible way, in the interests of all of our stakeholders including customers, our people and communities in order to promote Santander UK's long-term success.

The Committee supports the Board with shaping Santander UK's culture, reputation and customer propositions through oversight of matters related to conduct, compliance, culture, diversity and inclusion, employee wellbeing, sustainability, climate change, reputation, brand and financial crime.

The oversight of financial crime includes anti-money laundering, sanctions, terrorist financing, anti-bribery and corruption and two key transformation programmes that are critical to controls and systems.

The Committee Chairs collaborate to prevent any gaps in coverage and to ensure that any areas of overlap are addressed in the appropriate forum. Committee Chairs are members of other Board Committees to ensure breadth of visibility and open channels of communication.

The Chair thanks and recognises the material contribution of Garrett Curran as RFB Committee Chair and of the RFB Committee's work during the year as it considers the majority of matters.

Overview of the year

In 2020, the impact of the pandemic was prevalent in Committee discussions, which ranged from changes to the way that colleagues worked in head office sites, branches and contact centres including provision of additional training and support; wellbeing considerations and support; homeworking support; consideration of feedback from employee surveys; and support for customers and businesses, including as a result of

Government support schemes and by use of digital enhancements.

Summary of 2020 outcomes

Customers and Customer Outcomes

A strong focus at Board level for much of 2020 was support for customers and colleagues during the pandemic. The Committee also focused on:

- Vulnerable customers
- Fair customer treatment and outcomes
- Fraud prevention and detection
- Open Banking implementation and
- Resourcing.

Reputational risk

The Committee ensured that adequate and effective control processes were in place to identify and manage reputational risks.

It received reports on existing and possible reputational, brand and franchise risks, including media and public policy issues and climate change. The reports also included key decisions or key risk events that give rise to reputational risk issues.

Financial crime

The Committee:

- Received regular updates on Financial Crime from business accountable executives and the Money Laundering Reporting Officer, including his annual report, and approved the proposed strategic recommendations
- Discussed the importance of culture in the context of Financial Crime
- Monitored and challenged management on the progress of Santander UK in improving its systems and controls to combat financial crime and meet regulatory expectations, including regular updates on controls acceleration and financial crime transformation; and
- Reviewed potential financial crime risks and any actions required in response, including in respect of international sanctions compliance.

Board Responsible Banking Committee Chair's report continued

Conduct and Compliance

The Committee:

- Ensured that adequate and effective control processes and policies were in place to manage and measure Conduct and Compliance risk
- Considered key emerging Conduct and Compliance risk issues, lessons learned and anticipated risks via horizon scanning and investigations
- Received first and second line reporting against Conduct and Compliance risk metrics and reports on conduct-related regulatory interaction matters
- Considered the FCA Firm-Wide Evaluation and response plans
- Considered the Compliance Programme, including resourcing in the Compliance Monitoring Plan
- Considered any actions in response to regulatory developments, including individual and market developments, on conduct and compliance risk matters and
- Themes arising from customer complaints, whistleblowing, satisfaction metrics and FOS referrals.

People and Culture

During the pandemic, the Committee focused on the wellbeing of employees, due to the impact of necessary and ongoing home working. It also considered colleagues who were based in branches and the challenges inherent in each of the new circumstances that had been a response to the pandemic. In addition the Committee:

- Received updates on culture, considered thematic culture and conduct trends, including management-identified cultural drivers, changes in policy and working practices
- Monitored the culture strategy and management efforts to embed and maintain the desired culture throughout the business in line with the Company's purpose, the simple, personal and fair values and the Santander behaviours

- Received updates on the approach to employee wellbeing, diversity and inclusion, including actions to increase black representation and progress against gender and minority ethnic inclusion targets.
- Reviewed key themes arising from employee surveys, employee focus groups led by management and the Santander UK plc Designated Director, and people metrics to evaluate the impact on conduct and culture, including the external Banking Standards Board Assessment and the internal Global Pulse Engagement Survey results and
- Received updates on the operation of the engagement with the workforce mechanisms undertaken by the Santander UK plc Designated Director. The themes raised during engagement sessions and employee focus groups fed into People and Culture Updates. For more, see the Stakeholder Voice in the Boardroom.

Brand and Sustainability

The Committee:

- Considered brand and marketing and provided challenge on the brand proposition, the weight of factors within NPS and sought greater insight into the impact from changes made to the 11213 proposition and also on brand affinity
- Considered reputation and how reputational risk impacted its brand and market positioning
- Received two separate Workshops on Sustainability and Climate Change
- Monitored embedding of Sustainability into our business strategy, helping the bank deliver value to all stakeholders, protect its reputation and brand.

It also oversees alignment to international frameworks, such as the Sustainable Development Goals and the UN Principles for Responsible Banking. For more on our Sustainability strategy, Governance and metrics, please see our Environmental, Social and Governance (ESG) Supplement.

Priorities for 2021

In 2021, the Committee will continue to take a holistic approach to gain greater understanding and oversight of all of the key areas that contribute to the experiences of our customers, our people and wider stakeholders.

Key priorities will be:

- Oversight of progress on Financial Crime objectives, the successful embedding of the Controls Acceleration Programme and meeting regulatory expectations
- Oversight of programmes of regulatory change, to understand customer impact

- so that the highest standards of conduct and fair outcomes are delivered
- Oversight of Sustainability strategy, including initiatives to achieve our priorities and development of the UK Climate Change Programme strategy
- Oversight of conduct
- Oversight of culture
- Oversight of diversity and inclusion, with focus on actions to close the pay gaps, including increasing senior representation
- Oversight of employee wellbeing
- Monitoring reputational risk, the continued enhancement of Fraud prevention; complaints and treatment of vulnerable customers; and
- Progress and plans to drive improvements to NPS and brand affinity.

Governance

Committee membership

All Committee members, including the Chair, are Independent Non-Executive Directors. The members of the Committee in 2020 were Scott Whewey (Chair until 17 March 2020 and a member until 30 September 2020), Ed Giera (Chair from 17 March 2020), and Chris Jones (who joined the Committee on 1 November 2020). Details of members, including their skills and experience, are shown in the Board of Directors section. The Committee is satisfied that its composition and operation comply with ring-fencing rules.

In addition to the Committee members, in 2020, regular attendees at Committee meetings included the Board Chair, CEO, Chief Legal and Regulatory Officer, Chief Risk Officer, CEO, Retail and Business Banking, Chief HR Officer, Director of Corporate Communications and the Director of Conduct and Compliance. In 2020, the Committee met eight times in response to changes due to Covid-19.

Effectiveness of the Committee

The Committee's performance was assessed as part of the Board's evaluation process during the year. The results were considered by the Committee, with some actions agreed as a mechanism for continuous improvement and to keep areas for development in focus. The Committee continues to operate effectively, discharging its responsibilities against its Terms of Reference and the Board takes assurance from the Committee on particular decision matters.

Terms of Reference

The Terms of Reference are regularly reviewed by the Committee to make sure they continue to be appropriate. The Committee's Terms of Reference are available at www.aboutsantander.co.uk.



Board Remuneration Committee Chair's report



We aim to deliver remuneration aligned to sustainable performance outcomes for the long term benefit of our organisation.

Chris Jones

Board Remuneration Committee Chair
2 March 2021

Committee membership and attendance

Read more on **p73**

Our performance management, reward and benefits approach supports our business strategy, rewards strong performance and reinforces our culture and values within the approved risk management framework

On behalf of the Committee, I am pleased to present my first Directors' Remuneration Report for 2020. I would like to thank Scott Wheway for his stewardship of the Committee and support during my transition to Committee Chair in 2020, and Annemarie Durbin as Santander UK plc Committee Chair for her and that Committee's material contributions as this is where the majority of matters arise.

Role and responsibilities

The Committee is responsible for overarching remuneration policies and frameworks across the Santander UK group. It is responsible for remuneration arrangements of employing entities outside the Santander UK plc (the Ring-Fenced Bank or RFB) perimeter.

The Committee works in consultation with the RFB to ensure alignment of remuneration practices, policies, and procedures. The RFB's remuneration activities are governed by its Board Remuneration Committee.

Overview of the year

Through its monitoring and challenge of remuneration matters, the Committee completed its annual review of the regulated remuneration governance framework across the Santander UK group. In determining remuneration outcomes, we are mindful of the overall performance of the bank. We intensified prioritisation of the safety and wellbeing of our colleagues.

Taking account of financial and non financial performance in the year, and future risks, we approved the bonus pool for Santander Financial Services plc.

Summary of 2020 outcomes

Variable pay

The Committee is satisfied that 2020 variable pay outcomes for all colleagues are appropriately aligned to Santander UK's business performance, which is fair, consistent, and aligned to our stakeholder interests.

Board Changes

The Committee considered the remuneration for William Vereker who was appointed as Board Chair on 1

November 2020. Further details are set out later in this report.

Priorities for 2021

In 2021, we will (for entities outside the RFB perimeter) continue to:

- monitor our incentive structures and measures, to maintain alignment to our strategic aims, culture and behaviours, balancing the needs of our people, customers, communities and shareholders and supporting our business transformation.
- monitor external developments in executive remuneration best practices in the industry and broader market taking into account the regulatory landscape and corporate governance.

Committee Membership

The members of the Committee during 2020 were Chris Jones (Chair), Scott Wheway (until 30 September 2020), and Ed Giera (from 1 November 2020). The Committee met 9 (including ad hoc meetings) times in 2020, reflecting its responsiveness to the changing environment brought by Covid-19.

Effectiveness of the Committee

The Committee's performance was assessed as part of the Board's evaluation process during the year. We considered the results and agreed key areas of development for 2020. The plan focuses on allocating more time to remuneration strategy, longer term trends and challenges. The Committee continues to operate effectively in discharging its responsibilities, and the Board takes assurance from the quality of the Committee's work. The Committee considered the performance of its remuneration consultants, Deloitte LLP, and is satisfied that their advice and conduct remain independent, and objective.

Terms of Reference

The Committee's Terms of Reference are regularly reviewed to make sure they remain appropriate. The Terms of Reference are available at www.aboutsantander.co.uk.

Remuneration policy report

Basis of preparation

This report has been prepared on behalf of the Board by the Board Remuneration Committee. We comply with the statutory reporting obligations for large private companies. Furthermore, we follow the UK Corporate Governance Code 2018 (the Code) wherever applicable in order to practice best standards of corporate governance, and other listed disclosure requirements to the extent considered appropriate.

Accordingly, several voluntary disclosures relating to remuneration are presented in this report.

Forward-looking remuneration policy for Executive Directors

Our forward-looking remuneration policy, which applies to Main Board Executive Directors (Executive Directors), is outlined below. Remuneration is structured in two main elements: fixed and variable pay. Fixed pay is set at market competitive levels appropriate for the role, so that inappropriate risk taking is not encouraged. Variable pay rewards the delivery of internal financial targets, key strategic priorities and individual performance.

Executive Directors' remuneration structure

Fixed pay	Principle and description	Policy
Base salary	<ul style="list-style-type: none"> To attract and retain Executive Directors of sufficient calibre and with the skills to deliver our strategy, taking into account the demands and complexity of the role. 	<ul style="list-style-type: none"> Base salaries are normally reviewed annually. In reviewing base salaries the Committee considers a number of factors, including: <ul style="list-style-type: none"> The skills required and responsibilities of the role alongside the market value of those attributes; The requirement for base salaries to be set at a level to avoid inappropriate risk taking; Base salary increases across the colleague population; and Prevailing market and economic conditions.
Pension arrangements	<ul style="list-style-type: none"> To provide a discrete element of the package to contribute towards retirement. 	<ul style="list-style-type: none"> All Executive Directors receive a cash allowance in lieu of pension. Pension for new Board appointments will be in line with the average level of pension provision available to the broader workforce, currently 9% of salary. Our approach to current Executive Director pension allowances is set out in the Policy Report.
Other benefits	<ul style="list-style-type: none"> To offer a competitive package and to support employee wellbeing. 	<ul style="list-style-type: none"> Including but not limited to: private medical insurance for Executive Directors and their dependants, life assurance, health screening, relocation allowances and expatriate allowances where relevant. Access to Santander UK's all-employee share schemes on the same terms as all UK employees.

Variable pay	Principle and description	Policy
Variable pay plans	<ul style="list-style-type: none"> The Variable Pay Plan aims to motivate Executive Directors to achieve and exceed annual internal targets within Santander UK's Risk Appetite and in alignment with our business strategy and values. Multi-year deferral, further performance testing and delivery in Banco Santander SA shares aligns Executive Directors' interests to the long-term interests of Santander UK. Part of the award is deferred according to the requirements of the PRA Remuneration Code. The long-term Transformation Incentive plan recognises the collective achievement of key financial and non-financial internal targets associated with the bank's ongoing transformation. 	<ul style="list-style-type: none"> Bonus awards under the Variable Pay Plan are discretionary and determined by reference to performance against a scorecard of financial and non-financial goals, as well as individual performance. <ul style="list-style-type: none"> 40% of any bonus awarded is paid upfront after the performance year ends (year one), and delivered at least half in shares. 60% of the bonus awarded is deferred and delivered in equal tranches over years three to seven, with each tranche delivered at least half in shares. For Executive Directors, the first three of five deferred award tranches are subject to further performance testing, which may reduce the level of payout, but not increase it. The Transformation Incentive is based on performance assessed over a three year period with further deferral into cash and share based awards in line with regulatory requirements. Share based awards are subject to a minimum twelve-month retention period following vesting. Malus and clawback provisions apply to variable pay for up to ten years following the grant of an award. The structure of variable pay awards means Executive Directors acquire a meaningful shareholding in Banco Santander SA which may extend for a significant period post-employment. A formal post-employment shareholding requirement is therefore not in place.

Our remuneration policy continues to meet regulatory requirements. Santander UK applies a 2:1 variable to fixed pay cap in line with approvals granted to Banco Santander SA by its shareholders. For control function staff, a lower ratio of 1:1 is applied, apart from in exceptional circumstances

Executive remuneration policies and principles

Our core values of Simple, Personal and Fair drive our remuneration policy. We focus on delivering a reward framework that is simple to understand, tailored to individual roles and competitive yet fair.

The key drivers of our Remuneration Policy

Alignment to culture

- To design policies aligned to the long-term success of the business which support the delivery of our strategy and reinforce our values.
- To base variable pay on a balanced scorecard of quantitative and qualitative metrics which reflect our strategic priorities across Customers, Shareholders, People and Sustainability. This ensures that our day-to-day activities align with Santander UK's overarching strategy and our aim of being the best bank.

Simplicity

- To ensure our approach to remuneration is transparent and easily understood.
- To operate simple and clear structures for all Santander UK colleagues.

Risk

- To apply a consistent approach to reward for all our employees which upholds our prudent approach to Risk Appetite set as part of a Santander UK-wide framework. Risk adjustment occurs at an individual and bonus pool level.
- To provide a package that is balanced between fixed and variable pay, and short-term and long-term horizons, which aligns to our strategy whilst promoting prudent risk management.
- To ensure remuneration is compliant with applicable regulations and legislation.

Fairness

- To take into account an assessment of the Executive Directors' performance against objectives set at the start of the year covering a range of financial, non-financial, quantitative and qualitative criteria.
- To set robust and stretching internal targets and reward exceptional performance.
- To attract, retain and motivate employees of the highest calibre by providing total remuneration which reflects individual and Company performance, is competitive, reflects the responsibilities of the role and drives the organisation's growth.
- To consider wider employee pay when determining pay of our Executives.

Clarity

- The Committee reviews remuneration reporting on an annual basis against principles of best practice and developments in corporate governance, including the Code. Our reporting is designed to be transparent to promote effective stakeholder engagement, whilst reflective of our subsidiary structure.

Predictability

- The Committee annually reviews the variable pay opportunity for individuals and the basis of the pool calculation. Due to commercial sensitivity, these are not disclosed as per the requirements of the Code. Directors' remuneration is within the variable pay cap as approved by Banco Santander SA shareholders and set out above on this page.

Executive Director pension alignment

In 2018, following developments in corporate governance and best practice, the Committee took the decision to reduce pension allowances for new Executive Directors to 9% of salary, in line with the wider workforce average. This pension level applied on the appointment to the Board of Duke Dayal, Chief Financial Officer, on 16 September 2019.

In 2019, the Committee decided to extend this approach to existing Executive Directors, namely the Chief Executive Officer. This reduction has been phased with the Chief Executive Officer's allowance reducing from 35% to 22% of salary effective 1 January 2020, and to 9% of salary from 1 January 2021. Subsequently, with effect from January 2021 the Chief Executive Officer's pension provision is aligned with the current workforce average.

On recruitment

When appointing a new Executive Director, base salary is set at a market competitive level appropriate for the role, taking into consideration a range of factors including role scope and responsibilities, internal and external peer groups, the individual's previous remuneration, relevant experience, and affordability.

Unless determined otherwise, any new Executive Director will receive a pension allowance in line with the wider workforce average, currently 9% of salary. Benefits available will typically be aligned to the wider employee population.

Other elements of remuneration will be established in line with the Remuneration Policy, as set out in the Executive Directors' remuneration structure table in this report.

Relocation support and international mobility benefits may also be given. Where provided, relocation assistance will normally be a capped amount for a limited time. For an overseas appointment, the Committee will have discretion to offer benefits and pension provisions which reflect their home country market practice and align to relevant legislation.

Buy-out awards

Compensation may be provided to Executive Directors recruited externally for the forfeiture of any award on leaving their previous employer. The Committee retains discretion to make such compensation as deemed appropriate to secure the relevant Executive Director's employment and will ensure any such payments align with both the long-term interests of Santander UK and the prevailing regulatory framework.

Such payments will be in line with the awards foregone as a result of leaving the previous employer taking into account value, form of awards, vesting dates and the extent to which performance conditions applied to the original awards.

Service agreements

Terms and conditions of employment are set out in individual service agreements which include a notice period of six months from both the Executive Director and the Company.

The agreements may be terminated immediately with payment of fixed pay in lieu of notice. In the event of termination for gross misconduct, neither notice nor payment in lieu of notice is required, and any deferred awards are forfeited.

Remuneration policy report continued

Termination payments

The impact on remuneration of an Executive Director leaving the Company under various scenarios reflects the service agreements, the relevant scheme rules, regulatory requirements and the Committee's policy in this area.

Outstanding variable pay awards will generally lapse on termination, other than where an individual is considered a 'good leaver', in which case the awards will normally subsist until normal payment dates. The Committee determines whether an Executive Director is a good leaver under certain circumstances including but not limited to: injury, ill-health, disability, redundancy, retirement, death, or any other reason at the Committee's discretion.

There is a framework in place which is intended to guide the Committee to determine the discretionary circumstances when good leaver status is appropriate. Other than a payment in the event of redundancy, there are generally no other payments upon termination of employment for Executive Directors.

In the event of a change in control, awards will be treated in line with the relevant scheme rules, taking into account the applicable regulatory requirements.

Risk and Performance adjustment

We continue to ensure that the regulatory requirements of the Remuneration Code on risk and performance adjustment are met for our colleagues. All variable remuneration is subject to adjustment for current and future risks through our Additional Risk Adjustment Standard which is linked to our Board approved Risk Appetite.

The Standard provides both a formula-based assessment against Santander UK's Risk Appetite and an additional qualitative risk event assessment overlay that can reduce the bonus pool or individual awards to nil at the Committee's discretion. Given commercial sensitivity, the Committee does not provide annual detail on the application of discretion as required by the Code.

Our Individual Remuneration Adjustment Standard provides a framework for the process, governance and standards relevant for decisions in relation to individual performance adjustments following an incident, including the application of malus and clawback.

Performance adjustments may include, but are not limited to:

- Reducing a bonus for the current year;
- Reducing the amount of any unvested deferred variable remuneration;
- Requiring a bonus which has been awarded (but not yet paid) to be forfeited; and
- Requiring repayment on demand (on a net basis) of any cash and share awards received at any time for a period of up to ten years following the date of award.

The Committee has full discretion to prevent vesting of all or part of an amount of deferred remuneration and/or to freeze an award during an ongoing investigation in a number of circumstances, including:

- Colleague misbehaviour or material error;
- Material downturn in the performance of Santander UK or a relevant business unit's performance;
- Santander UK or a relevant business unit suffering a material failure of risk management;
- Significant changes in Santander UK's economic or regulatory capital base and the qualitative assessment of risk; and
- Material restatement of the Santander UK's financial statements (except when required due to modification of the accounting rules).

When determining variable pay awards for individuals performing roles across Santander UK plc and Santander UK Group Holdings plc, the Santander UK Group Holdings plc Board Remuneration Committee will apply any necessary discretion based on factors related to UK Group entities outside of Santander UK plc. This discretion is subject to validation by the Santander UK plc Board Remuneration Committee.

The Committee seeks input from the Chair of the Board Risk Committee, Chief Risk Officer, Chief Legal and Regulatory Officer, Chair of the Board Audit Committee, Chief HR Officer, Chair of the Board and Chief Internal Auditor when determining whether any performance or risk adjustments are required.

Policy for all employees

Our performance, reward and benefits approach across the Company supports and drives our business strategy, rewards strong performance and reinforces our values within the approved risk management framework. The general principles of the Remuneration Policy broadly apply across all colleagues where appropriate, and are designed to facilitate recruitment, motivation and retention whilst driving performance.

The composition of remuneration packages for the Executive Directors is aligned with the broader colleague population, comprising salary, pensions and benefits and eligibility for discretionary variable pay dependent on role and responsibility. From 1 January 2021, the level of pension allowance for all current Executive Directors is aligned with the current average employer contribution for the wider workforce.

The Committee annually approves the operation of all of our variable reward schemes for our customer-facing colleagues to ensure that all plans reward appropriate behaviour and do not incentivise unnecessary risk taking.

Remuneration implementation report

Introduction

This section of the report outlines how our Remuneration Policy was implemented for 2020.

Variable Pay Plan

To incentivise and reward Executive Directors for achieving superior and sustained performance, our Directors participate in an annual variable incentive plan. A balance of financial and non-financial performance metrics are selected annually by the Committee and are aligned with our strategy as measured over the financial year. Multi-year deferral, further performance testing and delivery in Banco Santander SA shares ensures that Executive Directors' interests are aligned to the long-term interests of the business. Both upfront and deferred awards are made at least half in shares. The deferred element is delivered over seven years, with the first three deferred tranches of awards subject to further performance testing against long-term metrics which can reduce but not increase the overall level of awards. Awards delivered in shares are subject to an additional one-year retention period from the point of delivery.

The structure of the plan is illustrated below. The 2020 Variable Pay Plan pool was determined based on a range of metrics using a balanced scorecard approach as follows:

Quantitative assessment

A quantitative assessment is undertaken against a balanced scorecard of financial and non-financial metrics that are key to Santander UK's 2020 strategy.

Performance metrics are reviewed annually to ensure continued alignment with strategy, and for 2020 were:

- Customers (Net Promoter Score and number of loyal customers)
- Shareholders
 - Risk (Cost of credit & Stage 3 ratios)
 - Capital (Contribution to Banco Santander group capital)
 - Profitability (Net profit & RoTE)
- Sustainability (Financial empowerment, Dementia Friendly Bank and emissions reduction)
- People (Employee Engagement).

A profit underpin was introduced for 2020 applicable to Executive Directors which requires Profit after Tax to remain positive in order to pay any award.

Qualitative assessment

A qualitative assessment adds context to the quantitative assessment and ensures a balanced view of performance is taken.

Banco Santander Group Multiplier

The Committee has the discretion to adjust the pool upwards or downwards to reflect overall Banco Santander performance if appropriate.

Exceptional Adjustment

Intended to cover unexpected factors or additional internal targets not covered by the quantitative or qualitative assessments. This may also include adjustments not covered in the qualitative assessments, including major risk events. No exceptional metrics were applied to the 2020 variable awards for Executive Directors

UK-focused risk adjustment

Linked to Santander UK's Risk Appetite, this provides both a formula-based assessment against Risk Appetite and an additional qualitative risk event assessment overlay (including consideration of other risk appetite limit breaches e.g. reputational risk and Financial Crime risk). This can result in a downward risk adjustment of up to 100% of the bonus pool or individual awards at the discretion of the Committee.

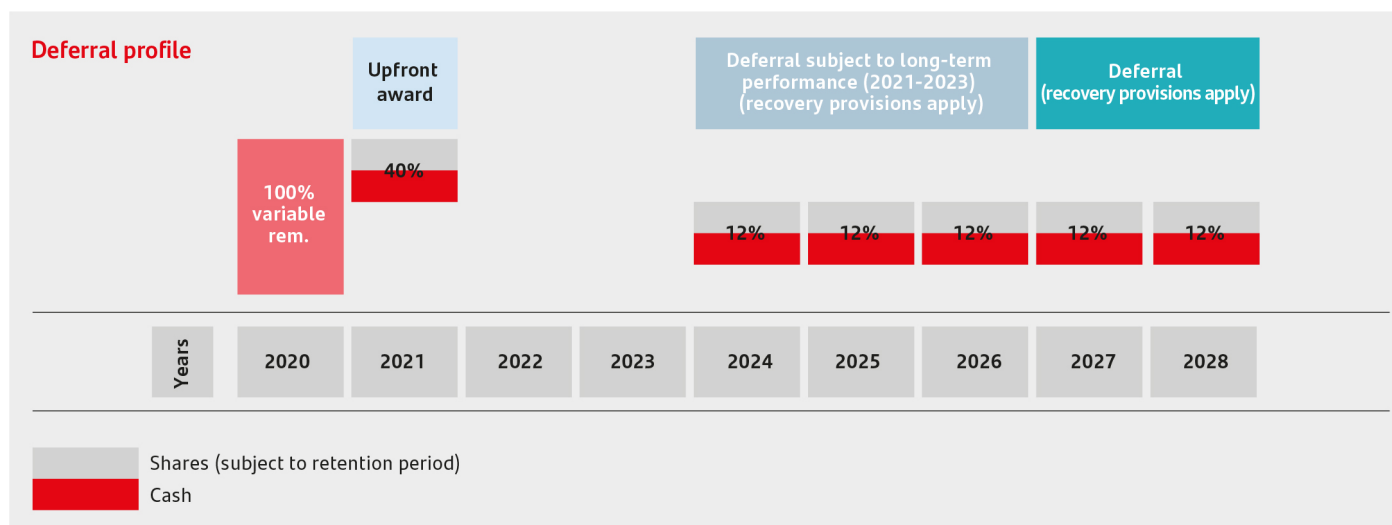
The Committee reviews and approves remuneration governance and frameworks on an annual basis to ensure continued compliance with the relevant regulatory rules, including for ring-fencing.

Individual assessment

The allocation of the pool is based on an individual's performance, taking into account a range of factors including behaviours, conduct and risk.

Deferred long-term awards

The payment of the first three deferred tranches of the 2020 awards (36% of the total award), payable in 2024, 2025 and 2026, is conditional on the achievement of long-term objectives measured over the three-year period 2021 to 2023. The performance measures for 2020 awards are EPS, relative TSR and compliance with the fully-loaded CET1 capital ratio. Following performance assessment, the level of awards will be adjusted accordingly. The measures can reduce but not increase the overall value of the deferred awards. The payment of the final two deferred tranches (24% of the total award), payable in 2027 and 2028 is subject to continued employment only and ex-post risk adjustment.



Remuneration implementation report continued

2020 Business Performance and Impact on Remuneration

In spite of the impact on the broader economy from the Covid-19 pandemic, we have been able to report a net profit for each quarter of 2020. Our balance sheet remains strong and resilient, and progress has been made to reduce expenses through the transformation programme. Our people have responded rapidly and positively to the challenges posed by the pandemic, to support our customers and meet their changing needs. It is in this context that the Committee made remuneration decisions in respect of the 2020 performance period. Bonus awards were significantly reduced from previous years, and included an exercise of discretion by the Committee to reduce the formulaic bonus pool outcome in recognition of the external environment.

The Committee made the decision not to award the CEO a bonus for the year, and instead the value of bonus he might otherwise have received has been used to fund a corporate donation to the Santander Foundation. The CEO fully supported this decision. In keeping with our responsible approach in the current environment, the other Executive Directors received a reduced bonus reflecting the challenging conditions this year and our financial results. This was paid wholly in shares to align to the long-term interests of our shareholders.

As noted in the Chair's statement, a comprehensive package of measures was introduced to support colleagues at the start of the pandemic. These included a series of wellbeing interventions and a commitment to pay all colleagues their contracted hours, alongside confirmation that the Government's Coronavirus Job Retention Scheme would not be used. In recognition of the contribution made by customer facing colleagues who continued to directly engage with customers throughout the pandemic, a one-off £500 award was made. In considering year-end outcomes, the Committee agreed that the allocation of the bonus pool should be weighted towards less senior colleagues.

The Committee confirms that the remuneration policy operated as intended, demonstrating pay for performance alignment.

Context for decision making

The Committee ensures that broader remuneration policies and practices for employees across the Santander UK group are taken into account when setting policy for Executive Director remuneration. The Committee reviews remuneration trends across the Santander UK group including the relationship between Executive remuneration and that of other Santander UK group employees, as well as remuneration in the wider UK market when making decisions on Executive pay.

The Committee oversees broader workforce remuneration policies and practices, the implementation of remuneration and related employment policies across Santander UK and the salary and variable pay awards for all MRTs. It also approves the design of any material performance-related pay plans. As part of the monitoring of pay, the following is considered:

- Santander UK's engagement with its recognised trade unions on pay and benefits matters for all colleagues;
- Annual pay reviews for the general employee population;
- Santander UK group-wide pension and other benefit provisions;
- The design of and overall spend on variable incentive arrangements; and
- An assessment of conduct across the business.

The Committee is focused on ensuring that colleagues are not unduly stretched or inappropriately incentivised. This is monitored using existing employee engagement indicators via the Global Engagement Survey, and The Santander Way survey which provides an indication of our progress in performance against the nine Santander behaviours.

The Committee always considers the broader stakeholder environment when setting policy or reaching decisions on executive pay.

Executive Directors' remuneration (audited)

Total remuneration of each Executive Director for the years ended 31 December 2020 and 2019.

	Nathan Bostock ^(2,4,5)		Duke Dayal ^(1,2)	
	2020	2019	2020	2019
	£000	£000	£000	£000
Salary and fees	1,680	1,680	950	277
Taxable benefits	44	56	502	504
Pension	370	588	86	25
Total fixed pay	2,094	2,324	1,538	806
Bonus (paid and deferred) ⁽³⁾	—	1,990	748	354
Total variable pay	—	1,990	748	354
Total remuneration	2,094	4,314	2,286	1,160

(1) Duke Dayal was appointed as an Executive Director on 16 September 2019 and his remuneration is shown from this date, with 2019 full year Santander UK Group Holdings plc equivalent total remuneration of £2.957m.

(2) Taxable benefits for the Executive Directors comprise a range of benefits including private health care, life and critical illness cover, health insurance and car allowance. Included in the 2020 benefits figure for Duke Dayal is a relocation allowance of £500,000.

(3) The bonus value shown is the total Variable Pay Plan award made in respect of 2020, which will be delivered wholly in shares. As set out in this report, a portion of the award (36% of the value shown) is subject to further performance testing which may reduce, but not increase, the value delivered.

(4) As set out in the Remuneration Policy report, the pension contribution received by Nathan Bostock was reduced from 35% to 22% of salary from 1 January 2020, and to 9% of salary from 1 January 2021.

(5) The CEO bonus outcome takes into account the external environment and the Committee's commitment to a reduction in the CEO's overall remuneration for the year.

Relative importance of spend on pay

	2020	2019	Change
	£m	£m	%
Profit before tax	552	981	(44)
Total employee costs	1,189	1,288	(8)

Stakeholder views

During 2020, Santander UK continued to engage with key stakeholders on remuneration related matters including its main regulators the PRA and FCA.

Employee opinion surveys are undertaken annually on employee engagement, and discussion takes place with union representatives during the annual pay review cycle and on relevant employee reward matters on a more frequent basis. The Committee receives updates on these discussions during the year. More frequent colleague pulse surveys were conducted in 2020, alongside other virtual listening forums, for a more frequent gauge of employee sentiment throughout the pandemic.

CEO pay ratio

Santander UK is committed to delivering fair pay which attracts, retains and motivates colleagues of the highest calibre across all grades. In line with this commitment, the Committee has oversight of compensation across the organisation, including pay ratios, and considers this when determining reward outcomes. For the second year we are voluntarily disclosing the ratio of the CEO's total remuneration to that of UK colleagues.

The CEO's pay mix is weighted more highly towards variable pay to incentivise the achievement of stretching internal targets and long-term value creation which can lead to greater variability in total remuneration each year. In contrast, the typical pay mix of our colleagues places more emphasis on fixed pay, to ensure a minimum level of earnings which offers greater security and reflects our commitment to colleague wellbeing.

This difference in pay mix plays a key role in the movement of the ratio which is in part driven by the variable nature of our CEO's remuneration. However, in reviewing the ratio the Committee is keen to ensure that changes in the ratio are influenced by the differences in remuneration structure rather than an increase in pay disparity. In assessing the pay ratio, the Committee is confident that the Company's policy on remuneration is fair. A summary of our approach to Fair Pay is included in the People section of our Sustainability report.

The ratio this year has reduced from 129:1 to 64:1. This is largely due to the fact the CEO has not received a bonus. The first phase of the reduction in CEO pension contribution to employee average (from 35% in 2019 to 22% in 2020) has also contributed to the reduction in the ratio.

Advice and support provided to the Committee

As permitted by its Terms of Reference, the Committee has engaged the advice and support of Deloitte LLP (Deloitte) as independent remuneration consultants at the expense of the Company. Total fees (excluding VAT) for advice and support provided to the Committee during 2020 were £143,600 (2019: £157,500). Deloitte is a founding member of the Remuneration Consultants Group and voluntarily operates under the Code of Conduct in relation to executive remuneration consulting in the UK.

The Committee is satisfied that the Deloitte engagement partner and team that provides remuneration advice to the Committee do not have connections with Santander UK that may impair their independence, following review in 2020.

In 2020, Deloitte also provided unrelated tax, financial and advisory, risk, assurance and consulting services to Santander UK.

By Committee invitation, the Chair, Chief Executive Officer and designated representatives from business functions attend meetings to advise on HR, Risk, Legal and Regulatory matters as appropriate, to support the Committee's work. Attendees included the Chief HR Officer, Performance & Reward Director, Chief Legal and Regulatory Officer, Chief Risk Officer and Company Secretary. No individual participates in discussions regarding their own remuneration.

CEO pay ratio

	Methodology ⁽¹⁾	25th percentile	Median	75th percentile
2020 CEO pay ratio	Option A	88:1	64:1	37:1
2019 CEO pay ratio⁽⁴⁾	Option A	178:1	129:1	76:1

	CEO remuneration ⁽³⁾	25th percentile ⁽²⁾	Median ⁽²⁾	75th percentile ⁽²⁾
	£	£	£	£
2020 CEO pay ratio				
Total salary £	£1,680,000	£20,009	£26,347	£43,228
Total remuneration £	£2,094,000	£23,903	£32,785	£56,190

(1) Employee pay is calculated based on the 'Option A' methodology. We have chosen Option A as it gives the most reliable and accurate result by calculating a comparable single figure for each employee.

(2) Employee pay data is based on full time equivalent pay for Santander UK plc employees. This excludes a small number of employees in the rest of the Santander UK group. Including those employees results in a ratio consistent with the above. For each employee, total remuneration is calculated based on fixed pay accrued during the financial year, and variable pay is either based on actual bonuses in respect of the 2020 year (where these are available) or modelled target bonuses where actuals are not yet available.

(3) The CEO's total remuneration is aligned to that disclosed in the Executive Directors' remuneration table on the previous page.

(4) The 2019 ratios are re-stated above. These were originally calculated based on fixed pay accrued within the 2019 year, in addition to bonuses paid in 2019 in respect of the 2018 year. The 2019 ratios have now been recalculated using 2019 fixed pay and bonuses paid in 2020 in respect of 2019 for all employees, to ensure closer alignment with the reporting requirements. This results in a reduction in the 2019 median pay ratio from 132:1 to 129:1.

Remuneration implementation report continued

Chair and Non-Executive Director remuneration

The Chair's fee is reviewed and approved by the Committee. The fees paid to Non-Executive Directors are reviewed and approved by the Chief Executive Officer and the Chair. Fees are reviewed annually taking into account the market rate and time commitment for the role. The Chair is paid an all-inclusive base fee. Non-Executive Directors are paid a base fee, with a supplement for serving on or chairing a Board Committee. Group Non-Executive Directors do not receive fees in respect of their Santander UK duties.

William Vereker was appointed Chair on 1 November 2020, previously Non-Executive Director from 1 October 2020. For the period served from 1 October 2020 to 31 October 2020, he received the base board member fee of £95,000 pro-rated for time served. From appointment as Chair, in line with his predecessor, he will be paid an annual fee of £675,000. In addition, William is eligible to receive private medical insurance.

All Non-Executive Directors and the Chair serve under letters of appointment and either party can terminate on three months' written notice, except in the case of the Chair where twelve months' written notice is required..

Neither the Chair nor the Non-Executive Directors have the right to compensation on the early termination of their appointment beyond payments in lieu of notice at the option of Santander UK. In addition, neither the Chair nor the Non-Executive Directors are eligible for pension scheme membership or other incentive arrangements.

In 2020, some of the Non-Executive Directors voluntarily elected to donate a portion of their fees to the Santander UK Foundation Covid relief fund. The fees shown below do not reflect those contributions.

Chair and Board Committee member fees

	1 January 2020 £000	1 January 2019 £000
Chair (inclusive of membership fee)	675	650
Board member	95	90
Additional responsibilities		
Senior Independent Director	35	30
Chair of Board Risk Committee	65	60
Chair of Board Audit Committee	60	60
Chair of Board Responsible Banking Committee	60	60
Chair of Board Remuneration Committee	60	60
Membership of Board Risk Committee	30	25
Membership of Board Audit Committee	25	25
Membership of Board Responsible Banking Committee	25	25
Membership of Board Remuneration Committee	25	25

	2020 Fees £000	2019 Fees £000	2020 Expenses £000	2019 Expenses £000	2020 Benefits £000	2019 Benefits £000	2020 Total £000	2019 Total £000
Non-Executive Directors								
Chair								
William Vereker ^(1,2)	120	—	—	—	1	—	121	—
Shriti Vadera ^(1,2)	563	667	—	—	47	22	610	689
Independent Non-Executive Directors								
Ed Giera	214	207	—	30	—	—	214	237
Chris Jones	214	207	—	—	—	—	214	207
Scott Wheway ⁽³⁾	165	240	2	8	—	—	167	248
Banco Santander nominated Non-Executive Directors ⁽⁵⁾								
Ana Botin	—	—	—	—	—	—	—	—
Bruce Carnegie-Brown ⁽⁴⁾	—	—	—	—	—	—	—	—

(1) Shriti Vadera stepped down on 31 October 2020. William Vereker joined on 1 October 2020 and was appointed Board Chair on 1 November 2020.

(2) 2019 full year fees for the Board Chair reflect the increase on 1 May 2019 from £650,000 to £675,000. Shriti Vadera was entitled to taxable benefits as follows: private medical cover of £548 (2019: £626) and transportation of £15,582 (2019: £20,752). In addition, she received a payment of £31,154 in respect of holiday pay. William Vereker received private medical cover of £411.

(3) Scott Wheway stepped down on 30 September 2020. Fees received are in respect of services to this date.

(4) Bruce Carnegie-Brown was appointed on 16 September 2019.

(5) None of the Banco Santander nominated Non-Executive Directors received any fees or expenses.

Board and Committee membership and attendance

		Board		Nomination Committee		Risk Committee		Audit Committee		Responsible Banking Committee		Remuneration Committee	
		Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended
Chair	William Vereker ⁽¹⁾	1/1	2/2	2/2	3/3	-	-	-	-	-	-	-	-
	Shriti Vadera ⁽²⁾	8/8	4/4	7/7	3/3	-	-	-	-	-	-	-	-
Independent Non-Executive Directors	Ed Giera	9/9	6/6	2/2	2/2	9/9	1/1	10/10	1/1	5/5	2/2	1/1	0/0
	Chris Jones	9/9	6/6	-	-	9/9	1/1	10/10	1/1	1/1	0/0	6/6	3/3
	Scott Wheway ⁽³⁾	6/7	4/4	6/6	2/2	7/7	0/0	-	-	5/5	2/2	5/5	3/3
Banco Santander nominated Non-Executive Directors	Ana Botin	7/9	2/6	0/2	0/1	-	-	-	-	-	-	-	-
	Bruce Carnegie-Brown	7/9	4/6	5/6	3/4	-	-	-	-	-	-	-	-
Executive Directors	Nathan Bostock	9/9	6/6	-	-	-	-	-	-	-	-	-	-
	Duke Dayal	9/9	6/6	-	-	-	-	-	-	-	-	-	-

1 William Vereker joined 1 October 2020; appointed Board Chair on 1 November 2020

2 Shriti Vadera resigned on 31 October 2020

3 Scott Wheway resigned on 30 September 2020

Directors' report

Introduction

The Directors submit their report together with the financial statements for the year ended 31 December 2020. The information in the Directors' Report is unaudited, except where marked.

History and corporate structure

Santander UK Group Holdings plc is a subsidiary of Banco Santander SA, a Spanish retail and commercial bank with a meaningful market share in ten core countries in Europe and the Americas.

Santander UK was formed from the acquisition of two former building societies, Abbey National and Alliance & Leicester together with the branch network of Bradford & Bingley, and has operated under a single brand since 2010. The ordinary shares of the Company are not traded.

In 2018, certain subsidiaries and portfolios were transferred as part of the implementation of the ring-fence arrangements required under the Financial Services (Banking Reform) Act 2013. Following these transfers, Santander UK plc and its subsidiaries comprise of only entities whose business is permitted under the Act as a ring-fenced bank. Other entities including Santander Financial Services plc are now directly or indirectly owned by the Company.

Result and dividends

The audited consolidated profit after tax for the year was £438m (2019: £709m). The Directors do not recommend the payment of a final dividend for 2020 (2019: £nil). One interim dividend was declared on the Company's ordinary shares in issue in the year. This dividend of £103m was declared on 10 December 2020 and was paid in 2020.

Details of Santander UK's activities and business performance in 2020, together with an indication of future outlook, are set out in the Strategic report and the Financial review.

Events after the balance sheet date

There have been no material post balance sheet events, except as set out in Note 42.

Directors

The names and biographical details of the current Directors are shown in the Board of Directors section. Details of their emoluments and interests in shares are set out in the Directors' Remuneration implementation report. Changes to the composition of the Board can be found in the Board of Directors section with more details in the Chair's report on Corporate Governance, and the relevant Committee Chairs' reports..

Appointment and retirement of Directors

All Directors are appointed and retired in accordance with the Company's Articles of Association, the UK Companies Act 2006 and the UK Group Framework. The following appointments took place in 2020: William Vereker was appointed as a Director on 1 October 2020 and appointed as Chair on 1 November 2020. The following resignations took place in 2020: Shriti Vadera (Chair & Director), Scott Whewey (SID & INED). Further details are set out in the governance section.

A resolution was passed at the 2019 Annual General Meeting which requires Directors to retire every year, with those wishing to serve again submitting themselves for election or re-election.

Directors' indemnities

Directors' and Officers' liability insurance cover was in place throughout 2020, in addition to deeds of indemnity which were also in place to provide cover to the Directors for liabilities to the maximum extent permitted by law. These remain in force for the duration of the Directors' period of office from the date of appointment until such time as any limitation periods for bringing claims against the Directors have expired. The Directors of the Company, including former Directors who resigned in the year, benefit from these deeds of indemnity.

They constitute as qualifying third party indemnity provisions for the purposes of the Companies Act 2006. Deeds for existing Directors are available for inspection at the Company's registered office.

The Company has also granted an indemnity which constitutes 'qualifying third party indemnity provisions' to the Directors of its subsidiary and affiliated companies, including former Directors who resigned in the year and since the year-end. Qualifying pension scheme indemnities were also granted to the Trustees of the Santander UK group's pension schemes.

Employees

We continue to ensure that Santander UK's remuneration policies are consistent with its strategic objectives and are designed with its long-term success in mind. In doing so, we aim to attract and retain the most talented and committed people.

Communication

Santander UK aims to involve and inform employees on matters that affect them. The intranet is a focal point for communications and the 'AskHR' website connects employees to all the information they need about working for Santander UK. We also use face-to-face communication, such as team meetings and roadshows for updates.

Santander UK considers employees' opinions and asks for their views on a range of issues through regular Santander UK-wide surveys.

Consultation

Santander UK has a successful history of working in partnership with its recognised trade unions, Advance and the Communication Workers Union (CWU), who collectively negotiate on behalf of our UK workforce (approximately 99.5% of colleagues). Both trade unions are affiliated to the Trades Union Congress. We consult Advance and the CWU on significant proposals including those relating to change across the business at both national and local levels.

Employee share ownership

Santander UK continues to operate two all-employee, HMRC-approved share schemes: a Save-As-You-Earn (Sharesave) Scheme and a Share Incentive Plan (SIP), the latter of which allows employees to purchase Banco Santander SA shares from gross salary. Eligible senior management participated in a Banco Santander long-term incentive plan. A further description of the plans and the related costs and obligations can be found in the Notes.

Disability

Santander UK is committed to equality of employment, access and quality of service for disabled people and complies with the UK Equality Act 2010 throughout its business operations. Santander UK has processes in place to help train, develop, retain and promote employees with disabilities. We are a Disability Confident Employer achieving the Leader level. We are committed to giving full and fair consideration to employment applications by disabled people, having regard to their particular aptitudes and abilities, and for continuing the employment of employees who have become disabled by arranging appropriate training and making reasonable adjustment in the workplace.

Streamlined Energy and Carbon Reporting (SECR)

In 2020 we used 123,152,495 kWh of energy, with associated GHG emissions of 6,452 tCO₂e (market-based emissions). This equates to 0.31 tCO₂e per employee, and compares to 139,467,401 kWh and 8,693 tCO₂e from 2019.

While Covid-19 had a significant impact on our figures for 2020, we have a programme of initiatives to improve energy efficiency and reduce our impact on the environment. These are outlined in our Strategic Report. We calculate our emissions using the UK government Department for Environment, Food and Rural Affairs (DEFRA) conversion factors. For full data and methodology, please see our ESG Supplement.

Political contributions

In 2020 and 2019, no contributions were made by the Company for political purposes and no political expenditure was incurred.

Share capital

Details about the structure of the Company's capital can be found in Note 32.

For details of employee share schemes and how rights are exercisable, see Note 37.

The powers of the Directors in relation to share capital are set out in the Company's Articles of Association as determined by the Companies Act 2006.

Subsidiaries and branches

The Santander UK group consists of a parent company, Santander UK Group Holdings plc, incorporated in England and Wales, and a number of directly and indirectly held subsidiaries and associates. The Company directly or indirectly holds 100% of the issued ordinary share capital of its principal subsidiaries. All companies operate principally in their country of

incorporation or registration. Santander Financial Services plc, a subsidiary of the Company, has branch offices in the Isle of Man and in Jersey. For more information, see Note 19.

Financial instruments

The financial risk management objectives and policies of Santander UK and the policy for hedging, along with details of Santander UK's exposure to credit risk, market risk and liquidity risk are outlined in the Risk review.

Research and development

Santander UK has a comprehensive product approval process and policy. New products, campaigns and business initiatives are reviewed by Santander UK's Proposition Approval Forum.

Supervision and regulation

Some of Santander UK's subsidiaries and associates are authorised by the PRA or the FCA, and regulated by the FCA or both the FCA and the PRA.

While Santander UK operates primarily in the UK, it is also subject to the laws and regulations of the other jurisdictions in which it operates, such as the rules of the SEC for its activities in the US.

Internal controls

Risk management and internal controls

The Board and its Committees are responsible for reviewing and ensuring the effectiveness of management's system of risk management and internal controls.

We have carried out a robust assessment of the principal and emerging risks facing Santander UK including those that would threaten its business model, future performance, solvency or liquidity. Details of our principal risks, our procedures to identify emerging risks, and an explanation of how these are being managed or mitigated are set out in the Risk review. A summary of our Top and Emerging Risks is also set out in the Strategic report. For more details, see the Strategic report and the Risk review.

Management's report on internal control over financial reporting

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

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

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

Management is responsible for establishing and maintaining adequate internal control over the financial reporting of Santander UK. Management assessed the effectiveness of Santander UK's internal control over financial reporting at 31 December 2020 based on the criteria established in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) in May 2013.

As a registrant under the US Securities Exchange Act of 1934, Santander UK Group Holdings plc's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting in order to ensure the accuracy and reliability of Santander UK Group Holdings plc's Financial Statements and the Form 20-F submitted to the US Securities and Exchange Commission.

In line with COSO and SEC requirements, those controls recognised as Sarbanes-Oxley applicable are subject to annual testing and certification by management including an attestation by the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) that the controls are operating effectively and that the internal control over financial reporting can be relied on.

Any Sarbanes-Oxley control weaknesses identified are captured, assessed and included within the year end assessment of the reliability of the Internal Control environment. These weaknesses are

Directors' report continued

reported on an ongoing basis to the Audit Committee to ensure continuous improvements to the control environment are achieved.

Based on this assessment, management concluded, at 31 December 2020, that Santander UK's internal control over financial reporting was effective.

Disclosure controls and procedures over financial reporting

Santander UK's management has evaluated, with the participation of its CEO and CFO, the effectiveness of its disclosure controls at 31 December 2020. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error, and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based upon this evaluation, the CEO and the CFO have concluded that, at 31 December 2020, Santander UK's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by Santander UK in the reports that it files and submits under the US Securities Exchange Act of 1934 is recorded, processed, summarised and reported within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to Santander UK's management, including the CEO and CFO, as appropriate, to allow timely decisions regarding disclosure.

Changes in internal control over financial reporting

There were no changes to our internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Statements of Compliance

The UK Corporate Governance Code 2018

Santander UK voluntarily complies with the Code wherever applicable in order to achieve best standards of corporate governance.

The Code applied to the financial year ended 31 December 2020. The Board confirms that, it applied the principles and complied with those provisions of the Code throughout the year, except as detailed as follows:

- Provision 5: The Company has not appointed a Non-Executive Director to represent the views of the workforce. For details, see 'Views of the workforce at the Board' in the Corporate Governance Section;
- Provision 11 and 17: The Company does not comply with the requirement for at least half the Board, excluding the Chair, to be Non-Executive Directors whom the Board considers to be independent. This is because our shareholder requires at least half the Board, including the Chair, to be independent (for details, see Board membership in the Chair's Report on Corporate Governance). This also affects compliance with Nomination Committee membership (majority INEDs) as the Chair is not treated as independent following appointment. We have assessed the implications and believe that the approach we follow is appropriate for our size and ownership structure. Furthermore, no one person or group of individuals dominates the Board's decision-making.
- Provision 24: The Board Audit Committee does not meet the membership requirements of the Code. For details, see the 'Board Committees' in the Chair's Report on Corporate Governance section;
- Provision 32: The Remuneration Committee does not meet the membership requirements of the Code. For details, see 'Board Committees' in the Chair's Report on Corporate Governance section;
- Provision 36: The Remuneration Committee has not developed a policy for post-employment shareholding requirements. The structure of variable pay for executive directors ensures that individuals acquire a meaningful shareholding in Banco Santander SA which is held over a period for up to eight years and which may extend for a significant period post employment. The Remuneration Committee does not intend to introduce a formal post employment shareholding policy for executive directors at this time, but will continue to keep this under review. For further details, see the Remuneration Policy Report;
- Provision 38: With effect from January 2021, alongside the other Executive Directors, the Chief Executive Officer's pension provision is aligned with the current workforce average. For further details, see the Remuneration Implementation Report;
- Provisions 40 and 41: When determining remuneration policy, the Remuneration Committee considers the factors of clarity, simplicity, risk, predictability, proportionality, and alignment to culture, and in particular how our remuneration policy and practices align to Santander UK's core values of Simple, Personal and Fair. Regular engagement takes place with our shareholder to ensure alignment with remuneration constructs across the wider Banco Santander group whilst ensuring that all regulatory requirements and expectations are met and the outcome of these discussions drives our bonus pool construct. Details of the structure of our remuneration arrangements and key considerations of the Committee in the year are included in the Remuneration Committee Chair's Report. Due to commercial sensitivity, whilst we have chosen to provide details of our pay arrangements beyond the requirements for an entity with our ownership structure, we have chosen not to provide all of the disclosures required by this part of the Code. The details not provided relate to individual award opportunities and certain descriptions of the Committee's work. For further details, see the Remuneration Policy Report.

The Code is publicly available on the Financial Reporting Council website at www.frc.org.uk.

UK Finance Code for Financial Reporting Disclosure

Santander UK's financial statements for the year ended 31 December 2020 have been prepared in compliance with the principles of the UK Finance Code for Financial Reporting Disclosure.

Engagement with stakeholders and employees

Santander UK recognises the importance of fostering relationships with their principal stakeholders and how this is key to the long term success of our business. They understand the importance to act fairly and responsibly between members of the company. For more see the S172 section in the Strategic report.

Going concern

The going concern of Santander UK is reliant on preserving a sufficient level of capital and adequately funding the balance sheet. In making their going concern assessment in connection with preparing the financial statements, the Directors considered a wide range of information similar to that considered as part of their assessment of longer-term viability including Santander UK's long-term business and strategic plans, forecasts and projections, estimated capital, funding and liquidity requirements, contingent liabilities and the reasonably possible changes in trading performance arising from potential economic, market and product developments.

During 2020, Government and Central Bank responses to Covid-19, including lending and financial stability measures and significant restrictions on people's movement, resulted in significant operational and financial impacts for Santander UK and its customers. The Directors' assessment therefore specifically considered the impacts of Covid-19, including for the following areas:

- **Economic scenarios and weights:** These underpin our ECL impairment allowances and are discussed in detail in the Credit risk section of the Risk review. The Directors reviewed the economic scenarios, revised as a result of Covid-19, to ensure that they captured the wide range of potential outcomes for the UK economy. These include a re-emergence of the virus and further lockdown measures being imposed, a slower economic recovery, and lag effects caused by higher and longer unemployment rates.
- **Liquidity:** Although the key aim of the UK Government's financial support measures introduced during 2020 (including the TFS and TFSME) was to limit damage to the wider economy from Covid-19, they had the side-effect of reducing any potential liquidity risks arising due to Covid-19. Although Covid-19 did not trigger a liquidity stress, its immediate negative impacts on liquidity, such as the drawing of committed credit and liquidity facilities, were largely offset by deposits from those same drawings as corporates reduced their spending. Similarly, the impact of the initial effective shutdown of the mortgage market and payment holidays granted to customers was offset by better than expected retail deposit balances as customers reduced their spending.

- **Capital:** Santander UK remains strongly capitalised and Covid-19 did not trigger a capital stress. As part of the Bank of England Interim Financial Stability Report (May 2020), the PRA developed a desktop stress scenario, which had less of an impact over the first two years of the scenario on the core banking system than their 2019 Stress Test, where our CET1 drawdown was the lowest across UK banks and we exceeded CET1 capital ratio and Tier 1 Leverage ratio hurdle rates across the projection horizon. We paid an ordinary share dividend in December in accordance with the PRA's approach to shareholder distributions for 2020.
- **Customers:** Santander UK has supported many thousands of individuals and businesses affected by Covid-19 with a range of measures, including payment holidays on mortgages, personal loans and credit cards as well as taking an active part in UK Government's loan schemes to help businesses. We are working with those customers who are experiencing difficulties to understand their individual situations and help them resume payments.
- **Operations:** All our operations continue to operate effectively with a significant majority of employees working from home and the majority of branches remaining open and returning to more normal hours. The current operating model could be sustained indefinitely with additional resilience being continuously implemented and is not affecting our ability to operate all our services, or raising concerns about our Business Continuity Planning, and
- **Key suppliers:** Suppliers are being closely monitored in line with our Third Party Risk Management Framework. No significant service issues were reported across our cohort of critical suppliers, and no material issues were reported across our broader (non-critical) supply chain. Isolated supplier impacts are being separately managed.

Having assessed the principal risks and uncertainties, the Directors are satisfied that the Santander UK group has adequate resources to continue operations for a period of at least twelve months from that date of this report and therefore consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

Viability

In accordance with Provision 31 of the UK Corporate Governance Code (2018), the Directors must make a statement in this Annual Report regarding the viability of Santander UK, including an explanation of how they assessed the prospects of Santander UK and the period of time for which they have made the assessment, including why they consider that period to be appropriate.

Considerations

In making their assessment, the Directors considered a wide range of information including:

- Santander UK's long-term business and strategic plans;
- Santander UK's risk profile and risk management practices, including the processes by which risks are identified and mitigated;
- Santander UK's top risks and emerging risks. Notable among these are risks which the Directors believe could cause Santander UK's future financial or financial condition to differ materially from current expectations or could adversely impact Santander UK's ability to meet regulatory requirements;
- Santander UK's forecasts and projections, estimated capital, funding and liquidity requirements;
- Santander UK's viability under specific internal and regulatory stress scenarios explained further below, including scenarios which might affect the operational resiliency of Santander UK;
- Santander UK's contingent liabilities and the reasonably possible changes in trading performance arising from potential economic, market and product developments; and
- The matters in connection with the impacts of Covid-19 as set out in the 'Going concern' section above.

For capital, funding and liquidity purposes, Santander UK operates on a standalone basis and is subject to regular and rigorous monitoring by external parties. In addition, for capital purposes, the Company operates as part of the Non ring-fenced bank Capital Support Deed with Santander Financial Services plc and Santander Equity Investments Limited.

Directors' report continued

Assessment

The viability of Santander UK is reliant on preserving a sufficient level of capital and adequately funding the balance sheet.

Santander UK's business activities and financial position, together with the factors likely to affect its future development and performance, are set out in the Financial review. Santander UK's objectives, policies and processes for managing the financial risks to which it is exposed are described in the Risk review.

Threats to the achievement of Santander UK's plans, are controlled and managed in line with Santander UK's Risk Framework and within the risk appetite approved by the Board. The risk profile, including an assessment of top and emerging risks, is reported regularly to the Board Risk Committee and the Board. Risks are selected on the basis of their ability to impact viability over the time frame of the assessment but most risks extend beyond this period.

Stress testing

Internal stress testing encompasses a series of extreme but plausible scenarios, covering a wide range of outcomes, risk factors, time horizons and market conditions. We also conduct reverse stress tests. These are tests in which we identify and assess scenarios that could cause Santander UK's business model to become unviable.

Santander UK participates in regulatory stress tests usually carried out annually by the Bank of England as well as being part of the biennial stress testing of Banco Santander carried out by the European Banking Authority (EBA).

The Directors review the outputs of stress testing as part of the approval processes for the ICAAP, the ILAAP, our Risk Appetite and regulatory stress tests

Time horizon

While a five-year plan is prepared for regulatory purposes and our stress testing encompasses scenarios some of which also extend out to that time period, using a longer time horizon increases uncertainty.

After taking account of Santander UK's current position and principal risks and uncertainties, the Directors consider that a period of three years from the balance sheet date is the most appropriate time frame from which a reasonable assessment of viability can be made.

This period is consistent with the period covered by Santander UK's three-year plan, and is representative of the time horizon to consider the impact of anticipated regulatory changes within the financial services industry.

Statement

Based on their assessment of longer-term viability, the Directors have a reasonable expectation that Santander UK will be able to continue in operation and meet its liabilities as they fall due over the next three years.

Ethical Code of Conduct

Santander UK is committed to maintaining high ethical standards – adhering to laws and regulations, conducting business in a responsible way, and treating all stakeholders with honesty and integrity. These principles are further reflected in Santander UK's Ethical Code of Conduct, which sets out the standard expected of all employees. Under their terms and conditions of employment, employees are required to act at all times with the highest standards of business conduct in order to protect Santander UK's reputation and ensure a Company culture which is free from any risk of corruption, compromise or conflicts of interest.

Employees are also required to comply with all Company policies, which require employees to:

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

The SEC requires companies to disclose whether they have a code of ethics that applies to the Chief Executive Officer and senior financial officers which promotes honest and ethical conduct, full, fair, accurate, timely and understandable disclosures, compliance with applicable governmental laws, rules and regulations, prompt internal reporting of violations, and accountability for adherence to such a code of ethics.

The Santander UK group meets these requirements through its Ethical Code of Conduct, the Anti-Bribery and Corruption Policy, the Whistleblowing Policy, the FCA's Principles for Businesses, and the FCA's Statements of Principle and Code of Practice for Approved Persons, with which the CEO and senior financial officers must comply.

These include requirements to manage conflicts of interest appropriately and to disclose any information the FCA may want to know about. Copies of these documents are available to anyone, free of charge, on application to Santander UK Group Holdings plc, 2 Triton Square, Regent's Place, London NW1 3AN.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Santander UK group and Company financial statements in accordance with international accounting standards (IAS) in conformity with the requirements of the Companies Act 2006. Additionally, the Financial Conduct Authority's Disclosure Guidance and Transparency Rules require the Directors to prepare the group financial statements in accordance with IFRS adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

In preparing the financial statements, the Directors have also elected to comply with IFRS as issued by the IASB. Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Santander UK group and the Company and of the profit or loss of the Santander UK group and the Company for that period.

In preparing the financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently
- State whether, for the Santander UK group and Company, IAS in conformity with the requirements of the Companies Act 2006 and, for the Santander UK group, IFRS adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union and IFRS issued by the IASB have been followed, subject to any material departures disclosed and explained in the financial statements
- Make judgements and accounting estimates that are reasonable and prudent
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Santander UK group and company will continue in business.

The Directors are also responsible for safeguarding the assets of the Santander UK group and the Company, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Santander UK group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Santander UK group and the Company, and enable them to ensure that the financial statements comply with requirements of the Companies Act 2006.

The Directors are responsible for the integrity and maintenance of Santander UK's website.

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

Having taken into account all the matters considered by the Board and brought to its attention during the year, the Directors are satisfied that the Annual Report taken as a whole is fair, balanced and understandable, and provides the information necessary to assess Santander UK's position and performance, business model and strategy. Each of the Directors at the date of approval of this report confirms, to the best of their knowledge, that:

- The group and company financial statements, which have been prepared in accordance with IAS in conformity with the requirements of the Companies Act 2006 and, for the group, IFRS adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union and IFRS issued by IASB, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Santander UK group
- The management report, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the Company and the Santander UK group, together with a description of the principal risks and uncertainties they face.

Disclosure of information to Auditors

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

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

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

Auditor

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

By Order of the Board

Simon Mitchley

Company Secretary

2 March 2021

2 Triton Square,
Regent's Place,
London NW1 3AN

Risk review

The Risk review consists of unaudited financial information unless otherwise stated. The audited financial information is an integral part of our Consolidated Financial Statements.

We aim to continually enhance our disclosures and their usefulness to readers in the light of developing market practice and areas of focus. As a result, our disclosures go beyond the minimum required by accounting standards and other regulatory requirements.

We support the recommendations and guidance made by the Taskforce on Disclosures about ECL (DECL Taskforce) and have adopted its recommendations where it is practical to do so. The DECL Taskforce was formed in 2017 by the FCA, FRC and PRA with a remit to help encourage high-quality ECL-related disclosures following adoption of IFRS 9.

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Risk governance

INTRODUCTION

Santander UK Group Holdings plc is the immediate parent company of Santander UK plc. The two companies operate on the basis of a unified business strategy with some overlap in membership, albeit the principal business activities of the Santander UK group are carried out by Santander UK plc and its subsidiaries (the Santander UK plc group). The Company's Risk Frameworks have been adopted by its subsidiaries to ensure consistent application.

As a financial services provider, managing risk is a core part of our day-to-day activities. To be able to manage our business effectively, it is critical that we understand and control risk in everything we do. We aim to use a prudent approach and advanced risk management techniques to help us deliver robust financial performance, withstand stresses, such as the impacts of the Covid-19 pandemic, and build sustainable value for our stakeholders. We aim to keep a predictable medium-low risk profile, consistent with our business model. This is key to achieving our strategic objectives.

In 2020, the Covid-19 pandemic had a material impact on our business and financial performance, and our risk profile. The main impacts were felt in credit risk and operational risk, although other risks such as conduct and reputational risk were also affected. In response, we managed the evolution of our credit and operational risk profiles across the business. Challenges remain, such as the significant increase in cyber and fraud risk seen across the industry. We have prioritised monitoring and oversight of these and other key operational risks with enhanced reporting and input to IT strategy, data management and business transformation. Detailed discussions of the impact of Covid-19 on specific risk types are set out in the relevant sections of this Risk review and summarised in the 'Risk management overview' in the Strategic report.

RISK FRAMEWORK

How we define risk

Risk is any uncertainty about us being able to achieve our business objectives. It can be split into a set of key risk types, each of which could affect our results and our financial resources. Enterprise wide risk is the aggregate view of all the key risk types described below:

Key risk types	Description
Credit	The risk of financial loss due to the default or credit quality deterioration of a customer or counterparty to which we have provided credit, or for which we have assumed a financial obligation.
Market	<p>Banking market risk – the risk of loss of income or economic value due to changes to interest rates in the banking book or to changes in other market risk factors (e.g. credit spread and inflation risk), where such changes would affect our net worth through a change to revenues, assets, liabilities and off-balance sheet exposures in the banking book.</p> <p>Trading market risk – the risk of changes in market factors that affect the value of positions in the trading book.</p>
Liquidity	The risk that we do not have sufficient liquid financial resources available to meet our obligations as they fall due, or we can only secure such resources at excessive cost.
Capital	The risk that we do not have an adequate amount or quality of capital to meet our internal business objectives, regulatory requirements and market expectations.
Pension	The risk caused by our statutory contractual or other liabilities with respect to a pension scheme (whether set up for our employees or those of a related company or otherwise). It also refers to the risk that we will need to make payments or other contributions with respect to a pension scheme due to a moral obligation or for some other reason.
Conduct and regulatory	<p>Conduct risk – the risk that our decisions and behaviours lead to a detriment or poor outcome for our customers. It also refers to the risk that we fail to maintain high standards of market behaviour and integrity.</p> <p>Regulatory risk – the risk of financial or reputational loss, or imposition or conditions on regulatory permission, as a result of failing to comply with applicable codes, regulator's rules, guidance and regulatory expectations.</p>
Operational risk	<p>The risk of loss due to inadequate or failed internal processes, people and systems, or external events. We give a particular focus to the following risks which we mitigate through our management of operational risk:</p> <p>Cyber – We rely extensively on the use of technology across our business. It is critically important that we give our customers a secure environment in which to deal with us, especially when the threat from cyber criminals is so prevalent and more sophisticated than ever. Failure to protect the data assets of Santander UK and its customers against theft, damage or destruction from cyber-attacks could result in damage to our reputation and direct financial losses.</p> <p>Change and transformation – A key part of our business strategy is to develop and deliver new banking channels and products. We are also implementing a large number of regulatory and legal changes, impacting all areas of our business.</p> <p>People – People risk include all risks related to employees and third parties working for us, covering resource management, health & safety and employee relations.</p>
Other key risk types	<p>Financial crime risk – the risk that we are used to further financial crime, including money laundering, sanctions evasion, terrorist financing, bribery and corruption. Failure to meet our legal and regulatory obligations could result in criminal or civil penalties against Santander UK or individuals, as well as affecting our customers and the communities we serve.</p> <p>Legal risk – the risk of an impact arising from legal deficiencies in contracts; failure to protect assets; failure to manage legal disputes appropriately; failure to assess or implement the requirements of a change of law; or failure to comply with law or regulation or to discharge duties or responsibilities created by law or regulation.</p> <p>Strategic and business risk – the risk of significant loss or underperformance against planned objectives; damage arising from strategic decisions or their poor implementation that impact the long-term interests of our key stakeholders or from an inability to adapt to external developments.</p> <p>Reputational risk – the risk of damage to the way our reputation and brand are perceived by the public, clients, government, colleagues, investors or any other interested party.</p> <p>Model risk – the risk that the predictions of our models may be inaccurate, causing us to make sub-optimal decisions, or that a model may be used inappropriately.</p>

Top and emerging risks

Several of our key risk types also have top risks associated with them. We regularly review the top risks that could impact our business, customers and shareholders, and they are monitored monthly at the ERCC and BRC. The top risks we actively monitored over 2020 are set out in the relevant section of this Risk review and summarised in the 'Top risks' section of the 'Risk management overview' in the Strategic report. Our top risks included the first and second order risks arising from Covid-19, Brexit, capital strength, financial crime, conduct and operational risks.

We also regularly review emerging risks that could impact our business, customers and shareholders, including regular review and discussion at the ERCC and BRC. The identification of emerging risks is co-ordinated by the Risk Division. A key part of the process is continual scanning of the external environment, focusing on emerging risk drivers such as regulation, markets, technology, competition, customers, geo-politics, environment (including climate change), and social and economic changes. Emerging risks actively monitored over 2020 are set out in the relevant section of this Risk review and summarised in the 'Emerging risks' section of the 'Risk management overview' in the Strategic report.

We introduced six new emerging risks to our risk radar in 2020, several of which reflected the impact of the Covid-19 pandemic. They consisted of negative rates, extended government involvement in the banking industry, an extended period of economic contraction, high inflation, disruption of macro-economic factors, and other environmental and social issues. We also continued to monitor previously identified emerging risks including changing customer behaviour, rapid technological change, LIBOR transition and climate change.

Key elements

Our Risk Framework sets out how we manage and control risk. In 2020, we updated it with a new standard to consider the impact for risks related to climate change and also added additional controls to deal with potential conflicts of interest which might affect Santander UK.

As a group, Banco Santander supports the recommendations of the TCFD, which were published with the aim of improving disclosure of climate financial risks and opportunities. We also welcome the UK developments of the PRA and FCA to improve management and disclosure of climate change related risks. In October 2019, we submitted an initial implementation plan to the PRA to address the expectations set out Supervisory Statement 3/19 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change'. Alongside this plan, responsibility for climate related financial risks was added to the Statement of Responsibility of the CRO as SMF holder. Delivering on our plan will be a multi-year programme. We are targeting the end of 2022 to achieve full adoption, aligned to the implementation path as set out in the TCFD recommendations.

How we approach risk – our culture and principles

The complexity and importance of the financial services industry demands a strong risk culture. We have extensive systems, controls and safeguards in place to manage and control the risks we face, but it is also crucial that everyone takes personal responsibility for managing risk. Our risk culture plays a key role in our aim to be the best bank for our customers, shareholders, people and communities by acting responsibly. It is vital that everyone in our business understands this. To achieve this, our people have a strong, shared understanding of what risk is, and what their role is in helping to control it. We express this in our Risk Culture Statement:

Risk Culture Statement

Santander UK will only take risks that it understands and will always remain prudent in identifying, assessing, managing and reporting all risks. We proactively encourage our people to take personal responsibility for doing the right thing and to challenge without fear. We ensure decisions and actions take account of the best interests of all our stakeholders and are in line with The Santander Way.

The Board reviews and approves our Risk Culture Statement every year. Senior executives are responsible for promoting our risk culture from the top. They drive cultural change and increased accountability across the business. We reinforce our Risk Culture Statement and embed our risk culture in all our business units through our Risk Framework, Risk Certifications and other initiatives. This includes highlighting that:

- It is everyone's personal responsibility to play their part in managing risk
- We must Identify, Assess, Manage and Report risk quickly and accurately
- We make risk part of how we assess our people's performance and how we recruit, develop and reward them
- Our internal control system is essential to ensure we manage and control risk in line with our principles, standards, Risk Appetite and policies.

We use Risk Certifications to confirm how we manage and control risks in line with our Risk Framework and within our Risk Appetite. As an example, every year, each member of our Executive Committee confirms that they have managed risk effectively in line with the Risk Framework in the part of the business for which they are responsible. Their certification lists any exceptions and the agreed actions to be taken to correct them. This is a tangible sign of the personal responsibility that is such a key part of our risk culture.

Our risk culture programme – I AM Risk

The Covid-19 pandemic has created additional risks in our business. At the same time, we continue with significant transformation programme activities, while dealing with a highly competitive financial services sector and a challenging political and regulatory environment. At times of change, it is important that we make the decisions that help us achieve our goals while supporting and protecting our colleagues and customers. I AM Risk continues to play a key part in our aim to be the best bank for our people, customers, shareholders and communities. Our I AM Risk approach aims to make sure our people:

- **Identify** risks and opportunities
- **Assess** their probability and impact
- **Manage** the risks and suggest alternatives
- **Report**, challenge, review, learn and 'speak up'.



I AM Risk is how we make risk management part of everyone's life as a Santander UK employee from how we recruit them and manage their performance to how we develop and reward them. It is also how we encourage people to take personal responsibility for risk to speak up and to come up with ideas. We use I AM Risk in our risk certifications, policies, frameworks and governance, and risk-related communications. We also include it in reward arrangements and in mandatory training. To support general awareness, our learning websites includes e-learning videos and factsheets.

As part of I AM Risk, we include mandatory risk objectives for all our people in our performance management processes – from our Executive Committee to branch staff. The Executive Committee leads our culture initiatives under the CEO's sponsorship. In our most recent employment engagement survey, 94% of employees recognised their personal responsibility for the risks they face in their day-to-day work. This demonstrates how we have embedded risk management in our culture.

I AM Risk in Action - Our Covid-19 Response

Our I AM Risk ethos was demonstrated through our response to the Covid-19 pandemic when we were faced with the rapid deployment of colleagues to remote working. This required a comprehensive review of the increased risks of remote working by all areas of the business. In addition, we devised additional mandatory training material at pace, in order to support our colleagues in their new working environments and to help them protect our customers. As the pandemic progressed and our colleagues were returning or continuing to work in our branches and offices, we created training to support them and to help them comply with the relevant government guidelines.

I AM Risk Week 2020

In November 2020, we once again joined colleagues from across the Banco Santander group to celebrate our risk culture, with an emphasis on our Speak Up behaviour. During this time, we encouraged our colleagues to use our I AM Risk resources to:

- Use our new and dynamic Speaking Up Channels Guide on the intranet to help find the right channels to raise any concerns
- Recognise a colleague for good risk behaviour
- Share a story of how an individual or team have taken personal accountability for risk.

Our risk governance structure

We are committed to the highest standards of corporate governance in every part of our business, including risk management. For details of our governance, including the Board and its Committees, see the 'Governance' section of this Annual Report. The Board delegates certain responsibilities to Board Level Committees as needed and where appropriate. Our risk governance structure strengthens our ability to identify, assess, manage and report risks, as follows:

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

Committees

The Board Level Committee responsibilities for risk are:

Board Level Committee	Main risk responsibilities
The Board (including the Santander UK plc Board)	<ul style="list-style-type: none"> – Has overall responsibility for business execution and for managing risk – Reviews and approves the Risk Framework and Risk Appetite.
Board Risk Committee (BRC)	<ul style="list-style-type: none"> – Assesses the Risk Framework and recommends it to the Board for approval – Advises the Board on our overall Risk Appetite, tolerance and strategy – Oversees our exposure to risk and our strategy and advises the Board on both – Reviews the effectiveness of our risk management systems and internal controls.
Board Responsible Banking Committee	<ul style="list-style-type: none"> – Responsible for culture and operational risk from conduct, compliance, competition, financial crime & legal matters – Reviews reports from the CLRO on the adequacy and effectiveness of the compliance function – Ensures that adequate and effective control processes are in place to identify and manage reputational risks – Oversees our Corporate Social Responsibility programme and how it impacts on employees, communities, the environment including sustainability and climate change, reputation, brand and market positioning.
Board Audit Committee	<ul style="list-style-type: none"> – Monitors and reviews the financial statements integrity, and any formal announcements on financial performance – Reviews the adequacy and effectiveness of the internal financial controls and whistleblowing arrangements – Monitors and reviews the effectiveness of the internal audit function. – Oversees the independence and performance of our auditors.
Board Remuneration Committee	<ul style="list-style-type: none"> – Oversees implementation of remuneration policies, ensuring they promote sound and effective risk management.

The Executive Level Committee responsibilities for risk are:

Executive Level Committee	Main risk responsibilities
Executive Committee	<ul style="list-style-type: none"> – Reviews business plans in line with our Risk Framework and Risk Appetite before they are sent to the Board to approve. – Receives updates on key risk issues managed by CEO-level committees and monitors the actions taken.
Senior Management Committee	<ul style="list-style-type: none"> – Focuses on the responsibilities of the Executive Committee Senior Management Function holders and how they are discharged – Reviews updates on key risk issues, customer, reputational and conduct matters.
Executive Risk Control Committee (ERCC)	<ul style="list-style-type: none"> – Reviews Risk Appetite proposals before they are sent to the Board Risk Committee and the Board to approve – Ensures that we comply with our Risk Framework, Risk Appetite and risk policies – Reviews and monitors our risk exposures and approves any corrective steps we need to take.
Asset and Liability Committee (ALCO)	<ul style="list-style-type: none"> – Reviews liquidity risk appetite (LRA) proposals – Ensures we measure and control structural balance sheet risks, including capital, funding and liquidity, in line with the policies, strategies and plans set by the Board – Reviews and monitors key asset and liability management activities to ensure we keep our exposures within our Risk Appetite.
Pensions Committee	<ul style="list-style-type: none"> – Reviews pension risk appetite proposals – Approves actuarial valuations and reviews the impact they may have on our contributions, capital and funding – Consults with the pension scheme trustees on the scheme's investment strategy.
Capital Committee	<ul style="list-style-type: none"> – Puts in place reporting systems and risk control processes to make sure capital risks are managed within our Risk Framework – Reviews capital adequacy and capital plans, including the ICAAP, before they are sent to the Board to approve.
Incident Accountability Committee	<ul style="list-style-type: none"> – Considers, calibrates, challenges and agrees any appropriate individual remuneration adjustments – Presents recommendations to the Board Remuneration Committee.
Credit Approval Committee	<ul style="list-style-type: none"> – Approves corporate and wholesale credit transactions which exceed levels delegated to lower level forums or individuals.
Investment Approval Committee	<ul style="list-style-type: none"> – Approves equity type investment transactions which exceed levels delegated to lower level approval forums or individuals.
Financial Crime Committee	<ul style="list-style-type: none"> – Ensures due reporting, consideration, oversight and informed decision making regarding compliance by the Company and its subsidiaries with financial crime laws and regulations, and best industry practice aligned to the Company's stated risk appetite.

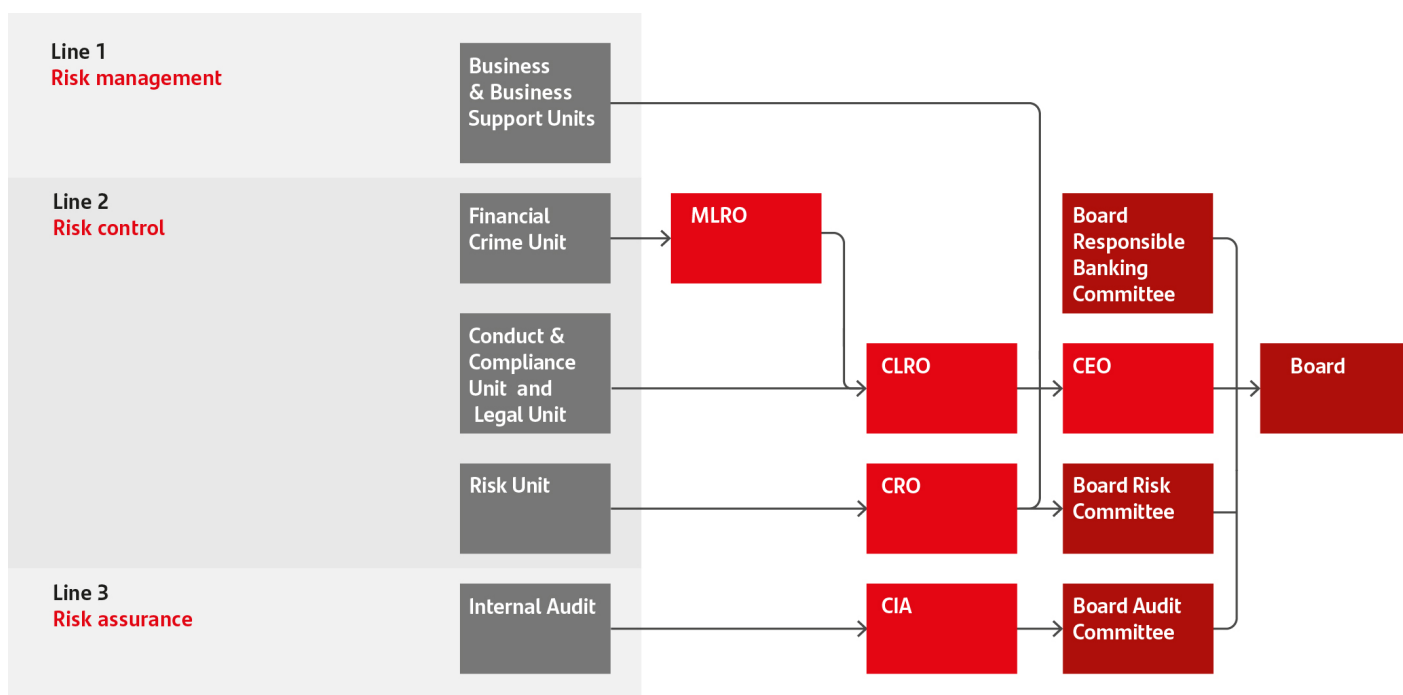
Key senior management roles

Senior roles with specific responsibilities for risk management are:

Role	Main risk responsibilities
Chief Executive Officer	The Board delegates responsibility for our business activities and managing risk on a day-to-day basis to the CEO. The CEO proposes our strategy and business plan, puts them into practice and manages the risks involved. The CEO must also ensure we have a suitable system of controls to manage risks and report to the Board on it.
Chief Risk Officer (CRO)	As Risk Division leader, oversees and challenges risk activities, and ensures lending decisions are made within our Risk Appetite. Accountable for control and oversight of credit, market, liquidity, capital, pension, strategic & business, operational and model risk.
Chief Legal and Regulatory Officer (CLRO)	Accountable for the control and oversight of legal, conduct and regulatory, reputational and financial crime risk, and is responsible for reporting on these risks to the CRO, to provide the CRO with a holistic enterprise wide view of all risks.
Chief Financial Officer	Responsible for developing strategy, leadership and management of the CFO Division. In supporting our corporate goals within our risk appetite, the CFO is responsible for managing interest rate, liquidity, pension and capital risks. The CFO aims to maximise the return on Regulatory and Economic Capital, ensuring transactions create value with the right risk-based profile.
Chief Internal Auditor (CIA)	Designs and uses an audit system that identifies key risks and evaluates controls. The CIA also develops an audit plan to assess existing risks that involve producing audit, assurance and monitoring reports.
Money Laundering Reporting Officer (MLRO)	Responsible to the CLRO for control and oversight of financial crime risk but has regulatory responsibility to report on this risk type to Executive and Board Committees and the FCA.

Risk organisational structure

We use the 'three lines of defence' model to manage risk. This model is widely used in the banking industry and has a clear set of principles to put in place a cohesive operating model across an organisation. It does this by separating risk management, risk control and risk assurance. The diagram below shows the reporting lines to the Board (including the Santander UK plc Board) with respect to risk:



Line 1: Business Units and Business Support Units identify, assess and manage the risks which originate and exist in their area, within our Risk Appetite.

Line 2: Risk Control Units are independent monitoring and control functions. They are under the executive responsibility of the CEO, but responsible to the CRO for overseeing the first line of defence. They make sure Business Units and Business Support Units manage risks effectively and within our Risk Appetite. The Risk Control Units are: Financial Crime; Conduct & Compliance, responsible for controlling reputational and conduct & regulatory risks; Legal; and Risk, responsible for controlling credit, market, liquidity, capital, pension, strategic and business, operational and model risks.

Line 3: Internal Audit is an independent corporate function. It gives assurance on the design and effectiveness of our risk management and control processes.

Internal control system

Our Risk Framework is an overarching view of our internal control system that helps us manage risk across the business. It sets out at a high level the principles, standards, roles and responsibilities, and governance for internal control. Our Risk Framework covers the categories below:

Category	Description
Risk Frameworks	Set out how we should manage and control risk across the business (overall framework), our key risk types (risk type frameworks) and our key risk activities (risk activity frameworks).
Risk Management Responsibilities	Set out the Line 1 risk management responsibilities for Business Units and Business Support Units.
Strategic Commercial Plans	Plans produced by business areas, at least annually, which describe the forecasted objectives, volumes and risk profile of new and existing business, within the limits defined in our Risk Appetite.
Risk Appetite	See our Risk Appetite section that follows.
Delegated Authorities/Mandates	Define who can do what under the authority delegated to the CEO by the Board.
Risk Certifications	Business Units, Business Support Units or Risk Control Units set out how they have managed and/or controlled risks in line with our risk frameworks and within our Risk Appetite. They are completed at least once a year and explain action to be taken. This helps ensure people can be held personally accountable.

RISK APPETITE

How we control the risks we are prepared to take

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

The principles of our Risk Appetite

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

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

How we describe the limits in our Risk Appetite

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

Metrics

We use metrics to set limits on losses, capital, liquidity and concentration. We set:

- Limits for losses for our most important risks, including credit, market, operational and conduct risk
- Capital limits, reflecting both the capital that regulators expect us to hold (regulatory capital) and our own internal measure economic capital (EC)
- Liquidity limits according to a range of plausible stress scenarios for our business
- Concentration limits, to determine the maximum concentration level that we are willing to accept.

These limits apply in normal business conditions, but also when we might be experiencing a far more difficult economic environment. A good example of this might be when the UK economy is performing much worse than we expected, such as in 2020 due to the Covid-19 pandemic. We refer to conditions like this as being under stress. See more on EC and stress scenarios on the next page.

Qualitative statements

For some types of risk we also use qualitative statements that describe in words the appetite we want to set. For example, in operational risk, we use them to describe our risk-averse appetite for cyber risk. We also use them to prohibit or restrict exposure to certain sectors, types of customer and activities.

How we set our Risk Appetite, and stay within it

We control our Risk Appetite through our Risk Appetite Framework. Our Board approves and oversees our Risk Appetite Statement every year. This ensures it is consistent with our strategy and reflects changes in the markets and economic environment in which we operate, such as due to the Covid-19 pandemic. Our ERCC is responsible for ensuring that our risk profile (the level of risk we are prepared to accept) is consistent with our Risk Appetite Statement. To do this they monitor our performance against our Risk Appetite, business plans and budgets each month.

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

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

STRESS TESTING

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

Scenarios for stress testing

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

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

We describe each scenario using a narrative setting out how events might unfold, as well as a market and/or economic context. For example, the key economic factors we reflect in our ICAAP scenarios include house prices, interest rates, unemployment levels and the size of the UK economy. One of the scenarios used in 2020 considered a further level of stress to the UK economy driven by a resurgence of the coronavirus cases in Q4 2020. This scenario is characterised by a double dip in GDP growth and unemployment reaching near 12%. We use a comprehensive suite of stress scenarios to explore sensitivities to market risk, including those based on historical market events.

How we use stress testing

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

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

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

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

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

Board oversight of stress testing

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

Regulatory stress tests

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

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

HOW RISK IS DISTRIBUTED ACROSS OUR BUSINESS

Economic capital

As well as assessing how much regulatory capital we need to hold, we use an internal EC model to measure our risk. We use EC to get a consistent measure across different risk types. EC also takes account of how concentrated our portfolios are, and how much diversification there is between our various businesses and risk types. As a consequence, we can use EC for a range of risk management activities. For example, we can use it to help us compare requirements in our ICAAP or to get a risk-adjusted comparison of income from different activities.

Regulatory capital – risk-weighted assets

We hold regulatory capital against our credit, market and operational risks. In 2020, the largest category continued to be credit risk in Retail Banking, which accounted for more than half of our risk-weighted assets. This reflects our business strategy and balance sheet.

For more on this, see 'Risk-weighted assets' in the 'Capital risk' section.

Credit risk

Overview

Credit risk is the risk of financial loss due to the default or credit quality deterioration of a customer or counterparty to which we provided credit, or for which we have assumed a financial obligation.

Santander UK group level

We start by discussing credit risk at a Santander UK group level. We set out how our exposures arise, our types of customer and how we manage them, and our approach to credit risk across the credit risk lifecycle. We discuss our ECL approach and the key inputs to our ECL model. We also summarise various Covid-19 support measures provided to our customers and their impact on ECL. We then analyse our key metrics, credit performance and forbearance, and highlight how Covid-19 affected them where relevant.

Business segments

Then we cover Retail Banking separately from our other business segments – Corporate & Commercial Banking, Corporate & Investment Banking and Corporate Centre – in more detail.

Key metrics

Stage 3 ratio increased to 1.42% (2019: 1.15%).

Loss allowances increased to £1,377m (2019: £863m).

Average LTV of 64% (2019: 65%) on new mortgage lending.

Credit risk – Santander UK group level

SANTANDER UK GROUP LEVEL – CREDIT RISK MANAGEMENT

Exposures (audited)

Exposures to credit risk arise in our business segments from:

Retail Banking	Corporate & Commercial Banking	Corporate & Investment Banking	Corporate Centre
<ul style="list-style-type: none"> Residential mortgages, business banking, consumer (auto) finance and other unsecured lending (credit cards, personal loans and overdrafts). We provide these to individuals and small businesses. 	<ul style="list-style-type: none"> Loans, bank accounts, treasury services, invoice discounting, cash transmission, trade finance and asset finance. We provide these to SMEs and mid corporates, Commercial Real Estate and Social Housing associations. 	<ul style="list-style-type: none"> Loans, bank accounts, treasury services, treasury markets activities, trade finance, receivables discounting and cash transmission. We provide these to large corporates and financial institutions. 	<ul style="list-style-type: none"> Asset and liability management of our balance sheet, as well as our non-core and Legacy Portfolios being run down. Exposures include sovereign and other international organisation assets that we hold for liquidity.

The segmental basis of presentation in this Annual Report has been changed, and the prior periods restated, to report some customer assets in Corporate & Commercial Banking rather than in Business Banking (in Retail Banking), some non-core corporate mortgages in Corporate & Commercial Banking rather than in Corporate Centre, and a number of smaller business lines in Corporate Centre rather than in Corporate & Investment Banking. See Note 2 for more information.

Our types of customers and how we manage them

We manage credit risk across all our business segments in line with the credit risk lifecycle that we show in the next section. We tailor the way we manage risk to the type of customer. We classify our customers as standardised or non-standardised:

Standardised	Non-standardised
<ul style="list-style-type: none"> Mainly individuals and small businesses. Their transactions are for relatively small amounts of money and share similar credit characteristics. We manage risk using automated decision-making tools. These are backed by teams of expert analysts. 	<ul style="list-style-type: none"> Mainly medium and large corporate customers. Their transactions are for larger values and have more diverse credit characteristics. We manage risk through expert analysis with support from internal risk assessment models.



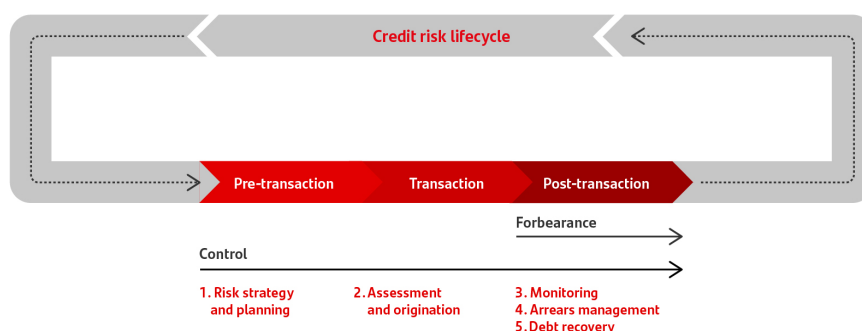
Covid-19 loan schemes

For many of our business customers, the impact of the Covid-19 pandemic has been extreme with, in some cases, revenue streams disappearing overnight and cash flows becoming very challenged. Many businesses that had been performing well were suddenly faced with considerable unforeseen challenges. Given the scale of these issues and their impact on the wider economy, it is understandable that the UK Government wanted to provide financial help and recognised that one of the most efficient ways to do so quickly was through the banking sector.

The result was the rapid development, introduction and implementation of the government-backed loan schemes, BBLS, CBILS and CLBILS. We mobilised quickly to implement these schemes in a way that allowed our customers to get much needed support quickly. In a matter of months, we granted such loans to circa 150,000 customers totalling £4.6bn, consisting of £4.0bn BBLS, £0.4bn CBILS and £0.2bn CLBILS. These loans ensured that our customers had liquidity to allow them to survive, and adapt their business models to the new environment. Almost all of our government-backed loans have been to existing customers, with an incredible 111,000 BBLS loans made to existing customers who had never borrowed from us before. Almost all of the remainder of the BBLS loans have been made to existing borrowers.

The rapid support provided to so many of our business customers has strengthened and deepened many of our customer relationships.

Our approach to credit risk



We manage our portfolios across the credit risk lifecycle (above), from drawing up our risk strategy, plans, budgets and limits to making sure the actual risk profile of our exposures stays in line with our business plans and within our Risk Appetite. We further tailor the way we manage risk across the lifecycle to the type of product. We say more on this in the Credit risk – Retail Banking and the Credit risk – Other business segments sections.

1. Risk strategy and planning (audited)

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

2. Assessment and origination (audited)

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

- The credit quality of the customer
- The underlying risk and how we can mitigate it, such as through netting or collateral, or participation in Government-sponsored programs, such as the coronavirus support loan schemes introduced in 2020
- Our risk policy, limits and appetite
- Whether we can balance the amount of risk we face with the returns we expect, and
- Assessment of customer affordability.

We lend responsibly by having a number of prohibitions and restrictions on a range of activities. For details, see the 'Other business segments - credit risk management' section.

3. Monitoring (audited)

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

Credit concentrations

A core part of our monitoring and management is a focus on credit concentrations, such as the proportion of our lending that goes to specific borrowers, groups or industries. We set concentration limits in line with our Risk Appetite and review them on a regular basis. We track how concentrated our portfolios are using a range of criteria, these include geographies, economic sectors, products and groups of customers.

