# Notes to the Financial Statements

**1. Principal accounting policies**
Bradford & Bingley plc ('the Company') is a public limited company incorporated in the United Kingdom under the Companies Act 1985 and registered in England and Wales.

These Financial Statements were authorised for issue by the Directors on 12 February 2008 and will be put to the shareholders for approval at the Company's Annual General Meeting to be held on 22 April 2008.

**(a) Statement of compliance**
The Group Financial Statements incorporate on a fully consolidated basis the Financial Statements of the Company and those entities (including special purpose structures) which are controlled by the Company (its subsidiaries), together referred to as 'the Group'. The Company Financial Statements present information about the Company as a separate entity and not about its Group.

Both the Company Financial Statements and the Group Financial Statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the European Union ('adopted IFRS'). In publishing the Company Financial Statements here together with the Group Financial Statements, the Company has taken advantage of the exemption in s230 of the Companies Act 1985 not to present its individual Income Statement and related notes.

For these 2007 Financial Statements, including the 2006 comparative financial information, the Group and Company have adopted for the first time the following statements:
- The Capital Disclosures amendment to IAS 1 'Presentation of Financial Statements' issued by the IASB in August 2005: this relates to disclosures only and has no impact on the Group's or the Company's Income Statements, Balance Sheets or Cash Flow Statements;
- IFRS 7 'Financial Instruments: Disclosures' issued by the IASB in August 2005 (including the consequential amendments to IAS 32 Financial Instruments Presentation): this relates to disclosures only and has no impact on the Group's or the Company's Income Statements, Balance Sheets or Cash Flow Statements;
- IFRIC 7 'Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies' is also mandatory for 2007 Financial Statements, but is not relevant to the Group or Company;
- IFRIC 8 'Scope of IFRS 2' issued by IFRIC in January 2006: this applies where share-based payments are made for less than fair value, and no such payments have been made by the Group or Company;
- IFRIC 9 'Reassessment of Embedded Derivatives' issued by IFRIC in March 2006: this requires entities to reassess whether an embedded derivative should be separated from a host contract when and only when the terms of the host contract are significantly modified. Adoption of this statement had no impact on the Group's or the Company's Income Statements, Balance Sheets or Cash Flow Statements; and
- IFRIC 10 'Interim Financial Reporting and Impairment' issued by IFRIC in July 2006. Under IFRS, impairment losses recognised against certain assets are not eligible for reversal in a subsequent period even if circumstances have improved. (However, this does not apply to impairment on loans and advances and available-for-sale debt securities; impairment losses recognised in respect of such financial instruments should be reversed to the extent that the impairment is no longer required due to events occurring after original impairment.) IFRIC 10 clarifies that a relevant impairment loss recognised in an Interim Financial Report may not be reversed in a subsequent part of the same full financial period of which the Interim Financial Report forms a part. Adoption of IFRIC 10 had no impact on the Group's or Company's Income Statements, Balance Sheets or Cash Flow Statements.

For these 2007 Financial Statements the Group and Company have not adopted the following statements:
- IFRS 8 'Operating Segments' issued by the IASB in November 2006 and mandatory for 2009 financial statements: this relates to disclosures only and adoption would have no impact on the Group's or the Company's Income Statements, Balance Sheets or Cash Flow Statements; and
- IFRIC 11 'IFRS 2 - Group and Treasury Share Transactions' issued by IFRIC in November 2006 and mandatory for 2008 financial statements: adoption of this statement is anticipated to have no material impact on the Group's or Company's Income Statements, Balance Sheets or Cash Flow Statements.

**(b) Basis of preparation**
The Financial Statements are prepared on the historical cost basis except:

(i) the following assets and liabilities are carried at their fair value:
- derivative financial instruments;
- financial instruments categorised under IAS 39 as 'at fair value through profit or loss'; and
- financial instruments categorised under IAS 39 as 'available-for-sale'; and

(ii) where fair value hedge accounting has been applied the carrying value of hedged items has been adjusted to take account of the fair value of the risk which has been hedged.