Geographical concentrations

We set exposure limits to countries and geographies, with reference to the country limits set by Banco Santander. These are determined according to how the country is classified (whether it is a developed OECD country or not), its credit rating, its gross domestic product, and the products and services we or Banco Santander want to offer in that country. For more geographical information, see 'Country risk exposures'.

Industry concentrations

We also set exposure limits by industry sector. We set these limits based on the industry outlook, our strategic aims and desired level of concentration, and relevant limits set by Banco Santander. We analyse committed exposures in the 'Credit risk review'.

4. Arrears management (audited)

Sometimes our customers face financial difficulty and may fall into payment arrears or breach the conditions of their credit facility. If this happens, we work with them to get their account back on track. We aim to support our customers and keep our relationship with them. To do this, we:

- Find affordable and sustainable ways of repaying to fit their circumstances
- Monitor their finances and use models to predict how they will cope. This helps us put in place the right strategy to manage their debt
- Work with them to get their account back on track as soon as possible in a way that works for them and us
- Monitor agreements we make to manage their debt, so we know they are working.

For more, see the Forbearance section on the next page.

5. Debt recovery (audited)

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

Loan modifications (audited)

We sometimes change the terms of a loan when a customer gets into financial difficulty (this is known as forbearance), or for other commercial reasons.

Forbearance

When a customer gets into financial difficulties, we can change the terms of their loan, either temporarily or permanently. We do this to help customers through temporary periods of difficulty so they can get back on to sustainable terms and fully pay off the loan over its lifetime, with support if needed. We try to do this before the customer defaults. Whatever we offer, we assess it to make sure the customer can afford the repayments. Forbearance improves our customer relationships and our credit risk profile. We review our approach regularly to make sure it is still effective. In a few cases, we can help a customer in this way more than once. This can happen if the plan to repay their debt doesn't work and we have to draw up another one. When this happens more than once in a year, or more than three times in five years, we call it multiple forbearance. We only use foreclosure or repossession as a last resort.

When we agree to forbearance, we consider that the account has suffered a Significant Increase in Credit Risk (SICR), as we explain later on. We review our loss allowance for it and report the account as forborne. For retail accounts, if an account is in Stage 1 (a 12-month ECL) when we agree forbearance, we transfer it to Stage 2 (a lifetime ECL). For all accounts, if an account is already in Stage 2 when we agree forbearance, we keep it in Stage 2 unless the forbearance arrangement involves an account that is deemed unlikely to pay (defined through a number of events listed in our Classification Policy), the forgiveness of fees and interest or debt, or is being granted multiple forbearances which would put the case into Stage 3 (a lifetime ECL). If an account is already in Stage 3 when we agree forbearance, we keep it in Stage 3. We monitor the performance of all forborne loans. A loan moves from a lifetime ECL to a 12-month ECL once the criteria to exit forbearance have been met, as set out below.

Exit from forbearance or cure

For an account in Stage 3 to exit forbearance, all the following conditions must be met:

- The account has been classed as Stage 3 for at least one year since the end of the latest forbearance strategy
- The account is not deemed unlikely to pay
- The account is no longer in arrears, and the customer has no other material debts with us which are more than 90 days in arrears.

If all the conditions are met, the account is re-classed as Stage 2 forbearance until the Stage 2 forbearance exit conditions set out below are also met.

For an account in Stage 2 to exit forbearance, all the following conditions must be met:

- The account has been classed as Stage 2 for at least two years since the end of the latest forbearance strategy
- The account has been performing, i.e. the customer is no longer in financial difficulty
- Meaningful capital and interest repayments have been made for at least 50% of the two year period
- The account is no longer in arrears, and the customer has no other material debts with us which are more than 30 days in arrears.

Other modifications

When a customer is not showing any signs of financial difficulties, we can also change the terms of their loan. We do this to assist them to manage their financial liabilities. In addition, since March 2020, we have provided mortgage customers with payment holiday terms in line with UK Government and FCA guidance. Similar payment holidays have also been granted in respect of consumer (auto) finance, personal loans, credit cards, businesses and corporates. For more on this, see 'Covid-19 Support measures'.

Loans for customers who were provided with payment holidays were considered to have the contract terms modified. The granting of a payment holiday on its own was not considered to be a Significant Increase in Credit Risk (SICR) event, nor was it considered a default under regulatory definitions. Neither were they considered to have been granted forbearance. For customers who have needed further financial support after the payment holiday period, we help them by offering assistance in line with our policies.

Risk measurement and control

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

- **Credit control:** as a core part of risk management we generate, extract and store accurate, comprehensive and timely data to track credit limits. We use internal data and data from third parties like credit bureaux.
- **Models:** we use models widely to measure credit risk and capital needs. They range from statistical and expert models to benchmarks.
- **Review:** we use formal and informal forums to approve, validate, review and challenge our risk management. We do this to help predict if our credit risk will worsen.

Key metrics (audited)

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

Metric	Description
Expected Credit Loss (ECL)	ECL tells us what credit risk is likely to cost us either over the next 12 months on qualifying exposures, or defaults over the lifetime of the exposure where there is evidence of a SICR since origination. We explain how we calculate ECL below.
Stages 1, 2 and 3	We assess each facility's credit risk profile to determine which stage to allocate them to, and we monitor where there is a SICR and transfers between the Stages including monitoring of coverage ratios for each stage. We explain how we allocate a facility to Stage 1, 2 or 3 below.
Stage 3 ratio	The Stage 3 ratio is total Stage 3 exposure as a percentage of customer loans plus undrawn Stage 3 exposures. The Stage 3 ratio is the main indicator of credit quality performance.
Expected Loss (EL)	EL is based on the regulatory capital rules of CRD IV and gives us another view of credit risk. It is the product of the probability of default, exposure at default and loss given default. We calculate each factor in accordance with CRD IV and include direct and indirect costs. We base them on our risk models and our assessment of each customer's credit quality. There are differences between regulatory EL and IFRS 9 ECL, which we set out below. The rest of our Risk review, impairments, losses and loss allowances refer to calculations in accordance with IFRS, unless we specifically say they relate to CRD IV. For our IFRS accounting policy on impairment, see Note 1 to the Consolidated Financial Statements.

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

Key differences between regulatory EL and IFRS 9 ECL models

There are differences between the regulatory EL and the IFRS 9 ECL approaches. Although our IFRS 9 models use the existing Basel advanced IRB risk components, we need to make several adjustments to ensure the outcome is in line with the IFRS 9 requirements, i.e. the financial reporting standard we use, as follows.

	Basel advanced IRB EL	IFRS 9 ECL
Rating philosophy	Mix of point-in-time, through-the-cycle or hybrid	Point-in-time, forward-looking. Considers a range of economic scenarios
Parameters calibration	Contains regulatory floors and downturn calibration	Unbiased estimate, based on conditions known at the balance sheet date
Calculation timing	Considers aggregation of possible default events in the next 12 months	Considers monthly calculation of parameters, for all possible future default dates. First 12 months are used for Stage 1, full lifetime for Stages 2 and 3
Probability of Default (PD)	PD in the next 12 months	Includes forward-looking economic data and removes conservatism. PD in next 12 months for Stage 1, lifetime for Stages 2 and 3
Loss Given Default (LGD)	Lifetime LGD for defaults in the next 12 months	Modelled without regulatory floors and exclusion of indirect costs
Exposure at Default (EAD)	Exposure at the point of default if the customer defaults in the next 12 months	Floored at amount owed, except on some revolving facilities. Recognises ability for exposure to reduce from the balance sheet date to default date
SICR	Does not include SICR concept	Includes SICR concept
Discounting applied	At the weighted average cost of capital to the default date	At the effective interest rate (EIR) to the balance sheet date

Recognising ECL (audited)

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

Multiple economic scenarios and probability weights (audited)

For all our portfolios, except CIB, we use five forward-looking economic scenarios. For 2020, they consist of a central base case, one upside scenario and three downside scenarios. We use five scenarios to reflect a wide range of possible outcomes for the UK economy.

(i) For all our portfolios, except CIB

Our forecasting approach

We derive our scenarios in part by using a set of parameters in GDP fan charts published by the Office for Budget Responsibility (OBR). To avoid major changes to the scenarios due to changes in the OBR fan charts, we place more weight on the long-run outlook of the fan charts rather than relying solely on each individual release as this can create large swings in the scenarios which may not be appropriate. We use the OBR fan charts to calculate our GDP paths for each scenario. For 2020 this applied to the Upside 1, Downside 1 and Downside 2 scenarios. These fan charts reflect the probability distribution of a deviation from the OBR's central forecast to illustrate the uncertainty regarding the outcome of a variable, in this case GDP.

We use the 0.6 fan chart path for our Upside 1 scenario and the 0.3 path for Downside 1. For Downside 2 we use a blend of the Downside 1 scenario and the base case rather than the 2008/09 recession, which is used under BAU. This is because the fall in GDP in the base case is markedly higher than the one seen in 2008/09, due to the lockdown restrictions imposed due to Covid-19. This means that in the longer run the GDP levels in our Downside 1 and 2 scenarios converge. To ensure that Downside 2 is kept consistent with any changes to the OBR fan charts, we calculate the Downside 2 GDP by taking the percentage difference between Downside 2 and Downside 1 GDP in the original forecast and applying this difference to the new Downside 1.

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

For the upside scenario, which has a higher growth path and rising productivity growth, we allow for a managed tightening of the monetary stance, so we assume small increases in Bank Rate. In contrast, for Downside 2 the scenario shows monetary policy forced into a reactive stance to contain CPI inflation at a time of weakening output growth, so we assume the Bank of England would raise rates in this scenario to bring inflation back to its target rate. The rising Bank Rate profiles are based on forward guidance from the Bank of England, where increases are assumed to be gradual and incremental. For the Downside 1 scenario, this is aligned to the base case forecast as inflation is similar to that of the base case, and for Downside 3, this shows a negative interest rate profile which the Bank of England follows to try and boost growth with inflation remaining low. In this way, our scenarios reflect a range of possible outcomes that the Bank of England may follow for different growth paths.

Our use of five scenarios is designed to reflect different possible outcomes to the base case forecast highlighting the upside and downside risks associated with the central scenario. The downside risks for the UK economy include further waves of Covid-19 leading to restrictions on economic activity, a further and sharper downturn in global growth, a continuation of the very low productivity growth seen in the UK, and a move to a more protectionist agenda for trade. The upside risks are more muted at present and include the smooth implementation of a new free trade agreement with the EU with limited trade frictions caused by customs checks and a recovery in global growth, coupled with a move to more open trade.

We update the baseline in our economic scenarios at least twice a year in line with our annual budgeting and three-year planning processes, or sooner if there is a material change in current or expected economic conditions (as was the case in Q4 2020 when a second national lockdown was imposed). We refresh all our economic scenarios each quarter to reflect the latest data and OBR fan charts if these have changed, which are then reviewed and approved by the Credit Risk Provisions Forum (CRPF). The CRPF also assesses the probability weights at least once a quarter.

We do not use consensus forecasts as inputs to our models, but we do compare the outputs of our models against consensus views for the base case, to make sure that we understand any significant differences and address them where needed. At the end of 2020, there were no significant differences between our base case forecasts and the consensus views.

In 2020, we were also able to do further peer benchmarking analysis of the economic scenarios using the data the PRA provided, which for Q4 2020 included the mean weighted analysis for a selection of economic variables, including GDP, unemployment rate and HPI. This meant that we could compare our weighted scenarios against the average of our peers to understand what differences there may be. The conclusion of this analysis demonstrated that our economic scenarios were in line with our peers.

Key changes to our forecasting approach in 2020

In 2020, although the number of alternative scenarios remained the same, we removed the best upside scenario and replaced it with a further downside scenario that reflects the key risks associated with Covid-19. This scenario was developed internally by the Economic Analysis team with the Enterprise Risk team, rather than using a different path from the OBR fan charts, in order to reflect the specific circumstances of Covid-19 and further lockdowns which are unprecedented in the economic history of the UK. In addition there was a slight change to the Downside 1 Bank Rate profile, which in 2019 had Bank Rate rising. In the 2020 scenarios it was decided that in an environment which has seen Bank Rate remain at record lows, there should be a downside scenario which reflects this status quo i.e. Bank Rate held flat at 10 bps.

Base case

Two key assumptions underpin the base case. Firstly it assumed a trade agreement was negotiated with the EU and that further discussions would take place post 2020 on aspects not covered. However despite the agreement, disruption would still occur in Q1 2021 as firms factor in the additional requirements they need to meet in order to trade. It further assumed that the second national lockdown was followed by the UK entering tier restrictions again and that this system would continue through Q1 2021 and into Q2 2021. However, it did not assume that there would be a third lockdown in Q1 2021. It is normal practice to review the scenarios and associated weights every quarter to ensure they appropriately reflect the current economic circumstances and we will continue to follow that approach particularly as the advice the UK Government issues is subject to change in this fluid environment. In order to factor in this further lockdown the Q4 2020 weights were updated with 5% removed from both Upside 1 and the base case and put onto Downside 2 and Downside 3. The reason for moving weight to both Downside 2 and Downside 3 is that Downside 3 incorporates a double dip recession, which is now considered more likely given the second lockdown in November 2020 and now a third in January 2021, although it is noted that this is still a very severe scenario and not a replacement for a base case. In terms of Downside 2, the longer restrictions remain in place, the greater the risk of longer-term effects which are reflected in this scenario.

Base case key macroeconomic assumptions

- **House price growth:** As we move into 2021, with the end of the stamp duty holiday in March 2021, the rise in unemployment, and negative real wage growth, there is likely to be a reduced demand and so lower house prices. As such we expect to see some negative growth towards the end of 2021 but, with the supply side still weak, this will be limited. We are projecting a fall of 2% by the end of 2021.
- **GDP:** The outlook assumes that the recovery is curtailed by the return of the virus and the second national lockdown which leaves Q4 2020 growth in negative territory with GDP expected to contract by 11.5% in 2020. For 2021, it assumes the gradual easing of restrictions towards the end of Q2 2021 will support a modest rebound in growth.
- **Unemployment rate:** Unemployment is expected to peak in Q2 2021 at just under 8% as the UK Government's job support schemes come to an end. With support ending for firms and limited savings left to keep trading, rising insolvency rates trigger a further increase in unemployment. As consumers and businesses become more confident about efforts to contain the coronavirus in the second half of 2021, unemployment falls back gradually. However, given the need for the economy to restructure, unemployment remains at elevated levels compared to recent figures over the remaining forecast period.
- **Bank Rate:** For the Bank Rate forecast, the base case assumes a flat profile of 10bps with a rise to 25bps at the beginning of 2024. This was based on the view that we have a limited trade agreement by the end of 2020, with inflation expected to remain near target over the five year forecast period. The Monetary Policy Committee will wait to understand how the economy responds to the new economic environment before changing the Bank Rate.

In the medium-term, the projections assume that current demographic and productivity trends will continue, causing a reduction in the UK's growth potential. This is reflected in an average growth expectation of 1.6% pa, the OBR's latest estimate of the UK's long run average growth rate. CPI inflation is forecast to be below the 2% target rate in the initial forecast period but returning to target by the end. Nominal earnings growth will fall in 2020 before starting to recover in 2021. This will then support household spending power as we move into 2022. However, the effect of limited business investment on growth will continue as firms look to repay debt that they have taken on due to the lockdown.

In summary, the base case assumes that activity starts to recover as the restrictions are lifted, but that progress will be tempered by the uncertainty around the UK's new trading relationship with the EU.

Key changes to our base case in 2020

The key changes to our base case assumptions in 2020 were: (i) lower GDP projections in 2020 and 2021 to reflect the impact of the ongoing restrictions on economic activity due to Covid-19; (ii) the unemployment rate, whilst lower than expected given the government furlough scheme, peaks in Q2 2021 and only slowly recovers as firms adapt to the new economic environment; (iii) there is negative house price growth for 2021 as the stamp duty holiday ends and unemployment rises; and (iv) the Bank Rate profile is held flat at 0.10% until Q1 2024, when there is a rise to 0.25% and remains flat over the rest of the forecast period.

Other scenarios

Based on this revised base case, we have reviewed our suite of scenarios to ensure that they capture the wide range of potential outcomes for the UK economy. These include (i) a significant rise in Covid-19 cases and further lockdown measures being imposed; (ii) a slower recovery that is more akin to the 'U' shape of past recessions; (iii) higher inflation; (iv) the long-term effects caused by higher and longer unemployment rates or higher and longer unemployment rate persisting, increasing the natural rate of unemployment; (v) a vaccine or treatments being developed at a quicker pace; and (vi) the global economy bouncing back more swiftly than expected.

In order to reflect these potential outcomes, we decided to continue to use the base case and four additional scenarios, which management considers to provide a range wide enough to reflect all of the above potential outcomes. However, as the risks remain skewed to the downside, to reflect these outcomes sufficiently, we concluded that only one upside scenario would be needed to reflect the upside risks to the base case. As with the base case, the scenarios are forecast over a five-year period and then mean revert over the next three years to the OBR's latest estimate of the UK's long run average growth rate.

The four scenarios are as follows:

One upside scenario

All our Q4 2020 scenarios reflect a sharp recession in 2020, although a modest upside scenario remains appropriate based on vaccines being distributed quickly and effectively to the population, with a faster global recovery and the UK quickly concluding trade agreements with a number of countries after leaving the EU, along with minimum effective tariffs. It is also based on productivity growth recovering. HPI for Upside 1 is less positive than for the base case and is based on the HPI equations built into the OGEM and the particular GDP profile used, whereas our base case reflects our planning view which allows for flexibility to align what is currently seen in the market to the outlook of the economic variable forecast.

Three downside scenarios

Downside 1 assumes further local/regional lockdowns as we move through 2021 than in the base case as a means of controlling increases in infection rates, which in turn impact economic growth as the vaccine(s) is not as effective in reducing the virus outbreak as hoped. The scenario also reflects a fall in demand for housing leading to significant downward price corrections over the next five years with a peak to trough of negative 10%. It assumes trade agreements with other countries being negotiated over the forecast period, but fewer than in the base case.

Downside 2 reflects a severe downturn with a longer recovery needed (U shape) capturing even more conservatism and lack of confidence in terms of spending by consumers with the higher levels of unemployment. For businesses it reflects a slower return to profitability and more insolvencies as the rollout of the vaccine progresses at a slower pace than needed to keep infection rates under control. It retains a rising bank rate profile to ensure there is a scenario which encapsulates rising inflation. However, the rise in interest rates results in a large increase in debt-service costs to households and a rapid undermining of demand in the housing market. House values fall sharply and the combination of rising interest rates and unemployment with falling house prices results in a rising profile of credit impairment losses.

Downside 3 features a double dip in economic activity (W shape) lasting three quarters, with higher unemployment and a sharper fall in house prices compared to the four other scenarios. The fall in GDP of c.11.5% between H2 2020 and H1 2021 is roughly half the fall of c22% in H1 2020, as this assumes that businesses have contingency plans to be able to stay open whilst practising social distancing. The peak in the unemployment rate is similar to that seen in the early 1980s recession peaking at 11.9% in 2021 and remaining in double digits until early 2022, before falling back very gradually. The long term effects of high unemployment result in a permanent hit to potential output, as persistent and elevated uncertainty leads to more job losses and corporate bankruptcies. Sharp falls in house prices (c30%) combined with persistently higher unemployment has particularly adverse consequences for credit impairment charges.

Key changes to our alternative scenarios in 2020

In terms of key changes to our alternative scenarios in 2020, these relate to changes to the base case, historic data for each variable, OBR fan charts and the OGEM. We also updated the way the GDP path is defined in Downside 2 as discussed above. Otherwise we did not make any methodological changes to the scenarios. The combination of these different inputs will mean differences across the variables for each of the alternative scenarios when we update them each quarter. As such it is not possible to pin-point a specific reason for each change as we do not run the inputs in isolation. However, we compare the variables between each quarter and review any large changes to ensure they are not erroneous.

The table sets out the house price growth and unemployment rate for 2020 and 2021, and GDP and Bank Rate for 2020-2022 for each of the five scenarios.

		Upside 1	Base case	Downside 1	Downside 2	Downside 3
		%	%	%	%	%
House price growth ⁽¹⁾	2020	3.70	3.50	3.70	3.70	3.50
	2021	(4.60)	(2.00)	(5.40)	(11.30)	(19.70)
GDP ⁽²⁾	2020	(10.50)	(11.50)	(10.50)	(11.10)	(11.50)
	2021	4.80	4.50	4.00	(0.80)	(8.00)
	2022	4.90	6.10	3.60	3.20	3.10
Unemployment rate	2020	6.30	6.80	6.30	6.30	6.80
	2021	6.10	7.50	6.50	8.50	11.40
Bank of England bank rate	2020	0.10	0.10	0.10	0.10	0.10
	2021	0.25	0.10	0.10	0.75	(0.50)
	2022	0.75	0.10	0.10	1.75	0.00

(1) Q4 annual growth rate.

(2) GDP is shown as an annual average and all other data points are at 31 December in the year indicated.

Our macroeconomic assumptions and their evolution throughout the forecast period

Our macroeconomic assumptions and their evolution throughout the forecast period for 2020 and 2019 were:

2020		Upside 1	Base case	Downside 1	Downside 2	Downside 3
		%	%	%	%	%
House price growth	5-year average increase/decrease	0.49	1.38	(2.01)	(4.54)	(4.44)
	Peak/(trough) at ⁽¹⁾	2.45	7.11	(9.65)	(20.72)	(20.32)
GDP	5-year average increase/decrease	0.75	0.39	(0.38)	(0.98)	(2.82)
	Cumulative growth/(fall) to peak/(trough) ⁽²⁾	3.82	1.96	(1.88)	(4.80)	(13.33)
Unemployment rate	5-year end period	4.14	5.50	5.84	6.52	7.40
	Peak/(trough) at ⁽¹⁾	6.28	7.90	6.51	8.78	11.90
Bank of England bank rate	5-year end period	1.75	0.25	0.25	2.75	0.00
	Peak/(trough) at ⁽¹⁾	1.75	0.25	0.25	3.00	(0.50)

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

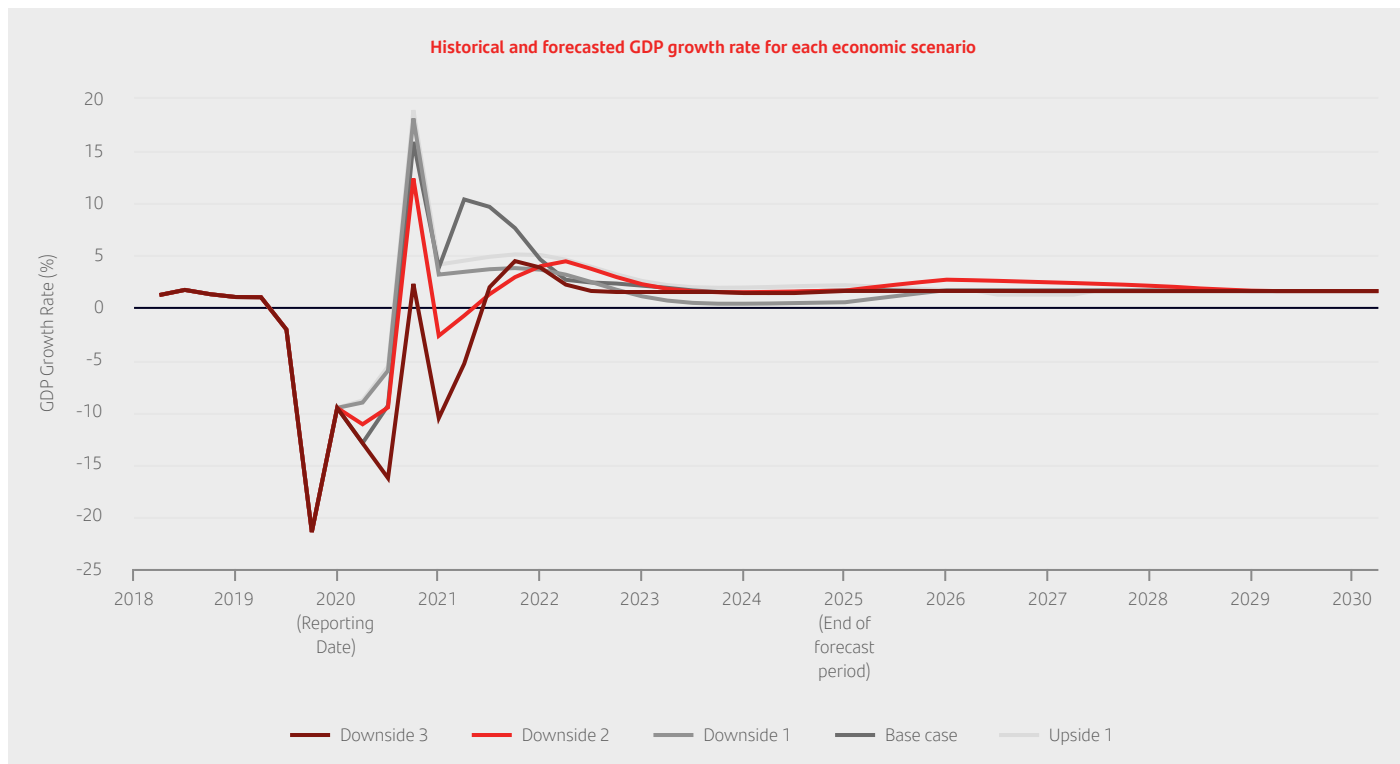
(1) For GDP and house price growth it is the peak to trough change over the 5 year period; for the unemployment rate it is the peak; and for Bank Rate it is the peak or trough.

(2) This is the cumulative growth for the 5 year period.

The historical and forecast growth rates for the GDP assumptions we use for scenario modelling

The evolutions of the historical and forecast growth rates for the GDP assumptions we used for scenario modelling at 31 December 2020 and 31 December 2019 were:

GDP assumptions applied at 31 December 2020



GDP assumptions applied at 31 December 2019



Our forecasting period for GDP is five years and then we revert to the average trend growth over three years based on the OBR's long-run GDP forecast.

For GDP assumptions applied at 31 December 2020, in the Downside 2 and Downside 3 scenarios the economy reaches a cyclical low in Q1 2021 and Q2 2021 respectively, after which GDP increases. In all scenarios, we assume that GDP will have reverted to the OBR's long-run forecast rate after Q4 2028. The reversion to mean for all macroeconomic variables is expected to take three years after the initial five-year forecast period.

Scenario weights

Given the change in scenarios for Q4 2020, we undertook a full review of the probability weights applied to the scenarios. The setting of probability weights needs to consider both the probability of the forecast economic scenarios occurring whilst ensuring that the scenarios capture the non-linear distribution of losses across a reasonable range. To support the initial assessment of how likely a scenario is to occur, we would typically undertake a Monte Carlo analysis which would ascertain the likelihood of a five-year average GDP forecast growth rate occurring based on the long run historically observed average. Creating a standard distribution bell curve around this long run average allows us to estimate the probability of a given GDP scenario occurring and therefore assign a probability weight to that scenario. However, a key challenge with this approach in a stressed environment is that the extreme GDP forecasts for the downside scenarios all fall in the last percentile which results in all of the new downside scenarios attracting very low probability weights.

Given this issue, we performed a similar analysis on a more limited time period relating to the global financial crisis in 2007-2012, as this reflected better the current UK outlook. In this case, the base case 5 year compound annual growth rate (CAGR) sat in the middle of the distribution, which is what is expected to occur. It also showed a ranking in terms of the weights to apply to the additional downside scenarios, and was able to show that the Downside 2 scenario should have a higher weight than Downside 3.

However, we also need to consider the UK economic and political environment when applying weights. The scenarios were developed in Q4 2020 and within this period there was considerable change, particularly relating to where UK regions sat within the tiers. For example, London moved through 4 different stages within a two week period. With the circumstances changing again in January 2021, although the Monte Carlo analysis would suggest keeping the weights from Q3 2020 and provides a useful starting point, it was clear that the move to a third lockdown in Q1 2021 would result in greater downside risks than would have been reflected by using the Q3 2020 weights. Therefore the weights were updated to reflect these further changes to the balance of risks moving forward. For the Q4 2020 weights, 5% was removed from both Upside 1 and the base case and put onto Downside 2 and Downside 3. The reason for moving weight to both Downside 2 and Downside 3 is that Downside 3 incorporates a double dip recession, which is now considered more likely given the second lockdown in November 2020 and now a third in January 2021, although it is noted that this is still a very severe scenario and not a replacement for a base case. In terms of Downside 2, the longer restrictions remain in place, the greater the risk of longer-term effects which are reflected in this scenario.

The scenario weights we applied for 2020 and 2019 were:

Scenario weights	Upside 1	Base case	Downside 1	Downside 2	Downside 3
	%	%	%	%	%
2020	5	45	15	25	10

Scenario weights	Upside 2	Upside 1	Base Case	Downside 1	Downside 2
	%	%	%	%	%
2019	5	10	40	30	15

ii) For our CIB portfolios

Our forecasting approach

The scenario we applied for CIB is an overlay calculation which is used for the overlay in provisions estimation, due to Covid-19. This is the same methodology as adopted since Q2 2020. The Long Run scenario is based on a long run view (rather than point in time) and is prepared in the context of a long-term stable outlook where the structural deterioration is materialized to quantify the overlay to account for the macroeconomic worsening. This is to avoid excessive volatility and considered appropriate due to the size of the portfolio. No weights are applied.

Key changes to our forecasting approach in 2020

The approach taken in 2020 is different to that of 2019. In 2019 the approach was to forecast global growth rates for three different scenarios (Base case, Upside and Downside) and apply weights to those. These were then used across Banco Santander to ensure consistent treatment of these large and/or international counterparties across the Banco Santander group.

Scenario weights

The scenario weights we applied to the scenarios for our CIB portfolio for 2020 and 2019 were:

Scenario weights	Upside	Base case	Downside
	%	%	%
2020	N/A	N/A	N/A
2019	30	40	30

As noted above, no scenario weights were applied to our CIB portfolio for 2020 as it is a single scenario based on a long-run view, rather than a point in time.

Our macroeconomic assumptions and their evolution throughout the forecast period

Our macroeconomic assumptions and their evolution throughout the forecast period for our CIB portfolio for 2020 and 2019 were:

GDP assumption		Upside	Base case	Downside
		%	%	%
2020	Long Run global growth scenario ⁽¹⁾			1.3

GDP assumption		Upside	Base case	Downside
		%	%	%
2019	5 year average increase/decrease	3.7	3.5	3.0
	Cumulative growth/(fall) to peak/(trough) ⁽²⁾	0.3	0.5	(1.2)

(1) The Long Run scenario is the average annual global growth rate over the 5 year period 2020 to 2024.

(2) The Cumulative growth/(fall) refers to the cumulative change from the last historical data point for GDP growth to the peak (for Upside scenarios) or to the trough (for Downside scenarios).

Sensitivity of ECL allowance

At 31 December 2020, the probability-weighted ECL allowance totalled £1,377m (2019: £863m), of which £1,344m (2019: £813m) related to exposures in Retail Banking, Corporate & Commercial Banking and Corporate Centre, and £33m (2019: £50m) related to exposures in Corporate & Investment Banking. The ECL allowance is sensitive to the methods, assumptions and estimates underlying its calculation. For example, management could have applied different probability weights to the economic scenarios and, depending on the weights chosen, this could have a material effect on the ECL allowance. In addition, the ECL allowance for residential mortgages, in particular, is significantly affected by the HPI assumptions which determine the valuation of collateral used in the calculations.

Had management used different assumptions on probability weights and HPI, a larger or smaller ECL charge would have resulted that could have had a material impact on the Santander UK group's reported ECL allowance and profit before tax. Sensitivities to these assumptions are set out below.

Scenario weights

The amounts shown in the tables below illustrate the ECL allowances that would have arisen had management applied a 100% weighting to each economic scenario. The allowances were calculated using a stage allocation appropriate to each economic scenario presented and differs from the probability-weighted stage allocation used to determine the ECL allowance shown above. For exposures subject to individual assessment, the distribution of ECL which could reasonably be expected has also been considered, assuming no change in the number of cases subject to individual assessment, and within the context of a potential best to worst case outcome.

As described above, our CIB segment uses a single forward-looking economic scenario for 2020 (2019: three scenarios). However, the three scenarios are still used within the model, with a PMA held to increase provisions up to the level required in the single scenario. In order to present a consolidated view in a single table and show variation from the forward-looking component, the three scenarios are presented in the table with the overlay value added to each scenario. As all other segments use five scenarios (2019: five scenarios), interpolation is also required. Data from the CIB Upside scenario is presented in the Upside 1 Column, the Downside scenario is in the Downside 3 column, the Base Case is in the Base Case column and values in Downside 1 and Downside 2 are interpolated from the Base Case and Downside scenarios. At 31 December 2019, the data for CIB in the table below presents the CIB Upside scenario in the Upside 2 column, the CIB Downside scenario in the Downside 2 column, and interpolated data for CIB in the Upside 1 and Downside 1 columns.

	Weighted	Upside 1	Base case	Downside 1	Downside 2	Downside 3
2020	£m	£m	£m	£m	£m	£m
Exposure	328,792	328,792	328,792	328,792	328,792	328,792
Retail Banking	213,323	213,323	213,323	213,323	213,323	213,323
– of which mortgages	183,077	183,077	183,077	183,077	183,077	183,077
CCB	24,503	24,503	24,503	24,503	24,503	24,503
CIB	11,646	11,646	11,646	11,646	11,646	11,646
Corporate Centre	79,320	79,320	79,320	79,320	79,320	79,320
ECL	1,377	1,129	1,222	1,301	1,613	1,802
Retail Banking	706	610	587	661	850	863
– of which mortgages	280	213	207	253	390	415
CCB	603	485	575	567	671	824
CIB	33	5	26	40	53	66
Corporate Centre	35	29	34	33	39	49
	%	%	%	%	%	%
Proportion of assets in Stage 2	5.2	4.5	4.6	4.6	6.5	6.7
Retail Banking	5.3	4.6	4.6	4.6	7.1	6.9
– of which mortgages	5.7	4.8	4.8	4.8	7.6	7.4
CCB	22.4	20.1	20.8	20.2	24.5	28.6
CIB	1.7	1.7	1.7	1.7	1.7	1.7
Corporate Centre	—	—	—	—	—	—

2019	Weighted £m	Upside 2 £m	Upside 1 £m	Base Case £m	Downside 1 £m	Downside 2 £m
Exposure	316,322	316,322	316,322	316,322	316,322	316,322
Retail Banking	204,780	204,780	204,780	204,780	204,780	204,780
– of which mortgages	178,788	178,788	178,788	178,788	178,788	178,788
CCB	24,118	24,118	24,118	24,118	24,118	24,118
CIB	13,384	13,384	13,384	13,384	13,384	13,384
Corporate Centre	74,040	74,040	74,040	74,040	74,040	74,040
ECL	863	640	680	726	855	1,542
Retail Banking	549	425	433	448	525	1,084
– of which mortgages	218	122	127	137	196	660
CCB	262	195	212	229	275	398
CIB	50	19	34	48	53	58
Corporate Centre	2	1	1	1	2	2
	%	%	%	%	%	%
Proportion of assets in Stage 2	3.7	2.7	2.8	2.8	3.1	6.7
Retail Banking	4.5	3.2	3.3	3.3	3.7	8.3
– of which mortgages	4.6	3.1	3.1	3.1	3.6	8.7
CCB	8.7	7.4	7.4	7.4	8.5	16.3
CIB	1.5	1.5	1.5	1.5	1.5	1.5
Corporate Centre	0.1	0.1	0.1	0.1	0.1	0.2

Changes to Stage 3 instruments are part of the sensitivity analysis but excluded from the disclosure because their values do not move due to changes in macroeconomic assumptions, i.e. they are either in or not in default at the reporting date.

We have incorporated our post model adjustments into the sensitivity analysis.

HPI

Given the relative size of our residential mortgage portfolio, management considers that changes in HPI assumptions underpinning the calculation of the ECL allowance for residential mortgages of £280m at 31 December 2020 (2019: £218m) would have the most significant impact on the ECL allowance. The table below shows the impact on profit before tax of applying an immediate and permanent house price increase / decrease to our unweighted base case economic scenario, and assumes no changes to the staging allocation of exposures. In 2019, we applied 40% weighting to the base case economic scenario, therefore a change in the basis of preparation in 2020. 2019 numbers have been restated.

Increase/(decrease) in profit before tax	Increase/decrease in house prices			
	+20%	+10%	-10%	-20%
	£m	£m	£m	£m
2020	63	38	(66)	(183)
2019	41	25	(39)	(105)

2020 compared to 2019

In response to the Covid-19 pandemic the economic forecasts were downgraded, with the Base Case becoming significantly worse, and the Upside 2 scenario being replaced with a specific Covid-19 'W' shaped severe downside, increasing ECLs and Stage 2 balances across the scenarios. Further increases have come from management actions taken outside the scenarios, which moved the most impacted cases to Stage 2, further increasing losses. ECLs in the Covid-19 'W' scenario are tempered by low Base Rate, keeping repayments low and allowing mortgage customers to more easily refinance.

In 2020, Stage 2 exposures increased as although arrears balances have reduced, management took actions in response to the Covid-19 pandemic, namely downgrading the economic scenarios and weights which increased PDs across the business causing more accounts to breach the SICR triggers to enter Stage 2, moving riskier balances of £0.8bn to which payment holidays were offered to from Stage 1 to Stage 2 and moving £3.1bn corporate loans most impacted by Covid-19 from Stage 1 to Stage 2. The increase in ECL balances reflected these actions.

Significant Increase in Credit Risk (SICR) (audited)

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

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

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

Quantitative criteria

We use quantitative criteria to identify where an exposure has increased in credit risk. The criteria we apply are based on whether any increase in the lifetime PD since the recognition date exceeds a set threshold both in relative and absolute terms. We base the value anticipated from the initial recognition on a similar set of assumptions and data to the ones we used at the reporting date, adjusted to reflect the account surviving to that date. The comparison uses either an annualised lifetime PD, where the lifetime PD is divided by the forecast period, or the absolute change in lifetime PD since initial recognition. For each portfolio, the quantitative criteria we used for 2020 were:

Retail Banking ⁽¹⁾						
Mortgages	Consumer (auto) finance ⁽²⁾	Other unsecured			Corporate & Commercial Banking	Corporate & Investment Banking
		Personal loans	Credit cards	Overdrafts		
30bps	300bps	30bps	340bps	260bps	30bps	Internal rating method

(1) In Business banking, for larger customers we apply the same criteria that we use for Corporate & Commercial Banking.

(2) Consumer (auto) finance use the comparison of lifetime PDs to determine Stage allocation, unlike other products which first turn the lifetime PD into an average yearly PD (annualised) and then do the comparison.

The criteria above are absolute (rather than relative) increases in lifetime PD since initial recognition. These are all absolute values.

We also applied a relative threshold of 100% (doubling the PD) across all portfolios except CIB.

In 2020, there were no changes to the way that we measure SICR. The granting of a payment holiday on its own was not considered to be a SICR event.

Qualitative criteria

We also use qualitative criteria to identify where an exposure has increased in credit risk, independent of any changes in PD. For each portfolio, the criteria we used for 2020 and 2019 were:

Retail Banking ⁽¹⁾						
Mortgages	Consumer (auto) finance	Other unsecured			Corporate & Commercial Banking	Corporate & Investment Banking
		Personal loans	Credit cards	Overdrafts		
- In forbearance - Default in last 24m	- In forbearance - Deceased or Insolvent	- In Collections - Default in last 12m	- In forbearance - Default in last 12m	- Fees suspended - Default in last 12m	- In forbearance - Default in last 12m	
- >30 Days past due (DPD) in last 12m	- Court 'Return of goods' order or Police watchlist	- Court	- In Collections	- Debit dormant >35 days	- Watchlist: proactive management	- Watchlist: proactive management
- Bankrupt	- Agreement terminated				- Default at proxy origination	
- £100+ arrears	- Payment holiday - Cash Collection	- £50+ arrears	- £100+ arrears	- Any excess in month		

(1) In Business Banking, for larger customers we apply the same criteria that we use for Corporate & Commercial Banking.

In addition, due to Covid-19 we introduced temporary Post Model Adjustments (PMAs) to Stage allocation based on collective assessments of portfolios in Retail Banking and client level in corporate lending (Corporate & Commercial Banking and Corporate & Investment Banking segments) based on sector and client credit quality. See the section 'Post Model Adjustments (PMAs)' below for more on this.

Backstop criteria

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

Improvement in credit risk or cure

In some cases, instruments with a lifetime ECL (in Stage 2 or 3) may be transferred back to 12 month ECL (Stage 1). Financial assets in Stage 3 can only be transferred to Stage 2 or Stage 1 when they are no longer considered to be credit impaired, as defined below. Financial assets in Stage 2 can only be transferred to Stage 1 when they are no longer considered to have experienced a SICR. Where we identified a SICR using quantitative criteria, the instruments automatically transfer back to Stage 1 when the original PD-based transfer criteria are no longer met. Where we identified a SICR using qualitative criteria, the issues that led to the transfer must be cured before the instruments can be reclassified to Stage 1. For a loan in forbearance to cure, it must meet the exit conditions set out in the earlier section 'Forbearance'.

Definition of default (Credit impaired) (audited)

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

Retail Banking
- They have been reported bankrupt or insolvent. This excludes accounts which are up to date and are not defaulted.
- Their loan term has ended, but they still owe us money more than three months later
- They have had forbearance while in default, but have not caught up with the payments they had missed before that, or they have had multiple forbearance
- We have suspended their fees and interest because they are in financial difficulties
- We have repossessed the property.
Other business segments: Corporate & Commercial Banking, Corporate & Investment Banking and Corporate Centre
- They have had a winding up notice issued, or something happens that is likely to trigger insolvency – such as another lender calls in a loan
- Something happens that makes them less likely to be able to pay us – such as they lose an important client or contract
- They have regularly missed or delayed payments, even though they have not gone over the three-month limit for default
- Their loan is unlikely to be refinanced or repaid in full on maturity
- Their loan has an excessive LTV that is unlikely to be resolved, such as by a change in planning policy, pay-downs, or increase in market value.

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

During 2020, we offered customers the option to take a payment holiday for up to 6 months where the customer had self certified they had been financially impacted by Covid-19. The granting of a payment holiday on its own was not considered to a Significant Increase in Credit Risk, nor was it considered to be a default under regulatory definitions. Customers requiring further longer term financial support after the 6 month period, such as term extension or interest-only conversion, would be treated in accordance with our normal SICR and default definitions.

Measuring ECL (audited)

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

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

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

Forecast period

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

Forward-looking information

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

Economic forecasts have the most impact on the measurement of ECL for residential mortgages and, to a lesser extent, corporate loans. This is due to the long behavioural lives and large sizes of these portfolios. Economic forecasts have less impact on the measurement of ECL for our other portfolios. This is due to the shorter behavioural lives and smaller sizes of these portfolios.

Grouping of instruments for losses measured on a collective basis

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

We use this approach for:

- all our Retail Banking portfolios (as described in Retail Banking – credit risk management)
- SME customers in Corporate & Commercial Banking
- Legacy Portfolios in run-off and the Crown Dependencies mortgage portfolio in Corporate Centre.

We calculate separate collective provisions for instruments in Stages 1, 2 and 3 where the instrument is not individually assessed.

As described above, for our CIB portfolios (whether we assess them for impairment individually or collectively) we used one forward-looking economic scenario for forecasting in 2020 (2019: three scenarios). For all our other portfolios (whether we assess them for impairment individually or collectively) we use five forward-looking economic scenarios.

Management judgement applied in calculating ECL (audited)

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

- **Definition of default:** We define a financial instrument as in default (i.e. credit impaired) for purposes of calculating ECL if it is more than three months past due, or if we have data to make us doubt they can keep up with their payments. The data we have on customers varies across our business segments.
- **Forward-looking multiple economic scenarios:** We use five scenarios, consisting of a central base case, one upside scenario and three downside scenarios except for our CIB portfolio, where we used one scenario in 2020 (2019: three scenarios). This symmetry meets the 'unbiased' requirement and we consider these scenarios sufficient to account for any non-linear relationships.
- **Probability weights:** In determining the initial scenario probability weights, we assign the highest probability to the base case, whilst the outer scenarios typically attract lower probabilities than the more moderate ones.
- **SICR thresholds:** We use a combination of quantitative (both absolute and relative), qualitative and backstop criteria to identify exposures that we consider have shown a SICR since initial recognition.
- **Post Model Adjustments:** These relate to adjustments which we need to account for identified model limitations – such as those that have arisen due to challenges in obtaining historical data. We expect these to gradually be incorporated into the underlying models as we build up more comparative data over future reporting periods.
- **Internal credit risk rating for corporate borrowers:** We assign each corporate borrower an internal credit rating based on our internal rating scale. To do this, we look at the customer's financial history and trends in the economy including reflecting the impacts of the Covid-19 pandemic – backed up by the expert judgement of a risk analyst. We review our internal ratings on a dynamic basis and at least once a year. The internal risk rating is used to determine the Probability of Default for a client.
- **Individually assessed corporate Stage 3 exposures:** We assess the ECL requirement for large single name corporate exposures on an individual basis when they meet our definition of default and are transferred into Stage 3. This assessment takes into consideration the latest specific information about the counterparty to determine a probability weighted ECL based on a best, worst and mid case outcome.

Probability weights

We made significant adjustments to our economic assumptions and scenario weightings during 2020 to reflect the emerging impact of the Covid-19 pandemic. Our five economic scenarios have been updated for Q4 2020 and weighted further to the downside, to reflect the expected longer path to recovery for the UK. The 2020 impact was an ECL charge of £164m. Had management applied Q3 2020 weights to the scenarios (Upside 1: 10%; Base case: 50%; Downside 1: 15%; Downside 2 :20%; Downside 3: 5%), the ECL would decrease by £34m to £130m.

Individually assessed corporate Stage 3 exposures

Management judgements are applied in assessing ECL provisions on individually assessed corporate loans. For those loans that were in default (i.e. Stage 3), the ECL was £157m at 31 December 2020. Had management assumed the best or worst outcome in terms of loss estimates, the ECL could have been within a range of £78m to £220m.

Post Model Adjustments (PMAs)

We use a range of methods to identify whether we need a PMA. These include regular review of model monitoring tools, period-to-period movement and trend analysis, comparison against forecasts, and input from expert teams who monitor and manage key portfolio risks. We only recognise a PMA if the ECL is over £1m. We keep PMAs in place until we no longer need them. This will typically be when they are built into our core credit model or the conditions that impacted the historical data no longer exist.

The Risk Provisions & Forecasting team calculates PMAs to ensure they are incremental to the core credit model and to ensure the calculation is performed in a consistent and controlled manner. We apply standard end-user computing controls to material and long-standing PMAs i.e. those expected to be in place for more than six months. Our Independent Validations Team may also review significant PMAs at their discretion. The CRPF approves all new PMAs. It delegates authority to approve temporary PMAs not expected to last beyond a quarter-end to the CFO. The Consolidated Reporting team reviews all new PMAs to ensure they comply with IFRS 9. We record all PMAs on a central log maintained by the Consolidated Reporting team which documents the justification, IFRS 9 compliance assessment, expected life, recalibration frequency, calculation methodology and value of each PMA. The CRPF reviews and approves the log each quarter.

The CRPF reviews and approves changes in all key management judgements at least each quarter. The Board Audit Committee reviews and challenges the appropriateness of changes in all key management judgements at least each quarter. The creation of new PMAs is a joint responsibility between the Risk Provisions & Forecasting team, as model owners who may identify issues with the historical data, and the Consolidated Reporting team who may identify changes in portfolio or credit quality performance.

The most significant PMAs that we applied at 31 December 2020 and 31 December 2019 were:

PMAs	2020	2019
	£m	£m
Interest-only maturity default risk ⁽¹⁾	49	51
Buy-to-Let	24	21
Long-term indeterminate arrears ⁽¹⁾	29	19
12+ months in arrears ⁽¹⁾	30	23
Corporate Covid-19 affected segments	193	—
Payment Holidays	27	—
Corporate single large exposure	35	—

(1) In model adjustment

- **Interest-only maturity default risk:** When an interest-only mortgage reaches contractual maturity and the capital payment becomes due, there is a risk that the customer won't be able to repay the full capital balance. Our model estimates the likelihood of a customer missing a monthly payment, rather than the capital repayment. We hold an incremental provision to address the risk of default on capital repayments on maturity ultimately leading to write-off. We calculate it using a Judgement Model which uses historically observed experience and expert judgement to determine the proportion of customers who won't be able to repay. Over time, as we continue to enhance our model, we expect the need for this PMA will diminish. This PMA increased our ECL by £49m. Had management applied different judgements to the expected proportion of customers who will not be able to repay at maturity, the PMA could have been within a range of £24m to £56m.
- **Buy-to-Let (BTL):** Historical data shows that the risk of default on a BTL mortgage is higher than on a residential mortgage, particularly in a downturn. However, our IFRS 9 models have been calibrated over a period of favourable and relatively benign economic conditions during which our BTL mortgage portfolio has continued to grow with limited loss events. To avoid underestimating ECL in an economic downturn, we adjust the loss allowance for our BTL accounts to increase the ECL. We use market data from the last economic crisis to estimate the adjustment. Over time, as our historical data grows and covers a wider range of economic conditions, we expect the need for this PMA will diminish. This PMA increased our ECL by £24m.
- **Long-term indeterminate arrears:** To mitigate the risk of model underestimation, we fully provide for accounts in arrears which have neither repaid (cured) or been written-off after a period of 2 years for unsecured portfolios or 5 years for secured portfolios. For our secured portfolios, we use expected security valuations at the point of repossession to estimate the adjustment. At 31 December 2020 and 31 December 2019, we only needed to make an adjustment for mortgages. As a result of regulatory suspension of repossession in response to the Covid-19 pandemic, management has assumed up to a 2 year delay in repossessions when calculating the ECL uplift for this PMA. This is to make sure LTVs are appropriately stressed by the economic scenarios. Over the medium term, as we continue to address long term arrears in the portfolio, we expect the need for this PMA will diminish. This PMA increased our ECL by £29m. Had management assumed no delay in repossessions or a 3 year delay, the PMA could have been within a range of £18m to £31m.
- **12+ months in arrears:** To mitigate the risk of underestimating ECL, mortgage accounts which are more than 12 months past due are fully provided for after deducting a historically observed self-cure rate. As a result of regulatory suspension of repossession in response to the Covid-19 pandemic, management has assumed up to a 2 year delay in repossessions when calculating the ECL uplift for this PMA. This is to make sure LTVs are appropriately stressed by the economic scenarios. Over the medium term, as we continue to address long term arrears in the portfolio, we expect the need for this PMA will diminish. This PMA increased our ECL by £30m. Had management assumed no delay in repossessions or a 3 year delay, the PMA could have been within a range of £19m to £35m.
- **Corporate Covid-19 affected segments:** In 2020, following internal sector and counterparty assessments, we transferred loans for some corporate and SME sectors and clients who have been severely impacted because of Covid-19 from Stage 1 into Stage 2. This includes exposures in a sector where trading has been highly impacted by Covid-19 including Hotels, Hospitality, Retail, Leisure and Care Homes sectors, and where the client has been assessed as most likely to require financial support based on their current financial circumstances. In addition, we have transferred some Stage 2 corporate and SME loans to Stage 3 based on a similar analysis of sector and client credit quality taking into consideration any concessions given to clients since the start of the pandemic as an indicator of those loans most likely to meet our default definition. We use our models to calculate the incremental ECL required from transferring loans between stages and apply stress factors to the client PD ratings based on our historical experience. Over the medium term, as our actual data on the performance of these customers grows, we expect the need for this PMA will diminish. This PMA increased our ECL by £193m, of which £70m relates to £3.1bn of exposures transferred from Stage 1 to Stage 2 and £123m relates to £0.4bn of Stage 2 exposures transferred to Stage 3. Had management assumed the lowest observed PD stress factors to all Stage 1 to Stage 2 transferred loans or transferred none of the Stage 2 exposures in highly impacted sectors to Stage 3, the PMA would reduce to £35m. Had management assumed the highest observed PD stress factor to all Stage 1 to Stage 2 transferred loans and transferred all £0.7bn high risk Stage 2 exposures in highly impacted sectors to Stage 3, the PMA would increase to £311m.
- **Payment holidays:** In 2020, we transferred a proportion of Stage 1 loans into Stage 2 where our discussions with retail customers on a Covid-19 payment holiday established they are in longer-term financial difficulties. This was done on a collective basis through a customer contact exercise and customer data profiling. Based on this assessment, we calculate the incremental ECL required by using the average Stage 2 coverage ratio of similar Stage 2 loans. Over the medium term, as our actual data on the performance of these customers grows, we expect the need for this PMA will diminish. This PMA increased our ECL by £27m. Had management assumed a higher or lower new to arrears flow rates, the PMA could have been within a range of £11m to £65m.
- **Corporate single large exposure:** In 2020, to mitigate against the risk of a single large corporate exposure with an ECL requirement of greater than £10m defaulting, which has not been covered by the existing model estimate or the corporate and SME PMA above, we applied a PMA for the risk of a company which unexpectedly defaults. This PMA has been calculated based on incurring three average historically observed single name large losses across our Corporate & Commercial and Corporate & Investment Banking business segments. We will continue to assess this risk over the medium term based on actual experience and we will refine the estimate based on changes in our portfolio credit quality and loan size mix. This PMA increased our ECL by £35m assuming three average losses are incurred or would reduce to £23m assuming only two average losses were incurred.

Governance around ECL impairment allowances (audited)

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

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

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

How we assess the performance of our ECL estimation process

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

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

Covid-19 Support measures

The Covid-19 crisis had a major impact on the UK and global economies in 2020. The UK Government's fiscal interventions helped our customers to mitigate some of the adverse financial effects. However, levels of uncertainty and volatility increased significantly in 2020 and this led to a £514m increase in our ECL provisions.

Since March 2020, we have provided mortgage customers with payment holiday terms in line with UK Government's and FCA's guidance. Similar payment holidays have also been granted in respect of consumer (auto) finance, personal loans, credit cards, businesses and corporates.

We participated in the UK Government's Coronavirus Loan Schemes:

- The Coronavirus Business Interruption Loan Scheme (CBILS),
- The Bounce Back Loan Scheme (BBLS), and
- The Coronavirus Large Business Interruption Loan Scheme (CLBILS).

We implemented new processes and procedures to facilitate delivery of these Covid-19 government support measures. We also increased our interactions and communications with our customers to better understand their individual needs. For instance, we initiated targeted retail customer out-reach to assess their need for ongoing support. We re-engineered our financial support activities to ensure our customers obtain the best individual outcomes.

The UK Government guarantees losses for amounts lent under these schemes, although losses are limited to 80% in the case of the CBILS and the CLBILS. As a result, ECL is not applied to the BBLS but a 20% weighting is applied to the ECL for the CBILS and the CLBILS. The UK Government also pays interest on behalf of customers for the first twelve months under the CBILS and the BBLS, plus any lender-levied charges under the CBILS.

Loans for customers who were provided with payment holidays were considered to have the contract terms modified. The granting of a payment holiday on its own was not considered to be a SICR event, nor was it considered a default under regulatory definitions. Neither were they considered to have been granted forbearance. See the section 'Significant Increase in Credit Risk (SICR)' above for more on this.

Interest income continues to be recognised during any payment holiday period. In the absence of any other credit risk indicators, the granting of a payment holiday does not evidence a SICR. This means that the majority of customers affected have not been moved to Stage 2 for a lifetime ECL assessment unless they had triggered other SICR criteria. Such payment holidays also did not cause accounts to become past due and therefore did not automatically trigger a Stage 2 or Stage 3 lifetime ECL assessment.

In early 2020, we increased our Recovery team to manage expected defaults arising from the Covid-19 pandemic. We continue to identify those customers for whom additional borrowing would require remedial action to return them to be within our risk appetite over the medium-term, as well as customers who were showing signs of financial stress before the Covid-19 crisis. Customers in either of these situations are considered to have been granted forbearance with exposures categorised as either Stage 2 or Stage 3 and subject to a lifetime ECL assessment.

SANTANDER UK GROUP LEVEL – CREDIT RISK REVIEW

Our maximum and net exposure to credit risk (audited)

The tables below show the main differences between our maximum and net exposure to credit risk. They show the effects of collateral, netting, and risk transfer to mitigate our exposure. The tables only show the financial assets that credit risk affects and to which the impairment requirements in IFRS 9 are applied.

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

2020	Maximum exposure						Collateral ⁽¹⁾			Net exposure £bn
	Balance sheet asset			Off-balance sheet			Cash £bn	Non-cash £bn	Netting ⁽²⁾ £bn	
	Gross amounts £bn	Loss allowance £bn	Net amounts £bn	Gross amounts £bn	Loss allowance £bn	Net amounts £bn				
Cash and balances at central banks	43.5	—	43.5	—	—	—	—	—	—	43.5
Financial assets at amortised cost:										
– Loans and advances to customers: ⁽³⁾										
– Loans secured on residential properties ⁽⁴⁾	170.0	(0.3)	169.7	13.3	—	13.3	—	(173.3)	—	9.7
– Corporate loans	24.5	(0.6)	23.9	15.4	(0.1)	15.3	(0.1)	(20.4)	—	18.7
– Finance leases	6.6	(0.1)	6.5	0.2	—	0.2	(0.1)	(5.8)	—	0.8
– Other unsecured loans	10.2	(0.3)	9.9	13.3	—	13.3	—	—	—	23.2
– Amounts due from fellow Banco Santander group subsidiaries and joint ventures	2.2	—	2.2	—	—	—	—	—	—	2.2
– Total loans and advances to customers	213.5	(1.3)	212.2	42.2	(0.1)	42.1	(0.2)	(199.5)	—	54.6
– Loans and advances to banks	2.0	—	2.0	1.0	—	1.0	—	—	—	3.0
– Reverse repurchase agreements – non trading	19.6	—	19.6	—	—	—	—	(19.5)	(0.1)	—
– Other financial assets at amortised cost	1.2	—	1.2	—	—	—	—	—	—	1.2
Total financial assets at amortised cost	236.3	(1.3)	235.0	43.2	(0.1)	43.1	(0.2)	(219.0)	(0.1)	58.8
Financial assets at fair value at FVOCI:										
– Loans and advances to customers	—	—	—	—	—	—	—	—	—	—
– Debt securities	9.0	—	9.0	—	—	—	—	—	—	9.0
Total financial assets at FVOCI	9.0	—	9.0	—	—	—	—	—	—	9.0
Total	288.8	(1.3)	287.5	43.2	(0.1)	43.1	(0.2)	(219.0)	(0.1)	111.3
2019										
Cash and balances at central banks	26.4	—	26.4	—	—	—	—	—	—	26.4
Financial assets at amortised cost:										
– Loans and advances to customers: ⁽³⁾										
– Loans secured on residential properties ⁽⁴⁾	165.6	(0.2)	165.4	13.4	—	13.4	—	(168.9)	—	9.9
– Corporate loans	27.0	(0.2)	26.8	14.3	(0.1)	14.2	(0.1)	(19.4)	—	21.5
– Finance leases	6.3	(0.2)	6.1	0.3	—	0.3	(0.1)	(6.3)	—	—
– Other unsecured loans	7.2	(0.2)	7.0	12.4	—	12.4	—	—	—	19.4
– Amounts due from fellow Banco Santander group subsidiaries and joint ventures	2.2	—	2.2	—	—	—	—	—	—	2.2
– Total loans and advances to customers	208.3	(0.8)	207.5	40.4	(0.1)	40.3	(0.2)	(194.6)	—	53.0
– Loans and advances to banks	2.5	—	2.5	1.2	—	1.2	—	—	—	3.7
– Reverse repurchase agreements – non trading	23.6	—	23.6	—	—	—	—	(23.1)	(0.5)	—
– Other financial assets at amortised cost	7.1	—	7.1	—	—	—	—	—	—	7.1
Total financial assets at amortised cost	241.5	(0.8)	240.7	41.6	(0.1)	41.5	(0.2)	(217.7)	(0.5)	63.8
Financial assets at FVOCI:										
– Loans and advances to customers	0.1	—	0.1	—	—	—	—	—	—	0.1
– Debt securities	9.6	—	9.6	—	—	—	—	—	—	9.6
Total financial assets at FVOCI	9.7	—	9.7	—	—	—	—	—	—	9.7
Total	277.6	(0.8)	276.8	41.6	(0.1)	41.5	(0.2)	(217.7)	(0.5)	99.9

(1) The forms of collateral we take to reduce credit risk include: residential and commercial property; other physical assets, including motor vehicles; liquid securities, including those transferred under reverse repurchase agreements; cash, including cash used as collateral for derivative transactions; and receivables. Charges on residential property are most of the collateral we take.

(2) We can reduce credit risk exposures by applying netting. We do this mainly for derivative and repurchase transactions with financial institutions. For derivatives, we use standard master netting agreements. They allow us to set off our credit risk exposure to a counterparty from a derivative against our obligations to the counterparty in the event of default. This gives us a lower net credit exposure. They may also reduce settlement exposure. For more on this, see 'Credit risk mitigation' in the 'Other business segments – credit risk management' section.

(3) Balances include interest we have charged to the customer's account and accrued interest that we have not charged to the account yet.

(4) The collateral value we have shown against advances secured on residential property is limited to the balance of each associated individual loan. It does not include the impact of over-collateralisation (where the collateral has a higher value than the loan balance) and includes collateral we would receive on draw down of certain off-balance sheet commitments.

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

	Balance sheet asset gross amount	Collateral ⁽¹⁾			Netting ⁽²⁾	Net exposure
		Cash	Non-cash			
	£bn	£bn	£bn	£bn	£bn	
2020						
Financial assets at FVTPL:						
– Derivative financial instruments	3.5	–	(1.8)	(0.8)	0.9	
– Other financial assets at FVTPL	0.8	–	–	–	0.8	
Total	4.3	–	(1.8)	(0.8)	1.7	
2019						
Financial assets at FVTPL:						
– Derivative financial instruments	3.4	–	(1.9)	(0.8)	0.7	
– Other financial assets at FVTPL	1.0	–	–	–	1.0	
Total	4.4	–	(1.9)	(0.8)	1.7	

(1) The forms of collateral we take to reduce credit risk include: liquid securities, including those transferred under reverse repurchase agreements; cash, including cash used as collateral for derivative transactions; and receivables.

(2) We can reduce credit risk exposures by applying netting. We do this mainly for derivative and repurchase transactions with financial institutions. For derivatives, we use standard master netting agreements. They allow us to set off our credit risk exposure to a counterparty from a derivative against our obligations to the counterparty in the event of default. This gives us a lower net credit exposure. They may also reduce settlement exposure. For more on this, see 'Credit risk mitigation' in the 'Other business segments – credit risk management' section.

Single credit rating scale

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

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

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

Rating distribution (audited)

The tables below show the credit rating of financial assets to which the impairment requirements in IFRS 9 apply. Post-PMA balances are used in risk grade allocation. For more on the credit rating profiles of key portfolios, see the 'Credit risk – Retail Banking' and 'Credit risk – Other business segments' sections.

2020	Santander UK risk grade							Other ⁽¹⁾ £bn	Loss allowance £bn	Total £bn
	9 £bn	8 £bn	7 £bn	6 £bn	5 £bn	4 £bn	3 to 1 £bn			
Exposures										
On balance sheet										
Cash and balances at central banks	43.5	—	—	—	—	—	—	—	—	43.5
– Stage 1	43.5	—	—	—	—	—	—	—	—	43.5
Financial assets at amortised cost:										
– Loans and advances to customers ⁽²⁾	8.0	28.2	75.8	44.8	13.6	27.4	8.2	7.5	(1.3)	212.2
– Stage 1	8.0	28.1	75.4	43.3	10.9	19.4	1.1	7.3	(0.2)	193.3
– Stage 2	—	0.1	0.4	1.5	2.7	8.0	4.2	0.2	(0.5)	16.6
– Stage 3	—	—	—	—	—	—	2.9	—	(0.6)	2.3
Of which mortgages:	7.9	24.8	69.3	37.6	5.7	19.9	4.5	0.3	(0.3)	169.7
– Stage 1	7.9	24.8	69.0	36.2	4.0	15.0	0.6	0.3	—	157.8
– Stage 2	—	—	0.3	1.4	1.7	4.9	2.1	—	(0.2)	10.2
– Stage 3	—	—	—	—	—	—	1.8	—	(0.1)	1.7
Loans and advances to banks	0.1	0.1	0.7	—	—	—	—	1.1	—	2.0
– Stage 1	0.1	0.1	0.7	—	—	—	—	1.1	—	2.0
– Reverse repo agreements – non trading	12.2	3.3	1.5	2.4	—	—	—	0.2	—	19.6
– Stage 1	12.2	3.3	1.5	2.4	—	—	—	0.2	—	19.6
– Other financial assets at amortised cost	1.2	—	—	—	—	—	—	—	—	1.2
– Stage 1	1.2	—	—	—	—	—	—	—	—	1.2
Total financial assets at amortised cost	21.5	31.6	78.0	47.2	13.6	27.4	8.2	8.8	(1.3)	235.0
Financial assets at FVOCI:	5.3	3.4	0.2	0.1	—	—	—	—	—	9.0
– Stage 1	5.3	3.4	0.2	0.1	—	—	—	—	—	9.0
Total on balance sheet	70.3	35.0	78.2	47.3	13.6	27.4	8.2	8.8	(1.3)	287.5
Total off-balance sheet										
– Stage 1	0.4	8.8	9.5	8.8	5.1	1.6	0.5	8.5	(0.1)	43.1
– Stage 2	—	—	—	0.2	0.4	0.5	0.2	—	(0.1)	1.2
– Stage 3	—	—	—	—	—	—	0.1	—	—	0.1
Total exposures	70.7	43.8	87.7	56.1	18.7	29.0	8.7	17.3	(1.4)	330.6
ECL										
On balance sheet										
Cash and balances at central banks	—	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—	—
Financial assets at amortised cost:										
– Loans and advances to customers ⁽²⁾	—	—	—	0.1	0.1	0.2	0.9	—	—	1.3
– Stage 1	—	—	—	0.1	—	—	0.1	—	—	0.2
– Stage 2	—	—	—	—	0.1	0.2	0.2	—	—	0.5
– Stage 3	—	—	—	—	—	—	0.6	—	—	0.6
Of which mortgages:	—	—	—	—	—	0.1	0.2	—	—	0.3
– Stage 1	—	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	0.1	0.1	—	—	0.2
– Stage 3	—	—	—	—	—	—	0.1	—	—	0.1
– Loans and advances to banks	—	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—	—
– Reverse repo agreements – non trading	—	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—	—
– Other financial assets at amortised cost	—	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—	—
Total financial assets at amortised cost	—	—	—	0.1	0.1	0.2	0.9	—	—	1.3
Financial assets at FVOCI:	—	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—	—
Total on balance sheet	—	—	—	0.1	0.1	0.2	0.9	—	—	1.3
Total off-balance sheet										
– Stage 1	—	—	—	—	—	—	0.1	—	—	0.1
– Stage 2	—	—	—	—	—	—	—	—	—	—
– Stage 3	—	—	—	—	—	—	—	—	—	—
Total ECL	—	—	—	0.1	0.1	0.2	1.0	—	—	1.4

2020	Santander UK risk grade							Other ⁽¹⁾	Total
	9	8	7	6	5	4	3 to 1		
	%	%	%	%	%	%	%	%	%
Coverage ratio									
On balance sheet									
Cash and balances at central banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Financial assets at amortised cost:									
– Loans and advances to customers ⁽²⁾	—	—	—	0.2	0.7	0.7	11.0	—	0.6
– Stage 1	—	—	—	0.2	—	—	9.1	—	0.1
– Stage 2	—	—	—	—	3.7	2.5	4.8	—	3.0
– Stage 3	—	—	—	—	—	—	20.7	—	26.1
Of which mortgages:									
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	2.0	4.8	—	2.0
– Stage 3	—	—	—	—	—	—	5.6	—	5.9
– Loans and advances to banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Reverse repo agreements – non trading	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Other financial assets at amortised cost	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total financial assets at amortised cost	—	—	—	0.2	0.7	0.7	11.0	—	0.6
Financial assets at FVOCI:	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total on balance sheet	—	—	—	0.2	0.7	0.7	11.0	—	0.5
Total off-balance sheet	—	—	—	—	—	—	20.0	—	0.2
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	—	50.0	—	8.3
– Stage 3	—	—	—	—	—	—	—	—	—
Total coverage ratio	—	—	—	0.2	0.5	0.7	11.5	—	0.4

2019	Santander UK risk grade							Other ⁽³⁾	Loss allowance	Total
	9	8	7	6	5	4	3 to 1			
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Exposures										
On balance sheet										
Cash and balances at central banks	26.4	—	—	—	—	—	—	—	—	26.4
– Stage 1	26.4	—	—	—	—	—	—	—	—	26.4
Financial assets at amortised cost:										
– Loans and advances to customers ⁽²⁾	11.4	30.6	75.4	52.1	18.8	10.9	6.2	2.9	(0.8)	207.5
– Stage 1	11.4	30.6	75.0	50.9	16.1	6.2	1.2	2.9	(0.1)	194.2
– Stage 2	—	—	0.4	1.2	2.7	4.7	2.7	—	(0.3)	11.4
– Stage 3	—	—	—	—	—	—	2.3	—	(0.4)	1.9
Of which mortgages:										
– Stage 1	9.8	25.0	71.9	42.9	7.7	4.2	3.9	—	(0.2)	165.2
– Stage 2	9.8	25.0	71.7	42.0	5.7	1.1	0.2	—	—	155.5
– Stage 3	—	—	0.2	0.9	2.0	3.1	2.0	—	(0.1)	8.1
– Stage 3	—	—	—	—	—	—	1.7	—	(0.1)	1.6
– Loans and advances to banks	0.1	0.2	1.0	—	—	—	—	1.2	—	2.5
– Stage 1	0.1	0.2	1.0	—	—	—	—	1.2	—	2.5
– Reverse repo agreements – non trading	15.3	2.4	4.2	1.5	—	—	—	0.2	—	23.6
– Stage 1	15.3	2.4	4.2	1.5	—	—	—	0.2	—	23.6
– Other financial assets at amortised cost	7.1	—	—	—	—	—	—	—	—	7.1
– Stage 1	7.1	—	—	—	—	—	—	—	—	7.1
Total financial assets at amortised cost	33.9	33.2	80.6	53.6	18.8	10.9	6.2	4.3	(0.8)	240.7
Financial assets at FVOCI:	6.1	3.2	0.4	—	—	—	—	—	—	9.7
– Stage 1	6.1	3.2	0.4	—	—	—	—	—	—	9.7
Total on balance sheet	66.4	36.4	81.0	53.6	18.8	10.9	6.2	4.3	(0.8)	276.8
Total off-balance sheet	0.9	8.5	8.3	8.1	5.0	1.1	0.6	9.1	(0.1)	41.5
– Stage 1	0.9	8.5	8.3	8.0	4.7	1.0	0.3	9.1	—	40.8
– Stage 2	—	—	—	0.1	0.3	0.1	0.2	—	(0.1)	0.6
– Stage 3	—	—	—	—	—	—	0.1	—	—	0.1
Total exposures	67.3	44.9	89.3	61.7	23.8	12.0	6.8	13.4	(0.9)	318.3

2019	Santander UK risk grade							Other ⁽³⁾	Total
	9	8	7	6	5	4	3 to 1		
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
ECL									
On balance sheet									
Cash and balances at central banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Financial assets at amortised cost:									
– Loans and advances to customers ⁽²⁾	—	—	—	—	0.1	0.2	0.5	—	0.8
– Stage 1	—	—	—	—	—	0.1	—	—	0.1
– Stage 2	—	—	—	—	0.1	0.1	0.1	—	0.3
– Stage 3	—	—	—	—	—	—	0.4	—	0.4
Of which mortgages:									
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	0.1	—	—	0.1
– Stage 3	—	—	—	—	—	—	0.1	—	0.1
– Loans and advances to banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Reverse repo agreements – non trading	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Other financial assets at amortised cost	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total financial assets at amortised cost	—	—	—	—	0.1	0.2	0.5	—	0.8
Financial assets at FVOCI:	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total on balance sheet	—	—	—	—	0.1	0.2	0.5	—	0.8
Total off-balance sheet	—	—	—	—	—	—	0.1	—	0.1
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	—	0.1	—	0.1
– Stage 3	—	—	—	—	—	—	—	—	—
Total ECL	—	—	—	—	0.1	0.2	0.6	—	0.9
2019	%	%	%	%	%	%	%	%	%
Coverage ratio									
On balance sheet									
Cash and balances at central banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Financial assets at amortised cost:									
– Loans and advances to customers ⁽²⁾	—	—	—	—	0.5	1.8	8.1	—	0.4
– Stage 1	—	—	—	—	—	1.6	—	—	0.1
– Stage 2	—	—	—	—	3.7	2.1	3.7	—	2.6
– Stage 3	—	—	—	—	—	—	17.4	—	21.1
Of which mortgages:									
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	3.2	—	—	1.2
– Stage 3	—	—	—	—	—	—	5.9	—	6.3
– Loans and advances to banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Reverse repo agreements – non trading	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Other financial assets at amortised cost	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total financial assets at amortised cost	—	—	—	—	0.5	1.8	8.1	—	0.3
Financial assets at FVOCI:	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total on balance sheet	—	—	—	—	0.5	1.8	8.1	—	0.3
Total off-balance sheet	—	—	—	—	—	—	16.7	—	0.2
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	—	50.0	—	16.7
– Stage 3	—	—	—	—	—	—	—	—	—
Total coverage ratio	—	—	—	—	0.4	1.7	8.8	—	0.3

(1) Includes cash at hand and smaller cases mainly in the consumer (auto) finance and commercial mortgages portfolios, as well as loans written as part of the Government Covid-19 support schemes for micro-SMEs. We use scorecards for these items, rather than rating models.

(2) Includes interest we have charged to the customer's account and accrued interest we have not charged to the account yet.

(3) Includes cash at hand and smaller cases mainly in the consumer (auto) finance and commercial mortgages portfolios. We use scorecards for these items, rather than rating models.

Credit performance (audited)

Our 2020 results include £448m of impairment charges arising from changes to economic scenarios and weights and the staging reclassification of certain loans following an in-depth sectoral and payment holiday review, explained in more detail below.

2020	Customer Loans				Gross write-offs £m	Loan Loss Allowances £m
	Total £bn	Stage 1 £bn	Stage 2 £bn	Stage 3 £bn		
Retail Banking:	186.5	173.2	11.4	1.9	180	706
– of which mortgages	169.8	157.6	10.4	1.8	14	280
– of which business banking	3.9	3.9	—	—	12	9
– of which consumer (auto) finance	8.0	7.6	0.4	—	25	118
– of which other unsecured lending	4.8	4.1	0.6	0.1	129	299
Corporate & Commercial Banking	17.6	11.1	5.5	1.0	51	603
Corporate & Investment Banking	2.8	2.6	0.2	—	22	33
Corporate Centre	3.5	3.5	—	—	—	35
	210.4	190.4	17.1	2.9	253	1,377
Undrawn Balances		41.8	1.3	0.1		
Stage 1, Stage 2 and Stage 3 ¹ ratios %		90.49	8.12	1.42		

2019	£bn	£bn	£bn	£bn	£m	£m
Retail Banking:	178.8	167.6	9.3	1.9	196	549
– of which mortgages	165.4	155.5	8.2	1.7	14	218
– of which business banking	0.2	0.2	—	—	14	9
– of which consumer (auto) finance	7.7	7.0	0.6	0.1	34	88
– of which other unsecured lending	5.5	4.9	0.5	0.1	134	234
Corporate & Commercial Banking	18.4	15.9	2.1	0.4	53	262
Corporate & Investment Banking	4.0	3.8	0.2	—	—	50
Corporate Centre	4.1	4.0	0.1	—	—	2
	205.3	191.3	11.7	2.3	249	863
Undrawn Balances		40.9	0.7	0.1		
Stage 1, Stage 2 and Stage 3 ¹ ratios %		93.20	5.69	1.15		

(1) Stage3 ratio = (Stage3 drawn + Stage3 undrawn assets)/(total drawn assets + Stage3 undrawn assets)

For more on the credit performance of our key portfolios by business segment, see the 'Retail Banking – credit risk review' and 'Other business segments – credit risk review' sections.

We made significant adjustments to our economic assumptions and scenario weightings during 2020 to reflect the emerging impact of the Covid-19 pandemic. Our five economic scenarios have been updated for Q4 2020 and weighted further to the downside, to reflect the expected longer path to recovery for the UK. The 2020 impact was an ECL charge of £164m (9M20: £150m), with an increase in Q4 2020 due to the weighting downgrade as a consequence of the January 2021 national lockdown, which was partially offset by higher house prices and a delayed peak in unemployment.

We have reclassified the staging of a number of corporate loans based on a review of the sectors and lending most at risk due to Covid-19, while also considering those customers who have been granted some form of concession. Furthermore, we have provided for unexpected large single name exposures defaulting due to a risk which could emerge as a result of the Covid-19 pandemic. The 2020 impact was an impairment charge of £215m, up from £172m in 9M20.

To support our customers, we have offered payment holidays on a range of products, most of which were taken by customers who were up to date with their repayments. The granting of a payment holiday on its own was not considered to be a Significant Increase in Credit Risk (SICR) event, nor was it considered a default under regulatory definitions, but we provided for potentially higher arrears as a result. In Q4 2020 we reviewed the ECL provision and loans that had taken payment holidays and decreased ECL by £11m to £27m (9M20: £38m).

We made other Covid-19 management judgement overlays, predominantly relating to mortgage and unsecured personal loan model risk refinement, including delay in repossessions, which increased ECL by £18m in Q4 2020 to £45m (9M20: £29m).

Credit quality (audited)

Total on-balance sheet exposures at 31 December 2020 comprised £210.4bn of customer loans, loans and advances to banks of £2.0bn, £20.8bn of sovereign assets measured at amortised cost, £9.0bn of assets measured at FVOCI, and £43.5bn of cash and balances at central banks.

2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Exposures				
On-balance sheet				
Retail Banking	173,157	11,384	1,935	186,476
– of which mortgages	157,614	10,388	1,799	169,801
Corporate & Commercial Banking	11,167	5,498	961	17,626
Corporate & Investment Banking	2,587	198	—	2,785
Corporate Centre	78,708	27	—	78,735
Total on-balance sheet	265,619	17,107	2,896	285,622
Off-balance sheet				
Retail Banking ⁽¹⁾	26,550	256	41	26,847
– of which mortgages ⁽¹⁾	13,180	82	14	13,276
Corporate & Commercial Banking	6,050	768	59	6,877
Corporate & Investment Banking	8,630	231	—	8,861
Corporate Centre	567	18	—	585
Total off-balance sheet⁽²⁾	41,797	1,273	100	43,170
Total exposures	307,416	18,380	2,996	328,792
ECL				
On-balance sheet				
Retail Banking	100	350	218	668
– of which mortgages	15	130	132	277
Corporate & Commercial Banking	46	189	342	577
Corporate & Investment Banking	5	17	—	22
Corporate Centre	35	—	—	35
Total on-balance sheet	186	556	560	1,302
Off-balance sheet				
Retail Banking	18	19	1	38
– of which mortgages	2	1	—	3
Corporate & Commercial Banking	8	10	8	26
Corporate & Investment Banking	4	7	—	11
Total off-balance sheet	30	36	9	75
Total ECL	216	592	569	1,377
	%	%	%	%
Coverage ratio⁽³⁾				
On-balance sheet				
Retail Banking	0.1	3.1	11.3	0.4
– of which mortgages	—	1.3	7.3	0.2
Corporate & Commercial Banking	0.4	3.4	35.6	3.3
Corporate & Investment Banking	0.2	8.6	—	0.8
Corporate Centre	—	—	—	—
Total on-balance sheet	0.1	3.3	19.3	0.5
Off-balance sheet				
Retail Banking	0.1	7.4	2.4	0.1
– of which mortgages	—	1.2	—	—
Corporate & Commercial Banking	0.1	1.3	13.6	0.4
Corporate & Investment Banking	—	3.0	—	0.1
Total off-balance sheet	0.1	2.8	9.0	0.2
Total coverage	0.1	3.2	19.0	0.4

(1) Off-balance sheet exposures include £7.7bn of retail mortgage offers in the pipeline.

(2) Off-balance sheet amounts consist of contingent liabilities and commitments. For more, see Note 31 to the Consolidated Financial Statements.

(3) ECL as a percentage of the related exposure.

Total on-balance sheet exposures at 31 December 2019 comprised £205.3bn of customer loans, loans and advances to banks of £2.6bn, £30.7bn of sovereign assets measured at amortised cost, £9.7bn of assets measured at FVOCI, and £26.4bn of cash and balances at central banks.

2019	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Exposures				
On-balance sheet				
Retail Banking	167,608	9,289	1,865	178,762
– of which mortgages	155,477	8,157	1,722	165,356
Corporate & Commercial Banking	15,871	2,096	424	18,391
Corporate & Investment Banking	3,843	198	—	4,041
Corporate Centre	73,424	97	—	73,521
Total on-balance sheet	260,746	11,680	2,289	274,715
Off-balance sheet				
Retail Banking ⁽¹⁾	25,795	186	37	26,018
– of which mortgages ⁽¹⁾	13,353	67	12	13,432
Corporate & Commercial Banking	5,410	289	28	5,727
Corporate & Investment Banking	9,129	199	15	9,343
Corporate Centre	519	—	—	519
Total off-balance sheet⁽²⁾	40,853	674	80	41,607
Total exposures	301,599	12,354	2,369	316,322
ECL				
On-balance sheet				
Retail Banking	76	246	200	522
– of which mortgages	11	100	103	214
Corporate & Commercial Banking	46	45	156	247
Corporate & Investment Banking	1	13	—	14
Corporate Centre	1	1	—	2
Total on-balance sheet	124	305	356	785
Off-balance sheet				
Retail Banking	13	13	1	27
– of which mortgages	3	1	—	4
Corporate & Commercial Banking	7	6	2	15
Corporate & Investment Banking	3	24	9	36
Total off-balance sheet	23	43	12	78
Total ECL	147	348	368	863
	%	%	%	%
Coverage ratio⁽³⁾				
On-balance sheet				
Retail Banking	—	2.6	10.7	0.3
– of which mortgages	—	1.2	6.0	0.1
Corporate & Commercial Banking	0.3	2.1	36.8	1.3
Corporate & Investment Banking	—	6.6	—	0.3
Corporate Centre	—	1.0	—	—
Total on-balance sheet	—	2.6	15.6	0.3
Off-balance sheet				
Retail Banking	0.1	7.0	2.7	0.1
– of which mortgages	—	1.5	—	—
Corporate & Commercial Banking	0.1	2.1	7.1	0.3
Corporate & Investment Banking	—	12.1	60.0	0.4
Total off-balance sheet	0.1	6.4	15.0	0.2
Total coverage	—	2.8	15.5	0.3

(1) Off-balance sheet exposures include £7.6bn of retail mortgage offers in the pipeline.

(2) Off-balance sheet amounts consist of contingent liabilities and commitments. For more, see Note 31 to the Consolidated Financial Statements.

(3) ECL as a percentage of the related exposure.

2020 compared to 2019

Key movements in exposures and ECL in the year by Stage were:

- The increase in Stage 1 exposures was due to the take up of BBLS by Business Banking customers, and other Covid-19 related UK Government's schemes by corporate customers as well as strong mortgage lending in H2 2020. Stage 1 ECL increased due to a £35m Corporate "Tall Tree" PMA to cover potential future large case losses, as well as increases from Retail unsecured portfolios as a result of the updated 2020 economic scenarios.
- Stage 2 exposures increased as although arrears balances have reduced, management took actions in response to the Covid-19 pandemic, namely downgrading the economic scenarios and weights which increased PDs across the business causing more accounts to breach the SICR triggers to enter Stage 2, moving riskier balances of £0.8bn to which payment holidays were offered to from Stage 1 to Stage 2 and moving £3.1bn corporate loans most impacted by Covid-19 from Stage 1 to Stage 2. The increase in ECL balances reflected these actions.
- Stage 3 exposures have increased due to the extension of the Covid-19 High Risk Corporate PMA to Stage 2 customers, which moved £0.4bn of Stage 2 exposures most at risk of being negatively impacted by Covid-19 to Stage 3. Stage 3 mortgage exposures also increased as accounts rolled off of payment holidays and into arrears. This was offset by strong performance across the Retail unsecured portfolios. The increase in ECL balances reflected these actions.

Stage 2 analysis (audited)

The following table analyses our Stage 2 exposures and ECL by the reason the exposure is classified as Stage 2.

	Retail Banking			Other business segments			Total		
	Exposure £m	ECL £m	Coverage %	Exposure £m	ECL £m	Coverage %	Exposure £m	ECL £m	Coverage %
2020									
PD deterioration	7,840	259	3.3	2,160	40	1.9	10,000	299	3.0
Forbearance	612	3	0.5	155	5	3.2	767	8	1.0
Other	1,447	22	1.5	1,046	90	8.6	2,493	112	4.5
30 DPD	897	58	6.5	253	5	2.0	1,150	63	5.5
Payment Holiday	844	27	3.2	—	—	—	844	27	3.2
High Risk Corporate	—	—	—	3,126	83	2.7	3,126	83	2.7
	11,640	369	3.2	6,740	223	3.3	18,380	592	3.2
2019									
PD deterioration	6,749	190	2.8	2,093	29	1.4	8,842	219	2.5
Forbearance	504	3	0.6	57	2	3.5	561	5	0.9
Other	1,174	20	1.7	563	56	9.9	1,737	76	4.4
30 DPD	1,048	46	4.4	166	2	1.2	1,214	48	4.0
	9,475	259	2.7	2,879	89	3.1	12,354	348	2.8

Where balances satisfy more than one of the criteria above for determining a significant increase in credit risk, we have assigned the corresponding gross carrying amount and ECL in order of the categories presented.

The following table analyses our Stage 2 exposures and the related ECL by whether or not they are in a cure period at the balance sheet date.

	2020			2019		
	Exposure £m	ECL £m	Coverage %	Exposure £m	ECL £m	Coverage %
Stage 2 not in cure period	17,036	554	3.3	12,020	342	2.8
Stage 2 in cure period (for transfer to Stage 1)	1,344	38	2.8	334	6	1.8
	18,380	592	3.2	12,354	348	2.8

2020 compared to 2019

Stage 2 exposures increased as although arrears balances have reduced, management took actions in response to the Covid-19 pandemic, namely downgrading the economic scenarios and weights which increased PDs across the business causing more accounts to breach the SICR triggers to enter Stage 2, moving riskier balances of £0.8bn to which payment holidays were offered to from Stage 1 to Stage 2 and moving £3.1bn corporate loans most impacted by Covid-19 from Stage 1 to Stage 2. The increase in ECL balances reflected these actions, with coverage increases coming from the downgraded economic forecasts.

The accounts in cure period at 31 December 2020 increased compared to 2019, as more mortgage accounts cured out of late arrears and are being held in Stage 2 in 2020.

We do not have any cure period criteria for exiting Stage 3 to Stage 2.

Reconciliation of exposures, loss allowance and net carrying amounts (audited)

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

	On-balance sheet			Off-balance sheet	
	Exposures £m	Loss allowance £m	Net carrying amount £m	Exposures £m	Loss allowance £m
2020					
Retail Banking ⁽²⁾	186,476	668	185,808	26,847	38
– of which mortgages ⁽³⁾	169,801	277	169,524	13,276	3
Corporate & Commercial Banking	17,626	577	17,049	6,877	26
Corporate & Investment Banking	2,785	22	2,763	8,861	11
Corporate Centre	78,735	35	78,700	585	—
Total exposures presented in Credit Quality tables	285,622	1,302	284,320	43,170	75
Other items ⁽¹⁾			3,111		
Adjusted net carrying amount			287,431		
Assets classified at FVTPL			4,285		
Non-financial assets			7,348		
Total assets per the Consolidated Balance Sheet			299,064		
2019					
Retail Banking ⁽²⁾	178,762	522	178,240	26,018	27
– of which mortgages ⁽³⁾	165,356	214	165,142	13,432	4
Corporate & Commercial Banking	18,391	247	18,144	5,727	15
Corporate & Investment Banking	4,041	14	4,027	9,343	36
Corporate Centre	73,521	2	73,519	519	—
Total exposures presented in Credit Quality tables	274,715	785	273,930	41,607	78
Other items ⁽¹⁾			2,985		
Adjusted net carrying amount			276,915		
Assets classified at FVTPL			4,336		
Non-financial assets			7,237		
Total assets per the Consolidated Balance Sheet			288,488		

(1) These assets mainly relate to loans as part of a joint venture agreement and the accrued interest on them. They carry low credit risk and therefore have an immaterial ECL.

(2) Off-balance sheet exposures include credit cards in addition to mortgages.

(3) Off-balance sheet exposures include offers in the pipeline and undrawn balances from flexible mortgage products.

Movement in total exposures and the corresponding ECL (audited)

The following table shows changes in total on and off-balance sheet exposures, subject to ECL assessment, and the corresponding ECL, in the year. The table presents total gross carrying amounts and ECLs at a Santander UK group level. We present segmental views in the sections below.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	301,599	147	12,354	348	2,369	368	316,322	863
Transfers from Stage 1 to Stage 2 ⁽³⁾	(9,814)	(47)	9,814	47	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	3,178	110	(3,178)	(110)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(385)	(8)	(1,126)	(61)	1,511	69	—	—
Transfers from Stage 3 ⁽³⁾	12	2	326	21	(338)	(23)	—	—
Transfers of financial instruments	(7,009)	57	5,836	(103)	1,173	46	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	(101)	—	239	—	241	—	379
Change in economic scenarios ⁽²⁾	—	15	—	139	—	10	—	164
Changes to model	—	—	—	—	—	25	—	25
New lending and assets purchased ⁽⁵⁾	55,546	40	1,372	64	104	51	57,022	155
Redemptions, repayments and assets sold ⁽⁷⁾	(47,671)	(30)	(2,250)	(42)	(441)	(18)	(50,362)	(90)
Other ⁽⁶⁾	4,953	88	1,068	(53)	184	99	6,205	134
Assets written off ⁽⁷⁾	(2)	—	—	—	(393)	(253)	(395)	(253)
At 31 December 2020	307,416	216	18,380	592	2,996	569	328,792	1,377
Net movement in the period	5,817	69	6,026	244	627	201	12,470	514

ECL charge/(release) to the Income Statement	69		244		454		767
Less: Discount unwind	—		—		(14)		(14)
Less: Recoveries net of collection costs	—		—		(108)		(108)
Total ECL charge/(release) to the Income Statement	69		244		332		645

At 1 January 2019	296,363	143	12,013	307	2,572	357	310,948	807
Transfers from Stage 1 to Stage 2 ⁽³⁾	(4,101)	(11)	4,101	11	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	3,458	74	(3,458)	(74)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(361)	(2)	(595)	(24)	956	26	—	—
Transfers from Stage 3 ⁽³⁾	10	1	516	23	(526)	(24)	—	—
Transfers of financial instruments	(994)	62	564	(64)	430	2	—	—
Net remeasurement of ECL on stage transfer ⁽⁴⁾	—	(66)	—	130	—	96	—	160
Change in economic scenarios ⁽²⁾	—	5	—	(15)	—	(9)	—	(19)
Changes to model	—	—	—	—	—	13	—	13
New lending and assets purchased ⁽⁵⁾	42,415	29	827	32	15	9	43,257	70
Redemptions, repayments and assets sold ⁽⁷⁾	(40,379)	(32)	(1,344)	(28)	(458)	(42)	(42,181)	(102)
Other ⁽⁶⁾	4,195	6	295	(14)	171	191	4,661	183
Assets written off ⁽⁷⁾	(1)	—	(1)	—	(361)	(249)	(363)	(249)
At 31 December 2019	301,599	147	12,354	348	2,369	368	316,322	863
Net movement in the period	5,236	4	341	41	(203)	11	5,374	56

ECL charge/(release) to the Income Statement	4		41		260		305
Less: Discount unwind	—		—		(14)		(14)
Less: Recoveries net of collection costs	(10)		(15)		(46)		(71)
Total ECL charge/(release) to the Income Statement	(6)		26		200		220

(1) Exposures that have attracted an ECL, and as reported in the Credit Quality table above.

(2) Changes to assumptions in the year. Isolates the impact on ECL from changes to the economic variables for each scenario, changes to the scenarios themselves as well as changes in the probability weights from all other movements. This also includes the impact of quarterly revaluation of collateral. The impact of changes in economics on exposure Stage allocations are shown within Transfers of financial instruments.

(3) Total impact of facilities that moved Stage(s) in the year. This means, for example, that where risk parameter changes (model inputs) or model changes (methodology) result in a facility moving Stage, the full impact is reflected here (rather than in Other). Stage flow analysis only applies to facilities that existed at both the start and end of the year. Transfers between Stages are based on opening balances and ECL at the start of the year.

(4) Relates to the revaluation of ECL following the transfer of an exposure from one Stage to another.

(5) Exposures and ECL of facilities that did not exist at the start of the year but did at the end. Amounts in Stage 2 and 3 represent assets which deteriorated in the period after origination in Stage 1.

(6) Residual movements on existing facilities that did not change Stage in the year, and which were not acquired in the year. Includes the net increase or decrease in the period of cash at central banks, the impact of changes in risk parameters in the period, unwind of discount rates and increases in ECL requirements of accounts which ultimately were written off in the year.

(7) Exposures and ECL for facilities that existed at the start of the year but not at the end.

COUNTRY RISK EXPOSURES (AUDITED)

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

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

	2020							2019							
	Financial Institutions							Financial Institutions							
	Governments	Government guaranteed	Banks ⁽¹⁾	Other	Retail	Corporate	Total ⁽²⁾	Governments	Government guaranteed	Banks ⁽¹⁾	Other	Retail	Corporate	Total ⁽²⁾	
£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	
Eurozone															
Ireland	—	—	—	6.0	—	0.1	6.1	—	—	—	7.5	—	0.1	7.6	
Italy	—	—	—	—	—	—	—	—	—	—	0.1	—	—	0.1	
Spain	—	—	—	—	—	0.1	0.1	—	—	—	—	—	—	—	
France	0.1	—	0.5	0.2	—	—	0.8	0.1	—	0.6	0.5	—	—	1.2	
Germany	—	—	0.7	0.1	—	0.1	0.9	—	—	1.2	0.1	—	0.1	1.4	
Luxembourg	—	—	0.1	1.3	—	0.1	1.5	—	—	0.1	2.7	—	0.1	2.9	
Other ⁽³⁾	0.4	—	1.1	—	—	0.4	1.9	0.3	—	1.1	—	—	—	1.4	
	0.5	—	2.4	7.6	—	0.8	11.3	0.4	—	3.0	10.9	—	0.3	14.6	
Other countries															
UK	44.4	—	2.8	15.5	209.3	40.4	312.4	33.5	—	3.6	15.6	204.6	38.2	295.5	
US	0.8	—	0.9	0.1	—	0.3	2.1	1.0	—	1.1	0.1	—	0.1	2.3	
Japan	2.4	—	1.0	—	—	—	3.4	2.3	—	1.6	—	—	—	3.9	
Denmark	—	—	—	—	—	—	—	—	—	—	—	—	0.5	0.5	
Other	0.3	—	0.5	0.1	0.3	0.7	1.9	0.1	—	0.5	0.1	0.3	0.8	1.8	
	47.9	—	5.2	15.7	209.6	41.4	319.8	36.9	—	6.8	15.8	204.9	39.6	304.0	
Total	48.4	—	7.6	23.3	209.6	42.2	331.1	37.3	—	9.8	26.7	204.9	39.9	318.6	

(1) Excludes balances with central banks.

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

(3) Includes The Netherlands of £0.6bn (2019: £0.2bn), Belgium of £0.9bn (2019: £0.6bn).

Balances with other Banco Santander group members (audited)

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

At 31 December 2020 and 31 December 2019, we had gross balances with other Banco Santander group members as follows:

	2020				2019			
	Financial institutions				Financial institutions			
	Banks	Other	Corporate	Total	Banks	Other	Corporate	Total
£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	
Assets								
Spain	1.8	—	—	1.8	1.8	—	—	1.8
UK	—	2.3	—	2.3	—	2.2	—	2.2
	1.8	2.3	—	4.1	1.8	2.2	—	4.0
Liabilities								
Spain	2.5	0.1	—	2.6	2.4	0.1	—	2.5
UK	—	1.3	—	1.3	—	1.2	—	1.2
Uruguay	0.1	—	—	0.1	0.2	—	—	0.2
	2.6	1.4	—	4.0	2.6	1.3	—	3.9

Covid-19 Support measures in place at 31 December 2020

A summary of the Covid-19 financial support measures that were in place at 31 December 2020 is set out below:

	Customers supported	Total loans for which PH granted £bn	Breakdown of total PH granted				Outstanding PH £bn
			Up to date after PH	Ongoing PH	New to arrears after PH ends	In arrears before PH	
			%	%	%	%	
Payment holidays (PH)⁽¹⁾							
Mortgages	251,000	37.1	88	8	2	2	2.5
Consumer (auto) finance ⁽²⁾	54,000	0.5	77	11	8	4	0.1
Unsecured Personal Loans (UPLs)	34,000	0.2	77	13	4	6	<0.1
Credit Cards	32,000	0.1	76	12	8	4	<0.1
Business and corporates	2,500	2.4	98	2	—	—	0.1

	Number of customers	Loan balance	% of relevant loan book
		£bn	%
Government lending schemes⁽³⁾			
Bounce Back Loan Scheme (BBLs) ⁽⁴⁾	148,000	4.0	19
Coronavirus Business Interruption Loan Scheme (CBILS)	2,000	0.4	2
Coronavirus Large Business Interruption Loan Scheme (CLBILS)	30	0.2	3

(1) Also known as payment deferrals. Retail balances are stock positions for customers supported and loans at 31 December 2020 that have had, or currently have, payment holidays granted.

(2) Includes customers supported by PSA Finance UK Limited.

(3) Applications drawn to 31 December 2020.

(4) 100% government guaranteed.

Corporate customer sector split⁽¹⁾

	2020	2019
	Total £bn	Total £bn
Social housing	5.8	6.4
Other real estate	4.9	5.5
Wholesale & retail trade	3.7	3.8
Accommodation & food	2.1	1.8
Construction	1.6	1.2
Human health & social work	1.5	1.4
Professional, scientific and technical	1.3	1.0
Administrative & support services	1.3	1.3
Manufacturing	1.0	1.2
Information & communication	0.8	0.5
Transport & storage	0.5	0.5
Electricity & gas	0.6	0.5
Arts, entertainment & recreation	0.4	0.3
Other segments	2.0	1.0
Total corporate loans	27.5	26.4
Of which government lending schemes	4.6	—

(1) Total corporate loans includes £24.3bn of Corporate lending (CCB, CIB and Business Banking) and £3.2bn of non-core loans in Corporate Centre (which is mostly Social Housing).

The corporate loan book is well-diversified with limited sectoral concentration.

Social housing is lending and treasury services for UK housing association groups (mainly charitable entities) secured by tenanted UK residential property. We have not had a default, loss or repossession in this portfolio.

Credit risk – Retail Banking

Overview

We offer a full range of retail products and services through our branches, the internet, digital devices and over the phone, as well as through intermediaries.

Retail Banking – credit risk management

In this section, we explain how we manage and mitigate credit risk.

Retail Banking – credit risk review

In this section, we analyse our credit risk exposures and how they are performing, including the impact of Covid-19. We also focus on forbearance and portfolios of particular interest. Our main portfolios are:

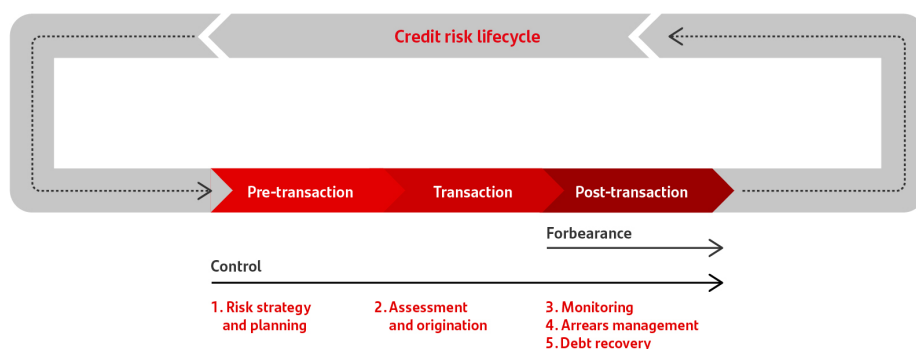
Residential mortgages – This is our largest portfolio. We lend to customers of good credit quality (prime lending). Most of our mortgages are for owner-occupied homes. We also have buy-to-let mortgages where we focus on non-professional landlords with small portfolios.

Consumer (auto) finance and other unsecured lending – Consumer (auto) finance includes financing for cars, vans, motorbikes and caravans – so long as they are privately bought. Other unsecured lending includes personal loans, credit cards and bank account overdrafts.

Business banking – This portfolio consists of small businesses with simple borrowing needs and an annual turnover of up to £6.5m. We offer unsecured lending products, including overdrafts, credit cards and business loans.

The segmental basis of presentation in this Annual Report has been changed, and the prior periods restated, to report some customer assets in Corporate & Commercial Banking rather than in Business Banking (in Retail Banking). See Note 2 for more information.

RETAIL BANKING – CREDIT RISK MANAGEMENT



For more on our approach to credit risk at a Santander UK group level
See pages 88 to 101

In Retail Banking, our customers are individuals and small businesses. We have a high volume of customers and transactions and they share similar credit characteristics, such as their credit score or LTV. As a result, we manage our overall credit risk by looking at portfolios or groups of customers who share similar credit characteristics. Where we take this approach, we call them 'standardised' customers. Exactly how we group customers into segments depends on the portfolio and the stage of the credit risk lifecycle. For example, we may segment customers at origination by their credit score. For accounts in arrears, we may segment them by how fast they improve or worsen. We regularly review each segment compared with our expectations for its performance, budget or limit.

1. Risk strategy and planning (audited)

For more on how we set our risk strategy and plans for Retail Banking, see the 'Santander UK group level – credit risk management' section.

2. Assessment and origination (audited)

We undertake a thorough risk assessment to make sure a customer can meet their obligations before we approve a credit application. We do this mainly by looking at affordability and the customer's credit profile:

Affordability

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

Credit profile

We look at each customer's credit profile and signs of how reliable they are at repaying credit. When they apply, we use the data they give us, and:

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

How we make the decision

Many of our decisions are automated as our risk systems contain data about affordability and credit history. We tailor the process and how we assess the application based on the type of product being taken. More complex transactions often need greater manual assessment. This means we have to rely more on our credit underwriters' skill and experience in making the decision. This is particularly true for secured lending, where we might need to do more checks on the customer's income, or get a property valuation from an approved surveyor, for example.

Credit risk mitigation

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

Portfolio	Description
Residential mortgages	Collateral is in the form of a first legal charge over the property. Before we grant a mortgage, the property is valued. We have our own guidelines for surveyor valuations, which build on guidance from the Royal Institution of Chartered Surveyors (RICS). But we also make use of automated valuation methodologies where our confidence in the accuracy of this method is high.
Unsecured lending	Unsecured lending means there is no collateral or security tied to the loan that can be used to mitigate any potential loss if the customer does not pay us back.
Consumer (auto) finance	Collateral is in the form of legal ownership of the vehicle for most consumer (auto) finance loans, with the customer being the registered keeper. Only a very small proportion of the consumer (auto) finance business is underwritten as a personal loan. In these cases, there is no collateral or security tied to the loan. We use a leading vehicle valuation company to assess the LTV at the proposal stage to ensure that the value of the vehicle being lent against is in line with market expectations, and thus any potential claims on said collateral would be sufficient to be able to mitigate against any potential losses. In addition, from time to time at a portfolio level we execute significant risk transfer transactions, which typically reduce RWAs.
Business banking	Business banking lending is unsecured so there is no collateral or security tied to the loan that can be used to mitigate any potential loss if the customer does not pay us back. When lending to incorporated businesses, we typically obtain personal guarantees from each director but we do not treat these as collateral.

3. Monitoring (audited)

Our risk assessment does not end once we have made the decision to lend. We monitor credit risk across the credit risk lifecycle, mainly using IT systems. There are three main parts:

- **Behaviour scoring:** we use statistical models that help to predict whether the customer will have problems repaying, based on data about how they use their accounts
- **Credit reference agencies:** we often use data from agencies on how the borrower is handling credit from other lenders in our behaviour scoring models. We also buy services like proprietary scorecards or account alerts, which tell us as soon as the customer does something that concerns us, such as missing a payment to another lender
- **Other Santander accounts:** each month, we also look at how the customer uses their other accounts with us, so we can identify problems early.

For secured lending, our monitoring also takes account of changes in property prices. We estimate the property's current value every three months. In most cases, statistical models based on recent sales prices and valuations in that local area are used. Use of this model is subject to Model Risk Governance. Where a lack of data means the model's valuation is not available, the original surveyor valuation with a House Price Index (HPI) adjustment as appropriate is used.

The way we use our monitoring to manage risk varies by product. For revolving credit facilities like credit cards and overdrafts, it might lead us to raise or lower credit limits. Our monitoring can also mean we change our minds about whether a product is still right for a customer. This can influence whether we approve a refinancing application. In these ways we can balance a customer's needs and their ability to manage credit. If we find evidence that a customer is in financial difficulties, we contact them about arrears management including forbearance, which we explain in more detail below.

Our day-to-day retail credit risk monitoring relies on a mix of product, customer and portfolio performance measures as described above. However, changes in the wider UK macro-economy also have an impact on our retail portfolios. To reflect this, since 2017 we have used a Retail Risk Playbook tolerance framework to enhance our day-to-day risk monitoring. This is a formal, structured framework that sets out the macroeconomic variables that are most relevant to retail portfolio performance. We monitor these variables against the related forecasts that we have used in our business plans. If the economy deviates materially from our forecasts, we will formally review and reconsider our retail risk management policy and strategy. This framework remains in place and will continue to do so for as long as we consider it necessary.

Covid-19 has and will continue to affect the macro-economic environment and we will respond to this using the Retail Risk Playbook tolerance framework and management judgements to ensure that portfolio quality remains within Risk Appetite.

4. Arrears management (audited)

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

5. Debt recovery (audited)

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

Loan modifications (audited)

Forbearance

If a customer lets us know they are having financial difficulty, we aim to come to an arrangement with them before they actually default. Their problems can be the result of losing their job, falling ill, a relationship breaking down, or the death of someone close to them.

Forbearance is mainly for mortgages and unsecured loans. We offer forbearance in line with our risk policies, and on a case-by-case basis to ensure we continue to lend responsibly and help customers be able to continue to afford their payments.

We may offer the following types of forbearance, but only if our assessments show the customer can meet the revised payments:

Action	Description
Capitalisation	We offer two main types, which are often combined with term extensions and, in the past, interest-only concessions: <ul style="list-style-type: none"> – If the customer cannot afford to increase their monthly payment enough to pay off their arrears in a reasonable time but has been making their monthly payments (usually for at least six months), then we can add the arrears to the mortgage balance. – We can also add to the mortgage balance at the time of forbearance, unpaid property charges which are due to a landlord and which we pay on behalf of the customer to avoid the lease being forfeited.
Term extension	We can extend the term of the loan, making each monthly payment smaller. For mortgages, the customer must also meet our policies for maximum loan term and age when they finish repaying (usually no more than 75). Customers with interest-only mortgages have to make arrangements to repay the principal at the end of the mortgage. If customers know they will not be able to repay their mortgage in full when it ends, or if their mortgage has already passed the date when it should have ended, we talk to them, and if we think it is in the customer's interests (and they can afford it) we look at other ways of managing it, such as term extensions.
Interest-only	In the past, if it was not possible or affordable for a customer to have a term extension, we may have agreed to let them pay only the interest on the loan for a short time – usually less than a year. We only agreed to this where we believed their financial problems were temporary and they were likely to recover. Since March 2015 we no longer provide this option. Instead, interest-only is only offered as a short-term standard collections arrangement. We now record any related shortfall in monthly payments as arrears and report them to the credit reference agencies. As a result, we no longer classify new interest-only arrangements agreed since March 2015 as forbearance. We continue to manage and report all interest-only arrangements offered before this date as forbearance.

Other modifications

Apart from forbearance, we have sometimes changed the contract terms to keep a good relationship with a customer. In addition, since March 2020, we have provided mortgage customers with payment holiday terms in line with the UK Government's Covid-19 guidance. Similar payment holidays have also been granted in respect of consumer (auto) finance, personal loans, credit cards and business banking. Where these customers showed no signs of financial difficulties at the time, we do not classify the contract changes as forbearance, and most of the loans are being repaid without any problems. For customers who have needed further financial support after the payment holiday period, we help them by offering assistance in line with our policies. We do not classify insolvency solutions for any unsecured retail customers as forbearance. This is in line with industry guidelines on the treatment of customers in insolvency or bankruptcy.

Risk measurement and control

Retail Banking involves managing large numbers of accounts, so it produces a huge amount of data. This allows us to take a more analytical and data intense approach to measuring risk. This is reflected in the wide range of statistical models we use across the credit risk lifecycle. We use:

- **Risk strategy and planning:** econometric models
- **Assessment and origination:** application scorecards, and attrition, pricing, loss allowance and capital models
- **Monitoring:** behavioural scorecards and profitability models
- **Arrears management:** models to estimate the proportion of cases that will result in possession (known as roll rates)
- **Debt recovery:** recovery models.

We assess and review our loss allowances regularly and have them independently reviewed. We look at a number of factors, including the cash flow available to service debt. We also use an agency to value any collateral – mainly mortgages.

RETAIL BANKING – CREDIT RISK REVIEW

Movement in total exposures and the corresponding ECL (audited)

The following table shows changes in total on and off-balance sheet exposures subject to ECL assessment, and the corresponding ECL in the year. The footnotes to the Santander UK group level table on page 112 also apply to this table.

2020	Stage 1		Stage 2		Stage 3		Total	
	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	193,403	89	9,475	259	1,902	201	204,780	549
Transfers from Stage 1 to Stage 2 ⁽³⁾	(5,242)	(9)	5,242	9	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	2,544	86	(2,544)	(86)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(305)	(7)	(540)	(27)	845	34	—	—
Transfers from Stage 3 ⁽³⁾	8	1	324	20	(332)	(21)	—	—
Transfers of financial instruments	(2,995)	71	2,482	(84)	513	13	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	(79)	—	144	—	42	—	107
Change in economic scenarios ⁽²⁾	—	8	—	81	—	10	—	99
Changes to model	—	—	—	—	—	25	—	25
New lending and assets purchased ⁽⁵⁾	34,986	29	479	36	9	6	35,474	71
Redemptions, repayments and assets sold ⁽⁷⁾	(25,835)	(16)	(1,139)	(22)	(319)	8	(27,293)	(30)
Other ⁽⁶⁾	150	17	342	(46)	99	94	591	65
Assets written off ⁽⁷⁾	(2)	(1)	1	1	(228)	(180)	(229)	(180)
At 31 December 2020	199,707	118	11,640	369	1,976	219	213,323	706
Net movement in the year	6,304	29	2,165	110	74	18	8,543	157
Charge/(release) to the Income Statement		30		109		198		337
Less: Discount unwind		—		—		(9)		(9)
Less: Recoveries net of collection costs		—		—		(20)		(20)
Income statement charge/(release) for the year		30		109		169		308
2019								
At 1 January 2019	181,600	88	10,356	259	2,170	203	194,126	550
Transfers from Stage 1 to Stage 2 ⁽³⁾	(3,078)	(8)	3,078	8	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	3,254	67	(3,254)	(67)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(315)	(2)	(482)	(19)	797	21	—	—
Transfers from Stage 3 ⁽³⁾	9	1	500	22	(509)	(23)	—	—
Transfers of financial instruments:	(130)	58	(158)	(56)	288	(2)	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	(60)	—	75	—	56	—	71
Change in economic scenarios ⁽²⁾	—	(5)	—	(26)	—	(9)	—	(40)
Changes to model	—	—	—	—	—	13	—	13
New lending and assets purchased ⁽⁵⁾	36,779	23	447	25	13	9	37,239	57
Redemptions, repayments and assets sold ⁽⁷⁾	(25,810)	(20)	(1,206)	(17)	(436)	(33)	(27,452)	(70)
Other ⁽⁶⁾	965	5	37	(1)	117	160	1,119	164
Assets written off ⁽⁷⁾	(1)	—	(1)	—	(250)	(196)	(252)	(196)
At 31 December 2019	193,403	89	9,475	259	1,902	201	204,780	549
Net movement in the year	11,803	1	(881)	—	(268)	(2)	10,654	(1)
Charge/(release) to the Income Statement		1		—		194		195
Less: Discount unwind		—		—		(8)		(8)
Less: Recoveries net of collection costs		—		—		(31)		(31)
Income statement charge/(release) for the year		1		—		155		156

(1) Exposures that have attracted an ECL, and as reported in the Credit Quality table above.

(2) Changes to assumptions in the year. Isolates the impact on ECL from changes to the economic variables for each scenario, changes to the scenarios themselves and changes in the probability weights from all other movements. This also includes the impact of quarterly revaluation of collateral. The impact of changes in economics on exposure Stage allocations are shown in Transfers of financial instruments.

(3) Total impact of facilities that moved stage(s) in the year. This means, for example, that where risk parameter changes (model inputs) or model changes (methodology) result in a facility moving Stage, the full impact is reflected here (rather than in Other). Stage flow analysis only applies to facilities that existed at both the start and end of the year. Transfers from each stage are based on opening balances, and transfers in are based on closing balances, giving rise to a net movement on transfer.

(4) Relates to the revaluation of ECL following the transfer of an exposure from one Stage to another.

(5) Exposures and ECL on facilities that did not exist at the start of the period but did at the end. Amounts in Stage 2 and 3 represent assets which deteriorated in the period after origination in Stage 1.

(6) Residual movements on facilities that did not change Stage in the period, and which were not acquired in the year. Included the impact of changes in risk parameters in the year, unwind of discount rates and increases in ECL requirements of accounts which ultimately were written off in the year.

(7) Exposures and ECL for facilities that existed at the start of the year, but not at the end.

Stage 2 analysis

The following table analyses our Stage 2 exposures and ECL by the reason the exposure is classified as Stage 2.

	Mortgages			Business banking			Consumer (auto) finance			Other unsecured lending			Total		
	Exposure	ECL	Coverage	Exposure	ECL	Coverage	Exposure	ECL	Coverage	Exposure	ECL	Coverage	Exposure	ECL	Coverage
2020	£m	£m	%	£m	£m	%	£m	£m	%	£m	£m	%	£m	£m	%
PD deterioration	7,102	92	1.3	—	—	—	88	13	14.8	650	154	23.7	7,840	259	3.3
Forbearance	602	3	0.5	—	—	—	—	—	—	10	—	—	612	3	0.5
Other	1,165	7	0.6	—	—	—	248	11	4.4	34	4	11.8	1,447	22	1.5
30 DPD	805	14	1.7	10	2	20.0	27	12	44.4	55	30	54.5	897	58	6.5
Payment Holiday	795	15	1.9	—	—	—	16	1	6.3	33	11	33.3	844	27	3.2
	10,469	131	1.3	10	2	20.0	379	37	9.8	782	199	25.4	11,640	369	3.2
2019															
PD deterioration	6,216	77	1.2	—	—	—	91	13	14.3	442	100	22.6	6,749	190	2.8
Forbearance	504	3	0.6	—	—	—	—	—	—	—	—	—	504	3	0.6
Other	520	6	1.2	—	—	—	478	4	0.8	176	10	5.7	1,174	20	1.7
30 DPD	983	15	1.5	6	2	33.3	35	11	31.4	24	18	75.0	1,048	46	4.4
	8,223	101	1.2	6	2	33.3	604	28	4.6	642	128	19.9	9,475	259	2.7

RESIDENTIAL MORTGAGES

We offer mortgages to people who want to buy a property and offer additional borrowing (known as further advances) to existing mortgage customers. The property must be in the UK, except for a small number of loans in the Isle of Man and Jersey.

2020 compared to 2019

A historically benign credit environment has supported our customers in the past and helped to reduce credit risk. However, from our experience we know that unemployment is one of the most important factors in defaults on mortgages, our biggest loan book. Whilst the UK housing market continues to show resilience, we are cautious on the outlook in light of recent economic uncertainty due to the Covid-19 pandemic. Strong net mortgage growth of £4.4bn (2019: £7.4bn), with a rebound in application volumes following the Q2 2020 housing market closure.

Borrower profile (audited)

In this table, 'Home movers' include both existing customers moving house and taking out a new mortgage with us, and customers who switch their mortgage to us when they move house. 'Remortgagers' are new customers who are taking a new mortgage with us.

	Stock				New business			
	2020		2019		2020		2019	
	£m	%	£m	%	£m	%	£m	%
Home movers	72,439	42	70,860	43	10,116	41	11,192	38
Remortgagers	51,796	31	52,480	32	6,861	27	9,197	31
First-time buyers	33,958	20	32,112	19	5,354	21	6,952	23
Buy-to-let	11,608	7	9,904	6	2,622	11	2,473	8
	169,801	100	165,356	100	24,953	100	29,814	100

As well as the new business in the table above, there were £31.7bn (2019: £31.6bn) of remortgages where we moved existing customers with maturing products onto new mortgages. We also provided £1.2bn (2019: £1.3bn) of further advances and flexible mortgage drawdowns.

2020 compared to 2019

The borrower profile of stock remained broadly unchanged. The new business borrower profile whilst similar to 2019 showed an increase in Home Movers and Buy-to-let mortgages with a decrease in First Time Buyers and Remortgages, which reflected market conditions. In 2020, we helped first-time buyers purchase their new home with £5.4bn of gross lending (2019: £7.0bn).

Interest rate profile (audited)

The interest rate profile of our mortgage asset stock was:

	2020		2019	
	£m	%	£m	%
Fixed rate	136,045	80	128,798	78
Variable rate	21,152	13	22,116	13
Standard Variable Rate (SVR)	10,682	6	14,124	9
Follow on Rate (FoR)	1,922	1	318	—
	169,801	100	165,356	100

2020 compared to 2019

In 2020, we continued to see customers refinance from SVR to fixed rate products influenced by low mortgage rates and the competitive mortgage market.

Geographical distribution (audited)

The geographical distribution of our mortgage asset stock was:

Region	Stock		New business	
	2020	2019	2020	2019
	£bn	£bn	£bn	£bn
London	42.6	41.4	6.1	7.5
Midlands and East Anglia	22.9	22.1	3.7	4.3
North	23.1	22.7	3.3	3.8
Northern Ireland	3.1	3.3	0.2	0.3
Scotland	6.7	6.8	0.8	1.2
South East excluding London	53.6	51.7	8.3	9.7
South West, Wales and other	17.8	17.4	2.6	3.0
	169.8	165.4	25.0	29.8
Average loan size for new business			£'000	£'000
South East including London			284	277
Rest of the UK			166	154
UK as a whole			218	207

2020 compared to 2019

The geographical distribution of the portfolio continued to represent a broad footprint across the UK, whilst maintaining a concentration around London and the South East. The loan-to-income multiple of mortgage lending in the year, based on average earnings of new business at inception, was 3.29 (2019: 3.27).

Larger loans (audited)

The mortgage asset stock of larger loans was:

Individual mortgage loan size	South East including London		UK	
	2020 £m	2019 £m	2020 £m	2019 £m
<£0.25m	45,553	45,828	105,493	105,855
£0.25m to £0.50m	36,241	34,027	47,903	44,549
£0.50m to £1.0m	12,214	11,471	14,076	13,114
£1.0m to £2.0m	1,934	1,538	2,085	1,644
>£2.0m	236	186	244	194
	96,178	93,050	169,801	165,356

At 31 December 2020, there were 98 (2019: 76) individual mortgages over £2.0m. In 2020, there were 38 (2019: 32) new mortgages over £2.0m.

Loan-to-value analysis (audited)

This table shows the LTV distribution for the gross carrying amount and the related ECL of our total mortgage portfolio and Stage 3 mortgages, as well as the LTV distribution for new business. We also show the collateral value and simple average LTV for our mortgage stock, Stage 3 stock and new business. We use our estimate of the property value at the balance sheet date. We include fees that have been added to the loan in the LTV calculation. For flexible products, we only include the drawn amount, not undrawn limits.

LTV	2020					2019				
	Stock Total £m	ECL £m	Stage 3 Total £m	ECL £m	New Business £m	Stock Total £m	ECL £m	Stage 3 Total £m	ECL £m	New Business £m
Up to 50%	74,620	28	858	11	4,180	70,714	24	743	11	5,113
>50-75%	69,771	90	633	36	10,088	67,311	65	626	24	11,876
>75-85%	18,508	41	125	19	5,858	17,436	31	136	13	6,130
>85-100%	6,165	44	93	22	4,781	9,011	34	110	17	6,650
>100%	737	77	90	44	46	884	64	107	38	45
	169,801	280	1,799	132	24,953	165,356	218	1,722	103	29,814
Collateral value of residential properties ⁽¹⁾	169,694		1,783		24,953	165,229		1,702		29,813
	%		%		%	%		%		%
Simple Average ⁽²⁾ LTV (indexed)	42		41		64	43		42		65

(1) Collateral value shown is limited to the balance of each related loan. Excludes the impact of over-collateralisation, where the collateral is higher than the loan. Includes collateral against loans in negative equity of £629m (2019: £757m).

(2) Total of all LTV% divided by the total of all accounts.

At 31 December 2020, the parts of loans in negative equity which were effectively uncollateralised before deducting loss allowances was £107m (2019: £127m).

In 2020, the simple average LTV of mortgage total new lending in London was 60% (2019: 61%).

2020 compared to 2019

There were no significant changes in the quality of our collateral in 2020. Overall simple average LTV remained broadly flat over the year with some slight improvements seen towards the end of the year. We continue to monitor the LTV profile of new lending and take action as needed to ensure the LTV mix of completions is appropriate.

Credit performance (audited)

	2020 £m	2019 £m
Mortgage loans and advances to customers of which:	169,801	165,356
– Stage 1	157,614	155,477
– Stage 2	10,388	8,157
– Stage 3	1,799	1,722
Loss allowances ⁽³⁾	280	218
	%	%
Stage 1 ratio ⁽¹⁾	92.82	94.03
Stage 2 ratio ⁽¹⁾	6.12	4.93
Stage 3 ratio ⁽²⁾	1.07	1.05

(1) Stage 1/Stage 2 exposures as a percentage of customer loans.

(2) Total Stage 3 exposure as a percentage of customer loans plus undrawn Stage 3 exposures.

(3) The ECL allowance is for both on and off-balance sheet exposures.

Movement in total exposures and the corresponding ECL (audited)

The following table shows changes in total on and off-balance sheet exposures subject to ECL assessment, and the corresponding ECL, for residential mortgages in the year. The footnotes to the Santander UK group level analysis on page 112 are also applicable to this table.

2020	Stage 1		Stage 2		Stage 3		Total	
	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	168,830	14	8,224	101	1,734	103	178,788	218
Transfers from Stage 1 to Stage 2 ⁽³⁾	(4,686)	(2)	4,686	2	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	1,911	17	(1,911)	(17)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(229)	(3)	(491)	(11)	720	14	—	—
Transfers from Stage 3 ⁽³⁾	4	—	311	14	(315)	(14)	—	—
Transfers of financial instruments	(3,000)	12	2,595	(12)	405	—	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	(15)	—	50	—	16	—	51
Change in economic scenarios ⁽²⁾	—	7	—	13	—	10	—	30
Changes to model	—	—	—	—	—	25	—	25
New lending and assets purchased ⁽⁵⁾	26,102	4	237	5	1	—	26,340	9
Redemptions, repayments and assets sold ⁽⁷⁾	(20,679)	(4)	(856)	(7)	(297)	(15)	(21,832)	(26)
Other ⁽⁶⁾	(459)	(1)	270	(19)	24	7	(165)	(13)
Assets written off ⁽⁷⁾	—	—	—	—	(54)	(14)	(54)	(14)
At 31 December 2020	170,794	17	10,470	131	1,813	132	183,077	280
Net movement in the year	1,964	3	2,246	30	79	29	4,289	62
Charge/(release) to the Income Statement		3		30		43		76
Less: Discount unwind		—		—		(2)		(2)
Less: Recoveries net of collection costs		—		—		(1)		(1)
Income statement charge/(release) for the year		3		30		40		73
2019								
At 1 January 2019	157,739	12	9,432	119	1,999	106	169,170	237
Transfers from Stage 1 to Stage 2 ⁽³⁾	(2,345)	(1)	2,345	1	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	2,921	24	(2,921)	(24)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(231)	—	(429)	(8)	660	8	—	—
Transfers from Stage 3 ⁽³⁾	5	(1)	485	16	(490)	(15)	—	—
Transfers of financial instruments	350	22	(520)	(15)	170	(7)	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	(23)	—	16	—	12	—	5
Change in economic scenarios ⁽²⁾	—	(5)	—	(22)	—	(9)	—	(36)
Changes to model	—	—	—	—	—	13	—	13
New lending and assets purchased ⁽⁵⁾	31,090	5	198	3	2	—	31,290	8
Redemptions, repayments and assets sold ⁽⁷⁾	(22,439)	(1)	(1,039)	(6)	(396)	(12)	(23,874)	(19)
Other ⁽⁶⁾	2,090	4	153	6	31	14	2,274	24
Assets written off ⁽⁷⁾	—	—	—	—	(72)	(14)	(72)	(14)
At 31 December 2019	168,830	14	8,224	101	1,734	103	178,788	218
Net movement in the year	11,091	2	(1,208)	(18)	(265)	(3)	9,618	(19)
Charge/(release) to the Income Statement		2		(17)		11		(4)
Less: Discount unwind		—		—		(4)		(4)
Less: Recoveries net of collection costs		—		—		—		—
Income statement charge/(release) for the year		2		(17)		7		(8)

Loan modifications

Forbearance⁽¹⁾

The following table (audited) sets out the financial assets that were forborne while they had a loss allowance measured at lifetime ECL.

	2020 £m	2019 £m
Financial assets modified in the year:		
– Amortised cost before modification	305	384
– Net modification loss	7	7
Financial assets modified since initial recognition:		
– Gross carrying amount of financial assets for which the loss allowance changed to 12 months ECL in the year	114	89

The balances (audited) at 31 December 2020 and 31 December 2019, analysed by their staging at the year-end and the forbearance we applied, were:

	Capitalisation £m	Term extension £m	Interest-only £m	Concessionary interest rate £m	Total £m	Loss allowances £m
2020						
Stage 2	409	393	310	—	1,112	13
Stage 3	219	83	86	28	416	29
	628	476	396	28	1,528	42
Proportion of portfolio	0.4%	0.3%	0.2%	—%	0.9%	
2019						
Stage 2	405	338	342	1	1,086	12
Stage 3	197	91	97	10	395	24
	602	429	439	11	1,481	36
Proportion of portfolio	0.4%	0.3%	0.3%	—%	0.9%	

(1) We base forbearance type on the first forbearance on the accounts.

2020 compared to 2019

In 2020, the number of new accounts granted forbearance reduced. Forbearance activity was higher in 2019 due to the launch of a new term extension forbearance solution for interest-only past maturity customers in August 2018, with volumes of this solution decreasing after its initial launch. The proportion of the mortgage portfolio in forbearance remained flat at 0.9% (2019: 0.9%).

- At 31 December 2020, the proportion of accounts in forbearance for more than six months that had made their last six months' contractual payments remained flat at 81% (2019: 81%).
- The weighted average LTV of all accounts in forbearance was 34% (2019: 35%) compared to the weighted average portfolio LTV of 38% (2019: 39%).
- At 31 December 2020, the carrying value of mortgages classified as multiple forbearance increased slightly to £143m (2019: £137m).

Other loan modifications

Since March 2020, we have provided mortgage customers with payment holiday terms in line with UK Government and FCA guidance. For more on this, see 'Covid-19 Support measures in place at 31 December 2020' in 'Santander UK group level - Credit risk review'.

At 31 December 2020, there were £2.6bn (2019: £4.5bn) of other mortgages on the balance sheet that we had modified since January 2008. At 31 December 2020:

The average LTV was 30% (2019: 32%), and 96% (2019: 96%) of accounts had made their last six months' contractual payments.

The proportion of accounts that were 90 days or more in arrears was 1.50% (2019: 2.14%).

RESIDENTIAL MORTGAGES – PORTFOLIOS OF PARTICULAR INTEREST

Introduction

We are mainly a residential prime lender and we do not originate sub-prime or second charge mortgages. Despite that, some types of mortgages have higher risks and others stand out for different reasons. These are:

Product	Description
Interest-only loans and part interest-only, part repayment loans	<p>With an interest-only mortgage, the customer pays interest every month but the principal until the end of the mortgage. Some mortgages have a part that is interest-only, with the rest being a normal repayment mortgage. Customers with part interest-only, part repayment mortgages still have to pay back a lump sum at the end of their mortgage for the interest-only part. This means there is a higher credit risk on these loans as we depend on the customers to pay back a lump sum. We design new account LTV maximums to mitigate this credit risk. We also make sure the customer has a plausible repayment plan before we lend to them and remains on track for the life of the loan.</p> <p>Since 2009, we have reduced the risk from new interest-only mortgages by lowering the maximum LTV. It has been 50% since 2012. When a customer plans to repay their mortgage by selling the property, we now only allow that if they own more than a set proportion of the equity.</p> <p>Customers with interest-only mortgages have to make arrangements to repay the principal at the end of the mortgage. We have a strategy to make sure that we tell these customers that they have to do this. We send them messages with their annual mortgage statements, and we run contact campaigns to encourage them to tell us how they plan to repay. We undertake these contact campaigns periodically throughout the customers' interest-only mortgage term and increase the frequency of contact as customers approach term maturity.</p> <p>If customers know they will not be able to repay their mortgage in full when it ends, or if their mortgage has already passed the date when it should have ended, we talk to them. If we think it is in the customer's interests and they can afford it, we look at other ways of managing it. That can mean turning the mortgage into a standard repayment one and extending it. Or, if the customer is waiting for their means of repaying it, such as an investment plan or bonds, to mature, it can just mean extending it.</p>
Flexible loans	<p>Flexible mortgages allow customers to pay more or less than their usual amount each month, or even to take 'payment holidays' when they pay nothing at all. Customers do not have to take or draw down the whole loan all at once – so if they took out a mortgage big enough to allow them to build a home extension after three years, they do not have to start paying interest on that extra money until they are ready to spend it. There are conditions on when and how much customers can draw down:</p> <ul style="list-style-type: none"> – There are often limits on how much can be drawn down in any month – The customer cannot be in payment arrears – The customer cannot have insolvency problems, such as a county court judgement, bankruptcy, an individual voluntary arrangement, an administration order or a debt relief order. <p>A customer can ask us to increase their credit limit, but that means we will go through our full standard credit approval process. We can also lower the customer's credit limit at any time, so it never goes above 90% of the property's current market value.</p> <p>We no longer offer flexible loan products for new mortgages.</p> <p>This is an area of interest in order to identify customers who might be using these facilities to self-forbear, such as regularly drawing down small amounts. If there is any sign that the credit risk has significantly increased, we reflect this in our provision calculations.</p>
Loans with an LTV >100%	<p>Where the mortgage balance is more than the property is now worth, we cannot recover the full value of the loan by repossessing and selling the property. This means there is a higher credit risk on these loans. In some cases, property prices have fallen, so mortgages we gave in the past with lower LTVs now have LTVs greater than 100%.</p> <p>We monitor existing accounts with LTVs >100% as part of our assessment of ongoing portfolio performance. We design new account LTV maximums to mitigate an increase in the volume of accounts with an LTV >100%.</p>
Buy-to-Let (BTL) loans	<p>In recent years, we have refined our BTL proposition to appeal to a wider catchment, and we have improved our systems to cater for this segment with a focus on non-professional landlords. We have prudent lending criteria, and specific policies for BTL. We only lend to a maximum 75% LTV. The first applicant must earn a minimum income of £25,000 per year, and we require evidence of income in all cases. We also use a BTL affordability rate as part of our assessment about whether to lend. This means that the rental income must cover the monthly mortgage interest payments by a prescribed amount when calculated using a stressed interest rate. We regularly review the prescribed amount and adjust it as needed.</p>

In addition, in 2020 we provided customers with payment holiday terms in line with the UK Government's Covid-19 guidance. For more on this, see 'Covid-19 Support measures in place at 31 December 2020' in 'Santander UK group level - Credit risk review'.

Credit performance (audited)

2020	Portfolio of particular interest ⁽¹⁾							Other portfolio £m
	Total £m	Interest-only £m	Part interest-only, part repayment ⁽²⁾ £m ⁽³⁾	Flexible ⁽³⁾ £m	LTV >100% £m	Buy-to-let £m	£m	
Mortgage portfolio	169,801	38,722	13,498	9,953	737	11,608	113,378	
– Stage 1	157,614	33,609	12,118	8,731	426	11,180	108,003	
– Stage 2	10,388	4,230	1,132	989	221	393	4,763	
– Stage 3	1,799	883	248	233	90	35	612	
Stage 3 ratio ⁽⁴⁾	1.07%	2.30%	1.84%	2.48%	12.25%	0.30%	0.54%	
PIPs	10	5	2	1	4	—	2	
Simple average LTV (indexed)	42%	44%	44%	26%	117%	59%	43%	

2019	Total £m	Interest-only £m	Part interest-only, part repayment ⁽²⁾ £m ⁽³⁾	Flexible ⁽³⁾ £m	LTV >100% £m	Buy-to-let £m	Other portfolio £m
Mortgage portfolio	165,356	38,062	13,247	11,273	884	9,904	109,234
– Stage 1	155,477	33,739	12,112	10,183	594	9,593	105,114
– Stage 2	8,157	3,502	888	873	183	285	3,526
– Stage 3	1,722	821	247	217	107	26	594
Stage 3 ratio ⁽⁴⁾	1.05%	2.17%	1.87%	2.03%	12.11%	0.26%	0.54%
PIPs	32	14	9	2	13	1	8
Simple average LTV (indexed)	43%	45%	45%	28%	117%	60%	44%

(1) Where a loan falls into more than one category, we include it in all the categories that apply. As a result, the sum of the mortgages in the segments of particular interest and the other portfolio does not agree to the total mortgage portfolio.

(2) Mortgage balance includes both the interest-only part of £10,037m (2019: £9,823m) and the non-interest-only part of the loan.

(3) Includes legacy Alliance & Leicester flexible loans that work in a more limited way than our current Flexi loan product.

(4) Total Stage 3 exposure as a percentage of customer loans plus undrawn Stage 3 exposures.

2020 compared to 2019

- In 2020, the proportion of interest-only loans together with part interest-only, part repayment and flexible loans reduced, reflecting our strategy to manage down the proportional exposure to these lending profiles.
- BTL mortgage balances increased £1.7bn to £1.6bn (2019:£9.9bn) driven by continued focus in growing this portfolio. In 2020, the simple average LTV of mortgage total new BTL lending was 65% (2019:64%).

Interest-only sub analysis**Full interest-only new business in the year**

	2020 £m	2019 £m
Full interest-only loans	4,267	4,000

Full interest-only maturity profile

2020	Term expired £m	Within 2 years £m	Between 2-5 years £m	Between 5-15 years £m	Greater than 15 years £m	Total £m
Full interest-only portfolio	374	1,736	3,722	20,490	12,400	38,722
– of which value weighted average LTV (indexed) is >75%	13	131	154	1,405	1,018	2,721

2019	Term expired £m	Within 2 years £m	Between 2-5 years £m	Between 5-15 years £m	Greater than 15 years £m	Total £m
Full interest-only portfolio	338	1,541	3,706	20,984	11,493	38,062
– of which value weighted average LTV (indexed) is >75%	11	111	219	1,793	1,051	3,185

2020 compared to 2019

For full interest-only mortgages, of the total £374m that was term expired at 31 December 2020, 84% continued to pay the interest due under the expired contract terms. Interest-only mortgages that matured in 2020 totalled £613m, of which: £272m was subsequently repaid, £6m was refinanced under normal credit terms, £105m was refinanced under forbearance arrangements and £230m remained unpaid and was classified as term expired at 31 December 2020.

At 31 December 2020, there were 69,713 (2019: 76,767) flexible mortgage customers, with undrawn facilities of £5,621m (2019: £5,841m). The portfolio's value weighted LTV (indexed) was 26% (2019: 27%).

Forbearance⁽¹⁾ (audited)

The balances at 31 December 2020 and 31 December 2019 were:

	Interest-only ⁽²⁾	Flexible	LTV >100%	Buy-to-Let
	£m	£m	£m	£m
2020				
Total	285	48	10	9
– Stage 2	184	34	3	6
– Stage 3	101	14	7	3
2019				
Total	392	73	17	10
– Stage 2	285	56	8	8
– Stage 3	107	17	9	2

(1) Where a loan falls into more than one category, we have included it in all the categories that apply.

(2) Comprises full interest-only loans and part interest-only, part repayment loans.

2020 compared to 2019

In 2020, the number of new accounts granted forbearance reduced. Forbearance activity was higher in 2019 due to the launch of a new term extension forbearance solution for interest-only past maturity customers in August 2018, with volumes of this solution decreasing after its initial launch.

CONSUMER (AUTO) FINANCE AND OTHER UNSECURED LENDING

Consumer (auto) finance

Retail Banking provides auto finance through Santander Consumer (UK) plc (SCUK). We offer a range of wholesale finance products (stock financing) and retail products for the purchase or lease of new and used cars, vans, motorcycles, bicycles and caravans. Our products are offered through dealers and brokers at the point of sale. At 31 December 2020, we operate with 15 manufacturers and have two joint venture agreements.

Through our joint ventures, Hyundai Capital UK Ltd (HCUK) and PSA Finance UK Ltd (PSAF), we provide retail point of sale customer finance as well as wholesale finance facilities (stock finance) for Hyundai and Kia, managed by HCUK, and Peugeot, Citroën and DS, managed by PSAF. We hold a 50.01% share in each of these joint ventures. However, due to the varying structures of the joint ventures, we apply the equity method of accounting for HCUK and consolidate PSAF.

Residual Value risk is one of our top risks. We check the portfolio each month, using triggers set to identify any material change in trends. We use leading independent vehicle valuation companies to assess the future value of the asset both before the start of the agreement and at points during the agreement. It is through this approach to RV setting and provisioning, where we react to market and car model level changes in future valuations, to help us make better decisions, strategies, and retain financial stability.

One of our main aims is sustainable profit which plays a key part in the strategy decisions made in relation to business growth. Our focus is on the broadening of our range of partners and maintaining a conservative risk appetite. We support climate change mitigation by funding alternative fuel technologies and give customers the option to offset the carbon emissions from their vehicles.

During the Covid-19 pandemic, we have made sure that our dealer partners, retail customers and staff have had the right products, services, and support in place. Close to 40,000 of our retail portfolio customers have had some form of support through payment deferrals or changes to their agreements.

Other unsecured lending

Retail Banking also provides other unsecured lending, which includes:

- Personal loans: we offer personal loans for most purposes, such as debt consolidation, home improvement, and to support significant life events such as weddings
- Credit cards: we offer a wide range of credit cards designed to suit a variety of customers, including balance transfer cards and cards that offer rewards
- Overdrafts: we also offer arranged overdrafts for customers who have a bank account with us. We evaluate our customers' circumstances to decide how much they can borrow. In other cases, a customer may have overdrawn their bank account without arranging it with us first.

For both Consumer (auto) finance and Other unsecured lending, we maintain rigorous credit scoring and affordability assessment criteria that we monitor and report regularly. There were no significant changes to our risk policy or appetite in these portfolios. This approach continued to result in stable, good credit quality consumer credit portfolios.

We use a combination of internal, credit reference agency and application data in our credit assessments. Scorecards supported by policy rules give us confidence that customers are creditworthy and can afford their repayments. We closely monitor and manage the performance of our consumer credit portfolios using a range of data that includes portfolio and key segments performance, macroeconomic indicators and customer risk data. Nonetheless, we are not complacent about the prospect for future risk events and always look at ways to strengthen our approach.

Credit performance (audited)

2020	Consumer (auto) finance £m	Other unsecured				Total other unsecured £m	Total £m
		Personal loans £m	Credit cards £m	Overdrafts £m			
Loans and advances to customers of which:	8,024	2,038	2,349	408	4,795	12,819	
– Stage 1	7,587	1,881	1,975	253	4,109	11,696	
– Stage 2	379	139	335	138	612	991	
– Stage 3	58	18	39	17	74	132	
Loss allowances ⁽²⁾	118	80	158	61	299	417	
Stage 3 undrawn exposures	—				27	27	
Stage 3 ratio ⁽¹⁾	0.72%				2.09%	1.24%	
Gross write-offs	25				129	154	

2019							
Loans and advances to customers of which:	7,684	2,135	2,788	590	5,513	13,197	
– Stage 1	7,038	2,020	2,473	404	4,897	11,935	
– Stage 2	604	95	267	160	522	1,126	
– Stage 3	42	20	48	26	94	136	
Loss allowances ⁽²⁾	88	51	120	62	233	321	
Stage 3 undrawn exposures	—				25	25	
Stage 3 ratio ⁽¹⁾	0.55%				2.15%	1.21%	
Gross write-offs	34				134	168	

(1) Total Stage 3 exposure as a percentage of loans and advances to customers plus undrawn Stage 3 exposures.

(2) The ECL allowance is for both on and off-balance sheet exposures.

Loan modifications**Forbearance**

The following table (audited) sets out the financial assets that were forborne while they had a loss allowance measured at lifetime ECL.

	Credit cards £m	Overdrafts £m	Total other unsecured £m
2020			
Financial assets modified in the year:			
– Amortised cost before modification	18	8	26
– Net modification gain	8	4	12
Financial assets modified since initial recognition:			
– Gross carrying amount of financial assets for which the loss allowance changed to 12m ECL in the year	2	2	4
2019			
Financial assets modified in the year:			
– Amortised cost before modification	23	15	38
– Net modification gain	12	8	20
Financial assets modified since initial recognition:			
– Gross carrying amount of financial assets for which the loss allowance changed to 12m ECL in the year	3	2	5

The balances (audited) at 31 December 2020 and 31 December 2019 were:

2020	Consumer (auto) Finance £m	Other unsecured			Total other unsecured £m	Total £m
		Personal loans £m	Credit cards £m	Overdrafts £m		
Total	9	—	43	16	59	68
– Stage 2	4	—	10	5	15	19
– Stage 3	5	—	33	11	44	49
2019						
Total	7	—	51	25	76	83
– Stage 2	5	—	10	7	17	22
– Stage 3	2	—	41	18	59	61

2020 compared to 2019

We maintained our prudent Consumer (auto) finance underwriting criteria throughout the year. In 2020, the product mix was broadly unchanged, with a slight increase in wholesale finance facilities (stock finance). The retail car finance market saw challenges in 2020 mainly due to dealerships closures as a result of Covid-19.

At 31 December 2020, Consumer (auto) finance balances increased by £340m (4%), and represented 4% (2019: 4%) of total Retail Banking loans and 4% (2019: 4%) of total customer loans. Gross lending (new business) was £3,074m (2019: £3,308m). Wholesale loans (Stock finance) to car dealerships were approximately 17% of the Consumer loan book, an increase of £65m since 31 December 2019. The average Consumer (auto) finance loan size was £15,918 (2019: £13,900).

The risk profile for Consumer (auto) finance and other unsecured lending remained stable in terms of our credit scoring acceptance policies, however there was a deterioration in the credit quality as a result of Covid-19. It is too early to assess whether this will be a permanent decline in the risk profile.

Other loan modifications

Since March 2020, we have provided Consumer (auto) finance, personal loans, and credit cards customers with payment holiday terms. For more on this, see 'Covid-19 Support measures in place at 31 December 2020' in 'Santander UK group level - Credit risk review'.

BUSINESS BANKING

We provide business banking services to small businesses with a turnover of up to £6.5m per annum and relatively simple borrowing needs. We only offer unsecured lending products, including overdrafts, credit cards and business loans.

Our risk management strategies operate on an automated basis (where possible) to ensure an efficient customer journey and a cost-effective credit decisioning process. We use a combination of internal, credit reference agency and application data in our credit assessments. Credit scoring combined with policy rules give us confidence that businesses are creditworthy and can afford their repayments. Post approval, we review revolving credit facilities each year to ensure the facilities remain appropriate for the customer's financial circumstances.

The Covid-19 pandemic has created an extremely challenging environment for many businesses, and we have supported customers by participating in government support schemes designed for small businesses. The Bounce Back Loans Scheme attracted unprecedented demand due to the efficient application process, which requires no credit risk assessment. At 31 December 2020, we had accepted over 148,000 applications for Bounce Back Loans with loan amounts totalling £4.0bn. Applications for lending outside of government schemes that would ordinarily be approved automatically are being manually underwritten, as a temporary measure due to Covid-19, to ensure we consider the uncertain and changing environment.

Lending exposure outside of government support schemes reduced as customers have used the support available to reduce their commitments. We continue to closely monitor the performance of the portfolio and have developed bespoke methods to understand customers' performance through the pandemic.

We substantially upgraded our decision system in 2020 to provide a greater breadth of data and flexibility to optimise risk strategies and meet the challenge of lending in a rapidly changing environment.

Credit performance (audited)

	2020 £m	2019 £m
Loans and advances to customers of which:	3,855	209
– Stage 1	3,845	197
– Stage 2	6	6
– Stage 3	4	6
Loss allowances ⁽²⁾	9	9
Stage 3 undrawn exposures	—	—
Stage 3 ratio ⁽¹⁾	0.10%	2.87%
Gross write offs	12	14

(1) Total Stage 3 exposure as a percentage of customer loans plus undrawn Stage 3 exposures.

(2) The ECL allowance is for both on and off-balance sheet exposures.

2020 compared to 2019

Business banking balances increased significantly in 2020 due to Bounce Back Loans advanced under the UK Government's Coronavirus Loan Schemes set up as a result of Covid-19. These loans are 100% guaranteed by the UK Government, and so ECL is not applied to them.

Loan modifications

Forbearance

There was no new forbearance granted in 2020 and 2019.

The balances (audited) at 31 December 2020 and 31 December 2019 were:

	2020 £m	2019 £m
Total	4	4
– Stage 3	4	4

Other loan modifications

Since March 2020, we have provided Business Banking customers with payment holiday terms. For more on this, see 'Covid-19 Support measures in place at 31 December 2020' in 'Santander UK group level - Credit risk review'.

Credit risk – other business segments

Overview

In Corporate & Commercial Banking, we are exposed to credit risk through providing overdraft, loan, invoice discounting, trade finance, asset finance and treasury products. We offer bank accounts and cash transmission services to further support clients.

In Corporate & Investment Banking, we are mainly exposed to credit risk through lending and selling treasury products to large corporates.

In Corporate Centre, our exposures come from asset and liability management of our balance sheet and our non-core and Legacy Portfolios in run-off.

Credit risk management

In this section, we explain how we manage and mitigate credit risk.

Credit risk review

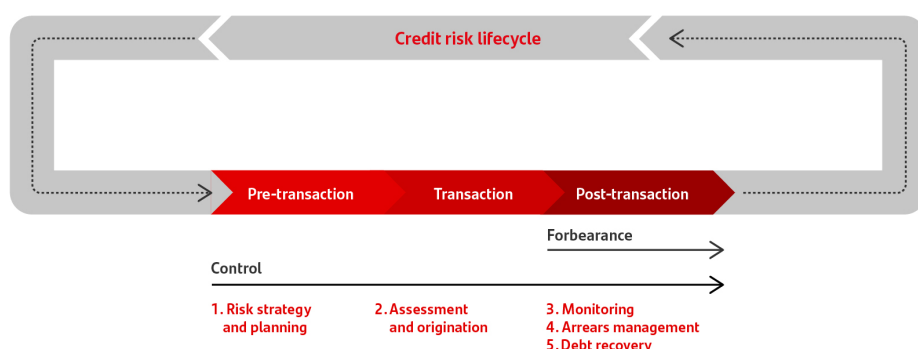
In this section, we analyse our credit risk exposures and how they are performing, including the impact of Covid-19. We also focus on forbearance and portfolios of particular interest.

Our main portfolios are:

Corporate & Commercial Banking	Corporate & Investment Banking	Corporate Centre
<ul style="list-style-type: none"> - SME and mid corporate – banking, trade finance, receivables finance, lending and treasury services mainly to enterprises with an annual turnover of up to £500m. - Commercial Real Estate – lending to experienced, professional landlords mainly secured by tenanted UK property in the office, retail, industrial and residential sub-sectors. - Social Housing – lending and treasury services for UK housing association groups secured by tenanted UK residential property. Borrowers are mainly charitable entities and registered with the appropriate regulator for the part of the UK in which they operate. 	<ul style="list-style-type: none"> - Large Corporate – loans and treasury products for large corporates to support their working capital and liquidity needs. - Financial Institutions – mainly derivatives for hedging purposes and trade finance instruments, under approved ring-fenced bank exceptions policy. 	<ul style="list-style-type: none"> - Sovereign and Supranational – securities issued by local and central governments, and government guaranteed counterparties. We hold some of them to help meet our liquidity needs. - Structured Products – we have two portfolios. The High Quality Liquid Assets (HQLA) portfolio is high quality assets, chosen for diversification and liquidity. The Legacy Treasury asset portfolio is mainly asset-backed securities. - Social Housing – legacy social housing loans that do not fit with our strategy. - Financial Institutions – mainly derivatives, repurchase and reverse repurchase transactions (known as repos and reverse repos), and stock borrowing/lending, under approved ring-fenced bank exceptions policy to facilitate hedging or liquidity management. - Legacy Portfolios in run-off – assets from acquisitions that do not fit with our strategy. These include some commercial mortgages. - Crown Dependencies – mainly residential mortgages to individuals in Jersey and the Isle of Man.

The segmental basis of presentation in this Annual Report has been changed, and the prior periods restated, to report some customer assets in Corporate & Commercial Banking rather than in Business Banking (in Retail Banking), some non-core corporate mortgages in Corporate & Commercial Banking rather than in Corporate Centre, and a number of smaller business lines in Corporate Centre rather than in Corporate & Investment Banking. See Note 2 for more information.

OTHER BUSINESS SEGMENTS – CREDIT RISK MANAGEMENT



For more on our approach to credit risk at a Santander UK group level
See pages 88 to 101

In Corporate & Commercial Banking, we classify most of our customers as non-standardised. We also have some SME customers classified as standardised as it is a high-volume portfolio with smaller exposures. In CIB and Corporate Centre, we classify all our customers as non-standardised, except for the commercial mortgages in our Legacy Portfolios in run-off, and the Crown Dependencies mortgage portfolio.

We set out how we manage the credit risk on our standardised customers in the previous section 'Credit risk – Retail Banking'. We manage the credit risk on our standardised customers in Corporate & Commercial Banking and Corporate Centre in the same way, except that we do not use scorecards or credit reference agencies. In the rest of this section, we explain how we manage the credit risk on our non-standardised customers.

1. Risk strategy and planning

For details of how we set risk strategy and plans, see the 'Santander UK group level – credit risk management' section. For treasury products, we take credit risk up to limits for each client. We control, manage and report risks on a counterparty basis, regardless of which part of our business takes the risk.

2. Assessment and origination (audited)

We do a thorough risk assessment to make sure customers can meet their obligations before we approve a credit application. We do this mainly by assigning each customer a credit rating, using our internal rating scale (see 'Credit quality' in 'Santander UK group level – credit risk review' section). To do this, we look at the customer's financial history and trends in the economy including reflecting the impacts of the Covid-19 pandemic – backed up by the expert judgement of a risk analyst. We review our internal ratings on a dynamic basis and at least once a year. We also assess the underlying risk of the transaction, taking into account any mitigating factors (see the tables below) and how it fits with our risk policies, limits and Risk Appetite, as set by the Board and lower level committees and fora. We consider transactions in line with credit limits approved by the relevant credit authority. In CIB and Corporate Centre, a specialist analyst usually reviews a transaction at the start and over its life. They base their review on the financial strength of the client, its position in its industry, and its management strengths.

We also use stress testing, for example to estimate how a customer might be able to cope if interest rates rise or to manage the impacts of the Covid-19 pandemic including local and regional lockdowns.

Responsible lending

We lend to a wide range of sectors and industries, including those that are intrinsic or of strategic importance to the economy of the UK or another country or territory. As part of lending responsibly, we comply with the Equator Principles, factoring social, ethical and environmental impacts into our risk analysis and decision-making process for financial transactions. These principles address climate change, prevention of pollution and toxic waste emissions, biodiversity, indigenous peoples and human rights. Our policies on Aerospace and Defence, Energy, Mining & Metals and Soft Commodities and our Sensitive Sectors policy continue to define our approach towards creating long-term value while managing reputational, social and environmental risks. These policies contain prohibitions and restrictions on a range of activities. Prohibited activities include the provision of products or services for new Coal Fired Power Plant (CFPP) projects and taking on new clients with existing CFPPs. In 2020, we included a further prohibition on the development, construction or expansion of oil and gas drilling projects north of the Arctic Circle. Restricted activities include transactions specific to CFPPs for existing clients which do not significantly improve environmental impacts, such as a significant reduction of CO₂. In 2020, we added a further restriction on the development, construction or expansion of Liquid Natural Gas facilities. Environmental and Social Risk Champions and the Reputational Risk Forum review and approve all restricted activities to ensure that they fall within our risk appetite. This forum reviews, monitors and escalates key decisions around financial and non-financial reputational risks to the Board.

Credit risk mitigation

The types of credit risk mitigation, including collateral, across each of our portfolios are as follows. In addition, from time to time at a portfolio level we execute significant risk transfer transactions, which typically reduce RWAs.

Corporate & Commercial Banking:

Portfolio	Description
SME and mid corporate	<p>Includes secured and unsecured lending. We can use covenants (financial or non-financial) to support a customer's credit rating. For example, we can set limits on how much they can spend or borrow, or how they operate as a business. We can take mortgage debentures as collateral. These are charges over a company's assets, almost always first charges. We can also take a first legal charge on commercial property as collateral. Before agreeing the loan, we get an independent professional valuation which assesses the property. We can also take guarantees, but we do not treat them as collateral and we do not put a cash value on them unless they are supported by a tangible asset which is charged to us. The UK Government guarantee supporting the losses for amounts lent under the UK Government's Coronavirus Loan Schemes are considered as collateral (80% for CBILS and CLBILS and 100% for BBLs). If a customer defaults, we work with them to consider debt restructuring options. We generally do not enforce our security over their assets except when restructuring options have been exhausted or to protect our position in relation to third party claims. In this case, we might appoint an administrator.</p> <p>We also lend against assets (like vehicles and equipment) and invoices for some customers. For assets, we value them before we lend. For invoices, we review the customer's ledgers regularly and lend against debtors that meet agreed criteria. If the customer defaults, we repossess and sell their assets or collect on their invoices.</p>
Commercial Real Estate	We take a first legal charge on commercial property as collateral. The loan is subject to strict criteria, including the property condition, age and location, tenant quality, lease terms and length, and the sponsor's experience and creditworthiness. Before agreeing the loan, we visit the property and get an independent professional valuation which assesses the property, the tenant and future demand (such as comparing market rent to current rent). Loan agreements typically allow us to view the property each year and get revaluations every two to three years, or more often if it is likely covenants may be breached.
Social Housing	We take a first legal charge on portfolios of residential real estate owned and let by UK Housing Associations as collateral, in most cases. We revalue this every three to five years (in line with industry practice), using the standard methods for property used for Social Housing. The value would be considerably higher if we based it on normal residential use. On average, the loan balance is 25% to 50% of the implied market value, using our LGD methodology. We have not had a default, loss or repossession on Social Housing. We manage older Social Housing loans that do not fit our current business strategy in Corporate Centre.

Corporate & Investment Banking:

Portfolio	Description
Large Corporate	Most of these corporate loans and products are unsecured. We also have a structured finance portfolio, where we typically hold legal charges over the assets we finance. For all customer segments, the bank monitors borrowers are in line with expected performance and (where applicable) documented covenants so we detect any financial distress early.
Financial Institutions	We manage the risk on derivatives in this portfolio in the same way as for the derivatives in Financial Institutions within Corporate Centre.

Corporate Centre:

Portfolio	Description
Sovereign and Supranational	In line with market practice, there is no collateral against these assets.
Structured Products	These are our HQLA and Legacy Treasury asset portfolios. These assets are primarily ABS and covered bonds, which benefit from senior positions in the creditor hierarchy. Their credit rating reflects the over-collateralisation in the structure, and the assets that underpin their cash flows and repayment schedules. We use a detailed expected cash flow analysis to assess the portfolios and we consider the structure and assets backing each individual security.
Social Housing	We manage the risk on this portfolio in the same way as for the Social Housing portfolio in Corporate & Commercial Banking.
Financial Institutions	<p>We use standard legal agreements to reduce credit risk on derivatives, repos and reverse repos, and stock borrowing/lending. We also hold collateral and trade through central counterparties (CCPs) to reduce risk.</p> <p>Netting – We use netting agreements where they have legal force, mainly in the UK, the rest of Europe and the US. This means that if a counterparty defaults, we can legally offset what we owe them and what they owe us and settle the net amount. However, netting arrangements often do not mean we can offset assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis. In line with market practice, we use standard legal agreements. For derivatives, we use ISDA Master Agreements; for repos and reverse repos, we use Global Master Repurchase Agreements; and for stock borrowing/lending and other securities financing, we use Global Master Securities Lending Agreements.</p> <p>Collateral – We use the Credit Support Annex with the ISDA Master Agreement. This gives us collateral for our net exposures. The collateral can be cash, securities or equities. For stock borrowing/lending and repos and reverse repos, it includes high quality liquid debt securities and highly liquid equities listed on major developed markets. We revalue our exposures and collateral daily, adjusting the collateral to reflect deficits or surpluses. We have processes to control how we value and manage collateral, including documentation reviews and reporting. Collateral has to meet our 'Liquid Assets and Eligible Collateral' policy, which controls the quality and how much of any one kind of collateral we can hold. That gives us confidence we will be able to cash in the collateral if a client defaults. We have these controls for equities and debt securities. The collateral held for reverse repos is worth at least 100% of our exposure.</p> <p>CCPs – These are intermediaries between a buyer and a seller – generally a clearing house. We use CCPs to reduce counterparty credit risk in derivatives.</p>
Legacy Portfolios in run off	<p>We often hold collateral through a first legal charge over the underlying asset or cash. We get independent third-party valuations on fixed charge security in line with industry guidelines. We then review our impairment loss allowance. To do that, we bear in mind:</p> <ul style="list-style-type: none"> – The borrower's ability to generate cash flow – The age of the assets – Whether the loan is still performing satisfactorily – Whether or not the reduction in value is likely to be temporary – Whether there are other ways to solve the problem. <p>Where a borrower gets into difficulty we look to dispose of the collateral, either with agreement or through the insolvency process. We do this as early as possible, to minimise any loss. We rarely take ownership of collateral.</p>
Crown Dependencies	We manage the risk on this portfolio in the same way as for mortgages in Retail Banking.

3. Monitoring (audited)

We regularly monitor and report our credit risk by portfolio, segment, industry, location and customer. We give our ERCC a detailed analysis of our credit exposures and risk trends every month. We also report our larger exposures and risks to the Board Risk Committee every month.

Our Watchlist

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

We classify Watchlist cases as:

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

We assess cases on the Watchlist for impairment as explained in 'Significant Increase in Credit Risk (SICR)' in the 'Santander UK group level – Credit risk management' section. When a customer is included in enhanced monitoring, we do not consider that it has suffered a SICR for ECL purposes, so it remains in Stage 1 for purposes of our loss allowance calculations. When a customer is included in proactive management, we consider that it has suffered a SICR. This means we transfer it to Stage 2 and subject it to a lifetime ECL assessment to calculate the new loss allowance. We take into account any forbearance we offer. This includes whether any extra security or guarantees are available, the likelihood of more equity and the potential to enhance value through asset management.

In Corporate & Commercial Banking, as part of our client review process, for loans approaching maturity, we look at the prospects of refinancing the loan on current market terms and applicable credit policy. Where this seems unlikely, we put the case on our Watchlist.

In CIB and Corporate Centre, we monitor the credit quality of our exposures daily. We use both internal and third-party data to detect any potential credit deterioration. In Corporate Centre, we manage the credit quality of our Crown Dependencies mortgages in the same way as for mortgages in Retail Banking.

4. Arrears management (audited)

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

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

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

5. Debt recovery

Consensual arrangements

Where we cannot find a solution like any of the ones we describe above, we look for an exit. If we can, we aim to do this by agreeing with the borrower that they will sell some or all of their assets on a voluntary basis or agreeing to give them time to refinance their debt with another lender.

Enforcement and recovery

Where we cannot find a way forward or reach a consensual arrangement, we consider recovery options. This can be through:

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

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

Loan modifications (audited)

Forbearance

If a customer is having financial difficulty, we will work with them before they default to see if the difficulty can be addressed through forbearance. Their problems might be clear from the results of covenant testing, reviews of trading and other data they give us under the terms of their loan or as part of our ongoing conversations with them.

We may offer the following types of forbearance. We only do this if our assessments indicate the customer can meet the revised payments:

Action	Description
Term extension	We can extend the term of the loan. At a minimum, we expect the customer to be able to pay the interest in the short-term and have a realistic chance of repaying the full balance in the long-term. We may offer this option if the customer is up to date with their payments but showing signs of financial difficulties. We may also offer this option where the loan is about to mature and near-term refinancing is not possible on market terms.
Interest-only	We can agree to let a customer pay only the interest on the loan for a short time – usually less than a year. We only agree to this if we believe their financial problems are temporary and they are going to recover. After the interest-only period, we expect the customer to go back to making full payments of interest and capital once they are in a stronger financial position. We regularly look at the customer's financial situation to see when they can afford to do that.
Other payment rescheduling (including capitalisation)	<p>If a customer is having cash flow issues, we may agree to lower or stop their payments until they have had time to recover. We may:</p> <ul style="list-style-type: none"> – Reschedule payments to better match the customer's cash flow – for example if the business is seasonal – Provide a temporary increase in facilities to cover peak demand ahead of the customer's trading improving. <p>We might do this by adding their arrears to their loan balance (we call this arrears capitalisation) or drawing from an overdraft. We may also offer other types of forbearance, including providing new facilities, interest rate concessions, seasonal profiling and interest roll-up. In rare cases, we agree to forgive or reduce part of the debt.</p>

Other forms of debt management and modifications

When customers are in financial difficulty, we can also manage debt in other ways, depending on the facts of the specific case:

Action	Description
Waiving or changing covenants	If a borrower breaks a covenant, we can either waive it or change it, taking their latest and future financial position into account. We may also add a condition on the use of any surplus cash (after operating costs) to pay down their debt to us.
Asking for more collateral or guarantees	If a borrower has unencumbered assets, we may accept new or extra collateral in return for revised financing terms. We may also take a guarantee from other companies in the same group and/or major shareholders. We only do this where we believe the guarantor will be able to meet their commitment.
Asking for more equity	Where a borrower can no longer pay the interest on their debt, we may accept fresh equity capital from new or existing investors to change the capital structure in return for better terms on the existing debt.

In addition, since March 2020, we have provided customers with payment holiday terms in line with the UK Government's Covid-19 guidance. Where these customers showed no signs of financial difficulties at the time, we do not classify the contract changes as forbearance. For customers who have needed further financial support after the payment holiday period, we help them by offering assistance in line with our policies.

Risk measurement and control

We measure the credit risk on treasury products by adding their potential future exposure to market movements over their lives to their fair value. Then we add it to any other exposure and measure the total against our credit limits for each client. In Corporate Centre, we manage the credit quality of our Crown Dependencies mortgages in the same way as for mortgages in Retail Banking.

We assess our loss allowances regularly and have them independently reviewed. We look at a number of factors, including the cash flow available to service debt and the value of collateral based on third-party professional valuations.

OTHER BUSINESS SEGMENTS – CREDIT RISK REVIEW

Movement in total exposures and the corresponding ECL (audited)

The following tables show changes in total on and off-balance sheet exposures and ECL in the year. The footnotes to the Santander UK group level table on page 102 also apply to these tables.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL
Corporate & Commercial Banking	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	21,281	53	2,385	51	452	158	24,118	262
Transfers from Stage 1 to Stage 2 ⁽³⁾	(4,443)	(37)	4,443	37	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	528	20	(528)	(20)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(78)	(1)	(543)	(21)	621	22	—	—
Transfers from Stage 3 ⁽³⁾	4	1	1	—	(5)	(1)	—	—
Transfers of financial instruments	(3,989)	(17)	3,373	(4)	616	21	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	(18)	—	92	—	198	—	272
Change in economic scenarios ⁽²⁾	—	7	—	44	—	—	—	51
New lending and assets purchased ⁽⁵⁾	7,984	10	805	28	94	44	8,883	82
Redemptions, repayments and assets sold ⁽⁷⁾	(6,487)	(13)	(818)	(18)	(118)	(25)	(7,423)	(56)
Other ⁽⁶⁾	(1,572)	32	521	6	97	5	(954)	43
Assets written off ⁽⁷⁾	—	—	—	—	(121)	(51)	(121)	(51)
At 31 December 2020	17,217	54	6,266	199	1,020	350	24,503	603
Net movement in the year	(4,064)	1	3,881	148	568	192	385	341

ECL charge/(release) to the Income Statement	1	148	243	392
Less: Discount unwind	—	—	(5)	(5)
Less: Recoveries net of collection costs	—	—	(93)	(93)
Income statement charge/(release) for the year	1	148	145	294

	£m	£m	£m	£m	£m	£m	£m	£m
Corporate & Investment Banking								
At 1 January 2020	12,972	4	397	37	15	9	13,384	50
Transfers from Stage 1 to Stage 2 ⁽³⁾	(43)	—	43	—	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	—	—	—	—	—	—	—	—
Transfers to Stage 3 ⁽³⁾	—	—	(40)	(13)	40	13	—	—
Transfers from Stage 3 ⁽³⁾	—	—	—	—	—	—	—	—
Transfers of financial instruments	(43)	—	3	(13)	40	13	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	—	—	—	—	—	—	—
Change in economic scenarios ⁽²⁾	—	—	—	8	—	—	—	8
New lending and assets purchased ⁽⁵⁾	1,119	1	43	—	—	—	1,162	1
Redemptions, repayments and assets sold ⁽⁷⁾	(5,005)	(1)	(287)	(1)	(1)	—	(5,293)	(2)
Other ⁽⁶⁾	2,174	5	273	(7)	(12)	—	2,435	(2)
Assets written off ⁽⁷⁾	—	—	—	—	(42)	(22)	(42)	(22)
At 31 December 2020	11,217	9	429	24	—	—	11,646	33
Net movement in the year	(1,755)	5	32	(13)	(15)	(9)	(1,738)	(17)

ECL charge/(release) to the Income Statement	5	(13)	13	5
Less: Discount unwind	—	—	—	—
Less: Recoveries net of collection costs	—	—	2	2
Income statement charge/(release) for the year	5	(13)	15	7

Credit risk

	Stage 1		Stage 2		Stage 3		Total	
	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL
Corporate Centre	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	73,943	1	97	1	—	—	74,040	2
Transfers from Stage 1 to Stage 2 ⁽³⁾	(87)	(2)	87	2	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	106	4	(106)	(4)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(2)	—	(3)	(1)	5	1	—	—
Transfers from Stage 3 ⁽³⁾	1	1	1	—	(2)	(1)	—	—
Transfers of financial instruments	18	3	(21)	(3)	3	—	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	(4)	—	3	—	1	—	—
Change in economic scenarios ⁽²⁾	—	—	—	6	—	—	—	6
New lending and assets purchased ⁽⁵⁾	11,457	1	45	—	1	—	11,503	1
Redemptions, repayments and assets sold ⁽⁷⁾	(10,344)	(1)	(7)	(1)	(3)	(1)	(10,354)	(3)
Other ⁽⁶⁾	4,201	35	(69)	(6)	1	—	4,133	29
Assets written off ⁽⁷⁾	—	—	—	—	(2)	—	(2)	—
At 31 December 2020	79,275	35	45	—	—	—	79,320	35
Net movement in the year	5,332	34	(52)	(1)	—	—	5,280	33

ECL charge/(release) to the Income Statement		34		(1)		—		33
Less: Discount unwind		—		—		—		—
Less: Recoveries net of collection costs		—		—		3		3
Income statement charge/(release) for the year		34		(1)		3		36

	Stage 1		Stage 2		Stage 3		Total	
	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL
Corporate & Commercial Banking	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2019	23,259	47	1,422	45	375	143	25,056	235
Transfers from Stage 1 to Stage 2 ⁽³⁾	(801)	(3)	801	3	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	156	7	(156)	(7)	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(42)	—	(109)	(5)	151	5	—	—
Transfers from Stage 3 ⁽³⁾	—	—	16	1	(16)	(1)	—	—
Transfers of financial instruments	(687)	4	552	(8)	135	4	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	(7)	—	18	—	38	—	49
Change in economic scenarios ⁽²⁾	—	8	—	11	—	—	—	19
New lending and assets purchased ⁽⁵⁾	3,733	6	379	7	2	1	4,114	14
Redemptions, repayments and assets sold ⁽⁷⁾	(4,062)	(10)	(32)	(11)	(7)	(9)	(4,101)	(30)
Other ⁽⁶⁾	(962)	5	64	(11)	55	35	(843)	29
Assets written off ⁽⁷⁾	—	—	—	—	(108)	(54)	(108)	(54)
At 31 December 2019	21,281	53	2,385	51	452	158	24,118	262
Net movement in the year	(1,978)	6	963	6	77	15	(938)	27

ECL charge/(release) to the Income Statement		6		6		69		81
Less: Discount unwind		—		—		(6)		(6)
Less: Recoveries net of collection costs		(10)		(8)		(12)		(30)
Income statement charge/(release) for the year		(4)		(2)		51		45

	Stage 1		Stage 2		Stage 3		Total	
	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL	Exposures ⁽¹⁾	ECL
Corporate & Investment Banking	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2019	17,389	5	134	3	26	10	17,549	18
Transfers from Stage 1 to Stage 2 ⁽³⁾	(208)	—	208	—	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	41	—	(41)	—	—	—	—	—
Transfers to Stage 3 ⁽³⁾	—	—	—	—	—	—	—	—
Transfers from Stage 3 ⁽³⁾	—	—	—	—	—	—	—	—
Transfers of financial instruments	(167)	—	167	—	—	—	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	—	—	36	—	—	—	36
New lending and assets purchased ⁽⁵⁾	54	—	—	—	—	—	54	—
Redemptions, repayments and assets sold ⁽⁷⁾	(5,179)	(1)	50	(1)	(28)	—	(5,157)	(2)
Other ⁽⁶⁾	875	—	46	(1)	17	(1)	938	(2)
Assets written off ⁽⁷⁾	—	—	—	—	—	—	—	—
At 31 December 2019	12,972	4	397	37	15	9	13,384	50
Net movement in the year	(4,417)	(1)	263	34	(11)	(1)	(4,165)	32
ECL charge/(release) to the Income Statement		(1)		34		(1)		32
Less: Discount unwind		—		—		—		—
Less: Recoveries net of collection costs		—		(8)		(2)		(10)
Income statement charge/(release) for the year		(1)		26		(3)		22
Corporate Centre	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2019	74,116	4	100	1	1	—	74,217	5
Transfers from Stage 1 to Stage 2 ⁽³⁾	(15)	—	15	—	—	—	—	—
Transfers from Stage 2 to Stage 1 ⁽³⁾	7	—	(7)	—	—	—	—	—
Transfers to Stage 3 ⁽³⁾	(4)	—	(4)	—	8	—	—	—
Transfers from Stage 3 ⁽³⁾	—	—	—	—	—	—	—	—
Transfers of financial instruments	(12)	—	4	—	8	—	—	—
Net ECL remeasurement on stage transfer ⁽⁴⁾	—	—	—	—	—	2	—	2
Change in economic scenarios ⁽²⁾	—	1	—	—	—	—	—	1
New lending and assets purchased ⁽⁵⁾	1,849	—	—	—	—	—	1,849	—
Redemptions, repayments and assets sold ⁽⁷⁾	(5,326)	—	(156)	—	13	—	(5,469)	—
Other ⁽⁶⁾	3,316	(4)	149	—	(19)	(2)	3,446	(6)
Assets written off ⁽⁷⁾	—	—	—	—	(3)	—	(3)	—
At 31 December 2019	73,943	1	97	1	—	—	74,040	2
Net movement in the year	(173)	(3)	(3)	—	(1)	—	(177)	(3)
ECL charge/(release) to the Income Statement		(3)		—		—		(3)
Less: Discount unwind		—		—		1		1
Less: Recoveries net of collection costs		—		—		(1)		(1)
Income statement charge/(release) for the year		(3)		—		—		(3)

Committed exposures

Credit risk arises on both on- and off-balance sheet transactions, e.g. guarantees. Therefore, committed exposures are typically higher than asset balances. However, committed exposures can be smaller than the asset balances due to netting. We show Sovereigns and Supranationals net of short positions and Large Corporate reverse repurchase agreement exposures net of repurchase agreement liabilities and include OTC derivatives. The derivative and other treasury product exposures (classified as 'Financial Institutions') are also typically lower than the asset balances, because we show our overall risk exposure which takes into account our procedures to mitigate credit risk. The balances on our balance sheet only reflect the more restrictive netting permitted by IAS 32.

Rating distribution (audited)

These tables show our credit risk exposure according to our internal rating scale (see 'Credit quality' in the 'Santander UK group level – credit risk review' section) for each portfolio. On this scale, the higher the rating, the better the quality of the counterparty.

2020	Santander UK risk grade								Total £m
	9 £m	8 £m	7 £m	6 £m	5 £m	4 £m	3 to 1 £m	Other ⁽¹⁾ £m	
Corporate & Commercial Banking									
SME and mid corporate	—	468	1,288	2,640	2,820	3,518	2,790	922	14,446
Commercial Real Estate	—	—	65	214	696	3,684	484	9	5,152
Social Housing	112	2,631	2,334	—	—	2	—	6	5,085
	112	3,099	3,687	2,854	3,516	7,204	3,274	937	24,683
Corporate & Investment Banking									
Large Corporate	174	1,826	3,267	3,882	1,523	157	81	—	10,910
Financial Institutions	367	444	639	23	6	—	—	—	1,479
	541	2,270	3,906	3,905	1,529	157	81	—	12,389
Corporate Centre									
Sovereign and Supranational	50,867	2,383	—	—	—	—	—	—	53,250
Structured Products	1,168	1,044	229	41	—	—	—	—	2,482
Social Housing	2	2,001	1,814	—	—	—	—	—	3,817
Financial Institutions	497	200	9	6	—	—	—	—	712
Legacy Portfolios in run-off ⁽²⁾	—	—	—	—	—	—	—	156	156
Crown Dependencies	—	—	—	—	—	—	—	275	275
Corporate Centre	52,534	5,628	2,052	47	—	—	—	431	60,692
Total	53,187	10,997	9,645	6,806	5,045	7,361	3,355	1,368	97,764
Of which:									
Stage 1	53,187	10,914	9,584	6,541	4,136	4,029	431	1,183	90,005
Stage 2	—	83	61	265	909	3,332	1,904	185	6,739
Stage 3	—	—	—	—	—	—	1,020	—	1,020
2019									
Corporate & Commercial Banking									
SME and mid corporate	—	25	798	1,953	4,833	3,896	1,450	299	13,254
Commercial Real Estate	—	—	—	426	3,787	1,574	121	149	6,057
Social Housing	1,231	3,655	26	—	—	2	4	—	4,918
	1,231	3,680	824	2,379	8,620	5,472	1,575	448	24,229
Corporate & Investment Banking									
Large Corporate	281	2,356	4,419	4,558	842	75	115	—	12,646
Financial Institutions	383	822	718	11	—	—	—	—	1,934
	664	3,178	5,137	4,569	842	75	115	—	14,580
Corporate Centre									
Sovereign and Supranational	37,359	2,255	—	—	—	—	—	—	39,614
Structured Products	1,166	981	396	29	—	—	—	—	2,572
Social Housing	934	3,036	90	—	—	—	—	—	4,060
Financial Institutions	542	246	43	25	1	—	—	—	857
Legacy Portfolios in run-off ⁽²⁾	—	—	—	130	—	—	110	—	240
Crown Dependencies	—	—	—	—	—	—	1	288	289
	40,001	6,518	529	184	1	—	111	288	47,632
Total	41,896	13,376	6,490	7,132	9,463	5,547	1,801	736	86,441
Of which:									
Stage 1	41,896	13,376	6,464	6,940	8,714	4,175	814	719	83,098
Stage 2	—	—	26	192	749	1,372	523	17	2,879
Stage 3	—	—	—	—	—	—	464	—	464

(1) Smaller exposures mainly in the commercial mortgage portfolio. We use scorecards for them, instead of a rating model.

(2) Residual structured and asset finance loans (shipping, aviation and structured finance).

2020 compared to 2019

In Corporate & Commercial Banking, we saw a 2% increase in committed exposures, with Covid-19 related lending in SME and mid Corporate offset by the continued deleveraging of the CRE portfolio. Our CRE portfolio decreased by 15% as we continue to manage our exposure in line with proactive risk management policies. The rating distribution deteriorated in Corporate & Commercial Banking following Covid-19 related downgrades.

Following a management review of our structure, customer assets of £2.0bn have transferred from Business Banking (within Retail Banking) to Corporate & Commercial Banking and non-core commercial mortgages of £0.4bn have been transferred from Corporate Centre. We use scorecards for these commercial mortgages, instead of a rating model.

In CIB, committed exposures decreased by 15% mainly due to reductions in our Large Corporate portfolio, largely driven by exposures being refinanced into Banco Santander London Branch as part of the agreed strategy. There has been limited demand for Covid-19 related funding as the majority of CIB customers have had access to equity markets and the Covid Corporate Financing Facility. The rating distribution flattened slightly in CIB following a number of Covid-19 related downgrades.

In Corporate Centre, committed exposures increased by 27% mainly driven by UK Sovereign and Supranational exposures which increased by 34% as part of the management of the liquid asset buffer driven by a change in customer funding, where deposit growth exceeded asset growth, as well as higher receipts of cash margin calls following the volatility as a result of Covid-19. The portfolio profile remained short-term, reflecting the purpose of the holdings. Legacy Portfolios in run-off reduced by 35%. Social Housing exposures reduced by 6%.

Geographical distribution (audited)

We typically classify geographical location according to the counterparty's country of domicile unless a full risk transfer guarantee is in place, in which case we use the guarantor's country of domicile instead.

	2020					2019				
	UK £m	Europe £m	US £m	Rest of World £m	Total £m	UK £m	Europe £m	US £m	Rest of World £m	Total £m
Corporate & Commercial Banking										
SME and mid Corporate	14,399	47	—	—	14,446	13,169	84	—	1	13,254
Commercial Real Estate	5,151	—	—	1	5,152	6,057	—	—	—	6,057
Social Housing	5,085	—	—	—	5,085	4,918	—	—	—	4,918
	24,635	47	—	1	24,683	24,144	84	—	1	24,229
Corporate & Investment Banking										
Large Corporate	9,838	1,052	—	20	10,910	10,665	1,922	2	57	12,646
Financial Institutions	655	439	131	254	1,479	611	849	169	305	1,934
	10,493	1,491	131	274	12,389	11,276	2,771	171	362	14,580
Corporate Centre										
Sovereign and Supranational	46,912	1,516	849	3,973	53,250	33,202	1,549	855	4,008	39,614
Structured Products	1,683	799	—	—	2,482	1,710	811	—	51	2,572
Social Housing	3,817	—	—	—	3,817	4,060	—	—	—	4,060
Financial Institutions	301	365	6	40	712	329	335	157	36	857
Legacy Portfolios in run-off	60	—	—	96	156	130	—	—	110	240
Crown Dependencies	—	—	—	275	275	—	—	—	289	289
	52,773	2,680	855	4,384	60,692	39,431	2,695	1,012	4,494	47,632

Credit risk mitigation (audited)

	Gross exposure Stage 3 £m	Collateral Stage 3 £m	Net exposure Stage 3 £m
2020			
Corporate & Commercial Banking			
SME and mid corporate	853	286	567
Commercial Real Estate	167	105	62
	1,020	391	629
Corporate & Investment Banking			
Large Corporate	—	—	—
	—	—	—
Corporate Centre			
Crown Dependencies	—	—	—
	—	—	—
2019			
Corporate & Commercial Banking			
SME and mid corporate	363	52	311
Commercial Real Estate	89	58	31
	452	110	342
Corporate & Investment Banking			
Large Corporate	15	—	15
	15	—	15
Corporate Centre			
Crown Dependencies	1	—	1
	1	—	1

Credit performance (audited)

We monitor exposures that show potentially higher risk characteristics using our Watchlist process (described in 'Monitoring' in the 'Credit risk management' section). The table below shows the exposures we monitor, and those we classify as Stage 3 by portfolio at 31 December 2020 and 31 December 2019.

2020	Committed exposure					Total ⁽¹⁾ £m	Loss allowances £m
	Watchlist			Stage 3 £m	Total ⁽¹⁾ £m		
	Fully performing £m	Enhanced monitoring £m	Proactive management £m				
Corporate & Commercial Banking							
SME and mid Corporate	10,844	340	2,409	853	14,446	478	
Commercial Real Estate	4,191	233	561	167	5,152	125	
Social Housing	5,012	—	73	—	5,085	—	
	20,047	573	3,043	1,020	24,683	603	
Corporate & Investment Banking							
Large Corporate	9,398	252	1,260	—	10,910	33	
Financial Institutions	1,479	—	—	—	1,479	—	
	10,877	252	1,260	—	12,389	33	
Corporate Centre							
Sovereign and Supranational	53,250	—	—	—	53,250	—	
Structured Products	2,482	—	—	—	2,482	35	
Social Housing	3,748	69	—	—	3,817	—	
Financial Institutions	712	—	—	—	712	—	
Legacy Portfolios in run-off	156	—	—	—	156	—	
Crown Dependencies	275	—	—	—	275	—	
	60,623	69	—	—	60,692	35	
Total loss allowances						671	
2019							
Corporate & Commercial Banking							
SME and mid Corporate	11,397	1,162	332	363	13,254	213	
Commercial Real Estate	5,778	107	83	89	6,057	49	
Social Housing	4,828	90	—	—	4,918	—	
	22,003	1,359	415	452	24,229	262	
Corporate & Investment Banking							
Large Corporate	11,834	252	545	15	12,646	50	
Financial Institutions	1,924	—	10	—	1,934	—	
	13,758	252	555	15	14,580	50	
Corporate Centre							
Sovereign and Supranational	39,614	—	—	—	39,614	—	
Structured Products	2,572	—	—	—	2,572	—	
Social Housing	4,047	13	—	—	4,060	—	
Financial Institutions	854	—	3	—	857	—	
Legacy Portfolios in run-off	240	—	—	—	240	2	
Crown Dependencies	288	—	—	1	289	—	
	47,615	13	3	1	47,632	2	
Total loss allowances						314	

(1) Includes committed facilities and derivatives. We define 'Enhanced Monitoring' and 'Proactive Management' in the 'Monitoring' section.

2020 compared to 2019

In Corporate & Commercial Banking, exposures subject to enhanced monitoring decreased by 58%. Exposures subject to proactive monitoring saw a seven fold increase. This was mainly in the SME and mid Corporate sector where restrictions imposed in response to the Covid-19 pandemic reduced economic activity. Accommodation and food service activities, and wholesale and non-food retail were adversely affected despite the measures taken by the UK Government to support industries through the Covid-19 pandemic. In Commercial Real Estate, falling capital and rental yields along with Covid-19 related rent collection challenges exacerbated structural issues in sub-sectors such as Retail. LTVs in this portfolio are relatively low with almost three quarters of the total CRE portfolio having an LTV below 50%, following planned deleveraging of the portfolio in recent years.

In CIB, Large Corporate exposures subject to enhanced monitoring remained stable, whilst exposures subject to proactive management more than doubled. The majority of downgrades were in sectors most impacted by Covid-19. There are no Stage 3 exposures following the repayment in full of a single borrower. Within Financial Institutions, there are no exposures subject to enhanced or proactive monitoring.

In Corporate Centre, exposures subject to proactive management reduced. Exposures subject to enhanced monitoring increased slightly within the Social Housing portfolio due to regulatory rather than risk concerns.

Across the Other business segments portfolios, loan loss allowances increased by £357m (114%), largely due to Covid-19. This reflected significant adjustments to economic assumptions and scenario weights, the reclassification of the Staging of corporate loans in the sectors and lending most at risk due to Covid-19, and provision for an unexpected default of a large single name exposure as a result of the Covid-19 pandemic.

Loan modifications

Forbearance

The following table (audited) sets out the financial assets that were forborne while they had a loss allowance measured at lifetime ECL.

	2020			2019		
	Corporate & Commercial Banking	Corporate & Investment Banking	Corporate Centre	Corporate & Commercial Banking	Corporate & Investment Banking	Corporate Centre
	£m	£m	£m	£m	£m	£m
Financial assets modified in the year:						
– Amortised cost before modification	201	23	—	160	—	—
– Net modification gain/ (loss)	(5)	1	—	1	—	—
Financial assets modified since initial recognition:						
– Gross carrying amount of financial assets for which the loss allowance changed to 12-month ECL in the year	40	—	—	38	—	—

We only make forbearance arrangements for lending to customers. The balances (audited) at 31 December 2020 and 31 December 2019, analysed by their staging at the year-end and the forbearance we applied, were:

	2020			2019		
	Corporate & Commercial Banking	Corporate & Investment Banking	Corporate Centre	Corporate & Commercial Banking	Corporate & Investment Banking	Corporate Centre
	£m	£m	£m	£m	£m	£m
Stock ⁽¹⁾						
– Term extension	141	23	—	66	42	—
– Interest-only	175	—	—	153	—	—
– Other payment rescheduling	180	—	—	229	15	—
	496	23	—	448	57	—
Of which:						
– Stage 1	13	—	—	61	42	—
– Stage 2	179	23	—	111	—	—
– Stage 3	304	—	—	276	15	—
	496	23	—	448	57	—
Proportion of portfolio	2.0%	0.2%	—%	1.8%	0.4%	—%

(1) We base forbearance type on the first forbearance we applied. Tables only show accounts open at the year-end. Amounts are drawn balances and include off balance sheet balances.

2020 compared to 2019

In line with guidance from the EBA and PRA in March 2020, concessions required as a result of Covid-19 where the borrower is exhibiting no other signs of financial difficulty are not reported as forbearance.

In Corporate & Commercial Banking, the cumulative forbearance stock increased slightly. Forbearance stock reduced in CIB, following the exit of the previous two forborne cases, and one new forbearance. At 31 December 2020, there was only one forborne case (2019: two cases) in CIB.

Other loan modifications

Since March 2020, we have provided corporates customers with payment holiday terms. For more on this, see 'Covid-19 Support measures in place at 31 December 2020' in 'Santander UK group level - Credit risk review'.

PORTFOLIOS OF PARTICULAR INTEREST

Introduction

Some types of lending have higher risk and others stand out for other reasons. We give more detail below on two areas of particular interest.

Portfolio	Description
Commercial Real Estate	The CRE market experienced a challenging environment in the immediate years after the last financial crisis and has previously seen regular cyclical downturns. For those reasons, this is a portfolio of particular interest. We manage and report our Commercial Real Estate portfolio in Corporate & Commercial Banking.
Social Housing	<p>The Social Housing sector in the UK is critical in ensuring the supply of affordable housing across the country. Housing associations play a prominent role in addressing the UK's shortage of housing across all tenures. The sector benefits from a zero-loss default history aided by its regulated nature. This is a portfolio of particular interest as we hold a significant position in the market.</p> <p>We see continued investment in this sector as a direct way to support the UK and, indirectly, the wider community initiatives undertaken by our customers. We manage and report our Social Housing portfolio in Corporate & Commercial Banking, except for older loans that do not fit our current business strategy, which we manage and report in Corporate Centre. We provide detailed disclosures of our Social Housing portfolios in the sections above. We provide a summary of our total Social Housing portfolio below, to give a Santander UK-wide view.</p>

In addition, in 2020 we provided customers with payment holiday terms in line with the UK Government's Covid-19 guidance. For more on this, see 'Covid-19 Support measures in place at 31 December 2020' in 'Santander UK group level - Credit risk review'.