In the application of these accounting policies the Directors have made judgements that have a significant effect on the Financial Statements and have also made estimates that have a significant risk of giving rise to material adjustment in the next year; these judgements and estimates are discussed in note 37 to the Financial Statements.

The Directors consider that the accounting policies set out in this note are the most appropriate to the Group's and the Company's circumstances, have been consistently applied both to the Group and the Company in dealing with items which are considered material, and are supported by reasonable and prudent estimates and judgements. The accounting policies have been applied to all periods presented in these Financial Statements and are consistent with the accounting policies used by the Group in preparing its Interim Financial Information for the six months ended 30 June 2007 except for the adoption of the Capital Disclosures amendment to IAS1 and IFRS 7.

The Financial Statements are presented in pounds sterling, which is the currency of the Group's and Company's primary operating environment and its functional currency.

The Group's business and operations comprise one single continuing activity, and hence no segmental analysis has been provided.

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

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

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

The EIR basis spreads the interest income or interest expense over the expected life of the instrument. The EIR is the rate that at the inception of the instrument exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, future cash flows are estimated, considering all contractual terms of the instrument (for example, prepayment options), but potential future credit losses are not considered. The calculation includes all directly

# Notes to the Financial Statements

attributable incremental fees and costs, premia on acquisition of mortgage portfolios and all other premia and discounts as well as interest.

**(e) Fee and commission income**
Where Value Added Tax (VAT) is charged, income is stated net of VAT.

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

Fee and commission income arises on various other activities and is accounted for within 'fee and commission income' in the Income Statement on an accruals basis as the services are performed. Fee and commission income includes items relating to lending which do not qualify for inclusion in the EIR on the loan.

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

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

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

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

**(g) Share-based payment**
The Group and Company operate various share-based incentive schemes for employees and officers, including a Sharesave Scheme. Grants of shares, share options and other equity instruments are accounted for in accordance with IFRS 2 'Share-based Payment', under which the fair value of awards is measured at the date of grant and charged to the Income Statement over the period to vesting, with a corresponding credit to retained earnings. Further details of the Group's fair value methodology are given in note 31. The charge is made only in respect of the number of awards that are expected to vest; this expected number is revised at each Balance Sheet date and any difference due to estimate revisions is charged or credited to the Income Statement over the period to vesting with a corresponding adjustment to retained earnings. The proceeds received on exercise of options net of any directly attributable transaction costs are credited to retained earnings.

The Group holds some shares in the Company to satisfy share-based payment commitments. These shares are included in the Group's and Company's Balance Sheets within retained earnings at purchase price including transaction costs.

**(h) Taxation**
The charge for taxation is based on the profit for the year and takes into account taxation deferred or accelerated arising from temporary differences between the carrying amounts of certain items for taxation and for accounting purposes. Deferred taxation is provided for in full at the tax rate which is expected to apply to the period when the deferred taxation is expected to be realised, including on tax losses carried forward, and is not discounted to take account of the expected timing of realisation. Deferred taxation assets are recognised only to the extent that it is probable that future taxable profits will be available against which the taxable differences can be utilised. Tax relating to items which are taken directly to reserves is also taken directly to reserves.

**(i) Dividends**
In accordance with IAS 10 'Events After the Balance Sheet Date' dividends payable on ordinary shares are recognised in retained earnings once they are appropriately authorised and are no longer at the discretion of the Company.

Dividends receivable (including those receivable from other Group entities) are recognised once the right to receive payment is established, in accordance with IAS 18 'Revenue'.

**(j) Financial instruments**
In accordance with IAS 39 'Financial Instruments: Recognition and Measurement' each financial asset is classified at initial recognition into one of four categories:
(i) Financial assets at fair value through profit or loss;
(ii) Held-to-maturity investments;
(iii) Loans and receivables; or
(iv) Available-for-sale;

and each financial liability into one of two categories:
(v) Financial liabilities at fair value through profit or loss; or
(vi) Other liabilities.