Commercial Real Estate

Credit performance

The table below shows the main CRE credit performance metrics at 31 December 2020 and 31 December 2019.

	Customer loans ⁽¹⁾	Stage 3 ⁽²⁾	Stage 3 Ratio ⁽³⁾	Gross write-offs	Total loss allowance
	£m	£m	%	£m	£m
2020	4,689	165	3.60	13	125
2019	5,573	89	1.60	8	49

(1) CRE drawn loans in the CRE portfolio of our Corporate & Commercial Banking segment of £4,689m (2019: £5,573m).

(2) We define Stage 3 in the 'Credit risk management' section.

(3) Total Stage 3 exposure as a percentage of customer loans plus undrawn Stage 3 exposures.

LTV analysis

The table below shows the LTV distribution for our CRE total stock and Stage 3 stock (based on the drawn balance and our latest estimate of the property's current value) of the portfolio at 31 December 2020 and 31 December 2019.

LTV	2020				2019			
	Stock		Stage 3		Stock		Stage 3	
	Total	ECL	Total	ECL	Total	ECL	Total	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
Up to 50%	3,043	53	43	13	3,157	14	13	7
>50-70%	1,342	59	109	42	1,564	22	63	16
>70-100%	49	6	7	3	29	1	—	1
> 100%	8	4	6	4	9	4	6	4
Other portfolio ⁽¹⁾	230	3	—	—	809	7	7	3
Total with collateral	4,672	125	165	62	5,568	48	89	31
Development loans	17	—	—	—	5	—	—	—
	4,689	125	165	62	5,573	48	89	31

(1) Smaller value transactions, mainly commercial mortgages.

Due to the ongoing Covid-19 pandemic and legal restrictions on travel and inspection, we issued a Temporary Valuation Policy which was in place between April and July 2020. This effectively suspended valuations for the period. For valuations falling due in this period, our approach was to defer this for a maximum of six months.

Sector analysis

Sector	2020		2019	
	£m	%	£m	%
Office	1,491	32	1,288	23
Retail	853	18	850	15
Industrial	680	15	699	12
Residential	766	16	762	14
Mixed use	358	8	759	14
Student accommodation	62	1	85	1
Hotels and leisure	181	4	268	5
Other	51	1	53	1
Standardised portfolio ⁽¹⁾	247	5	809	15
	4,689	100	5,573	100

(1) Smaller value transactions, mainly commercial mortgages.

The CRE portfolio is well diversified across sectors, with no significant regional or single name concentration. Falling capital and rental yields along with Covid-19 related rent collection challenges have exacerbated structural issues in sub-sectors such as Retail. However, at 31 December 2020, the LTV profile of the portfolio remained conservative with £4,385m and 99% (2019: £4,721m and 99%) of the non-standardised portfolio at or below 70% LTV following planned deleveraging of the portfolio. Almost three quarters of the Non-Standardised CRE portfolio have an LTV below 50%.

Refinancing risk

At 31 December 2020, CRE loans of £1,337m (2019: £1,172m) were due to mature within 12 months. Of these, £9m or 0.7% (2019: £6m or 0.5%) had an LTV ratio higher than is acceptable under our current credit policy, all of which was reported as Stage 3 (2019: £6m).

2020 compared to 2019

In our CRE portfolio, customer loans decreased by £884m, as we focus on risk-weighted returns to manage our exposure in line with proactive risk management policies. In 2020, we maintained a prudent lending approach, with all new business (2019: 100%) written at or below 60% LTV. The weighted average LTV on the CRE portfolio was 45% (2019: 45%).

Drawn facilities subject to enhanced monitoring increased to £225m (2019: £106m). Drawn facilities subject to proactive management increased by 537% to £522m (2019: £82m). The majority of downgrades were in sub sectors most impacted by Covid-19. Stage 3 exposures increased to £165m (2019: £89m) as a result of further deterioration in the retail sub-sector.

Social Housing

We manage and report our Social Housing portfolio in Corporate & Commercial Banking, except for older Social Housing loans that do not fit our current business strategy, which we manage and report in Corporate Centre. We provide detailed disclosures of our Social Housing portfolios in the sections above. At 31 December 2020 and 31 December 2019, our total Social Housing exposure was:

	2020			2019		
	On-balance sheet	Total exposure	Total loss allowances	On-balance sheet	Total exposure	Total loss allowances
	£m	£m	£m	£m	£m	£m
Corporate & Commercial Banking	2,770	5,085	—	2,794	4,918	—
Corporate Centre	3,043	3,817	—	3,585	4,060	—
	5,813	8,902	—	6,379	8,978	—

Market risk

Overview

Market risk comprises banking market risk and trading market risk.

Banking market risk is the risk of loss of income or economic value due to changes to interest rates in the banking book or to changes in other market risk factors (e.g. credit spread and inflation risk), where such changes would affect our net worth through an adjustment to revenues, assets, liabilities and off-balance sheet exposures in the banking book.

Trading market risk is the risk of changes in market factors that affect the value of the positions in the trading book.

In this section, we set out which of our assets and liabilities are exposed to banking and trading market risk. Then we explain how we manage these risks and discuss our key market risk metrics. We also provide an update on the process of replacing LIBOR and other Interbank Offered Rates.

Key metrics

Santander UK plc group Net Interest Margin (NIM) sensitivity to +50bps was £225m and to -50bps was £(15)m (2019: £99m and £56m)

SFS NIM sensitivity to +50bps was £6m and to -50bps was £(1)m (2019: £19m and £(14)m)

Santander UK plc group Economic Value of Equity (EVE) sensitivity to +50bps was £367m and to -50bps was £(585)m (2019: £10m and £(88)m)

SFS EVE sensitivity to +50bps was £(4)m and to -50bps was £(7)m (2019: £23m and £(22)m)

BALANCE SHEET ALLOCATION BY MARKET RISK CLASSIFICATION (AUDITED)

We manage our assets and liabilities exposed to market risk as either banking or trading market risk. We classify all our assets and liabilities exposed to market risk as banking market risk, except for certain derivatives that we manage on a trading intent basis. For accounting purposes, we classify all derivatives as held for trading unless they are designated as being in a hedging relationship. The derivatives that we manage on a trading intent basis are a small proportion of the derivatives that we classify as held for trading for accounting purposes. For more, see Note 11 to the Consolidated Financial Statements.

BANKING MARKET RISK

OUR KEY BANKING MARKET RISKS (AUDITED)

Banking market risk mainly comes from providing banking products and services to our customers, as well as our structural balance sheet exposures. It arises in all our business segments.

In Retail Banking and Corporate & Commercial Banking, it is a by-product of us writing customer business and we transfer most of these risks to Corporate Centre to manage. The only types of banking market risk that we keep in Retail Banking and Corporate & Commercial Banking are short-term mismatches due to forecasting variances in prepayment and launch risk. This is where customers repay their loans earlier than their expected maturity date or do not take the expected volume of new products.

In Corporate & Investment Banking, it arises from lending to corporates, which we also transfer to Corporate Centre to manage. Corporate Centre also manages our structural balance sheet exposures, such as foreign exchange and Income Statement volatility risk.

Our key banking market risks are:

Key risks	Description
Interest rate risk	<p>Yield curve risk: comes from timing mismatches in repricing fixed and variable rate assets, liabilities and off-balance sheet instruments. It also comes from investing non-rate sensitive liabilities in interest-earning assets. We mainly measure yield curve risk with NIM and EVE sensitivities, which are measures that are commonly used in the financial services industry. We also use other risk measures, such as Value at Risk (VaR) which is a statistical measure based on a historical simulation of events, and stress testing. Our NIM and EVE sensitivities cover all the material yield curve risk in our banking book balance sheet.</p> <p>Basis risk: comes from pricing assets using a different rate index to the liabilities that fund them. We are exposed to basis risks associated with Bank of England bank rate, reserve rate linked assets we deposit with central banks, the Sterling Overnight Index Average (SONIA) rate, and LIBOR rates of different terms. As LIBOR and other Interbank Offered Rates are being replaced, we continue to engage with stakeholders across the business to ensure we capture and understand new risks as they emerge.</p>
Spread risks	<p>Spread risk arises when the value of assets or liabilities which are accounted for at fair value (either through Other Comprehensive Income or through Profit and Loss) are affected by changes in the spread. We measure these spreads as the difference between the discount rate we use to value the asset or liability, and an underlying interest rate curve.</p> <p>Spread risks can be split into Swap Spread (where the instrument has been issued by a Sovereign counterparty) and Credit Spread (where the instrument has been issued by for example a corporate or bank counterparty). It mainly arises in the bond portfolios we hold for liquidity purposes. We measure spread risk with sensitivities, stress tests and VaR measures.</p>
Foreign exchange risk	<p>Our banking businesses operate mainly in sterling markets, so we do not create significant foreign exchange exposures. The only exception to this is money we raise in foreign currencies. For more on this, see 'Wholesale funding' in the 'Liquidity risk' section.</p>
Income statement volatility risk	<p>We measure most of the assets and liabilities in our banking book balance sheet at amortised cost. We sometimes manage their risk profile by using derivatives. As all derivatives are accounted for at fair value, the mismatch in their accounting treatment can lead to volatility in our Income Statement. This happens even if the derivative is an economic hedge of the asset or liability.</p>

BANKING MARKET RISK MANAGEMENT

Risk appetite

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

Risk measurement

For banking market risk, we mainly measure our exposures with NIM and EVE sensitivity analysis. We support this with VaR risk measures and stress testing. We also monitor our interest rate repricing gap.

NIM and EVE sensitivities

The calculations for NIM and EVE sensitivities involve many assumptions, including expected customer behaviour (such as early repayment of loans) and how interest rates may move. These assumptions are a key part of our overall control framework, so we update and review them regularly.

Our NIM and EVE sensitivities include the interest rate risk from all our banking book positions. Our banking book positions generate almost all our reported net interest income.

NIM sensitivity

- NIM sensitivity is an income-based measure we use to forecast the changes to interest income and interest expense in different scenarios. It gives us a combined impact on net interest income over a given period – usually 12 or 36 months.
- We calculate NIM sensitivity by simulating the NIM using two yield curves. The difference between the two NIM totals is the NIM sensitivity.
- Our main model assumptions are that:
 - The balance sheet is dynamic. This means that it includes the run-off of current assets and liabilities as well as retained and new business
 - We use a behavioural balance sheet rather than contractual one. This means that we adjust balances for behavioural or assumed profile. We do this with most retail products whose behavioural maturity is different to the contractual maturity. This is usually because customers are exercising the option to withdraw or prepay early, or there is no contractual maturity,

EVE sensitivity

- We calculate EVE as the change in the net present value of all the interest rate sensitive items in the banking book balance sheet for a defined set of instantaneous parallel and non-parallel shifts in the yield curve.
- We use a static balance sheet. This means that all balance sheet items run-off according to their contractual, behavioural or assumed run-off behaviour (whichever is appropriate), and there is no retained or new business.

The limitations of sensitivities

We use sensitivities to measure the impact of standard, instantaneous, parallel shifts in relevant yield curves. The advantage of using standard parallel shifts is they generally give us a constant measure of the size of our market risk exposure, with a simple and consistent stress. This compares to specific scenarios like 'flat rates'. The magnitude of flat rates depends on the shape of the current curve and the shift required to reach the flat rate scenario.

There is one exception to the relative simplicity of parallel shifts. In order to limit negative interest rates, the yield curve may be 'floored'. Using material parallel shocks does not always seem realistic, or it might not necessarily test the scenarios that have the most impact on us. So we run non-parallel stress tests too, to calculate the impact of some plausible non-parallel scenarios, and over various time periods for income stresses, usually one or three years.

VaR (audited)

VaR

- VaR indicates the losses that we might suffer because of unfavourable changes in the markets under normal (non-stressed) market conditions.
- We run a historical simulation using the past two years of daily price moves, at a 99% confidence level, to find how much we might lose – the VaR.
- For any given day's position, we expect to suffer losses greater than the VaR estimate 1% of the time – once every 100 trading days, or two to three times a year.
- This gives us a consistent way of assessing risk for all relevant market risk factors in our portfolios.

The limitations of VaR

VaR is a useful and important market standard measure of risk, but it does have some limitations. These include:

- VaR assumes what happened in the past is a reliable way to predict what will happen in the future. This may not always be the case
- VaR is based on positions at the end of the business day so it doesn't include intra-day positions
- VaR does not predict how big the loss could be on the 1% of trading days that it is greater than the VaR
- Using a time horizon of one day means VaR does not tell us everything about exposures that we cannot liquidate or hedge within a day, or products with infrequent pricing.

Back-testing – comparing VaR estimates with reality

To check that the way we estimate VaR is reasonable, we back-test our VaR by comparing it against both actual and hypothetical profits and losses, using a one-day time horizon. Back-testing allows us to identify exceptions – times when the predictions were out of line with what happened. We can then look for trends in these exceptions, which can help us decide whether we need to recalibrate our VaR model.

Other ways of measuring risk

As well as using sensitivities and stress tests, we can measure banking market risk using net notional positions. This can give us a simple view of our exposure, although we generally need to combine it with other risk measures to cover all aspects of a risk profile, such as projected changes over time.

Other metrics we can use include Earnings at Risk (EaR). Although VaR can be useful as it captures changes in economic values, as we describe above, VaR will not reflect the actual Income Statement impact of most of our banking book positions. This is because we account for them at amortised cost rather than fair value. EaR is like VaR but captures changes in income rather than value. We use this approach mainly to generate a one-year EaR measure to assess Basis risk.

Stress testing

Stress testing is an essential part of our risk management. It helps us to measure and evaluate the potential impact on portfolio values of more extreme, although plausible, events or market moves. We express limits as on how much we could lose in a stress event, and this restricts how much risk we take.

Stress testing scenarios

Simple stress tests (like parallel shifts in relevant curves) give us clear measures of risk control and a consistent starting point for setting limits. More complex, multi-factor and multi-time period stress tests can give us information about specific potential events. They can also test outcomes that we might not capture through parallel stresses or VaR-type measures because of data or model limitations. We can also use stress tests to estimate losses in extreme market events beyond the confidence level used in VaR models.

We can adapt our stress tests to reflect current concerns such as Brexit, the Covid-19 pandemic and other macroeconomic events or changing market conditions quicker than we can with other risk measures, like VaR. We can include both individual business area stresses and Santander UK-wide scenarios. We can produce stress tests using either income or value measures. They cover one or more categories of exposures on an accruals basis or at fair value. We use expert judgement to define appropriate hypothetical stress tests and any adjusting assumptions based on the balance sheet, management actions and customer behaviour.

How we use stress testing

We discuss stress testing results at senior management committees. They affect Corporate Centre's decisions by highlighting possible risks in the banking book and the effectiveness of remedial actions we could take. We compare stress test results with stress limits and triggers set by our internal committees, or against metrics set by the PRA. If the results are over our limits or triggers, we take remedial actions and follow an escalation process.

Risk mitigation (audited)

We mitigate Income Statement volatility mainly through hedge accounting. We monitor any hedge accounting ineffectiveness that might lead to Income Statement volatility with a VaR measure and trigger, reported monthly. For our accounting policies for derivatives and hedge accounting, see Note 1 to the Consolidated Financial Statements.

We typically hedge the interest rate risk of the securities we hold for liquidity and investment purposes with interest rate swaps, retaining spread exposures. These retained exposures are the key drivers of the VaR and stress tests we use to assess the risk of the portfolio.

We hedge our foreign currency funding positions back to sterling, so our foreign exchange positions tend to be residual exposures that remain after hedging. These positions could be, for example, to 'spot' foreign exchange rates on to cross currency basis. We monitor foreign exchange risk against absolute net exposures and VaR-based limits and triggers.

For more on this, see 'Funding strategy' and 'Term issuance' in the 'Liquidity risk' section.

Risk monitoring and reporting (audited)

We monitor the banking market risks of the securities we hold for liquidity and investment purposes using sensitivities, VaR and stress tests. We report them against limits and triggers to senior management daily and to ALCO and ERCC each month. The VaR we report captures all key sources of volatility (including interest rate and spread risks) to fully reflect the potential volatility.



Following the decision by global regulators to phase out IBORs and replace them with alternative reference rates, we set up a project to oversee the design of alternative reference rate products and the transition for any of our contracts that could be affected. The CFO sponsors the project and it is driven by senior staff from across the business, including our client-facing business areas, Legal, Compliance, Risk, Operations and Technology, and Finance. It has a formal governance structure, including a Senior Management Forum that meets monthly, and thematic and product working groups. ALCO and the Board Risk Committee receive regular reports.

In 2020, we deployed new products to support the transition off IBORs and completed the transition of some existing IBOR agreements. We continued to actively participate in a wide range of industry forums. Following our progress in 2020, we are confident that we will be able to process transitions to risk-free rates (RFRs) that will be needed in 2021 for interest rate benchmarks that cease to be available. We have in place detailed plans, processes and procedures to support the transition throughout 2021 (including for amending the contractual terms of affected financial instruments to incorporate new benchmark rates) and will keep them under review to ensure they remain consistent with industry standards as they evolve.

IBOR reform exposes banks to various risks, which we are monitoring closely. These risks include:

- Conduct risk arising from discussions with clients and market counterparties due to the changes to existing contracts needed to effect IBOR transition
- Risk of financial losses to our clients and us that markets are disrupted due to IBOR transition
- Pricing risk from potential lack of market data if liquidity in IBORs reduces and some RFRs are not yet liquid
- Operational risk arising from changes to our IT systems and processes, and the risk of payments being disrupted if an IBOR ceases to be available
- Accounting risk if our hedging relationships fail, and from unrepresentative income statement volatility as financial instruments transition to RFRs.

While these risks may be increased by diverging approaches to IBOR transition in different geographies, our main exposures are to GBP LIBOR corporate loans and derivatives, and we are closely monitoring IBOR reform developments in different countries. The current expectation is that GBP, EUR, JPY and CHF LIBOR, and one week and two month USD LIBOR, will generally cease to be available for use after 31 December 2021. The other USD LIBOR tenors are currently expected to cease after 30 June 2023. Our main new alternative reference rates are:

- Sterling Overnight Index Average (SONIA) which replaces GBP LIBOR, and
- the Secured Overnight Financial Rate (SOFR), which replaces USD LIBOR.

We also recognise that IBOR transition presents potential challenges for our customers. We have communicated with customers and have launched a website to provide more information and to help outline the possible options available. We are also actively planning further customer communications on transitioning existing agreements off impacted IBORs.

For quantitative information, see Note 43 to the Consolidated Financial Statements.

Managing LIBOR transition

BANKING MARKET RISK REVIEW

Interest rate risk

Yield curve risk

The table below shows how our base case income and valuation would be affected by a 50 basis point parallel shift (both up and down) applied instantaneously to the yield curve at 31 December 2020 and 31 December 2019 for the Santander UK plc group and SFS. Sensitivity to parallel shifts represents the amount of risk in a way that we think is both simple and scalable. 50 basis points is the stress we typically focus on for banking market risk controls, although we also monitor sensitivities to other parallel and non-parallel shifts as well as scenarios.

	Santander UK plc group			
	2020		2019	
	+50bps £m	-50bps £m	+50bps £m	-50bps £m
NIM sensitivity (audited)	225	(15)	99	56
EVE sensitivity	367	(585)	10	(88)
	SFS			
NIM sensitivity (audited)	6	(1)	19	(14)
EVE sensitivity	(4)	(7)	23	(22)

Basis risk

We report basis risk using the EaR approach.

	2020	2019
	£m	£m
Basis risk EaR	8	18

Interest rate repricing gap

The table below shows the interest rate repricing gap of our balance sheet by repricing buckets.

2020	3 months £m	1 year £m	3 years £m	5 years £m	>5years £m	Not sensitive £m	Total £m
Assets	121,812	47,975	71,729	37,114	7,944	16,513	303,087
Liabilities	191,178	22,836	21,013	16,322	27,385	25,551	304,285
Off-balance sheet	25,788	(11,081)	(17,322)	(1,794)	5,607	—	1,198
Net gap	(43,578)	14,058	33,394	18,998	(13,834)	(9,038)	—
2019							
Assets	107,155	50,284	67,439	32,918	12,561	16,539	286,896
Liabilities	188,773	17,513	22,774	12,892	21,900	24,064	287,916
Off-balance sheet	14,945	(18,495)	4,481	(1,516)	1,605	—	1,020
Net gap	(66,673)	14,276	49,146	18,510	(7,734)	(7,525)	—

Spread risks

The table below shows the risk metrics covering the portfolios of securities we hold for liquidity and investment purposes.

	2020	2019
	£m	£m
VaR	7	3
Worst three month stressed loss	93	102

2020 compared to 2019

The movement in Santander UK plc group NIM and EVE sensitivities in 2020 was largely driven by further margin compression risk as a result of lower levels of the yield curve following the base rate cut in March 2020 and continuing growth in administered rate liability volumes. The movement in Santander UK plc group sensitivities also reflect the transfer of mortgages from Santander UK plc to Santander Financial Services plc during 2020.

During the year, we periodically review our risk models including underlying modelling assumptions to ensure they better reflect the risks inherent in the current rate environment and incorporate regulatory expectations. These changes in our underlying assumptions for risk measurement purposes also contributed to the movements in the year.

The basis risk EaR in 2020 decreased due to the natural evolution of the balance sheet leading to a reduced underlying net basis position.

TRADING MARKET RISK

OUR KEY TRADING MARKET RISKS (AUDITED)

Our main trading market risks are in Corporate & Investment Banking. They come from providing financial services to our customers. Our exposures are affected by market movements in interest rates, credit spreads, and foreign exchange. We do not have trading market risk in Retail Banking or Corporate & Commercial Banking. Trading market risk can reduce our net income.

We only have a very small amount of trading market risk in the Santander UK ring fenced bank. This is from permitted products and permitted customers. We hedge risks from client trades and our books are as close to back-to-back as possible. Market risk is hedged with Banco Santander SA or CCPs. This is required by Banking Reform legislation.

Our ring-fenced bank Santander UK plc has two trading desks. The Link Desk sells ring-fenced bank permissible products to clients. The Retail Structured Products desk (RSP) sells investments (Santander UK plc issued notes) to retail investors, through our UK branches and other channels. The Link Desk is exposed to the credit quality of our clients. We adjust valuations for this - Credit Valuation Adjustment (CVA), which feeds our valuations and hence income and expenses. The low market risk in our trading business means that CVA is the main driver of income movements, along with similar factors - Debt Valuation Adjustment (DVA) driven by our own credit, and Liquidity Valuation Adjustment (LVA) driven by the market price of liquidity. These valuation adjustments are collectively referred to as XVAs.

We calculate market risk capital using standard rules.

TRADING MARKET RISK MANAGEMENT

Risk appetite

Market risk is managed within our overall Risk Framework. The market risk framework sets our high level arrangements and standards for managing, controlling, and overseeing trading market risk. Our Risk Appetite for trading market risk is low. We only need to report a qualitative measure to the Board. We monitor trading market risk using stress measures.

Risk measurement

We have a range of ways of measuring trading market risk, including stress testing (explained in the Banking market risk management section above) and detailed sensitivity measures.

Stress testing

This is an essential part of our risk management. It helps us measure and evaluate the possible results of extreme, although plausible, events or market moves. We set limits on what we could lose in a stress event. This restricts how much risk we take.

Stress testing scenarios

We calculate the impact of 100 scenarios on our trading books every month. The scenarios we create may be inspired by past events, like the global financial crisis. They may include ways that unusual market conditions could happen. They include interest rates, equity prices and exchange rates. Most are reported against limits, and so could lead to our front office being asked to reduce risk. Our scenarios are not all calibrated to the same severity; some may be for a much longer holding period or a completely artificial and unrealistic scenario. We therefore do not limit all of them in the same way.

How we use stress testing

We use limits to manage how much we can lose in a crisis. This limits the risk we take. We make sure that plausible losses are below the Risk Appetite set by the Board. We report to senior management regularly at the Market & Structural Risk Control Forum.

Risk mitigation (audited)

We manage and control trading market risk within clear limits. There are specific levels that need escalation or action. This means we limit the impact of negative market movements. We keep the areas that create trading market risk separate from areas which control and oversee risk.

Risk monitoring and reporting (audited)

We maintain a complete set of written policies, procedures, and processes. These make sure we identify, assess, manage, and report trading market risk.

TRADING MARKET RISK REVIEW

2020 compared to 2019

In 2020, there were no significant changes to our trading market risk exposures in the Santander UK plc group. We are only exposed to a small amount of trading market risk. This is from permitted products sold to permitted customers, offset by permitted market risk hedges.

The Internal VaR for exposure to trading market risk in 2020 and 2019 was less than £1m.

Liquidity risk

Overview

Liquidity risk is the risk that we do not have the liquid financial resources to meet our obligations when they fall due, or we can only secure such resources at excessive cost.

In this section, we describe our sources and uses of liquidity and how we manage liquidity risk. We also analyse our key liquidity metrics, including our LCRs and our eligible liquidity pools.

We then explain our funding strategy and structure and we analyse our wholesale funding. Finally, we analyse how we have encumbered some of our assets to support our funding activities.

Key metrics

RFB DoLSub LCR of 150% (2019: 142%)

SFS LCR of 165% (2019: 471%)

Wholesale funding and AT1 with maturity <1 year
£21.1bn (2019: £22.5bn)

RFB DoLSub LCR eligible liquidity pool of £51.5bn (2019:
£42.0bn)

SFS LCR eligible liquidity pool of £2.8bn (2019: £5.7bn)

OUR KEY LIQUIDITY RISKS (AUDITED)

Through our LRA framework, we manage our funding or structural contingent and market liquidity risks wherever they arise. This can be in retail and corporate deposit outflows, wholesale secured and unsecured liquidity outflows and off-balance sheet activities. Other risks our framework covers include funding concentrations, intra-day cash flows, intra-group commitments and support, and franchise retention.

Our main sources of liquidity

Customer deposits finance most of our customer lending. Although these funds are mostly callable, in practice they give us a stable and predictable core of funding. This is due to the nature of retail accounts and the breadth of our retail customer relationships.

We have a strong wholesale funding investor base, diversified across product types and geographies. Through the wholesale markets, we have active relationships in many sectors including banks, other financial institutions, corporates and investment funds. We access the wholesale funding markets through the issuance of capital, senior unsecured debt, covered bonds, structured notes and short-term funding. We also access these markets through securitisations of certain assets of Santander UK plc and our operating subsidiaries. For more on our programmes, see Notes 14, 22 and 26 in the Consolidated Financial Statements.

We generate funding on the strength of our own balance sheet, our own profitability and our own network of investors. In addition, we have access to UK Government funding schemes. We comply with rules set by the PRA, other regulators, and Banco Santander standards. While we manage, consolidate and monitor liquidity risk centrally, we also manage and monitor it in the business area it comes from. For more on our structural relationship with Banco Santander and how that impacts our liquidity management, see the Directors' report.

Our main uses of liquidity

Our main uses of liquidity are to fund our lending in Retail Banking, Corporate & Commercial Banking and Corporate & Investment Banking, to pay interest and dividends, and to repay debt. Our ability to pay dividends depends on various factors. These include our regulatory capital needs, the level of our distributable reserves, and our financial performance. We also use liquidity to pay for business combinations.

LIQUIDITY RISK MANAGEMENT

Introduction

We manage liquidity risk on a consolidated basis in our CFO division, which is our centralised function for managing funding, liquidity and capital. We created our governance, oversight and control frameworks, and our LRA, on the same consolidated basis.

We monitor and manage liquidity risk for the Santander UK plc group and SFS separately. Under this model, and the PRA's liquidity rules, Santander UK plc and its subsidiary Cater Allen Limited form the RFB Domestic Liquidity Sub-group (the RFB DoLSub), which allows the entities to collectively meet regulatory requirements for the purpose of managing liquidity risk. Each member of the RFB DoLSub will support the other by transferring surplus liquidity in times of stress.

We continue to transfer liquidity risks from the products Santander UK Group Holdings plc issues, or the contracts it executes, into our subsidiaries largely through back-to-back transactions. We fund any mismatches, if needed, by ordinary share dividends from subsidiaries.

Risk appetite

Separate LRAs are in place for Santander UK plc and SFS. These are appropriate to their individual business models and consistent with the strategy of Santander UK Group Holdings plc.

Our LRA statement is based on the principles of liquidity management we use to manage our balance sheet. It also supports our need to meet or exceed the rules of our regulators. In line with our liquidity management principles, we avoid an over-reliance on funding from a single product, customer or counterparty. We also maintain enough unencumbered customer assets to support current and future funding and collateral requirements and maintain enough capacity to monetise liquid assets and other counterbalancing capacity within an appropriate timeframe.

Our LRA is proposed to the Risk division and the Board, which is then approved under advice from the Board Risk Committee. Our LRA, in the context of our overall Risk Appetite, is reviewed and approved by the Board each year, or more often if needed.

Risk measurement

We use a number of metrics to manage liquidity risk. These include metrics that show the difference between cash and collateral inflows and outflows in different periods. They also include structural metrics, such as our level of encumbered assets.

Ongoing business management

Within our framework of prudent funding and liquidity management, we manage our activities to minimise our liquidity risk. We have clear responsibilities for short-term funding, medium-term funding, encumbrance, collateral and liquid asset management. This ensures we manage liquidity risks as part of our daily operations, strategy and planning.

Our liquidity management framework is split between short-term and strategic activities. Our short-term activities focus on intra-day collateral; management and maintaining liquid assets to cover unexpected demands on cash in a stress scenario (such as large and unexpected deposit withdrawals by customers and loss of wholesale funding). Our strategic activities focus on ensuring we are not over reliant on any one source for funding and that we avoid excessive concentrations in the maturity of our funding.

We regularly test the liquidity of our eligible liquidity pool, in line with PRA and Basel rules. We do this by realising some of the assets through repurchase or outright sale to the market. We make sure that over any 12-month period we realise a significant part of our eligible liquidity pool. As well as our eligible liquidity pool, we always hold a portfolio of unencumbered liquid assets. Our LRA and PRA requirements determine the size and composition of this portfolio. These assets give us a source of contingent liquidity, as we can realise some of them in a time of stress to create liquidity through repurchase or outright sale to the market.

Stress testing

We have a liquidity stress test framework in place which is central to our LRA measurement and monitoring. It includes three severe but plausible stress test scenarios. To fit with our risk appetite, the liquidity outflows that come from these stress tests must be fully covered with high-quality liquid assets, other liquid assets and management actions sanctioned at the right level of governance. A funding plan disruption stress scenario also forms part of our LRA monitoring.

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

Our other tests consider scenarios such as a global economic slowdown that results in reduced confidence in the banking industry, a slowdown in one of the major economies or a deterioration in the availability of liquidity. These are considered on both an acute and protracted basis. We also run severe combined stress tests which look at both a deep and prolonged UK recession that results in a reduction in wholesale funding availability and a simultaneous idiosyncratic shock that would lead to retail and commercial outflows. In 2020, we added a new Covid-19 pandemic stress which excludes any UK government support.

We also conduct sensitivity analysis and reverse stress testing for instant liquidity shocks by each key liquidity risk. We do this to understand the impacts they would have on our LRA and our regulatory liquidity metrics.

We monitor our LCR to ensure we continue to meet the requirements. We also monitor the Net Stable Funding Ratio (NSFR), which is due to be implemented on 1 January 2022, and we expect to exceed any future requirements.

Risk mitigation (audited)

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

Recovery framework

Our recovery plan sets out the risks we face, the indicators we use to monitor these risks and the actions available to mitigate a stress to liquidity or capital. We can therefore respond to a wide variety of stresses, from mild to severe, in a coordinated, effective and timely manner. We are mindful of our recovery capacity and monitor the headroom to recovery triggers. Recovery indicators are both qualitative and quantitative and are embedded into our management processes. If needed, recovery would be invoked early, in order to mitigate the effects of a stress and restore our financial position and balance sheet strength.

Our recovery plan is approved by the Board under advice from the Board Audit Committee and is subject to ongoing review and enhancement. It is owned by the CFO and managed by the CFO division.

Risk monitoring and reporting (audited)

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

LIQUIDITY RISK REVIEW

Liquidity Coverage Ratio

This table shows our LCR and LRA at 31 December 2020 and 31 December 2019. We also show the SFS LCR and LRA separately, as we monitor and manage liquidity risk for SFS separately. The LRA data reflect the stress testing methodology in place at that time.

	LCR RFB DoLSub ⁽¹⁾		LRA RFB ⁽²⁾	
	2020	2019	2020	2019
	£bn	£bn	£bn	£bn
Eligible liquidity pool (liquidity value) ⁽³⁾	51.2	41.6	47.2	40.6
Net stress outflows	(34.1)	(29.3)	(34.4)	(31.7)
Surplus	17.1	12.3	12.8	8.9
Eligible liquidity pool as a percentage of anticipated net cash flows	150%	142%	137%	128%

	LCR SFS		LRA SFS	
	2020	2019	2020	2019
	£bn	£bn	£bn	£bn
Eligible liquidity pool (liquidity value)	2.8	5.7	2.8	5.7
Net stress outflows	(1.7)	(1.2)	(1.7)	(1.1)
Surplus	1.1	4.5	1.1	4.6
Eligible liquidity pool as a percentage of anticipated net cash flows	165%	471%	168%	518%

(1) The RFB LCR was 152% (2019:146%).

(2) The LRA is calculated for the Santander UK plc group (the RFB Group) and is a three-month Santander UK specific requirement.

(3) The liquidity value is calculated as applying an applicable haircut to the carrying value.

LCR eligible liquidity pool

This table shows the carrying value of our eligible liquidity pool assets at 31 December 2020 and 31 December 2019. It also shows the weighted average carrying value in the year. We also show SFS at 31 December 2020 and 31 December 2019, as we monitor and manage liquidity risk for SFS separately.

	Carrying value						RFB DoLSub Weighted average carrying value in the year	
	2020			2019			2020	2019
	Level 1	Level 2	Total	Level 1	Level 2	Total	Total	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	39.4	—	39.4	19.3	—	19.3	26.8	19.1
Government bonds	8.9	0.1	9.0	16.7	1.2	17.9	15.5	20.8
Supranational bonds and multilateral development banks	1.5	—	1.5	2.9	—	2.9	2.9	2.9
Covered bonds	1.0	—	1.0	1.4	0.1	1.5	1.2	2.4
Asset-backed securities	—	0.6	0.6	—	0.4	0.4	0.6	1.4
	50.8	0.7	51.5	40.3	1.7	42.0	47.0	46.6

	SFS						SFS	
	2020	2019	2020	2019	2020	2019	2020	2019
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	2.3	—	2.3	5.2	—	5.2	4.7	4.4
Government bonds	0.5	—	0.5	0.5	—	0.5	0.5	0.5
	2.8	—	2.8	5.7	—	5.7	5.2	4.9

Currency analysis

This table shows the carrying value of our eligible liquidity pool by major currencies at 31 December 2020 and 31 December 2019. The composition of the pool is consistent with the currency profile of our net liquidity outflows. We also show SFS at 31 December 2020 and 31 December 2019, as we monitor and manage liquidity risk for SFS separately.

	RFB DoLSub				Total
	US Dollar	Euro	Sterling	Other	
	£bn	£bn	£bn	£bn	£bn
2020	2.0	1.2	48.1	0.2	51.5
2019	3.6	1.2	36.1	1.1	42.0

	SFS				Total
	US Dollar	Euro	Sterling	Other	
	£bn	£bn	£bn	£bn	£bn
2020	—	—	2.8	—	2.8
2019	—	—	5.7	—	5.7

2020 compared to 2019

RFB DoLSub LCR at 150% reflects our prudent approach in an uncertain operating environment and is significantly above regulatory requirements. SFS LCR Eligible Liquidity Pool reduced to £2.8bn as a result of £3.2bn of mortgage assets transferred from Santander UK plc to SFS, which utilised the deposits in SFS.

Although the key aim of the UK Government financial support measures introduced in 2020 (including the TFS and TFSME) was to limit damage to the wider economy from Covid-19, they had the side-effect of reducing any potential liquidity risks arising due to Covid-19. Although Covid-19 did not trigger a liquidity stress, its immediate negative impacts on liquidity, such as the drawing of committed credit and liquidity facilities, were largely offset by deposits from those same drawings as corporates reduced their spending. Similarly, the impact of the initial effective shutdown of the mortgage market and payment holidays granted to customers was offset by better than expected retail deposit balances as customers reduced their spending.

FUNDING RISK MANAGEMENT

Funding strategy

Our funding strategy continues to be based on maintaining a conservatively structured balance sheet and diverse sources of funding to meet the needs of our business strategy and plans. The CFO Division maintains a funding plan and ensures it is compliant with the LRA and regulatory liquidity and capital requirements.

Most of our funding comes from customer deposits. We source the rest from a mix of secured and unsecured funding in the wholesale markets. Overall, this means that we do not rely too heavily on wholesale funds. We manage funding requirements by targeting a specific Liquidity Coverage Ratio, we ensure maturities are prefunded and capital/TLAC requirements are prioritised. We also have checks and controls to limit our asset encumbrance from our secured funding operations.

As part of maintaining a diverse funding base, we raise funding in a number of currencies, including euro and USD, and convert it into sterling through currency swaps to fund our commercial assets which are largely sterling denominated.

Our base of stable retail and corporate deposits is a key funding source for us. We leverage our large and diverse customer base to offer products that give us a long-term sustainable source of funding. We do this by focusing on building long-term relationships. Over 85% of our total core retail customer liabilities are covered by the Financial Services Compensation Scheme (the FSCS).

Behavioural maturities

The contractual maturity of our balance sheet assets and liabilities highlights the maturity transformation that underpins the role of banks to lend long term, but to fund themselves mainly with shorter-term liabilities, like customer deposits. We do this by diversifying our funding operations across a wide customer base, both in numbers and by type of depositor. In practice, the behavioural profiles of many liabilities show more stability and longer maturity than their contractual maturity. This is especially true of many types of retail and corporate deposits that, while they may be repayable on demand or at short notice, have shown good stability even in times of stress. We model behaviour profiles using our experience of customer behaviour. We use this data to determine the funds transfer pricing interest rates at which we reward and charge our business units for sources and uses of funds. We apply this rate until a customer changes to a different product or service offered by us or by one of our competitors.

We continue to maintain the quality of our retail, commercial and wholesale deposits. We aim to deepen our customer relationships across all customer segments. We do this to lengthen the contractual and behavioural profile of our liability base.

Deposit funding

We mainly fund our Retail Banking, Corporate & Commercial Banking and Corporate & Investment Banking activities by customer deposits. We fund the rest through wholesale markets.

Wholesale funding

Wholesale funding and issuance model

Banco Santander is a multiple point of entry resolution group. This means that should it fail, it would be split up into parts. Healthy parts might be sold or be kept as a residual group without their distressed sister companies. The resolution or recapitalisation of the distressed parts might be effected via 'bail in' of bonds that had been issued to the market by a regional intermediate holding company.

Santander UK is a single point of entry resolution group. This means that resolution would work downwards from the group's holding company i.e. Santander UK Group Holdings plc. Losses in subsidiaries would first be transferred up to Santander UK Group Holdings plc. If the holding company is bankrupt as a result, the group is deemed to be failing or likely to fail, it will be put into resolution. The 'bail in' tool is applied to the holding company, with the equity being written off and bonds written off or converted into equity as needed to recapitalise the group. Those bondholders would become the new owners, and the group would stay together.

Santander UK Group Holdings plc is the immediate holding company of Santander UK plc but does not guarantee its debts or other obligations. This structure is a Bank of England recommended configuration which aims to ensure the activities of the operating company are not disrupted as the Santander UK group goes through resolution, thereby maintaining continuity of services for customers.

Composition of wholesale funding

We are active in the wholesale markets and we have direct access to both money market and long-term investors through our funding programmes. This makes our wholesale funding well diversified by product, maturity, geography and currency. This includes currencies available across a range of channels from money markets, repo markets, senior unsecured, secured, medium-term and capital. For details of our main programmes, see the Funding Information section of our website www.santander.co.uk/uk/about-santander-uk/investor-relations/funding-information.

Santander UK plc is our main operating company issuer of senior unsecured debt, structured notes, short-term funding and covered bonds.

Santander UK Group Holdings plc is the issuer of capital and MREL/Total Loss Absorbing Capacity (TLAC) eligible senior unsecured debt. Since the implementation of CRR II in June 2019, G-SIBs have been subject to the MREL standard. Since 1 January 2019, UK resolution entities that are G-SIBs or are part of a G-SIB, including Santander UK Group Holdings plc, have been required to meet the MREL minimum requirements, implemented through the Bank of England Statement of Policy on MREL in the UK. From 1 January 2020 the MREL requirement is the higher of (i) two times the Pillar 1 capital requirements and one times their Pillar 2A add-ons; (ii) 6% of CRR leverage exposures or (iii) two times the minimum leverage ratio requirement. The MREL requirements will be fully implemented from 1 January 2022 and G-SIBs will be required to meet to the higher of (i) two times the sum of Pillar 1 capital requirements and their Pillar 2A add-ons; (ii) 6.75% of CRR leverage exposures or (iii) two times the minimum leverage ratio requirement.

Our main operating company Santander UK plc is subject to internal MREL as it meets the requirements of a material subsidiary of our ultimate parent Banco Santander SA.

We also access the wholesale markets through securitisations of certain assets of our operating subsidiaries. In addition, we have access to UK Government funding schemes. Eligible collateral for these schemes includes all collateral that is eligible in the Bank of England's Discount Window Facility. We ensure that enough collateral is placed and available at the Discount Window.

FUNDING RISK REVIEW

Our funding strategy continues to be based on maintaining a conservatively structured balance sheet and diverse sources of funding to meet the needs of our business strategy and plans. The CFO Division maintains a funding plan and ensures it is compliant with the LRA and regulatory liquidity and capital requirements.

2020 compared to 2019

- Our overall funding strategy remains to develop and sustain a diversified funding base. We also need to fulfil regulatory requirements as well as support our credit ratings.
- 2020 presented unforeseen challenges in the debt capital markets with the Covid-19 pandemic causing significant volatility in March and April. However, despite the ongoing effect of Covid-19 on global economies and the growing concerns around a Brexit deal, the credit markets remained open, although at wider credit spreads. Following a rapid response from central banks to provide liquidity, notably the BoE's Term Funding Scheme with additional incentives for SMEs (TFSME) in the UK, credit spreads retraced towards the end of the year.
- In January 2020 it was estimated that the 2020 funding requirement was £10bn to £12bn. At the end of Q1 2020, and before the impact of Covid-19 on global markets, we had issued £4.6bn of medium-term funding. We issued a further £0.8bn in August 2020 as we continued on our plan to achieve the required end state MREL requirement in January 2022. The introduction of the TFSME scheme in March 2020 meant there was no further need to access markets for funding, as any residual requirement would be met by drawing down on our initial borrowing allowance from the BoE scheme.
- We issued £5.4bn of wholesale funding, including £1.4bn MREL eligible senior unsecured issued from the Company and £4.0bn of core funding, consisting of covered bonds and senior unsecured, issued from Santander UK plc, our ring-fenced bank (RFB).
- In 2020 the total term funding was £5.4bn (2019: £4.5bn), of which £3.0bn was covered bonds and £2.4bn of senior unsecured notes.
- We have £6.3bn outstanding under the TFS and £11.7bn outstanding under the TFSME.
- Maturities in 2020 were £16.5bn (2019: £8.1bn). At 31 December 2020, 68% (2019: 67%) of wholesale funding had a maturity of greater than one year, with an overall residual duration of 38 months (2019: 33 months).
- In October 2020, Santander UK plc transferred £3.2bn of mortgage assets to Santander Financial Services plc (SFS). The transaction allows us to optimise our overall funding structure within Santander UK plc, utilising the deposits in SFS and reducing our funding requirement in Santander UK plc.
- In 2020, c£4.3bn of medium-term funding was left in US Dollars and a further £0.7bn in Euro. These balances were used to fund customer assets and our HQLA portfolio.
- Our level of encumbrance from external and internal issuance of securitisations and covered bonds was broadly static in 2020, as planned.

Reconciliation of wholesale funding to the balance sheet (audited)

This table reconciles our wholesale funding to our balance sheet at 31 December 2020 and 31 December 2019.

	Balance sheet line item							
	Funding analysis	Deposits by banks ⁽³⁾	Deposits by customers ⁽¹⁾	Repurchase agreements - non trading	Financial liabilities designated at fair value	Debt securities in issue	Subordinated liabilities	Other equity instruments and non-controlling interests ⁽²⁾
2020	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Deposits by banks	—	—	—	—	—	—	—	—
Certificates of deposit and commercial paper	5.7	—	—	—	—	5.7	—	—
Senior unsecured – public benchmark	15.5	—	—	—	—	15.5	—	—
– privately placed	1.1	—	—	—	0.9	0.2	—	—
Covered bonds	17.9	—	—	—	—	17.9	—	—
Securitisation and structured issuance	2.8	—	—	—	0.5	2.3	—	—
Term Funding Scheme	6.3	6.3	—	—	—	—	—	—
TFSME	11.7	11.7	—	—	—	—	—	—
Subordinated liabilities and equity	4.7	—	—	—	—	—	2.2	2.5
Total wholesale funding	65.7	18.0	—	—	1.4	41.6	2.2	2.5
Repos	15.8	—	—	15.8	—	—	—	—
Foreign exchange and hedge accounting	2.5	—	—	—	—	2.1	0.4	—
Other	3.0	3.0	—	—	—	—	—	—
Balance sheet total	87.0	21.0	—	15.8	1.4	43.7	2.6	2.5
2019								
Deposits by banks	0.3	0.3	—	—	—	—	—	—
Certificates of deposit and commercial paper	5.8	—	—	—	—	5.8	—	—
Senior unsecured – public benchmark	18.9	—	—	—	—	18.9	—	—
– privately placed	2.7	—	—	—	1.0	1.7	—	—
Covered bonds	18.2	—	—	—	—	18.2	—	—
Securitisation and structured issuance	5.6	—	—	1.4	0.5	3.7	—	—
Term Funding Scheme	10.8	10.8	—	—	—	—	—	—
Subordinated liabilities and equity	5.5	—	—	—	—	—	2.9	2.6
Total wholesale funding	67.8	11.1	—	1.4	1.5	48.3	2.9	2.6
Repos	16.9	—	—	16.9	—	—	—	—
Foreign exchange and hedge accounting	2.5	—	—	—	—	1.9	0.6	—
Other	3.5	3.3	—	—	0.2	—	—	—
Balance sheet total	90.7	14.4	—	18.3	1.7	50.2	3.5	2.6

(1) This is included in our balance sheet total of £193,088m (2019: £179,006m).

(2) Consists of £nil (2019: £nil) fixed/floating rate non-cumulative callable preference shares, £235m (2019: £235m) Step-up Callable Perpetual Reserve Capital Instruments and £2,241m (2019: £2,241m) Perpetual Capital Securities (net of issuance costs). See Notes 33 and 34 to the Consolidated Financial Statements.

(3) Other consists of items in the course of transmission and other deposits, excluding the TFS. See Note 24 to the Consolidated Financial Statements.

Maturity profile of wholesale funding (audited)

This table shows our main sources of wholesale funding. It does not include securities finance agreements. The table is based on exchange rates at issue and scheduled repayments and call dates. It does not reflect the final contractual maturity of the funding.

2020	≤ 1 month £bn	>1 and ≤ 3 months £bn	>3 and ≤ 6 months £bn	>6 and ≤ 9 months £bn	>9 and ≤ 12 months £bn	Sub-total ≤ 1 year £bn	>1 and ≤ 2 years £bn	>2 and ≤ 5 years £bn	>5 years £bn	Total £bn
Santander UK Group Holdings plc⁽¹⁾										
Senior unsecured – public benchmark	0.7	—	—	1.1	—	1.8	1.2	4.9	1.3	9.2
– privately placed	—	—	—	—	—	—	—	—	0.1	0.1
Subordinated liabilities and equity (incl. AT1)	—	—	—	—	—	—	0.8	1.5	0.7	3.0
	0.7	—	—	1.1	—	1.8	2.0	6.4	2.1	12.3
Santander UK plc										
Certificates of deposit and commercial paper	0.7	3.7	1.2	—	0.1	5.7	—	—	—	5.7
Senior unsecured – public benchmark	0.4	—	1.6	—	0.8	2.8	0.6	2.6	0.3	6.3
– privately placed	—	0.3	—	—	0.1	0.4	—	0.2	0.4	1.0
Covered bonds	—	—	3.7	1.7	—	5.4	1.7	6.4	4.4	17.9
Securitisation and structured issuance ⁽²⁾	0.2	—	—	0.2	—	0.4	0.9	0.3	—	1.6
Term Funding Scheme	—	1.5	1.5	1.0	—	4.0	2.3	—	—	6.3
TFSME	—	—	—	—	—	—	—	11.7	—	11.7
Subordinated liabilities	—	—	—	—	—	—	—	0.5	1.2	1.7
	1.3	5.5	8.0	2.9	1.0	18.7	5.5	21.7	6.3	52.2
Other group entities										
Securitisation & structured issuance ⁽³⁾	0.2	0.1	—	0.1	0.2	0.6	0.4	0.2	—	1.2
Total at 31 December 2020	2.2	5.6	8.0	4.1	1.2	21.1	7.9	28.3	8.4	65.7
Of which:										
– Secured	0.4	1.6	5.2	3.0	0.2	10.4	5.3	18.6	4.4	38.7
– Unsecured	1.8	4.0	2.8	1.1	1.0	10.7	2.6	9.7	4.0	27.0
2019										
Total at 31 December 2019	1.7	5.5	4.7	2.1	8.5	22.5	16.6	18.8	9.9	67.8
Of which:										
– Secured	0.2	0.1	2.7	0.3	5.8	9.1	11.5	10.4	3.6	34.6
– Unsecured	1.5	5.4	2.0	1.8	2.7	13.4	5.1	8.4	6.3	33.2

(1) 95% of Senior Unsecured debt issued from Santander UK Group Holdings plc has been downstreamed to Santander UK plc as 'secondary non-preferential debt' in line with the guidelines from the Bank of England for Internal MREL.

(2) Includes funding from mortgage-backed securitisation vehicles where Santander UK plc is the asset originator.

(3) Includes funding from asset-backed securitisation vehicles where entities other than Santander UK plc are the asset originator.

Currency composition of wholesale funds (audited)

This table shows our wholesale funding by major currency at 31 December 2020 and 31 December 2019.

	2020				2019			
	Sterling %	US Dollar %	Euro %	Other %	Sterling %	US Dollar %	Euro %	Other %
Santander UK Group Holdings plc								
Senior unsecured – public benchmark	11	61	28	—	12	64	22	2
– privately placed	—	—	—	100	—	—	—	100
Subordinated liabilities and equity (incl. AT1)	75	25	—	—	70	30	—	—
	27	51	21	1	27	54	16	3
Santander UK plc								
Deposits by banks	—	—	—	—	3	97	—	—
Certificates of deposit and commercial paper	51	44	4	1	45	54	1	—
Senior unsecured – public benchmark	10	73	17	—	14	54	32	—
– privately placed	41	37	10	12	21	15	59	5
Covered bonds	48	5	46	1	54	—	45	1
Securitisation & structured issuance	77	23	—	—	72	28	—	—
Term Funding Scheme	100	—	—	—	100	—	—	—
TFSME	100	—	—	—	—	—	—	—
Subordinated liabilities	63	37	—	—	49	51	—	—
	63	18	19	—	54	22	24	—
Other group entities								
Securitisation & structured issuance	100	—	—	—	95	5	—	—
Total	57	24	19	—	50	27	22	1

Term issuance (audited)

In 2020, our external term issuance (sterling equivalent) was:

	Sterling £bn	US Dollar £bn	Euro £bn	Total 2020 £bn	Total 2019 £bn
Santander UK Group Holdings plc					
Senior unsecured – public benchmark	—	0.8	0.6	1.4	—
Subordinated debt and equity (inc. AT1)	—	—	—	—	0.5
	—	0.8	0.6	1.4	0.5
Santander UK plc					
Covered bonds	1.0	0.9	1.1	3.0	2.9
Senior unsecured – public benchmark	—	1.0	—	1.0	0.9
TFSME	11.7	—	—	11.7	—
	12.7	1.9	1.1	15.7	3.8
Other group entities					
Securitisations	—	—	—	—	0.2
Total gross issuances	12.7	2.7	1.7	17.1	4.5

Santander UK Group Holdings plc repurchased several securities to improve its future interest expense while maintaining a prudent approach to the management of Santander UK plc's funding and liquidity base.

Encumbrance

We have encumbered an asset if we have pledged or transferred it as collateral against an existing liability. This means it is no longer available to secure funding, meet our collateral needs or be sold to reduce future funding needs. Being able to pledge or transfer assets as collateral is an integral part of a financial institution's operations. We do various things that lead to asset encumbrance. These include where we:

- Enter into securitisation, covered bonds, and repurchase agreements (including central bank programmes) to access medium and long-term funding
- Enter into short-term funding transactions. These include repurchase agreements and stock borrowing transactions as part of our operational liquidity management
- Pledge collateral as part of participating in payment and settlement systems
- Post collateral as part of derivatives activity.

We monitor our mix of secured and unsecured funding sources in our funding plan. We aim to use our available collateral efficiently to raise secured funding and to meet our other collateralised obligations.

Our biggest source of encumbrance is where we use our mortgage portfolio to raise funds through securitisation, covered bonds or other structured borrowing. We control our levels of encumbrance from these by setting a minimum level of unencumbered assets that must be available after we factor in our future funding plans, whether we can use our assets for our future collateral needs, the impact of a possible stress and our current level of encumbrance.

Assets classified as readily available for encumbrance include cash and securities we hold in our eligible liquidity pool. They also include other unencumbered assets that give us a source of contingent liquidity. We do not rely on these extra unencumbered assets in our LRA, but we might use some of them in a time of stress. We can create liquidity by using them as collateral for secured funding or through outright sale.

Loans and advances to customers are only classified as readily available for encumbrance if they are already in a form we can use to raise funding without any other actions on our part. This includes excess collateral that is already in a secured funding structure. It also includes collateral that is pre-positioned at central banks and is available for use in secured funding.

All other loans and advances are classified as not readily available for encumbrance, however, may still be suitable for use in secured funding structures.

Encumbrance of customer loans and advances

We have issued prime retail mortgage-backed and other asset-backed securitised products to a diverse investor base through our mortgage-backed and other asset-backed funding programmes.

We have raised funding with mortgage-backed notes, both issued to third parties and retained – the latter being central bank eligible collateral for funding purposes in other Bank of England facilities. We also have a covered bond programme, under which we issue securities to investors secured by a pool of residential mortgages.

For more on how we have issued notes from our secured programmes externally and also retained them, and what we have used them for, see Notes 14 and 26 to the Consolidated Financial Statements in the 2020 Annual Report.

On-balance sheet encumbered and unencumbered assets (audited)

	Encumbered with counterparties other than central banks				Assets positioned at central banks ⁽³⁾	Readily available	Unencumbered assets not pre-positioned with central banks			Total assets
	Covered bonds	Securitisations	Other	Total			Other available assets	Cannot be encumbered	Total	
2020	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks ⁽¹⁾⁽²⁾	—	—	985	985	871	41,681	—	—	42,552	43,537
Financial assets at FVTPL:										
– Derivative financial instruments	—	—	—	—	—	—	—	3,451	3,451	3,451
– Other financial assets at FVTPL	—	—	—	—	—	—	—	834	834	834
Financial assets at amortised cost:										
– Loans and advances to customers	23,669	7,469	149	31,287	61,292	77,833	19,801	21,965	180,891	212,178
– Loans and advances to banks	—	—	804	804	—	—	—	1,200	1,200	2,004
– Repurchase agreements – non trading	—	—	—	—	—	—	—	19,599	19,599	19,599
– Other financial assets at amortised cost	—	—	648	648	—	515	—	—	515	1,163
Financial assets at FVOCI	—	—	5,677	5,677	—	3,273	—	—	3,273	8,950
Interests in other entities	—	—	—	—	—	—	—	172	172	172
Intangible assets	—	—	—	—	—	—	—	1,649	1,649	1,649
Property, plant and equipment	—	—	—	—	—	—	1,740	—	1,740	1,740
Current tax assets	—	—	—	—	—	—	—	271	271	271
Retirement benefit assets	—	—	—	—	—	—	—	496	496	496
Other assets	—	—	—	—	—	—	—	3,020	3,020	3,020
Total assets	23,669	7,469	8,263	39,401	62,163	123,302	21,541	52,657	259,663	299,064

	Encumbered with counterparties other than central banks				Assets positioned at central banks ⁽³⁾	Unencumbered assets not pre-positioned with central banks				Total assets
	Covered bonds	Securitisations	Other	Total		Readily available	Other available assets	Cannot be encumbered	Total	
2019	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks ⁽¹⁾⁽²⁾	—	—	1,080	1,080	707	24,608	—	—	25,315	26,395
Financial assets at FVTPL:										
– Derivative financial instruments	—	—	—	—	—	—	—	3,363	3,363	3,363
– Other financial assets at FVTPL	—	—	—	—	—	—	—	973	973	973
Financial assets at amortised cost:										
– Loans and advances to customers	23,310	12,915	366	36,591	55,272	76,568	22,875	16,192	170,907	207,498
– Loans and advances to banks	—	—	615	615	—	—	—	1,968	1,968	2,583
– Repurchase agreements – non trading	—	—	—	—	—	—	—	23,636	23,636	23,636
– Other financial assets at amortised cost	—	—	3,026	3,026	—	4,030	—	—	4,030	7,056
Financial assets at FVOCI	—	—	6,020	6,020	—	3,727	—	—	3,727	9,747
Interests in other entities	—	—	—	—	—	—	—	117	117	117
Intangible assets	—	—	—	—	—	—	—	1,776	1,776	1,776
Property, plant and equipment	—	—	—	—	—	—	1,971	—	1,971	1,971
Current tax assets	—	—	—	—	—	—	—	186	186	186
Retirement benefit assets	—	—	—	—	—	—	—	670	670	670
Other assets	—	—	—	—	—	—	—	2,517	2,517	2,517
Total assets	23,310	12,915	11,107	47,332	55,979	108,933	24,846	51,398	241,156	288,488

(1) Encumbered cash and balances at central banks include minimum cash balances we have to hold at central banks for regulatory purposes.

(2) Readily realisable cash and balances at central banks are amounts held at central banks as part of our liquidity management activities.

(3) Comprises pre-positioned assets and encumbered assets.

Capital risk

Overview

Capital risk is the risk that we do not have an adequate amount or quality of capital to meet our internal business needs, regulatory requirements and market expectations.

In this section, we set out how we are regulated. We also give details of the results of the Bank of England's 2019 stress testing exercise. We explain how we manage capital on a standalone basis as a subsidiary in the Banco Santander group. We then analyse our capital resources and key capital ratios including our leverage and RWAs.

Key metrics

CET1 capital ratio of 15.2% (2019: 14.3%)

Total qualifying regulatory capital of £15.4bn (2019: £15.8bn)

UK leverage ratio of 5.1% (2019: 4.7%)

THE SCOPE OF OUR CAPITAL ADEQUACY

Regulatory supervision

For capital purposes, we are subject to prudential supervision by the PRA, as a UK banking group, and by the European Central Bank (ECB) as part of the Banco Santander group. The ECB supervises Banco Santander as part of the Single Supervisory Mechanism (SSM). Although we are part of the Banco Santander group, we do not have a guarantee from our immediate and ultimate parent Banco Santander SA and we operate as a standalone subsidiary. As we are part of the UK sub-group that is regulated by the PRA, we have to meet the PRA capital requirements on a standalone basis. We also have to show the PRA that we can withstand capital stress tests without the support of our parent. Reinforcing our corporate governance framework, the PRA exercises oversight through its rules and regulations on the Board and senior management appointments. Santander UK Group Holdings plc is the holding company of Santander UK plc and is the head of the Santander UK group for regulatory capital and leverage purposes. Santander UK plc is the head of the ring-fenced bank sub-group and is subject to regulatory capital and leverage rules in relation to that sub-group.

Our basis of consolidation for our capital disclosures is substantially the same as for our Consolidated Financial Statements.

CAPITAL RISK MANAGEMENT

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

Management of capital requirements (audited)

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

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

Management of capital resources (audited)

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

Risk measurement

We apply Banco Santander's approach to capital measurement and risk management for CRD IV. Santander UK Group Holdings plc is classified as a significant subsidiary of Banco Santander SA. For more on the CRD IV risk measurement of our exposures, see Banco Santander's Pillar 3 report. For more on our capital, see our Additional Capital and Risk Management Disclosures on www.aboutsantander.co.uk.

Key metrics

The main metrics we use to measure capital risk are CET1 capital ratio, total capital ratio and UK leverage ratio. We continue to be in excess of overall capital requirements, minimum leverage requirements and minimum requirements for own funds and eligible liabilities (MREL).

Stress testing

Each year we create a capital plan, as part of our ICAAP. We share our ICAAP with the PRA. The PRA then tells us how much capital (Pillar 2A), and of what quality, it thinks we should hold on top of our Pillar 1 requirements and buffer levels. We also develop a series of economic scenarios to stress test our capital needs and confirm that we have enough regulatory capital to meet our projected and stressed capital needs and to meet our obligations as they fall due. We augment our regulatory minimum capital with internal buffers. We hold buffers to ensure we have enough time to take action against unexpected movements.

Risk mitigation

We have designed our capital risk framework, policies and procedures to ensure that we operate within our Risk Appetite. We manage capital transferability between our subsidiaries in line with our business strategy, our risk and capital management policies, and UK laws and regulations. There are no legal restrictions on us moving capital resources promptly, or repaying liabilities, between the Company and its subsidiaries except for distributions between Santander UK entities in the ring-fenced bank sub-group and Santander UK entities that are not members of the ring-fenced bank sub-group, where the PRA is required to assess the impact of proposed distribution prior to payment. For details on our Recovery framework in the event of a capital stress, see the risk mitigation section in the 'Liquidity risk' section.

Santander UK plc, Cater Allen Limited and certain other non-regulated subsidiaries within the ring-fenced bank entered into a capital support deed dated 13 November 2018 (the RFB Sub-Group Capital Support Deed). The parties to the RFB Sub-Group Capital Support Deed are permitted by the PRA to form a core UK group, as defined in the PRA Rulebook, a permission which will expire on 31 December 2021. Exposures of each of the regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the RFB Sub-Group Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties breaches or is at risk of breaching its capital resources requirements or risk concentrations requirements.

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

Risk monitoring and reporting

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

CAPITAL RISK REVIEW

Impact of IFRS 9 on regulatory capital

We expect ECL-based provisions continue to be more volatile than our IAS 39 incurred loss-based provisions used prior to 2018 as our ECL methodology takes account of forward-looking data and covers a range of possible economic outcomes. This is likely to impact our CET1 capital levels, and result in increased pro-cyclicality of risk-based capital and leverage ratios. However, the impact is currently mitigated by our surplus of ECL over provisions for exposures using the IRB approach. For such exposures (which include residential mortgages) the adverse impact on CET1 capital of provision increases from reserve movements is offset by the related reduction of the negative CET1 capital adjustment for regulatory expected loss amounts. Furthermore, the EU transition arrangements for the capital impact of IFRS 9 mean that adverse CET1 effects from increases in ECL-based provisions from the level of such provisions at 1 January 2018 are partly reduced until the end of 2024.

We reflect projections of ECL provisions in our capital position forecasting under base case and stress scenarios for ICAAP and capital management purposes. We also consider the dynamics of ECL in how we assess, monitor and manage capital risk. The greater volatility from IFRS 9 ECL could result in material favourable and unfavourable swings to our Income Statement. Whilst the initial impacts of IFRS 9 were based on estimates prepared in a supportive economic environment, a period of economic instability (such as was seen in 2020 due to the impacts of the Covid-19 pandemic) could significantly impact our results and our financial assets. It could also impact the amount of capital we have to hold. We take into account the volatility of ECL in our capital planning strategy.

Bank of England stress testing

Due to the Covid-19 pandemic, the Bank of England cancelled the 2020 Annual Stress Test to help lenders focus on meeting the needs of UK households and businesses via the continuing provision of credit.

In the August 2020 Financial Stability Report, the Financial Policy Committee published a 'reverse stress test' exercise performed without direct input from banks which judged UK banks to be resilient to a very wide range of possible outcomes.

Meeting evolving capital requirements

We target a CET1 management buffer of sufficient size to absorb volatility in CET1 deductions, capital supply and capital demand whilst remaining above the regulatory CET1 requirement. Distribution restrictions would be expected to be applied if we were unable to meet both our minimum requirement, which consists of the Pillar 1 minimum plus Pillar 2A, the CRD IV buffers consisting of the Capital Conservation Buffer (CCB), the Countercyclical Capital Buffer (CCyB), and from 28 December 2020 the Other Systemically Important Institutions Buffer (O-SII) (previously the Systemic Risk Buffer (SRB)) at the level of the RFB Group.

The Bank of England's Financial Policy Committee (FPC) reduced UK CCyB to 0% in March 2020 in response to the Covid-19 pandemic, and the FPC stated that it expected to maintain the UK CCyB at this rate for at least 12 months. As there is a one year time lag for any announced CCyB increases to apply, any subsequent increase would not take effect until March 2022 at the earliest.

We review the resilience of our capital position via internal stress tests conducted as part of our ICAAP exercise, and we participate in the annual UK Banking Stress Test. In the last exercise in 2019, our projected CET1 ratio and UK Leverage ratio exceeded the hurdle rates after 'strategic' management actions and the Prudential Regulation Committee judged that the stress test did not reveal capital inadequacies in our balance sheet.

Headroom of our CET1 capital ratio to our current MDA trigger level at 31 December 2020

At 31 December 2020, the headroom of our CET1 capital ratio of 15.2% to our 7% AT1 permanent write down (PWD) securities trigger was 8.2% of total RWAs or £6.0bn (2019: 7.3% of total RWAs or £5.3bn).

The headroom of our CET1 capital ratio to our current maximum distributable amount (MDA) trigger level at 31 December 2020 was:

	Current MDA %
Pillar 1	4.5
Pillar 2A ⁽¹⁾	2.8
CCB	2.5
CCyB ⁽²⁾	—
Current MDA trigger	9.8
Headroom to current MDA	5.4
Total CET1 capital ratio	15.2

(1) Santander UK's Pillar 2 CET1 requirement was 4.94% at 31 December 2020, Pillar 2A guidance is a point in time assessment.

(2) The current applicable UK CCyB rate is 0% (2019: 1%).

MREL recapitalisation

We have made major progress to meet MREL requirements. To date, we have issued £7.5bn of MREL compliant senior unsecured bonds.

Our forward-looking MREL recapitalisation plan assumes the Pillar 2A requirement remains at 4.9% and is calculated using RWA, leverage exposures and exchange rates at 31 December 2020. Based on this set of assumptions, our MREL requirements are driven by leverage. Santander UK's indicative MREL requirements excluding buffers is currently circa. £21bn from 1 January 2022. Assuming the current plan by 2022, we expect to issue up to a further £2.5bn of senior unsecured bonds by year-end 2021 to cover the maturities and meet our total 2022 MREL requirement

In addition to meeting our minimum requirement, we intend to have an MREL recapitalisation management buffer in excess of the value of Santander UK Group Holdings plc senior unsecured securities that are due to become MREL ineligible over the following six months.

Key capital ratios

	Santander UK Group Holdings plc		Santander UK plc	
	2020	2019	2020	2019
	%	%	%	%
CET1 capital ratio	15.2	14.3	15.4	14.3
AT1	3.1	3.1	2.7	2.7
Grandfathered Tier 1	0.3	0.5	0.4	0.7
Tier 2	2.5	3.7	2.7	4.0
Total capital ratio	21.1	21.6	21.2	21.7

The total capital difference between Santander UK Group Holdings plc and Santander UK plc was due to the recognition of minority interests. The total subordination available to Santander UK plc bondholders was 21.2% (2019:21.7%) of RWAs.

Return on ordinary shareholders' equity divided by average total assets was 2.9% (2019: 4.9%).

Our CET1 capital ratio was up 90bps to 15.2%, with a 5.4p.p. buffer to MDA restrictions. The CET1 capital ratio includes a benefit of c.30bps and UK leverage ratio c.10bps from the change in treatment of software assets. Amendments to Capital Requirements Regulation (CRR), which were published in the Official Journal on 26 June 2020, contributed 17bps to the CET1 capital ratio, through the implementation of the RWA reduction factors for certain SME and infrastructure exposures.

Regulatory capital resources (audited)

This table shows our qualifying regulatory capital.

	2020	2019
	£m	£m
CET1 capital instruments and reserves:		
–Capital instruments	7,060	7,060
–Retained earnings	6,030	6,251
–Accumulated other reserves and non-controlling interests	679	554
CET1 capital before regulatory adjustments	13,769	13,865
CET1 regulatory adjustments:		
–Additional value adjustments	(21)	(35)
–Goodwill (net of tax)	(1,150)	(1,155)
–Other intangibles	(199)	(573)
–Fair value reserves related to gains or losses on cash flow hedges	(486)	(368)
–Negative amounts resulting from the calculation of regulatory expected loss amounts	(368)	(619)
–Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	(6)	(5)
–Deferred tax assets that rely on future profitability excluding timing differences	(9)	(8)
–Defined benefit pension fund assets	(364)	(502)
–Dividend accrual	(18)	(18)
–IFRS 9 Transitional Adjustment	73	16
–Deductions for non-controlling interests	(162)	(160)
CET1 capital	11,059	10,438
AT1 capital instruments:		
–Capital instruments	2,241	2,241
–Amount of qualifying items subject to phase out from AT1	324	487
–Regulatory deductions for instruments issued by subsidiary undertakings	(93)	(83)
AT1 capital	2,472	2,645
Tier 1 capital	13,531	13,083
Tier 2 capital instruments:		
–Capital instruments	2,076	2,901
–Amount of qualifying items subject to phase out from Tier 2	352	377
–Regulatory deductions for instruments issued by subsidiary undertakings or subject to CRDIV amortisation and repurchases	(571)	(583)
Tier 2 capital	1,857	2,695
Total regulatory capital⁽¹⁾	15,388	15,778

(1) Capital resources include a transitional IFRS 9 benefit at 31 December 2020 of £73m (2019: £16m).

2020 compared to 2019

CET1 capital increased to £11.1bn, with capital accretion through retained profits, the impact of the change in treatment of software assets in UK Capital Requirements Regulation (which increased CET1 capital by £0.25bn) and a lower deduction from the excess of regulatory expected loss amounts over credit provisions. These increases were partially offset by adverse market driven movements in the defined benefit pension schemes.

AT1 capital decreased in 2020, primarily reflecting the annual increase in the transitional limit applied to grandfathered AT1 capital instruments.

Tier 2 capital decreased in 2020, largely reflecting the amortisation of dated instruments.

We remain strongly capitalised and Covid-19 did not trigger a capital stress. As part of the Bank of England Interim Financial Stability Report (May 2020), the PRA developed a desktop stress scenario, which had less of an impact over the first two years of the scenario on the core banking system than their 2019 Stress Test, where our CET1 drawdown was the lowest across UK banks and we exceeded CET1 capital ratio and Tier 1 Leverage ratio hurdle rates across the projection horizon.

We paid an ordinary share dividend in December in accordance with the PRA's approach to shareholder distributions for 2020.

Movements in regulatory capital :

	CET1 capital £m	AT1 capital £m	Tier 2 capital £m	Total £m
At 1 January 2020	10,438	2,645	2,695	15,778
– Retained earnings	(221)	–	–	(221)
– Other reserves and non-controlling interests	125	–	–	125
– Additional value adjustments	14	–	–	14
– Goodwill (net of tax)	5	–	–	5
– Other intangibles	374	–	–	374
– Fair value reserves related to gains and losses on cash flow hedges	(118)	–	–	(118)
– Negative amounts resulting from the calculation of regulatory expected loss amounts	251	–	–	251
– Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	(1)	–	–	(1)
– Deferred tax assets that rely on future profitability excluding timing differences	(1)	–	–	(1)
– Defined benefit pension fund assets	138	–	–	138
– Deductions for non-controlling interests	(2)	–	–	(2)
– Capital instruments	–	–	(825)	(825)
– IFRS 9 Transitional Adjustment	57	–	–	57
– Amount of qualifying items subject to phase out from AT1	–	(163)	–	(163)
– Amount of qualifying items subject to phase out from Tier 2	–	–	(25)	(25)
– Deductions for instruments issued by subsidiary undertakings or subject to CRD IV amortisation	–	(10)	12	2
At 31 December 2020	11,059	2,472	1,857	15,388

In line with the position of the Basel Committee views following the outbreak of the Covid-19 pandemic, the UK has now adopted revised IFRS 9 transitional adjustment rules which apply a higher level of transitional relief to capital following rises in IFRS 9 provisions.

The original transitional adjustments consisted of a Static component, which was impacted on 1 January 2018 and a Dynamic component with changes in provisions for non-impaired assets made after 1 January 2018. A transitional factor was applied to the Dynamic component to determine the level of offset that was available over time (95% in 2018, 85% in 2019, 70% in 2020, 50% in 2021 and 25% in 2022).

The revisions to the transitional adjustment are part of the 'Quick fix' CRR amendments which have been in force from 27 June 2020. They have involved dividing the original Dynamic component into two parts – creating an 'old' component for provision changes from 1 January 2018 to 1 January 2020, and then a new Dynamic component for provision changes from 1 January 2020 and applying a revised higher transitional factor to this latter component, with an extended transitional period.

CET1, AT1 and Tier 2 regulatory adjustments

These are adjustments required by CRD IV.

AT1 capital

These are preference shares and innovative/hybrid Tier 1 securities. None of the instruments we issued before 1 January 2014 fully meet the CRD IV AT1 capital rules, which apply from that date. The instruments contribution to Tier 1 capital will be phased out by CRD IV rules until the start of 2022. The £750m Fixed Rate Reset Perpetual AT1 Capital Securities (net of issuance costs), the £800m Perpetual Capital Securities and the £500m Perpetual Capital Securities we issued since then fully meet the CRD IV AT1 capital rules.

In August 2019, as part of a capital management exercise, the Company purchased and redeemed the £300m Fixed Rate Reset Perpetual AT1 Capital Securities, and issued a further £500m Fixed Rate Reset Perpetual AT1 Capital Securities to Banco Santander SA.

Tier 2 capital

These are fully CRD IV eligible Tier 2 instruments and grandfathered Tier 2 instruments whose recognition as capital is being phased out under CRD IV until the start of 2022.

Risk-weighted assets

The tables below are consistent with our regulatory filings for 31 December 2020 and 31 December 2019.

RWAs by risk	2020 £bn	2019 £bn
Credit risk	64.8	64.1
Counterparty risk	1.1	1.5
Market risk	0.2	0.3
Operational risk	6.8	7.3
	72.9	73.2

RWAs by segment	2020 £bn	2019 £bn
Retail Banking	49.5	47.8
Corporate & Commercial Banking	13.3	14.0
Corporate & Investment Banking	3.8	4.8
Corporate Centre	6.3	6.6
	72.9	73.2

Movements in RWAs by risk:

	Credit/ counterparty risk £bn	Market risk £bn	Operational risk £bn	Total £bn
At 1 January 2020	65.6	0.3	7.3	73.2
Asset size	(1.2)	(0.1)	—	(1.3)
Asset quality	1.9	—	—	1.9
Methodology and policy	(0.4)	—	—	(0.4)
Other	—	—	(0.5)	(0.5)
At 31 December 2020	65.9	0.2	6.8	72.9

2020 compared to 2019

The Pillar 2A capital requirement was 4.94%, the majority of which remained with an RWA percentage based element.

We use significant risk transfer (SRT) securitisation transactions to manage and diversify credit and other risks, with associated reductions to the level of RWAs. Currently, we have SRT securitisation transactions which cover portfolios of corporate facilities and Consumer Finance loans.

Regulatory leverage

	2020	2019
	£m	£m
Regulatory exposure	259,044	269,162
End-point Tier 1 capital ⁽¹⁾	13,164	12,625
UK leverage ratio	5.1%	4.7%
BBLs lending excluded from leverage exposure	(3,986)	—

(1) Includes deductions and AT1 adjustment permitted under the recommendation from the Financial Policy Committee on 25 July 2016.

Under the PRA rules, we adjust our total assets per the Consolidated Balance Sheet to calculate our regulatory exposure for leverage purposes. We do this as follows:

	2020	2019
	£m	£m
Total assets per the Consolidated Balance Sheet	299,064	288,488
Derivatives netting and potential future exposure	(1,521)	(1,671)
Securities financing current exposure add-on	767	1,006
Removal of IFRS netting	1,144	1,191
Removal of qualifying central bank claims	(47,537)	(26,400)
Commitments calculated in accordance with Basel Committee Leverage Framework	8,114	8,393
CET1 regulatory adjustments	(987)	(1,845)
	259,044	269,162

The adjustments are:

- **Derivatives netting and potential future exposure:** where a qualifying netting agreement is in place netting is allowed for leverage purposes. This is partially offset by including the PEE we use to calculate EADs
- **Securities financing current exposure add-on:** we include an add-on for securities financing transactions to show current exposure for leverage purposes
- **Removal of IFRS netting:** where netting of assets and liabilities is allowed under IFRS, but not under the Basel rules, we remove it for leverage purposes
- **Removal of qualifying central banks claims:** permitted under the recommendation of the FPC on 25 July 2016, under CRD IV rules the exposure measure does not allow the removal of qualifying central bank deposits or claims
- **Commitments calculated in accordance with Basel Committee Leverage Framework:** we add the gross value of off-balance sheet commitments for leverage purposes after we apply regulatory credit conversion factors
- **CET1 regulatory adjustments:** where we have deducted assets from CET1, they can be deducted for leverage purposes.

2020 compared to 2019

UK leverage ratio of 5.1% was up 40bps, primarily through improvement in CET1 capital and active management of leverage exposures. It remains 1.5p.p. above the regulatory requirement.

Distributable items

Distributable items are equivalent to distributable profits under the UK Companies Act 2006. The distributable items of Santander UK Group Holdings plc under CRD IV at 31 December 2020 and 31 December 2019, and movements in the year, were as follows:

	2020	2019
	£m	£m
At 1 January	4,262	4,221
Dividends approved:		
– AT1 Capital Securities	(147)	(142)
– Tax on above item	28	38
– Ordinary shares	(103)	(262)
Dividends receivable:		
– Investment in AT1 Capital Securities	131	125
– Tax on above item	(25)	(34)
– Investment in ordinary shares of subsidiary	129	323
Other income statement items (Company)	(23)	(7)
At 31 December	4,252	4,262

Pension risk

Overview

Pension risk is the risk caused by our statutory contractual or other liabilities with respect to a pension scheme (whether set up for our employees or those of a related company or otherwise). It also refers to the risk that we will need to make payments or other contributions with respect to a pension scheme due to some other reason.

In this section, we explain how we manage and mitigate pension risk, including our investment and hedging strategies.

Key metrics

Funding Deficit at Risk was £1,280m (2019: £1,520m)

Funded defined benefit pension scheme accounting surplus was £135m (2019: £431m)

OUR KEY PENSION RISKS

Sources of risk

Pension risk is one of our key financial risks. Santander UK plc is the sponsor of the Santander (UK) Group Pension Scheme (the Scheme), a defined benefit scheme. Our risk is that over the long-term the Scheme's assets are not enough to meet its liabilities as they fall due. When this happens, we could have to (or choose to) make extra contributions. We might also need to hold more capital to reflect this risk.

The key pension risk factors the Scheme is exposed to are:

Key risks	Description
Interest rate risk	The risk that a decrease in (long-term) interest rates causes an increase in the value of the Scheme's liabilities that are not matched by an increase in the value of its assets.
Inflation risk	Annual pension increases are directly linked to RPI or CPI. The risk is that an increase in inflation causes an increase in the value of the Scheme's liabilities that are not matched by an increase in the value of its assets.
Longevity risk	The Scheme's liabilities are in respect of current and past employees and are expected to stretch beyond 2080 due to the long-term nature of the obligation. Therefore, the value of the Scheme's liabilities is also impacted by changes to the life expectancy of Scheme members over time.
Investment risk	The risk that the return on the Scheme's assets is insufficient to meet the liabilities.

The accounting and regulatory capital can be sensitive to changes in the assumptions of these key risk factors.

For more on our defined benefit schemes, see Note 30 to the Consolidated Financial Statements. This includes a sensitivity analysis of our key actuarial assumptions.

Defined contribution schemes

We also have defined contribution schemes for some of our employees. The benefits received at retirement will mainly depend on the contributions made (by both the employees and us) and the performance of the investments which are typically chosen by employees. These schemes carry far less market risk for us, although we are still exposed to operational and reputational risks. To manage these risks, we monitor the administration performance of the provider and the performance of the investment funds and the costs met by members. We ensure our employees are given enough information about their investment choices.

For more on our defined contribution schemes, see Note 30 to the Consolidated Financial Statements.

The impact of our defined benefit schemes on capital

We take account of the impact of pension risk on our capital as part of our stress testing process, considering measures such as the impact on CET1 and Pillar 2A, and also where relevant the impact on the related measures such as the leverage ratio. This includes our ICAAPs, PRA stress tests and our quarterly assessment of capital requirements. We also consider the impact of any changes proposed to the Scheme or its investment strategy.

Our defined benefit pension schemes affect capital in two ways:

- We treat an IAS 19 deficit as a liability on our balance sheet. We recognise movements in a deficit through Other Comprehensive Income and so this reduces our shareholders' equity and CET1 capital. Deficit movements on the balance sheet are mainly due to re-measurements, including actuarial losses. We treat an IAS 19 surplus as an asset on our balance sheet. This increases shareholders' equity. However, it is deducted for the purposes of determining CET1 capital. An IAS 19 surplus or deficit on our balance sheet is partially offset by a deferred tax liability or asset, respectively. These may be recognised for calculating CET1 capital depending on our overall deferred tax position at that time.
- The PRA takes pension risk into account in the Pillar 2A capital assessment through the annual ICAAP exercise. The Pillar 2A requirement forms part of our overall regulatory minimum requirement for CET1 capital, Tier 1 capital and total capital. We perform a quarterly assessment internally. For more on our minimum regulatory requirements, see the 'Capital risk' section.

PENSION RISK MANAGEMENT

Scheme governance

The Scheme operates under a trust deed. Santander (UK) Group Pension Scheme Trustees Limited (the Trustee), is a wholly owned subsidiary of the Santander UK group. The Trustee ensures that the Scheme is run properly, and that members' benefits are secure. It delegates investment decisions within ranges determined in the Statement of Investment Principles to the board of Santander (CF Trustee) Limited (the CF Trustee). The CF Trustee is responsible for reviewing, agreeing and implementing investment strategies, with our input as and when needed. Every month, we discuss pension-related matters at our Pensions Committee and Pension Risk Forum. For example, our Pensions Committee reviews the Scheme's investment strategies and approves actuarial valuations. The Pension Risk Forum is a Risk division management forum that monitors our pension risk within approved risk appetite and policies. We work with the Trustee to ensure that the Scheme is adequately funded but our responsibilities are clearly segregated from the Trustee's.

Risk appetite

Our risk appetite is a key consideration in all decisions and risk management activities related to the Scheme. Our pension risk appetite is reviewed by our Pensions Committee at least once a year. It is then sent to the Board for approval. We measure pension risk on both a technical provisions (funding) basis and an accounting (IAS 19) basis. We manage pension risk on both the accounting and the funding basis. Both bases are inputs into our capital calculations.

Risk measurement

Our key risk metrics include:

Key risk metrics	Description
Funding Deficit at Risk	We use a VaR and a forward-looking stress testing framework to model the Scheme's assets and liabilities to show the potential deterioration in the current funding position. This ensures we adequately capture the risks, diversification benefits and liability matching characteristics of the obligations and investments of the Scheme. We use a time period of 1 year and a 95% confidence interval in our VaR model.
Required Return	This estimates the return required from the Scheme's assets each year to reach a pre-defined funding target by a fixed date in the future.
Pensions Volatility	We use a VaR and a forward-looking stress testing framework to model the volatility in the pension-related capital deduction. We use a time period of 1 year and a 95% confidence interval in our VaR model.

We perform stress tests for regulators, including for ICAAPs and PRA stress tests. The stress testing framework allows us to also consider how macroeconomic events could impact the Scheme's assets and liabilities. For more on our stress testing, see the 'Risk governance' section.

Risk mitigation

The key tools we use to maintain the above key risk metrics within appetite are:

Key tools	Description
Investment strategies	<p>The Trustee developed the following investment objectives to reflect their principal duty to act in the best interests of the Scheme beneficiaries:</p> <ul style="list-style-type: none"> – To maintain a diversified portfolio of assets of appropriate suitability, quality, security, liquidity and profitability which will generate income and capital growth to meet, together with new contributions from members and the employers, the cost of current and future benefits which the Scheme provides, as set out in the rules of the Scheme – To limit the risk that the assets fail to meet the liabilities – To invest in a manner appropriate to the nature and duration of the expected future retirement benefit payments under the Scheme – To minimise the long-term costs of the Scheme by maximising asset returns net of fees and expenses whilst reflecting the objectives above. <p>The investment strategy is regularly reviewed. The impact of the investment strategy on Funding Deficit at Risk is considered. This assessment includes the changing impact of different forward-looking stress tests as the asset allocation evolves over time, as the profile of the Scheme evolves on the journey to lower dependence on Santander UK. Fund managers are also reviewed annually to ensure the investments remain appropriate for the Scheme.</p>
Hedging strategies	<p>The Trustee has a hedging strategy to reduce key market risks, mainly interest rate and inflation risk. This includes investing in suitable fixed income and inflation-linked assets and entering into interest rate and inflation hedges.</p> <p>The CF Trustee also hedges some of its equity and currency risk. This is achieved by using equity put options, equity collars and other derivatives that provide downside protection. Currency hedging is used to reduce risks from investing in assets denominated in currencies other than sterling. The hedging of interest rate and inflation risk in particular reduce the Funding Deficit at Risk.</p> <p>As the Scheme matures, the Trustee also actively monitors and manages longevity risk through transactions such as buy-ins and longevity swaps.</p>
Environmental, social and governance (ESG)	<p>The Trustee has a long-term investment horizon. It believes that an appropriate assessment of factors such as sustainable growth, environmental and climate change impacts, as well as other social and governance considerations, will help to better achieve the objectives set and improve outcomes for members and beneficiaries through enhanced long-term returns and management of arising risks in respect of the Scheme's assets.</p> <p>The Trustee also believes that investors who are responsible owners, and who engage, support better outcomes for the companies they invest in and ultimately enhance their investments by using their rights as shareholders influencing more sustainable corporate strategies, performance, risk management, capital structure, tax transparency and corporate governance, including culture, diversity and remuneration, potential conflicts of interest and social and environmental impact. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings. The Trustee will also monitor its supply chain for modern slavery risk.</p>

We look at the impact on our risk metrics when determining the appropriateness of the investment and hedging strategies. We also use the impact on our risk metrics to propose changes to optimise these strategies.

Risk monitoring and reporting

We monitor pension risk each month and report on it at Pension Risk Forum, ERCC, Pensions Committee and, where thresholds are exceeded (or likely to be), to the Board Risk Committee and the Board in line with our pension risk appetite. We discuss any remedial action with the Trustee. For all key risk metrics, we determine tolerance levels for deterioration based on our risk appetite. We use different triggers to indicate our position relative to those risks and report all key risk metrics against these triggers to Pensions Committee and Pension Risk Forum each month. We consider actions to reduce risk to an acceptable level where the position looks likely to exceed the red trigger level.

In addition, we monitor the performance of third parties who support the valuation of the Scheme's assets and liabilities. The models they use are reviewed and validated by our internal model validation team and approved by the model risk committee. Every year, we carry out a full analysis of the assumptions we use which is considered by the Board Audit Committee and Pensions Committee. We ensure that we carry out consistency checks for all liability calculations supplied by third parties. We obtain audited figures of the asset values from the appointed investment manager. Independent audits are then carried out on behalf of the custodian. We also apply our own checks to make sure that the asset values provided are consistent with expectations.

PENSION RISK REVIEW

2020 compared to 2019

Interest and inflation hedging increased in 2020. There was a reduction in risk in the asset portfolio with £1.7bn of growth assets being sold and the proceeds invested in the matching asset portfolio. The Scheme also purchased an annuity policy covering £300m of pension obligations.

Risk monitoring and measurement

Our main focus is to ensure the Scheme achieves the right balance between risk and reward whilst minimising the impact on our capital and financial position. In 2020, overall asset returns were positive with strong performance from liability-matching assets, mainly bonds. The Funding Deficit at Risk decreased to £1,280m (2019: £1,520m), mainly due to the sale of growth assets, increased interest rate and inflation hedging, and risk metrics now reflecting the 2019 triennial valuation. Our long-term objective is to reduce the risk of the Scheme and eliminate the deficit on the funding basis. On the funding basis, the interest rate hedging ratio was 81% (2019: 64%) and the inflation hedging ratio was 79% (2019: 63%) at 31 December 2020. The Scheme was invested in certain assets at 31 December 2020 whose values are not based on market observable data, such as investments in private equity funds and property. Due diligence has been conducted to ensure the values obtained in respect of these assets are appropriate and represent fair value.

We also monitor the potential impact from variations in the IAS 19 position on CET1 capital. The negative impact on CET1 capital increased in 2020. For more on the impact of our defined benefit schemes on capital, see the 'Capital risk' section.

Accounting position

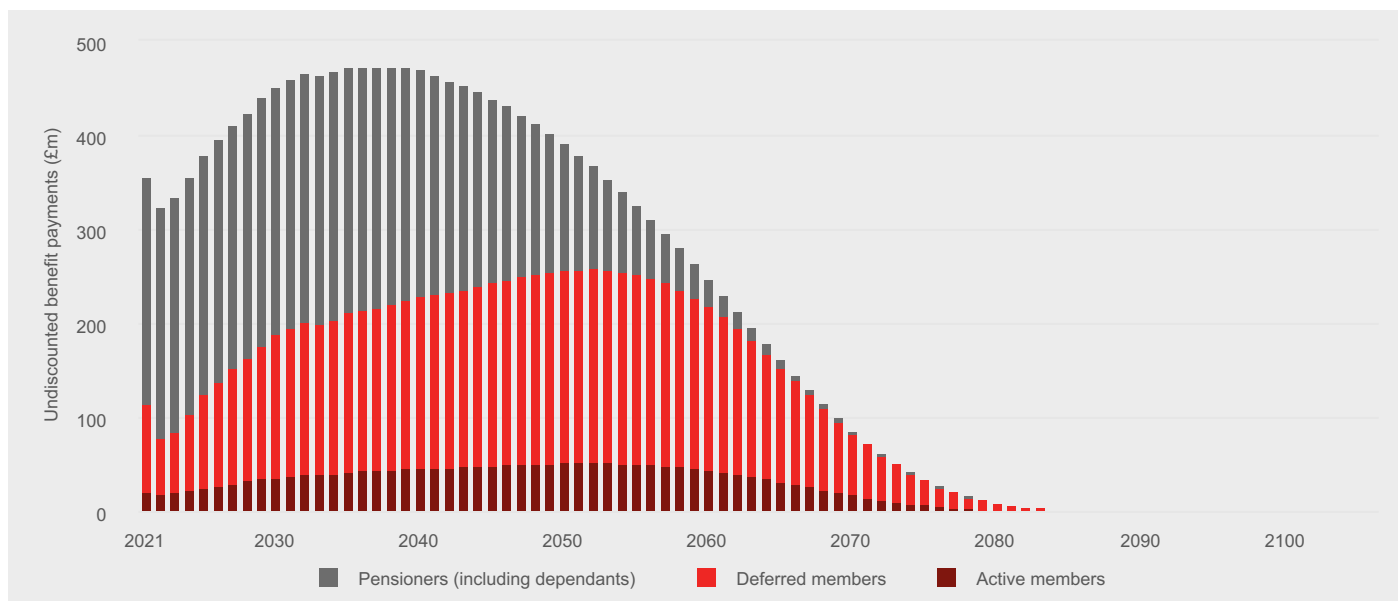
The accounting position was volatile in 2020 reflecting volatility in bond yields, a decline in gilt yields and movement in asset values, particularly equities. There remains considerable market uncertainty and while the actions highlighted above mitigate some of the impact of market movements in yields, our position could change materially over a short period.

In 2020, the accounting surplus of the Scheme and other funded schemes decreased. Some sections in the Scheme had a surplus of £496m at 31 December 2020 (2019: £670m) whilst other sections had a deficit of £361m (2019: £239m). The overall position was a £135m surplus (2019: £431m surplus). There were also unfunded scheme liabilities of £42m at 31 December 2020 (2019: £41m). The deterioration in the overall position was mainly driven by a decrease in the discount rate in the period. This was due to falling corporate bond yields which increased the value of liabilities. However, this was partially offset by a rise in overall asset values.

For more on our pension schemes, including the current asset allocation and our accounting assumptions, see Note 30 to the Consolidated Financial Statements.

Maturity profile of undiscounted benefit payments

The Scheme's obligation to make benefit payments extends over the long-term. This is expected to stretch beyond 2080. The graph below shows the maturity profile of the undiscounted benefit payments expected to be paid from the Scheme over its life at 31 December 2020:



Conduct and regulatory risk

Overview

We manage the conduct and non-financial regulatory risk types in one framework. We do this to reflect their similarities.

Conduct risk is the risk that our decisions and behaviours lead to a detriment or poor outcome for our customers. It also refers to the risk that we fail to maintain high standards of market behaviour and integrity.

Regulatory risk is the risk of financial or reputational loss, or imposition of or conditions on regulatory permission, as a result of failing to comply with applicable codes, regulator's rules, guidance and regulatory expectations.

We are committed to ensuring conduct strategy is embedded in our business and that the fair treatment of our customers is at the heart of what we do.

In this section, we explain how we manage conduct and regulatory risk and highlight new processes we implemented in response to Covid-19. We also describe our main conduct provisions, with a focus on PPI, and give some insight into our work to protect vulnerable consumers via our Reaching Out initiative during the Covid-19 pandemic.