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

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

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

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

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

The Group and Company operate a trading book. The assets and liabilities in the trading book are categorised as 'at fair value through profit or loss' and the net trading gains and losses are included in the Income Statement in 'realised gains less losses on financial instruments'.

**(k) Recognition and derecognition of financial assets**

Purchases and sales of mortgage portfolios are accounted for on the completion date. All other purchases and sales of financial assets are accounted for on the date of commitment to buy or sell (the 'trade date'). A financial asset is derecognised (i.e. removed from the Balance Sheet) only when substantially all of the risks and rewards associated with that asset have been transferred to another party and control is lost. In respect of the Company's secured funding structures, the Company sells to another entity the right to receive the cash flows arising on the loans which have been securitised. However, the Company receives substantially all of the post-tax profit of that entity, and hence retains substantially all of the risks and rewards of the securitised loans. Hence the securitised loans are retained on the Company's Balance Sheet.

**(l) Impairment of financial assets**

Financial assets, are reviewed for indications of possible impairment throughout the year and at each published Balance Sheet date.

Loans and receivables

For each individual loan which exhibits indications of impairment (which includes all loans 12 or more months in arrears, those in possession and others which management consider to be individually impaired) the carrying value of the loan at the Balance Sheet date is reduced to the net present value of the expected future cash flows associated with the loan, calculated at the loan's original EIR. These cash flows include, where appropriate, estimated amounts recoverable by repossession and sale of the secured property, taking into account a discount on property value to reflect a forced sale. All loans that have been assessed as having no individual impairment are then assessed collectively, grouped by loans with similar risk characteristics. Assessment is made of impairment arising due to events which are believed to have occurred by the Balance Sheet date but had not yet been reported, taking into account the economic climate in the market. This collective impairment is reflected by reducing the carrying value of total loans.

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

A loan is written off and any associated impairment allowance released when and only when the property has been taken into possession and sold. Any subsequent proceeds are recognised on a cash basis and offset against impairment charges in the Income Statement.

Debt securities held

Debt securities are carried at fair value net of impairment as detailed in paragraph (m). Impairment is recognised when the debt security exhibits objective evidence of impairment or is uncollectible. Evidence includes:

- Significant financial difficulty
- Payment defaults
- Renegotiation of terms due to borrower difficulty
- Sustained fall in credit rating
- Significant restructuring
- Disappearance of an active market
- Significant and sustained fall in market price
- Observable data indicating measurable decrease in the estimated future cashflows from a group of financial assets, although the decrease cannot yet be identified within individual assets in the Group.

Movements in the fair value which are a reflection of impairment of the long-term value of the debt security of a Structured Investment Vehicle ('SIV'), would be charged to 'investment impairment loss' in the Income Statement. Investment impairment losses recognised against debt securities would be reversed in a subsequent period if the improvement is related to an event occurring after the initial impairment was recognised.

**(m) Debt securities held**

Debt securities intended for use on a continuing basis in the Group's activities are classified as 'available-for-sale'. They are carried at fair value net of impairment with movements, excluding impairment provisions, transferred to the 'Available-for-sale reserve'. Debt securities include investments in Structured Investment Vehicles ('SIV's') Principal Protected Notes ('PPNs') and Collateralised Debt Obligations ('CDOs'). The Group has no entitlement to board or management representation in respect of its investment in any SIV, PPN or CDO, and cannot exert influence, and therefore the instruments are considered to fall outside the scope of IAS 27 'Consolidated and Separate Financial Statements', IAS 28 'Investments in Associates' and IAS 31 'Interests in Joint Ventures'. SIV and PPN investments earn a guaranteed coupon plus a potential additional variable unguaranteed amount; in these cases the guaranteed coupon is recognised on an EIR basis but unguaranteed amounts are recognised on receipt.