Key metrics

PPI provision was £76m (2019: £189m)

Other conduct provision was £8m (2019: £25m)

OUR KEY CONDUCT AND REGULATORY RISKS

Our purpose is to help customers and businesses prosper by meeting their needs and expectations. To achieve this, we are committed to making sure that our strategy, proposition and initiative approval process, and systems, operations and controls are well designed and delivered.

We see our key exposure to conduct and regulatory risk through:

- the risk of errors in our product design, sales practices, post-sale servicing, operational processes, complaint handling, and
- failure to supervise, monitor and control the activities of our employees.

All of these may result in the risk that we do not meet our customers' needs, align to the expectations of our regulators or deliver the expected outcomes or observe required standards of market behaviour.

Our Conduct and Regulatory Framework is built on the following underlying types of risk:

Key risks	Description
Regulatory	<p>The risk that we fail to adhere to relevant laws, regulations and codes which could have serious financial, reputational and customer impacts. This includes the risk that we may be adversely impacted by changes and related uncertainty around UK and international regulations. We categorise regulatory risk into financial and non-financial risk. This is aligned to our main regulators who are the PRA and FCA but also includes other regulators and authorities such as the CMA, Payment Systems Regulator, Lending Standards Board, Financial Ombudsman Service and Information Commissioner's Office.</p> <p>As well as being subject to UK regulation, as part of the Banco Santander group, we are impacted indirectly through regulation by the Banco de España (the Bank of Spain) and, at a corporate level, by the ECB through the SSM. We also fall within the scope of US regulation, including the Dodd-Frank Wall Street Reform and Consumer Protection Act. This restricts our activities both in the UK and the US. We must also adhere to the rules and guidance of other regulators and voluntary codes in the UK.</p>
Product	The risk that we offer products and services that do not result in the right outcomes for our customers.
Sales	The risk that we sell products and services to our customers without giving them enough information to make an informed decision or we do not provide correct advice.
After-sale and servicing	<p>The risk that failures of our operations, processes, servicing activity, IT or controls result in poor outcomes for our customers. This includes the risks that:</p> <ul style="list-style-type: none"> – We do not give appropriate after-sale communications to customers, making it difficult for them to contact us, or we fail to take account of a customer's vulnerability – We do not have robust systems and controls to detect and prevent fraud or errors in the customer experience.
Culture	The risk that we do not maintain a culture that encourages the right behaviour and puts the customer at the heart of what we do.
Competition	The risk of financial harm, criminal liability, customer harm or reputational damage that we may incur because we fail to comply with relevant competition law or being involved in any competition law investigation or proceedings.
Controls	The risk that we do not supervise and monitor our employees effectively or do not have robust systems and controls in place to prevent and detect misconduct.

CONDUCT AND REGULATORY RISK MANAGEMENT

Risk appetite

We aim to comply with all regulatory requirements, and we have no appetite to make decisions or operate in a way that leads to unfair outcomes for our customers or negatively impacts the market. Our Board approves our risk appetite on an annual basis, or more often if needed, and we cascade it to our business units through our risk framework and policies. We also have lower level risk tolerance thresholds that are agreed at least annually. Our material conduct and regulatory risk exposures are subject to, and reported against, our conduct and regulatory risk appetite statements, as well as lower level triggers and thresholds for action.

Risk measurement

Due to the close links between our conduct, regulatory and operational risk frameworks, our tools to identify, assess, manage and report operational risks also apply where such exposures and risks have a conduct and/or regulatory risk impact. Since the outbreak of Covid-19 we have continuously reviewed our communications with customers, our policies and have provided additional tools, such as digital budget planners and online triage guides to support customers in understanding their financial position. Despite the introduction of these digital enhancements our intention remains to speak to each customer in financial difficulty to ensure the most appropriate solutions are offered. We have been increasing our resource in this area to ensure that we can meet customer demand.

We support our conduct and regulatory risk framework and policies with tools that aim to identify and assess new and emerging conduct risks. These include:

Key tools	Description
Strategy and business planning	Our Strategy and Corporate Development team help align our overall corporate strategy, financial plans, risk appetite and operational capabilities through our annual process to set our strategy. We derive our business unit plans from our overall corporate strategy and they contain a view of conduct and regulatory risk with our other key risk types.
Sales quality assurance	We subject retail sales and processes to internal quality assurance and, as needed, external monitoring to ensure their quality.
Operational risk and control assessments	Our business and business support units assess our operational risks, systems and controls to give us a consolidated risk view across all our business areas. We complete the assessments through a central tool to evaluate and manage our residual risk exposures.
Scenario testing and horizon scanning	We consider conduct and regulatory risk in our scenario testing. This reviews possible root causes and assumptions to determine the likelihood and size of the impact, and actions to enhance our controls where required.
Conduct risk reporting	We use dashboards to give us an end-to-end view of our conduct risks across our business. This allows us to apply a lens to manage conduct risk and understand if it is in line with our risk appetite.
Compliance monitoring	We carry out an annual conduct and regulatory risk assurance programme approved by the Board and tracked through the year.

Risk mitigation

Our conduct and regulatory risk framework and policies set out the principles, standards, roles and responsibilities and governance for conduct and regulatory risk, such as:

Policies	Description
Product approval	Our product approval process aims to minimise our conduct, legal, regulatory or reputational risks in the design, marketing, sales and service of new products and services. We assess all our products and services within a formal framework to make sure they are within our risk appetite and agreed metrics, and to ensure that processes and controls are in place.
Suitable advice for customers	We give guidance to advisers and staff on the key principles, requirements and ethical behaviours they must follow. This ensures our customers are sufficiently informed when they make a buying decision. In our Retail Banking division, the main products we cover are mortgages, investments, savings and protection.
Training and competence	In line with the expectations of our regulators, we train our staff and require them to maintain an appropriate level of competence (in line with their role and responsibilities) to ensure customers achieve fair outcomes. We invest in all our people to ensure that we achieve our mandatory risk objectives and that everyone acknowledges their personal responsibility for risk management through our I AM Risk approach. We place a specific focus on: <ul style="list-style-type: none"> – Vulnerability: Ensuring that our colleagues are trained to help customers who may be vulnerable (see below). – Financial abuse: We work closely with other members of UK Finance, as part of the Financial Abuse Working Party, with a shared vision to help victims regain control of their finances. Through this collaboration we have adopted a Financial Abuse Code of Practice as part of our overall vulnerable customer strategy. We have specific training material for colleagues to raise awareness and improve understanding around the devastating impacts of financial abuse and how we can help. Due to the very complex nature of situations involving financial abuse, we also have a dedicated Specialist Support Team that offers guidance to colleagues dealing with customers who are victims and need tailored solutions to help them regain control of their finances. – Covid-19: We designed and delivered tailored training across key areas of the business to support customers affected by Covid-19.
Treating vulnerable customers fairly	Some customers may be impacted financially or personally as a result of their circumstances. Our Vulnerable Customer Policy gives business areas a clear and consistent understanding of what vulnerability can mean and the types of situations when customers may need more support. Our guidelines focus on identifying vulnerable customers, and the support we can give to help them avoid financial difficulty. We work with key charities, authorities, trade associations and other specialists to develop our understanding of vulnerability. In addition to mandatory training, we train our customer-facing colleagues using real customer scenarios to highlight different vulnerable situations. This enables our colleagues to deal with a wide range of sensitive issues. We also have an online Vulnerable Customer Support Tool for our colleagues to give them more guidance and support. Our colleagues have access to our Specialist Support Team who can give specific help and guidance for the most complex vulnerable customer situations. We consider vulnerability in every initiative. Adapting our technology to the needs of customers with physical disabilities is a key part of our design and testing stages and we work closely with the Digital Accessibility Centre. We have also developed our training approach through a series of real-life customer stories available to colleagues to access anytime to develop their skills. Our objective throughout the Covid-19 pandemic has been, and continues to be providing a range of support and solutions for customers who find themselves facing financial difficulty, based on individual customer circumstances, with the aim of rehabilitating customers back into a healthy financial position. Our Financial Support model has evolved to ensure that we help customers who are facing temporary but severe financial difficulty. We are enhancing our model further, for circumstances that may remain for a longer term.

Risk monitoring and reporting

We consider conduct and regulatory risk as part of the governance around all our business decisions. We have specific fora and committees such as the Conduct and Compliance Forum, and business specific risk management fora to make decisions on conduct and regulatory risk matters and we ultimately report to the ERCC and Board Responsible Banking Committee. The data we report to senior management and Committees gives them a clear understanding of current and potential emerging conduct and regulatory risks and issues. Our risk and control fora support management to control risks in their business units. Reporting includes conduct risk dashboards, which set out a range of metrics across common areas. These include policy breaches logged, mystery shopping, quality assurance and complaints, as well as commentary on trends and root causes. This approach enables us to take effective action. As well as the reports issued by the business, our Legal and Regulatory Division reports directly to the Board to give a view on legal, conduct and regulatory, reputational and financial crime risks, and to escalate issues or any breach of our risk appetite.

In 2020, to ensure we continue to drive fair and consistent outcomes, whilst managing the increased inflow of customers resulting from the Covid-19 pandemic, we have invested in people and technology. Tailored customer support is already in place and continues to evolve to ensure there is a robust, forward-looking governance model in place to allow us to recognise and address risks related to our personal and business customers. Conduct risk dashboards have been developed and escalated through governance as outlined above.

CONDUCT AND REGULATORY RISK REVIEW

2020 compared to 2019

In 2020, to ensure we fully considered customer and conduct impacts across our business, we continued to maintain a strong focus on robust oversight and control of the full customer journey. We maintain Compliance teams across all our key business divisions and in key cross functional areas such as fraud, payment services, data protection and Financial Support Centre of Excellence. Conduct and regulatory risk frameworks are in place across all business divisions that operate alongside our wider Risk Framework to identify, assess, manage and report conduct and regulatory risk.

In 2020, we continued to build on our progress in 2019 and remained vigilant in taking a customer-focused approach in developing strategy, products and policies that support fair customer outcomes and market integrity, in particular within the context of regulator and government driven Covid-19 initiatives. These have all been deployed at a fast pace, with systems and controls in place to enable and increase our working from home capability, whilst continuing to provide critical services to our customers. As part of this, we:

- Assessed the views and new policy areas in the FCA's 2020/21 Business Plan. Most of the measures and initiatives aim to ensure financial services firms give customers the support they need during and post the Covid-19 pandemic. This is a re-focus by the FCA on its key priorities against other work, driven by Covid-19. We have considered and addressed them in our controls, product processes and frameworks
- Maintained focus on Covid-19 and forbearance measures following further FCA's Guidance on Support for Consumer Credit and Overdraft Customers along with mortgage customers guidance extending the period customers can access further payment holiday
- Implemented processes to support customers including creating the Financial Support Centre of Excellence and SME support to ensure we continue to drive fair and consistent outcomes, whilst managing the increased inflow of customers impacted by Covid-19, with further investment in people and technology
- Took steps to maintain appropriate monitoring and surveillance capability for our market and customer facing staff working from home due to Covid-19
- Continued to manage technological change and increased digitalisation in line with regulatory initiatives
- Delivered change to meet the evolving regulatory landscape, including changes brought about by Payment Systems Regulator (PSR), EU Cross Border Regulation, Open Banking and PSD2, and the FCA Consumer Protection Agenda, and
- Continued to prepare for the transition from LIBOR to risk-free rates at the end of 2021, including planning for customer communications and recognition of potential conduct risks.

Following the launch of the Contingent Reimbursement Model, a voluntary code of practice to deal with authorised push payment fraud, we agreed along with seven other banks to a funding loan for no-blame cases. We continue to engage with the industry and authorities, giving input and support to embed the code.

Like all UK banks, we continue to see a demanding regulatory agenda focused on addressing customer detriment, price regulation and vulnerability. Conduct risks will rise in the near- and medium-term as banks deal with a large number of personal and business borrowers impacted by the Covid-19 pandemic. When implementing regulatory change, we focus on ensuring that our strategy, leadership, governance arrangements, and approach to managing and rewarding staff does not lead to a detrimental impact on our customers, competition, or to market integrity. We expect all our staff to take responsibility for managing risk through our IAM Risk programme.

Accounting position

For more on our provisions, see Note 29 to the Consolidated Financial Statements. For more on our contingent liabilities, see Note 31 to the Consolidated Financial Statements.



Protecting vulnerable customers

In 2020, we recognised that many of our customers who would normally use a branch for their day-to-day banking might be shielding at home during the Covid-19 pandemic, and we wanted to reach out to them and check on their wellbeing – both personal and financial. We launched our Reaching Out initiative, focused around calling those customers who regularly visit our branches. The calls were about customer wellbeing, with informal conversations focused on checking the customer was coping okay and reassuring them that we were available to help if they needed some support.

For our customers who felt isolated, it was an opportunity to simply have a chat with a familiar voice, while for others it was an opportunity to ask about the different ways they could still access cash and do their banking. As part of the calls, colleagues also took the opportunity to remind customers of the importance of not sharing personal information over the phone.

This initiative involved the collaboration of our charity partners at Age UK and Alzheimer's Society, who welcomed this type of proactive contact. The reaction from both colleagues and customers was overwhelmingly positive with many stories of how customers reacted to our calls and from colleagues who felt enormously proud taking part in this activity.

Operational risk

Overview

Operational risk is the risk of loss due to inadequate or failed internal processes, people and systems, or external events.

In this section, we explain how we manage operational risk, with a focus on our top three key operational risks. In 2020, these consisted of Cyber, Change and transformation, and People. The classifications were enhanced in the year, driven primarily by the impacts of the Covid-19 pandemic.

We also describe our operational risk event losses and developments in the year, and give some insight into how we have demonstrated operational resilience as an organisation in response to Covid-19.

Key metrics

Operational risk losses (over £10,000, and excluding PPI) increased by 51%

OUR KEY OPERATIONAL RISKS

Operational risk is inherent in our business. As a result, we aim to manage it down to as low a level as possible, rather than eliminate it entirely. Operational risk events can have a financial impact and can also affect our business objectives, customer service and regulatory obligations. These events can include product mis-selling, fraud, process failures, system downtime and damage to assets or external events.

Our top three operational risks are:

Key risks	Description
Cyber	<p>We rely extensively on the use of technology to support our customers and to run our business. This includes internal platforms, such as our core banking systems, mortgage platforms, telecommunications, remote working and finance systems, and customer-facing platforms such as our mobile app and online banking websites. The use of technology and the internet have changed the way we live and work, and the Covid-19 pandemic has further evidenced the reliance on technology. While technology allows us to develop and improve the way we serve our customers, it is critically important that we protect our customers' information and provide them with a secure environment in which to deal with us, especially when the threat from cyber criminals is so prevalent and more sophisticated than ever.</p> <p>Failure to protect the data assets of Santander UK and its customers against theft, damage or destruction from cyber-attacks could cause operational disruption, breach of data security or regulations, negative customer outcomes, financial loss or reputational damage. Even small periods of disruption that deny access to our services can erode our customers' trust in us. This applies not only to our own systems but also to those of our third-party providers and counterparties in the market. The value of the data itself, especially the personal details of customers and employees, has increased considerably and is a core focus of cyber criminals along with systems, such as payments and ATM networks, that enable the monetisation of cyber system breaches. It is therefore critical that we are resilient to cyber-attacks and can withstand and quickly recover from those events should they occur.</p>
Change and transformation	<p>We have to constantly change to keep up with an increasing pace of change in technological innovation, evolving business models and the competitive landscape. A key part of our business strategy is to develop and deliver new banking products and services, while making our processes and systems more efficient and resilient. Third party involvement is increasing as part of this strategy.</p> <p>We are also implementing a large number of changes to keep up with the latest regulatory and legal requirements, impacting all areas of our business. There is more on this in the 'Conduct and Regulatory Risk' section.</p> <p>The scale and pace of our plans, and the potential compounding effect of various changes happening at the same time, increases our operational risk. These changes could have financial, customer, reputational and regulatory impacts if we do not manage them properly.</p>
People	<p>People risks include all risks related to employees and third parties working for us, covering resource management, health, safety and wellbeing and employee relations. These have collectively increased in significance to become a top risk for the bank driven primarily by the Covid-19 pandemic. The majority of non-branch employees have been working from home since pandemic restrictions were first introduced by the UK Government, and most will continue to do so for some time. This has raised potential impacts on mental wellbeing and ergonomic risks. In addition, as the bank transforms itself, the significant level of organisational change may cause disruption for employees. As we develop our working practices and adapt to changing circumstances, people impacts and risks continue to be key considerations.</p>

We remained operationally stable throughout the periods of UK Government and regionally-imposed Covid-19 restrictions in 2020 by redeploying the majority of our non-branch workforce from working in an office to working from home (WFH). We achieved this by quickly increasing our capacity for staff to work remotely fivefold and by improving the resilience of our connectivity solution. We have invested significantly in controls and other mitigants to support WFH arrangements including: enhanced monitoring of employees' transactional activity, the distribution of circa 6,000 items of office equipment to support home working, the implementation of an intranet-based Coronavirus Support Hub for all employees, and remote working mandatory training. We also conduct ongoing health trackers and feedback surveys. Spare employee capacity has been reassigned to assist operational hotspots such as enabling branch employees to support customer contact centres via the 'Voice in Branch' initiative, and the establishment of a Financial Support Centre to help customers coming to the end of a payment holiday or furlough arrangement. We successfully implemented changes to products and processes generated by the UK Government's Covid-19 support schemes and have delivered to desired deadlines. Where roles could not operate from home, or on-site training/coaching was required, we have transformed our Head Office sites into Covid-19 safe environments with temperature checks, health questionnaires, screens, signage, and one-way systems. Working locations and arrangements for employees not based in branches will remain the same until the start of May 2021, when we will again review the situation.

Following the UK's exit from the transition period on 31 December 2020, we continue to focus on assessing the potential impacts of the new Trade and Cooperation deal on our customers and our business. Our Brexit Planning was developed on the basis of a 'no deal' scenario and remains relevant, as the initial agreement with the EU mainly relates to goods and does not cover financial services in any significant detail, as expected. Therefore we continue to manage with reference to those plans, as the new relationship with the EU evolves, which address a number of areas requiring cross-divisional communication including: financial markets infrastructure, cross-border data flows, international payments, third-party service, cyber risk, operational resilience, and internal and external stakeholder communications.

Our Brexit planning continues to be overseen by the Board and the Senior Management Committee (SMC). Our Brexit Working Group consists of senior representatives from across the business and support functions, who meet regularly and escalate areas that require further focus and attention to the Board and the SMC.

We are also exposed to tax risk which, even though it is a lower risk for us, is still a high-profile risk and may include legacy items. We define tax risk as the risk that we fail to comply with domestic and international tax regulations because we misinterpret legislation, regulations or guidance, or we report to the tax authorities inaccurately or late. This could lead to financial penalties, additional tax charges or reputational damage. Santander UK adopted the Code of Practice on Taxation for Banks in 2010. For more on this, see our Tax Strategy at www.santander.co.uk/about-santander/sustainability/taxation-strategy.

In 2020, we responded to the UK regulators' Consultation Papers (CPs) on building operational resilience in the financial services sector issued in December 2019. We have since been actively engaged in industry collaboration groups and with UK Finance to support the development of operational resilience best practice. We also conducted a pilot to assess our operational risk and resilience-related practices against the CPs' requirements. We are developing an enhanced set of activities to support a new target operating model to further strengthen our capability to deliver operations through disruption. We have started a programme of work to deliver these enhancements through 2021 and 2022 as well as to address the regulatory requirements which are due to be issued in Q1 2021.

Banco Santander aims to cut total carbon emissions by 46% between 2019 and 2025. In order to support the transition to a low carbon economy and minimise the environmental impact of our energy use, we are committed to continual improvement in the energy performance of our property operations. We maintain ISO 50001 energy management systems in all head office buildings, and we set annual energy reduction targets to drive improvement in energy performance. Our Operational Risk Framework requires that all business units consider the impact of risks related to climate change in their risk management processes.

OPERATIONAL RISK MANAGEMENT

Risk appetite

We set our operational risk appetite at a Santander UK group level and we express it through measures approved by the Board. These include risk statements and metrics set against our principal non-financial risk loss event types. We cascade our appetite across our business areas by setting out clear lower level triggers, qualitative parameters and quantitative thresholds. We monitor our risk profile and performance against the risk appetite under several Principal Risk Areas, and we also have processes to enable us to identify, manage and escalate risks and events, and our governance requires us to mitigate or accept all identified risks.

Coverage across the seven CRD IV loss event types is comprehensive and aligns to principal risk areas approved by ERCC. As a result, we have specific embedded monitoring and measurement of our operational risks, including our top three operational risk types which are as follows:

- **Cyber:** We have a comprehensive set of Risk Appetite statements and metrics which have been agreed by the Board, and which allow us to measure our cyber risk. We have defined statements and metrics with key subject matter experts in our Cyber and IT teams, and we incorporate Banco Santander group principles and standards, regulatory requirements and industry best practice, where applicable.
- **Change and transformation:** Change is one of our risk appetite areas of focus, ensuring we can specifically monitor risk appetite in relation to Change via a clearly defined suite of statements and metrics. Consideration of Change risk appetite is embedded within our project risk governance methodology, as part of the approval of every project's Business Case. We specifically monitor Change risk related to Regulatory change initiatives via statements and metrics. We also consider Change risk within our IT & Cyber Risk appetite to address obsolescence considerations as part of our change agenda, and as part of our third party risk appetite, in line with their increasing involvement in Change and Transformation related activities.
- **People:** We have People-related Risk Appetite statements and metrics which have been agreed by the Board. We use these to measure our People risk, including the well-being of our employees, and to inform employee relations and engagement. We employ subject matter experts in our HR function to help us to monitor and manage our people risk. Formal actions are required to address and mitigate any measures which are reported out of tolerance. We communicate, action, and escalate, as needed, any material issues to the Board.

Risk measurement and mitigation

The key components of the operational risk toolset we use to measure and mitigate risk are:

Operational risk toolset	Description
Operational risk and control assessments	Our business units identify and assess their operational risks to ensure they manage and control them within our operational risk appetite. They also ensure that we prioritise any actions needed. Every area has to identify their risks, assess their controls for adequacy and then accept the risk or formulate a plan to address any deficiencies. We also use operational risk assessments and project risk rating tools as
Risk scenario analysis	We perform this across business units. It involves a top down assessment of our most significant operational risks. We have a set of scenarios that we review and update each year. The analysis gives us insight into rare but high impact events. It also allows us to better understand the potential impacts and to address any issues.
Key indicators	Key indicators and their tolerance levels give us an objective view of the degree of risk exposure or the strength of a control at any point in time. They also show trends over time and give us early warning of potential increasing risk exposures. Of primary importance are business-wide risk appetite indicators which measure our adherence to our defined risk appetite statements.
Operational risk losses	Our operational risk loss appetite sets the level of total operational risk loss (expected and unexpected) in any given year (on a 12-month rolling basis) that we consider to be acceptable. We track actual losses against our appetite, and we escalate as needed.
Operational risk event management	Operational risk events occur when our controls do not operate as we planned and this leads to customer impact, financial loss, regulatory impacts and/or damage to our reputation. We have processes to capture and analyse loss events. We use data from these processes to identify and correct any control weaknesses. We also use root cause analysis to identify emerging themes, to prevent or reduce the impacts of recurrence and to support risk and control assessments, scenario analysis and risk reporting.
Risk based insurance	Where appropriate, we use insurance to complement other risk mitigation measures.

We mitigate our key operational risks in the following ways:

Key risks	Risk mitigation
Cyber	<p>Protecting our customers, systems and data remains a top priority for us. Online security and data breach stories, along with many reports of scams and online fraud, continue to feature in the press. All organisations, including banks, are in an ongoing race to keep ahead of criminals who are becoming ever more sophisticated and destructive in their approach. Criminals persist in attempts to deny our customers access to our digital channels, target online services and data, or steal online credentials and appropriate funds by various methods, including social engineering.</p> <p>We continue to enhance our resilience to cyber disruption as our Security and Information Technology teams continually identify and assess technological risks. They are guided by standardised, industry-leading control frameworks to ensure that we remain within our operational risk appetite. We measure the maturity of our controls in terms of their design and effectiveness and when combined with our cyber threat intelligence, we use it to define and prioritise our programmes of mitigation. We have processes to capture and analyse events from our security systems that drive escalation processes as needed. We operate a layered defence approach to cyber risk which we test and assess continually to ensure that it addresses the prevailing threats. Our comprehensive approach to validating our controls includes tests designed to replicate real-world cyber-attacks with test findings driving our ongoing improvement plans. As part of this, we participate in industry wide cyber security stress tests, such as CBEST, through to weekly cyber testing of our internet facing digital services that enables us to compare against our peers.</p> <p>But keeping our systems secure is a bank wide responsibility and we continue to enhance our training programmes for employees to support this. We have Board-level expertise and supervision in cyber security matters to ensure robust monitoring and challenge. We also have targeted training for Board members and senior management and other employees who may be singled out by criminals, such as those facilitating payments. New cyber security training ensures that everyone understands the threats we face, and that we all have the expertise to spot emails from criminals and attacks on our systems. We continue to work with other banks as members of the Cyber Defence Alliance, where we share intelligence on cyber threats and effective strategies to counter them.</p> <p>We campaign to raise awareness and give customers the knowledge they need to avoid becoming victims of fraud. We use robust technology to protect our customers, in particular to look for anomalous behaviour or malicious software on customer devices, and we continually invest in the fight to counter scams. As part of this, we run customer education campaigns, and we offer advice through our online security centre.</p> <p>There have been no material security breaches to date, and we are highly vigilant at all times. We have a cyber insurance policy to provide us with immediate response to assess and control the impact of a breach.</p>
Change and transformation	<p>We are constantly changing to maximize technological innovation, evolve business models and give our customers the best possible service. This includes the introduction of new third-party suppliers, the adoption of new technologies and business models, organisational changes, and dealing with legacy systems and processes. Our operational risk exposure increases when we make changes, and the risks can compound when several changes happen at the same time. The scale of change that we are currently planning and managing is unprecedented for us.</p> <p>In order to support the constant need for change whilst minimising the operational risk, we review:</p> <ul style="list-style-type: none"> – The risk management of individual projects – The risk management of the aggregate change from our portfolio of projects – Our capacity and capability to deliver the overall change agenda. <p>For individual projects, our Change risk management process starts with an early assessment of the change impact using the Project Risk Rating (PRR) tool, which determines the level of subsequent risk management required. Projects with higher change impacts are required to track risks and mitigating actions using the Operational Risk Assessment (ORA). Operational risks for all material changes in each new project, product and supplier are assessed before they are allowed to go ahead. At the portfolio level, we monitor our portfolio for concentrations of change which can compound a risk or place high demands for our teams to deliver several changes at once. In terms of our overall capacity and capability, we constantly recruit, train and upskill more dedicated project managers to support the delivery of our overall change agenda. We track and monitor the number of regulatory projects with a red risk status (under our Transformation Office's Execution Risk Management Framework). We give priority to our regulatory change projects for funding and delivery.</p> <p>Our Risk and Control Self-Assessment (RCSA) captures the risks related to Change and Transformation that are identified by the business, alongside an assessment of the effectiveness of the controls, and the residual risk exposure. We log any operational risk events that occur and escalate them through our operational risk Santander Early Escalation Notification (SEEN) process.</p>
People	<p>We mitigate the People risks associated with wellbeing impacts of Covid-19 and the remote working environment using virtual meeting tools and keeping-in-touch schemes. We also provide regular communications and other support. We are also aware that extended remote working arrangements may increase ergonomic risks; we are mitigating such risks through Occupational Health Service support and assessments for individuals where these are appropriate. We launched a 'Coronavirus Hub' in April 2020, to support employees and people managers during this challenging time. We track and monitor all related indicators, with a focus on those with red risk status. All significant people-related change initiatives must have Operational Risk Assessments conducted. We have processes to capture and assess people-related events, as well as operational risk indicators in place to measure the ongoing People risk profile of our business.</p>

Risk monitoring and reporting

Reporting is a key part of how we manage risk. It ensures we identify, escalate and manage issues on a timely basis. We can identify exposures through our operational risk and control assessments, risk scenario analysis, key indicators, operational risk assessments and incidents and events. We report exposures for each business unit through regular risk and control reports. These include details of risk exposures and how we plan to mitigate them. We prioritise and highlight events that have a material impact on our customers, reputation or finance by reporting them to key executives and committees.

We use The Standardised Approach (TSA) for Pillar 1 operational risk capital needs. We use an internal model aligned to the CRD IV advanced measurement approach to assess our Pillar 2 capital needs.

We have a crisis management framework that covers all levels of the business. This includes the Board, Executive Committee, senior management and business and support functions. Our framework identifies possible trigger events and sets out how we will manage a crisis or major incident and we test it at least annually. If an event occurs, we have business continuity plans in place to recover as quickly as possible and we undertake post incident reviews to ensure any learnings are taken forward. These are aligned with our key customer journeys and delivery of critical IT services.

Cyber

We base our monitoring and reporting on the metrics and operational dashboards in our cyber security and IT functions. Our Cyber Threat Unit and experts carry out analysis in the worldwide Santander Security Operations Centre in Madrid. We use a wide range of key risk indicators, threat intelligence reports and results from security testing to identify improvements to our cyber defences. Our operational teams, with input from Risk, review these trends and steer management activity where required.

We also formally track our cyber and technological risks against our risk appetite through a monthly risk control forum. Part of the forum's remit is to identify changes in risk posture and to inform senior risk committees of any significant changes. Issues such as technological obsolescence and the challenges in keeping our technologies free from known vulnerabilities, are examples of where a metric-driven approach to reporting through our risk management frameworks has led to proactive mitigation of risk.

Change and transformation

We monitor and report Change and Transformation risks by reviewing the project PRR and ORA, both for individual projects and at a more aggregated level. In addition, we monitor and report Change and Transformation risks in the relevant governance stream for the type of change. For example, products, services and technological changes have specific governance with their own operational risk reporting requirements. We report an aggregated view of change risk by every business division, at least each quarter, using our Non-Financial Risk Dashboard. We capture risks related to change and transformation identified by the business in our RCSAs, and we report operational risk events related to change using the SEEN process. We oversee Change and Transformation, including the related risks, through our Transformation Dashboard, which is regularly reviewed by the Board.

People

We formally track our People risk profile against our risk appetite through our monthly HR Risk and Control Forum and other Risk Governance Fora. We use key risk indicators to support our monitoring activity and we report them to this Forum. We escalate any significant risks, or changes in the risk profile, to the relevant senior risk committees and the Board where appropriate. We report a monthly aggregated view of People risk in terms of sickness absence, wellbeing and attrition. We use the results of regular wellbeing surveys to help drive our areas of People focus.

OPERATIONAL RISK REVIEW

Operational risk event losses

The table below shows our operational losses in 2020 and 2019 for reportable events with an impact over £10,000, excluding conduct risk events (which we discuss separately in the 'Conduct and regulatory risk' section), by CRD IV loss event types. We manage some of these risks using frameworks for other risk types, including regulatory and financial crime risk even though we report them here.

	2020		2019	
	Value %	Volume %	Value %	Volume %
Internal fraud	1	—	—	—
External fraud	58	89	30	80
Employment practices and workplace safety	1	1	—	—
Clients, products, and business practices	34	3	39	6
Business disruption and systems failures	1	—	2	1
Execution, delivery, and process management	5	7	29	13
	100	100	100	100

2020 compared to 2019

In 2020 we did not experience any material operational risk losses. Aligned to the rest of the industry, we experienced an increase in Push Payment fraud volumes and losses with external fraud now accounting for 59% of all losses over £10,000. In addition, provisions were raised to cover customer remediation programmes and associated costs. Overall, whilst we experienced an increased level of loss against 2019, the level remained comfortably within our forecast and 2020 risk appetite.

Cyber

We rely extensively on the use of technology to support our customers and to run our business. This includes internal platforms, such as our core banking systems, mortgage platforms, telecommunications, remote working and finance systems, and customer-facing platforms such as our mobile app and online banking websites. The use of technology and the internet have changed the way we live and work, and the Covid-19 pandemic has further evidenced the reliance on technology. Technology and the internet allow us to develop and improve the way we serve our customers. It is critically important that we protect our customers' information and provide them with a secure environment in which to deal with us, especially when the threat from cyber criminals is so prevalent and more sophisticated than ever.

As such, information and cyber security remains a top risk and a priority. We experienced no notable information and cyber security incidents in 2020. Cyber threats continue to increase and evolve in sophistication as criminals seek new ways to monetise their efforts. Externally in 2020, we saw a large increase in ransomware attacks across all sectors and we expect this trend to continue. As a result, we continue to review and enhance our ransomware controls based on the latest intelligence. We actively work with peers in the Cyber Defence Alliance to share threat intelligence, expertise and experience to help identify common features of cyber-attacks and effective mitigation strategies.

Covid-19 related cyber activity has so far had limited impact on the finance sector. There has been a notable increase in Covid-19 phishing lures reaching our staff, however our technical controls and awareness training have provided strong mitigation. We also monitor a range of other common cyber threats including attacks on payment systems, ATM networks and third-party suppliers, where insider threat and network intrusion are the most common methods of attack. We have taken mitigating action against these threats including deploying a cyber threat intelligence platform, increased intelligence through chairing the Geopolitical Financial Services working group and enhancing online service access construction to further strengthen our resilience against Distributed Denial of Service attacks. Our cyber transformation programme continues to enhance our control environment and ensures we deliver secure products and solutions for our customers and the communities we serve. We also continue investing to maintain the right skills and resources to manage information and cyber security risk effectively across all our lines of defence.

Change and transformation

Following a substantial review of our portfolio of change in 2019, we set up a transformation programme (Transforming for Success) to transform us into a digital bank that serves our customers and colleagues with improved customer journeys and colleague experiences. This was accompanied by the launch of an updated project governance framework, known as One Governance, and the implementation of a new project governance tool (Wave) by the COO division in Q4 2020, to further strengthen project planning and prioritisation, cost discipline and risk management. One Governance and Wave bring all Santander UK plc group project portfolios under one unified system environment, and embed risk requirements within the project governance system workflow for the first time. The key risk requirements are the Project Risk Rating (PRR), the Executive Risk Summary (ERS) and the Operational Risk Assessment (ORA). The PRR enables us to identify the risk profile of initiatives at the earliest opportunity, prioritising subsequent risk management for higher-risk initiatives. The ERS provides a 'live' summary of key risks related to an initiative's business case for senior management, supporting the funding decision and then throughout the project lifecycle. The ORA captures a more detailed assessment of an initiative's risks, relevant controls and mitigating actions, tracking them through execution to closure. We continue to refine our operational risk management methodology, particularly to support the shift away from traditional 'waterfall' funding models to more iterative funding approaches and agile development.

People

As noted above, people risk increased significantly in 2020, mainly driven by Covid-19. As the Covid-19 pandemic developed, we increased our focus on people-related issues to support and maintain colleague wellbeing through ongoing communications and bank-wide support. The results of regular Employee Surveys conducted throughout 2020 continued to reflect positive satisfaction levels. Notwithstanding this, the Covid-19 environment remains challenging, with a third lockdown in January 2021 accompanied by seasonal factors, likely to impact on mental health, fatigue and increased absence. We continue to adapt our strategy to allow for these factors, along with the potential impact on productivity. People risk is also compounded further by other factors including outsourcing activities, changes in operating models, and execution of future strategies, which we recognise need to be managed carefully.

LIBOR transition

Whilst the Bank of England and the FCA have recognised the challenges presented by Covid-19 to the industry-wide IBOR transition by adjusting some interim milestones, we have continued to make progress on this transition and remain on target to meet industry and regulatory deadlines. We are transforming key systems and processes to deal with the new risk-free rates. We expect some increase in operational risk in the transition as we embed new systems and processes, particularly as differing responses across jurisdictions may need multi-stage transitions for products with cross-currency dimensions. For quantitative information, see Note 43 to the Consolidated Financial Statements.

Data management

Data Management continues to increase in importance. We have invested and are making good progress with our ability to identify and manage key risks such as data quality. We have implemented a data governance model including a Senior Data Forum which reports to the SMC, Board Audit Committee and Board Risk Committee. We are also enhancing our data management architecture to better support our Digital Transformation strategy.

Operational resilience

The Bank of England, PRA and FCA published a consultation paper in December 2019 to help financial firms evolve their approach to operational resilience. The regulators recognised the Covid-19 impacts across the industry in early 2020 and extended the time to respond to the paper by six months to the end of October 2020 to allow lessons learnt from the Covid-19 pandemic to be considered in the final regulations due to be published in H1 2021. They expect firms to assume disruptive operational incidents will occur, and be able to show that they can withstand, absorb, recover and manage these in a way which considers the needs of all affected parties. We are improving our operational resilience by enhancing our working from home capability as well as the operational risk and resilience framework and implementing a Board-approved strategy. This will focus on defining our key business services, providing enriched data, and mapping our end-to-end process dependencies. It will also set, approve and test the impact tolerances of our ability to provide those services to the limit. In addition to regulatory compliance, this will achieve business and operational benefits through a programme of work in 2021 designed to embed operational resilience in our Digital Transformation programme as well as day-to-day activities.



Resilience in Covid-19

The key challenge in delivering the Covid-19 lockdown contingency solution was the rapid ramping up of our Remote Access Service (RAS) solution and deployment of IT equipment to allow the majority of our head office workforce to work from home.

We mobilised our Covid-19 response before the UK Government announced its lockdown restrictions in March 2020. Whilst the RAS technology was well understood and has been in use for many years, the pace with which the infrastructure needed to be upgraded to support the extra staff numbers meant we had to include multiple tactical technical solutions during the implementation. We prioritised staff performing critical activities for the deployment of IT equipment and we reallocated remote access licences to priority staff. In parallel, our Procurement team sourced additional laptops to replace office-based desktops. Over 7,500 additional laptops were purchased, configured and distributed to staff.

We reconfigured meetings and communications to operate over Microsoft Teams and the Outlook Web App to reduce our dependency on RAS for basic day-to-day operations. Our extended use of remote access to allow staff to operate outside of the office has been key to our Covid-19 response. Within a period of only a few weeks, we had 90% of our head office staff operating from home whilst the business remained operationally stable and able to maintain service to our customers.

Other key risks

Overview

In this section, we describe how we manage our other key risks and discuss developments in the year. Our other key risks are:

- **Financial crime risk:** the risk that we are used to further financial crime, including money laundering, sanctions evasion, terrorist financing, bribery and corruption.
- **Legal risk:** the risk of loss arising from legal deficiencies in contracts; failure to protect assets; failure to manage legal disputes appropriately; failure to assess or implement the requirements of a change of law; or failure to comply with law or regulation or to discharge duties or responsibilities created by law or regulation.
- **Strategic and business risk:** the risk of significant loss or underperformance against planned objectives; damage arising from strategic decisions or their poor implementation that impact the long-term interests of our key stakeholders, or from an inability to adapt to external developments.
- **Reputational risk:** the risk of damage to the way our reputation and brand are perceived by the public, clients, government, colleagues, investors, or any other interested party.
- **Model risk:** the risk that the prediction of our models may be inaccurate, causing us to make sub-optimal decisions, or that a model may be used inappropriately.

FINANCIAL CRIME RISK

OUR KEY FINANCIAL CRIME RISKS

We are committed to conducting business in accordance with regulatory and legal requirements and the highest ethical standards. We believe that having a comprehensive and effective financial crime framework through policies, procedures, systems and controls to prevent and detect financial crime is a business imperative and a positive investment that protects us from legal, regulatory and reputational risks. Financial crime is a high priority risk for us. We recognise that financial crime activities can have a significant impact on our customers. Criminals use the financial system to launder the profits of illegal activity such as human trafficking and to fund terrorism. We may be adversely affected if we fail to effectively mitigate the risk that third parties or our employees facilitate, or that our products and services are used to facilitate financial crime. The bank wide anti-financial crime strategy (AFC) sets out the principles of 'Deter, Detect and Disrupt'. We adopt a risk-based approach in line with UK and international laws and standards, and we work with government, law enforcement and the private sector to help meet our commitments and to inform our AFC strategy.

Our key financial crime risks are:

Key risks	Description
Money laundering	We are used by criminals to transform the proceeds of crime into seemingly legitimate money or other assets.
Terrorist financing	We are used by terrorists to deposit, distribute or collect funds that are used to fund their activity.
Sanctions	We do not identify payments, customers or entities that are subject to economic or financial sanctions.
Bribery and corruption	We fail to put in place effective controls to prevent or detect bribery and corruption.
Facilitation of tax evasion	We fail to put in place effective systems and controls to prevent the facilitation of tax evasion.

FINANCIAL CRIME RISK MANAGEMENT

Risk appetite

We are committed to complying with all applicable financial crime regulations and legislation that prevent Santander UK from being used to facilitate financial crime. Financial crime risk appetite is the level of financial crime risk we are prepared to accept in carrying out our activities. This is approved at Board level and disseminated across the business, with limits specified to control exposures and activities that have material concentration risk implications for us and the communities we are part of. Our customers and shareholders will be impacted if we do not mitigate the risks of Santander UK being used to facilitate financial crime. We seek to comply with applicable UK and international sanctions laws and other regulations and make sure our risk appetite adapts to external events. We have minimal tolerance for residual financial crime risk, bribery and corruption risk, and zero tolerance for sanctions. We require employees to act with integrity, due diligence and care, to those who breach our policy and regulatory requirements.

Risk measurement

We measure our exposure to financial crime risk regularly. Our AFC strategy along with frameworks sets the strategic direction for risk management by defining standards, objectives and responsibilities for all areas of the business. It supports senior management in effective risk management and developing a strong risk culture. We screen and risk rate all our customers and monitor activity to identify potential suspicious behaviour. We complete ad-hoc reviews based on key trigger events. Our Financial Intelligence Unit assesses specific types of threat, drawing on data from law enforcement and public authorities.

Risk mitigation

We take a proactive approach to mitigating financial crime risk. Our financial crime risk frameworks are supported by policies and standards which explain the requirements for mitigating money laundering, terrorist financing, sanctions compliance risks, bribery and corruption, and facilitation of tax evasion risks. We update these regularly to ensure they reflect new requirements and industry best practice. We support our colleagues to make sure they can make the right decisions at the right time. We raise awareness and provide role-specific training to build knowledge of emerging risks.

Key elements of our financial crime risk mitigation approach are that we:

- Undertake customer due diligence measures for new and existing customers, which include understanding their activities and banking needs
- Conduct risk assessments of customers, products, businesses, sectors and geographic risks to tailor our mitigation efforts
- Ensure all our staff complete mandatory financial crime training and, where required, role-based specialist training
- Deploy new systems to better capture, analyse and act on data to mitigate financial crime risks
- Partner with public authorities, the Home Office and the wider financial services industry to pool expertise and data. We are also involved in partnerships such as the Joint Money Laundering Intelligence Taskforce (JMLIT) which supports public-private collaboration to tackle financial crime.

Risk monitoring and reporting

We use key risk indicators to monitor our exposure to financial crime risks, and we report all issues in a timely manner. We work closely with subject matter experts across the business on all risk management and monitoring activities alongside more effective communication of policy changes. Regulators around the world continue to emphasise the importance of effective risk culture, personal accountability and the adoption and enforcement of risk-based requirements and adequate internal reporting processes and procedures. We continue to develop and enhance our financial crime operating and governance model to ensure that our control environment evolves at pace, keeping up with new or amended laws, regulations or industry guidance.

We adhere to a strong governance and reporting schedule to our ERCC and Financial Crime Committee, including analysis of the risks on the horizon, key risk indicators and a directional indication of the risk profile. Throughout the year, management continued to update the risk committees on management and mitigation of financial crime risks including our activities to understand and address emerging challenges. We have introduced an enhanced set of financial crime risk indicators for effective risk reporting to senior management. We also regularly report to the Board Responsible Banking Committee on financial crime risk, the impact on the business and the actions we are taking to mitigate the risk.

FINANCIAL CRIME RISK REVIEW

2020 compared to 2019

In 2020, we continued to progress towards a more sustainable and effective strategic financial crime compliance approach. Engagement on the topic from senior management and the Board has remained high, proportionate to one of our top risks. We continued embedding our AFC strategy, policies, and improving training across the business in 2020, endorsed by senior management.

Our Board continued to support investment to improve improvements to systems and controls to increased efficiency through automation. We assigned investment to design and establish a Centre of Excellence to manage end-to-end financial crime operations, designed to develop a talented workforce with the right skill sets and cultural approaches. In 2020, we also set up the Control Acceleration Programme (CAP) to provide near-term risk mitigation and demonstrable evidence of enhancements to key controls. In 2020, we promoted the embedding of the AFC culture across the business by establishing a defined framework.

The financial crime landscape continued to be complex through 2020, with evolving regulatory and legal requirements, geo-political factors and changing criminal methods influencing the risks we face. In 2020, we updated our AML, Sanctions and Anti Bribery and Corruption (AB&C) policies and standards to ensure that all current external obligations are reflected appropriately, and we continued to proactively monitor external developments and with particular regard to post-Brexit requirements. We take a proactive approach to engagement with the FCA and HM Government, including through our participation in the Economic Crime Reform Program. This external engagement helps inform our internal policies and strategies.

We also continued to proactively participate in external partnerships of a more operational nature, including the Joint Money Laundering Intelligence Task Force. We built partnerships with Regional Organised Crime Units and with NGOs. These partnerships enabled us to learn more about emerging risks and turn these into alerts and intelligence briefings that are communicated to colleagues across the bank to support proactive prevention and detection of financial crime risks.



Raising fraud awareness

In 2020, we continued our focus on raising consumer awareness of fraud, with creative and eye-catching media campaigns designed to address current scam trends and grab people's attention by delivering important messages in ways they wouldn't expect.

In June 2020, we tackled 'safe account scams' by recreating the famous bubble bath scene from the film 'The Big Short' where Margot Robbie unlocks the jargon around financial terms. We used our own Robbie (former footballer Robbie Savage) to explain safe account scams - from a bathtub, of course! The video was shared by Robbie on his social media accounts and his posts were shared by a number of high profile footballers - which along with widespread media coverage, helped spread the word far and wide.

Later in 2020, we turned our attention to the issue of 'investment scams', a type of fraud that has seen a significant rise over the last year, with victims losing an average of £10,000. We created a campaign that aimed to 'use rhymes to prevent financial crimes' and commissioned poets Pam Ayres and Suli Breaks to pen the Santander Scam Sonnets. Each poet used real case studies of scams as the background to their poems which warned people what to look out for to avoid becoming the victim of an investment scam. Through wide-ranging media interviews and posts across social media, our poets helped share the message and keep people safe across the UK.

LEGAL RISK

Legal risk includes the legal consequences of operational risk, such as breach of contract, and operational risk with legal origins, such as a legally defective contract. We manage legal risk as a standalone risk type to reflect the continued pace and breadth of regulatory change across financial services.

We define legal risk as losses or impacts arising from legal deficiencies in contracts or failure to:

- Take appropriate measures to protect assets
- Manage legal disputes appropriately
- Assess, implement or comply with law or regulation
- Discharge duties or responsibilities created by law or regulation.

Legal risk management	Description
Risk appetite	We should aim to make decisions and operate in a way that does not lead to legal risk. We apply robust controls to manage these risks and we have a low tolerance for residual legal risk.
Risk measurement	Due to the close links between our legal and operational risk frameworks, our tools to identify, assess, manage and report operational risks also apply where such exposures have a legal risk impact.
Risk mitigation	The Legal teams provide specialist advice and support to all business units to ensure we effectively manage legal risk. They help to implement a strong legal risk culture throughout our business using guidelines, templates, policies and procedures and specific support on a product, service, transaction or arrangement basis and decide whether legal advice should be sourced internally or externally.
Risk monitoring and reporting	An internal legal risk reporting framework is in place to provide visibility of the Santander UK-wide legal risk profile. We provide regular updates of our key legal risks, issues or breaches, to senior management and the Board through our Legal & Regulatory Division. This is in addition to reports issued by the business.

2020 compared to 2019

Our legal risk profile remained heightened but broadly stable in 2020, reflecting the high number and value of legal risks that continue to be managed.

We prepared for the changes of law and regulation arising from Brexit, including compliance frameworks in relation to new and existing transactions or arrangements. We took into account the EU-UK Trade and Cooperation Agreement in relation to financial services and the lack of uniformity in legal and regulatory regimes in EEA member states in relation to products and services we provide, undertake or offer to EEA based customers. The measures we have taken remain under review as the post-Brexit regulatory landscape evolves.

Progress continues to be made through the LIBOR transition programme to manage the legal risks related to IBOR transition, with our accession to the ISDA fallback supplement protocol, successful consent solicitations in relation to outstanding debt securities and the development of plans to outreach to our CCB and CIB clients to effect amendments to affected contracts. Some of the legal risks related to LIBOR transition may be mitigated by powers proposed to be granted to the FCA under the Financial Services Bill to enable a 'tough legacy regime' using a synthetic LIBOR.

We have developed a third party supplier contracting standard, reflecting the EBA guidelines on outsourcing, to help us manage legal risks as part of our third party risk management framework. We have taken steps to address certain CCA and PSR related points and to complete the remediation of issues associated with failure to implement overdraft alerts as part of the Competition & Markets Authority Market Investigation Order.

Nevertheless, legal risks continued to emerge and develop throughout 2020. The Covid-19 pandemic and the measures taken by the UK Government and regulators to address it generated a range of legal risks, including in relation to the shift of our employees to mainly work from home, payment holidays and other forms of forbearance granted to our customers and the scope and requirements of the UK Government's Coronavirus Loan Schemes. Litigated PPI claim volumes continued to increase and there is evidence of claim management companies testing mortgage-related claims. Changes to the UK insolvency regime through the Corporate Insolvency and Governance Act 2020 and the introduction from May 2021 of moratoriums under the Breathing Space Regulations require assimilation by affected business units. We continue to identify, assess and manage the legal risks associated with implementing our transformation programme, including making sure that we reflect contractual terms and legal requirements in our systems and operating processes. We will continue to manage these risks in 2021.

In 2020, we put in place further oversight of external spend, and we continued to simplify and cascade our processes to drive even greater consistency and discipline. We expect further improvements in 2021 with the development and implementation of an automated legal spend tool. This will enable greater oversight and challenge of all legal spend across the Santander UK group.

STRATEGIC AND BUSINESS RISK

Strategic and business risk could impact our long-term success if it caused our business model to become out of date, ineffective, or inconsistent with our goals. This could arise if we:

- Have an incomplete picture of our environment, such as the economy, regulation, competitor activity and changes in technology and customer expectations
- Misjudge our capabilities, or ability to implement our strategy
- Pursue initiatives like acquisitions that do not fit with our business model or miss opportunities that we could benefit from.

Strategic and business risk management	Description
Risk appetite	We have a low to moderate appetite for strategic and business risk. This limits the risks we are prepared to take to achieve our strategic objectives and is aligned to our balanced, customer-centric business model.
Risk measurement	Our Board and senior management regularly review potential risks with our operations and plans to ensure we stay within our risk appetite.
Risk mitigation	We manage strategic and business risk by having a clear and consistent strategy that takes account of external factors and our own capabilities. We have an effective planning process which ensures we refine, strengthen, and adapt our strategy to reflect changes in the environment and other key risks and opportunities.
Risk monitoring and reporting	We closely track our business environment, including long-term trends that might affect us in the future. As part of this, we report a range of indicators. These include our KPIs as set out in the 'Strategic report'.

2020 compared to 2019

Our business environment is always changing, and this affects how we do business. The Covid-19 pandemic and UK national and regional lockdowns have been a significant challenge impacting the economic backdrop as well as our business operations and financial results. Our top priority throughout has been the welfare of our people, our customers and the communities in which we operate. We have adapted by supporting our customers with a range of measures such as payment holidays and UK Government's Coronavirus Loan Schemes, as well as enhancing online services and doing our utmost to continue to offer important services face-to-face, especially for our more vulnerable customers. The learnings we take from the crisis will help us to become even more agile, efficient, and responsive to the needs of our customers, and enable us to emerge as a stronger and more resilient bank.

Competitive pressures remained high in 2020, mainly from established players, but new technology-led entrants could disrupt the market in the longer term. We expect these trends to continue in 2021, but we believe our customer-focused business model and strategy, and our adaptable and innovative approach, will support our continued success.

Overall, we remain focused on customer loyalty, simplification, improved efficiency, and sustainable growth as we continue to transform the business for success. This will enable us to meet the changing needs of our customers and deliver improved returns over the medium-term. For more on this, see the 'Strategic report'.

REPUTATIONAL RISK

Our key reputational risks arise from both internal and external factors. Failures in corporate governance or management, failing to treat our customers fairly, the actual or perceived way we do business, and the sectors and countries we deal with can impact on our reputation. We also consider how our clients and those who act for us conduct themselves, and how business is conducted in our industry.

External factors which can include the macro environment and the performance of the sector must be considered. In 2020, both these elements were significantly impacted by the Covid-19 pandemic and the response of the UK government to support the economy. Sustained damage to our reputation could have a material impact on our ability to operate fully. In turn, this could affect our financial performance and prospects. Reputational risk is not static; today's decisions may be judged by different standards tomorrow. We build this into our risk culture, evaluation and sanction procedures.

Reputational risk management	Description
Risk appetite	We have a low appetite for reputational risk, which is agreed by the Board at least each year. We express it in terms of the risk measures set out below.
Risk measurement	We assess our exposure to reputational risk daily. We base this on expert judgement and analysis of social, print, and broadcast media, and the views of political and market commentators. We also commission independent third parties to analyse our activities and those of our UK peers to identify significant reputational events, or a prolonged decline in our reputation and any sector level or thematic issues that may impact our wider business. We also measure the perception of Santander UK amongst key stakeholder groups through regular interactions and perform annual reviews of staff sentiment. We review our reputation daily through media and political interactions and updates, and through weekly reputation reports from an external supplier.
Risk mitigation	Our business units consider reputational risk as part of their operational risk and control assessments. We also consider it as part of our new product assessments. Our Corporate Communications, Legal and Marketing team helps our business units to mitigate the risk and agree action plans as needed. They do this as part of their role to monitor, build and protect our reputation and brand.
Risk monitoring and reporting	We monitor and report reputational risks and issues on a timely basis. Our Reputational Risk Forum reviews, monitors and escalates to Board level key decisions on reputational risks. It also has regular and ad-hoc meetings to discuss the risks we face. We escalate them to the ERCC and Board Responsible Banking Committee, as needed. Our Corporate Communications, Legal and Marketing teams also reports regularly to our Executive Committee on Corporate Social Responsibility, Sustainability and Public Affairs policies. They do this from an environment, community and sector point of view.

2020 compared to 2019

In 2020, our key reputational risks lay in our response to the Covid-19 pandemic. To manage this, we regularly and proactively shared information with key external stakeholders on the numerous actions we took to support customers, colleagues and communities over the course of the year. Particular areas of external focus included our provision of payment holidays for customers, our participation in the UK Government's Coronavirus Loan Schemes for businesses and our ability to provide daily services from the branch network, contact centres and our online platforms.

We also worked to manage the impact of the UK's departure from the EU and the end of the transition period. We developed communications for our customers to advise them on any potential impact from Brexit to the products and services they enjoy, at the same time as giving reassurance on our ongoing commitment to serving the UK.

Our Reputational Risk Forum continued to meet regularly to discuss our emerging and material risks, bringing together senior representatives from across the business, alongside the use of our formal Reputational Risk Register. This ensured that reputational risk is a leading consideration with the ERCC and the Board Responsible Banking Committee. This maintains the visibility and discussion of reputational risk issues at Board level.

MODEL RISK

Models typically analyse data to look for relationships, formulating a methodology with a set of assumptions and parameters. Generally, we consider a model to be any method that relies on assumptions to produce estimates of uncertain outcomes. Our key model risks arise from weaknesses and limitations in our models, or the incorrect use of a model. They include risks stemming from model data, systems, development, performance and governance. The most material models we use help us calculate our regulatory capital and credit losses, and perform stress tests. Increased regulatory standards influence how we manage and control model risk. During 2020, we significantly enhanced our Capital Adequacy models to ensure they comply with these new regulatory standards. The Covid-19 pandemic impacted our models so we put in place additional levels of monitoring to ensure they remain fit for purpose. In order to calibrate models based on the new macroeconomic variables as a result of Covid-19, where applicable we use post model adjustments until the variables are built into our models.

Model risk management	Description
Risk appetite	We express our model risk appetite through risk assessments of our key risk models. The Board is asked to agree this at least each year.
Risk measurement	We consider both the percentage of models that have been independently assessed, and the outcome of those reviews, in how we measure model risk. All models have several assumptions and in general the more limitations we have for those assumptions, the higher the levels of uncertainty and therefore model risk.
Risk mitigation	We mitigate model risk through controls over how we use models throughout their life. We maintain a central model inventory that includes data on owners, uses and model limitations. We assess how important each model is to our business, and we track and resolve actions from independent reviews. We also maintain a clear approval path for new models and changes to existing models.
Risk monitoring and reporting	We report model risks and issues using management and control forums. We escalate issues to the ERCC when needed, or if our risk appetite is breached or showing adverse trends that could lead to future issues.

2020 compared to 2019

We maintain a risk-based approach to management and control. For example, we focus independent model reviews on our more material models, such as those for credit losses or those with specific regulatory standards defined.

We continue to assess both the short-term and medium-term impacts to our models due to the Covid-19 pandemic. We have created a taskforce focusing on models and data to ensure that data is captured robustly and that any required model changes are approved by the appropriate authority. Government-led schemes and initiatives such as mortgage payment holidays and bounce back loans will affect the data that feeds into our scoring and rating models, moreover, the significant changes observed within the macroeconomic environment could affect those models we use for stress testing and provisioning. Whilst all models need active monitoring, the Covid-19 pandemic has resulted in some models requiring closer and more frequent oversight to ensure their performance remains acceptable. The current unprecedented environment means that models are often working outside of normal parameters, and so are likely to require more overlays and post-model adjustments.

The redevelopment of the suite of regulatory capital models to account for new regulations is a key model project. This focuses on several regulations across the PRA and the ECB including the Hybrid Philosophy for Secured Residential Real Estate and the new Definition of Default requirements. Whilst several models were rebuilt in 2020 and submitted to the regulators for review, the regulatory change agenda for 2021 is significant.

Furthermore, we continue to enhance our suite of models used for IFRS 9 and stress testing purposes, ensuring alignment with the PRA regulatory policy and supervisory statement on stress test models.

Our plans for migration away from models using LIBOR are progressing well with more than 50% of models already updated. Further work is expected to take place in 2021 to support the transition, including new model developments and amendments to existing models.

Due to our minimal traded activities, we are not impacted materially by the Fundamental Review of the Trading Book.

Financial review

Critical factors affecting results

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

Estimates and judgements that are considered important to the portrayal of our financial condition including, where applicable, quantification of the effects of reasonably possible ranges of such estimates are set out in 'Critical Judgements and Accounting Estimates' in Note 1 to the Consolidated Financial Statements.

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Income statement review

SUMMARISED CONSOLIDATED INCOME STATEMENT

			Adjusted ⁽²⁾	
	2020	2019	2020	2019
	£m	£m	£m	£m
Net interest income	3,437	3,295	3,393	3,295
Non-interest income ⁽¹⁾	521	875	429	757
Total operating income	3,958	4,170	3,822	4,052
Operating expenses before credit impairment losses, provisions and charges	(2,487)	(2,526)	(2,258)	(2,373)
Credit impairment losses	(645)	(220)	(645)	(220)
Provisions for other liabilities and charges	(274)	(443)	(209)	(159)
Total operating credit impairment losses, provisions and charges	(919)	(663)	(854)	(379)
Profit before tax	552	981	710	1,300
Tax on profit	(114)	(272)		
Profit after tax	438	709		
Attributable to:				
Equity holders of the parent	402	672		
Non-controlling interests	36	37		
Profit after tax	438	709		

(1) Comprises 'Net fee and commission income' and 'Other operating income'.

(2) Non-IFRS measure. The financial results were impacted by a number of specific income, expenses and charges with an aggregate impact on profit before tax of £158m in 2020 and £319m in 2019. See 'Alternative Performance Measures' for details and reconciliation to the nearest IFRS measure.

A more detailed Consolidated Income Statement is contained in the Consolidated Financial Statements.

2020 compared to 2019

Profit before tax was down 44% to £552m and adjusted profit before tax⁽²⁾ was down 45% to £710m due to the factors outlined below. By income statement line item, the movements were:

- Net interest income was up 4%, with repricing actions on the 11213 Current Account and other deposits offsetting base rate cuts and back book mortgage margin pressure, including £1.8bn net attrition on SVR and Follow on Rate products (2019: £3.9bn). When adjusted for the £44m one-off impact of the accounting adjustment (for details, see 'Revenue recognition - Interest income and expense' in the Accounting policies in Note 1 to the Consolidated Financial Statements), net interest income⁽²⁾ was up 3%.
- Non-interest income was down 40%, with significantly lower banking and transaction fees in our retail business largely due to the implementation of regulatory changes to overdrafts. When adjusted for £92m of operating lease depreciation, non-interest income⁽²⁾ was down 43%.
- Operating expenses before credit impairment losses, provisions and charges were down 2%, with efficiency savings, and lower variable pay accrual. When adjusted for £92m operating lease depreciation, £113m of transformation programme costs and £24m of expenses in H120 as a result of Covid-19, operating expenses⁽²⁾ were down 5%.
- Credit impairment losses were up £425m to £645m. This includes £448m arising from changes to economic scenarios and weights, the staging reclassification of certain loans, payment holidays and other Covid-19 management judgement overlays. Portfolio performance remains resilient with low write-offs and deterioration seen only on a few single name corporate cases.
- Provisions for other liabilities and charges were down 38% to £274m, largely due to the absence of an additional PPI charge, lower transformation restructuring charges and a release of other conduct provisions related to the sale of interest rate derivatives (IRD). This was partially offset by a previously reported regulatory and other provision in our Retail Banking business. When adjusted for transformation restructuring charges (2020: £65m, 2019: £105m), PPI charges (2020: nil, 2019: £169m) and regulatory and other provisions (2020: nil, 2019: £10m), provisions⁽²⁾ were up £50m with higher non-conduct remediation charges, as well as the non-repeat of 2019 property provision releases.
- Tax on profit decreased £158m to £114m. The 2020 Effective Tax rate (ETR) of 20.7% is lower (2019: 20.7%) primarily as a result of 2019 non-allowable conduct charges which were not repeated in 2020, partially offset by adverse movements in deferred tax.

PROFIT BEFORE TAX BY SEGMENT

The segmental information in this Annual Report reflects the reporting structure in place at the reporting date in accordance with the segmental information in Note 2 to the Consolidated Financial Statements.

	Retail Banking ⁽²⁾	Corporate & Commercial Banking ⁽²⁾	Corporate & Investment Banking ⁽²⁾	Corporate Centre ⁽²⁾	Total
2020	£m	£m	£m	£m	£m
Net interest income/(expense)	3,105	364	55	(87)	3,437
Non-interest income ⁽¹⁾	375	93	68	(15)	521
Total operating income/(expense)	3,480	457	123	(102)	3,958
Operating expenses before credit impairment losses, provisions and charges	(1,913)	(316)	(114)	(144)	(2,487)
Credit impairment losses	(308)	(294)	(7)	(36)	(645)
Provisions for other liabilities and (charges)/releases	(175)	(12)	(10)	(77)	(274)
Total operating credit impairment losses, provisions and charges	(483)	(306)	(17)	(113)	(919)
Profit/(loss) before tax	1,084	(165)	(8)	(359)	552

2019					
Net interest income/(expense)	2,827	422	62	(16)	3,295
Non-interest income ⁽¹⁾	691	109	70	5	875
Total operating income/(expense)	3,518	531	132	(11)	4,170
Operating expenses before credit impairment losses, provisions and charges	(1,980)	(324)	(130)	(92)	(2,526)
Credit impairment (losses)/releases	(156)	(45)	(22)	3	(220)
Provisions for other liabilities and charges	(290)	(22)	(16)	(115)	(443)
Total operating credit impairment losses, provisions and charges	(446)	(67)	(38)	(112)	(663)
Profit/(loss) before tax	1,092	140	(36)	(215)	981

(1) Comprises 'Net fee and commission income' and 'Other operating income'.

(2) The segmental basis of presentation has changed following a management review of our structure and segmental income statements and customer balances for 2019 have been restated accordingly. See Note 2 to the Consolidated Financial Statements.

2020 compared to 2019

- For Retail Banking, profit before tax decreased 1%, with an increase in credit impairment charges largely due to Covid-19, partially offset by an increase in net interest income largely due to 11213 Current Account and other deposit repricing. Non-interest income was impacted by reduced banking and transaction fees as a result of regulatory changes to overdrafts.
- For Corporate & Commercial Banking, loss before tax of £165m, with an increase in credit impairment charges largely due to Covid-19, as well as a small number of single name exposures. Income was impacted by the base rate reductions and lower fees due to lower business activity levels which have been adversely affected by Covid-19.
- For Corporate & Investment Banking, loss before tax of £8m, with lower credit impairment charges and lower operating expenses, driven by transformation programme efficiencies. As part of our drive for continuous improvement in customer experience and following a review of the way we operate the CIB business in the UK, we intend to conduct substantially all of this business from SLB beginning later this year. To undertake this change, and subject to court approval, we are proposing to transfer substantially all of the CIB business to SLB in H221 by way of a banking business transfer scheme under Part VII of the Financial Services and Markets Act 2000.
- For Corporate Centre, loss before tax increased to £359m with net interest income impacted by the effect of the reduction in the base rate on our liquidity asset buffer. Furthermore, operating expenses increased with centrally held transformation programme costs and credit impairment losses. Credit impairment losses were higher driven by a provision for unexpected large single name exposures at risk of defaulting as a result of the Covid-19 crisis. Our structural hedge position has remained stable at c£97bn, with an average duration of c2.5 years. Our structural hedge contribution is reallocated to our other business segments in line with our transfer pricing policy.

Balance sheet review

SUMMARISED CONSOLIDATED BALANCE SHEET

	2020 £m	2019 £m
Assets		
Cash and balances at central banks	43,537	26,395
Financial assets at fair value through profit or loss	4,285	4,336
Financial assets at amortised cost	234,944	240,773
Financial assets at fair value through other comprehensive income	8,950	9,747
Interest in other entities	172	117
Property, plant and equipment	1,740	1,971
Retirement benefit assets	496	670
Tax, intangibles and other assets	4,940	4,479
Total assets	299,064	288,488
Liabilities		
Financial liabilities at fair value through profit or loss	3,354	3,422
Financial liabilities at amortised cost	276,144	265,350
Retirement benefit obligations	403	280
Tax, other liabilities and provisions	2,918	3,095
Total liabilities	282,819	272,147
Equity		
Total shareholders' equity	15,848	15,946
Non-controlling interests	397	395
Total equity	16,245	16,341
Total liabilities and equity	299,064	288,488

A more detailed Consolidated Balance Sheet is contained in the Consolidated Financial Statements.

2020 compared to 2019

Assets

Cash and balances at central banks

Cash and balances at central banks increased by 65% to £43,537m at 31 December 2020 (2019: £26,395m). This was mainly driven by cash inflows from higher customer deposits, lower non-bounce back lending, the drawdown of TFSME funding and normal liquidity management, partially offset by increased mortgage and bounce back lending.

Financial assets at fair value through profit or loss: Financial assets at fair value through profit or loss decreased by 1% to £4,285m at 31 December 2020 (2019: £4,336m), mainly due to:

- A £0.4bn increase in derivatives held for hedging with an increase in interest rate contracts and a decrease in exchange rate contracts.
- A decrease in derivatives held for trading of £0.3bn, linked to transactions with corporate customers that are not held in hedging relationships.

Financial assets at amortised cost:

Financial assets at amortised cost decreased by 2% to £234,944m at 31 December 2020 (2019: £240,773m), largely driven by the disposal of £5.5bn of UK Government gilts, a £4.0bn decrease in reverse repurchase agreements and, a decrease in time deposits and third party cash collateral of £0.6bn, as part of normal liquidity management. This was partially offset by an increase in customer loans of £5.1bn, with £4.4bn increase in mortgages due to pent up demand from the lockdown period and the temporary reduced rates of stamp duty. In addition, consumer (auto) finance increased by £0.3bn, and unsecured retail lending decreased by £0.7bn due to lower consumer spending during lockdown. Corporate loans increased £1.1bn, driven by our participation in the government lending schemes (£4.6bn), partially offset by lower investment appetite resulting borrowing requirements.

Financial assets at fair value through other comprehensive income

Financial assets at fair value through other comprehensive income decreased by 8% to £8,950m at 31 December 2020 (2019: £9,747m) mainly due to the disposal of UK Government bonds and the maturity of bank issued securities, partially offset by an increase in non-UK government securities due to normal liquidity management.

Property, plant and equipment

Property, plant and equipment decreased by 12% to £1,740m at 31 December 2020 (2019: £1,971m) reflecting freehold and leasehold property sales and lower contract hire sales.

Retirement benefit assets

Retirement benefit assets decreased by 26% to £496m at 31 December 2020 (2019: £670m), due to a decrease in the overall accounting surplus of the Santander (UK) Group Pension Scheme (the Scheme) resulting from a decrease in the discount rate in the period. This was partially offset by a rise in overall asset values.

Tax, intangibles and other assets

Tax, intangibles and other assets increased by 10% to £4,940m at 31 December 2020 (2019: £4,479m), mainly due to changes in interest rates impacting the macro hedge of interest rate risk included in other assets.

Liabilities**Financial liabilities at amortised cost**

Financial liabilities at amortised cost increased by 4% to £276,144m at 31 December 2020 (2019: £265,350m). This was mainly due to an increase of £13.9bn in customer deposits, of which £7.6bn was corporate and business banking customers building up their cash reserves and £6.7bn related to retail customers increasing current account balances through reduced spending. Deposits from banks increased £6.6bn reflecting funding received through TFSME and additional amounts deposited as collateral. This was partially offset by a £2.4bn decrease in non-trading repurchase agreements as part of normal liquidity management and a £6.5bn decrease in subordinated liabilities following the repurchase of certain subordinated liabilities as part of ongoing liability management.

Retirement benefit obligations

Retirement benefit obligations increased by 44% to £403m at 31 December 2020 (2019: £280m), due to a decrease in the overall accounting surplus of the Scheme. This was principally due to a decrease in the discount rate in the period due to falling corporate bond yields which increased the value of liabilities in the Scheme. This was partially offset by a rise in overall asset values.

Equity**Total shareholders' equity**

Total shareholders' equity decreased by 1% to £15,848m at 31 December 2020 (2019: £15,946m). This was principally due to an increase in the cash flow hedging reserve and profit after tax for the period, partially offset by dividends paid and a decrease in the defined benefit pension asset.

CUSTOMER BALANCES

Consolidated

	2020 £bn	2019 £bn
Customer loans	210.4	205.3
Other assets	88.7	83.2
Total assets	299.1	288.5
Customer deposits	191.7	177.8
Total wholesale funding	63.2	65.3
Other liabilities	28.0	29.1
Total liabilities	282.9	272.2
Shareholders' equity	15.8	15.9
Non-controlling interest	0.4	0.4
Total liabilities and equity	299.1	288.5

Further analyses of credit risk on customer loans, and on our funding strategy, are included in the Credit risk and Liquidity risk sections of the Risk review.

2020 compared to 2019

- Customer loans increased £5.1bn, with a £4.4bn increase in mortgages due to pent-up demand from the lockdown period and the temporary reduced rates of stamp duty. In addition, consumer (auto) finance increased by £0.3bn and unsecured retail lending decreased by £0.7bn due to lower consumer spending during lockdown. Corporate loans increased £1.1bn, driven by our participation in the government lending schemes (£4.6bn), partially offset by lower investment appetite reducing borrowing requirements.
- Customer deposits increased £13.9bn, of which £7.6bn was corporate and business banking customers building up their cash reserves and £6.7bn related to retail customers increasing current account balances through reduced spending.

Retail Banking

	2020 £bn	2019 £bn
Mortgages	169.8	165.4
Business banking	3.9	0.2
Consumer (auto) finance	8.0	7.7
Other unsecured lending	4.8	5.5
Customer loans	186.5	178.8
Current accounts	75.6	68.7
Savings	57.4	57.2
Business banking accounts	13.4	10.5
Other retail products	5.8	6.3
Customer deposits	152.2	142.7

Corporate & Commercial Banking

	2020 £bn	2019 £bn
Non-Commercial Real Estate trading businesses	12.9	13.3
Commercial Real Estate	4.7	5.1
Customer loans	17.6	18.4
Customer deposits	25.0	20.5

Corporate & Investment Banking

	2020 £bn	2019 £bn
Customer loans	2.8	4.0
Customer deposits	6.5	6.1

Corporate Centre

	2020 £bn	2019 £bn
Social Housing	3.0	3.6
Crown Dependencies (Isle of Man and Jersey)	0.3	0.3
Non-core	0.2	0.2
Customer loans	3.5	4.1
Customer deposits	8.0	8.5
– of which Crown Dependencies	6.0	6.1

Cash flows

SUMMARISED CONSOLIDATED CASH FLOW STATEMENT

	2020 £m	2019 £m
Net cash flows from operating activities	16,181	3,523
Net cash flows from investing activities	6,631	2,885
Net cash flows from financing activities	(7,983)	(4,091)
Change in cash and cash equivalents	14,829	2,317

A more detailed Consolidated Cash Flow Statement is contained in the Consolidated Financial Statements.

The major activities and transactions that affected cash flows in 2020 and 2019 were as follows:

In 2020, the net cash inflows from operating activities of £16,181m resulted from net cash inflows generated from profits in the year and higher customer deposits, offset by additional retail and corporate lending. The net cash inflows from investing activities of £6,631m mainly reflected the net disposal of certain asset backed securities as part of normal liquid asset portfolio management. The net cash outflows from financing activities mainly reflected net cash outflows relating to debt securities in issue. These resulted in cash and cash equivalents increasing by £14,829m in the year.

In 2019, the net cash inflows from operating activities of £3,523m resulted from net cash inflows generated from profits in the year and higher customer deposits, offset by additional retail lending. The net cash inflows from investing activities of £2,885m mainly reflected the net disposal of certain asset backed securities as part of normal liquid asset portfolio management. The net cash outflows from financing activities mainly reflected net cash outflows relating to debt securities in issue. These resulted in cash and cash equivalents increasing by £2,317m in the year.

Capital and funding

	2020 £bn	2019 £bn
Capital		
CET1 capital	11.1	10.4
Total qualifying regulatory capital	15.4	15.8
CET1 capital ratio	15.2%	14.3%
Total capital ratio	21.1%	21.6%
UK leverage ratio	5.1%	4.7%
Risk-weighted assets	72.9	73.2
– of which Retail Banking	49.5	47.8
– of which Corporate & Commercial Banking	13.3	14.0
– of which Corporate & Investment Banking	3.8	4.8
– of which Corporate Centre	6.3	6.6
Funding		
Total wholesale funding and AT1	65.7	67.8
- of which with a residual maturity of less than one year	21.1	22.5

Liquidity

	2020 £bn	2019 £bn
Santander UK Domestic Liquidity Sub Group (RFB DoLSub)		
Liquidity Coverage Ratio (LCR)	150%	142%
LCR eligible liquidity pool	51.5	42.0
Santander Financial Services (SFS)		
LCR	165%	471%
LCR eligible liquidity pool	2.8	5.7

Further analysis of capital, funding and liquidity is included in the Capital risk and Liquidity risk sections of the Risk review.

2020 compared to 2019

- CET1 capital increased to £11.1bn with capital accretion through retained profits, the impact of the change in treatment of software assets outlined in the EBA technical standard on the prudential treatment of software assets and a lower deduction from the excess of regulatory expected loss amounts over credit provisions. These increases were partially offset by adverse market driven movements in the defined benefit pension schemes.
- CET1 capital ratio increased 90 basis points to 15.2% with a 5.4p.p. buffer to Maximum Distributable Amount (MDA) restrictions. UK leverage ratio up 40 bps to 5.1%, 1.5p.p. above the regulatory requirement. The increase was primarily through improvement in CET1 capital and active management of leverage exposures. The CET1 capital ratio includes a benefit of c30bps and UK leverage ratio c10bps from the change in treatment of software assets.
- Amendments to Capital Requirements Regulation (CRR), which were published in the Official Journal on 26 June 2020, contributed 17 basis points to the CET1 ratio, through the implementation of the RWA reduction factors for certain Small and Medium-sized Enterprise (SME) and infrastructure exposures.
- The Pillar 2A capital requirement was 4.94%, the majority of which remained with an RWA percentage-based element.
- Following the PRA's announcement regarding the resumption of dividend payments, an interim dividend of £103m for 2020 was paid in Dec 20.
- We issued £5.4bn of wholesale funding, including £1.4bn MREL eligible senior unsecured issued from Santander UK Group Holdings plc and £4bn of core funding, consisting of covered bonds and senior unsecured, issued from Santander UK plc.
- We have £6.3bn outstanding under the TFS and £11.7bn outstanding under the TFSME.
- In October 2020, Santander UK plc transferred £3.2bn of mortgage assets to SFS. The transaction allows us to optimise our overall funding structure within Santander UK, utilising the deposits in SFS and reducing our funding requirement in Santander UK plc.

Selected financial data

The financial information set forth below for the years ended 31 December 2020, 2019 and 2018 and at 31 December 2020 and 2019 has been derived from the audited Consolidated Financial Statements of Santander UK Group Holdings plc (the Company) and its subsidiaries (together, the Santander UK group) prepared in accordance with IFRS included elsewhere in this Annual Report. The information should be read in connection with, and is qualified in its entirety by reference to, the Santander UK group's Consolidated Financial Statements and the Notes thereto.

The financial information in this selected financial data does not constitute statutory accounts within the meaning of the Companies Act 2006. The auditor's report on the Consolidated Financial Statements for each of the five years ended 31 December 2020 was unmodified and did not include a statement under sections 237(2) and 237(3) of the Companies Act 1985 or sections 498(2) and 498(3) of the Companies Act 2006, as applicable. The Consolidated Financial Statements of the Santander UK group at 31 December 2020, 2019, 2018, 2017 and 2016 were audited by PricewaterhouseCoopers LLP.

BALANCE SHEETS

	2020 ^(1,2)	2019 ^(3,4,5)	2018	2017	2016
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	43,537	26,395	24,180	32,771	17,107
Financial assets at fair value through profit or loss	4,285	4,336	11,458	52,593	57,646
Financial assets at amortised cost	234,944	240,773	233,489	205,412	204,085
Financial assets at fair value through other comprehensive income	8,950	9,747	13,302		
Financial investments				17,611	17,466
Interests in other entities	172	117	88	73	61
Intangible assets	1,649	1,776	1,814	1,742	1,685
Property, plant and equipment	1,740	1,971	1,835	1,598	1,491
Current tax assets	271	186	106	—	—
Retirement benefit assets	496	670	842	449	398
Other assets	3,020	2,517	2,267	2,511	2,571
Total assets	299,064	288,488	289,381	314,760	302,510
Liabilities					
Financial liabilities at fair value through profit or loss	3,354	3,422	7,880	51,037	41,103
Financial liabilities at amortised cost	276,144	265,350	261,933	243,858	241,590
Other liabilities	2,343	2,373	2,507	2,728	3,221
Provisions	468	577	515	558	700
Current tax liabilities	—	—	—	3	53
Deferred tax liabilities	107	145	211	88	128
Retirement benefit obligations	403	280	115	286	262
Total liabilities	282,819	272,147	273,161	298,558	287,057
Equity					
Total shareholders' equity	15,848	15,946	15,820	15,801	15,054
Non-controlling interests	397	395	400	401	399
Total equity	16,245	16,341	16,220	16,202	15,453
Total liabilities and equity	299,064	288,488	289,381	314,760	302,510

⁽¹⁾ In 2020, the Santander UK group adopted 'Interest Rate Benchmark Reform – Phase 2 – Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16'.

⁽²⁾ In October 2020, Santander UK plc sold £3.2bn of mortgages to Santander Financial Services plc.

⁽³⁾ On 1 January 2019, the Santander UK group adopted IFRS 16 (2016-2018: IAS 17).

⁽⁴⁾ On 1 January 2018, the Santander UK group adopted IFRS 9 (2016 and 2017: IAS 39).

⁽⁵⁾ In 2018, the Santander UK group completed the implementation of its ring-fencing plans.

INCOME STATEMENTS

	2020 ^(1,2)	2019 ^(3,4,5)	2018 ^(4,5)	2017	2016
	£m	£m	£m	£m	£m
Net interest income	3,437	3,295	3,606	3,803	3,582
Net fee and commission income	383	689	749	807	770
Other operating income	138	186	188	302	443
Total operating income	3,958	4,170	4,543	4,912	4,795
Operating expenses before credit impairment losses, provisions and charges	(2,487)	(2,526)	(2,563)	(2,502)	(2,417)
Credit impairment losses	(645)	(220)	(153)	(203)	(67)
Provisions for other liabilities and charges	(274)	(443)	(260)	(393)	(397)
Total operating credit impairment losses, provisions and charges	(919)	(663)	(413)	(596)	(464)
Profit before tax	552	981	1,567	1,814	1,914
Tax on profit	(114)	(272)	(403)	(514)	(597)
Profit after tax	438	709	1,164	1,300	1,317

⁽¹⁾ In 2020, the Santander UK group adopted 'Interest Rate Benchmark Reform – Phase 2 – Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16'.

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⁽⁵⁾ In 2018, the Santander UK group completed the implementation of its ring-fencing plans.

ALTERNATIVE PERFORMANCE MEASURES (APMs)

In addition to the financial information prepared under IFRS, this Annual Report contains non-IFRS financial measures that constitute APMs, as defined in European Securities and Markets Authority (ESMA) guidelines. The financial measures contained in this Annual Report that qualify as APMs have been calculated using the financial information of the Santander UK group but are not defined or detailed in the applicable financial information framework or under IFRS.

We use these APMs when planning, monitoring and evaluating our performance. We consider these APMs to be useful metrics for management and investors to facilitate operating performance comparisons from period to period. Whilst we believe that these APMs are useful in evaluating our business, this information should be considered as supplemental in nature and is not meant as a substitute for IFRS measures.

Adjusted APMs

A description of the Santander UK group's adjusted APMs, the reasons why management feel they provide useful information and their calculation are set out below.

Adjusted APM	Description and calculation
Adjusted net interest income	Net interest income adjusted for items management believe to be significant, to facilitate underlying operating performance comparisons from period to period.
Adjusted non-interest income	Non-interest income adjusted for items management believe to be significant, to facilitate underlying operating performance and cost-to-income comparisons from period to period.
Adjusted operating expenses before credit impairment losses, provisions and charges	Operating expenses before credit impairment losses, provisions and charges adjusted for items management believe to be significant, to facilitate underlying operating performance and cost-to-income comparisons from period to period.
Adjusted provisions for other liabilities and charges	Provisions for other liabilities and charges adjusted for items management believe to be significant, to facilitate underlying operating performance comparisons from period to period.
Adjusted profit before tax	Profit before tax adjusted for items management believe to be significant, to facilitate underlying operating performance comparisons from period to period.
Adjusted cost-to-income ratio	Adjusted total operating expenses before credit impairment losses and provisions for other liabilities and charges as a percentage of the total of adjusted net interest income and adjusted non-interest income. We consider this metric useful for management and investors as an efficiency measure to capture the amount spent to generate income, as we invest in our multi-year transformation programme.
Adjusted Return on Tangible Equity (RoTE)	Adjusted profit before tax, less tax on profit, attributable to equity holders of the parent, divided by average shareholders' equity less non-controlling interests, other equity instruments and average goodwill and other intangible assets. We consider this adjusted measure useful for management and investors as a measure of income generation on shareholder investment, as we focus on improving returns through our multi-year transformation programme.
Adjusted Banking NIM	In 2020 we introduced this as a new APM to remove the 2020 positive impact of the accounting change, which is not expected to be repeated and did not occur in earlier periods. It is calculated as adjusted net interest income as a percentage of average customer assets over the period. We consider this metric useful for management and investors as it removes the 2020 positive impact of the accounting change on net interest income.

Reconciliation of adjusted APMs to nearest IFRS measure**a) Adjusted profit metrics and average customer assets**

Net interest income, non-interest income, operating expenses before credit impairment losses, provisions and charges, provisions for other liabilities and charges, and profit before tax are all adjusted for items management believe to be significant, to facilitate underlying operating performance comparisons from period to period.

	Ref	2020 £m	2019 £m
Net interest income			
Reported	(i)	3,437	3,295
Adjust for accounting treatment		(44)	—
Adjusted	(ii)	3,393	3,295
Non-interest income			
Reported	(iii)	521	875
Adjust for operating lease depreciation		(92)	(103)
Adjust for Vocalink Holdings Limited shareholding		—	(15)
Adjusted	(iv)	429	757
Operating expenses before credit impairment losses, provisions and charges			
Reported	(v)	(2,487)	(2,526)
Adjust for transformation		113	50
Adjust for operating lease depreciation		92	103
Adjust for higher IT costs, staff expenses and increased site cleaning as a result of Covid-19		24	—
Adjusted	(vi)	(2,258)	(2,373)
Provisions for other liabilities and charges			
Reported		(274)	(443)
Adjust for transformation		65	105
Adjust for PPI		—	169
Adjust for regulatory and other		—	10
Adjusted		(209)	(159)
Profit before tax			
Reported		552	981
Specific income, expenses and charges		158	319
Adjusted profit before tax		710	1,300
Average customer assets	(vii)	208,525	201,334

The financial results for 2020 and 2019 were impacted by a number of specific income, expenses and charges with an aggregate impact on profit before tax of £158m in 2020 and £319m in 2019. The specific income, expenses and charges are outlined below:

– Accounting adjustment

During Q4 2020, we revised the accounting treatment for certain items of mortgage income with an impact on net interest income of £44m for 2020. For details, see 'Revenue recognition - Interest income and expense' in the Accounting policies in Note 1 to the Consolidated Financial Statements.

– Vocalink Holdings Limited shareholding

Santander UK was part of the consortium of banks that sold a majority of the shares in Vocalink Holdings Limited to Mastercard in 2017. Under the terms of the sale agreement, we retained a shareholding of 0.775%. In respect of the shares we sold in 2017, we were entitled to receive additional consideration where Vocalink's 2018 earnings performance exceeded an agreed amount and in June 2019 we received additional consideration of £15m.

– Operating lease depreciation

In Q4 2019 we began to adjust operating expenses and non-interest income for operating lease depreciation. We believe this provides a clearer explanation of expenses and income as operating lease depreciation is a direct cost associated with growing business volumes largely in consumer (auto) finance.

– Adjustment for higher IT costs, staff expenses and increased site cleaning as a result of Covid-19

In Q220 we introduced an adjustment for Covid-19 expenses as we believe the underlying performance of the business is clearer if we exclude these charges due to the unprecedented nature of the crisis. These costs include higher IT costs, remote network, staff expenses, mail outs and increased site cleaning. These expenses were identified as being incurred as a direct result of Covid-19 actions as the crisis emerged and are not expected to recur.

- Transformation costs and charges

Transformation costs and charges relate to a multi-year project to deliver on our strategic priorities and enhance efficiency in order for us to better serve our customers and meet our medium-term targets.

- PPI

We have been closely involved in the additional industry activities to support the regulatory time-bar for claims and orderly closure of the FCA remediation campaign. We made an additional provision of £70m in Q2 2019 reflecting an increase of claims volumes and additional industry activities and having considered guidance provided by the FCA and our approach to PPI claims, in advance of the PPI claims deadline on 29 August 2019. In Q3 2019, and in line with industry experience, we received unprecedented volumes of information requests in August 2019 and saw a significant spike in both these requests and complaints in the final days prior to the complaint deadline. Our best estimate of the additional provision required at Q4 2019 was £99m.

- Regulatory and other

In Q4 2019 we made a £10m provision in relation to our consumer credit business operations.

- Removal of certain adjusting items

During Q420, APMs were reassessed and management concluded that charges relating to regulatory and other conduct matters incurred during the year were no longer sufficiently material to warrant separate adjustments in the context of the results for the full year 2020.

b) Adjusted Banking NIM

	Calculation, refers to table a) above	2020 £m	2019 £m
Banking NIM	(i) divided by (vii)	1.65%	1.64%
Adjusted Banking NIM	(ii) divided by (vii)	1.63%	1.64%

c) Adjusted cost-to-income ratio

	Calculation, refers to table a) above	2020 £m	2019 £m
Cost-to-income ratio	(v) divided by the sum of (i) and (iii)	63%	61%
Adjusted cost-to-income ratio	(vi) divided by the sum of (ii) and (iv)	59%	59%

d) Adjusted RoTE

		Specific income, expenses and charges £m	As adjusted £m
2020			
Profit after tax		438	553
Annualised profit after tax		—	—
Phasing adjustments		—	—
Less non-controlling interests of annual profit		(36)	(36)
Profit due to equity holders of the parent (A)		402	517
2020			
Average shareholders' equity		16,293	
Less average AT1 securities		(2,243)	
Less average non-controlling interests		(398)	
Average ordinary shareholders' equity (B)		13,652	
Average goodwill and intangible assets		(1,713)	
Average tangible equity (C)		11,939	11,968
Return on ordinary shareholders' equity (A/B)		2.9%	—
Adjusted RoTE (A/C)		—	4.3%

		Specific income, expenses and charges	As adjusted
2019	£m	£m	£m
Profit after tax	709	270	979
Less non-controlling interests of annual profit	(37)		(37)
Profit due to equity holders of the parent (A)	672		942

		Equity adjustments	As adjusted
2019	£m	£m	£m
Average shareholders' equity	16,281		
Less average AT1 securities	(2,141)		
Less average non-controlling interests	(398)		
Average ordinary shareholders' equity (B)	13,742		
Average goodwill and intangible assets	(1,795)		
Average tangible equity (C)	11,947	68	12,015
Return on ordinary shareholders' equity (A/B)	4.9%		—
RoTE (A/C)	—		7.8%

– Specific income, expenses, charges

Details of these items are outlined in a) Adjusted profit metrics and average customer assets above with a total impact on profit before tax of £158m. The tax on these items is c£43m and profit after tax on these items is £115m.

– Equity adjustments

These adjustments are made to reflect the impact of adjustments to profit on average tangible equity.

Management does not assess forward-looking 'Return on ordinary shareholders' equity' (ROE) as a performance indicator of the business, and therefore a reconciliation of the forward-looking non-IFRS Adjusted RoTE targets for the medium term to an equivalent IFRS measure for ROE is not available without unreasonable efforts.

Other non-IFRS measures

A description of the Santander UK group's other non-IFRS measures and their calculation, in addition to the adjusted APMs above, is set out below.

Other non-IFRS measure	Description and calculation
Banking NIM	Banking net interest margin. Net interest income divided by average customer assets.
Cost of risk	Credit impairment charge for the 12 month period as a percentage of average customer loans.
Cost-to-income ratio	Total operating expenses before credit impairment losses and provisions for other liabilities and charges as a percentage of the total of net interest income and non-interest income.
Non-interest income	Net fee and commission income plus Other operating income.
Stage 3 ratio	Total Stage 3 exposure as a percentage of customer loans plus undrawn Stage 3 exposures.

Financial statements

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Independent auditors' report to the members of Santander UK Group Holdings plc

Report on the audit of the financial statements

Opinion

In our opinion, Santander UK Group Holdings plc's group financial statements and company financial statements (the "financial statements"):

- give a true and fair view of the state of the group's and of the company's affairs as at 31 December 2020 and of the group's and company's profit and the group's and company's cash flows for the year then ended;
- have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report, which comprise: the Consolidated and Company Balance Sheets as at 31 December 2020; the Consolidated Income Statement and Statement of Comprehensive Income; the Consolidated and Company Cash Flow Statements; the Consolidated and Company Statements of Changes in Equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

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

Separate opinion in relation to international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union

As explained in note 1 to the group financial statements, the group, in addition to applying international accounting standards in conformity with the requirements of the Companies Act 2006, has also applied international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

In our opinion, the group financial statements have been properly prepared in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the financial statements, the group, in addition to applying international accounting standards in conformity with the requirements of the Companies Act 2006, has also applied international financial reporting standards (IFRSs) as issued by the International Accounting Standards Board (IASB).

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

Basis for opinion

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

Independence

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

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

Other than those disclosed in note 7 to the financial statements, we have provided no non-audit services to the group in the period under audit.

Our audit approach

Context

The 2020 audit was impacted by the need to conduct our work remotely and to consider the impact of COVID-19 on the nature and extent of our work. We used technology effectively to coordinate with and oversee the work of component teams and to exchange information between PwC and the group. By adapting our working practices, including greater communication between teams, we mitigated the risks arising from the remote working environment. As part of our audit, we also considered the impact of remote working on the group's processes and controls. We evaluated the design and tested the operating effectiveness of relevant controls over financial reporting. In this regard, we did not identify any significant audit issues arising from the impact of remote working. The extent of our work on expected credit losses was, however, impacted as COVID-19 led to a slowdown in the economy with consequences for the creditworthiness of personal and corporate borrowers. We have set out our response to this audit risk in a Key Audit Matter below. The 2020 audit was also my 5th and last audit of the group. During the year, we introduced my successor and she shadowed the audit team during the later stages of the audit process.

Overview

Audit scope

- The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error).
- The group conducts business in four segments: Retail Banking (including Consumer Finance), Corporate & Commercial Banking, Corporate & Investment Banking and Corporate Centre. We structured our audit in line with the segments and requested component audit teams to audit the in scope components by business segment. We performed audit procedures over components considered to be financially significant in the context of the group (full scope audit) or in the context of individual primary statement account balances (audit of specific account balances). Certain balances and processes of the group and the company, including pension assets and liabilities, litigation, conduct matters and certain other provisions, the consolidation process, goodwill, investments in subsidiaries and taxation were audited centrally by the group engagement team.
- Our audit plan was discussed with the Board Audit Committee in June 2020 and updates were provided to the Committee at later stages of the audit. We discussed the key audit matters with the Committee at the conclusion of the audit.