**(n) Derivative financial instruments and hedge accounting**

The Group enters into derivative contracts in order to manage exposures to interest rate risks, foreign currency risks and risks arising from forecast transactions, in accordance with IAS 39. As explained in note 1(j), the Company has used the provisions of the Fair Value Option amendment to IAS 39 to prevent technical accounting mismatches in respect of intra-Group swap arrangements.

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

One-to-one fair value hedges

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

Portfolio fair value hedges

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

Cash flow hedges

Where a derivative financial instrument hedges the variability in cash flows of an asset or liability, or of a highly probable forecast transaction, the effective portion of the change in fair value of the derivative is taken to the 'cash flow hedge reserve' and the remaining portion is charged immediately to the 'hedge ineffectiveness' line of the Income Statement. Where a cash flow hedge is terminated or deemed not to be effective, the balance remaining in the cash flow hedge reserve is amortised over the remaining life of the hedged item. Where a forecast transaction is cashflow hedged and the transaction is no longer highly probable, the gain or loss still held in the reserve is immediately recognised in the Income Statement.

Hedge effectiveness

At the inception of each hedging arrangement, the relationship between the hedging instruments and the hedged items is documented, as well as the risk management

# Notes to the Financial Statements

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

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

Embedded derivatives
Certain financial instruments have derivative features embedded within them. Where the economic characteristics and risks of the embedded derivative are not closely related to those of the host instrument, and where changes in value on the host instrument are not reflected in the income statement the embedded derivative is separated from the host and carried in the Balance Sheet at fair value within 'derivative financial instruments', with gains and losses on the embedded derivative being recognised in the Income Statement in 'fair value movements'. The Group recognises that its holding of synthetic CDO's (where the SPV issuing the CDO contains a credit derivative) contains an embedded derivative if the CDO's originator does not hold the reference assets on its balance sheet or if the sponsor of the CDO is not required to hold the reference assets on its own balance sheet. Consequently the fair value of the credit derivative contract is separated from the host synthetic CDO with changes in its fair value recognised within 'fair value movements'. In accordance with IFRIC 9 'Reassessment of Embedded Derivatives' the decision as to whether to separate and value an embedded derivative is reassessed when and only when the terms of the host contract are significantly modified.

**(o) Shares in Group undertakings**
In the Financial Statements of the Company, shares in Group undertakings are carried at cost less any impairment. Shares are reviewed at each published Balance Sheet date for any indications of impairment. If there is indication of impairment of any share, the carrying value of the share is reviewed, and any impairment identified is charged immediately in the Income Statement.

**(p) Property, plant and equipment**
The cost of additions and major alterations to land and buildings, equipment, fixtures and motor vehicles is capitalised. All property, plant and equipment is stated at historical cost less depreciation.

Depreciation is provided so as to write off the cost less the estimated residual value of each significant component of each item of property, plant and equipment over that component's estimated useful life, as follows:
- Land is not depreciated;
- Freehold buildings at 2% per annum on a straight line basis;
- Leasehold properties over the shorter of the lease period and 50 years on a straight line basis;
- Fixtures and fittings at 20% per annum on a straight line basis;
- Motor vehicles at 25% per annum on a reducing balance basis;
- Computer equipment at rates ranging from 20% to 33% per annum on a straight line basis; and
- Other equipment and major alterations to buildings at 10% per annum on a straight line basis.

All items of property, plant and equipment are reviewed annually for impairment.

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

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

**(r) Intangible assets**
Computer software licences are capitalised as intangible assets where it is probable that expected future benefits will flow to the Group. Thereafter they are carried at cost less accumulated amortisation. Amortisation is provided on a straight line basis over their useful economic lives, which may be up to five years. Those which have a life expectancy at the outset of less than two years are not capitalised but instead their costs are charged to the Income Statement as they arise. Costs that are directly associated with developing identifiable computer software systems are capitalised if the criteria in IAS 38 'Intangible Assets' are satisfied; the main criteria are that the successful completion of the development project is reasonably certain and that the software is expected to generate future economic benefits. Each item of capitalised developed computer software is carried at cost less accumulated amortisation; amortisation is provided on a straight line basis over its estimated useful life. Costs that do not qualify for capitalisation are charged to the Income Statement as they arise.

**(s) Debt and equity securities in issue**
Issued securities are classed as liabilities if they represent a contractual obligation to deliver cash or another financial asset to another entity. Otherwise they are classed as equity. Any coupon paid on liabilities is accounted for as interest expense on an EIR basis and any coupon on equity as dividends.

On initial recognition, debt issued is measured at its fair value net of directly attributable issue and transaction costs. Subsequent measurement is at amortised cost using the EIR method to amortise attributable issue and transaction costs, premia and discounts over the life of the instrument. These costs are charged along with interest on the debt to 'interest expense and similar charges'. Unamortised amounts are added to or deducted from the carrying value of the instrument.

It is the Group's policy to hedge fixed interest rate risk on debt issued and to apply fair value hedge accounting.

**(t) Provisions**
Provisions are recognised when, and only when, the following criteria are all met:
- there is a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

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

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

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

**(v) Foreign currencies**
The presentational and functional currency of the Group and Company is pounds sterling. Transactions which are not denominated in pounds sterling are translated into sterling at the spot rate of exchange on the date of the transaction. Monetary assets and liabilities which are not denominated in pounds sterling are translated into sterling at the closing rate of exchange at the Balance Sheet date.

Any foreign exchange gains or losses arising from settlement of transactions at rates different from those at the date of the transaction, and any unrealised foreign currency exchange gains and losses on unsettled foreign currency monetary assets and liabilities, are included in the Income Statement in 'interest receivable and similar income' or 'interest expense and similar charges' depending on whether the underlying instrument is an asset or a liability.

**(w) Financial guarantees**
The Company applies insurance accounting to financial guarantee contracts, and provides against any claims arising under such contracts.

## 2. Sale of commercial assets

| | Commercial properties £m | Housing associations £m | Total £m |
|---|---|---|---|
| Net proceeds from sale | (1,890.0) | (2,064.0) | (3,954.0) |
| Book value of assets sold | 1,972.1 | 2,026.6 | 3,998.7 |
| | 82.1 | (37.4) | 44.7 |
| Less: | | | |
| Costs | | | 13.3 |
| **Loss on sale of assets** | | | 58.0 |

In April 2007, the Board took the strategic decision to sell our commercial property and housing association mortgage portfolios in order to focus on the higher margin, high growth, specialist mortgage market to maximise future returns and capital efficiency. The sale of the commercial property and housing association loans completed for £4.0bn.

## 3. Net interest income

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Net interest income | **547.7** | 510.2 |
| Average interest-earning assets ('IEA') | **49,743** | 42,692 |
| Financed by | | |
| - Interest-bearing liabilities | **47,904** | 41,122 |
| - Interest-free liabilities | **1,839** | 1,570 |
| Average rates | % | % |
| - Gross yield on IEA | **5.96** | 5.57 |
| - Cost of interest-bearing liabilities | **(5.05)** | (4.55) |
| Interest spread | **0.91** | 1.02 |
| Contribution of interest-free liabilities | **0.19** | 0.17 |
| **Net interest margin** | **1.10** | 1.19 |
| Average bank base rate | **5.51** | 4.64 |
| Average 3-month LIBOR | **6.00** | 4.84 |
| Average 3-year swap rate | **5.81** | 5.07 |

Included within interest receivable and similar income are the following amounts:

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Interest accrued on impaired financial assets | **3.7** | 2.8 |

## 4. Administrative expenses

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Staff costs (see note 5) | **105.7** | 100.5 |
| Property operating lease rentals | **7.7** | 7.9 |
| Equipment hire | **0.6** | 0.4 |
| Depreciation and amortisation (see notes 18 and 19) | **23.7** | 18.2 |
| Other legal and professional services | **26.6** | 26.2 |
| IT costs | **42.6** | 41.4 |
| Other administrative expenses | **73.3** | 77.0 |
| Ongoing administrative expenses | **280.2** | 271.6 |
| Compensation costs | **-** | 89.4 |
| | **280.2** | 361.0 |

Compensation costs relate to the provision for potential compensation payments to customers for business written in the past by our independent financial advisory business. The independent financial advisory business which made these sales was closed in 2004.