Key audit matters

- Impact of COVID-19 (group and parent)
- Expected credit loss allowance for loans and advances to customers (group)
- Legal and regulatory matters (group)
- Valuation of defined benefit scheme pension obligations (group)
- Impairment of goodwill (group) and investment in subsidiaries (company)

Materiality

- Overall group materiality: £57 million (2019: £67 million) based on 5% of the adjusted average profit before tax for the last three years (2019: 5% of adjusted profit before tax).
- Overall company materiality: £57 million (2019: £18 million) based on 0.5% of net assets (2019: 5% of adjusted profit before tax).
- Performance materiality: £43 million (group) and £43 million (company).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Capability of the audit in detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined in the Auditors' responsibilities for the audit of the financial statements section, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of banking laws and regulations such as, but not limited to, regulations relating to consumer credit and unethical and prohibited business practices, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to management bias through judgements and assumptions in significant accounting estimates. The group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the group engagement team and/or component auditors included:

- Discussions with management, including the Chief Legal and Regulatory Officer, Internal Audit and those charged with governance in relation to known or suspected instances of non-compliance with laws and regulation and fraud;
- Evaluation of the completeness of matters identified by management which might impact financial reporting, including but not restricted to the procedures below;
- Evaluation and testing of the operating effectiveness of management's entity level controls designed to prevent and detect irregularities, in particular their code of conduct and whistleblowing helpline;
- Assessment of matters reported on the group's whistleblowing helpline and the results of management's investigation of such matters;
- Observing the effectiveness of key governance forums, reviewing management information presented and reviewing minutes of executive management meetings;
- Reviewing key correspondence with the Financial Conduct Authority and Prudential Regulation Authority and meeting with these regulators during the year;
- Challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to the expected credit loss allowance for loans and advances to customers, legal and regulatory matters, the valuation of defined benefit obligations and the impairment of goodwill and investments in subsidiaries (see related key audit matters below);
- Identifying and testing journal entries, in particular any journal entries posted by senior management and testing period end adjustments; and
- Incorporated unpredictability into the nature, timing and/or extent of our testing.

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

Key audit matters

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

This is not a complete list of all risks identified by our audit.

The impact of COVID-19 (group and parent) and impairment of goodwill (group) and investment in subsidiaries (company) are new key audit matters this year. Otherwise, the key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
<p><i>Impact of COVID-19 (group and parent)</i></p> <p>The impact of the COVID-19 pandemic has resulted in unprecedented economic conditions and resulting government support programmes and regulatory interventions to support businesses and people. The COVID-19 pandemic has also changed the way that companies operate their businesses, with one of the most substantial impacts being the transition to remote working.</p> <p>A substantial proportion of the group's employees have been working remotely during 2020, with some consequential changes on their processes and the control environment, some of which were relevant for financial reporting purposes. Our audit team has also been working remotely for most of 2020.</p> <p>The roll out of vaccines has created an expectation that the restrictions will be eased in the foreseeable future. However, there remains uncertainty about the future mutation and spread of the disease, the extent and impact of government measures and economic outlook.</p> <p>The impact of the COVID-19 pandemic and resulting uncertainty has impacted a number of the estimates in the financial statements in the group and parent company financial statements.</p>	<p>Our planning and execution of the audit has given specific consideration to the impact of COVID-19. This included adopting a different basis for determining materiality to take account of the significant reduction in profits due to expected credit losses.</p> <p>We considered the impact of COVID-19 on the group's control environment through our audit testing and inquiries of management. We reflected any changes in our audit approach. We also adapted our own working practices to remote working and ensured we gathered appropriate audit evidence.</p> <p>The impact of COVID-19 on the most significant accounting judgements and our audit is set out in the following other key audit matters in this opinion:</p> <ul style="list-style-type: none"> – Expected credit loss allowance for loans and advances to customers – Impairment of goodwill and investments in subsidiaries <p>We have reviewed management's going concern assessment and findings are included in the section 'Conclusions relating to going concern' later in this opinion. This included a review of the future profitability of the group, capital resources and liquidity.</p> <p>As a result of these procedures we concluded that the impact of COVID-19 has been appropriately evaluated and reflected in the preparation of these financial statements.</p>
<p><i>Expected credit loss allowance for loans and advances to customers (group)</i></p> <p>Refer to the Board Audit Committee Chair's report, note 1 (Accounting Policies and Critical Accounting Estimates) and note 13: Loans and Advances to customers.</p> <p>Impairment allowances represent management's best estimate of expected credit loss ('ECL') within each portfolio at the balance sheet date. The identification and the determination of allowances is inherently judgemental. The key allowance risks relate to residential mortgage loans within Retail Banking and the corporate loans within Corporate & Commercial Banking and Corporate & Investment Banking. Under IFRS 9 management is required to determine ECLs that are expected to occur based on possible default events over a 12 month period or the remaining life of the asset, depending on the categorisation of the individual asset. This categorisation is determined by an assessment of whether there has been a significant increase in credit risk ('SICR') of the borrower since loan origination. It is also necessary to consider the impact of different future macroeconomic conditions in the determination of ECLs. Management uses a number of models and post model adjustments ('PMAs') to achieve compliance with the requirements of IFRS 9. The determination of ECLs is complex and a number of significant judgements are involved in the estimation process.</p> <p>The COVID-19 pandemic has impacted many individuals and businesses and their ability to operate normally. The economy has contracted and unemployment has begun to increase, although government support schemes have offset some of the impact of the disruption. There continues to be significant uncertainty regarding the path to recovery and the impact on the ability of borrowers to repay. As at the year end, the bank has experienced only a low level of defaults. The additional allowances for impairment therefore mainly comprise an increase in the estimated expected credit losses that might be incurred in the future.</p> <p>Management introduced the following material PMAs in 2020:</p> <ul style="list-style-type: none"> – A PMA related to SICR to move certain corporate loans into Stage 2; – A PMA to identify a proportion of corporate loans that are unlikely to repay and should be moved to Stage 3; – A payment holiday PMA was also introduced for retail customers. 	<p><u>Testing of key management controls</u></p> <p>We understood and evaluated the design of the key controls over the determination of ECLs and tested their operating effectiveness. These controls included:</p> <ul style="list-style-type: none"> – Model performance monitoring controls, including testing model estimates against actual outcomes; – The Credit Risk Provisions Forum's review and approval of significant judgements, estimates and the assessment of ECL modelled outputs. This includes judgements made in respect of the impact of the COVID-19 pandemic; – Review and approval of periodically assessed risk ratings for individual corporate borrowers; and – Review and approval of the key judgements used to calculate ECLs on individually assessed corporate loans including the valuation of collateral and probability weighting of likely outcomes. <p>We noted no significant exceptions in the design or operating effectiveness of the above controls. In addition, we performed the substantive procedures described below.</p> <p><u>Significant model assumptions and judgements</u></p> <p>We assessed whether the IFRS 9 ECL model methodologies used by management were appropriate, making use of our credit risk modelling experts and our industry knowledge. This included an evaluation of the ability of the models to appropriately reflect the impact of the COVID-19 pandemic on certain model assumptions, as well as the criteria set by management for determining whether there had been a SICR. When evaluating the SICR criteria, we specifically considered the treatment of borrowers granted payment concessions because of the pandemic.</p> <p>We independently recalculated critical model components and re-performed the calculation of ECL for Corporate & Commercial Banking loans and a sample of the mortgage portfolio.</p> <p>We ensured that the ECL calculations were consistent with the approved model methodologies.</p>

Key audit matter	How our audit addressed the key audit matter
<p>Management also updated significant assumptions and judgements in existing Retail PMAs dealing with accounts in long-term arrears and a data lag for collateral valuations.</p> <p>As a result, we consider the following elements of our work to be a key audit matter.</p> <p>We consider the appropriateness of the model methodologies, including their ability to reflect the impact of COVID-19 through appropriate calibration of existing assumptions, and the following judgements and assumptions used in the determination of the modelled ECL for the residential mortgage and corporate loan portfolios to be significant:</p> <ul style="list-style-type: none"> - Setting of appropriate thresholds for what represents an SICR; - The determination of forward looking macroeconomic scenarios and the probability weights applied to ECLs associated with each scenario; - The determination of internal credit ratings in corporate loan portfolios due to the uncertainty over the future performance of corporate borrowers in the current environment; and - The completeness and appropriateness of PMAs to address data and model limitations, such as certain impacts of the COVID-19 pandemic on ECLs. <p>In the corporate loan portfolios, individual impairment assessments are performed for credit impaired loans and advances which are categorised as Stage 3. Judgement is required to estimate the level of any allowance. Our focus was on the principal judgements applied by management in estimating impairment allowances such as the valuation of collateral, forecast cash flows and the reasonableness of the probability weighting of expected likely outcomes.</p>	<p>We independently re-performed key aspects of model monitoring performed by management relating to model performance, segmentation and stability. We critically assessed the monitoring results. We found no exceptions in this work.</p> <p><i>Forward looking economic scenarios and scenario probability weightings</i></p> <p>We used our economics and credit risk modelling experts to critically assess the reasonableness of the multiple economic scenarios and scenario probability weightings adopted by management. We considered external economic data and consensus forecasts and whether management's forecasts appropriately reflected the possible economic consequences of the outcome of trade negotiations with the EU and the pandemic, including different possible paths that the pandemic could take. In particular, we challenged the appropriateness of the scenario probability weightings and COVID-19 stress downside scenario.</p> <p>As part of our testing of the scenario probability weightings, we considered the inferred GDP 'time to recovery' for each scenario based on historic distribution and made a comparison to other external consensus forecasts. We observed that generally the group assigns a higher weighting to a slower recovery than the historical distribution would imply. We concluded that this is broadly consistent with external forecasts and reflects the unique nature of the current economic crisis. It is also reflective of the updates made by management to the scenario weightings in response to the third national lockdown, vaccination rollout challenges and outcome of the trade negotiations with the EU. We found that the change to scenario weights appropriately captured the additional economic uncertainty created by these three factors.</p> <p>Similarly, we challenged the use of a very severe COVID-19 stress scenario, which reflects a prolonged shock to UK GDP, with hysteresis effects resulting in a permanent hit to potential output. We found the selection of this scenario appropriate in the context of the range of scenarios selected and the probability weightings assigned to this scenario. Overall, we concluded that management's scenarios and associated weights were reasonable.</p> <p><i>Internal credit ratings for corporate borrowers</i></p> <p>We tested a sample of loan ratings. We obtained management's internal credit rating assessments and, supported by our credit experts, evaluated the appropriateness of the key data inputs used by management to determine the customer rating, and whether the assessment took account of the impacts of the current economic circumstances. We also tested whether there was any evidence of default to evaluate the completeness of the stage 3 population.</p> <p><i>Post model adjustments (PMAs)</i></p> <p>We considered whether management had identified PMAs where risks were not captured in the modelled loss allowances, and whether appropriate methodologies were applied in their calculation. This included new PMAs introduced during the period to address modelling and operational limitations highlighted by the economic conditions caused by the pandemic.</p> <p><i>Corporate PMAs</i></p> <p>The new corporate loan PMAs were introduced to address the risk that corporate risks were not sufficiently captured on a timely basis by the internal risk ratings and the model, and therefore stage 2 and 3 loans may be understated. The PMAs seek to identify customers and sectors at higher risk and transfer these loans to stage 2 or 3.</p> <p>We critically assessed management's PMA methodologies and sector analysis used by management in the calculations. We used our economics and restructuring experts to provide input on sector risks.</p> <p>Where customers were transferred into stage 2, management applied a downward rating adjustment based on their experience of customer rating changes. We tested this by assessing the average rating changes experienced across the book when customers are moved into stage 2. We also tested the calculations for the ECL impact of these changes.</p> <p>For the customers transferred into stage 3, we challenged whether the methodology was appropriate for determining which customers have defaulted but not yet been identified. We developed independent alternative methodologies, and assessed the impact on ECL. We also tested the accuracy of management's calculation of the PMA.</p>

Key audit matter	How our audit addressed the key audit matter
	<p><u>Retail PMAs</u></p> <p>We assessed key judgements and assumptions used in PMAs for the Retail portfolios. In particular, we challenged the appropriateness of PMAs:</p> <ul style="list-style-type: none"> – Introduced to account for the impact of retail payment holidays; – Reversing the impact of recent HPI growth on collateral valuation; and – Where the reduced repossession activity can affect measurement of ECLs for exposures in long-term arrears. <p>Overall, we were satisfied with the PMAs included in the estimate of ECL.</p> <p><u>Individually assessed cases</u></p> <p>For a sample of credit impaired loans, we evaluated the specific circumstances of the borrower, including the latest developments, scenarios and weightings assigned for measuring the impairment provision, and whether key judgements were appropriate. We re-performed management's impairment calculations and tested key inputs. We tested the valuation of collateral held on a sample basis and challenged management on subjective estimates and assumptions. Where applicable, we engaged our real estate experts to critically assess the collateral valuation. We also compared gains and losses realised when a loan is sold or exited to the existing provision.</p> <p>Based on the procedures performed and the evidence obtained, we found management's judgements used in the determination of the ECLs to be reasonable.</p>
<p>Legal and regulatory matters (group)</p> <p>Refer to the Board Audit Committee Chair's report, note 1 (Accounting Policies and Critical Accounting Estimates), note 29 (Provisions), note 31 (Contingent Liabilities and Commitments)</p> <p>Included within Provisions is the group's best estimate of the cost of present obligations related to past events, including the impact of legal actions and regulatory investigations. Significant judgement may be required when accounting for provisions, including in determining whether a present obligation exists and in estimating the probability and amount of any outflows. These judgements are based on the specific facts available and often require specialist professional advice. There can be a wide range of possible outcomes and uncertainties, particularly in relation to legal actions and regulatory investigations. As a result it is often not possible to make reliable estimates of the likelihood and amount of any potential outflows.</p> <p>The key matters are a dispute with a third party in relation to liability for PPI redress in respect of a specific portfolio, an investigation by German authorities into tax arbitrage transactions and an enforcement action by a UK regulatory authority.</p> <p>The potential cost to the group of each of these matters is material. The assessment of present obligations involves judgement and these matters are the subject of ongoing monitoring by those charged with governance. As a result, the provisions and disclosures in respect of these exposures represents a key audit matter.</p>	<p>We tested the effectiveness of controls relating to management's determination of the likelihood of a loss and whether the amount of loss could be reasonably estimated.</p> <p>We evaluated and challenged the provisioning methodologies and underlying assumptions used by management. Where no provision was made, we challenged management's conclusion in the context of the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Our work included:</p> <ul style="list-style-type: none"> – We understood the risks facing the group, the status of the investigations and the legal case. – We evaluated management's assessment of the potential outcomes and associated probabilities. – We reviewed reports provided to governance committees. We discussed the status of the key matters with the Board Audit Committee. – We evaluated the advice received from management's external legal experts. We held discussions with these experts to confirm our understanding of their views on certain judgements applied by management and obtained a written confirmation of the key facts and status of each case. – We held discussions with an external regulator and reviewed correspondence with that regulator. – We considered market practice in dealing with similar matters. <p>Based on the procedures performed and evidence obtained, we found management's conclusions to be appropriate.</p> <p>Given the uncertainty associated with the calculation of the provisions and the contingent liabilities, we evaluated the disclosures made in the financial statements. In particular, we focused on challenging management around whether the disclosures were sufficiently clear in highlighting the uncertainties. We considered the completeness of information disclosed, in particular where management concluded that it was not possible to determine a possible loss reliably or that it was seriously prejudicial to disclose certain information. We evaluated the disclosures against the requirements of IAS 37. We found the disclosures to be appropriate.</p>
<p>Valuation of defined benefit scheme pension obligations (group)</p> <p>Refer to the Board Audit Committee Chair's report, note 1 (Accounting Policies and Critical Accounting Estimates), note 30 (Retirement Benefit Plans)</p> <p>The valuation of the defined benefit obligations of the Santander (UK) Group Pension Scheme (the 'Scheme') is dependent on a number of assumptions, including the discount rate, inflation rate and mortality rates. Small changes in these assumptions can have a material impact on the valuation due to the size and the duration of the pension obligations. Management performs a review of the valuation methodology and assumptions each year with the assistance of external experts. There were no changes to the methodologies used to derive the financial assumptions during the year. Mortality rates were updated to reflect the latest data for life expectancy.</p> <p>The valuation of the defined benefit obligations is complex and judgemental and therefore represents a key audit matter.</p>	<p>We understood and tested the controls for determining the actuarial assumptions used in calculating the valuation of future pension obligations and the approval of those assumptions by management. We determined we could rely on these controls for the purposes of our audit.</p> <p>We engaged our actuarial specialists to evaluate the judgements made by management in determining the key financial and mortality assumptions used in the calculation of the liability. We assessed the reasonableness of the methodologies and assumptions adopted using our knowledge of market practice and industry developments, PwC developed benchmarks and external market data. We used sensitivity analysis to determine the impact of alternative assumptions. We concluded that the assumptions used by management, in aggregate, were appropriate.</p> <p>We considered the objectivity and competence of management's actuarial expert. We reviewed the expert's IAS 19 report and discussed with the expert the methods adopted to determine the valuation of the obligations. We performed calculations of pension liabilities and compared these with the expert's calculations. We also reviewed management's comparison of the expert's estimate with the output of another actuarial model. We concluded that any differences were within reasonable thresholds.</p> <p>Based on the evidence obtained, we found the valuation of the Scheme's defined benefit obligations to be reasonable.</p> <p>We read and assessed the disclosures made in the financial statements, including the disclosures of the assumptions, and found them to be appropriate.</p>

Key audit matter	How our audit addressed the key audit matter
<p>Impairment of goodwill (group) and Investment in subsidiaries (company)</p> <p>Refer to the Board Audit Committee Chair's report, note 1 (Accounting Policies and Critical Accounting Estimates), note 20 (Intangible assets) and, in relation to the company, note 7 (Interests in other entities)</p> <p>The group has a goodwill balance of £1.2bn at 31 December 2020 which relates to the Personal Financial Services business cash generating unit ('PFS CGU') within Santander UK plc ('SUK'). The parent company has an investment of £13.6bn in other entities, of which £11.2bn relates to an investment in SUK. The UK banking market has been impacted by economic uncertainty and the market prices for retail financial services businesses have fallen. The carrying values of these assets are contingent upon future cash flows, the value of which has been impacted by these developments. Management performed impairment assessments using a value in use methodology and concluded that no impairments existed as at 31 December 2020.</p> <p>The impairment assessments are complex and involve subjective assumptions. The discount rate and the methodology adopted, including the method for determining the amount of regulatory capital and carrying value of the PFS CGU are judgemental. The key judgements used in the impairment assessment of the investment in SUK are the methodology adopted, the forecast cash flows, the discount rate and the terminal growth rate.</p> <p>Due to the magnitude of these balances and these judgements, these impairment assessments represent a key audit matter. We have presented our response to these matters in a single key audit matter as the PFS CGU is a significant part of SUK and many of the assumptions are common to both impairment assessments.</p>	<p>To address the risk of impairment of the parent company's investment in SUK and the goodwill relating to the PFS CGU, we performed a number of audit procedures over the assessments performed by management. We challenged and tested the reasonableness of management's methodology and key assumptions. This resulted in a number of changes and a reduction in the headroom in the SUK assessment. Our work included the following:</p> <ul style="list-style-type: none"> - We tested the mathematical integrity of the impairment models. - We performed a comparison of the performance of SUK in recent years to the budgets and 3 year plans for the equivalent periods to assess the accuracy of the budgeting and forecasting process. - We engaged our valuation specialists to assist in the assessment of the reasonableness of the methodology and certain key assumptions, for example, the determination of the carrying value of the PFS CGU, the amount of capital to be retained in the business, the discount rate and terminal term growth rate. - Agreed the cash flow forecasts to the Board approved three-year plans and tested the reasonableness of adjustments to the plans included in the value in use model. - We reviewed the forecasts, identified the key assumptions and assessed these for reasonableness using our understanding of the group gathered from our audit work and the market, external evidence and sensitivity analysis. - Our specialists compared the return on investment within management's models with the returns achieved by other banks in the market. <p>We assessed the disclosures made in the financial statements. We are satisfied that these disclosures are appropriate and in compliance with the accounting requirements.</p>

How we tailored the audit scope

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

The group comprises the company and a number of subsidiaries which predominantly operate within the UK. The company operates as a holding company. The principal operating subsidiary in the group is Santander UK plc. We considered which entities ("components") required a full scope audit either due to being individually financially significant (defined as 15% of adjusted profit before tax) or due to their risk characteristics, including a consideration of the history of misstatements due to fraud or error, in the context of the group's consolidated financial statements. We identified the significant audit risks and key audit matters and these all relate to the company or Santander UK plc. We concluded that we should perform a full scope audit of the company and Santander UK plc. Although the profit before tax of Santander Consumer (UK) plc exceeded 15% of the group, taking into account the small proportion of the group's balance sheet, the audit risks and the impact of expected credit losses in the group which reduced the group's profit before tax, we determined not to perform a full scope audit, consistent with the prior years.

We then considered the components in the group that had either financially significant or unusual account balances which were required to be brought into scope. Where this was the case, we performed specific audit procedures over these account balances. For example, we adopted this approach for Santander Financial Services plc, including its Crown Dependency branches, and the group's consumer finance business, including Santander Consumer (UK) plc.

The group conducts business in four segments: Retail Banking (including Consumer Finance), Corporate & Commercial Banking, Corporate & Investment Banking and Corporate Centre. Each segment is made up of a number of components and, with the exception of the Consumer Finance business, the financial reporting and key operating functions are centralised. We structured our audit in line with the segments and requested component audit teams to audit the in scope components by business segment. Certain balances and processes of the group, including pension assets and liabilities, goodwill, litigation, conduct matters and certain other provisions, the consolidation process and taxation were audited centrally by the group engagement team. The audit of the parent company was also undertaken by the group engagement team and involved auditing investments in subsidiaries, loans to group companies and debt securities.

Almost all of the audit work is undertaken by PwC UK component auditors. Processes and controls supporting the group's operations are also undertaken by Banco Santander S.A. in Spain, including the hosting and monitoring of certain IT systems, and therefore we place reliance on the work of other auditors. As part of the planning and execution of the audit, we worked closely with the component auditors throughout the year to ensure that the procedures performed on our behalf were sufficient for our purposes. We reviewed the results of their work and held meetings with the component auditors to discuss their findings.

The procedures which we performed over the reporting units accounted for 92.5% of total operating income and 99.6% of total assets of the group.

Materiality

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

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

	Financial statements - group	Financial statements - company
Overall materiality	£57 million (2019: £67 million)	£ 57 million (2019: £ 18 million)
How we determined it	5% of the adjusted average profit before tax for the last three years (2019: 5% of adjusted profit before tax)	0.5% of net assets (2019: 5% of adjusted profit before tax)
Rationale for benchmark applied	Profit before tax is a primary measure used by the shareholder in assessing the performance of the group and is a generally accepted benchmark for determining audit materiality. We have considered the economic impact of the COVID-19 pandemic in the group's results. Whilst profit before tax is still considered to be the most suitable benchmark, we used a three year average, adjusted for certain non recurring items, to eliminate the volatility introduced by COVID-19. We adjusted the profit before tax for significant PPI and restructuring charges in 2019 which did not reflect the long term performance of the group.	We have selected net assets as a benchmark for the parent company materiality. In the prior year, we used a profit based benchmark. A net asset benchmark is considered appropriate for a parent company materiality as the company is not required to disclose an income statement. Using a rule of thumb of 0.5% of net assets, the calculated materiality exceeded the group materiality and hence the parent company overall materiality was restricted to equal the group materiality level.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £8 million and £40 million, based on the relative size of each in scope component and assessment of our audit risk. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% of overall materiality, amounting to £43 million for the group financial statements and £43 million for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the Board Audit Committee that we would report to them misstatements identified during our audit above £4 million (group audit) (2019: £4 million) and £4 million (company audit) (2019: £4 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the group's and the company's ability to continue to adopt the going concern basis of accounting included:

- A risk assessment to identify factors that could impact the going concern basis of accounting, including the current and forecast financial performance, regulatory metrics and the sector in which the group operates;
- Evaluation of the reasonableness of the group's three year plan, including testing the mathematical accuracy of the forecasts, testing key assumptions and a sensitivity analysis using our understanding of the group and its financial and operating performance obtained during the course of our audit;
- Review of the group's ICAAP and ILAAP, regulatory correspondence and reports provided to governance forums, and testing of the total capital resources and liquidity financing facilities;
- Evaluation of the results of stress testing performed by management; and
- Reviewing the appropriateness of the disclosures in the Annual Report.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the group's and the company's ability to continue as a going concern.

In relation to the company's reporting on how they have applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

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

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

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

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' Report for the year ended 31 December 2020 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

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

Corporate governance statement

ISAs (UK) require us to review the directors' statements in relation to going concern, longer-term viability and that part of the corporate governance statement relating to the company's compliance with the provisions of the UK Corporate Governance Code, which the Listing Rules of the Financial Conduct Authority specify for review by auditors of premium listed companies. Our additional responsibilities with respect to the corporate governance statement as other information are described in the Reporting on other information section of this report.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement, included within the Directors' report is materially consistent with the financial statements and our knowledge obtained during the audit, and we have nothing material to add or draw attention to in relation to:

- The directors' confirmation that they have carried out a robust assessment of the emerging and principal risks;
- The disclosures in the Annual Report that describe those principal risks, what procedures are in place to identify emerging risks and an explanation of how these are being managed or mitigated;
- The directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- The directors' explanation as to their assessment of the group's and company's prospects, the period this assessment covers and why the period is appropriate; and
- The directors' statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of its assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our review of the directors' statement regarding the longer-term viability of the group was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statement; checking that the statement is in alignment with the relevant provisions of the UK Corporate Governance Code; and considering whether the statement is consistent with the financial statements and our knowledge and understanding of the group and company and their environment obtained in the course of the audit.

In addition, based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- The directors' statement that they consider the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the members to assess the group's and company's position, performance, business model and strategy;
- The section of the Annual Report that describes the review of effectiveness of risk management and internal control systems; and
- The section of the Annual Report describing the work of the Board Audit Committee.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

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

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

Auditors' responsibilities for the audit of the financial statements

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

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

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

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Board Audit Committee, we were appointed by the members on 31 March 2016 to audit the financial statements for the year ended 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement is 5 years, covering the years ended 31 December 2016 to 31 December 2020.

Other voluntary reporting

Other Code provisions

The directors have prepared a corporate governance statement and requested that we review it as though the company were a premium listed company. We have nothing to report in respect of the requirement for the auditors of premium listed companies to report when the directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Jonathan Holloway (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
2 March 2021

Consolidated Income Statement

For the years ended 31 December

	Notes	2020 £m	2019 £m	2018 £m
Interest and similar income	3	5,146	5,972	6,072
Interest expense and similar charges	3	(1,709)	(2,677)	(2,466)
Net interest income		3,437	3,295	3,606
Fee and commission income	4	756	1,117	1,170
Fee and commission expense	4	(373)	(428)	(421)
Net fee and commission income		383	689	749
Other operating income	5	138	186	188
Total operating income		3,958	4,170	4,543
Operating expenses before credit impairment losses, provisions and charges	6	(2,487)	(2,526)	(2,563)
Credit impairment losses	8	(645)	(220)	(153)
Provisions for other liabilities and charges	8	(274)	(443)	(260)
Total operating credit impairment losses, provisions and charges		(919)	(663)	(413)
Profit before tax		552	981	1,567
Tax on profit	9	(114)	(272)	(403)
Profit after tax		438	709	1,164
Attributable to:				
Equity holders of the parent		402	672	1,125
Non-controlling interests	34	36	37	39
Profit after tax		438	709	1,164

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

Consolidated Statement of Comprehensive Income

For the years ended 31 December

	2020	2019	2018
	£m	£m	£m
Profit after tax	438	709	1,164
Other comprehensive income/(expense) that may be reclassified to profit or loss subsequently:			
Movement in fair value reserve (debt instruments):			
– Change in fair value	114	147	(74)
– Income statement transfers	(107)	(147)	21
– Taxation	(2)	—	14
	5	—	(39)
Cash flow hedges:			
– Effective portion of changes in fair value	974	(864)	788
– Income statement transfers	(803)	1,021	(751)
– Taxation	(53)	(40)	(14)
	118	117	23
Currency translation on foreign operations	—	(3)	—
Net other comprehensive income that may be reclassified to profit or loss subsequently	123	114	(16)
Other comprehensive income/(expense) that will not be reclassified to profit or loss subsequently:			
Pension remeasurement:			
– Change in fair value	(505)	(523)	469
– Taxation	133	131	(117)
	(372)	(392)	352
Own credit adjustment:			
– Change in fair value	(3)	(77)	84
– Taxation	—	19	(21)
	(3)	(58)	63
Net other comprehensive expense that will not be reclassified to profit or loss subsequently	(375)	(450)	415
Total other comprehensive income/(expense) net of tax	(252)	(336)	399
Total comprehensive income	186	373	1,563
Attributable to:			
Equity holders of the parent	152	334	1,524
Non-controlling interests	34	39	39
Total comprehensive income	186	373	1,563

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

Consolidated Balance Sheet

At 31 December

	Notes	2020 £m	2019 £m
Assets			
Cash and balances at central banks		43,537	26,395
Financial assets at fair value through profit or loss:			
– Derivative financial instruments	11	3,451	3,363
– Other financial assets at fair value through profit or loss	12	834	973
Financial assets at amortised cost:			
– Loans and advances to customers	13	212,178	207,498
– Loans and advances to banks		2,004	2,583
– Reverse repurchase agreements – non trading	16	19,599	23,636
– Other financial assets at amortised cost	17	1,163	7,056
Financial assets at fair value through other comprehensive income	18	8,950	9,747
Interests in other entities	19	172	117
Intangible assets	20	1,649	1,776
Property, plant and equipment	21	1,740	1,971
Current tax assets		271	186
Retirement benefit assets	30	496	670
Other assets		3,020	2,517
Total assets		299,064	288,488
Liabilities			
Financial liabilities at fair value through profit or loss:			
– Derivative financial instruments	11	1,920	1,709
– Other financial liabilities at fair value through profit or loss	22	1,434	1,713
Financial liabilities at amortised cost:			
– Deposits by customers	23	193,088	179,006
– Deposits by banks	24	20,973	14,359
– Repurchase agreements – non trading	25	15,848	18,286
– Debt securities in issue	26	43,679	50,171
– Subordinated liabilities	27	2,556	3,528
Other liabilities	28	2,343	2,373
Provisions	29	468	577
Deferred tax liabilities		107	145
Retirement benefit obligations	30	403	280
Total liabilities		282,819	272,147
Equity			
Share capital	32	7,060	7,060
Other equity instruments	33	2,241	2,241
Retained earnings		6,030	6,251
Other reserves		517	394
Total shareholders' equity		15,848	15,946
Non-controlling interests	34	397	395
Total equity		16,245	16,341
Total liabilities and equity		299,064	288,488

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

Nathan Bostock

Chief Executive Officer

Company Registered Number: 08700698

Madhukar Dayal

Chief Financial Officer

Consolidated Cash Flow Statement

For the years ended 31 December

	2020 £m	2019 £m	2018 £m
Cash flows from operating activities			
Profit after tax	438	709	1,164
Adjustments for:			
Non-cash items included in profit:			
– Depreciation and amortisation	570	545	378
– Provisions for other liabilities and charges	274	443	260
– Impairment losses	672	238	189
– Corporation tax charge	114	272	403
– Other non-cash items	93	(345)	(68)
– Pension charge/(credit) for defined benefit pension schemes	38	35	81
	1,761	1,188	1,243
Net change in operating assets and liabilities:			
– Cash and balances at central banks	(152)	(84)	(161)
– Trading assets	—	—	24,528
– Derivative assets	(88)	1,959	14,621
– Other financial assets at fair value through profit or loss	1,561	1,637	(3,467)
– Loans and advances to banks and customers	(5,421)	(605)	(8,221)
– Other assets	(343)	240	203
– Deposits by banks and customers	20,812	2,225	1,845
– Derivative liabilities	211	115	(16,018)
– Trading liabilities	—	—	(31,101)
– Other financial liabilities at fair value through profit or loss	(1,618)	(959)	4,480
– Debt securities in issue	(202)	(548)	(2,760)
– Other liabilities ⁽¹⁾	(983)	(600)	(824)
	13,777	3,380	(16,875)
Corporation taxes paid	(161)	(309)	(445)
Effects of exchange rate differences	366	(1,445)	1,731
Net cash flows from operating activities	16,181	3,523	(13,182)
Cash flows from investing activities			
Investments in other entities	—	—	(66)
Purchase of property, plant and equipment and intangible assets	(378)	(510)	(699)
Proceeds from sale of property, plant and equipment and intangible assets	166	108	26
Purchase of financial assets at amortised cost and financial assets at fair value through other comprehensive income	(3,015)	(5,013)	(7,002)
Proceeds from sale and redemption of financial assets at amortised cost and financial assets at fair value through other comprehensive income	9,858	8,300	3,816
Net cash flows from investing activities	6,631	2,885	(3,925)
Cash flows from financing activities			
Issue of other equity instruments	—	500	—
Issue of debt securities and subordinated notes	5,599	4,145	13,329
Issuance costs of debt securities and subordinated notes	(13)	(15)	(31)
Repayment of debt securities and subordinated notes	(13,287)	(7,969)	(6,303)
Repurchase of non-controlling interests and other equity instruments	—	(318)	—
Dividends paid on ordinary shares	(103)	(262)	(1,123)
Dividends paid on other equity instruments	(147)	(142)	(145)
Dividends paid on non-controlling interests	(32)	(30)	(40)
Net cash flows from financing activities	(7,983)	(4,091)	5,687
Change in cash and cash equivalents	14,829	2,317	(11,420)
Cash and cash equivalents at beginning of the year	33,233	30,969	42,228
Effects of exchange rate changes on cash and cash equivalents	45	(53)	161
Cash and cash equivalents at the end of the year	48,107	33,233	30,969
Cash and cash equivalents consist of:			
Cash and balances at central banks	43,537	26,395	24,180
Less: regulatory minimum cash balances	(871)	(720)	(636)
	42,666	25,675	23,544
Other cash equivalents	5,441	7,558	7,425
Cash and cash equivalents at the end of the year	48,107	33,233	30,969

(1) Total cash outflow for leases was £49m (2019: £59m), including payment of principal amount of £46m (2019: £55m).

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

Consolidated Statement of Changes in Equity

For the years ended 31 December

	Share capital	Other equity instruments	Other reserves				Retained earnings	Total	Non-controlling interests	Total
			Available for sale ⁽²⁾	Fair value ⁽²⁾	Cash flow hedging	Currency translation				
	£m	£m	£m	£m	£m	£m	£m	£m	£m	
At 1 January 2020	7,060	2,241		24	368	2	6,251	15,946	395	16,341
Profit after tax	—	—		—	—	—	402	402	36	438
Other comprehensive income, net of tax:										
– Fair value reserve (debt instruments)	—	—		5	—	—	—	5	—	5
– Fair value reserve (equity instruments)	—	—		—	—	—	—	—	—	—
– Cash flow hedges	—	—		—	118	—	—	118	—	118
– Pension remeasurement	—	—		—	—	—	(370)	(370)	(2)	(372)
– Own credit adjustment	—	—		—	—	—	(3)	(3)	—	(3)
– Currency translation on foreign	—	—		—	—	—	—	—	—	—
Total comprehensive income	—	—		5	118	—	29	152	34	186
Dividends on ordinary shares	—	—		—	—	—	(103)	(103)	—	(103)
Dividends on other equity instruments	—	—		—	—	—	(147)	(147)	—	(147)
Dividends on non-controlling interests	—	—		—	—	—	—	—	(32)	(32)
At 31 December 2020	7,060	2,241		29	486	2	6,030	15,848	397	16,245
At 1 January 2019	7,060	2,041		24	251	5	6,439	15,820	400	16,220
Profit after tax	—	—		—	—	—	672	672	37	709
Other comprehensive income, net of tax:										
– Cash flow hedges	—	—		—	117	—	—	117	—	117
– Pension remeasurement	—	—		—	—	—	(394)	(394)	2	(392)
– Own credit adjustment	—	—		—	—	—	(58)	(58)	—	(58)
– Currency translation on foreign	—	—		—	—	(3)	—	(3)	—	(3)
Total comprehensive income	—	—		—	117	(3)	220	334	39	373
Issue of other equity instruments	—	500		—	—	—	—	500	—	500
Repurchase of non-controlling interests and other equity instruments	—	(300)		—	—	—	(4)	(304)	(14)	(318)
Dividends on ordinary shares	—	—		—	—	—	(262)	(262)	—	(262)
Dividends on other equity instruments	—	—		—	—	—	(142)	(142)	—	(142)
Dividends on non-controlling interests	—	—		—	—	—	—	—	(30)	(30)
At 31 December 2019	7,060	2,241		24	368	2	6,251	15,946	395	16,341
At 31 December 2017	7,060	2,041	68		228	5	6,399	15,801	401	16,202
Adoption of IFRS 9 ⁽¹⁾	—	—	(68)	63	—	—	(187)	(192)	—	(192)
At 1 January 2018	7,060	2,041	—	63	228	5	6,212	15,609	401	16,010
Profit after tax	—	—		—	—	—	1,125	1,125	39	1,164
Other comprehensive income, net of tax:										
– Fair value reserve (debt instruments)	—	—		(39)	—	—	—	(39)	—	(39)
– Cash flow hedges	—	—		—	23	—	—	23	—	23
– Pension remeasurement	—	—		—	—	—	352	352	—	352
– Own credit adjustment	—	—		—	—	—	63	63	—	63
Total comprehensive income	—	—		(39)	23	—	1,540	1,524	39	1,563
Other	—	—		—	—	—	(45)	(45)	—	(45)
Dividends on ordinary shares	—	—		—	—	—	(1,123)	(1,123)	—	(1,123)
Dividends on other equity instruments	—	—		—	—	—	(145)	(145)	—	(145)
Dividends on non-controlling interests	—	—		—	—	—	—	—	(40)	(40)
At 31 December 2018	7,060	2,041		24	251	5	6,439	15,820	400	16,220

(1) The adoption of IFRS 9 decreased shareholders' equity at 1 January 2018 by £192m (net of tax), comprised of a £49m decrease arising from the application of the new classification and measurement requirements for financial assets, and a £211m decrease arising from the application of the new ECL impairment methodology, partially offset by the recognition of a deferred tax asset of £68m.

(2) Following the adoption of IFRS 9, a fair value reserve was introduced to replace the available-for-sale reserve.

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

1. ACCOUNTING POLICIES

These financial statements are prepared for Santander UK Group Holdings plc (the Company) and the Santander UK Group Holdings plc group (the Santander UK group) under the UK Companies Act 2006. The principal activity of the Santander UK group is the provision of a wide range of banking and financial services to personal, business and corporate customers. Santander UK Group Holdings plc is a public company, limited by shares and incorporated in England and Wales having a registered office at 2 Triton Square, Regent's Place, London, NW1 3AN, phone number 0870-607-6000. It is a financial services holding company.

Basis of preparation

These financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. The consolidated financial statements have been prepared on the going concern basis using the historical cost convention, except for financial assets and liabilities that have been measured at fair value. An assessment of the appropriateness of the adoption of the going concern basis of accounting is disclosed in the statement of going concern in the Directors' Report.

Compliance with International Financial Reporting Standards

The consolidated financial statements of the Santander UK group and the separate financial statements of the Company comply with international accounting standards in conformity with the requirements of the Companies Act 2006 and have also applied international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union. The financial statements are also prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB), including interpretations issued by the IFRS Interpretations Committee, as there are no applicable differences from IFRSs as issued by the IASB for the periods presented.

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

Recent accounting developments

Interest Rate Benchmark Reform

In September 2019, the IASB issued 'Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS 7'. The Santander UK group applies IAS 39 hedge accounting so the amendments to IFRS 9 do not apply. The IAS 39 amendments apply to all hedging relationships directly affected by uncertainties related to interbank offered rate (IBOR) reform and must be applied for annual periods beginning on or after 1 January 2020. Following their endorsement for use in the European Union, the Santander UK group adopted the IAS 39 and IFRS 7 amendments in the preparation of the financial statements for the year ended 31 December 2019. The exceptions given by the IAS 39 amendments mean that IBOR reform had no impact on hedge relationships for affected hedges. In August 2020, the IASB issued 'Interest Rate Benchmark Reform – Phase 2 – Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16'. These amendments apply only to changes required by IBOR reform to financial instruments and hedging relationships. The amendments are effective from 1 January 2021 and must be applied retrospectively without restating comparative information. Following their endorsement for use in the European Union and the UK, the Santander UK group has elected to apply the amendments in the preparation of these financial statements. The amendments address the accounting issues for financial instruments when IBOR reform is implemented including providing a practical expedient for changes to contractual cash flows, giving relief from specific hedge accounting requirements, and specifying a number of additional disclosures to enable users of financial statements to understand the effect of IBOR reform on an entity's financial instruments and risk management strategy.

Further details of the impact of these amendments on the financial statements for the year ended 31 December 2020 and the additional disclosures required are provided in Note 43.

Other changes

The Santander UK group adopted IFRS 16 and amendments to IAS 12 in 2019 and adopted IFRS 9 in 2018, with the impact included in the statement of changes in equity for that year end.

Future accounting developments

At 31 December 2020, for the Santander UK group, there were no significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective or which have otherwise not been early adopted where permitted.

Comparative information

As required by US public company reporting requirements, these financial statements include two years of comparative information for the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and related Notes.

Consolidation

a) Subsidiaries

The Consolidated Financial Statements incorporate the financial statements of the Company and entities (including structured entities) controlled by it and its subsidiaries. Control is achieved where the Company (i) has power over the investee; (ii) is exposed, or has rights, to variable returns from its involvement with the investee; and (iii) has the ability to use its power to affect its returns. The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above. When the Company has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- The size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders
- Potential voting rights held by the Company, other vote holders or other parties
- Rights arising from other contractual arrangements
- Any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, the results of a subsidiary acquired or disposed of during the year are included in the consolidated income statement and the consolidated statement of comprehensive income from the date the Company gains control until the date when the Company ceases to control the subsidiary. Inter-company transactions, balances and unrealised gains on transactions between Santander UK group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered.

The acquisition method of accounting is used to account for the acquisition of subsidiaries which meet the definition of a business. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition. Acquisition-related costs are expensed as incurred. The excess of the cost of acquisition, as well as the fair value of any interest previously held, over the fair value of the Santander UK group's share of the identifiable net assets of the subsidiary at the date of acquisition is recorded as goodwill. When the Santander UK group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), less liabilities of the subsidiary and any non-controlling interests. Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred directly to retained earnings) in the same manner as would be required if the relevant assets or liabilities are disposed of. The fair value of any investment retained in a former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IFRS 9 or, when applicable, the costs on initial recognition of an investment in an associate or joint venture.

Business combinations between entities under common control (i.e. fellow subsidiaries of Banco Santander SA, the ultimate parent) are outside the scope of IFRS 3 – 'Business Combinations', and there is no other guidance for such transactions under IFRS. The Santander UK group elects to account for business combinations between entities under common control at their book values in the acquired entity by including the acquired entity's results from the date of the business combination and not restating comparatives. Reorganisations of entities within the Santander UK group are also accounted for at their book values.

Interests in subsidiaries are eliminated during the preparation of the Consolidated Financial Statements. Interests in subsidiaries in the Company unconsolidated financial statements are held at cost subject to impairment.

Credit protection entities established as part of significant risk transfer (SRT) transactions are not consolidated by the Santander UK group in cases where third party investors have the exposure, or rights, to all of the variability of returns from the performance of the entities.

b) Joint ventures

Joint ventures are joint arrangements whereby the parties that have joint control of the arrangement have rights to its net assets. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control. Accounting policies of joint ventures have been aligned to the extent there are differences from the Santander UK group's policies. Investments in joint ventures are accounted for by the equity method of accounting and are initially recorded at cost and adjusted each year to reflect the Santander UK group's share of their post-acquisition results. When the Santander UK group's share of losses of a joint venture exceed its interest in that joint venture, the Santander UK group discontinues recognising its share of further losses. Further losses are recognised only to the extent that the Santander UK group has incurred legal or constructive obligations or made payments on behalf of the joint venture.

Foreign currency translation

Items included in the financial statements of each entity (including foreign branch operations) in the Santander UK group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity (the functional currency). The Consolidated Financial Statements are presented in sterling, which is the functional currency of the Company.

Income statements and cash flows of foreign entities are translated into the Santander UK group's presentation currency at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences on the translation of the net investment in foreign entities are recognised in other comprehensive income. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Foreign currency transactions are translated into the functional currency of the entity involved at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement unless recognised in other comprehensive income in connection with a cash flow hedge. Non-monetary items denominated in a foreign currency measured at historical cost are not retranslated. Exchange rate differences arising on non-monetary items measured at fair value are recognised in the consolidated income statement except for differences arising on equity securities measured at fair value through other comprehensive income (FVOCI), which are recognised in other comprehensive income.

Revenue recognition

a) Interest income and expense

Interest and similar income comprises interest income on financial assets measured at amortised cost, investments in debt instruments measured at FVOCI and interest income on hedging derivatives. Interest expense and similar charges comprises interest expense on financial liabilities measured at amortised cost, and interest expense on hedging derivatives. Interest income on financial assets measured at amortised cost, investments in debt instruments measured at FVOCI and interest expense on financial liabilities other than those at fair value through profit or loss (FVTPL) is determined using the effective interest rate method.

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

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for financial assets that have subsequently become credit-impaired (or 'Stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the ECL provision). For more information on stage allocations of credit risk exposures, see 'Significant increase in credit risk' in the 'Santander UK group level – credit risk management' section of the Risk Review.

During Q4 2020, we revised the accounting treatment for certain items of mortgage income. Mortgage account fees, which are normally paid at the end of the mortgage and were previously recognised as received in fee income, are now recognised in interest income as part of the effective interest rate method throughout the life of the mortgage to better reflect the requirements of IFRS. In addition, we no longer accrue interest income relating to the period after mortgages revert to the standard variable rate (or equivalent) beyond the incentive period. This better aligns our policy to current practice. These changes resulted in an increase in net interest income of £44m for 2020. The net impact of these changes is not material and comparatives have not been restated.

b) Fee and commission income and expense

Fees and commissions that are not an integral part of the effective interest rate are recognised when the service is performed. Most fee and commission income is recognised at a point in time. Certain commitment, upfront and management fees are recognised over time but are not material. For retail and corporate products, fee and commission income consists principally of collection services fees, commission on foreign currencies, commission and other fees

received from retailers for processing credit card transactions, fees received from other credit card issuers for providing cash advances for their customers through the Santander UK group's branch and ATM networks, annual fees payable by credit card holders and fees for non-banking financial products.

For insurance products, fee and commission income consists principally of commissions and profit share arising from the sale of building and contents insurance and life protection insurance. Commissions arising from the sale of buildings and contents insurance are recognised over the period of insurance cover, adjusted to take account of cancelled policies. Profit share income from the sale of buildings and contents insurance which is not subject to any adjustment is recognised when the profit share income is earned. Commissions and profit share arising from the sale of life protection insurance is subject to adjustment for cancellations of policies within 3 years from inception.

Fee and commission income which forms an integral part of the effective interest rate of a financial instrument (for example certain loan commitment fees) is recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.

c) Dividend income

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

d) Other operating income

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

Borrowing costs

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

Pensions and other post-retirement benefits

a) Defined benefit schemes

A defined benefit scheme is a pension scheme that guarantees an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service or compensation. Pension costs are charged to 'Administration expenses', within the line item 'Operating expenses before impairment losses, provisions and charges' with the net interest on the defined benefit asset or liability included within 'Net interest income' in the income statement. The asset or liability recognised in respect of defined benefit pension schemes is the present value of the defined benefit obligation at the balance sheet date, less the fair value of scheme assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The assets of the schemes are measured at their fair values at the balance sheet date.

The present value of the defined benefit obligation is estimated by projecting forward the growth in current accrued pension benefits to reflect inflation and salary growth to the date of pension payment, then discounted to present value using the yield applicable to high-quality AA rated corporate bonds of the same currency and which have terms to maturity closest to the terms of the scheme liabilities, adjusted where necessary to match those terms. In determining the value of scheme liabilities, demographic and financial assumptions are made by management about life expectancy, inflation, discount rates, pension increases and earnings growth, based on past experience and future expectations. Financial assumptions are based on market conditions at the balance sheet date and can generally be derived objectively.

Demographic assumptions require a greater degree of estimation and judgement to be applied to externally derived data. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). An asset is only recognised to the extent that the surplus can be recovered through reduced contributions in the future or through refunds from the scheme. The income statement includes the net interest income/expense on the net defined benefit liability/asset, current service cost and any past service cost and gain or loss on settlement. Remeasurement of defined benefit pension schemes, including return on scheme assets (excludes amounts included in net interest), actuarial gains and losses (arising from changes in demographic assumptions, the impact of scheme experience and changes in financial assumptions) and the effect of the changes to the asset ceiling (if applicable), are recognised in other comprehensive income. Remeasurement recognised in other comprehensive income will not be reclassified to the income statement. Past-service costs are recognised as an expense in the income statement at the earlier of when the scheme amendment or curtailment occurs and when the related restructuring costs or termination benefits are recognised. Curtailments include the impact of significant reductions in the number of employees covered by a scheme, or amendments to the terms of the scheme so that a significant element of future service will no longer qualify for benefits or will qualify only for reduced benefits. Curtailment gains and losses on businesses that meet the definition of discontinued operations are included in profit or loss for the year from discontinued operations. Gains and losses on settlements are recognised when the settlement occurs.

b) Defined contribution plans

A defined contribution plan is a pension scheme under which the Santander UK group pays fixed contributions as they fall due into a separate entity (a fund). The pension paid to the member at retirement is based on the amount in the separate fund for each member. The Santander UK group has no legal or constructive obligations to pay further contributions into the fund to 'top up' benefits to a certain guaranteed level. The regular contributions constitute net periodic costs for the year in which they are due and are included in staff costs within Operating expenses in the income statement.

c) Post-retirement medical benefit plans

Post-retirement medical benefit liabilities are determined using the projected unit credit method, with actuarial valuations updated at each year-end. The expected benefit costs are accrued over the period of employment using an accounting methodology similar to that for the defined benefit pension scheme.

Share-based payments

The Santander UK group engages in cash-settled and equity-settled share-based payment transactions in respect of services received from certain of its employees. Shares of the Santander UK group's parent, Banco Santander SA are purchased in the open market by the Santander UK group (for the Employee Sharesave scheme) or are purchased by Banco Santander SA or another Banco Santander subsidiary (including awards granted under the Long-Term Incentive Plan and the Deferred Shares Bonus Plan) to satisfy share options or awards as they vest.

Options granted under the Employee Sharesave scheme are accounted for as cash-settled share-based payment transactions. Awards granted under the Long-Term Incentive Plan and Deferred Shares Bonus Plan are accounted for as equity-settled share-based payment transactions.

The fair value of the services received is measured by reference to the fair value of the shares or share options initially on the date of the grant for both the cash and equity settled share-based payments and then subsequently at each reporting date for the cash-settled share-based payments. The cost of the employee services received in respect of the shares or share options granted is recognised in the income statement in administration expenses over the period that the services are received i.e. the vesting period.

A liability equal to the portion of the services received is recognised at the fair value determined at each balance sheet date for cash-settled share-based payments. A liability equal to the amount to be reimbursed to Banco Santander SA is recognised at the fair value determined at the grant date for equity-settled share-based payments.

The fair value of the options granted under the Employee Sharesave scheme is determined using an option pricing model, which takes into account the exercise price of the option, the current share price, the risk free interest rate, the expected volatility of the Banco Santander SA share price over the life of the option and the dividend growth rate. The fair value of the awards granted for the Long-Term Incentive Plan was determined at the grant date using an option pricing model, which takes into account the share price at grant date, the risk free interest rate, the expected volatility of the Banco Santander SA share price over the life of the award and the dividend growth rate. Vesting conditions included in the terms of the grant are not taken into account in estimating fair value, except for those that include terms related to market conditions. Non-market vesting conditions are taken into account by adjusting the number of shares or share options included in the measurement of the cost of employee service so that, ultimately, the amount recognised in the income statement reflects the number of vested shares or share options. Where vesting conditions are related to market conditions, the charges for the services received are recognised regardless of whether or not the market-related vesting conditions are met, provided that the non-market vesting conditions are met.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the modification of the award is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

Cancellations in the vesting period are treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

Goodwill and other intangible assets

Goodwill represents the excess of the cost of an acquisition, as well as the fair value of any interest previously held, over the fair value of the share of the identifiable net assets of the acquired subsidiary, associate, or business at the date of acquisition. Goodwill on the acquisition of subsidiaries and businesses is included in intangible assets. Goodwill on acquisitions of associates is included as part of investment in associates. Goodwill is tested for impairment annually, or more frequently when events or changes in circumstances dictate, and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity or business include the carrying amount of goodwill relating to the entity or business sold.

Other intangible assets are recognised if they arise from contractual or other legal rights or if they are capable of being separated or divided from Santander UK and sold, transferred, licensed, rented or exchanged. The value of such intangible assets is amortised on a straight-line basis over their useful economic life of three to seven years. Other intangible assets are reviewed annually for impairment indicators and tested for impairment where indicators are present.

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

Property, plant and equipment

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

Owner-occupied properties	Not exceeding 50 years
Office fixtures and equipment	3 to 15 years
Computer software	3 to 7 years
Right-of-use assets (see 'Leases – The Santander UK group as lessee' below)	Shorter of the lease term or the useful life of the underlying asset

Depreciation is not charged on freehold land and assets under construction. Depreciation on operating lease assets where the Santander UK group is the lessor is described in 'Leases' below.

Financial instruments

a) Initial recognition and measurement

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

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

b) Financial assets and liabilities

i) Classification and subsequent measurement

The Santander UK group classifies its financial assets in the measurement categories of amortised cost, FVOCI and FVTPL.

Financial assets and financial liabilities are classified as FVTPL where there is a requirement to do so or where they are otherwise designated at FVTPL on initial recognition. Financial assets and financial liabilities which are required to be held at FVTPL include:

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

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

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

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

a) Financial assets: debt instruments

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

Business model

The business model reflects how the Santander UK group manages the assets in order to generate cash flows and, specifically, whether the Santander UK group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of the assets. If neither of these is applicable, such as where the financial assets are held for trading purposes, then the financial assets are classified as part of an 'other' business model and measured at FVTPL. Factors considered in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the assets' performance is evaluated and reported to key management personnel, and how risks are assessed and managed.

SPPI

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

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

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

- Amortised cost – Financial assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL recognised and measured as presented in Note 13. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method. When estimates of future cash flows are revised, the carrying amount of the respective financial assets or financial liabilities is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in the income statement.
- FVOCI – Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are recognised in OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Other operating income'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.
- FVTPL – Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt instrument that is subsequently measured at FVTPL, including any debt instruments designated at fair value, is recognised in profit or loss and presented in the income statement in 'Other operating income' in the period in which it arises.

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

b) Financial assets: equity instruments

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

c) Financial liabilities

Financial liabilities are classified as subsequently measured at amortised cost, except for:

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

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

d) Sale and repurchase agreements (including stock borrowing and lending)

Securities sold subject to a commitment to repurchase them at a predetermined price (repos) under which substantially all the risks and rewards of ownership are retained by the Santander UK group remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell (reverse repos) are not recognised on the balance sheet and the consideration paid is recorded as an asset. The difference between the sale and repurchase price is treated as trading income in the income statement, except where the repo is not treated as part of the trading book, in which case the difference is recorded in interest income or expense.

Securities lending and borrowing transactions are generally secured, with collateral in the form of securities or cash advanced or received. Securities lent or borrowed are not reflected on the balance sheet. Collateral in the form of cash received or advanced is recorded as a deposit or a loan. Collateral in the form of securities is not recognised.

e) Day One profit adjustments

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

ii) Impairment of debt instrument financial assets

The Santander UK group assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from financial guarantee contracts and loan commitments. The Santander UK group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

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

Grouping of instruments for losses measured on a collective basis

We typically group instruments and assess them for impairment collectively where they share risk characteristics (as described in Retail Banking – credit risk management in the Risk review) using one or more statistical models. Where we have used internal capital or similar models as the basis for our ECL models, this typically results in a large number of relatively small homogenous groups which are determined by the permutations of the underlying characteristics in the statistical models. We calculate separate collective provisions for instruments in Stages 1, 2 and 3 where the instrument is not individually assessed, as described below.

Individually assessed impairments (IAIs)

We assess significant Stage 3 cases individually. We do this for CIB and Corporate & Commercial Banking cases, but not for Business Banking cases in Retail Banking which we assess collectively. To calculate the estimated loss, we estimate the future cash flows under several scenarios each of which uses case-specific factors and circumstances. We then probability-weight the net present value of the cash flows under each scenario to arrive at a weighted average provision requirement. We update our assessment process every quarter and more frequently if there are changes in circumstances that might affect the scenarios, cash flows or probabilities we apply.

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

a) Write-off

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

There is no threshold based on past due status beyond which all secured loans are written off as there can be significant variations in the time needed to enforce possession and sale of the security, especially due to the different legal frameworks that apply in different regions of the UK. For unsecured loans, a write-off is only made when all internal avenues of collecting the debt have been exhausted. Where appropriate the debt is passed over to external collection agencies. A past due threshold is applied to unsecured debt where accounts that are 180 days past due are written off unless there is a dispute awaiting resolution. Contact is made with customers with the aim to achieve a realistic and sustainable repayment arrangement. Litigation and/or enforcement of security is usually carried out only when the steps described above have been undertaken without success.

All write-offs are assessed / made on a case-by-case basis, taking account of the exposure at the date of write-off, after accounting for the value from any collateral or insurance held against the loan. The exception to this is in cases where fraud has occurred, where the exposure is written off once investigations have been completed and the probability of recovery is minimal. The time span between discovery and write-off will be short and may not result in an impairment loss allowance being raised. The write-off policy is regularly reviewed. Write-offs are charged against previously established loss allowances.

b) Recoveries

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

iii) Modifications of financial assets

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

- **Contractual modifications due to financial difficulties of the borrower:** where the Santander UK group modifies the contractual conditions to enable the borrower to fulfil their payment obligations, the asset is not derecognised. The gross carrying amount of the financial asset is recalculated as the present value of the renegotiated/modified contractual cash flows that are discounted at the financial asset's original EIR and any gain or loss arising from the modification is recognised in the income statement.
- **Contractual modifications for other commercial reasons:** an assessment is performed to determine whether the terms of the new agreement are substantially different from the terms of the existing agreement, after considering changes in the cash flows arising from the modified terms and the overall instrument risk profile. Where terms are substantially different, such modifications are treated as a new transaction resulting in derecognition of the original financial asset, and the recognition of a 'new' financial asset with any difference between the carrying amount of the derecognised asset and the fair value of the new asset is recognised in the income statement as a gain or loss on derecognition. Where terms are not substantially different, the carrying value of the financial asset is adjusted to reflect the present value of modified cash flows discounted at the original EIR with any gain or loss arising from modification recognised immediately in the income statement.

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

iv) Derecognition other than on a modification

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

Financial liabilities are derecognised when extinguished, cancelled or expired.

c) Financial guarantee contracts and loan commitments

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

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of the amount of the loss allowance, and the premium received on initial recognition less income recognised in accordance with the principles of IFRS 15. Loan commitments are measured as the amount of the loss allowance (determined in accordance with IFRS 9 as described in Credit risk section of the Risk review). The Santander UK group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

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

Derivative financial instruments (derivatives)

Derivatives are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement, which require no or little initial net investment and are settled at a future date. Transactions are undertaken in interest rate, cross currency, equity, residential property and other index-related swaps, forwards, caps, floors, swaptions, as well as credit default and total return swaps, equity index contracts and exchange traded interest rate futures, and equity index options.

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

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

Certain derivatives may be embedded in hybrid contracts, such as the conversion option in a convertible bond. If the hybrid contract contains a host that is a financial asset, then the Santander UK group assesses the entire contract as described in the financial asset section above for classification and measurement purposes. Otherwise, embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. Contracts containing embedded derivatives are not subsequently reassessed for separation unless either there has been a change in the terms of the contract which significantly modifies the cash flows (in which case the contract is reassessed at the time of modification) or the contract has been reclassified (in which case the contract is reassessed at the time of reclassification).

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

Offsetting financial assets and liabilities

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

Hedge accounting

The Santander UK group applies hedge accounting to represent, to the maximum possible extent permitted under accounting standards, the economic effects of its risk management strategies. Derivatives are used to hedge exposures to interest rates, exchange rates and certain indices such as retail price indices.

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

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

a) Fair value hedge accounting

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. Where the hedged item is measured at amortised cost, the fair value changes due to the hedged risk adjust the carrying amount of the hedged asset or liability. Changes in the fair value of portfolio hedged items are presented separately in the consolidated balance sheet in macro hedge of interest rate risk and recognised in the income statement within other operating income. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. For fair value hedges of interest rate risk, the cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity. For portfolio hedged items, the cumulative adjustment is amortised to the income statement using the straight line method over the period to maturity.

b) Cash flow hedge accounting

The effective portion of changes in the fair value of qualifying cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement. The Santander UK group is exposed to cash flow interest rate risk on its floating rate assets, foreign currency risk on its fixed rate debt issuances denominated in foreign currency and equity price risk arises from the Santander UK group operating the Employee Sharesave scheme. Cash flow hedging is used to hedge the variability in cash flows arising from these risks.

Securitisation transactions

The Santander UK group has entered into arrangements where undertakings have issued mortgage-backed and other asset-backed securities or have entered into funding arrangements with lenders in order to finance specific loans and advances to customers. The Santander UK group has also entered into synthetic securitisation arrangements, as part of significant risk transfer (SRT) transactions to reduce its risk-weighted assets, where undertakings have issued credit-linked notes and deposited the funds raised as collateral for credit protection in respect of specific loans and advances to customers. As the Santander UK group has retained substantially all the risks and rewards of the underlying assets, such financial instruments continue to be recognised on the balance sheet, and a liability recognised for the proceeds of the funding transaction, or in the case of SRT transactions, collateral deposited.

Impairment of non-financial assets

At each balance sheet date, or more frequently when events or changes in circumstances dictate, property plant and equipment (including operating lease assets) and intangible assets (including goodwill) are assessed for indicators of impairment. If indications are present, these assets are subject to an impairment review. The impairment review comprises a comparison of the carrying amount of the asset or cash generating unit with its recoverable amount: the higher of the asset's or cash-generating unit's fair value less costs to sell and its value in use. The cash-generating unit represents the lowest level at which non-financial assets, including goodwill, are monitored for internal management purposes and is not larger than an operating segment.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Value in use is calculated by discounting management's expected future cash flows obtainable as a result of the asset's continued use (after making allowance for increases in regulatory capital requirements), including those resulting from its ultimate disposal, at a market-based discount rate on a pre-tax basis. The recoverable amounts of goodwill have been based on value in use calculations.

The carrying values of property, plant and equipment, goodwill and other intangible assets are written down by the amount of any impairment and the loss is recognised in the income statement in the period in which it occurs. A previously recognised impairment loss relating to property, plant and equipment may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the property, plant and equipment's recoverable amount. The carrying amount of the property, plant and equipment will only be increased up to the amount that would have been had the original impairment not been recognised. Impairment losses on goodwill are not reversed. For conducting goodwill impairment reviews, cash generating units are the lowest level at which management monitors the return on investment on assets.

Leases

a) The Santander UK group as lessor

Operating lease assets are recorded at cost and depreciated over the life of the asset after taking into account anticipated residual value (RV). Operating lease rental income and depreciation is recognised on a straight-line basis over the life of the asset. After initial recognition, residual values are reviewed regularly, and any changes are recognised prospectively through remaining depreciation charges.

Amounts due from lessees under finance leases and hire purchase contracts are recorded as receivables at the amount of the Santander UK group's net investment in the leases. Finance lease income is allocated to accounting periods to reflect a constant periodic rate of return on the Santander UK group's net investment outstanding in respect of the leases and hire purchase contracts. A provision is recognised to reflect a reduction in any anticipated unguaranteed RV. A provision is also recognised for voluntary termination of the contract by the customer, where appropriate.

b) The Santander UK group as lessee

The Santander UK group assesses whether a contract is or contains a lease at the inception of the contract and recognises a right-of-use (ROU) asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments for all leases, except for leases with a term of 12 months or less which are expensed in the income statement on a straight-line basis over the lease terms. Lease payments exclude irrecoverable VAT which is expensed in the income statement as lease payments are made.

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

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

Income taxes, including deferred taxes

The tax expense represents the sum of the income tax currently payable and deferred income tax.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. Current taxes associated with the repurchase of equity instruments are reported directly in equity.

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

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Santander UK group is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future. The Santander UK group reviews the carrying amount of deferred tax assets at each balance sheet date and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax relating to actuarial gains and losses on defined benefits is recognised in other comprehensive income. Deferred tax relating to fair value re-measurements of financial instruments accounted for at FVOCI and cash flow hedging instruments is charged or credited directly to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

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

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks and short-term investments in securities. Balances with central banks represent amounts held at the Bank of England as part of the Santander UK group's liquidity management activities. In addition, it includes certain minimum cash balances held for regulatory purposes required to be maintained with the Bank of England.

Provisions

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

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

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

Loan commitments are measured as the amount of the loss allowance, determined in line with IFRS 9 as set out in the Credit risk section of the Risk review.

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

Share capital

a) Share issue costs

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

b) Dividends

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

CRITICAL JUDGEMENTS AND ACCOUNTING ESTIMATES

The preparation of the Consolidated Financial Statements requires management to make judgements and accounting estimates that affect the reported amount of assets and liabilities at the date of the Consolidated Financial Statements and the reported amount of income and expenses during the reporting period. Management evaluates its judgements and accounting estimates, which are based on historical experience and on various other factors that are believed to be reasonable under the circumstances, on an ongoing basis. Actual results may differ from these accounting estimates under different assumptions or conditions. In preparing the Consolidated Financial Statements, no significant judgements have been made in the process of applying the accounting policies, other than those involving estimations about credit impairment losses, provisions and contingent liabilities, pensions and goodwill.

The following accounting estimates, as well as the judgements inherent within them, are considered important to the portrayal of the Santander UK group's financial results and financial condition because: (i) they are highly susceptible to change from period to period as assumptions are made to calculate the estimates, and (ii) any significant difference between the estimated amounts and actual amounts could have a material impact on the Santander UK group's future financial results and financial condition. In calculating each accounting estimate, a range of outcomes was calculated based principally on management's conclusions regarding the input assumptions relative to historical experience. The actual estimates were based on what management concluded to be the most probable assumptions within the range of reasonably possible assumptions.

a) Credit impairment allowance

The application of the ECL impairment methodology for calculating credit impairment allowances is highly susceptible to change from period to period. The methodology requires management to make judgmental assumptions in determining the estimates. Any significant difference between the estimated amounts and actual amounts could have a material impact on the future financial results and financial condition. The impact of Covid-19 has increased the uncertainty around ECL impairment calculations, and has required management to make additional judgements and accounting estimates that affect the amount of assets and liabilities at the reporting date and the amount of income and expenses in the reporting period. The key additional judgements due to the impact of Covid-19 mainly reflect the increased uncertainty around forward-looking economic data and the need for additional post model adjustments.

Key areas of judgement in accounting estimates

The key judgements made by management in applying the ECL impairment methodology are the definition of default, forward-looking economic scenarios, probability weights, SICR thresholds, post model adjustments, internal credit risk rating for corporate borrowers and individually assessed corporate Stage 3 exposures. For more on each of these key judgements, including the impact of Covid-19 on them, see 'Management judgement applied in calculating ECL' in the 'Credit risk – Santander UK group level – credit risk management' section of the Risk review.

Sensitivity of ECL allowance

For detailed disclosures, see 'Sensitivity of ECL allowance' in the 'Credit risk – Santander UK group level – credit risk management' section of the Risk review.

b) Provisions and contingent liabilities

Significant judgment may be required when accounting for provisions, including in determining whether a present obligation exists and in estimating the probability and amount of any outflows. These judgments are based on the specific facts available and often require specialist professional advice. There can be a wide range of possible outcomes and uncertainties, particularly in relation to legal actions, and regulatory and consumer credit matters. As a result it is often not possible to make reliable estimates of the likelihood and amount of any potential outflows. The main areas of judgement relating to provisions and contingent liabilities are set out below. For more details, see Notes 29 and 31.

Included in Regulatory and other provisions in Note 29 is an amount in respect of management's best estimate of liability relating to a legal dispute regarding allocation of responsibility for a specific PPI portfolio of complaints. Note 31 provides disclosure relating to ongoing factual issues and reviews that could impact the timing and amount of any outflows.

In addition, Note 31 includes disclosure relating to an investigation in relation to the historical involvement of Santander UK plc, Santander Financial Services plc and Cater Allen International Limited (all subsidiaries of Santander UK Group Holdings plc) in German dividend tax arbitrage transactions, as well as an FCA civil regulatory investigation which commenced in July 2017 into our compliance with the Money Laundering Regulations 2007 and potential breaches of FCA principles and rules relating to anti-money laundering and financial crime systems and controls. It also includes disclosure relating to certain leases in which current and former Santander UK group members were the lessor that are currently under review by HMRC in connection with claims for tax allowances.

c) Pensions

The Santander UK group operates a number of defined benefit pension schemes as described in Note 30 and estimates their position as described in the accounting policy 'Pensions and other post retirement benefits'.

Key areas of judgement in accounting estimates

Accounting for defined benefit pension schemes requires management to make assumptions principally about the discount rate adopted, but also about price inflation and life expectancy. Management's assumptions are based on past experience and current economic trends, which are not necessarily an indication of future experience. These are described in more detail in the 'Actuarial assumptions' section in Note 30.

Sensitivity of defined benefit pension scheme estimates

Had management used different assumptions, a larger or smaller pension remeasurement gain or loss would have resulted that could have had a material impact on the Santander UK group's reported financial position. Detailed disclosures on the actuarial assumption sensitivities of the schemes can be found in the 'Actuarial assumption sensitivities' section of Note 30.

d) Goodwill

The carrying amount of goodwill is based on the application of judgements including the basis of goodwill impairment calculation assumptions. Santander UK undertakes an annual assessment to evaluate whether the carrying value of goodwill is impaired, carrying out this assessment more frequently if reviews identify indicators of impairment or when events or changes in circumstances dictate.

Estimates include the determination of the carrying value of the Personal Financial Services Cash Generating Unit based on an allocation of regulatory capital, forecasts used for determining cash flows for Cash Generating Units and discount rates which factor in risk-free rates and applicable risk premiums, which are variables subject to fluctuations in external market rates and economic conditions beyond management's control. The estimation of future cash flows and the level to which they are discounted is inherently uncertain and requires significant judgement and is subject to potential change over time. For more on these assumptions, including changes in the assumptions that would trigger an impairment, see Note 20.

2. SEGMENTS

Santander UK's principal activity is financial services, mainly in the UK. The business is managed and reported on the basis of four segments, which are strategic business units that offer different products and services, have different customers and require different technology and marketing strategies.

- **Retail Banking** offers a wide range of products and financial services to individuals and small businesses through our omni-channel presence comprising branches, ATMs, telephony, digital and intermediary channels. Retail Banking includes business banking customers, small businesses with simple banking needs and Santander Consumer Finance, predominantly a vehicle finance business.
- **Corporate & Commercial Banking** offers a wide range of financial services and solutions to more complex businesses across multiple sectors, typically with annual turnovers of between £2m and £500m. Service and expertise are provided by relationship managers, product specialists and through digital and telephony channels, and cover clients' needs both in the UK and overseas.
- **Corporate & Investment Banking** services corporate clients with an annual turnover of £500m and above. CIB clients require specially tailored solutions and value-added services due to their size, complexity and sophistication. We provide these clients with products to manage currency fluctuations, protect against interest rate risk, and arrange capital markets finance and specialist trade finance solutions, as well as providing support to the rest of Santander UK's business segments.
- **Corporate Centre** mainly includes the treasury, non-core corporate and legacy portfolios, as well as the Crown Dependencies. Corporate Centre is also responsible for managing capital and funding, balance sheet composition, structure, pension and strategic liquidity risk. To enable a more targeted and strategically aligned apportionment of capital and other resources, revenues and costs incurred in Corporate Centre are allocated to the three business segments. The non-core corporate and legacy portfolios are being run-down and/or managed for value.

The segmental basis of presentation in this Annual Report has changed following a management review of our structure. As a result, customer assets of £2.0bn and customer deposits of £3.1bn have been transferred from Business Banking (in Retail Banking) to CCB, non-core corporate mortgages of £0.4bn have been transferred from Corporate Centre to CCB, and a number of smaller business lines have been transferred from CIB to Corporate Centre. This resulted in an increase in profit before tax in Retail Banking of £18m (2019: decrease of £36m), a decrease in CCB of £9m (2019: increase of £24m), a decrease in CIB of £10m (2019: decrease of £1m), and an increase of £1m in Corporate Centre (2019: increase of £13m). The net impact for Santander UK was nil.

The segmental data below is presented in a manner consistent with the internal reporting to the committee which is responsible for allocating resources and assessing performance of the segments and has been identified as the chief operating decision maker. The segmental data is prepared on a statutory basis of accounting, in line with the accounting policies set out in Note 1. Transactions between segments are on normal commercial terms and conditions. Internal charges and internal UK transfer pricing adjustments are reflected in the results of each segment. Revenue sharing agreements are used to allocate external customer revenues to a segment on a reasonable basis. Funds are ordinarily reallocated between segments, resulting in funding cost transfers disclosed in operating income. Interest charged for these funds is based on Santander UK's cost of wholesale funding. Interest income and interest expense have not been reported separately. The majority of segment revenues are interest income in nature and net interest income is relied on primarily to assess segment performance and to make decisions on the allocation of segment resources.

Results by segment

	Retail Banking	Corporate & Commercial Banking	Corporate & Investment Banking	Corporate Centre	Total
2020	£m	£m	£m	£m	£m
Net interest income/(expense)	3,105	364	55	(87)	3,437
Non-interest income	375	93	68	(15)	521
Total operating income/(expense)	3,480	457	123	(102)	3,958
Operating expenses before credit impairment losses, provisions and charges	(1,913)	(316)	(114)	(144)	(2,487)
Credit impairment losses	(308)	(294)	(7)	(36)	(645)
Provisions for other liabilities and (charges)/release	(175)	(12)	(10)	(77)	(274)
Total operating credit impairment losses, provisions and charges	(483)	(306)	(17)	(113)	(919)
Profit/(loss) before tax	1,084	(165)	(8)	(359)	552
Revenue from external customers	4,175	549	123	(889)	3,958
Inter-segment revenue	(695)	(92)	—	787	—
Total operating income/(expense)	3,480	457	123	(102)	3,958
Revenue from external customers includes the following fee and commission income disaggregated by income type: ⁽¹⁾					
– Current account and debit card fees	441	41	10	—	492
– Insurance, protection and investments	65	—	—	—	65
– Credit cards	67	—	—	—	67
– Non-banking and other fees ⁽²⁾	15	47	66	4	132
Total fee and commission income	588	88	76	4	756
Fee and commission expense	(335)	(19)	(10)	(9)	(373)
Net fee and commission income/(expense)	253	69	66	(5)	383
Customer loans	186,476	17,626	2,784	3,483	210,369
Total assets⁽³⁾	195,142	17,626	2,784	83,512	299,064
Customer deposits	152,167	24,985	6,506	8,074	191,732
Total liabilities	152,715	25,011	6,517	98,576	282,819
Average number of full-time equivalent staff	19,151	2,092	716	180	22,139

(1) The disaggregation of fees and commission income as shown above is not included in reports provided to the chief operating decision maker but is provided to show the split by reportable segments.

(2) Non-banking and other fees include mortgages (except mortgage account fees), consumer finance, commitment commission, asset finance, invoice finance and trade finance.

(3) Includes customer loans, net of credit impairment loss allowances.

	Retail Banking	Corporate & Commercial Banking	Corporate & Investment Banking	Corporate Centre	Total
2019	£m	£m	£m	£m	£m
Net interest income/(expense)	2,827	422	62	(16)	3,295
Non-interest income	691	109	70	5	875
Total operating income/(expense)	3,518	531	132	(11)	4,170
Operating expenses before credit impairment losses, provisions and charges	(1,980)	(324)	(130)	(92)	(2,526)
Credit impairment (losses)/releases	(156)	(45)	(22)	3	(220)
Provisions for other liabilities and charges	(290)	(22)	(16)	(115)	(443)
Total operating credit impairment losses, provisions and charges	(446)	(67)	(38)	(112)	(663)
Profit/(loss) before tax	1,092	140	(36)	(215)	981
Revenue from external customers	4,255	633	138	(856)	4,170
Inter-segment revenue	(737)	(102)	(6)	845	—
Total operating income/(expense)	3,518	531	132	(11)	4,170
Revenue from external customers includes the following fee and commission income disaggregated by income type: ⁽¹⁾					
– Current account and debit card fees	696	49	13	—	758
– Insurance, protection and investments	76	—	—	1	77
– Credit cards	86	—	—	—	86
– Non-banking and other fees ⁽²⁾	61	58	67	10	196
Total fee and commission income	919	107	80	11	1,117
Fee and commission expense	(373)	(23)	(17)	(15)	(428)
Net fee and commission income/(expense)	546	84	63	(4)	689
Customer loans	178,762	18,391	4,041	4,104	205,298
Total assets⁽³⁾	185,920	18,391	4,046	80,131	288,488
Customer deposits	142,735	20,546	6,102	8,438	177,821
Total liabilities	143,602	20,572	6,233	101,740	272,147
Average number of full-time equivalent staff	20,594	2,151	804	157	23,706

2018					
Net interest income	3,076	470	69	(9)	3,606
Non-interest income	632	115	132	58	937
Total operating income	3,708	585	201	49	4,543
Operating expenses before credit impairment losses, provisions and charges	(1,914)	(318)	(203)	(128)	(2,563)
Credit impairment (losses)/releases	(135)	(8)	(14)	4	(153)
Provisions for other liabilities and charges	(228)	(16)	(8)	(8)	(260)
Total operating credit impairment losses, provisions and (charges)/releases	(363)	(24)	(22)	(4)	(413)
Profit/(loss) before tax	1,431	243	(24)	(83)	1,567
Revenue from external customers	4,361	750	245	(813)	4,543
Inter-segment revenue	(653)	(165)	(44)	862	—
Total operating income	3,708	585	201	49	4,543
Revenue from external customers includes the following fee and commission income disaggregated by income type: ⁽¹⁾					
– Current account and debit card fees	690	49	14	—	753
– Insurance, protection and investments	105	—	—	—	105
– Credit card fees	85	—	—	—	85
– Non-banking and other fees ⁽²⁾	76	65	81	5	227
Total fee and commission income	956	114	95	5	1,170
Fee and commission expense	(382)	(25)	(14)	—	(421)
Net fee and commission income	574	89	81	5	749
Customer loans	171,134	19,858	4,543	4,334	199,869
Total assets⁽³⁾	177,959	19,858	3,244	88,320	289,381
Customer deposits	139,976	19,695	4,853	7,607	172,131
Total liabilities	140,750	19,723	4,400	108,288	273,161
Average number of full-time equivalent staff	20,964	2,102	985	159	24,210

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– Insurance, protection and investments	105	—	—	—	105
– Credit card fees	85	—	—	—	85
– Non-banking and other fees ⁽²⁾	76	65	81	5	227
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(1) The disaggregation of fees and commission income as shown above is not included in reports provided to the chief operating decision maker but is provided to show the split by reportable segments.

(2) Non-banking and other fees include mortgages (except mortgage account fees), consumer finance, commitment commission, asset finance, invoice finance and trade finance.

(3) Includes customer loans, net of credit impairment loss allowances.

Geographical information is not provided, as substantially all of Santander UK's activities are in the UK.

3. NET INTEREST INCOME

	Group		
	2020	2019	2018
	£m	£m	£m
Interest and similar income:			
Loans and advances to customers ⁽³⁾	4,847	5,237	5,459
Loans and advances to banks	62	182	207
Reverse repurchase agreements – non trading	118	244	124
Other	119	309	282
Total interest and similar income⁽¹⁾	5,146	5,972	6,072
Interest expense and similar charges:			
Deposits by customers	(884)	(1,331)	(1,224)
Deposits by banks	(47)	(135)	(120)
Repurchase agreements – non trading	(43)	(126)	(37)
Debt securities in issue	(614)	(938)	(936)
Subordinated liabilities	(111)	(137)	(141)
Other	(10)	(10)	(8)
Total interest expense and similar charges⁽²⁾	(1,709)	(2,677)	(2,466)
Net interest income	3,437	3,295	3,606

(1) This includes £38m (2019: £155m) of interest income on financial assets at fair value through other comprehensive income.

(2) This includes £451m (2019: £310m) of interest expense on derivatives hedging debt issuances and £3m (2019: £4m) of interest expense on lease liabilities.

(3) During 2020, we revised the accounting treatment for certain items of mortgage income to better align our policy to current practice. The net impact of these changes is not material and comparatives have not been restated. Further details are provided in Note 1 Accounting Policies.

4. NET FEE AND COMMISSION INCOME

	Group		
	2020	2019	2018
	£m	£m	£m
Fee and commission income:			
Current account and debit card fees	492	758	753
Insurance, protection and investments	65	77	105
Credit cards	67	86	85
Non-banking and other fees ⁽¹⁾	132	196	227
Total fee and commission income	756	1,117	1,170
Total fee and commission expense	(373)	(428)	(421)
Net fee and commission income	383	689	749

(1) Non-banking and other fees include mortgages (except mortgage account fees), consumer finance, commitment commission, asset finance, invoice finance and trade finance.

5. OTHER OPERATING INCOME

	Group		
	2020	2019	2018
	£m	£m	£m
Net losses on financial instruments designated at fair value through profit or loss	(24)	(94)	(85)
Net gains on financial instruments mandatorily at fair value through profit or loss	64	113	23
Hedge ineffectiveness	19	8	34
Net profit on sale of financial assets at fair value through other comprehensive income	17	15	19
Income from operating lease assets	126	124	86
Other	(64)	20	111
	138	186	188

Following the implementation of our ring-fencing plans in 2018, assets and liabilities held at fair value through profit or loss, including derivatives, are predominantly used to provide customers with risk management solutions, and to manage and hedge the Santander UK group's own risks, and do not give rise to significant overall net gains/(losses) in the income statement.

'Net gains on financial instruments mandatorily at fair value through profit or loss' includes fair value gains of £89m (2019: losses of £42m, 2018: gains of £22m) on embedded derivatives bifurcated from certain equity index-linked deposits, as described in the derivatives accounting policy in Note 1. The embedded derivatives are economically hedged, the results of which are also included in this line item, and amounted to losses of £88m (2019: gains of £43m, 2018: losses of £21m). As a result, the net fair value movements recognised on the equity index-linked deposits and the related economic hedges were net gains of £1m (2019: £1m, 2018: £1m).

In 2019, 'net profit on sale of financial assets at fair value through other comprehensive income' included additional consideration of £15m in connection with the 2017 Vocalink Holdings Limited shareholding sale.

Exchange rate differences recognised in the Consolidated Income Statement on items not at fair value through profit or loss were £719m expense (2019: £1,102m income, 2018: £689m expense) and are presented in the line 'Other'. These are principally offset by related releases from the cash flow hedge reserve of £803m income (2019: £1,021m expense, 2018: £751m income) as set out in the Consolidated Statement of Comprehensive Income, which are also presented in 'Other'. Exchange rate differences on items measured at fair value through profit or loss are included in the line items relating to changes in fair value.

In 2020, Santander UK repurchased certain securities as part of its ongoing liability management exercises, resulting in a loss of £24m.

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

	Group		
	2020 £m	2019 £m	2018 £m
Staff costs:			
Wages and salaries	845	866	905
Performance-related payments	99	160	160
Social security costs	102	112	111
Pensions costs: – defined contribution plans	67	67	66
– defined benefit plans	38	35	81
Other share-based payments	4	7	3
Other personnel costs	34	41	50
	1,189	1,288	1,376
Other administration expenses	728	693	809
Depreciation, amortisation and impairment	570	545	378
	2,487	2,526	2,563

Staff costs

'Performance-related payments' include bonuses paid in cash and share awards granted under the Long-Term Incentive Plan and the Deferred shares bonus plan, as described in Note 37. Included in this are equity-settled share-based payments, none of which related to option-based schemes. These are disclosed in the table below as 'Share awards'. Performance-related payments above include amounts related to deferred performance awards as follows:

	Costs recognised in 2020			Costs expected to be recognised in 2021 or later		
	Arising from awards in current year	Arising from awards in prior year	Total	Arising from awards in current year	Arising from awards in prior year	Total
	£m	£m	£m	£m	£m	£m
Cash	2	7	9	2	9	11
Shares	2	6	8	2	9	11
	4	13	17	4	18	22

The following table shows the amount of bonus awarded to employees for the performance year 2020. In the case of deferred cash and share awards, the final amount paid to an employee is influenced by forfeiture provisions and any performance conditions to which these awards are subject. The deferred share award amount is based on the fair value of these awards at the date of grant.

	Expenses charged in the year		Expenses deferred to future periods		Total	
	2020	2019	2020	2019	2020	2019
	£m	£m	£m	£m	£m	£m
Cash award – not deferred	79	131	–	–	79	131
– deferred	9	10	11	17	20	27
Shares award – not deferred	3	10	–	–	3	10
– deferred	8	9	11	17	19	26
Total discretionary bonus	99	160	22	34	121	194

On 26 October 2018, the High Court handed down a judgement concluding that defined benefit schemes should equalise pension benefits for men and women in relation to GMP and concluded on the methods that were appropriate. The estimated increase in liabilities at the date of the judgement was £40m and was based on a number of assumptions and the actual impact may be different. This was reflected in the income statement and in the closing net accounting surplus of the Scheme in 2018. The allowance included in the Scheme liabilities at 31 December 2020 increased by £5m (2019: £5m) to £50m (2019: £45m) to reflect the latest assumptions. This change was recognised in other comprehensive income. We work is being undertaken to consider and agree how to implement GMP equalisation.

'Other share-based payments' consist of options granted under the Employee Sharesave scheme which comprise the Santander UK group's cash-settled share-based payments. For more, see Note 37.

The average number of full-time equivalent staff was 22,139 (2019: 23,706, 2018: 24,210). The increase in staff numbers in 2018 reflected Santander UK plc's acquisition of Santander UK Operations Ltd (formerly Geoban UK Ltd, a subsidiary of Geoban SA) and Santander UK Technology Ltd (formerly Isban UK Ltd, a subsidiary of Ingenieria de Software Bancario SL).

Depreciation, amortisation and impairment

In 2020, depreciation, amortisation and impairment was impacted by operating lease depreciation of £92m (2019: £103m) on operating lease assets (where the Santander UK group is the lessor) with a net book value of £542m at 31 December 2020 (2019: £574m). It was also impacted by depreciation of £59m (2019: £61m) on right-of-use assets with a net book value of £103m at 31 December 2020 (2019: £153m), following the adoption of IFRS 16 on 1 January 2019.

Other administration expenses

'Other administration expenses' includes £10m (2019: £13m) expenses related to short-term leases.

7. AUDIT AND OTHER SERVICES

	Group		
	2020 £m	2019 £m	2018 £m
Audit fees:			
Fees payable to the Company's auditor and its associates for the audit of the Santander UK group's annual accounts	10.5	8.5	7.7
Fees payable to the Company's auditor and its associates for other services to the Santander UK group:			
– Audit of the Santander UK group's subsidiaries	1.8	1.9	1.6
Total audit fees⁽¹⁾	12.3	10.4	9.3
Non-audit fees:			
Audit-related assurance services ⁽²⁾	1.7	1.7	2.2
Other assurance services	0.5	0.4	0.1
Other non-audit services	—	0.2	1.0
Total non-audit fees	2.2	2.3	3.3

(1) 2020 audit fees included £0.8m (2019: £0.3m) which related to the prior year.

(2) 2020 audit-related assurance services included £ nil (2019: £nil) which related to the prior year.

Audit fees payable for the statutory audit of Santander UK Group Holdings plc were £0.5m (2019: £0.5m, 2018: £0.5m).

Audit-related assurance services mainly comprises services performed in connection with review of the interim financial information of the Company and reporting to the Company's UK regulators.

Of the total non-audit fees, £1.2m (2019: £1.6m, 2018: £1.1m) accords with the definition of "Audit Fees" per US Securities and Exchange Commission (SEC) guidance, £1.0m (2019: £0.5m, 2018: £1.1m) accords with the definition of "Audit related fees" per that guidance and £nil (2019: £0.2m, 2018: £1.1m) accords with the definition of "All other fees" per that guidance.

In 2020, the Company's auditors earned £24,000 fees (2019: no fees, 2018: £150,000) payable by entities outside the Santander UK group for the review of the financial position of corporate and other borrowers.

8. CREDIT IMPAIRMENT LOSSES AND PROVISIONS

	Group		
	2020 £m	2019 £m	2018 £m
Credit impairment losses:			
Loans and advances to customers	672	238	189
Recoveries of loans and advances, net of collection costs	(24)	(40)	(42)
Off-balance sheet exposures (See Note 29)	(3)	22	6
	645	220	153
Provisions for other liabilities and charges (excluding off-balance sheet credit exposures) (See Note 29)	268	437	260
Provisions for residual value and voluntary termination	6	6	—
	274	443	260
	919	663	413

In 2020 and 2019 there were no material credit impairment losses on loans and advances to banks, non-trading reverse repurchase agreements, other financial assets at amortised cost and financial assets at fair value through other comprehensive income.

9. TAXATION

			Group
	2020	2019	2018
	£m	£m	£m
Current tax:			
UK corporation tax on profit for the year	105	255	413
Adjustments in respect of prior years	(27)	(30)	(22)
Total current tax	78	225	391
Deferred tax:			
Charge for the year	35	51	11
Adjustments in respect of prior years	1	(4)	1
Total deferred tax	36	47	12
Tax on profit	114	272	403

The standard rate of UK corporation tax was 27% for banking entities and 19% for non-banking entities (2019: 27% for banking entities and 19% for non-banking entities; 2018: 27% for banking entities and 19% for non-banking entities) following the introduction of an 8% surcharge to be applied to banking companies from 1 January 2016. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions. Finance Act 2016 introduced a reduction in the standard rate of corporation tax rate to 17% from 2020 but this was reversed in the UK Budget in March 2020. As a result, the standard rate of corporation tax remains at 19% and the effect of the increase of 2% over that expected at 31 December 2019 has been reflected in the opening deferred tax balance at 1 January 2020.

The Santander UK group's effective tax rate for 2020 was 20.7% (2019: 27.7%, 2018: 25.7%). The tax on profit before tax differs from the theoretical amount that would arise using the basic corporation tax rate of the Company as follows:

			Group
	2020	2019	2018
	£m	£m	£m
Profit before tax	552	981	1,567
Tax calculated at a tax rate of 19% (2019: 19%, 2018: 19%)	105	186	298
Bank surcharge on profits	28	64	111
Non-deductible preference dividends paid	8	8	8
Non-deductible UK Bank Levy	20	24	20
Non-deductible conduct remediation, fines and penalties	(4)	44	6
Other non-deductible costs and non-taxable income	23	29	26
Effect of change in tax rate on deferred tax provision	6	(10)	(2)
Tax relief on dividends in respect of other equity instruments	(40)	(39)	(43)
Adjustment to prior year provisions	(32)	(34)	(21)
Tax charge	114	272	403

Current tax assets and liabilities

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

			Group
	2020	2019	
	£m	£m	£m
Assets	186		106
Liabilities	—		—
At 1 January	186		106
Income statement charge	(78)		(225)
Other comprehensive income (charge)/credit	1		(3)
Corporate income tax paid	161		309
Other movements	1		(1)
	271		186
Assets	271		186
Liabilities	—		—
At 31 December	271		186

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

Santander UK proactively engages with HM Revenue & Customs to resolve tax matters relating to prior years. The accounting policy for recognising provisions for such matters are described in Note 1. It is not expected that there will be any material movement in such provisions within the next 12 months. Santander UK adopted the Code of Practice on Taxation for Banks in 2010. For more on this, see our Tax Strategy at www.santander.co.uk/about-santander/sustainability/taxation-strategy.

Deferred tax

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

	Group							
	Fair value of financial instruments	Pension remeasurement	Cash flow hedges	Fair value reserve	Tax losses carried forward	Accelerated tax depreciation	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	(52)	(98)	(58)	(8)	13	18	40	(145)
Income statement (charge)/ credit	(13)	(62)	—	—	2	21	16	(36)
Transfers/reclassifications	—	—	12	—	—	—	(15)	(3)
Credited/(charged) to other comprehensive income	—	133	(54)	(2)	—	—	—	77
At 31 December 2020	(65)	(27)	(100)	(10)	15	39	41	(107)
At 1 January 2019	(51)	(182)	(43)	(12)	20	(4)	61	(211)
Income statement (charge)/credit	(1)	(47)	—	—	(7)	22	(14)	(47)
Transfers/reclassifications	—	—	22	4	—	—	(26)	—
Credited/(charged) to other comprehensive income	—	131	(37)	—	—	—	19	113
At 31 December 2019	(52)	(98)	(58)	(8)	13	18	40	(145)

The deferred tax assets and liabilities above have been recognised in the Santander UK group on the basis that sufficient future taxable profits are forecast within the foreseeable future, in excess of the profits arising from the reversal of existing taxable temporary differences, to allow for the utilisation of the assets as they reverse. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions underlying the estimated future taxable profits in the Santander UK group's three-year plan (described in Note 20) would not cause a reduction in the deferred tax assets recognised. At 31 December 2020, the Santander UK group had a recognised deferred tax asset in respect of UK capital losses carried forward of £12m (2019: £11m) included within tax losses carried forward. There are no unrecognised deferred tax assets on capital losses carried forward (2019: £nil).

10. DIVIDENDS ON ORDINARY SHARES

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

	Group			Group		
	2020	2019	2018	2020	2019	2018
	Pence per share	Pence per share	Pence per share	£m	£m	£m
In respect of current year – first interim	1.46	1.95	3.54	103	138	250
– second interim	—	1.76	9.46	—	124	668
– third interim	—	—	2.90	—	—	205
	1.46	3.71	15.90	103	262	1,123

Following the PRA's announcement regarding the resumption of dividend payments, an interim dividend of £103m for 2020 was paid in December 2020.

In 2018, in addition to the interim dividends of £250m and £205m, we also paid a dividend of £668m that related to the ring-fencing transfers to Banco Santander, London Branch.

11. DERIVATIVE FINANCIAL INSTRUMENTS

a) Use of derivatives

The Santander UK group undertakes derivative activities primarily to provide customers with risk management solutions and to manage and hedge the Santander UK group's own risks.

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

For information on how the Santander UK group is managing the transition to alternative benchmark interest rates, see 'Managing LIBOR transition' in the Banking market risk section of the Risk review and Note 43 Interest Rate Benchmark Reform.

b) Analysis of derivatives

The table below includes the notional amounts of transactions outstanding at the balance sheet date; they do not represent actual exposures.

	Group					
	2020			2019		
	Notional amount £m	Fair value		Notional amount £m	Fair value	
Assets £m		Liabilities £m	Assets £m		Liabilities £m	
Derivatives held for trading:						
Exchange rate contracts	15,465	395	431	14,249	136	199
Interest rate contracts	40,630	926	837	47,045	754	566
Equity and credit contracts	1,319	124	83	2,583	292	167
Total derivatives held for trading	57,414	1,445	1,351	63,877	1,182	932
Derivatives held for hedging						
Designated as fair value hedges:						
Exchange rate contracts	789	84	6	1,482	166	2
Interest rate contracts	93,748	1,225	1,885	94,550	1,022	1,488
Equity derivative contracts	—	—	—	—	—	—
	94,537	1,309	1,891	96,032	1,188	1,490
Designated as cash flow hedges:						
Exchange rate contracts	27,020	1,978	409	28,502	2,023	462
Interest rate contracts	19,407	467	23	17,451	184	35
Equity derivative contracts	13	6	—	49	—	4
	46,440	2,451	432	46,002	2,207	501
Total derivatives held for hedging	140,977	3,760	2,323	142,034	3,395	1,991
Derivative netting⁽¹⁾		(1,754)	(1,754)		(1,214)	(1,214)
Total derivatives	198,391	3,451	1,920	205,911	3,363	1,709

(1) Derivative netting excludes the effect of cash collateral, which is offset against the gross derivative position. The amount of cash collateral received that had been offset against the gross derivative assets was £330m (2019: £222m) and the amount of cash collateral paid that had been offset against the gross derivative liabilities was £651m (2019: £629m).

For information about the impact of netting arrangements on derivative assets and liabilities in the table above, see Note 41.

The reduction in the notional value of interest rate derivatives held for trading reflected the completion of a series of derivative trade compressions to reduce our gross LIBOR exposure.

The table below analyses the notional and fair values of derivatives by trading and settlement method.

	Notional							
	Traded over the counter				Asset		Liability	
	Traded on recognised exchanges	Settled by central counterparties	Not settled by central counterparties	Total	Traded on recognised exchanges	Traded over the counter	Traded on recognised exchanges	Traded over the counter
2020	£m	£m	£m	£m	£m	£m	£m	£m
Exchange rate contracts	—	—	43,274	43,274	—	2,457	—	846
Interest rate contracts	—	144,343	9,442	153,785	—	864	—	991
Equity and credit contracts	—	—	1,332	1,332	—	130	—	83
	—	144,343	54,048	198,391	—	3,451	—	1,920
2019								
Exchange rate contracts	—	—	44,233	44,233	—	2,325	—	663
Interest rate contracts	—	131,538	27,508	159,046	—	747	—	876
Equity and credit contracts	—	—	2,632	2,632	—	291	—	170
	—	131,538	74,373	205,911	—	3,363	—	1,709

c) Analysis of derivatives designated as hedges

The Santander UK group applies hedge accounting on both a fair value and cash flow basis depending on the nature of the underlying exposure. We establish the hedge ratio by matching the notional of the derivative with the underlying position being hedged. Only the designated risk is hedged and therefore other risks, such as credit risk are managed but not hedged. For interest rate hedges, the designated hedged risk is determined with reference to the underlying benchmark rate.

Fair value hedges**Portfolio hedges of interest rate risk**

Santander UK holds various portfolios of fixed rate assets and liabilities which expose it to changes in fair value due to movements in market interest rates. We manage these exposures by entering into interest rate swaps. Each portfolio contains assets or liabilities that are similar in nature and share the risk exposure that is designated as being hedged.

The interest rate risk component is the change in fair value of fixed rate instruments for changes in the designated benchmark rate. Such changes are usually the largest component of the overall change in fair value. Separate hedges are maintained for each underlying currency. Effectiveness is assessed by comparing changes in fair value of the hedged item attributable to changes in the designated benchmark interest rate, with changes in the fair value of the interest rate swaps.

Micro hedges of interest rate risk and foreign currency risk

Santander UK accesses international markets to obtain funding, issuing fixed rate debt in its functional currency and other currencies. We are therefore exposed to changes in fair value due to changes in market interest rates and/or foreign exchange rates, principally in USD and EUR, which we mitigate through the use of receive fixed/pay floating rate interest rate swaps and/or receive fixed/pay floating rate cross currency swaps.

The interest rate risk component is the change in fair value of the fixed rate debt due to changes in the benchmark LIBOR rate or risk free rate. The foreign exchange component is the change in the fair value of the fixed rate debt issuance due to changes in foreign exchange rates prevailing from the time of execution. Effectiveness is assessed by using linear regression techniques to compare changes in the fair value of the debt caused by changes in the benchmark interest rate and foreign exchange rates, with changes in the fair value of the interest rate swaps and/or cross currency swaps.

Cashflow hedges**Hedges of interest rate risk**

Santander UK manages its exposure to the variability in cash flows of floating rate assets and liabilities attributable to movements in market interest rates by entering into interest rate swaps. The interest rate risk component is determined with reference to the underlying benchmark rate attributable to the floating rates asset or liability. Designated benchmark rates referenced are currently SONIA or LIBOR. Effectiveness is assessed by comparing changes in the fair value of the interest rate swap with changes in the fair value of the hedged item attributable to the hedged risk, applying a hypothetical derivative method using linear regression techniques.

Hedges of foreign currency risk

As Santander UK obtains funding in international markets, we assume significant foreign currency risk exposure, mainly in USD and EUR. In addition, the Santander UK group also holds debt securities for liquidity purposes which assumes foreign currency exposure, principally in JPY.

Santander UK manages the exposures to the variability in cash flows of foreign currency denominated assets and liabilities to movements in foreign exchange rates by entering into either foreign exchange contracts (spot, forward and swaps) or cross currency swaps. These instruments are entered into to match the cash flow profile and maturity of the estimated interest and principal repayments of the hedged item.

The foreign currency risk component is the change in cash flows of the foreign currency debt arising from changes in the relevant foreign currency forward exchange rate. Such changes constitute a significant component of the overall changes in cash flows of the instrument. Effectiveness is assessed by comparing changes in the fair value of the cross currency or foreign exchange swaps with changes in the fair value of the hedged debt attributable to the hedged risk applying a hypothetical derivative method using linear regression techniques.

Equity risk on cash settled share-based transactions

Santander Equity Investments Limited (SEIL) offers employees the chance to buy shares in Banco Santander SA at a discount under Sharesave schemes. This exposes Santander UK to equity price risk. The equity risk is managed by purchasing share options which allow Santander UK to buy shares at a fixed price. These instruments are entered into to match the amount of employee share options expected to be exercised.

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

During 2020, due to changes in the Banco Santander share price the outgoing cashflows relating to schemes prior to the 2020 sharesave schemes are no longer expected to occur.

LIBOR Reform

Details of the notional value of hedging instruments by benchmark interest rate impacted by IBOR reform are disclosed in Note 43.

Hedge effectiveness measurement

Hedge effectiveness is assessed by using either dollar offset or linear regression techniques to compare changes in the fair value of the hedged item attributable to changes in the designated hedged risk and the hedging instrument. For cash flow hedges, a hypothetical derivative method is used to model the cash flows of the hedged item.

Possible sources of hedge ineffectiveness

For both fair value and cash flow hedges, hedge ineffectiveness can arise from hedging derivatives with a non-zero fair value at the date of initial designation. In addition, for:

Fair value hedges

Hedge ineffectiveness can also arise due to differences in discounting between the hedged item and the hedging instrument as cash collateralised swaps discount using Overnight Indexed Swaps discount curves not applied to the hedged item; and where counterparty credit risk impacts the fair value of the derivative but not the hedged item. For portfolio hedges of interest rate risk, it can also arise due to differences in the expected and actual volume of repayments.

Cash flow hedges

Hedge ineffectiveness can also arise due to differences in the timing of cash flows between the hedged item and the hedging instrument. For micro hedges of interest rate risk, it can also arise due to differences in the basis of cash flows between the hedged item and the hedging instrument. For hedges of equity risk on cash settled share-based transactions, it can also arise due to changes in the expected number of Sharesave options to be exercised.

Maturity profile and average price/rate of hedging instruments

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

2020	Hedging Instruments	Group					Total
		≤1 month	>1 and ≤3 months	>3 and ≤12 months	>1 and ≤5 years	>5 years	
Fair value hedges:							
Interest rate risk	Interest rate contracts- Nominal Amount (£m)	2,429	7,617	27,791	47,749	7,889	93,475
	Average fixed interest rate - GBP	0.69 %	0.65 %	0.82 %	0.73 %	3.61 %	—
	Average fixed interest rate - EUR	1.18 %	0.23 %	3.02 %	0.98 %	2.34 %	—
	Average fixed interest rate - USD	1.87 %	1.72 %	2.89 %	2.49 %	4.16 %	—
Interest rate/FX risk	Exchange rate contracts - Nominal Amount (£m)	—	—	132	461	196	789
	Interest rate contracts - Nominal Amount (£m)	—	—	—	236	37	273
	Average GBP - EUR exchange rate	—	—	1.1405	1.1700	1.1669	—
	Average GBP - USD exchange rate	—	—	—	—	—	—
	Average fixed interest rate - EUR	—	—	4.64 %	1.78 %	3.56 %	—
	Average fixed interest rate - USD	—	—	—	—	—	—
Cash flow hedges:							
Interest rate risk	Interest rate contracts - Nominal Amount (£m)	—	897	2,528	7,964	1,061	12,450
	Average fixed interest rate - GBP (%)	—	0.46 %	0.57 %	1.45 %	1.33 %	—
FX risk	Exchange rate contracts- Nominal Amount (£m)	1,439	2,015	3,877	7,113	1,119	15,563
	Interest rate contracts- Nominal Amount (£m)	—	—	—	366	—	366
	Average GBP - JPY exchange rate	—	137.9769	135.6073	132.2714	—	—
	Average GBP - EUR exchange rate	—	—	—	1.1629	1.1787	—
	Average GBP - USD exchange rate	1.2931	1.3164	1.3231	1.3039	—	—
Equity risk	Equity derivative contracts - Nominal Amount (£m)	—	—	—	12	1	13
Interest rate/FX risk	Exchange rate contracts - Nominal Amount (£m)	732	—	2,583	6,550	1,592	11,457
	Interest rate contracts - Nominal Amount (£m)	732	—	882	4,062	915	6,591
	Average GBP - EUR exchange rate	—	—	1.3543	1.2525	1.1965	—
	Average GBP - USD exchange rate	1.4649	—	—	1.6085	1.3811	—
	Average fixed interest rate - GBP (%)	2.01 %	—	3.18 %	2.48 %	3.39 %	—
2019							
Fair value hedges:							
Interest rate risk	Interest rate contracts- Nominal Amount (£m)	4,354	5,804	27,405	43,652	13,099	94,314
	Average fixed interest rate - GBP	0.77 %	0.90 %	0.88 %	1.33 %	3.00 %	—
	Average fixed interest rate - EUR	(0.41) %	0.29 %	2.21 %	1.36 %	2.36 %	—
	Average fixed interest rate - USD	—	1.54 %	1.99 %	2.69 %	4.56 %	—
Interest rate/FX risk	Exchange rate contracts - Nominal Amount (£m)	—	755	—	317	410	1,482
	Interest rate contracts - Nominal Amount (£m)	—	—	—	18	218	236
	Average GBP - EUR exchange rate	—	—	—	1.1781	1.1603	—
	Average GBP - USD exchange rate	—	1.5110	—	—	—	—
	Average fixed interest rate - EUR	—	—	—	3.52 %	2.12 %	—
	Average fixed interest rate - USD	—	2.38 %	—	—	—	—
Cash flow hedges:							
Interest rate risk	Interest rate contracts - Nominal Amount (£m)	—	339	1,066	4,671	500	6,576
	Average fixed interest rate - GBP (%)	—	0.76 %	0.82 %	1.46 %	0.40 %	—
FX risk	Exchange rate contracts- Nominal Amount (£m)	1,187	2,119	3,758	5,217	—	12,281
	Interest rate contracts- Nominal Amount (£m)	—	—	—	755	—	755
	Average GBP - JPY exchange rate	—	145.9275	143.0857	140.8152	—	—
	Average GBP - EUR exchange rate	—	1.1444	1.1167	1.1526	—	—
	Average GBP - USD exchange rate	1.2856	1.2624	1.2925	1.2991	—	—
Equity risk	Equity derivative contracts - Nominal Amount (£m)	—	—	7	41	1	49
Interest rate/FX risk	Exchange rate contracts - Nominal Amount (£m)	812	—	3,367	8,009	4,033	16,221
	Interest rate contracts - Nominal Amount (£m)	—	—	3,121	4,829	2,170	10,120
	Average GBP - EUR exchange rate	1.2742	—	1.1689	1.3114	1.2090	—
	Average GBP - USD exchange rate	—	—	1.5357	1.5811	1.4499	—
	Average fixed interest rate - GBP (%)	2.49 %	—	2.16 %	2.87 %	2.96 %	—

Net gains or losses arising from fair value and cash flow hedges included in other operating income

	2020		2019		Group
	£m	£m	£m	£m	2018
Fair value hedging:					£m
(Losses)/gains on hedging instruments	(299)	(360)			4
Gains/(losses) on hedged items attributable to hedged risks	364	414			75
Fair value hedging ineffectiveness	65	54			79
Cash flow hedging ineffectiveness	(46)	(46)			(45)
	19	8			34

Hedge ineffectiveness can be analysed by risk category as follows:

	2020			2019			Group
	Change in FV of hedging instruments	Change in FV of hedged items	Recognised in income statement	Change in FV of hedging instruments	Change in FV of hedged items	Recognised in income statement	2018
	£m	£m	£m	£m	£m	£m	£m
Fair value hedges:							
Interest rate risk	(358)	384	26	(264)	284	20	
Interest rate/FX risk	59	(20)	39	(96)	130	34	
	(299)	364	65	(360)	414	54	

Income statement line item affected by reclassification	2020				2019				Group
	Hedging Instruments		Recognised in income statement	Reclassified from reserves to income	Hedging Instruments		Recognised in income statement	Reclassified from reserves to income	2018
	Change in FV	Recognised in OCI			Change in FV	Recognised in OCI			2017
	£m	£m	£m	£m	£m	£m	£m	£m	
Cash flow hedges:									
Interest rate risk Net interest income	185	(179)	6	33	34	(33)	1	13	
FX risk Net interest income/other operating income	(42)	38	(4)	2	(333)	329	(4)	(316)	
Equity risk Operating expenses	2	(2)	—	(5)	(7)	7	—	(9)	
Interest rate/FX risk Net interest income/other operating income	782	(830)	(48)	773	(604)	561	(43)	(709)	
	927	(973)	(46)	803	(910)	864	(46)	(1,021)	

In 2020, cash flow hedge accounting of £57m (2019: £4m) had to cease due to the hedged cash flows no longer being expected to occur.

The following table provides a reconciliation by risk category of components of equity and analysis of OCI items (before tax) resulting from hedge accounting.

	2020		2019		Group
	£m	£m	£m	£m	2018
Balance at 1 January		479		322	
Effective portion of changes in fair value:					
– Interest rate risk		179		33	
– Foreign currency risk		(38)		(329)	
– Equity risk		2		(7)	
– Interest rate/foreign currency risk		830		(561)	
		973		(864)	
Income statement transfers:					
– Interest rate risk		(33)		(13)	
– Foreign currency risk		(2)		316	
– Equity risk		5		9	
– Interest rate/foreign currency risk		(773)		709	
		(803)		1,021	
Balances at 31 December		649		479	

Hedged exposures

Santander UK hedges its exposures to various risks, including interest rate risk and foreign currency risk, as set out in the following table.

	Group									
	2020					2019				
	Carrying value	Accumulated amount of FV hedge adjustments			Change in value to calculate hedge ineffectiveness	Carrying value	Accumulated amount of FV hedge adjustments			Change in value to calculate hedge ineffectiveness
		Hedged item	Portfolio hedge of interest rate risks	Of which discontinued hedges			Hedged item	Portfolio hedge of interest rate risks	Of which discontinued hedges	
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Fair value hedges										
Interest rate risk:										
Loans and advances to customers	54,118	—	1,202	904	332	43,098	—	870	630	258
Other financial assets at amortised cost	772	—	36	13	121	6,627	—	142	121	83
Reverse repos – non trading	12,149	—	1	—	3	17,121	—	(2)	—	(2)
Other financial assets at FVOCI	5,129	155	—	74	88	5,944	102	—	82	125
Deposits by customers	(4,305)	(15)	(10)	(10)	(13)	(6,261)	—	4	—	3
Deposits by banks	—	—	—	—	—	(517)	(16)	—	(17)	(1)
Debt securities in issue	(8,889)	(518)	(137)	(305)	(120)	(11,782)	(388)	(166)	(311)	(163)
Subordinated liabilities	(636)	(185)	(41)	(166)	(27)	(707)	(181)	(48)	(204)	(19)
Interest rate/FX risk:										
Other financial assets at FVOCI	299	5	—	—	15	241	3	—	—	(4)
Debt securities in issue	(621)	(94)	—	(76)	(34)	(1,396)	(135)	—	(122)	136
Subordinated liabilities	3	3	—	3	(1)	7	7	—	7	(2)
	58,019	(649)	1,051	437	364	52,375	(608)	800	186	414

		Group						
		2020				2019		
		Hedged item balance sheet line item	Change in value to calculate hedge ineffectiveness	Cash flow hedge reserve	Balances on cash flow hedge reserve for discontinued hedges	Change in value to calculate hedge ineffectiveness	Cash flow hedge reserve	Balances on cash flow hedge reserve for discontinued hedges
Cash flow hedges:								
Interest rate risk:								
Loans and advances to customers	(183)	165	1	(34)	21	(11)		
Loans and advances to banks	(2)	1	—	(2)	—	—		
Reverse repurchase agreements – non trading	(2)	1	—	—	—	—		
Deposits by banks	7	(2)	—	3	(2)	—		
Repurchase agreements – non trading	1	(1)	—	—	—	—		
FX risk:								
Other financial assets at FVOCI	40	6	—	(122)	3	—		
Not applicable – highly probable forecast transactions	33	3	—	267	2	—		
Deposits by customers	(7)	—	—	3	—	—		
Deposits by banks	—	—	—	4	—	—		
Debt securities in issue	(13)	(46)	—	177	(3)	—		
Repurchase agreements – non trading	(15)	—	—	—	—	—		
Equity risk:								
Other liabilities	(2)	6	—	7	(2)	(1)		
Interest rate/FX risk:								
Debt securities in issue/loans and advances to customers	(701)	322	(2)	630	280	20		
Subordinated liabilities/loans and advances to customers	(130)	194	—	(69)	180	—		
	(974)	649	(1)	864	479	8		

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

	Group	
	2020	2019
	£m	£m
Loans and advances to customers:		
Loans to housing associations	13	12
Other loans	579	528
	592	540
Debt securities	112	298
Equity securities	130	135
Reverse repurchase agreements - non trading	—	—
	834	973

For the Santander UK group, other financial assets at FVTPL comprised £508m (2019: £465m) of financial assets designated at FVTPL and £325m (2019: £509m) of financial assets mandatorily held at FVTPL.

Loans and advances to customers principally represented other loans, being a portfolio of roll-up mortgages and deferred consideration following the partial sale of the portfolio. These are managed, and have their performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them is provided on that basis to management. Since 2009, the Santander UK group's policy has been not to designate similar new loans at fair value through profit or loss.

In 2019 £2.1bn of senior tranches of credit linked notes related to an SRT securitisation, which were previously classified as debt securities in the table above, were presented on a net basis. This followed a deed of amendment, including a legal right of set-off between the principal amounts of the senior tranches of credit linked notes and the related cash deposits included as collateral in Note 36. At 31 December 2020, the amount of this netting was £825m (2019: £1.5bn).

The net (loss)/gain in the year attributable to changes in credit risk for loans and advances at fair value through profit or loss was £nil (2019: £nil, 2018: £(1)m). The cumulative net loss attributable to changes in credit risk for loans and advances at fair value through profit or loss at 31 December 2020 was £2m (2019: £2m).

13. LOANS AND ADVANCES TO CUSTOMERS

	Group	
	2020	2019
	£m	£m
Loans secured on residential properties	170,089	165,645
Corporate loans	24,474	27,043
Finance leases	6,554	6,264
Secured advances	—	—
Other unsecured loans	10,169	7,188
Amounts due from fellow Banco Santander subsidiaries and joint ventures	2,249	2,204
Loans and advances to customers	213,535	208,344
Credit impairment loss allowances on loans and advances to customers	(1,303)	(785)
RV and voluntary termination provisions on finance leases	(54)	(61)
Net loans and advances to customers	212,178	207,498

For movements in expected credit losses, see the Credit risk section of the Risk review.

Finance lease and hire purchase contract receivables may be analysed as follows:

	2020			2019		
	Gross investment	Unearned finance income	Net investment	Gross investment	Unearned finance income	Net investment
	£m	£m	£m	£m	£m	£m
No later than one year	3,468	(297)	3,171	3,060	(303)	2,757
Later than one year and not later than two years	1,829	(173)	1,656	2,046	(207)	1,839
Later than two years and not later than three years	1,099	(106)	993	1,157	(119)	1,038
Later than three years and not later than four years	575	(55)	520	541	(54)	487
Later than four years and not later than five years	231	(25)	206	41	(4)	37
Later than five years	8	—	8	147	(41)	106
	7,210	(656)	6,554	6,992	(728)	6,264

The prior year analysis by maturity in the table above has been restated to conform with the current year presentation.

The Santander UK group enters into finance leasing arrangements primarily for the financing of motor vehicles and a range of assets for its corporate customers. Included in the carrying value of net investment in finance leases and hire purchase contracts is £3,552m (2019: £3,512m) of unguaranteed RV at the end of the current lease terms, which is expected to be recovered through re-payment, re-financing or sale. Contingent rent income of £nil (2019: £nil, 2018: £nil) was earned during the year, which was classified in 'Interest and similar income'. Finance income on the net investment in finance leases was £308m (2019: £299m, 2018: £346m).

Finance lease receivable balances are secured over the asset leased. The Santander UK group is not permitted to sell or repledge the asset in the absence of default by the lessee. The Directors consider that the carrying amount of the finance lease receivables approximates to their fair value.

Included within loans and advances to customers are advances assigned to bankruptcy remote structured entities and Abbey Covered Bonds LLP. These loans provide security to issues of covered bonds and mortgage-backed or other asset-backed securities issued by the Santander UK group. For more, see Note 14.

14. SECURITISATIONS AND COVERED BONDS

The information in this Note relates to securitisations and covered bonds for consolidated structured entities, used to obtain funding or collateral. It excludes structured entities relating to credit protection vehicles.

The Santander UK group uses structured entities to securitise some of the mortgage and other loans to customers that it originates. The Santander UK group also issues covered bonds, which are guaranteed by, and secured against, a pool of the Santander UK group's mortgage loans transferred to Abbey Covered Bonds LLP. The Santander UK group issues mortgage-backed securities, other asset-backed securities and covered bonds mainly in order to obtain diverse, low cost funding, but also to use as collateral for raising funds via third party bilateral secured funding transactions or for liquidity purposes in the future. The Santander UK group has successfully used bilateral secured transactions as an additional form of medium-term funding; this has allowed the Santander UK group to further diversify its medium-term funding investor base.

Loans and advances to customers include portfolios of residential mortgage loans, and receivables derived from credit agreements with retail customers for the purchases of financed vehicles, which are subject to non-recourse finance arrangements. These loans and receivables have been purchased by, or assigned to, structured entities or Abbey Covered Bonds LLP, and have been funded primarily through the issue of mortgage-backed securities, other asset-backed securities or covered bonds. No gain or loss has been recognised as a result of these sales. The structured entities and Abbey Covered Bonds LLP are consolidated as subsidiaries. The Company and its subsidiaries do not own directly, or indirectly, any of the share capital of any of the structured entities.

a) Securitisations

i) Master trust structures

The Santander UK group makes use of master trust structures, whereby a pool of residential mortgage loans is assigned to a trust company by the asset originator. A funding entity acquires a beneficial interest in the pool of assets held by the trust company with funds borrowed from qualifying structured entities, which at the same time issue asset-backed securities to third-party investors or the Santander UK group.

Santander UK plc and its subsidiaries receive payments from the securitisation companies in respect of fees for administering the loans, and payment of deferred consideration for the sale of the loans. Santander UK plc and its subsidiaries have no right or obligation to repurchase any securitised loan, except if certain representations and warranties given by Santander UK plc or its subsidiaries at the time of transfer are breached and, in certain cases, if there is a product switch or further advance, if a securitised loan is in arrears for over two months or if a securitised loan does not comply with regulatory requirements.

In April 2020, Santander UK plc followed FCA guidance on how they expect mortgage lenders and administrators to treat customers fairly during the Covid-19 pandemic and restructured all its securitisations to accommodate its obligations as servicer under the principles set out in the FCA Handbook and Mortgage Conduct of Business rules.

The granting of payment holidays to any securitised loans results in a corresponding decrease in revenue receipts available to the trust company to distribute to the funding entity on each distribution date. To mitigate the potential impact to the securitisations, the qualifying structured entities were amended to direct a cash payment to the funding entity in an amount equal to the funding entity's share of the aggregate amount of the interest that would have been due on any loans which are the subject of a payment holiday. To effect such cash payment, Santander UK plc's share of revenue receipts is reduced by such amount and the funding entity's share of revenue receipts increased accordingly, making the impact neutral to the securitisation.

ii) Other securitisation structures

The Santander UK group issues notes through pass-through stand-alone vehicles for the securitisation of receivables derived from credit agreements with retail customers for the purchase of financed vehicles. Santander UK plc and its subsidiaries are under no obligation to support any losses that may be incurred by the master trust or other structures, securitisation companies or holders of the securities, and do not intend to provide such further support.

b) Covered bonds

Santander UK plc also issues covered bonds, which are its direct, unsecured and unconditional obligation. The covered bonds benefit from a guarantee from Abbey Covered Bonds LLP. Santander UK plc makes a term advance to Abbey Covered Bonds LLP equal to the sterling proceeds of each issue of covered bonds. Abbey Covered Bonds LLP uses the proceeds of the term advance to purchase portfolios of residential mortgage loans and their security from Santander UK plc. Under the terms of the guarantee, Abbey Covered Bonds LLP has agreed to pay an amount equal to the guaranteed amounts when the same shall become due for payment but which would otherwise be unpaid by Santander UK plc.

c) Analysis of securitisations and covered bonds

The Santander UK group's principal securitisation programmes and covered bond programme, together with the balances of the advances subject to securitisation (or for the covered bond programme assigned) and the carrying value of the notes in issue at 31 December 2020 and 2019 are listed below.

	Gross assets		External notes in issue		Notes issued to Santander UK plc/subsidiaries as collateral	
	2020 £m	2019 £m	2020 £m	2019 £m	2020 £m	2019 £m
Mortgage-backed master trust structures:						
– Holmes	3,073	4,262	829	1,931	334	463
– Fosse	2,258	3,708	290	295	1,402	1,404
– Langton	2,782	3,076	—	—	2,355	2,354
	8,113	11,046	1,119	2,226	4,091	4,221
Other asset-backed securitisation structures:						
– Motor	189	490	104	324	97	197
– Auto ABS UK Loans	1,460	1,532	1,107	1,229	361	368
	1,649	2,022	1,211	1,553	458	565
Total securitisation programmes	9,762	13,068	2,330	3,779	4,549	4,786
Covered bond programmes						
– Euro 35bn Global Covered Bond Programme	23,670	23,323	19,285	19,004	—	—
Total securitisation and covered bond programmes	33,432	36,391	21,615	22,783	4,549	4,786
Less: held by Santander UK group:						
– Euro 35bn Global Covered Bond Programme			—	—		
Total securitisation and covered bond programmes (See Note 26)			21,615	22,783		

The following table sets out the internal and external issuances and redemptions in 2020 and 2019 for each securitisation and covered bond programme.

	Internal issuances		External issuances		Internal redemptions		External redemptions	
	2020 £bn	2019 £bn	2020 £bn	2019 £bn	2020 £bn	2019 £bn	2020 £bn	2019 £bn
Mortgage-backed master trust structures:								
– Holmes	—	—	—	—	0.3	—	0.9	1.1
– Fosse	—	1.4	—	0.1	—	—	—	—
– Langton	—	—	—	—	—	—	—	—
Other asset-backed securitisation structures:								
– Motor	—	—	—	—	0.1	0.2	0.2	0.4
– Auto ABS UK Loans	—	0.1	0.3	0.2	—	0.1	0.1	0.2
Covered bond programme	—	—	3.0	2.9	—	0.5	2.7	1.5
	—	1.5	3.3	3.2	0.4	0.8	3.9	3.2

Holmes Funding Ltd has a beneficial interest of £1.0bn (2019: £2.1bn) in the residential mortgage loans held by Holmes Trustees Ltd. The remaining share of the beneficial interest in residential mortgage loans held by Holmes Trustees Ltd belongs to Santander UK plc.

Fosse Funding (No.1) Ltd has a beneficial interest of £1.7bn (2019: £1.7bn) in the residential mortgage loans held by Fosse Trustee (UK) Ltd. The remaining share of the beneficial interest in residential mortgage loans held by Fosse Trustee (UK) Ltd belongs to Santander UK plc.

Langton Funding (No.1) Ltd has a beneficial interest of £2.4bn (2019: £2.4bn) in the residential mortgage loans held by Langton Mortgage Trustee (UK) Ltd. The remaining share of the beneficial interest in residential mortgage loans held by Langton Mortgage Trustee (UK) Ltd belongs to Santander UK plc.

The Holmes securitisation companies have cash deposits of £186m (2019: £283m), which have been accumulated to finance the redemption of a number of securities issued by the Holmes securitisation companies. The share of Holmes Funding Ltd in the trust assets is therefore reduced by this amount.

Fosse Master Issuer plc has cash deposits of £nil (2019: £nil), which have been accumulated to finance the redemption of a number of securities issued by Fosse Master Issuer plc. Fosse Funding (No.1) Ltd's beneficial interest in the assets held by Fosse Trustee (UK) Ltd is therefore reduced by this amount.

15. TRANSFERS OF FINANCIAL ASSETS NOT QUALIFYING FOR DERECOGNITION

The Santander UK group enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to structured entities. These transfers may give rise to the full or partial derecognition of those financial assets. Transferred financial assets that do not qualify for derecognition consist of (i) securities held by counterparties as collateral under repurchase agreements, (ii) securities lent under securities lending agreements, and (iii) loans that have been securitised under arrangements by which the Santander UK group retains a continuing involvement in such transferred assets. As the substance of the sale and repurchase and securities lending transactions is secured borrowings, the asset collateral continues to be recognised in full and the related liability reflecting the Santander UK group's obligation to repurchase the transferred assets for a fixed price at a future date is recognised in deposits from banks or customers, as appropriate. As a result of these transactions, the Santander UK group is unable to use, sell or pledge the transferred assets for the duration of the transaction. The Santander UK group remains exposed to interest rate risk and credit risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

The Santander UK group securitisation transfers do not qualify for derecognition. The Santander UK group remains exposed to credit risks arising from the mortgage loans or credit agreements and has retained control of the transferred assets. Circumstances in which the Santander UK group has continuing involvement in the transferred assets may include retention of servicing rights over the transferred assets, entering into a derivative transaction with the securitisation vehicle, retaining an interest in the securitisation vehicle or providing a cash reserve fund. Where the Santander UK group has continuing involvement it continues to recognise the transferred assets to the extent of its continuing involvement and recognises an associated liability. The net carrying amount of the transferred assets and associated liabilities reflects the rights and obligations that the Santander UK group has retained.

The following table analyses the carrying amount of financial assets that did not qualify for derecognition and their associated financial liabilities:

Nature of transaction	2020		Group	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Sale and repurchase agreements	1,597	(1,340)	7,592	(6,739)
Securities lending agreements	918	(752)	195	(143)
Securitisations (See Notes 14 and 26)	6,980	(2,330)	9,992	(3,779)
	9,495	(4,422)	17,779	(10,661)

16. REVERSE REPURCHASE AGREEMENTS – NON TRADING

	2020		Group	
	£m		£m	
Agreements with banks	1,258		2,161	
Agreements with customers	18,341		21,475	
	19,599		23,636	

17. OTHER FINANCIAL ASSETS AT AMORTISED COST

	2020		Group	
	£m		£m	
Asset backed securities	491		532	
Debt securities	672		6,524	
	1,163		7,056	

A significant portion of the debt securities are held in our eligible liquidity pool and consist mainly of government bonds and covered bonds. Detailed disclosures can be found in the 'Liquidity risk' section of the Risk review.

18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	2020		Group	
	£m		£m	
Debt securities	8,929		9,691	
Loans and advances to customers	21		56	
	8,950		9,747	

A significant portion of the debt securities are held in our eligible liquidity pool and consist mainly of government bonds and covered bonds. Detailed disclosures can be found in the 'Liquidity risk' section of the Risk review.

19. INTERESTS IN OTHER ENTITIES

	2020		Group	
	£m		£m	
Joint Ventures	172		117	
	172		117	

The Santander UK group consists of a parent company, Santander UK Group Holdings plc, incorporated and domiciled in the UK and a number of subsidiaries and joint ventures held directly and indirectly by the Company. The Company has no individually significant associates. Details of subsidiaries, joint ventures and associates are set out in the Shareholder Information section and form an integral part of these financial statements.

a) Interests in subsidiaries

The Company holds directly or indirectly 100% of the issued ordinary share capital of its principal subsidiaries. All companies operate principally in their country of incorporation or registration. SFS has branch offices in Jersey and the Isle of Man.

Subsidiaries with significant non-controlling interests

The only subsidiary with significant non-controlling interests is PSA Finance UK Limited, which operates in the UK. In 2020 and 2019, the proportion of ownership interests and voting rights held by non-controlling interests was 50%.

	2020	2019
	£m	£m
Profit attributable to non-controlling interests	19	19
Accumulated non-controlling interests of the subsidiary	162	160
Dividends paid to non-controlling interests	15	12
Summarised financial information:		
Total assets	3,451	3,228
Total liabilities	3,127	2,905
Profit for the year	38	40
Total comprehensive income for the year	33	40

Interests in consolidated structured entities

Structured entities are formed by Santander UK to accomplish specific and well-defined objectives. Santander UK consolidates these structured entities when the substance of the relationship indicates control, as described in Note 1. In addition to the structured entities disclosed in Note 14 which are used for securitisation and covered bond programmes, the only other structured entities consolidated by Santander UK are described below. All the external assets and liabilities in these entities are included in the financial statements and in relevant Notes. Other than as set out below, no significant judgements were required with respect to control or significant influence.

i) Guaranteed Investment Products 1 PCC Limited (GIP)

All protected cells in GIP, a Guernsey-incorporated, closed-ended, protected cell company, were redeemed in 2020 with the final redemption taking place on 31 December 2020. Santander Guarantee Company, a Santander UK group company, guaranteed the shareholders of cells a fixed return on their investment and/or the investment amount on redemption. As Santander UK has no remaining exposure to the variable risks and returns through Santander Guarantee Company's guarantee, it no longer consolidates GIP.

ii) Motor Securities 2018-1 Designated Activity Company (Motor 2018)

Motor 2018 is a credit protection entity, and a Designated Activity Company limited by shares, incorporated in Ireland. It has issued a series of credit linked notes varying in seniority which reference portfolios of Santander UK group loans. Concurrently, these entities sell credit protection to Santander UK in respect of the referenced loans and, in return for a fee, are liable to make protection payments to Santander UK upon the occurrence of a credit event in relation to any of the referenced loans. Motor 2018 is consolidated as Santander UK holds a variable interest by retaining the junior tranche of notes issued by the entity.

b) Interests in joint ventures

Santander UK does not have any individually material interests in joint ventures. As set out in the accounting policies in Note 1, interests in joint ventures are accounted for using the equity method. In 2020, Santander UK's share in the profit after tax of its joint ventures was £20m (2019: £30m) before elimination of transactions between Santander UK and the joint ventures. At 31 December 2020, the carrying amount of Santander UK's interest was £172m (2019: £117m). At 31 December 2020 and 2019, the joint ventures had no commitments and contingent liabilities.

c) Interests in unconsolidated structured entities**Structured entities sponsored by the Santander UK group**

Santander UK has interests in structured entities which it sponsors but does not control. Santander UK considers itself a sponsor of a structured entity when it facilitates the establishment of the structured entity. Other than as set out below, no significant judgements were required with respect to control or significant influence. The structured entities sponsored but not consolidated by Santander UK are as follows.

i) Santander (UK) Common Investment Fund

The Santander (UK) Common Investment Fund (the Fund) is a common investment fund that was established to hold the assets of the Santander (UK) Group Pension Scheme. The Fund is not consolidated by Santander UK, but its assets of £13,553m (2019: £12,446m) are accounted for as part of the defined benefit assets and obligations recognised on Santander UK's balance sheet. For more on the Fund, see Note 30. As the Fund holds the assets of the pension scheme, it is outside the scope of IFRS 10. Santander UK's maximum exposure to loss is the carrying amount of the assets held.

ii) Credit protection entities

Santander UK has established three (2019: four) unconsolidated credit protection entities, which are Designated Activity Companies limited by shares, incorporated in Ireland. Each entity has issued a series of credit linked notes varying in seniority which reference portfolios of Santander UK group loans. Concurrently, these entities sell credit protection to Santander UK in respect of the referenced loans and, in return for a fee, are liable to make protection payments to Santander UK upon the occurrence of a credit event in relation to any of the referenced loans. Senior credit linked notes, which amounted to £2,160m (2019: £3,766m), are issued to, and held by, Santander UK. Junior credit linked notes, which amounted to £678m (2019: £825m), are all held by third party investors and suffer the first losses incurred in the referenced portfolios. Funds raised by the sale of the credit linked notes are deposited with Santander UK as collateral for the credit protection. The senior credit linked notes, along with the deposits and associated guarantees, are presented on a net basis, to reflect a legal right of set-off between the principal amounts of senior notes and the cash deposits. Deposits and associated guarantees in respect of the junior credit linked notes are included in 'Deposits by customers' (see Note 23). The entities are not consolidated by Santander UK because the third party investors have the exposure, or rights, to all of the variability of returns from the performance of the entities. No assets are transferred to, or income received from, these entities. Since the credit linked notes (including those held by Santander UK) are fully cash collateralised, Santander UK's maximum exposure to loss is equal to any unamortised fees paid to the entities in connection with the credit protection outlined above.

Structured entities not sponsored by the Santander UK group

Santander UK also has interests in structured entities which it does not sponsor or control. These consist of holdings of mortgage and other asset backed securities issued by entities that were established and/or sponsored by other unrelated financial institutions. These securities comprise the asset backed securities included in Note 17. Management has concluded that the Santander UK group has no control or significant influence over these entities and that the carrying value of the interests held in these entities represents the maximum exposure to loss.

20. INTANGIBLE ASSETS

a) Goodwill

	Group		
	Cost £m	Accumulated impairment £m	Net book value £m
At 31 December 2019, 1 January 2020 and 31 December 2020	1,285	(82)	1,203

Impairment of goodwill

In 2020 and 2019, no impairment of goodwill was recognised. Goodwill is tested for impairment annually at 30 November, with a review for indicators of impairment at 30 June and 31 December. Goodwill is tested for impairment if reviews identify an indicator of impairment or when events or changes in circumstances dictate.

At 30 November 2020, the annual review identified the continuing uncertainty created by the Covid-19 pandemic and its potential impact on the carrying value of goodwill as indicators of impairment for all cash-generating units (CGUs). As a result, management performed an updated impairment test at 31 December 2020 for all CGUs.

Basis of the recoverable amount

The recoverable amount of all CGUs was determined based on its value in use (VIU) at each testing date for 2020 and 2019. For each CGU, the VIU is calculated by discounting management's cash flow projections for the CGU. The cash flow projections also take account of increased internal capital allocations needed to achieve internal and regulatory capital targets including the leverage ratio. The key assumptions used in the VIU calculation for each CGU are set out below.

Key assumptions in the VIU calculation.

CGU	Goodwill		Discount rate		Growth rate beyond initial cash flow projections	
	2020 £m	2019 £m	2020 %	2019 %	2020 %	2019 %
Personal financial services	1,169	1,169	13.6	9.8	1.6	1.6
Private banking	30	30	8.9	9.8	1.6	1.6
Other	4	4	13.6	9.8	1.6	1.6
	1,203	1,203				

The CGUs do not carry on their balance sheets any other intangible assets with indefinite useful lives.

Management's judgement in estimating the cash flows of a CGU

The cash flow projections for the purpose of impairment testing for each CGU are derived from the latest 3-year plan presented to the Board. The Board challenges and endorses management's planning assumptions in light of internal capital allocations needed to support Santander UK's strategy, current market conditions and the macro-economic outlook. For the goodwill impairment tests conducted at 31 December 2020, the determination of the carrying value of the Personal Financial Services CGU was based on an allocation of regulatory capital and management's cash flow projections until the end of 2023. The assumptions included in the cash flow projections reflect an allocation to the cost of capital to support future growth, as well as the expected impact of Covid-19 on the UK economic environment and the financial outlook within which the CGUs operate. The cash flow projections are supported by Santander UK's base case economic scenario. For more on the base case economic scenario, including our forecasting approach and the assumptions in place at 31 December 2020, see the Credit risk – Santander UK group level section of the Risk review.

Cash flow projections for the purpose of impairment testing do not take account of any adverse outcomes arising from contingent liabilities (see Note 31), whose existence will be confirmed by uncertain future events or where any obligation is not probable or otherwise cannot be measured reliably, nor do they take account of the benefits arising from Santander UK's transformation plans that had not yet been implemented or committed at 31 December 2020.

Discount rate

The rate used to discount the cash flows is based on the cost of equity assigned to each CGU, which is derived using a capital asset pricing model (CAPM). The CAPM depends on a number of inputs reflecting financial and economic variables, including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement.

Growth rate beyond initial cash flow projections

The growth rate for periods beyond the initial cash flow projections is used to extrapolate the cash flows in perpetuity because of the long-term perspective of CGUs. In line with the accounting requirements, management uses the UK Government's official estimate of UK long-term average GDP growth rate, as this is lower than management's estimate of the long-term average growth rate of the business.

Sensitivities of key assumptions in calculating VIU

The VIU of each CGU remains higher than the carrying value of the related goodwill. However, at 31 December 2020, the Personal Financial Services CGU was sensitive to reasonably possible changes in the key assumptions supporting the recoverable amount, although no reasonably possible changes in any of the key assumptions would have resulted in an impairment.

The table below presents a summary of the key assumptions underlying the most sensitive inputs to the model for the Personal Financial Services CGU, the key risks associated with each and details of a reasonably possible change in assumptions that could result in an impairment.

The VIU calculation is not sensitive to the UK long-term average GDP growth rate assumption given the amount of headroom as the increased profit after tax generated by growth of the business is mostly offset by the need to retain more profit to meet increased regulatory capital requirements driven by the growth in assets.

Reasonably possible changes in key assumptions

CGU	Input	Key assumptions	Associated risks	Reasonably possible change
Personal Financial Services	– Cash flow projections	– BoE Bank Rate	– Uncertain market outlook	– Cash flow projections decrease by 5%.
		– UK house price growth	– Persistent low interest rate environment	
		– UK mortgage loan market growth	– Customer remediation and regulatory action outcomes	
		– UK unemployment rate	– Uncertain regulatory capital requirements.	
		– Position in the market	– Market rates of interest rise.	– Discount rate increases by 100 basis points.
	– Discount rate	– Regulatory capital levels.		
		– Discount rate used is a reasonable estimate of a suitable market rate for the profile of the business.		

Sensitivity of VIU changes to current assumptions to achieve nil headroom

Although there was no impairment of goodwill at 31 December 2020, the amount by which the Personal Financial Services CGU's recoverable amount exceeds the carrying value (the headroom) reduced and the test is now sensitive to some of the assumptions used. The changes in assumptions detailed below for the discount rate and cash flow projections would eliminate the current headroom. As a result, there is a risk of impairment in the future should business performance or economic factors diverge from forecasts.

The sensitivity analysis presented below has been prepared on the basis that a change in each key assumption would not have a consequential impact on other assumptions used in the impairment review. However, due to the interrelationships between some of the assumptions, a change in one of the assumptions might impact one or more of the other assumptions and could result in a larger or smaller overall impact.

CGU	Carrying value	Value in use	Headroom	Increase in post tax discount rate	Decrease in cash flows
	£m	£m	£m	bps	%
Personal Financial Services	6,758	8,602	1,844	239	22

At 31 December 2019, there were no reasonably possible changes in any of the key assumptions that would have resulted in an impairment.

b) Other intangibles

	Group		
	Cost	Accumulated amortisation / impairment	Net book value
	£m	£m	£m
At 1 January 2020	1,263	(690)	573
Additions	101	—	101
Disposals	(47)	47	—
Charge	—	(198)	(198)
Impairment	—	(30)	(30)
At 31 December 2020	1,317	(871)	446
At 1 January 2019	1,099	(488)	611
Additions	178	—	178
Disposals	(14)	—	(14)
Charge	—	(192)	(192)
Impairment	—	(10)	(10)
At 31 December 2019	1,263	(690)	573

Other intangibles which consist of computer software, include computer software under development of £99m (2019: £197m), of which £68m is internally generated (2019: £123m).

21. PROPERTY, PLANT AND EQUIPMENT

						Group
	Property £m	Office fixtures and equipment £m	Computer software £m	Operating lease assets £m	Right-of-use assets £m	Total ⁽³⁾ £m
Cost:						
At 1 January 2020	1,275	1,442	439	738	214	4,108
Additions	61	24	2	185	10	282
Disposals	(61)	(104)	(5)	(203)	(2)	(375)
At 31 December 2020	1,275	1,362	436	720	222	4,015
Accumulated depreciation:						
At 1 January 2020	457	1,022	434	164	60	2,137
Charge for the year ⁽²⁾	80	111	—	92	59	342
Disposals	(46)	(80)	—	(78)	—	(204)
At 31 December 2020	491	1,053	434	178	119	2,275
Net book value	784	309	2	542	103	1,740
Cost:						
At 1 January 2019⁽¹⁾	1,295	1,405	438	604	211	3,953
Additions	5	66	1	251	4	327
Disposals	(25)	(29)	—	(117)	(1)	(172)
At 31 December 2019	1,275	1,442	439	738	214	4,108
Accumulated depreciation:						
At 1 January 2019	432	908	434	134	—	1,908
Charge for the year	39	162	—	81	60	342
Disposals	(14)	(48)	—	(51)	—	(113)
At 31 December 2019	457	1,022	434	164	60	2,137
Net book value	818	420	5	574	154	1,971

(1) Represents the value of the right-of-use assets, principally premises, recognised on 1 January 2019 upon adoption of IFRS 16.

(2) Following a review of the estimated useful lives of property as part of Santander UK's transformation program, the charge for the year includes accelerated property depreciation of £9m (2019: £2m).

(3) Property, plant and equipment includes assets under construction of £55m (2019: £16m).

The Santander UK group leases properties, vehicles and other equipment which are classified as operating leases because they do not transfer substantially all of the risks and rewards incidental to ownership of the assets. Short-term leases are excluded. See the accounting policy in Note 1.

22. OTHER FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	Group	
	2020 £m	2019 £m
US\$30bn Euro Medium Term Note Programme	102	159
Structured Notes Programmes	805	809
Eurobonds	150	137
Structured deposits	375	435
Collateral and associated financial guarantees	2	173
Repurchase agreements - non trading	—	—
	1,434	1,713

For the Santander UK group all (2019: all) of the other financial liabilities at fair value through profit or loss were designated as such.

Collateral and associated financial guarantees in the table above represent collateral received, together with associated credit protection guarantees, in respect of the proceeds of the retained senior tranches of credit linked notes described in Note 12. The financial guarantees are valued using the same parameters as the related credit linked notes, such that changes in the respective valuations are offset exactly, and there is no charge or credit to the income statement. In 2019 £2.1bn of cash deposits, which were previously included within collateral and associated financial guarantees in the table above, were presented on a net basis. This followed a deed of amendment, including a legal right of set-off between the principal amounts of senior tranches of credit linked notes, classified as debt securities in Note 12, and the cash deposits. At 31 December 2020 the amount of this netting was £825m (2019: £1.5bn). For more, see 'Credit protection entities' in Note 19.

Gains and losses arising from changes in the credit spread of securities issued by the Santander UK group reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount. The net loss during the year attributable to changes in the Santander UK group's own credit risk on the above securities was £3m (2019: £77m loss, 2018: £84m gain). The cumulative net loss attributable to changes in the Santander UK group's own credit risk on the above securities at 31 December 2020 was £3m (2019: £nil).

At 31 December 2020, the amount that would be required to be contractually paid at maturity of the securities above was £11m higher (2019: £4m lower) than the carrying value.

23. DEPOSITS BY CUSTOMERS

	Group	
	2020	2019
	£m	£m
Demand and time deposits ⁽¹⁾	191,774	177,772
Amounts due to fellow Banco Santander subsidiaries and joint ventures	1,314	1,234
	193,088	179,006

(1) Includes equity index-linked deposits of £577m (2019: £1,139m). The capital amount guaranteed/protected and the amount of return guaranteed in respect of the equity index-linked deposits were £577m and £2m (2019: £1,139m and £18m) respectively.

24. DEPOSITS BY BANKS

	Group	
	2020	2019
	£m	£m
Items in the course of transmission	375	337
Deposits held as collateral	2,071	2,175
Other deposits ⁽¹⁾	18,527	11,847
	20,973	14,359

(1) Includes drawdown from the TFS of £6.3bn (2019: £10.8bn) and drawdown from the TFSME of £11.7bn (2019:£nil).

25. REPURCHASE AGREEMENTS – NON TRADING

	Group	
	2020	2019
	£m	£m
Agreements with banks	6,358	10,227
Agreements with customers	9,490	8,059
	15,848	18,286

26. DEBT SECURITIES IN ISSUE

	Group	
	2020	2019
	£m	£m
Medium-term notes:		
– US\$30bn Euro Medium Term Note Programme	1,694	4,679
– Euro 30bn Euro Medium Term Note Programme	3,619	5,175
– US SEC-registered Debt Programme – Santander UK Group Holdings plc	4,882	5,763
– US SEC-registered Debt Programme – Santander UK plc	4,723	5,891
– Euro 750m Senior Unsecured Notes	673	—
– US\$1bn Senior Unsecured Notes	734	—
	16,325	21,508
Euro 35bn Global Covered Bond Programme (See Note 14)	19,285	19,004
US\$20bn Commercial Paper Programmes	2,824	3,014
Certificates of deposit	2,858	2,806
Credit linked notes	57	60
Securitisation programmes (See Note 14)	2,330	3,779
	43,679	50,171

The funding from the Euro 30bn Euro Medium Term Note Programme and the US SEC-registered Debt Programme in the name of Santander UK Group Holdings plc has predominantly been downstreamed to our operating company Santander UK plc.

27. SUBORDINATED LIABILITIES

	Group	
	2020	2019
	£m	£m
£325m Sterling preference shares	344	344
Undated subordinated liabilities	557	581
Dated subordinated liabilities	1,655	2,603
	2,556	3,528

In 2020, the Santander UK group repurchased certain debt securities and subordinated liabilities as part of ongoing liability management exercises, resulting in a loss of £24m. In 2019, the Santander UK group did not repurchase any of its debt securities or subordinated liabilities.

The above securities will, in the event of the winding up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination amongst each of the subordinated liabilities upon a winding up of the issuer is specified in their respective terms and conditions.

In 2020 and 2019, the Santander UK group had no defaults of principal, interest or other breaches with respect to its subordinated liabilities. No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the PRA.

Undated subordinated liabilities

	First call date	Group	
		2020	2019
		£m	£m
10.0625% Exchangeable capital securities	n/a	205	205
7.375% 20 Year Step-up perpetual callable subordinated notes	2020	—	15
7.125% 30 Year Step-up perpetual callable subordinated notes	2030	352	361
		557	581

In common with other debt securities issued by Santander UK group companies and notwithstanding the issuer's first call dates in the table above, in the event of certain tax changes affecting the treatment of payments of interest on subordinated liabilities in the UK, the 7.125% 30 Year Step-up perpetual callable subordinated notes are redeemable at any time, and the 10.0625% Exchangeable capital securities are redeemable on any interest payment date – each in whole at the option of Santander UK plc, at their principal amount together with any accrued interest. The 7.375% 20 Year Step-up perpetual callable subordinated notes were redeemed in full on 28 September 2020.

The 10.0625% Exchangeable capital securities are exchangeable into fully paid 10.375% non-cumulative non-redeemable sterling preference shares of £1 each, at the option of Santander UK plc, on the business day immediately following any interest payment date.

Dated subordinated liabilities

	Maturity	Group	
		2020	2019
		£m	£m
5% Subordinated notes (US\$1,500m)	2023	542	1,132
4.75% Subordinated notes (US\$1,000m)	2025	536	763
7.95% Subordinated notes (US\$1,000m)	2029	242	280
6.50% Subordinated notes	2030	31	40
5.875% Subordinated notes	2031	10	9
5.625% Subordinated notes (US\$500m)	2045	294	379
		1,655	2,603

The dated subordinated liabilities are redeemable in whole at the option of Santander UK plc in the event of certain tax changes affecting the treatment of payments of interest on the subordinated liabilities in the UK, at their principal amount together with any accrued interest.

Each of the subordinated liabilities issued by Santander UK Group Holdings plc has been downstreamed to Santander UK plc by means of Santander UK plc issuing equivalent subordinated liabilities to Santander UK Group Holdings plc.

28. OTHER LIABILITIES

	Group	
	2020	2019
	£m	£m
Lease liabilities	100	138
Other	2,243	2,235
	2,343	2,373

29. PROVISIONS

	Conduct remediation						Group
	PPI	Other products	Bank Levy	Property	Off balance sheet ECL	Regulatory and other	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	189	25	48	61	78	176	577
Additional provisions (See Note 8)	—	—	74	9	—	209	292
Provisions released (See Note 8)	—	(15)	—	(8)	(3)	(1)	(27)
Utilisation and other ⁽¹⁾	(113)	(2)	(94)	(17)	—	(158)	(384)
Recharge ⁽²⁾	—	—	10	—	—	—	10
At 31 December 2020	76	8	38	45	75	226	468
To be settled:							
– Within 12 months	76	2	38	24	75	125	340
– In more than 12 months	—	6	—	21	—	101	128
	76	8	38	45	75	226	468

(1) Utilisation and other included a transfer from 'PPI' to 'Regulatory and other' in respect of an ongoing legal dispute. No further information has been provided on the basis it would be seriously prejudicial.

(2) This relates to a recharge in respect of the UK Bank Levy paid on behalf of other UK entities of Banco Santander SA.

a) Conduct remediation

i) Payment Protection Insurance (PPI)

At 31 December 2020, the remaining provision for PPI redress and related costs was £76m (2019: £189m). There was no additional provision in 2020.

Cumulative complaints from the inception of the PPI complaints process to 31 December 2020, regardless of the likelihood of Santander UK incurring a liability, were 4.6m. At 31 December 2020, there were an estimated 3,500 complaints still requiring assessment and we had also entered into a commercial negotiation with the Official Receiver.

Although the deadline for bringing complaints has passed, customers can still commence litigation concerning the historical sale of PPI. Provision has been made for the best estimate of any obligation to pay compensation in respect of current stock and estimated future claims. However, there are ongoing factual issues to be resolved regarding such litigation which may have legal consequences including the volume and quality of future litigation claims. As a result, the extent of the potential liability and amount of any compensation to be paid remains uncertain.

The provision for conduct remediation recognised represents management's best estimate of Santander UK's liability in respect of mis-selling of PPI policies.

(ii) Other products

A provision for conduct remediation has also been recognised in respect of sales of other products. A number of uncertainties remain as to the eventual costs with respect to conduct remediation in respect of these products given the inherent difficulties in determining the number of customers involved and the amount of any redress to be provided to them. The remaining provision for other conduct was £8m (2019: £25m), which primarily related to the sale of mortgage endowments.

b) Bank Levy

In addition to changes in UK corporation tax rates, Finance (No.2) Act 2015 reduced the UK Bank Levy rate from 0.21% via subsequent annual reductions to 0.10% from 1 January 2021. As a result, a rate of 0.14% applies for 2020 (2019: 0.15%). The UK Bank Levy cost for 2020 was £74m (2019: £87m, 2018: £69m). The Santander UK group paid £88m in 2020 (2019: £90m) and provided for a liability of £38m at 31 December 2020 (2019: £48m).

c) Property

Property provisions include vacant property provisions and property dilapidation provisions for leased properties within the scope of IFRS 16. Vacant property provisions are made by reference to an estimate of any expected sub-let income, compared to the head rent, and the possibility of disposing of Santander UK's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on a semi-annual basis and will normally run off over the period of the leases concerned. Where a property is disposed of earlier than anticipated, any remaining provision relating to that property is released.

Property provisions were impacted by £1m of transformation charges in 2020. These relate to a multi-year project to deliver on our strategic priorities and enhance efficiency in order for us to better serve our customers and meet our medium-term targets. These charges largely related to restructuring of our branch network, and in particular the closure of university branches in 2020.

d) Off-balance sheet ECL

Provisions include expected credit losses relating to guarantees given to third parties and undrawn loan commitments.

e) Regulatory and other

Regulatory and other provisions principally comprised amounts in respect of regulatory charges (including fines), operational loss and operational risk provisions, restructuring charges and litigation and related expenses. A number of uncertainties exist with respect to these provisions given the uncertainties inherent in operational, restructuring and litigation matters that affect the amount and timing of any potential outflows with respect to which provisions have been established. These provisions are reviewed at least quarterly.

At 31 December 2020 Regulatory and other provisions included an amount of £47m (2019: £68m) that arose from a systems-related historical issue identified by Santander UK, relating to compliance with certain requirements of the Consumer Credit Act (CCA). This provision is based on detailed reviews of relevant systems related to consumer credit business operations, supported by external legal and regulatory advice, and reflects our best estimate at 31 December 2020 of potential costs in respect of the identified issue. As detailed in Note 31, there are aspects of the issue which remain under review.

The balance also included an amount in respect of our best estimate of liability relating to a legal dispute regarding allocation of responsibility for a specific PPI portfolio of complaints, further described in Note 31. No further information on the best estimate is provided on the basis that it would be seriously prejudicial.

In 2020 there was a charge of £17m included in Regulatory and other provisions, relating to breaches of certain requirements to provide SMS warning alerts to customers regarding overdraft charges in our Retail Banking Business. It also included a charge of £65m as part of our multi-year transformation programme to improve future returns, focused on simplifying, digitising and automating the bank, a charge for operational risk provisions of £91m, and smaller charges for legal and redundancy provisions.

30. RETIREMENT BENEFIT PLANS

The amounts recognised in the balance sheet were as follows:

	Group	
	2020	2019
	£m	£m
Assets/(liabilities)		
Funded defined benefit pension scheme - surplus	496	670
Funded defined benefit pension scheme - deficit	(361)	(239)
Unfunded pension and post retirement medical benefits	(42)	(41)
Total net assets	93	390

Remeasurement losses/(gains) recognised in other comprehensive income during the year were as follows:

	Group		
	2020	2019	2018
	£m	£m	£m
Pension remeasurement	505	523	(469)

a) Defined contribution pension plans

The Santander UK group operates a number of defined contribution pension plans. The assets of the defined contribution pension plans are held and administered separately from those of the Santander UK group. The majority of employees are members of a defined contribution Master Trust, LifeSight. This is the plan into which eligible employees are enrolled automatically. The assets of LifeSight are held in separate trustee-administered funds. In October 2020, there was a transfer of assets and liabilities to LifeSight from the defined contribution section of the main Santander UK Group defined benefit pension scheme (see below). Funds arising from Additional Voluntary Contributions (AVCs) largely remained within the main Santander UK Group scheme.

An expense of £67m (2019: £67m, 2018: £66m) was recognised for defined contribution plans in the period and is included in staff costs classified within operating expenses (see Note 6).

b) Defined benefit pension schemes

The Santander UK group operates a number of defined benefit pension schemes. The main scheme is the Santander (UK) Group Pension Scheme (the Scheme). It comprises seven legally segregated sections. The Scheme covers 11% (2019: 11%) of the Santander UK group's current employees and is a funded defined benefit scheme which is closed to new members.

The corporate trustee of the Scheme is Santander (UK) Group Pension Scheme Trustees Limited (the Trustee), a private limited company incorporated in 1996 and a wholly-owned subsidiary of Santander UK Group Holdings plc. The principal duty of the Trustee is to act in the best interests of the members of the Scheme. The Trustee board comprises five (2019: five) Directors selected by Santander UK Group Holdings plc, plus five (2019: five) member-nominated Directors selected from eligible members who apply for the role.

The assets of the funded schemes including the Scheme are held independently of the Santander UK group's assets in separate trustee administered funds. Investment strategy across the sections of the Scheme remains under regular review. Investment decisions are delegated by the Trustee to a common investment fund, managed by Santander (CF Trustee) Limited, a private limited company owned by five Trustee directors, three appointed by Santander UK plc and two by the Trustee. The Santander (CF Trustee) Limited directors' principal duty, within the investment powers delegated to them, is to act in the best interest of the members of the Scheme. Ultimate responsibility for investment policy and strategy rests with the Trustee of the Scheme who is required under the Pensions Act 2004 to prepare a statement of investment principles. The defined benefit pension schemes expose the Santander UK group to risks such as investment risk, interest rate risk, longevity risk and inflation risk. The Santander UK group does not hold material insurance policies over the defined benefit pension schemes and has not entered into any significant transactions with them.

Formal actuarial valuations of the assets and liabilities of the defined benefit schemes are carried out on at least a triennial basis by independent professionally-qualified actuaries and valued for accounting purposes at each balance sheet date. The Scheme Trustee is responsible for the actuarial valuations and in doing so considers, or relies in part on, a report of a third-party expert. The latest formal actuarial valuation for the Scheme at 31 March 2019 was finalised in August 2019, with a deficit to be funded of £1,136m. The next scheduled triennial funding valuation will be at 31 March 2022. Any funding surpluses can be recovered by Santander UK plc from the Scheme through refunds as the Scheme is run off over time or could be used to pay for the cost of benefits which are accruing.

The main differences between the assumptions used for assessing the defined benefit liabilities for the funding valuation and those used for IAS19 is that the financial and demographic assumptions used for the funding valuation are generally more prudent than those used for the IAS 19 valuation.

The total amount charged to the income statement was as follows:

			Group
	2020	2019	2018
	£m	£m	£m
Net interest income	(10)	(24)	(7)
Current service cost	36	34	41
Past service and GMP costs	1	1	41
Administration costs	8	8	8
	35	19	83

On 26 October 2018, the High Court handed down a judgement concluding that defined benefit schemes should equalise pension benefits for men and women in relation to GMP and concluded on the methods that were appropriate. The estimated increase in liabilities at the date of the judgement was £40m and was based on a number of assumptions and the actual impact may be different. This was reflected in the income statement and in the closing net accounting surplus of the Scheme in 2018. The allowance included in the Scheme liabilities at 31 December 2020 increased by £5m (2019: £5m) to £50m (2019: £45m) to reflect the latest assumptions. This change was recognised in other comprehensive income. Work is being undertaken to consider and agree how to implement GMP equalisation.

On 20 November 2020, a further court ruling on the Lloyds GMP equalisation case took place on the issue of whether or not there is an obligation to equalise transfers that occurred prior to October 2018. It was concluded that historic transfers should be equalised. The potential additional liability was estimated and was not material. As a result, no additional liability has been accounted for.

The amounts recognised in other comprehensive income were as follows:

			Group
	2020	2019	2018
	£m	£m	£m
Return on plan assets (excluding amounts included in net interest expense)	(1,328)	(873)	246
Actuarial losses/(gains) arising from changes in demographic assumptions	34	42	(56)
Actuarial (gains)/losses arising from experience adjustments	(141)	(40)	15
Actuarial losses/(gains) arising from changes in financial assumptions	1,940	1,394	(674)
Pension remeasurement	505	523	(469)

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

			Group
	2020	2019	2019
	£m	£m	£m
At 1 January		(12,165)	(10,805)
Current service cost paid by Santander UK plc		(24)	(22)
Current service cost paid by other subsidiaries		(12)	(12)
Interest cost		(253)	(308)
Employer salary sacrifice contributions		(2)	(8)
Past service cost		(1)	(1)
Remeasurement due to actuarial movements arising from:			
– Changes in demographic assumptions		(34)	(42)
– Experience adjustments		141	40
– Changes in financial assumptions		(1,940)	(1,394)
Benefits paid		396	387
At 31 December		(13,894)	(12,165)

Movements in the fair value of the schemes' assets were as follows:

			Group
	2020	2019	2019
	£m	£m	£m
At 1 January		12,555	11,532
Interest income		263	332
Contributions paid by employer and scheme members		245	213
Administration costs paid		(8)	(8)
Return on plan assets (excluding amounts included in net interest expense)		1,328	873
Benefits paid		(396)	(387)
At 31 December		13,987	12,555

The composition and fair value of the schemes' assets by category was:

	Group					
	Quoted prices in active markets		Prices not quoted in active markets		Total	
	£m	%	£m	%	£m	%
2020						
UK equities	40	—	—	—	40	—
Overseas equities	1,271	9	1,004	7	2,275	16
Corporate bonds	1,121	8	457	3	1,578	11
Government fixed interest bonds	1,618	12	—	—	1,618	12
Government index-linked bonds	6,695	48	—	—	6,695	48
Property	—	—	1,454	10	1,454	10
Derivatives	—	—	312	2	312	2
Cash	—	—	1,161	8	1,161	8
Repurchase agreements ⁽¹⁾	—	—	(2,198)	(15)	(2,198)	(15)
Other	—	—	1,052	8	1,052	8
	10,745	77	3,242	23	13,987	100
2019						
UK equities	128	1	—	—	128	1
Overseas equities	1,742	14	933	7	2,675	21
Corporate bonds	1,333	11	444	4	1,777	15
Government fixed interest bonds	2,710	22	—	—	2,710	22
Government index-linked bonds	4,543	35	—	—	4,543	35
Property	—	—	1,332	11	1,332	11
Derivatives	—	—	94	1	94	1
Cash	—	—	984	8	984	8
Repurchase agreements ⁽¹⁾	—	—	(3,263)	(26)	(3,263)	(26)
Other	—	—	1,575	12	1,575	12
	10,456	83	2,099	17	12,555	100

(1) Sale and repurchase agreements net of purchase and resale agreements.

Scheme assets are stated at fair value based upon quoted prices in active markets except for property, property funds, derivatives, private equity and those classified under 'Other'. The 'Other' category includes annuities, infrastructure funds and hedge funds. The property funds and the infrastructure funds were valued using market valuations prepared by an independent expert. Investments in hedge funds that are included in the 'Other' category, and investments in foreign exchange, inflation, equity and interest rate derivatives that are included in the 'Derivatives' category, were valued by investment managers by reference to market observable data. Private equity funds were valued by reference to the latest valuation statements provided by the private equity managers. The insured annuities were valued by actuaries based on the liabilities insured.

At 31 December 2020, the value of the insured annuities included in the 'Other' category included the value of a pensioner buy-in that was entered into on 27 May 2020 by the Trustee with an insurance company. This transaction insured 100% of the SMA section pensioner liabilities and 50% of the SPI section pensioner liabilities based on membership in the Scheme at 31 December 2018. At 31 December 2020, as highlighted above the Scheme was invested in certain assets whose values are not based on market observable data, such as investments in private equity funds and property. Due diligence has been conducted to ensure the values obtained in respect of these assets are appropriate and represent fair value.

A strategy is in place to manage interest rate and inflation risk relating to the liabilities. In 2020, the level of interest rate and inflation rate hedging was increased. The Scheme also has in place an equity collar to manage equity risk and hedges a proportion of its foreign exchange exposure to manage currency risk. At 31 December 2020 the equity collar had a notional value of £1,076m (2019: £1,560m) and the currency forwards had a notional value of £2,378m (2019: £2,079m). Some asset de-risking took place in 2020, with disinvestments from equity funds and multi-asset funds. The proceeds from disinvestment were used in a liability driven investment portfolio. An ESG monitoring framework has also been implemented to ensure regulatory compliance and to support the consideration of ESG issues in the decision-making framework.

The Santander UK group's pension schemes did not directly hold any equity securities of the Company or any of its related parties at 31 December 2020 and 2019. The Santander UK group's pension scheme assets do not include any property or other assets that are occupied or used by the Santander UK group.

Funding

In August 2019, in compliance with the Pensions Act 2004, the Trustee and the Santander UK group agreed to a new recovery plan in respect of the Scheme and schedule of contributions following the finalisation of the 31 March 2019 actuarial valuation. The funding target for this actuarial valuation is for the Scheme to have sufficient assets to make payments to members in respect of the accrued benefits as and when they fall due. In accordance with the terms of the Trustee agreement in place at the time, the Santander UK group contributed £236m in 2020 (2019: £203m) to the Scheme, of which £187m (2019: £153m) was in respect of agreed deficit repair contributions. The agreed schedule of the Santander UK group's remaining contributions to the Scheme broadly comprises contributions of £187m each year from 30 September 2019 to 31 March 2026. In addition, the Santander UK group has agreed to pay further contingent contributions should the funding position have fallen behind plan. The Santander UK group also meets Scheme administration expenses. The funding valuation is used to judge the amount of cash contributions the Group needs to put into the pension scheme. It will always be different to the IAS 19 accounting deficit, which is an accounting rule concerning employee benefits and shown on the balance sheet of our financial statements.

Actuarial assumptions

The principal actuarial assumptions used for the defined benefit schemes were:

	Group		
	2020	2019	2018
	%	%	%
To determine benefit obligations:			
– Discount rate for scheme liabilities	1.3	2.1	2.9
– General price inflation	3.0	3.0	3.2
– General salary increase	1.0	1.0	1.0
– Expected rate of pension increase	2.9	2.9	2.9
	Years	Years	Years
Longevity at 60 for current pensioners, on the valuation date:			
– Males	27.5	27.3	27.3
– Females	30.0	29.8	30.1
Longevity at 60 for future pensioners currently aged 40, on the valuation date:			
– Males	29.0	28.9	28.7
– Females	31.5	31.3	31.6

Discount rate for scheme liabilities

The rate used to discount the retirement benefit obligation for accounting purposes is based on the annual yield at the balance sheet date of high-quality corporate bonds on that date. There are only a limited number of higher quality Sterling-denominated corporate bonds, particularly those that are longer-dated. Therefore, in order to set a suitable discount rate, we need to construct a corporate bond yield curve. The model which we use for constructing the curve uses corporate bond data but excludes most convertible and asset-backed bonds. The curve is then constructed from this data by extrapolating the horizontal forward curve from 30 years, with the level of this forward rate being the average of the fitted forward rates over the 15 to 30 year range. When considering an appropriate assumption, we project forward the expected cash flows of the Scheme and adopt a single equivalent cash flow weighted discount rate, subject to management judgement.

General price inflation

Consistent with our discount rate methodology, we set the inflation assumption using the expected cash flows of the Scheme, fitting them to an inflation curve to give a weighted average inflation assumption. We then deduct an inflation risk premium to reflect the compensation holders of fixed rate instruments expect to receive for taking on the inflation risk. This premium is subject to a cap, to better reflect management's view of inflation expectations. In 2020, management amended the general price inflation assumptions to reflect the expectation that the Retail Price Index would be brought in line with the Consumer Price Index from 2030. At 31 December 2020, this change increased the liabilities of the Scheme by £64m.

General salary increase

From 1 March 2015, a cap on pensionable pay increases of 1% each year was applied to staff in the Scheme.

Expected rate of pension increase

The pension increase assumption methodology uses a stochastic model, which is calibrated to consider both the observed historical volatility term structure and derivative pricing. The model allows for the likelihood that high or low inflation in one-year feeds into inflation remaining high or low in the next year.

Mortality assumptions

The mortality assumptions are based on an independent analysis of the Scheme's actual mortality experience, carried out as part of the triennial actuarial valuation, together with recent evidence from the Continuous Mortality Investigation. An allowance is then made for expected future improvements to life expectancy based on the Continuous Mortality Investigation Tables. Following this review the S3 Medium all pensioner mortality table was adopted with appropriate adjustments to reflect the actual mortality experience. For future improvements, at 31 December 2020 the CMI 2019 projection model was adopted, with model parameters selected having had regard to the Scheme's membership profile with an initial addition to improvements of 0.15% per annum, together with a long-term rate of future improvements to life expectancy of 1.25% for male and female members. Both of these are published by the Continuous Mortality Investigation.

In 2019, the methodology for setting the demographic assumptions was changed to better represent current expectations, following a review carried out by the Trustee as part of the 2019 triennial valuation and a separate review conducted on early retirement experience. These reviews resulted in changes in the assumptions for commutation, family statistics and early retirement, which were retained at 31 December 2020.

Actuarial assumption sensitivities

The sensitivity analyses below have been determined based on reasonably possible changes of the respective assumptions occurring at the end of the reporting period, while holding all other assumptions constant.

Assumption	Change in pension obligation at period end from	(Decrease)/increase	
		2020	2019
		£m	£m
Discount rate	25 bps increase	(662)	(564)
General price inflation	25 bps increase	365	407
Mortality	Each additional year of longevity assumed	515	419

The 25 bps sensitivity to the inflation assumption includes the corresponding impact of changes in future pension increase assumptions before and after retirement. The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated. Furthermore, in presenting the sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same method used to calculate the defined benefit obligation recognised in the balance sheet. There were no changes in the methods and assumptions used in preparing the sensitivity analyses from prior years.

The benefits expected to be paid in each of the next five years, and in the aggregate for the five years thereafter are:

Year ending 31 December	£m
2021	359
2022	327
2023	336
2024	359
2025	382
Five years ending 2030	2,139

The average duration of the defined benefit obligation at 31 December 2020 was 19.4 years (2019: 18.8 years).

Covid-19

The Covid-19 pandemic led to significant volatility in financial markets in 2020. This translated into a volatile pension surplus/deficit, with large movements going through Other Comprehensive Income as a result. Significant progress was made in 2020 to improve the Scheme's resilience to market volatility, which includes the increase in the level of interest rate and inflation rate hedging, de-risking within the asset portfolio and investment in a buy-in.

The Santander UK group has collaborated with the Trustee to ensure the delivery of key functions and services could be maintained throughout the Covid-19 pandemic, to include most vitally the payment of pensions to members. At the start of the Covid-19 pandemic, an enhanced risk monitoring framework was also established to identify and monitor such risks and ensure they were adequately managed.

31. CONTINGENT LIABILITIES AND COMMITMENTS

	Group	
	2020	2019
	£m	£m
Guarantees given to third parties	939	1,198
Formal standby facilities, credit lines and other commitments	42,231	40,410
	43,170	41,608

At 31 December 2020, the Santander UK group had credit impairment loss provisions relating to guarantees given to third parties and undrawn loan commitments. See Note 29 for further details. For segmental and credit risk staging analysis relating to off-balance sheet exposures, see the credit quality table in the 'Santander UK group level – credit risk review' section.

Where the items set out below can be reliably estimated, they are disclosed in the table above.

Capital support arrangements

Santander UK plc, Cater Allen Limited and certain other non-regulated subsidiaries within the ring-fenced bank entered into a capital support deed dated 13 November 2018 (the RFB Sub-Group Capital Support Deed). The parties to the RFB Sub-Group Capital Support Deed are permitted by the PRA to form a core UK group, as defined in the PRA Rulebook, a permission which will expire on 31 December 2021. Exposures of each of the regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the RFB Sub-Group Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties breaches or is at risk of breaching its capital resources requirements or risk concentrations requirements.

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

Liquidity support arrangements

We monitor and manage liquidity risk for the Santander UK plc group and its former subsidiary SFS separately. Under this model, and the PRA's liquidity rules, Santander UK plc and its subsidiary Cater Allen Limited form the RFB Domestic Liquidity Sub-group (the RFB DoLSub), which allows the entities to collectively meet regulatory requirements for the purpose of managing liquidity risk. Each member of the RFB DoLSub will support the other by transferring surplus liquidity in times of stress.

Guarantees given to third parties

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

Formal standby facilities, credit lines and other commitments

Standby facilities, credit lines and other commitments are also granted as part of normal product facilities which are offered to customers. Retail facilities comprise undrawn facilities granted on flexible mortgages, bank overdrafts and credit cards. On flexible mortgages, the credit limit is set at the point of granting the loan through property value and affordability assessments. Ongoing assessments are made to ensure that credit limits remain appropriate considering any change in the security value or the customer's financial circumstances. For unsecured overdraft facilities and credit cards, the facilities are granted based on new business risk assessment and are reviewed more frequently based on internal, as well as external data. The delinquency status of the account would result in the withdrawal of the facility. Corporate facilities can comprise standby and revolving facilities which are subject to ongoing compliance with covenants and may require the provision of agreed security. Failure to comply with these terms can result in the withdrawal of the unutilised facility headroom.

FSCS

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

Following the default of a number of deposit takers since 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. The remaining debt due to the FSCS, that related to the failure of Bradford & Bingley plc, has now been repaid. This has enabled the FSCS to make a corresponding repayment of the balance of its loan to HM Treasury. The provision was £nil in 2020 (2019: £nil).

Loan representations and warranties

In connection with the securitisations and covered bond transactions described in Note 14, the Santander UK group entities selling the relevant loans into the applicable securitisation or covered bond portfolios make representations and warranties with respect to such loans, in each case as of the date of the sale of the loans into the applicable portfolio. These representations and warranties cover, among other things, the ownership of the loan by the relevant Santander UK group entity, absence of a material breach or default by the relevant borrower under the loan, the loan's compliance with applicable laws and absence of material disputes with respect to the relevant borrower, asset and loan. The specific representations and warranties made by Santander UK group companies which act as sellers of loans in these securitisations and covered bond transactions depend in each case on the nature of the transaction and the requirements of the transaction structure. In addition, market conditions and credit rating agency requirements may affect the representations and warranties required of the relevant Santander UK group companies in these transactions.

In the event that there is a material breach of the representations and warranties given by Santander UK plc as seller of loans under the residential mortgage-backed securitisations or the covered bond programmes included in Note 14, or if such representations and warranties prove to be materially untrue as at the date when they were given (being the sale date of the relevant mortgage loans), Santander UK plc may be required to repurchase the affected mortgage loans (generally at their outstanding principal balance plus accrued interest). These securitisations and covered bond programmes are collateralised by prime residential mortgage loans. Santander UK plc is principally a retail prime lender and has no appetite or product offering for any type of sub-prime business. In addition, Santander UK plc's credit policy explicitly prohibits such lending.

Similarly, under the auto loan securitisations in Note 14, in the event that there is a breach or inaccuracy in respect of a representation or warranty relating to the loans, the relevant Santander UK group entity who sold the auto loans into the securitisation portfolio will be required to repurchase such loans from the structure (also at their outstanding principal balance plus accrued interest). In addition to breaches of representation and warranties, under the auto loan securitisations, the seller may also have a repurchase obligation if certain portfolio limits are breached (which include, amongst other things, limits as to the size of a loan given to an individual customer, LTV ratio, average term to maturity and average seasoning).

In the case of a repurchase of a loan from the relevant securitisation or covered bond programmes, the Santander UK group may bear any subsequent credit loss on such loan. The Santander UK group manages and monitors its securitisation and covered bond activities closely to minimise potential claims.

Other legal actions and regulatory matters

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

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

Payment Protection Insurance

In relation to a specific PPI portfolio of complaints, a legal dispute regarding allocation of liability is in its early stages. The dispute relates to the liability for PPI mis-selling complaints relating to pre-2005 PPI policies underwritten by AXA France IARD and AXA France Vie (together, AXA France - previously Financial Insurance Company Ltd and Financial Assurance Company Ltd respectively) and involves Santander Cards UK Limited (a former GE Capital Corporation entity and distributor of pre-2005 PPI known as GE Capital Bank Limited which was acquired by Banco Santander S.A. in 2008 and subsequently transferred to Santander UK plc) and a Banco Santander S.A. subsidiary Santander Insurance Services UK Limited (together the Santander Entities). During the relevant period, AXA France were owned by Genworth Financial International Holdings, Inc. (Genworth).

In September 2015 AXA S.A. acquired AXA France from Genworth. In July 2017, the Santander Entities notified AXA France that they did not accept liability for losses on PPI policies relating to this period. Santander UK plc entered into a Complaints Handling Agreement (CHA) with AXA France pursuant to which it agreed to handle complaints on their behalf, and AXA France agreed to pay redress assessed to be due to relevant policyholders on a without prejudice basis. A standstill agreement was entered into between the Santander Entities and AXA France as a condition of the CHA.

In July 2020 Genworth announced that it had agreed to pay AXA circa £624m in respect of PPI mis-selling losses in settlement of the related dispute concerning obligations under the sale and purchase agreement pursuant to which Genworth sold AXA France to AXA. The CHA between Santander UK plc and AXA France terminated on 26 December 2020. On 30 December 2020, AXA France provided written notice to the Santander Entities to terminate the standstill agreement and claimed that the Santander Entities are liable to reimburse AXA France for pre-2005 PPI mis-selling losses, currently estimated at £631 million. This dispute is at an early stage and there are ongoing factual issues to be resolved which may have legal consequences including in relation to liability. These issues create uncertainties which mean that it is difficult to reliably predict the outcome or the timing of the resolution of the matter. The Regulatory and other

provision in Note 29 includes our best estimate of the Santander Entities' liability to the specific portfolio. Further information has not been provided on the basis that it would be seriously prejudicial to the Santander Entities' interests in connection with the dispute.

In addition, and in relation to PPI more generally the PPI provision includes an amount relating to legal claims challenging the FCA's industry guidance on the treatment of Plevin / recurring non-disclosure assessments. This provision is based on current stock levels, future projected claims, and average redress. There remains a risk that volumes received in future may be higher than forecast. The provision in Note 29 includes our best estimate of Santander UK's liability for the specific issue. The actual cost of customer compensation could differ from the amount provided. It is not currently practicable to provide an estimate of the risk and amount of any further financial impact.

German dividend tax arbitrage transactions

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

During 2020 we have continued to cooperate with the German authorities and, with the assistance of external experts, to progress an internal investigation into the matters in question. From Santander UK plc's perspective the investigation is focused principally on the period 2009-2011 and remains on-going. There remain factual issues to be resolved which may have legal consequences including potentially material financial penalties. These issues create uncertainties which mean that it is difficult to predict the resolution of the matter including timing or the significance of the possible impact.

Consumer credit

The Santander UK group's unsecured lending and other consumer credit business is governed by consumer credit law and related regulations, including the CCA. Claims brought by customers in relation to these requirements, including potential breaches, could result in costs to the Santander UK group where such potential breaches are not found to be de minimis. The CCA includes very detailed and prescriptive requirements for lenders, including in relation to post contractual information.

As described in Note 29, other provisions include an amount of £47m arising from a systems-related historical issue identified by Santander UK, relating to compliance with certain requirements of the CCA. This provision has been based on detailed reviews of relevant systems related to consumer credit business operations, supported by external legal and regulatory advice. The Regulatory and other provision in Note 29 includes our best estimate of Santander UK's liability for the specific issue. The actual cost of customer compensation could differ from the amount provided. It is not practicable to provide an estimate of the risk and amount of any further financial impact.

FCA civil regulatory investigation into Santander UK plc financial crime systems, processes and controls and compliance with the Money Laundering Regulations 2007

Santander UK plc is cooperating with an FCA civil regulatory investigation which commenced in July 2017 into our compliance with the Money Laundering Regulations 2007 and potential breaches of FCA principles and rules relating to anti-money laundering and financial crime systems and controls. The FCA's investigation focuses primarily on the period 2012 to 2017 and includes consideration of high risk customers including Money Service Businesses. It is not currently possible to make a reliable assessment of any liability resulting from the investigation including any financial penalty.

Taxation

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

Certain leases in which the Santander UK group is or was the lessor are currently under review by HMRC in connection with claims for tax allowances. Under the terms of the lease agreements, the Santander UK group is fully indemnified in all material respects by the respective lessees for any liability arising from the disallowance of tax allowances plus accrued interest, which could be up to £152m. Whilst legal opinions have been obtained to support the Santander UK group's position, the matter remains uncertain pending formal resolution with HMRC and any subsequent litigation. In 2020, as required under the terms of the leases these matters have moved to formal litigation and it is currently anticipated that hearings will be held at the First Tier Tax Tribunal in 2021 or 2022.

Other

On 2 November 2015, Visa Europe Ltd agreed to sell 100% of its share capital to Visa Inc. The deal closed on 21 June 2016. As a member and shareholder of Visa Europe Ltd, Santander UK received upfront consideration made up of cash and convertible preferred stock. Conversion of the preferred stock into Class A Common Stock of Visa Inc. depends on the outcome of litigation against Visa involving UK & Ireland (UK&I) multilateral interchange fees (MIFs). Following ring-fencing, all Visa stock is now held by Santander Equity Investments Limited (SEIL), outside the ring fenced bank. In valuing the preferred stock, SEIL makes adjustments for illiquidity and the potential for changes in conversion rate. In June 2020 the Supreme Court issued a judgment finding that MIFs restricted competition. In 2020 this resulted in the fair value of the convertible preferred stock being reduced by £10m.

In September 2020, pursuant to the scheduled release assessment, Visa released half of the value of the convertible preferred stock. As a result of this release, SEIL was issued with 5211 units of Series A Convertible Participating Preferred Stock (Series A Preferred Stock). When sold by SEIL, each share of Series A Preferred Stock will automatically convert into 100 shares of Class A Common Stock of Visa Inc.

In addition, Santander UK and certain other UK&I banks have agreed to indemnify Visa Inc. in the event that the preferred stock is insufficient to meet the costs of this litigation. Visa Inc. has recourse to this indemnity once more than €1bn of losses relating to UK&I MIFs have arisen or once the total value of the preferred stock issued to UK&I banks on closing has been reduced to nil. Whilst Santander UK's liability under this indemnity is capped at €39.85m, Visa Inc. may have recourse to a general indemnity in place under Visa Europe Operating Regulations for damages not satisfied through the above mechanism. At this stage, it is unclear whether the litigation will give rise to more than €1bn of losses relating to UK&I MIFs which means it is difficult to predict the resolution of the matter including the timing or the significance of the possible impact.

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

Obligations under stock borrowing and lending agreements

Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations are offset by a contractual right to receive stock under other contractual agreements. See Note 36.

Other off-balance sheet commitments

The Santander UK group has commitments to lend at fixed interest rates which expose us to interest rate risk. For more, see the Risk review.

Lease commitments as lessee

The majority of leases are subject to a third party outsourcing contract which expired on 24 December 2020 and the remainder are held directly by the Santander UK group with third party landlords. The leasehold interests subject to the outsourcing contract are held directly by the Santander UK group from 25 December 2020. Where Santander UK group leases have expired, negotiations are in progress/will be progressed with the landlords of these properties, to agree renewal terms, where occupation is still required. Negotiations will be in accordance with a conventional landlord and tenant negotiation on lease expiry, subject to a lease renewal being available from the external landlords. Where the freehold interest in a property is held by the outsourcing company (91 properties in total), new lease terms have been negotiated and all these leases are due to complete in January 2021, save for two, where the outsourcing company own a long leasehold interest and the leases will be completed upon receipt of landlords consent.

32. SHARE CAPITAL

Issued and fully paid share capital	Group	
	Ordinary shares of £1 each	
	No.	£m
At 31 December 2019, 1 January 2020 and 31 December 2020	7,060,000,000	7,060

33. OTHER EQUITY INSTRUMENTS

	Interest rate	Next call date	Group	
			2020	2019
	%		£m	£m
AT1 securities:				
– £500m Fixed Rate Reset Perpetual AT1 Capital Securities	6.75	June 2024	496	496
– £750m Fixed Rate Reset Perpetual AT1 Capital Securities	7.375	June 2022	745	745
– £500m Fixed Rate Reset Perpetual AT1 Capital Securities	5.33	March 2021	500	500
– £500m Fixed Rate Reset Perpetual AT1 Capital Securities	6.30	March 2025	500	500
			2,241	2,241

AT1 securities

The AT1 securities are perpetual and pay a distribution on 24 March, June, September and December. At each distribution payment date, the Company can decide whether to pay the distribution, which is non-cumulative, in whole or in part. The distribution rate resets every five years. The securities will be automatically written down and the investors will lose their entire investment in the securities should the CET1 capital ratio of the Santander UK prudential consolidation group fall below 7%. They are redeemable at the option of the Company on their first call date or on any reset date thereafter in the cases of the 6.75% and 7.375% Fixed Rate Reset Perpetual AT1 Capital Securities, and on any distribution payment date thereafter in the cases of the 5.33% and 6.30% Fixed Rate Reset Perpetual AT1 Capital Securities. No such redemption may be made without the consent of the PRA.

The £500m 5.33% Fixed Rate Reset Perpetual AT1 Capital Securities and the £500m 6.30% Fixed Rate Reset Perpetual AT1 Capital Securities were fully subscribed by the Company's immediate parent company, Banco Santander SA. £100m of the £750m 7.375% Fixed Rate Reset Perpetual AT1 Capital Securities were subscribed by Banco Santander SA.

34. NON-CONTROLLING INTERESTS

	Initial interest rate		2020		2019	
	%	First call date	£m	£m	£m	£m
Santander UK plc issued:						
– £300m Step-up Callable Perpetual Reserve Capital Instruments	7.037	February 2026	235		235	
PSA Finance UK Limited			162		160	
			397		395	

Step-up Callable Perpetual Reserve Capital Instruments

These instruments are redeemable by Santander UK plc on 14 February 2026 or on any coupon payment date thereafter, subject to the prior approval of the PRA. They are perpetual and pay interest annually. The coupon rate resets every five years, based on the UK five-year benchmark gilt rate. Interest payments may be deferred by Santander UK plc. The instruments are not redeemable at the option of the holders and the holders do not have any rights against other Santander UK group companies.

PSA Finance UK Limited

PSA Finance UK Limited is the only subsidiary in the Santander UK group that gives rise to significant non-controlling interests. See Note 19 for summarised financial information of PSA Finance UK Limited.

35. CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

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

	2020					2019					Group
	Balance sheet line item					Balance sheet line item					2019
	Debt securities in issue	Subordinated liabilities	Other equity instruments	Dividends paid	Total	Debt securities in issue	Subordinated liabilities	Other equity instruments	Dividends paid	Total	
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	50,171	3,528	2,241	—	55,940	55,906	3,601	2,041	—	61,548	
Cash flows from financing activities	(6,762)	(939)	—	(282)	(7,983)	(3,839)	—	196	(434)	(4,077)	
Cash flows from operating activities	(202)	—	—	—	(202)	(548)	—	—	—	(548)	
Non-cash changes:											
– Unrealised foreign exchange	359	(6)	—	—	353	(1,647)	(94)	—	—	(1,741)	
– Other changes	113	(27)	—	282	368	299	21	4	434	758	
At 31 December	43,679	2,556	2,241	—	48,476	50,171	3,528	2,241	—	55,940	

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

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

a) Assets charged as security for liabilities

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

	Group	
	2020	2019
	£m	£m
On-balance sheet:		
Cash and balances at central banks	985	1,080
Loans and advances to banks	804	615
Loans and advances to customers – securitisations and covered bonds (See Note 14)	31,138	36,225
Loans and advances to customers – other	23,690	16,315
Other financial assets at amortised cost	648	3,026
Financial assets at fair value through other comprehensive income	5,677	6,020
Total on-balance sheet	62,942	63,281
Total off-balance sheet	24,701	15,111

The Santander UK group provides assets as collateral in the following areas of the business.

Sale and repurchase agreements

The Santander UK group enters into sale and repurchase agreements and similar transactions of debt securities, which are accounted for as secured borrowings. Upon entering into such transactions, the Santander UK group provides collateral in excess of the borrowed amount. The carrying amount of assets that were so provided at 31 December 2020 was £25,874m (2019: £20,634m), of which £1,392m (2019: £2,067m) was classified within 'Loans and advances to customers – securitisations and covered bonds' in the table above.

Securitisations and covered bonds

As described in Note 14, Santander UK plc and certain of its subsidiaries issue securitisations and covered bonds. At 31 December 2020, there were £33,432m (2019: £36,391m) of gross assets in these secured programmes and £2,294m (2019: £166m) of these related to internally retained issuances that were available for use as collateral for liquidity purposes in the future.

At 31 December 2020, a total of £4,530m (2019: £4,728m) of notes issued under securitisation and covered bond programmes had been retained internally, a proportion of which had been used as collateral via third party bilateral secured funding transactions, which totalled £1,114m at 31 December 2020 (2019: £1,581m), or for use as collateral for liquidity purposes in the future.

Stock borrowing and lending agreements

Asset balances under stock borrowing and lending agreements represent stock lent by the Santander UK group. These balances amounted to £30,135m at 31 December 2020 (2019: £21,639m) and are offset by contractual commitments to return stock borrowed or cash received.

Derivatives business

In addition to the arrangements described, collateral is also provided in the normal course of derivative business to counterparties. At 31 December 2020 £1,888m (2019: £1,961m) of such collateral in the form of cash had been provided by the Santander UK group and is included in the table.

b) Collateral accepted as security for assets

The collateral held as security for assets, analysed between those liabilities accounted for on balance sheet and off-balance sheet, was:

	2020	Group 2019
	£m	£m
On-balance sheet:		
Deposits by banks	2,071	2,175
Total on-balance sheet	2,071	2,175
Total off-balance sheet	31,043	25,461

Purchase and resale agreements

The Santander UK group also enters into purchase and resale agreements and similar transactions of debt securities, which are accounted for as collateralised loans. Upon entering into such transactions, the Santander UK group receives collateral in excess of the loan amount. The level of collateral held is monitored daily and if required, further calls are made to ensure the market values of collateral remains at least equal to the loan balance. The subsidiaries are permitted to sell or repledge the collateral held in the absence of default. At 31 December 2020, the fair value of such collateral received was £25,972m (2019: £20,444m). Of the collateral received, almost all was sold or repledged. The subsidiaries have an obligation to return collateral that they have sold or pledged.

Stock borrowing and lending agreements

Obligations representing contractual commitments to return stock borrowed by the Santander UK group amounted to £5,071m at 31 December 2020 (2019: £5,017m) and are offset by a contractual right to receive stock lent.

Derivatives business

In addition to the arrangements described, collateral is also received from counterparties in the normal course of derivative business. At 31 December 2020, £2,071m (2019: £2,175m) of such collateral in the form of cash had been received by the Santander UK group and is included in the table.

Lending activities

In addition to the collateral held as security for assets, the Santander UK group may obtain a charge over a customer's property in connection with its lending activities. Details of these arrangements are set out in the 'Credit risk' section of the Risk review.

37. SHARE-BASED COMPENSATION

The Santander UK group operates share schemes and arrangements for eligible employees. The main current schemes are the Sharesave Schemes, the Long-Term Incentive Plan (the LTIP), the Deferred Shares Bonus Plan and the Partnership Shares scheme. All the share options and awards relate to shares in Banco Santander SA.

The amount charged to the income statement in respect of share-based payment transactions is set out in Note 6.

a) Sharesave Schemes

The Santander UK group launched its thirteenth HM Revenue & Customs approved Sharesave invitation under Banco Santander SA ownership in September 2020. Sharesave invitations have been offered since 2008 under broadly similar terms. Under the Sharesave Scheme's HMRC-approved savings limits, eligible employees may enter into contracts to save between £5 and £500 per month. For all schemes, at the end of a fixed term of three or five years after the grant date, the employees can use these savings to buy shares in Banco Santander SA at a discount, calculated in accordance with the rules of the scheme. This year no discount was applied. The option price is calculated as the average middle market quoted price of Banco Santander SA shares over the first three dealing days prior to invitation. The vesting of awards under the scheme depends on continued employment with the Banco Santander SA group. Participants in the scheme have six months from the date of vest to exercise the option.

The table below summarises movements in the number of options, and changes in weighted average exercise price over the same period.

	2020		2019	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	'000	£	'000	£
Outstanding at 1 January	23,373	3.03	26,838	3.12
Granted	11,642	1.65	9,594	2.83
Exercised	(860)	2.75	(7,978)	2.83
Forfeited/expired	(12,993)	2.96	(5,081)	3.42
Outstanding at 31 December	21,162	2.32	23,373	3.03
Exercisable at 31 December	1,805	3.59	2,519	3.62

The weighted average share price at the date the options were exercised was £2.92 (2019: £3.18).

The following table summarises the range of exercise prices and weighted average remaining contractual life of the options at 31 December 2020 and 2019.

Range of exercise prices	2020		2019	
	Weighted average remaining contractual life	Weighted average exercise price	Weighted average remaining contractual life	Weighted average exercise price
	Years	£	Years	£
£1 to £2	4	1.65	—	—
£2 to £3	2	2.81	3	2.80
£3 to £4	1	3.38	2	3.38
£4 to £5	1	4.02	2	4.13

The fair value of each option at the date of grant is estimated using a partial differentiation equation model. This model uses assumptions on the share price, the EUR/GBP FX rate, the risk-free interest rate, dividend yields, the expected volatility of the underlying shares and the expected lives of options granted. The weighted average grant-date fair value of options granted during the year was £0.21 (2019: £0.49).

At 31 December 2020, the carrying amount of liabilities arising from share-based payment transactions in the Santander UK Group Holdings plc group was £0.5m (2019: £2.4m), of which £nil had vested at 31 December 2020 (2019: £1.4m).

b) LTIP

In 2015, a conditional cash award was made to certain Executive Directors, Key Management Personnel (as defined in Note 38) and other nominated individuals which are converted into shares in Banco Santander SA at the time of vesting and deferred for three years. There have been no LTIP awards granted since 2015 due to the introduction of a single variable remuneration framework across the Banco Santander group in 2016.

The LTIP plan granted in 2015 involved a one-year performance cycle for vesting, deferred for a further three-year period dependent upon performance conditions applied. Beneficiaries were granted an initial award determined in GBP which was converted into shares in Banco Santander SA in January 2016 respectively based on performance over the performance cycle. The 2015 LTIP vested in January 2016, was deferred over three years and was subject to performance conditions based on Banco Santander SA's Earnings Per Share (EPS) and Return on Tangible Equity (RoTE) performance against budget. The conditions of the 2015 LTIP were met and payment was made to the remaining eligible population in March 2019 at 65.78% of the original award.

The following table summarises the movement in the value of conditional awards in the LTIP in 2020 and 2019:

	2015 LTIP	
	2020	2019
	£000	£000
Outstanding at 1 January	—	6,374
Payments made	—	(4,578)
Forfeited/cancelled	—	(1,796)
Outstanding at 31 December	—	—

c) Deferred shares bonus plan

Deferred bonus awards are designed to align employee performance with shareholder value and encourage increased retention of senior employees. During 2019 and 2020, conditional share awards were made to employees (designated as Material Risk Takers). Such employees receive part of their annual bonus as a deferred award comprising 50% in shares, and 50% in cash. Any deferred awards are dependent on continued employment or subject to Santander UK's discretion for leavers. For 2019 and 2020 bonus awards, deferral of the award is over a three, five or seven-year period from the anniversary of the initial award. Deferred bonus awards in shares are subject to an additional one-year retention period from the point of delivery.

Material Risk Takers are required to defer either 40% or 60% of any annual bonus (40% for variable pay of less than £500,000, 60% for variable pay at or above this amount). Vesting of both deferred bonus awards and long-term bonus awards is subject to risk and performance adjustment in the event of deficient performance and prudent financial control provisions.

d) Partnership Shares scheme

A Partnership Shares scheme is operated for eligible employees under the Share Incentive Plan (SIP) umbrella. Participants can choose to invest up to £1,800 per tax year (or no more than 10% of an employee's salary for the tax year) from pre-tax salary to buy Banco Santander SA shares. Shares are held in trust for the participants. There are no vesting conditions attached to these shares, and no restrictions as to when the shares can be removed from the trust. However, if a participant chooses to sell the shares before the end of five years, they will be liable for the taxable benefit received when the shares are taken out of the trust. The shares can be released from trust after five years free of income tax and national insurance contributions. 3,254,900 shares were outstanding at 31 December 2020 (2019: 2,396,909 shares).

38. TRANSACTIONS WITH DIRECTORS AND OTHER KEY MANAGEMENT PERSONNEL

The Directors of Santander UK Group Holdings plc did not receive any remuneration in respect of their services to the Company. The remuneration disclosures in these financial statements reflect their remuneration in respect of the Santander UK plc group.

a) Remuneration of Directors and Other Key Management Personnel

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

	2020	2019	2018
	£	£	£
Directors' remuneration			
Salaries and fees	3,906,401	5,045,302	5,028,434
Performance-related payments ⁽¹⁾	748,495	3,896,382	5,194,317
Other fixed remuneration (pension and other allowances & non-cash benefits)	1,047,986	1,386,439	1,467,011
Expenses	2,579	42,526	25,198
Total remuneration	5,705,461	10,370,649	11,714,960
	2020	2019	2018
	£	£	£
Directors' and Other Key Management Personnel compensation			
Short-term employee benefits ⁽²⁾	17,886,869	23,238,187	24,445,189
Post-employment benefits ⁽³⁾	2,107,544	3,674,772	2,399,261
Total Compensation	19,994,413	26,912,959	26,844,450

(1) In line with the Code, a proportion of the performance-related payment was deferred. Further details can be found in Note 37.

(2) In addition to the remuneration in the table above, grants of shares in Banco Santander SA were made as buy-outs of deferred performance-related payments of shares in connection with previous employment for two individuals. One to a director of £1,293,678 of which £242,605 vested in the year and one to Key Management Personnel of £924,133 of which £60,500 vested in the year (2019: £nil).

(3) No Termination payments were paid in 2020 to key management persons (2019: £1,076,435 for one individual; 2018: £847,388 for two individuals).

In 2020, the remuneration, excluding pension contributions, of the highest paid Director, was £2,200,138 (2019: £3,725,993) of which £748,495 (2019: £1,989,900) was performance related. In 2020, there was no pension benefit accrued for the highest paid Director.

b) Retirement benefits

Defined benefit pension schemes are provided to certain employees. See Note 30 for details of the schemes and the related costs and obligations. One director has a deferred pension benefit accruing under a defined benefit scheme. Ex gratia pensions paid to former Directors of Santander UK plc in 2020, which have been provided for previously, amounted to £366,248 (2019: £335,202; 2018: £87,300). In 1992, the Board decided not to award any new such ex gratia pensions.

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

Directors, Other Key Management Personnel (defined as the Executive Committee of Santander UK plc who served during the year) and their connected persons have undertaken the following transactions with the Santander UK group in the ordinary course of business.

	2020		2019	
	No.	£000	No.	£000
Secured loans, unsecured loans and overdrafts				
At 1 January	18	4,920	16	3,035
Net movements	(9)	(3,095)	2	1,885
At 31 December	9	1,825	18	4,920
Deposit, bank and instant access accounts and investments				
At 1 January	32	11,975	30	10,963
Net movements	(16)	(3,912)	2	1,012
At 31 December	16	8,063	32	11,975

In 2020 and 2019 no Director held any interest in the shares of any company in the Santander UK group and no Director exercised or was granted any rights to subscribe for shares in any company in the Santander UK group. In addition, in 2020 and 2019, no Directors exercised share options over shares in Banco Santander SA, the ultimate parent company of the Company.

Secured loans, unsecured loans and overdrafts are made to Directors, Other Key Management Personnel and their connected persons, in the ordinary course of business, with terms prevailing for comparable transactions and on the same terms and conditions as applicable to other employees in the Santander UK group. Such loans do not involve more than the normal risk of collectability or present any unfavourable features. Amounts deposited by Directors, Other Key Management Personnel and their connected persons earn interest at the same rates as those offered to the market or on the same terms and conditions applicable to other employees in the Santander UK group. Deposits, bank and instant access accounts and investments are entered into by Directors, Other Key Management Personnel and their connected persons on normal market terms and conditions, or on the same terms and conditions as applicable to other employees in Santander UK group.

In 2020, loans were made to four Directors (2019: nine Directors), with a principal amount of £13,994 outstanding at 31 December 2020 (2019: £1,767,066). In 2020, loans were made to five Other Key Management Personnel (2019: nine), with a principal amount of £1,811,171 outstanding at 31 December 2020 (2019: £3,153,343).

In 2020 and 2019, there were no other transactions, arrangements or agreements with Santander UK in which Directors, Other Key Management Personnel or their connected persons had a material interest. In addition, in 2020 and 2019, no Director had a material interest in any contract of significance with Santander UK other than a service contract.

39. RELATED PARTY DISCLOSURES

a) Parent undertaking and controlling party

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

b) Transactions with related parties

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

	Interest, fees and other income received			Interest, fees and other expenses paid			Amounts owed by related parties		Amounts owed to related parties	
	2020	2019	2018	2020	2019	2018	2020	2019	2020	2019
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Ultimate parent	(120)	(150)	(73)	158	334	231	1,857	1,817	(2,463)	(2,409)
Fellow subsidiaries	(54)	(58)	(81)	148	158	169	37	34	(498)	(500)
Associates & joint ventures	(29)	(29)	(28)	—	—	—	2,234	2,194	(1,034)	(930)
	(203)	(237)	(182)	306	492	400	4,128	4,045	(3,995)	(3,839)

For more on this, see 'Balances with other Banco Santander companies' in the Risk review. In addition, transactions with pension schemes operated by the Santander UK group are described in Note 30.

The above transactions were made in the ordinary course of business, except those carried out with Banco Santander SA as part of our ring-fencing implementation in 2018, on substantially the same terms as for comparable transactions with third party counterparties, and within limits acceptable to the PRA. Such transactions do not involve more than the normal risk of collectability or present any unfavourable features.

In addition, in July 2018 we transferred £1.4bn of customer loans, £21.5bn of other assets and £20.7bn of liabilities from Santander UK to Banco Santander London Branch. Of these transfers £19.7bn of assets and £18.8bn of liabilities related to derivatives business. These transfers reduced RWAs by £5.5bn and we paid an associated dividend of £668m.

40. FINANCIAL INSTRUMENTS

a) Measurement basis of financial assets and liabilities

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

b) Fair value measurement and hierarchy

(i) Fair value measurement

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

Financial instruments valued using observable market prices

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

Financial instruments valued using a valuation technique

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

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

(ii) Fair value hierarchy

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

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

- Level 1 Unadjusted quoted prices for identical assets or liabilities in an active market that Santander UK can access at the measurement date. Active markets are assessed by reference to average daily trading volumes in absolute terms and, where applicable, by reference to market capitalisation for the instrument.
- Level 2 Quoted prices in inactive markets, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability.
- Level 3 Significant inputs to the pricing or valuation techniques are unobservable. These unobservable inputs reflect the assumptions that market participants would use when pricing assets or liabilities and are considered significant to the overall valuation.

Changes in the observability of significant valuation inputs during the reporting period may result in a transfer of assets and liabilities within the fair value hierarchy. The Santander UK group recognises transfers between levels of the fair value hierarchy when there is a significant change in either its principal market or the level of observability of the inputs to the valuation techniques as at the end of the reporting period.

c) Valuation techniques

The main valuation techniques employed in internal models to measure the fair value of the financial instruments at 31 December 2020 and 2019 are set out below. In substantially all cases, the principal inputs into these models are derived from observable market data. Santander UK did not make any material changes to the valuation techniques and internal models it used in 2020, 2019 and 2018.

- A In the valuation of financial instruments requiring static hedging (for example interest rate, currency derivatives and property derivatives) and in the valuation of loans and advances and deposits, the 'present value' method is used. Expected future cash flows are discounted using the interest rate curves of the applicable currencies or forward house price index levels, as well as credit spreads. The interest rate curves are generally observable market data and reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cash flows and maturities of the instruments. The forward commodity house price index levels are generally observable market data.
- B In the valuation of equity financial instruments requiring dynamic hedging (principally equity securities, options and other structured instruments), proprietary local volatility and stochastic volatility models are used. These types of models are widely accepted in the financial services industry. Observable market inputs used in these models include the bid-offer spread, foreign currency exchange rates, volatility and correlation between indices. In limited circumstances, other inputs may be used in these models that are based on unobservable market data, such as the Halifax's UK HPI volatility, HPI forward growth, HPI spot rate, mortality, mean reversion and contingent litigation risk.
- C In the valuation of financial instruments exposed to interest rate risk that require either static or dynamic hedging (such as interest rate futures, caps and floors, and options), the present value method (futures), Black's model (caps/floors) and the Hull/White and Markov functional models (Bermudan options) are used. These types of models are widely accepted in the financial services industry. The significant inputs used in these models are observable market data, including appropriate interest rate curves, volatilities, correlations and exchange rates. In limited circumstances, other inputs may be used in these models that are based on unobservable market data, such as HPI volatility, HPI forward growth, HPI spot rate and mortality.
- D In the valuation of linear instruments such as credit risk and fixed-income derivatives, credit risk is measured using dynamic models similar to those used in the measurement of interest rate risk. In the case of non-linear instruments, if the portfolio is exposed to credit risk such as credit derivatives, the probability of default is determined using the credit default spread market. The main inputs used to determine the underlying cost of credit of credit derivatives are quoted credit risk premiums and the correlation between the quoted credit derivatives of various issuers.

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

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

d) Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker. To this end, ultimate responsibility for the determination of fair values lies with the Risk Department. For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, Santander UK will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

The factors that are considered in this regard include:

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

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

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

e) Fair values of financial instruments carried at amortised cost

The following tables analyse the fair value of the financial instruments carried at amortised cost at 31 December 2020 and 2019, including their levels in the fair value hierarchy - Level 1, Level 2 and Level 3. It does not include fair value information for financial assets and financial liabilities carried at amortised cost if the carrying amount is a reasonable approximation of fair value. Cash and balances at central banks, which consist of demand deposits with the Bank of England, together with cash in tills and ATMs, have been excluded from the table as the carrying amount is deemed an appropriate approximation of fair value. The fair value of the portfolio of UK Government debt securities, included in other financial assets at amortised cost, is the only material financial instrument categorised in Level 1 of the fair value hierarchy.

	2020					2019				
	Fair value			Total	Carrying value	Fair value			Total	Carrying value
	Level 1	Level 2	Level 3			Level 1	Level 2	Level 3		
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Assets										
Loans and advances to customers	—	—	214,730	214,730	212,178	—	—	212,007	212,007	207,498
Loans and advances to banks	—	2,004	—	2,004	2,004	—	2,039	539	2,578	2,583
Reverse repurchase agreements - non trading	—	19,382	226	19,608	19,599	—	23,634	—	23,634	23,636
Other financial assets at amortised cost	799	393	—	1,192	1,163	6,575	535	—	7,110	7,056
	799	21,779	214,956	237,534	234,944	6,575	26,208	212,546	245,329	240,773
Liabilities										
Deposits by customers	—	109	193,102	193,211	193,088	—	96	179,040	179,136	179,006
Deposits by banks	—	20,966	16	20,982	20,973	—	13,962	407	14,369	14,359
Repurchase agreements - non trading	—	15,847	—	15,847	15,848	—	18,292	—	18,292	18,286
Debt securities in issue	—	43,500	1,430	44,930	43,679	—	51,736	—	51,736	50,171
Subordinated liabilities	—	2,830	239	3,069	2,556	—	4,220	—	4,220	3,528
	—	83,252	194,787	278,039	276,144	—	88,306	179,447	267,753	265,350

The carrying value above of any financial assets and liabilities that are designated as hedged items in a portfolio (or macro) fair value hedge relationship excludes gains and losses attributable to the hedged risk, as this is included in other assets on the balance sheet.

Valuation methodology for financial instruments carried at amortised cost

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

Assets:**Loans and advances to customers**

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

i) Advances secured on residential property

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

ii) Corporate loans

The determination of the fair values of performing loans takes account of the differential between existing margins and estimated new business rates for similar loans in terms of segment and maturity. Provisions are considered appropriate for the book that is not impaired. A discount has been applied to impaired loans. Although exits have generally been achieved at carrying value, this does not reflect the discount a purchaser would require. A discount has therefore been applied based on the target return sought by distressed bond funds, who are the typical purchaser of the assets.

iii) Other loans

These consist of unsecured personal loans, credit cards, overdrafts and consumer (auto) finance. The weighted average lives of these portfolios are short and relate to relatively new business. As a result, contractual interest rates approximate new business interest rates, and therefore no mark-to-market surplus or deficit has been recorded with respect to the performing book, with the exception of unsecured personal loans and consumer (auto) finance loans, where a small surplus or deficit has been recognised based on the differential between existing portfolio margins and the current contractual interest rates.

Loans and advances to banks

These comprise secured loans, short-term placements with banks including collateral and unsettled financial transactions. The secured loans have been valued based on a discounted spread for the term of the loans using valuation technique A as described above. The carrying amount of the other items is deemed a reasonable approximation of their fair value, as the transactions are very short-term in duration.

Reverse repurchase agreements - non-trading

The fair value of the reverse repurchase agreements - non trading has been estimated using valuation technique A as described above, using a spread appropriate to the underlying collateral.

Other financial assets at amortised cost

These consist of asset backed securities and debt securities. The asset backed securities can be complex products and in some instances are valued with the assistance of an independent, specialist valuation firm. These fair values are determined using industry-standard valuation techniques, including discounted cash flow models. The inputs to these models used in these valuation techniques include quotes from market makers, prices of similar assets, adjustments for differences in credit spreads, and additional quantitative and qualitative research. The debt security investments consist of a portfolio of government debt securities. The fair value of this portfolio has been determined using quoted market prices.

Liabilities:**Deposits by customers**

The majority of deposit liabilities are payable on demand and therefore can be deemed short-term in nature with the fair value equal to the carrying value. Certain of the deposit liabilities are at a fixed rate until maturity. The deficit/surplus of fair value over carrying value of these liabilities has been estimated by reference to the market rates available at the balance sheet date for similar deposit liabilities of similar maturities. The fair value of such deposit liabilities has been estimated using valuation technique A as described above.

Deposits by banks

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

Repurchase agreements - non trading

The fair value of the repurchase agreements - non trading has been estimated using valuation technique A as described above, discounted at a spread appropriate to the underlying collateral.

Debt securities in issue and subordinated liabilities

Where reliable prices are available, the fair value of debt securities in issue and subordinated liabilities has been calculated using quoted market prices.

f) Fair values of financial instruments measured at fair value

The following tables summarise the fair values of the financial assets and liabilities accounted for at fair value at 31 December 2020 and 31 December 2019, analysed by their levels in the fair value hierarchy - Level 1, Level 2 and Level 3.

		2020				2019				Group
		Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total	Valuation
		£m	£m	£m	£m	£m	£m	£m	£m	technique
Assets										
Derivative financial instruments	Exchange rate contracts	—	2,455	2	2,457	—	2,319	6	2,325	A
	Interest rate contracts	—	2,604	14	2,618	—	1,951	9	1,960	A & C
	Equity and credit contracts	—	71	59	130	—	223	69	292	B & D
	Netting	—	(1,754)	—	(1,754)	—	(1,214)	—	(1,214)	
		—	3,376	75	3,451	—	3,279	84	3,363	
Other financial assets at FVTPL	Loans and advances to customers	—	493	99	592	—	448	92	540	A
	Debt securities	—	3	109	112	2	2	294	298	A, B & D
	Equity securities	83	—	47	130	16	—	119	135	B
	Reverse repurchase agreements – non trading	—	—	—	—	—	—	—	—	A
		83	496	255	834	18	450	505	973	
Financial assets at FVOCI	Debt securities	8,501	428	—	8,929	9,209	482	—	9,691	D
	Loans and advances to customers	—	—	21	21	—	—	56	56	D
		8,501	428	21	8,950	9,209	482	56	9,747	
Total assets at fair value		8,584	4,300	351	13,235	9,227	4,211	645	14,083	
Liabilities										
Derivative financial instruments	Exchange rate contracts	—	846	—	846	—	659	4	663	A
	Interest rate contracts	—	2,742	3	2,745	—	2,087	2	2,089	A & C
	Equity and credit contracts	—	54	29	83	—	142	29	171	B & D
	Netting	—	(1,754)	—	(1,754)	—	(1,214)	—	(1,214)	
		—	1,888	32	1,920	—	1,674	35	1,709	
Other financial liabilities at FVTPL	Debt securities in issue	—	1,051	6	1,057	—	1,099	6	1,105	A
	Structured deposits	—	375	—	375	—	406	29	435	A
	Repurchase agreements – non trading	—	—	—	—	—	—	—	—	A
	Collateral and associated financial guarantees	—	—	2	2	—	147	26	173	D
		—	1,426	8	1,434	—	1,652	61	1,713	
Total liabilities at fair value		—	3,314	40	3,354	—	3,326	96	3,422	

Transfers between levels of the fair value hierarchy

In 2020 there was an £81m (2019: none) transfer of Visa shares from Level 3 to Level 1 due to the changes in litigation matters relating to these shares. A ruling was made whereby Type B Visa shares were converted into Type A Visa shares. Type B Visa shares are not liquid observable, but Type A Visa shares are.

g) Fair value adjustments

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

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

	2020	2019
	£m	£m
Risk-related:		
- Bid-offer and trade specific adjustments	(8)	(12)
- Uncertainty	45	37
- Credit risk adjustment	11	6
- Funding fair value adjustment	3	6
	51	37
Model-related	—	—
Day One profit	—	—
	51	37

Risk-related adjustments

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

(i) Bid-offer and trade specific adjustments

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

(ii) Uncertainty

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

(iii) Credit risk adjustment

Credit risk adjustments comprise credit and debit valuation adjustments. The credit valuation adjustment (CVA) is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default, and Santander UK may not receive the full market value of the transactions. The debit valuation adjustment (DVA) is an adjustment to the valuation of the OTC derivative contracts to reflect within the fair value the possibility that Santander UK may default, and that Santander UK may not pay full market value of the transactions.

Santander UK calculates a separate CVA and DVA for each Santander UK legal entity, and within each entity for each counterparty to which the entity has exposure. Santander UK calculates the CVA by applying the probability of default of the counterparty to the expected positive exposure to the counterparty, and multiplying the result by the loss expected in the event of default i.e. LGD. Conversely, Santander UK calculates the DVA by applying the PD of the Santander UK group, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to Santander UK and multiplying the result by the LGD. Both calculations are performed over the life of the potential exposure.

For most products Santander UK uses a simulation methodology to calculate the expected positive exposure to a counterparty. This incorporates a range of potential exposures across the portfolio of transactions with the counterparty over the life of the portfolio. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty.

The methodologies do not, in general, account for wrong-way risk. Wrong-way risk arises where the underlying value of the derivative prior to any credit risk adjustment is positively correlated to the probability of default of the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect the wrong-way risk within the valuation. Exposure to wrong-way risk is limited via internal governance processes and deal pricing. Santander UK considers that an appropriate adjustment to reflect wrong-way risk is £nil (2019: £nil).

(iv) Funding fair value adjustment (FFVA)

The FFVA is an adjustment to the valuation of OTC derivative positions to include the net cost of funding uncollateralised derivative positions. This is calculated by applying a suitable funding cost to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio.

Model-related adjustments

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

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

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

Balance sheet line item	Category	Financial instrument product type	Balance sheet value		Fair value movements recognised in profit/(loss)		
			2020	2019	2020	2019	2018
			£m	£m	£m	£m	£m
1. Derivative assets	Equity and credit contracts	Reversionary property interests	51	52	3	2	30
2. FVTPL assets	Loans and advances to customers	Roll-up mortgage portfolio	56	51	6	—	8
3. FVTPL assets	Loans and advances to customers	Other loans	43	41	3	1	2
4. FVTPL assets	Debt securities	Reversionary property securities	107	120	6	(17)	(28)
5. FVTPL assets	Equity securities	Unlisted equity shares	47	119	12	42	19
6. FVTPL assets	Debt securities	Credit linked notes	2	174	(16)	7	13
7. FVOCI assets	Loans and advances to customers	Other loans	21	56	(4)	(2)	(5)
8. Derivative liabilities	Equity contracts	Property options and forwards	(29)	(26)	(3)	—	—
9. FVTPL liabilities	Financial guarantees	Credit protection guarantee	(2)	(26)	16	(7)	(13)
			296	561	23	26	26
Other Level 3 assets			24	32	7	15	(2)
Other Level 3 liabilities			(9)	(44)	(3)	(7)	1
Total net assets			311	549	—	—	—
Total income/(expense)					27	34	25

Valuation techniques**1. Derivative assets – Equity and credit contracts**

These are valued using a probability weighted set of HPI forward prices, which are assumed to be a reasonable representation of the increase in value of the Santander UK group's reversionary interest portfolio underlying the derivatives. The probability used reflects the likelihood of the home owner vacating the property and is calculated from mortality rates and acceleration rates which are a function of age and gender, obtained from the relevant mortality tables. Indexing is felt to be appropriate due to the size and geographical dispersion of the reversionary interest portfolio. These are determined using HPI Spot Rates adjusted to reflect estimated forward growth. Non-seasonally adjusted (NSA) national and regional HPI are used in the valuation model to avoid any subjective judgement in the adjustment process which is made by Markit, which publishes the Halifax House Price Index.

The inputs used to determine the value of the reversionary property derivatives are HPI spot, HPI forward growth and mortality rates. The principal pricing parameter is HPI forward growth.

2. FVTPL assets – Loans and advances to customers – roll-up mortgage portfolio

These represent roll-up mortgages (sometimes referred to as lifetime mortgages), which are an equity release scheme under which a property owner takes out a loan secured against their home. The owner may not make any interest payments during their lifetime in which case the fixed interest payments are rolled up into the mortgage. The loan or mortgage (capital and rolled-up interest) is repaid upon the owner's vacation of the property and the value of the loan is only repaid from the value of the property. This is known as a 'no negative equity guarantee'. Santander UK suffers a loss if the sale proceeds from the property are insufficient to repay the loan, as it is unable to pursue the homeowner's estate or beneficiaries for the shortfall.

The value of the mortgage 'rolls up' or accretes until the owner vacates the property. In order to value the roll-up mortgages, Santander UK uses a probability-weighted set of European option prices (puts) determined using the Black-Scholes model, in which the 'no negative equity guarantee' is valued as short put options. The probability weighting applied is calculated from mortality rates and acceleration rates as a function of age and gender, taken from mortality tables.

The inputs used to determine the value of these instruments are HPI spot, HPI forward growth, HPI volatility, mortality rates and repayment rates. The principal pricing parameter is HPI forward growth. The HPI forward growth rate used is unobservable and is the same as used in the valuation of Instrument 1 above. The other parameters do not have a significant effect on the value of the instruments.

3. FVTPL assets – Loans and advances to customers – other loans

These relate to loans to transport and education companies. The fair value of these loans is estimated using the 'present value' model based on a credit curve derived from current market spreads. Loan specific credit data is unobservable, so a proxy population is applied based on industry sector and credit rating.

4. FVTPL assets – Debt securities

These consist of reversionary property securities and are an equity release scheme, where the property owner receives an upfront lump sum in return for paying a fixed percentage of the sales proceeds of the property when the owner vacates the property. These reversionary property securities are valued using a probability-weighted set of HPI forward prices which are assumed to be a reasonable representation of the increase in value of Santander UK's reversionary interest portfolio underlying the derivatives. The probability weighting used reflects the probability of the home owner vacating the property through death or moving into care and is calculated from mortality rates and acceleration factors which are a function of age and gender, obtained from the relevant mortality table.

The inputs used to determine the value of these instruments are HPI spot, HPI forward growth and mortality rates. The principal pricing parameter is HPI forward growth. Discussion of the HPI spot rate, HPI forward growth rate and mortality rates for this financial instrument is the same as Instrument 1 above. An adjustment is also made to reflect the specific property risk. Discussion of the specific property risk adjustment is the same as Instrument 1 above.

5. FVTPL assets – Equity securities

These consist of unquoted equity investments in companies providing infrastructure services to the financial services industry. In the valuation of equity financial instruments requiring dynamic hedging, proprietary local volatility and stochastic volatility models are used. These types of models are widely accepted in the financial services industry. Observable market inputs used in these models include equity prices, bid-offer spread, foreign currency exchange rates. The significant unobservable input is contingent litigation costs and related expenses in respect of convertible preferred stock in Visa Inc, as described in Note 31. This is estimated by reference to best estimates received from third party legal counsel.

6. FVTPL assets – Debt securities (Credit linked notes)

These consist of the retained senior tranches of credit linked notes in respect of credit protection vehicles sponsored by Santander UK and are mandatorily held at fair value through profit or loss. These vehicles provide credit protection on reference portfolios of Santander UK group loans with junior notes sold to external investors. The notes retained by Santander UK are classified as level 3 financial instruments as their valuation depends upon unobservable parameters relating to the underlying reference portfolios of loans, including credit spreads, correlations and prepayment speed, which have a significant effect on the overall valuation. For more information, see 'Credit protection entities' in Note 19.

7. FVOCI assets – Loans and advances to customers – other loans

These relate to shipping and construction loans. The fair value of these loans is estimated using the 'present value' model based on a credit curve derived from current market spreads. Loan specific credit data is unobservable, so a proxy population is applied based on industry sector and credit rating.

8. Derivative liabilities – Equity contracts

There are three types of derivatives in this category:

European options – These are valued using a modified Black-Scholes model where the HPI is log-normally distributed with the forward rates determined from the HPI forward growth.

Asian options – Asian (or average value) options are valued using a modified Black-Scholes model, with an amended strike price and volatility assumption to account for the average exercise period, through a closed form adjustment that reflects the strike price relative to the distribution of stock prices at each relevant date. This is also known as the Curran model.

Forward contracts – Forward contracts are valued using a standard forward pricing model.

The inputs used to determine the value of the above instruments are HPI spot rate, HPI forward growth rate and HPI volatility. The principal pricing parameter is HPI forward growth rate.

9. FVTPL liabilities – Financial guarantees

These relate to credit protection guarantees in respect of the proceeds of the retained senior tranches of credit linked notes described in Instrument 6 above, and have been designated at fair value through profit or loss. These instruments are valued using the same unobservable parameters described in Instrument 6 above, such that changes in the valuation of the senior tranches of the credit linked notes are offset by changes in the value of these credit protection guarantees. For more information, see 'Credit protection entities' in Note 19.

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

The following table sets out the movements in Level 3 financial instruments in 2020 and 2019:

	Assets				Liabilities		
	Derivatives	Other financial assets at FVTPL	Financial assets at FVOCI	Total	Derivatives	Other financial liabilities at FVTPL	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	84	505	56	645	(35)	(61)	(96)
Total (losses)/gains recognised:							
- Fair value movements	10	11	(4)	17	(7)	17	10
- Foreign exchange and other movements	—	(9)	—	(9)	—	8	8
Transfers in	1	1	—	2	—	—	—
Transfers out	—	(81)	—	(81)	—	28	28
Netting ⁽¹⁾	—	(42)	—	(42)	—	—	—
Additions	9	—	—	9	—	(2)	(2)
Sales	—	(19)	(19)	(38)	—	—	—
Settlements	(29)	(111)	(12)	(152)	10	2	12
At 31 December 2020	75	255	21	351	(32)	(8)	(40)
(Losses)/gains recognised in profit or loss/other comprehensive income relating to assets and liabilities held at the end of the period	10	2	(4)	8	(7)	25	18
At 1 January 2019	115	1,055	73	1,243	(70)	(49)	(119)
Total gains/(losses) recognised:							
- Fair value movements	17	33	(2)	48	(8)	(6)	(14)
- Foreign exchange and other movements	—	4	—	4	—	(6)	(6)
Transfers in	—	11	—	11	—	—	—
Netting ⁽¹⁾	—	(430)	—	(430)	—	—	—
Additions	2	188	—	190	—	(3)	(3)
Sales	—	—	—	—	—	—	—
Settlements	(50)	(356)	(15)	(421)	43	3	46
At 31 December 2019	84	505	56	645	(35)	(61)	(96)
Gains/(losses) recognised in profit or loss/other comprehensive income relating to assets and liabilities held at the end of the period	17	37	(2)	52	(8)	(12)	(20)

(1) This relates to the effect of netting on the fair value of the credit linked notes due to a legal right of set-off between the principal amounts of the senior notes and the associated cash deposits. For more, see 'ii) Credit protection entities' in Note 19.

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

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

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

2020	Fair value £m	Significant unobservable input			Sensitivity		
		Assumption description	Assumption value		Shift	Favourable changes £m	Unfavourable changes £m
			Range ⁽¹⁾	Weighted average			
1. Derivative assets – Equity and credit contracts:	51	HPI Forward growth rate	0% - 5%	2.57%	1%	8	(8)
– Reversionary property derivatives		HPI Spot rate ⁽²⁾	n/a	445	10%	7	(7)
2. FVTPL – Loans and advances to customers:	56	HPI Forward growth rate	0% - 5%	2.69%	1%	2	(2)
– Roll-up mortgage portfolio							
3. FVTPL – Loans and advances to customers:	43	Credit spreads	0.07% - 1.55%	0.44%	0.2%	–	–
– Other loans							
4. FVTPL – Debt securities:	107	HPI Forward growth rate	0% - 5%	2.57%	1%	1	(1)
– Reversionary property securities		HPI Spot rate ⁽²⁾	n/a	445	10%	5	(5)
5. FVTPL – Equity securities:	47	Contingent litigation risk	0% - 100%	49%	20%	8	(8)
– Unlisted equity shares							
7. FVOCI – Loans and advances to customers:	21	Credit spreads	0.15% - 0.53%	0.32%	20%	–	–
– Other loans							
8. Derivative liabilities – Equity contracts:	(29)	HPI Forward growth rate	0% - 5%	2.42%	1%	2	(2)
– Property-related options and forwards		HPI Spot rate ⁽²⁾	n/a	433	10%	3	(3)
2019							
1. Derivative assets – Equity and credit contracts:	52	HPI Forward growth rate	0% - 5%	2.57%	1%	8	(8)
– Reversionary property derivatives		HPI Spot rate ⁽²⁾	n/a	802	10%	7	(7)
2. FVTPL – Loans and advances to customers:	51	HPI Forward growth rate	0% - 5%	2.69%	1%	2	(2)
– Roll-up mortgage portfolio							
3. FVTPL – Loans and advances to customers:	41	Credit spreads	0% - 1%	0.35%	20%	–	–
– Other loans							
4. FVTPL – Debt securities:	120	HPI Forward growth rate	0% - 5%	2.57%	1%	–	–
– Reversionary property securities		HPI Spot rate ⁽²⁾	n/a	802	10%	6	(6)
5. FVTPL – Equity securities:	119	Contingent litigation risk	0% - 100%	20%	20%	6	(6)
– Unlisted equity shares							
7. FVOCI – Loans and advances to customers:	56	Credit spreads	0% - 1%	0.51%	20%	–	–
– Other loans							
8. Derivative liabilities – Equity contracts:	(26)	HPI Forward growth rate	0% - 5%	2.44%	1%	2	(2)
– Property-related options and forwards		HPI Spot rate ⁽²⁾	n/a	758	10%	3	(3)

(1) The range of actual assumption values used to calculate the weighted average disclosure.

(2) The HPI spot rate in the weighted average column represents the HPI spot rate index level at 31 December 2020 and 2019.

No sensitivities are presented for FVTPL assets – Debt securities, Credit Linked Notes (instrument 6) and FVTPL liabilities – financial guarantees (instrument 9), as the terms of these instruments are fully matched. As a result, any changes in the valuation of the credit linked notes would be offset by an equal and opposite change in the valuation of the financial guarantees.

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

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

2020						Group
	On demand £m	Not later than 3 months £m	Later than 3 months and not later than 1 year £m	Later than 1 year and not later than 5 years £m	Later than 5 years £m	Total £m
Financial liabilities						
Derivative financial instruments	—	320	134	584	950	1,988
Other financial liabilities at fair value through profit or loss	—	1	107	570	759	1,437
Deposits by customers	179,499	4,251	5,994	2,767	682	193,193
Deposits by banks	2,426	1,894	2,535	14,044	207	21,106
Repurchase agreements – non trading	—	15,350	500	—	—	15,850
Debt securities in issue	—	5,759	11,042	19,269	8,921	44,991
Subordinated liabilities	—	30	92	1,221	2,718	4,061
Lease liabilities	—	—	18	57	37	112
Total financial liabilities	181,925	27,605	20,422	38,512	14,274	282,738
Off-balance sheet commitments given	21,055	4,493	4,983	11,493	1,146	43,170

2019**Financial liabilities**

Derivative financial instruments	9	250	294	424	796	1,773
Other financial liabilities at fair value through profit or loss	1	6	203	617	969	1,796
Deposits by customers	162,774	3,851	7,931	3,563	1,101	179,220
Deposits by banks	2,717	487	4,765	6,339	220	14,528
Repurchase agreements – non trading	6	15,878	1,578	846	—	18,308
Debt securities in issue	—	7,211	9,815	24,676	10,989	52,691
Subordinated liabilities	—	239	131	1,539	3,961	5,870
Lease liabilities	—	—	46	59	52	157
Total financial liabilities	165,507	27,922	24,763	38,063	18,088	274,343
Off-balance sheet commitments given ⁽¹⁾	20,171	2,927	5,742	11,490	1,277	41,608

1. In 2020, an administrative error was identified regarding the incorrect classification of £4.9bn of 2019 loan commitments between 'Not later than 3 months' and 'later than 3 months and not later than 1 year'. As a result, the 2019 loan commitments have been amended to reduce loan commitments 'Not later than 3 months' and increase loan commitments 'later than 3 months and not later than 1 year'. In 2020, administrative errors were identified regarding the omission of £1.3bn of 2019 financial guarantees and the incorrect inclusion of £3.7bn of 2019 financial guarantees from the 'off-balance sheet commitments given'. As a result, the 2019 'off-balance sheet commitments given' have been amended to correct these amounts.

As the above table is based on contractual maturities, no account is taken of call features related to subordinated liabilities. In addition, the repayment terms of debt securities may be accelerated in line with relevant covenants. Further, no account is taken of the possible early repayment of Santander UK's mortgage-backed non-recourse finance which is redeemed by Santander UK as funds become available from redemptions of the residential mortgages. Santander UK has no control over the timing and amount of redemptions of residential mortgages.

41. OFFSETTING FINANCIAL ASSETS AND LIABILITIES

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

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

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

For derivative contracts, the 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting agreements, such as the ISDA Master Agreement or derivative exchange or clearing counterparty agreements, whereby all outstanding transactions with the same counterparty can be offset and close-out netting applied across all outstanding transactions covered by the agreements if an event of default or other predetermined events occur. Financial collateral refers to cash and non-cash collateral obtained, typically daily or weekly, to cover the net exposure between counterparties by enabling the collateral to be realised in an event of default or if other predetermined events occur. For repurchase and reverse repurchase agreements and other similar secured lending and borrowing, the 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting agreements, such as global master repurchase agreements and global master securities lending agreements, whereby all outstanding transactions with the same counterparty can be offset and close-out netting applied across all outstanding transactions covered by the agreements if an event of default or other predetermined events occur. Financial collateral typically comprises highly liquid securities which are legally transferred and can be liquidated if a counterparty defaults.

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

	Amounts subject to enforceable netting arrangements							Assets not subject to enforceable netting arrangements ⁽²⁾	Balance sheet total ⁽³⁾
	Effects of offsetting on balance sheet			Related amounts not offset					
	Gross amounts £m	Amounts offset £m	Net amounts on balance sheet £m	Financial instruments £m	Financial collateral ⁽¹⁾ £m	Net amount £m	£m		
2020									
Assets									
Derivative financial assets	5,116	(1,754)	3,362	(820)	(1,840)	702	89	3,451	
Reverse repurchase, securities borrowing & similar agreements:									
- Amortised cost	26,084	(6,485)	19,599	(129)	(19,470)	—	—	19,599	
- Fair value	—	—	—	—	—	—	—	—	
Loans and advances to customers and banks ⁽⁴⁾	7,524	(1,073)	6,451	—	—	6,451	207,731	214,182	
	38,724	(9,312)	29,412	(949)	(21,310)	7,153	207,820	237,232	
Liabilities									
Derivative financial liabilities	3,597	(1,754)	1,843	(820)	(839)	184	77	1,920	
Repurchase, securities lending & similar agreements:									
- Amortised cost	22,333	(6,485)	15,848	(129)	(15,719)	—	—	15,848	
- Fair value	—	—	—	—	—	—	—	—	
Deposits by customers and banks ⁽⁴⁾	3,222	(1,073)	2,149	—	(502)	1,647	211,912	214,061	
	29,152	(9,312)	19,840	(949)	(17,060)	1,831	211,989	231,829	
2019									
Assets									
Derivative financial assets	4,493	(1,214)	3,279	(768)	(1,915)	596	84	3,363	
Reverse repurchase, securities borrowing & similar agreements:									
- Amortised cost	25,312	(1,676)	23,636	(537)	(23,099)	—	—	23,636	
- Fair value	—	—	—	—	—	—	—	—	
Loans and advances to customers and banks ⁽⁴⁾	6,036	(1,248)	4,788	—	—	4,788	205,293	210,081	
	35,841	(4,138)	31,703	(1,305)	(25,014)	5,384	205,377	237,080	
Liabilities									
Derivative financial liabilities	2,877	(1,214)	1,663	(768)	(572)	323	46	1,709	
Repurchase, securities lending & similar agreements:									
- Amortised cost	19,962	(1,676)	18,286	(537)	(17,749)	—	—	18,286	
- Fair value	—	—	—	—	—	—	—	—	
Deposits by customers and banks ⁽⁴⁾	2,482	(1,248)	1,234	—	(502)	732	192,131	193,365	
	25,321	(4,138)	21,183	(1,305)	(18,823)	1,055	192,177	213,360	

(1) Financial collateral is reflected at its fair value, but has been limited to the net balance sheet exposure so as not to include any over-collateralisation.

(2) This column includes contractual rights of set-off that are subject to uncertainty under the laws of the relevant jurisdiction.

(3) The balance sheet total is the sum of 'Net amounts reported on the balance sheet' that are subject to enforceable netting arrangements and 'Amounts not subject to enforceable netting arrangements'.

(4) The amounts offset within loans and advances to customers/banks or deposits by customers/banks relate to offset mortgages which are classified as either and that are subject to netting.

42. EVENTS AFTER THE BALANCE SHEET DATE

There have been no significant events between 31 December 2020 and the date of approval of these financial statements which would require a change to or additional disclosure in the financial statements, except as follows:

Proposed transfer of the Corporate & Investment Banking (CIB) business to the London Branch of Banco Santander SA (SLB)

As part of our drive for continuous improvement in customer experience and following a review of the way we operate the CIB business in the UK, we intend to conduct substantially all of this business from SLB beginning later in 2021. To undertake this change, and subject to court approval, we are proposing to transfer substantially all of the CIB business to SLB in H2 2021 by way of a banking business transfer scheme under Part VII of the Financial Services and Markets Act 2000.

Although this decision was made prior to 31 December 2020, the transfer, which is subject to court approval, is proposed to take effect in H2 2021. We will continue to engage with regulators in relation to the proposed transfer.

43. INTEREST RATE BENCHMARK REFORM

In September 2019, the IASB amended IFRS 9 'Financial Instruments', IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures' to address issues affecting financial reporting in the period before the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate (the Phase 1 amendments). These Phase 1 amendments provided temporary exceptions to specific hedge accounting requirements because of the uncertainty arising from the reform. After issuing the Phase 1 amendments, in August 2020, the IASB issued further amendments to various IFRSs to address issues that might affect financial reporting during the reform of an interest rate benchmark, including the effects of changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate (the Phase 2 amendments). The Phase 2 amendments do not supersede the Phase 1 amendments.

Phase 1 amendments

The amendments provide temporary exceptions from applying specific hedge accounting requirements to hedging relationships that are directly affected by the IBOR reform. The exceptions have the effect that IBOR reform should not generally cause hedge accounting to terminate, however any hedge ineffectiveness continues to be recognised in the income statement. The exceptions end at the earlier of:

- when the uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows is no longer present, and
- discontinuance of the hedge relationship (or reclassification of all amounts from the cash flow hedge reserve).

The amendments apply to all hedging relationships directly affected by uncertainties related to IBOR reform and had no impact on hedge relationships for affected hedges. The main assumptions or judgements made by Santander UK in applying the amendments are outlined below.

- For cash flow hedges affected by IBOR reform, Santander UK management has assumed that the interest rate benchmark on which hedged cash flows are based is not altered as a result of IBOR reform when assessing whether the future cash flows are highly probable. For discontinued hedging relationships, the same assumption has been applied for determining whether the hedged future cash flows are expected to occur.
- In making its prospective hedge effectiveness assessments, Santander UK assumes that the interest rate benchmark on which the hedged item and the hedging instrument are based is not altered as a result of IBOR reform.
- Santander UK will not discontinue hedge accounting during the period of IBOR-related uncertainty solely because the retrospective effectiveness falls outside the required 80-125% range.
- For hedges of a non-contractually specified benchmark portion of an interest rate, Santander UK only considers at inception of such a hedging relationship whether the separately identifiable requirement is met.

Phase 2 amendments

These amendments apply only to changes required by IBOR reform to financial instruments and hedging relationships. Changes are directly required by IBOR reform if, and only if, the change is necessary as a direct consequent of interest rate benchmark reform, and the new basis for determining the contractual cash flow is economically equivalent to the previous basis. The exceptions given by the amendments mean that IBOR reform did not result in the discontinuation of hedge accounting and any hedge ineffectiveness continued to be recognised in profit or loss for affected hedges at and for the year ended 31 December 2020. The amendments address the accounting issues for financial instruments when IBOR reform is implemented as described below.

Practical expedient for changes to contractual cash flows For instruments to which the amortised cost measurement applies, the amendments require entities, as a practical expedient, to account for a change in the basis for determining the contractual cash flows by updating the effective interest rate using the guidance in IFRS 9 resulting in no immediate gain or loss being recognised, provided that, the change is directly required by IBOR reform and takes place on an economically equivalent basis. Whereas some instruments were converted to alternative benchmark interest rates during 2020, the majority of instruments referencing LIBOR or other IBORs will transition to alternative benchmark interest rates during 2021. Santander UK has no lease contracts which are indexed to LIBOR or other IBORs. Consequently, the application of the practical expedient had no material impact for the Santander UK group for 2020.

Relief from specific hedge accounting requirements The table below sets out the hedge accounting amendments, and their impact for Santander UK, which provide additional temporary reliefs from applying specific IAS 39 hedge accounting requirements to hedging relationships directly affected by IBOR reform.

Hedge accounting amendment	Impact for the Santander UK group
Allow amendment of the designation of a hedging relationship to reflect changes that are required by the reform. The hedge designation must be amended by the end of the reporting period in which the changes are made.	This amendment means any change to hedge documentation will not result in discontinuation of hedge accounting nor the designation of a new hedge relationship. The Santander UK group did not use this relief in 2020. It expects the majority of its hedge relationships will transition to alternative benchmark rates in 2021.
When a hedged item in a cash flow hedge is amended to reflect the changes that are required by the reform, the amount accumulated in the cash flow hedge reserve will be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.	This amendment would result in the release of the cash flow hedge reserve to profit or loss in the same period or periods in which the hedged cash flows that are now based on the alternative benchmark interest rate affect profit or loss. At 31 December 2020, the Santander UK group's existing cash flow hedges have not yet transitioned to alternative benchmark interest rates which is expected to take place in 2021.
An entity may, on an individual hedge basis, reset to zero the cumulative fair value changes of the hedged item and hedging instrument when ceasing to apply the retrospective effectiveness assessment relief provided by the Phase 1 amendments.	At 31 December 2020, the amendment had no impact on the Santander UK group. The Santander UK group will assess on a hedge-by-hedge basis as the hedging instrument transitions away from LIBORs or other IBORs in 2021 and expects resetting the cumulative fair value changes to zero will have no effect on the amounts recorded in profit or loss. All hedge ineffectiveness including any outside the 80-125% range arising from IBOR reform will be recognised in profit or loss.
When amending the hedge relationships for groups of items, hedged items are allocated to sub-groups based on the alternative benchmark interest rate being hedged, and the benchmark rate for each sub-group is designated as the hedged risk.	At 31 December 2020, the amendment had no impact on the Santander UK group as the affected portfolio has not yet begun transitioning away from LIBOR.
An alternative benchmark interest rate designated as a non-contractually specified risk component, that is not separately identifiable at the date when it is designated, is deemed to have met the requirements at that date if the entity reasonably expects that it will meet the requirements within a period of 24 months from the date of first designation. The 24-month period will apply to each alternative benchmark interest rate separately. The risk component will, however, be required to be reliably measurable.	The amendment eases transition to alternative benchmark interest rates by allowing hedging relationships to be designated and to continue even before the new benchmark interest rates are fully established as market benchmarks. At 31 December 2020, for the Santander UK group, the majority of hedge relationships, where an alternative benchmark interest rate is to be designated as a non-contractually specified risk component, are GBP fair value hedge relationships. Santander UK group expects alternative benchmark interest rates to be separately identifiable and reliably measurable when they transition in 2021.

For other changes that are not as a direct consequence of IBOR reform, Santander UK separately assesses those changes to determine if they result in derecognition or discontinuation of hedge accounting by applying the relevant accounting policies as set out in Note 1.

The following table shows the notional amounts of assets, liabilities and off-balance sheet commitments at 31 December 2020 affected by IBOR reform that have yet to transition to an alternative benchmark interest rate as provided internally to key management personnel.

	Group			Total £m
	GBP ⁽²⁾ LIBOR £m	USD ⁽²⁾ LIBOR £m	Other ⁽²⁾ £m	
Assets				
Derivatives ⁽¹⁾	33,857	4,844	2,149	40,850
Other financial assets at fair value through profit and loss	968	22	—	990
Financial assets at amortised cost	15,062	1,191	90	16,343
Financial assets at fair value through comprehensive income	428	—	—	428
	50,315	6,057	2,239	58,611
Liabilities				
Derivatives ⁽¹⁾	35,312	5,381	88	40,781
Other financial liabilities at fair value through profit and loss	1,128	69	—	1,197
Financial liabilities at amortised cost	2,354	3,515	—	5,869
	38,794	8,965	88	47,847
Off-balance sheet commitments given	11,405	2,126	573	14,104

(1) Many of the Santander UK group's derivatives subject to IBOR reform are governed by ISDA definitions. In October 2020 ISDA issued an IBOR fallbacks supplement setting out how the amendments to new alternative benchmark rates will be accomplished, the effect of which is to create fallback provisions in derivatives that describe what floating rates will apply on the permanent discontinuation of certain key IBORs or upon ISDA declaring a non-representative determination of an IBOR. The Santander UK group has adhered to the protocol to implement the fallbacks to derivative contracts that were entered into before the effective date of the supplement (25 January 2021). If derivative counterparties also adhere to the protocol, new fallbacks will automatically be implemented in existing derivative contracts when the supplement becomes effective.

(2) Cessation dates are: - GBP, JPY, NOK LIBOR 31/12/2021, USD LIBOR 30/06/23, EONIA 03/01/2022

The following tables show the notional amount of derivatives in hedging relationships directly affected by uncertainties related to IBOR reform.

2020	Group			Total £m
	GBP LIBOR £m	USD LIBOR £m	Other £m	
Total notional value of hedging instruments:				
– Cash flow hedges	15,198	5,119	—	20,317
– Fair value hedges	32,223	1,077	778	34,078
	47,421	6,196	778	54,395
Maturing after cessation date⁽¹⁾				
– Cash flow hedges	10,553	2,562	—	13,115
– Fair value hedges	12,477	162	720	13,359
	23,030	2,724	720	26,474

(1) Cessation dates are: - GBP, JPY, NOK LIBOR 31/12/2021, USD LIBOR 30/06/23, EONIA 03/01/2022

The Santander UK group's GBP LIBOR and USD LIBOR cash flow hedges extend beyond the anticipated cessation dates for both LIBORs. The Santander UK group expects that GBP LIBOR and USD LIBOR will be replaced by SONIA and SOFR respectively but there remains uncertainty over the timing and amount of the replacement rate cash flows. Hedging relationships impacted by uncertainty about IBOR reform may experience ineffectiveness due to market participants' expectations of when the shift from the existing IBOR benchmark rate to an alternative benchmark interest rate will occur or because transition of the hedged item and the hedging instrument could occur at different times.

The Santander UK group will cease to apply the assumptions that the hedged benchmark interest rate, the cash flows of the hedged item and/or hedging instrument will not be altered because of IBOR reform when the uncertainty arising from IBOR reform is no longer present. This will require amendment to hedge documentation by the end of the reporting period in which the changes occur. Cumulative changes in the hedged cash flows and the hedging instrument based on new alternative benchmark rates will also be remeasured when IBOR reform uncertainty is removed.

Further details of the significant interest rate benchmarks to which hedging relationships are exposed, the extent of risk exposure that is affected by IBOR reform, the effect of IBOR reform on interest rate risk management and how Santander UK's transition to alternative benchmark interest rates is being managed, are disclosed in the Banking market risk section of the Risk review.

Company Balance Sheet

At 31 December

	Notes	2020 £m	2019 £m
Assets			
Financial assets at fair value through profit or loss:			
– Other financial assets at fair value through profit or loss	4	1,425	—
Financial assets at amortised cost:			
– Loans and advances to banks	5	7,934	8,920
– Other financial assets at amortised cost	6	830	1,142
Interests in other entities	7	13,585	13,600
Current tax assets		11	6
Other assets		1	2
Total assets		23,786	23,670
Liabilities			
Financial liabilities at fair value through profit or loss:			
– Other financial liabilities at fair value through profit or loss	8	1,425	—
Financial liabilities at amortised cost:			
– Deposits by banks	9	7	8
– Debt securities in issue	10	7,970	8,957
– Subordinated liabilities	11	830	1,142
Other liabilities		1	—
Total liabilities		10,233	10,107
Equity			
Share capital	14	7,060	7,060
Other equity instruments	15	2,241	2,241
Retained earnings		4,252	4,262
Total shareholders' equity		13,553	13,563
Total liabilities and equity		23,786	23,670

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

The profit after tax of the Company attributable to shareholders was £240m (2019: £449m). As permitted by Section 408 of the UK Companies Act 2006, the Company's income statement has not been presented.

The Financial Statements were approved and authorised for issue by the Board on 2 March 2021 and signed on its behalf by:

Nathan Bostock

Chief Executive Officer

Company Registered Number: 08700698

Madhukar Dayal

Chief Financial Officer

Company Cash Flow Statement

At 31 December

	2020 £m	2019 £m
Cash flows from operating activities		
Profit after tax	240	449
Adjustments for:		
Non-cash items included in profit	15	3
Net change in operating assets and liabilities	(449)	370
Effects of exchange rate differences	(51)	(371)
Net cash flows from operating activities	(245)	451
Cash flows from investing activities		
Proceeds from sale and redemption of financial assets at amortised cost and financial assets at fair value through other comprehensive income	336	—
Investments in other entities	—	(200)
Net cash flows from investing activities	336	(200)
Cash flows from financing activities		
Issue of other equity instruments	—	500
Issue of debt securities and subordinated notes	1,410	—
Repayment of debt securities	(1,250)	—
Repurchase of other equity instruments	—	(304)
Issuance costs of debt securities and subordinated notes	(1)	—
Dividends paid on ordinary shares	(103)	(262)
Dividends paid on other equity instruments	(147)	(142)
Net cash flows from financing activities	(91)	(208)
Change in cash and cash equivalents	—	43
Cash and cash equivalents at beginning of the year	51	8
Cash and cash equivalents at the end of the year	51	51

Company Statement of Changes in Equity

For the years ended 31 December

	Share capital £m	Other equity instruments £m	Retained earnings £m	Total £m
At 1 January 2020	7,060	2,241	4,262	13,563
Total comprehensive income: ⁽¹⁾				
– Profit after tax	—	—	240	240
Dividends on ordinary shares	—	—	(103)	(103)
Dividends on other equity instruments	—	—	(147)	(147)
At 31 December 2020	7,060	2,241	4,252	13,553
At 1 January 2019	7,060	2,041	4,221	13,322
Total comprehensive income: ⁽¹⁾				
– Profit after tax	—	—	449	449
Issue of other equity instruments	—	500	—	500
Repurchase of other equity instruments	—	(300)	(4)	(304)
Dividends on ordinary shares	—	—	(262)	(262)
Dividends on other equity instruments	—	—	(142)	(142)
At 31 December 2019	7,060	2,241	4,262	13,563

(1) Total comprehensive income comprises only the profit for the year; no statement of comprehensive income has been shown for the Company, as permitted by Section 408 of the UK Companies Act 2006.

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

1. ACCOUNTING POLICIES

These financial statements are prepared for Santander UK Group Holdings plc (the Company) under the Companies Act 2006. The principal activity of the Company is a financial services holding company. Santander UK Group Holdings plc is a public limited company incorporated in England and Wales having a registered office in England.

Basis of preparation

The accounting policies of the Company are the same as those of the Santander UK Group Holdings plc group which are set out in Note 1 to the Consolidated Financial Statements, to the extent that the Company has similar transactions to the Santander UK Group Holdings plc group, except as set out below. The financial statements have been prepared on the going concern basis using the historical cost convention. An assessment of the appropriateness of the adoption of the going concern basis of accounting is disclosed in the Directors' statement of going concern set out in the Directors' Report.

Compliance with International Financial Reporting Standards

The Company's financial statements comply with international accounting standards in conformity with the requirements of the Companies Act 2006 and have also applied international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union. The financial statements are also prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB), including interpretations issued by the IFRS Interpretations Committee, as there are no applicable differences from IFRSs as issued by the IASB for the periods presented.

Recent accounting developments

See Note 1 to the Consolidated Financial Statements.

CRITICAL JUDGEMENTS AND ACCOUNTING ESTIMATES

The preparation of the financial statements requires management to make judgements and accounting estimates that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the reporting period. Management evaluates its judgements and accounting estimates, which are based on historical experience and on various other factors that are believed to be reasonable under the circumstances, on an ongoing basis. Actual results may differ from these accounting estimates under different assumptions or conditions. In preparing the financial statements, no significant judgements have been made in the process of applying the accounting policies, other than those involving estimations about interests in other entities.

Interests in other entities - Investment in subsidiaries

The carrying amount of investments in subsidiaries is based on the application of judgements including the basis of the cost of investment impairment calculation assumptions. Estimates include forecasts used for determining cash flows for the subsidiary's business and discount rates which factor in risk-free rates and applicable risk premiums, which are variables subject to fluctuations in external market rates and economic conditions beyond management's control. Santander UK undertakes an annual assessment to evaluate whether the carrying value of investments in subsidiaries is impaired, carrying out this assessment more frequently if reviews identify indicators of impairment or when events or changes in circumstances dictate.

The estimation of future cash flows and the level to which they are discounted is inherently uncertain and requires significant judgement and is subject to potential change over time. For more on these assumptions, including changes in the assumptions that would trigger an impairment, see Note 7.

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

These comprise wages and salaries of £7m (2019: £7m) recharged by the operating company, Santander UK plc. In 2020 and 2019, the Company had no full-time staff as they are all employed by Santander UK plc.

3. DIVIDENDS ON ORDINARY SHARES

Dividends on ordinary shares declared and paid during the year are set out in Note 10 to the Consolidated Financial Statements.

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

	2020	2019
	£m	£m
Debt securities	1,425	—
	1,425	—

Other financial assets at FVTPL comprised £1,425m (2019: nil) of financial assets designated at FVTPL. In 2020, as part of MREL requirements, the Company issued £1,425m debt securities, which were subsequently downstreamed to Santander UK plc.

5. LOANS AND ADVANCES TO BANKS

Loans and advances to banks principally comprise amounts due from Santander UK group undertakings. The fair values of loans and advances to banks are equal to their carrying amounts. In 2020 and 2019, no material expected credit losses. All of our senior debt issued out of Santander UK Group Holdings plc is downstreamed to our principal operating company Santander UK plc.

6. OTHER FINANCIAL ASSETS AT AMORTISED COST

These consist of investments in subordinated notes and have a maturity greater than 10 years.

7. INTERESTS IN OTHER ENTITIES

	2020 £m	2019 £m
Interests in ordinary shares of subsidiaries	11,630	11,645
£500m Fixed Rate Reset Perpetual AT1 Capital Securities	495	495
£750m Fixed Rate Reset Perpetual AT1 Capital Securities	750	750
£300m Fixed Rate Reset Perpetual AT1 Capital Securities	—	—
£500m Fixed Rate Reset Perpetual AT1 Capital Securities	210	210
£500m Fixed Rate Reset Perpetual AT1 Capital Securities	500	500
	13,585	13,600

Details of subsidiaries, joint ventures and associates are set out in the Shareholder information section. For information on AT1 Capital Securities, see Note 33 to the Consolidated Financial Statements. The Company has no interests in joint ventures or associates.

Interests in other entities mainly relate to investments in 100% of the ordinary share capital of Santander UK plc, Santander Financial Services plc and Santander Equity Investments Limited, as well as holdings of AT1 Capital Securities issued by Santander UK plc.

Interests in subsidiaries are held at cost subject to impairment. In 2020 and 2019, no significant impairment was recognised.

The movement in the Company's interests in subsidiaries was as follows:

	Cost £m	Impairment £m	Net book value £m
At 31 December 2020	11,645	(15)	11,630
At 1 January 2019 and 31 December 2019	11,645	—	11,645

Impairment testing

At the end of each reporting period, an impairment review is undertaken in respect of interests in other entities. Impairment is required where an investment exceeds its recoverable amount. The recoverable amount is calculated using a value in use (VIU) methodology to arrive at the present value of future cash flows expected to be derived from the investment.

The VIU calculation uses cash flow projections derived from the latest 3-year plan presented to the Board. Cash flow projections for the purpose of impairment testing do not take account of any adverse outcomes arising from contingent liabilities (see Note 31 to the Consolidated Financial Statements), whose existence will be confirmed by uncertain future events or where any obligation is not probable or otherwise cannot be measured reliably, nor do they take account of the benefits arising from Santander UK's transformation plans that had not yet been implemented or committed at 31 December 2020.

The rate used to discount the cash flows is based on the cost of equity, which is derived using a CAPM. The CAPM depends on a number of inputs reflecting financial and economic variables, including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement.

The growth rate for periods beyond the initial cash flow projections is used to extrapolate the cash flows in perpetuity because of the long-term perspective of the business. In line with the accounting requirements, management uses the UK Government's official estimate of the UK long-term average GDP growth rate, as this is lower than management's estimate of the long-term average growth rate of the business.

Investments in Santander UK plc and Santander Financial Services plc

The VIU review at 31 December 2020 did not indicate the need for an impairment in the Company's investments in Santander UK plc and Santander Financial Services plc. Management considered the reduction in headroom and the uncertainty relating to the respective estimates of the VIU for those investments, but determined that there was a sufficient basis to conclude that no impairment was required.

Sensitivities of key assumptions in calculating the VIU for the investment in Santander UK plc

The VIU is sensitive to reasonably possible changes in the key assumptions similar to those applied in determining the recoverable amount of goodwill recognised in the Santander UK plc group (see Note 20 to the Consolidated Financial Statements). The discount rate assumption for the investment in Santander UK plc was 14.0%. In addition, the VIU is also sensitive to the UK long-term average GDP growth rate used to extrapolate cash flows beyond the initial forecast period and management considers it reasonably possible for that rate to decrease by 10 basis points, although this impact is largely offset by higher capital requirements although this impact is largely offset by higher capital requirements.

At 31 December 2020, a reasonably possible change in the following key assumptions in relation to the VIU calculation for the Company's investment in Santander UK plc would have resulted in an impairment, as follows:

- If the cash flows used had been 5% lower than management's estimates, including the impact of holding back the required capital to support the growth of the business, the Company would have had to recognise an impairment against the carrying amount of its investment of £109m.
- If the discount rate used had been 100 basis points higher than management's estimates, the Company would have had to recognise an impairment against the carrying amount of its investment of £637m.
- No impairment against the carrying amount of the investment in Santander UK plc would have arisen if the UK long-term average GDP growth rate were to decrease by 10 basis points. The calculation is not sensitive to the long-term GDP growth rate assumption as the increased profit after tax generated by growth of the business is mostly offset by the need to retain more profit to meet increased regulatory capital requirements driven by the growth in assets.

Although there was no impairment of the Company's investment in Santander UK plc at 31 December 2020, the amount by which the recoverable amount exceeds the carrying value (the headroom) reduced and the test is now sensitive to the assumptions used, as described above. In addition, the changes in assumptions detailed below for the discount rate and cash flow projections would eliminate the current headroom. As a result, there is a risk of impairment in the future should business performance or economic factors diverge from forecasts.

The sensitivity analysis presented below has been prepared on the basis that a change in each key assumption would not have a consequential impact on other assumptions used in the impairment review. However, due to the interrelationships between some of the assumptions, a change in one of the assumptions might impact one or more of the other assumptions and could result in a larger or smaller overall impact.

Subsidiary	Carrying value £m	Value in use £m	Headroom £m	Increase in post tax discount rate bps	Decrease in cash flows %
Santander UK plc	11,267	11,745	478	40	4

At 31 December 2019, there were no reasonably possible changes in any of the key assumptions that would have resulted in an impairment.

Sensitivities of key assumptions in calculating the VIU for the investment in Santander Financial Services plc

The VIU is sensitive to reasonably possible changes in the key assumptions for the discount rate and cash flows similar to those applied in determining the recoverable amount of goodwill recognised in the Santander UK plc group (see Note 20 to the Consolidated Financial Statements). The discount rate assumption for the investment in Santander Financial Services plc was 13.7%.

At 31 December 2020, a reasonably possible change in the following key assumptions in relation to the VIU calculation for the Company's investment in Santander Financial Services plc would have resulted in an impairment, as follows:

- No impairment against the carrying amount of the investment in Santander Financial Services plc would have arisen if the cashflows used had been 5% lower than management's estimates, including the impact of holding back the required capital to support the growth of the business.
- If the discount rate used had been 100 basis points higher than management's estimates, the Company would have had to recognise an impairment against the carrying amount of its investment of £5m.

Although there was no impairment of the Company's investment in Santander Financial Services plc at 31 December 2020, the amount by which the recoverable amount exceeds the carrying value (the headroom) reduced and the test is now sensitive to the assumptions used, as described above. In addition, the changes in assumptions detailed below for the discount rate and cash flow projections would eliminate the current headroom. As a result, there is a risk of impairment in the future should business performance or economic factors diverge from forecasts.

The sensitivity analysis presented below has been prepared on the basis that a change in each key assumption would not have a consequential impact on other assumptions used in the impairment review. However, due to the interrelationships between some of the assumptions, a change in one of the assumptions might impact one or more of the other assumptions and could result in a larger or smaller overall impact.

Subsidiary	Carrying value £m	Value in use £m	Headroom £m	Increase in post tax discount rate bps	Decrease in cash flows %
Santander Financial Services plc	337	363	26	82	7

At 31 December 2019, there were no reasonably possible changes in any of the key assumptions that would have resulted in an impairment.

8. OTHER FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2020 £m	2019 £m
Medium-term notes	1,425	—
	1,425	—

Other financial liabilities at FVTPL comprised £1,425m of other financial liabilities designated at fair value through profit or loss.

In 2020, as part of MREL requirements, the Company issued £1,425m of debt securities, which were then downstreamed to Santander UK plc.

Gains and losses arising from changes in the credit spread of securities issued by the Santander UK group reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount. The cumulative net gain or loss at 31 December 2020, and net gain or loss for the year attributable to changes in the Santander UK group's own credit risk on the above securities was £nil and has been included in profit and loss to offset credit risk on internal MREL assets held which are required to be recorded at fair value through profit and loss in accordance with IFRS9.

At 31 December 2020, the amount that would be required to be contractually paid at maturity of the securities above was £21m lower than the carrying value.

9. DEPOSITS BY BANKS

These consist of amounts due to subsidiaries and are repayable on demand.

10. DEBT SECURITIES IN ISSUE

The Company issues notes in the US from time to time pursuant to a shelf registration statement on Form F-3 filed with the SEC in 2018.

11. SUBORDINATED LIABILITIES

	Maturity	2020 £m	2019 £m
Dated subordinated liabilities			
4.75% Subordinated notes (US\$1,000m)	2025	536	763
5.625% Subordinated notes (US\$500m)	2045	294	379
		830	1,142

12. CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

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

	2020					2019				
	Balance sheet line item				Total £m	Balance sheet line item				Total £m
	Debt securities in issue £m	Subordinated liabilities £m	Other equity instruments £m	Dividends paid £m		Debt securities in issue £m	Subordinated liabilities £m	Other equity instruments £m	Dividends paid £m	
At 1 January	8,957	1,142	2,241	—	12,340	9,295	1,185	2,041	—	12,521
Cash flows from financing activities	440	(281)	—	(250)	(91)	—	—	196	(404)	(208)
Non-cash changes:										
– Unrealised foreign exchange	(17)	(28)	—	—	(45)	(327)	(44)	—	—	(371)
– Other changes	(1)	(3)	—	250	246	(11)	1	4	404	398
At 31 December	9,379	830	2,241	—	12,450	8,957	1,142	2,241	—	12,340

13. CONTINGENT LIABILITIES AND COMMITMENTS

Details of the capital support arrangements entered into by the Company are set out in Note 31 to the Consolidated Financial Statements.

14. SHARE CAPITAL

Details of the Company's share capital are set out in Note 32 to the Consolidated Financial Statements.

15. OTHER EQUITY INSTRUMENTS

Details of the Company's other equity instruments are set out in Note 33 to the Consolidated Financial Statements.

16. TRANSACTIONS WITH DIRECTORS AND OTHER KEY MANAGEMENT PERSONNEL

The Directors of Santander UK Group Holdings plc did not receive any remuneration in respect of their services to the Company. The remuneration disclosures in respect of the Santander UK group are set out in Note 38 to the Consolidated Financial Statements.

17. RELATED PARTY TRANSACTIONS

The Company's only transactions with related parties arise in connection with the receipt of dividends declared by its subsidiaries, payment of dividends on its own ordinary shares and Perpetual Capital Securities, interest payments to its subsidiary on intercompany loans and interest received from its subsidiaries relating to downstreamed funding of senior debt, as well as any transactions entered into as part of the implementation of Santander UK's ring-fencing plans.

18. EVENTS AFTER THE BALANCE SHEET DATE

See Note 42 to the Consolidated Financial Statements.

19. INTEREST RATE BENCHMARK REFORM

At 31 December 2020, the Company had £2,196m of USD LIBOR-linked Financial liabilities at amortised cost that were affected by IBOR reform and have yet to transition to an alternative benchmark interest rate as provided internally to key management personnel.

Further details of the significant interest rate benchmarks to which hedging relationships are exposed, the extent of risk exposure that is affected by IBOR reform, the effect of IBOR reform on interest rate risk management and how Santander UK's transition to alternative benchmark interest rates is being managed, are disclosed in Note 43 to the Consolidated Financial Statements and the Banking market risk section of the Risk review.

Shareholder information

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Subsidiaries, joint ventures and associates

In accordance with Section 409 of the Companies Act 2006, details of Santander UK Group Holdings plc's subsidiaries, joint ventures and associates at 31 December 2020 are set out below.

Subsidiaries

All subsidiaries are consolidated by the Santander UK group.

Incorporated and registered in England and Wales:

Name of subsidiary	Registered office ⁽¹⁾	Direct/Indirect ownership	Share class through which ownership is held	Proportion of ownership interest %	Ultimate proportion of ownership %
2 & 3 Triton Limited	A	Indirect	Ordinary £1	—	100
A & L CF June (2) Limited	A	Indirect	Ordinary £1	—	100
A & L CF June (3) Limited	A	Indirect	Ordinary £1	—	100
A & LCF March (5) Limited	A	Indirect	Ordinary £1	—	100
A & L CF September (4) Limited	A	Indirect	Ordinary £1	—	100
Abbey National Beta Investments Limited	A	Indirect	Ordinary £1	—	100
Abbey National Business Office Equipment Leasing Limited	A	Indirect	Ordinary £1	—	100
Abbey National Nominees Limited	A	Indirect	Ordinary £1	—	100
Abbey National PLP (UK) Limited	A	Indirect	Ordinary £1	—	100
Abbey National Property Investments	A	Indirect	Ordinary £1	—	100
Abbey National Treasury Services Investments Limited	A	Indirect	Ordinary £1	—	100
Abbey National Treasury Services Overseas Holdings	A	Indirect	Ordinary £1	—	100
Abbey National UK Investments	A	Indirect	Ordinary €0.20 Ordinary £1	—	100
Abbey Stockbrokers (Nominees) Limited	A	Indirect	Ordinary £1	—	100
Abbey Stockbrokers Limited	A	Indirect	Ordinary £1 A Preference £1 B Preference £1	—	100
Alliance & Leicester Cash Solutions Limited	A	Indirect	Ordinary £1	—	100
Alliance & Leicester Commercial Bank Limited	A	Indirect	Ordinary £1	—	100
Alliance & Leicester Investments (Derivatives) Limited	A	Indirect	Ordinary £1	—	100
Alliance & Leicester Investments (No.2) Limited	A	Indirect	Ordinary £1	—	100
Alliance & Leicester Investments Limited	A	Indirect	Ordinary £1	—	100
Alliance & Leicester Limited	G	Indirect	Ordinary £0.50	—	100
Alliance & Leicester Personal Finance Limited	G	Indirect	Ordinary £1	—	100
AN (123) Limited	A	Indirect	Ordinary £0.10	—	100
ANITCO Limited	A	Indirect	Ordinary £1	—	100
Athena Corporation Limited	A	Indirect	Ordinary £1	—	100
Cater Allen Holdings Limited	A	Indirect	Ordinary £1	—	100
Cater Allen International Limited	A	Indirect	Ordinary £1	—	100
Cater Allen Limited	A	Indirect	Ordinary £1	—	100
Cater Allen Lloyd's Holdings Limited	A	Indirect	Ordinary £1	—	100
Cater Allens Syndicate Management Limited	A	Indirect	Ordinary £1	—	100
First National Motor Business Limited (In liquidation)	F	Indirect	Ordinary £1	—	100
First National Motor Contracts Limited (In liquidation)	F	Indirect	Ordinary £1	—	100
First National Motor Facilities Limited (In liquidation)	F	Indirect	Ordinary £1	—	100
First National Motor Finance Limited (In liquidation)	F	Indirect	Ordinary £1	—	100
First National Motor Leasing Limited (In liquidation)	F	Indirect	Ordinary £1	—	100
First National Motor plc	B	Indirect	Ordinary £1	—	100
First National Tricity Finance Limited	A	Indirect	Ordinary £1	—	100
Insurance Funding Solutions Limited	A	Indirect	Ordinary £1	—	100
Liquidity Limited	A	Indirect	Ordinary A £0.10 Ordinary B1 £0.10 Ordinary B2 £0.10 Preference £1	—	100
Mortgage Engine Limited	A	Indirect	Ordinary £1	—	100
PSA Finance UK Limited	H	Indirect	Ordinary £1	—	50

(1) Refer to the key at the end of this section for the registered office address.

Subsidiaries, joint ventures and associates continued

Name of subsidiary	Registered office ⁽¹⁾	Direct/Indirect ownership	Share class through which ownership is held	Proportion of ownership interest %	Ultimate proportion of ownership %
Santander (CF Trustee Property Nominee) Limited	S	Trust relationship	Ordinary £1	—	—
Santander (CF Trustee) Limited	S	Trust relationship	Ordinary £1	—	—
Santander (UK) Group Pension Scheme Trustees Limited	S	Direct	Ordinary £1	100	100
Santander Assets Finance (December) Limited	G	Indirect	Ordinary £1	—	100
Santander Asset Finance plc	A	Indirect	Ordinary £0.10	—	100
Santander Cards Limited	A	Indirect	Ordinary £1	—	100
Santander Cards UK Limited	A	Indirect	Ordinary £1	—	100
Santander Consumer (UK) plc	B	Indirect	Ordinary £1	—	100
Santander Consumer Credit Services Limited	A	Indirect	Ordinary £1	—	100
Santander Equity Investments Limited	A	Direct	Ordinary £1	100	100
Santander Estates Limited	G	Indirect	Ordinary £1	—	100
Santander Financial Services plc	A	Direct	Ordinary £1	100	100
Santander Global Consumer Finance Limited	A	Indirect	Ordinary £0.0001	—	100
Santander Guarantee Company	A	Indirect	Ordinary £1	—	100
Santander Lending Limited	A	Indirect	Ordinary £1	—	100
Santander Mortgage Holdings Limited	A	Indirect	Ordinary £1	—	100
Santander Private Banking UK Limited	A	Indirect	Ordinary £1	—	100
Santander Secretariat Services Limited	A	Direct	A Ordinary US\$0.01	100	100
Santander UK Operations Limited	A	Indirect	Ordinary A £1 Ordinary B £1	— —	100 100
Santander UK (Structured Solutions) Limited	A	Indirect	Ordinary £0.01	—	100
Santander UK plc	A	Direct	Ordinary £0.10	100	100
Santander UK Technology Limited	A	Indirect	Ordinary £1	—	100
Sheppards Moneybrokers Limited	A	Indirect	Ordinary £1	—	100
Solarlaser Limited	A	Indirect	Ordinary £1	—	100
SCF Eastside Locks GP Limited	S	Trust relationship	Ordinary £1	—	—
The Alliance & Leicester Corporation Limited	A	Indirect	Ordinary £1	—	100
Time Retail Finance Limited (In liquidation)	F	Indirect	Ordinary £1 Ordinary £0.0001	— —	100 100
Tuttle and Son Limited	A	Indirect	Ordinary £1	—	100

(1) Refer to the key at the end of this section for the registered office address.

Incorporated and registered outside England and Wales:

Name of subsidiary	Registered office ⁽¹⁾	Direct/Indirect ownership	Share class through which ownership is held	Proportion of ownership interest %	Ultimate proportion of ownership %
A & LCF (Guernsey) Limited	T	Indirect	Ordinary £1	—	100
Abbey Business Services (India) Private Limited	Q	Indirect	Ordinary INR 10	—	100
Abbey National International Limited	U	Indirect	Ordinary £1	—	100
ALIL Services Limited (In liquidation)	R	Indirect	Ordinary £1	—	100
Carfax (Guernsey) Limited	T	Indirect	Ordinary £1	—	100
Santander Cards Ireland Limited	J	Indirect	Ordinary €1 Ordinary €1.27	—	100
Santander ISA Managers Limited	I	Indirect	Ordinary £1	—	100
Sovereign Spirit Limited	P	Indirect	Ordinary BMD 1	—	100

(1) Refer to the key at the end of this section for the registered office address, including the country

Other subsidiary undertakings

All entities are registered in England and Wales except for Guaranteed Investment Products 1 PCC Limited which is registered in Guernsey and Motor Securities 2018-1 Designated Activity Company and Motor Securities 2020-1 Designated Activity Company which are registered in Ireland.

The Company and its subsidiaries do not own directly, or indirectly, any of the share capital of any of the entities, however they are consolidated by the Santander UK group because the substance of the relationship indicates control, as described in Note 1 to the Consolidated Financial Statements.

Name of entity	Registered office ⁽¹⁾	Name of entity	Registered office ⁽¹⁾
Abbey Covered Bonds (Holdings) Limited	E	Holmes Trustees Limited	A
Abbey Covered Bonds (LM) Limited	E	Langton Funding (No.1) Limited	C
Abbey Covered Bonds LLP	A	Langton Mortgages Trustee (UK) Limited	A
Auto ABS UK Loans 2017 Holdings Limited	C	Langton PECO Limited	C
Auto ABS UK Loans 2017 plc	C	Langton Securities (2008-1) plc	C
Auto ABS UK Loans 2019 Holdings Limited	L	Langton Securities (2010-1) plc	C
Auto ABS UK Loans 2019 plc	L	Langton Securities (2010-2) plc	C
Auto ABS UK Loans Holdings Limited	C	Langton Securities Holdings Limited	C
Auto ABS UK Loans plc	C	MAC No.1 Limited	A
Fosse (Master Issuer) Holdings Limited	C	Motor 2015-1 Holdings Limited	C
Fosse Funding (No.1) Limited	C	Motor 2016-1 Holdings Limited	C
Fosse Master Issuer plc	C	Motor 2016-1 plc	C
Fosse PECO Limited	C	Motor 2017-1 Holdings Limited	C
Fosse Trustee (UK) Limited	A	Motor 2017-1 plc	C
Guaranteed Investment Products 1 PCC Limited	M	Motor Securities 2018-1 Designated Activity Company	N
Holmes Funding Limited	A	Motor Securities 2020-1 Designated Activity Company	N
Holmes Holdings Limited	A	PECO Limited	A
Holmes Master Issues plc	A		

(1) Refer to the key at the end of this section for the registered office address.

Joint ventures and associates

All of these entities, which are registered in England and Wales, are associated undertakings accounted for by the equity method of accounting.

Name of subsidiary	Registered office ⁽¹⁾	Direct/Indirect ownership	Share class through which ownership is held	Proportion of ownership interest %	Ultimate proportion of ownership %
Hyundai Capital UK Limited	K	Indirect	Ordinary £1	—	50
PSA UK Number 1 plc (In liquidation)	H	Indirect	B Ordinary £1 C Ordinary £1	—	50
Syntheo Limited (In liquidation)	F	Indirect	Ordinary £1	—	50
Volvo Car Financial Services UK Limited	O	Indirect	Ordinary £1	—	50

(1) Refer to the key at the end of this section for the registered office address.

All entities are joint ventures, except for PSA UK Number 1 plc which is an associate.

Overseas branches

The Company has no overseas branches. Santander Financial Services plc, a subsidiary, has branch offices in Jersey and the Isle of Man.

Key of registered office addresses

A	2 Triton Square, Regent's Place, London NW1 3AN	L	10th Floor, 5 Churchill Place, London E14 5HU
B	Santander House, 86 Station Road, Redhill RH1 1SR	M	Ground Floor, Dorey Court, Admiral Park, St Peter Port, Guernsey GY1 2HT
C	1 Bartholomew Lane, London EC2V 2AX	N	3rd Floor, Flemming Court, Flemming's Place, Dublin 4
D	40a Station Road, Upminster, Essex RM14 2TR	O	Scandinavia House, Norreys Drive, Maidenhead, Berkshire SL6 4FL
E	Wilmington Trust SP Services (London) Limited, 1 Kings Arms Yard, London EC2R 7AF	P	Clarendon House, 2 Church Street, Hamilton HM11, Bermuda
F	Griffins, Tavistock House South, Tavistock Square, London WC1H 9LG	Q	The Residency, 7th Floor, 133/1 Residency Road, Bangalore, KA 560 025, India
G	Carlton Park, Narborough, Leicester LE19 0AL	R	19/21 Prospect Hill, Douglas, Isle of Man IM99 1RY
H	61 London Road, Redhill RH1 1QA	S	201 Grafton Gate East, Milton Keynes MK9 1AN
I	287 St. Vincent Street, Glasgow, Scotland G2 5NB	T	Fourth Floor, The Albany, South Esplanade, St. Peter Port, Guernsey GY1 4NF
J	25/28 North Wall Quay, Dublin 1, Ireland	U	19-21 Commercial Street, St. Helier, Jersey JE2 3RU
K	London Court, 39 London Road, Reigate RH2 9AQ		

Forward-looking statements

The Company and its subsidiaries (together Santander UK) may from time to time make written or oral forward-looking statements. The Company makes written forward-looking statements in this Annual Report and may also make forward-looking statements in its periodic reports to the SEC on Forms 20-F and 6-K, in its offering circulars and prospectuses, in press releases and in other written materials and in oral statements made by its officers, directors or employees to third parties. Examples of such forward-looking statements include, but are not limited to:

- projections or expectations of revenues, costs, profit (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios
- statements of plans, objectives or goals of Santander UK or its management, including those related to products or services
- statements of future economic performance, and
- statements of assumptions underlying such statements

Words such as 'believes', 'anticipates', 'expects', 'intends', 'aims', 'plans', 'targets' and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements.

By their very nature, forward-looking statements are not statements of historical or current facts; they cannot be objectively verified, are speculative and involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. Santander UK cautions readers that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements made by Santander UK or on its behalf. Some of these factors, which could affect Santander UK's business, financial condition and/or results of operation, are considered in detail in the Risk review, and they include:

- the effects of disruptions in the global economy and global financial markets
- the effects of UK economic conditions
- the effects of UK's withdrawal from the European Union
- the effects of competition with other financial institutions, including new entrants into the financial services sector
- the risk that Santander UK's new or existing products and services may not become (or may not continue to be) successful
- the risk that Santander UK may be unable to continue offering products and services from third parties
- the extent to which Santander UK's loan portfolio is subject to prepayment risk
- the risk that Santander UK may be unable to manage the growth of its operations
- the effects of any changes to the reputation of Santander UK or its affiliates
- the extent to which regulatory capital, liquidity and leverage requirements, and any changes to these requirements may limit Santander UK's operations
- Santander UK's ability to access liquidity and funding on acceptable financial terms
- the effects of an adverse movement in external credit rating assigned to Santander UK, any Santander UK member or any of their respective debt securities
- the effects of any changes in the pension liabilities and obligations of Santander UK
- the effects of fluctuations in interest rates and other market risks
- risks arising from the integrity and continued existence of reference rates
- the extent to which Santander UK may be required to record negative changes in positions recorded at fair value for its financial assets due to changes in market conditions
- Santander UK's ability to control the level of non-performing or poor credit quality loans and whether Santander UK's loan loss reserves are sufficient to cover loan losses
- the risk that the value of the collateral, including real estate, securing Santander UK's loans may not be sufficient and that Santander UK may be unable to realise the full value of the collateral securing its loan portfolio
- the effects of the financial services laws, regulations, government oversight, administrative actions and policies and any changes thereto in each location or market in which Santander UK operates
- the risk that Santander UK may become subject to the provisions of the Banking Act 2009, including the bail-in and write down powers thereunder
- the effects of any failure to comply with anti-money laundering, anti-terrorism, anti-corruption, anti-tax evasion or sanctions laws or regulations, or the risk of any failure to prevent or detect any illegal or improper activities fully or timeously
- the effects of taxation (and any changes to tax), in each location in which Santander UK operates
- Santander UK's exposure to any risk of loss from civil litigation and/or criminal legal or regulatory proceedings
- the risk of failing to successfully apply or to improve Santander UK's credit risk management systems
- the risk that Santander UK's data management policies and processes may not be sufficiently robust
- the effect of cyber-crime on Santander UK's business
- the risks arising from any non-compliance with Santander UK's policies, from any employee misconduct or human error, or from any negligence or fraud
- the risk of failing to effectively manage changes in Santander UK's information technology infrastructure and management information systems in a timely manner
- the risk that Santander UK, along with the government, may not have the ability to manage and mitigate the impacts of climate change effectively
- Santander UK's exposure to unidentified or unanticipated risks despite its risk management policies, procedures and methods
- the risks arising from Santander UK's reliance on third parties and affiliates for key infrastructure support, products and services
- the ability of Santander UK to recruit retain and develop appropriate senior management and skilled personnel
- the effects of any inaccuracy within the judgements and accounting estimates which underpin aspects of the financial statements, and the consequent risk of any material misstatement of Santander UK's financial results
- the effect of any change in accounting standards

Please refer to our latest filings with the SEC (including, without limitation, our Annual Report on Form 20-F for the year ended 31 December 2020) for a discussion of certain risk factors and forward-looking statements. Undue reliance should not be placed on forward-looking statements when making decisions with respect to any Santander UK member and/or its securities. Investors and others should take into account the inherent risks and uncertainties of forward-looking statements and should carefully consider the foregoing non-exhaustive list of important factors. Forward-looking statements speak only as of the date on which they are made and are based on the knowledge, information available and views taken on the date on which they are made; such knowledge, information and views may change at any time. Santander UK does not undertake any obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Glossary

Our glossary of industry and other main terms is available on our website: www.santander.co.uk/uk/about-santander-uk/investor-relations-glossary.

The definitions of our KPIs are included in the table below. KPIs are presented at 31 December in the periods indicated and are based on spot balances at these dates, except for:

- The adjusted CIR, adjusted RoTE, retail NPS and business and corporate NPS, which are based on performance in the relevant period
- Top 10 company to work for, which we aim to gain accreditation for over the medium-term
- Financially empowered people, which is a cumulative figure from the start of 2019.

KPI	Definition
Loyal customers	Loyal customers are defined as primary banking current account customers who hold an additional product.
Net Promoter Score Business and corporate	Measured by the MarketVue Business Banking from Savanta. This is an ongoing telephone based survey designed to monitor usage and attitude of UK businesses towards banks. Structured telephone interviews are conducted each year among businesses of all sizes from new start-ups to large corporates and are weighted by region and turnover to be representative of businesses in Great Britain. NPS - recommendation score is based on an 11 point scale (%Top 2 - %Bottom 7).
Net Promoter Score Retail	The Financial Research Survey (FRS) is a monthly personal finance survey of around 5,000 consumers prepared by the independent market research agency, IPSOS MORI. The NPS is based on a 11-point scale (%Top2 - %Bottom 7) across mortgages, savings, main current accounts, home insurance, UPLs and credit cards, based on a weighting of those products calculated to reflect the average product distribution across Santander UK and competitor brands.
Digital customers	Digital customers reflect the number of customers who have logged onto Retail or Business online banking or mobile app(s) (Retail Mobile includes SanWallet & OnePayFX) at least once in the month.
Adjusted RoTE	The adjusted profit after tax attributable to equity holders of the parent divided by average shareholders' equity less non-controlling interests, other equity instruments and average goodwill and intangible assets.
Adjusted cost to income ratio	Adjusted total operating expenses before credit impairment losses and provisions for other liabilities and charges as a percentage of adjusted total operating income.
Top 10 company to work for	In line with Banco Santander's aspiration, we will aim to achieve the accreditation of a Top 10 company to work for, as measured by an industry-wide benchmarking survey, over the medium-term.
Financially empowered people	The number of people we are supporting who are unbanked, underbanked or in a situation of vulnerability to get access to the financial system, receive tailored finance and increase their knowledge and resilience through financial education. In 2019 we started to contribute to Banco Santander's target to financially empower 10m people by 2025.


Further Information

Contact us

Customer services

For more information on our products and services, please visit our website:

 santander.co.uk
customerservices@santander.co.uk

 +44 (0)800 389 7000


Shareholders

Information for UK shareholders of Banco Santander can be found at our website:

 santandershareview.com
santandershareholders@equiniti.com

By post, please write to:

Santander Nominee Service
Aspect House
Spencer Road
Lancing BN99 6DA

 +44 (0)371 384 2000
+44 (0)121 415 7188
(From outside the UK)

Community involvement

To find out more about applying for donations and the Santander UK Foundation, please visit our website:

 santanderfoundation.org.uk

Media centre

Contacts for the media relations team are available at our website via the media section:

 aboutsantander.co.uk
mediarelations@santander.co.uk

Investor relations

For financial results and presentations, stock exchange announcements, credit ratings and information for debt investors, please visit the investor relations section of our website:

 santander.co.uk/about-santander/investor-relations
ir@santander.co.uk

Registered address

Santander UK
2 Triton Square
Regent's Place
London NW1 3AN

Key dates

28 April 2021	Q1 2021 results
28 July 2021	Q2 2021 results
27 October 2021	Q3 2021 results

Glossary

For a glossary of terms used in this report:

www.santander.co.uk/about-santander/investor-relations/glossary



[santander.co.uk](https://www.santander.co.uk)

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