# Notes to the Financial Statements

## 4. Administrative expenses continued

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Remuneration of auditor and associates | | |
| - Statutory audit of the Company and consolidated accounts | **0.5** | 0.5 |
| Fees payable to the Group's auditor and its associates for other services: | | |
| - Auditing of the Company's subsidiaries | **0.1** | 0.2 |
| - Other services pursuant to legislation | **0.1** | 0.2 |
| - Other services relating to taxation | **-** | 0.2 |
| - Regulatory and other services | **0.7** | 0.6 |
| Total | **1.4** | 1.7 |

## 5. Staff costs and numbers

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

| | Full time | | Part time | | Full time equivalent | |
|---|---|---|---|---|---|---|
| | **2007 Number** | 2006 Number | **2007 Number** | 2006 Number | **2007 Number** | 2006 Number |
| Group | **2,451** | 2,511 | **691** | 663 | **2,862** | 2,892 |
| Company | **1,811** | 1,940 | **534** | 528 | **2,246** | 2,236 |

The full time equivalent is based on the average hours worked by employees in the year. The total headcount at each year end was:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007 Number** | 2006 Number | **2007 Number** | 2006 Number |
| | **3,035** | 3,154 | **2,559** | 2,445 |

The aggregate costs of these persons were as follows:

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Wages and salaries | **87.4** | 78.9 |
| Social security costs | **8.7** | 8.6 |
| Defined benefit pension costs (see note 25d) | **3.0** | 6.7 |
| Defined contribution pension costs (see note 25a) | **1.4** | 1.2 |
| Other post-retirement benefits costs (see note 25d) | **0.6** | 0.5 |
| Equity-settled share based payment (see note 31) | **4.6** | 4.6 |
| | **105.7** | 100.5 |

## 6. Taxation

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Current taxation expense | | |
| - UK corporation tax on profits for the year | **6.1** | 48.5 |
| - Adjustments in respect of previous years | **7.3** | (13.8) |
| | **13.4** | 34.7 |
| Foreign taxation | **22.1** | 20.1 |
| Total current taxation | **35.5** | 54.8 |
| Deferred taxation expense | | |
| - Origination and reversal of temporary differences (see note 17) | **(3.4)** | 14.2 |
| - Change in rate effective 1 April 2008 on deferred tax items | **0.7** | - |
| Total taxation expense per the Income Statement | **32.8** | 69.0 |
| The following tax was recognised directly in equity during the year | | |
| - Relating to available-for-sale debt securities | **25.9** | 3.2 |
| The following tax was recognised in equity during the year in deferred tax | | |
| - Relating to cash flow hedge reserve | **32.3** | (8.9) |
| - Relating to actuarial gains and losses on post-retirement benefit obligations | **(15.4)** | (5.9) |
| - Relating to share-based payments | **(1.5)** | 0.5 |
| Net credit/(charge) to equity | **41.3** | (11.1) |

The 2007 foreign taxation charge includes a charge of £nil (2006: £nil) in respect of previous periods.

## 6. Taxation continued

The total taxation expense differs from the theoretical amount that would be derived by applying the basic UK corporation tax rate to the Group's results as follows:

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Profit before taxation | **126.0** | 246.7 |
| UK corporation tax at 30% | **37.8** | 74.0 |
| Effects of | | |
| - Expenses not deductible for taxation | **4.3** | 3.6 |
| - Lower rate on overseas earnings | **(7.2)** | (3.0) |
| - Change in rate effective 1 April 2008 on deferred tax items | **(0.7)** | - |
| - Adjustments in respect of previous years | **(1.4)** | (5.6) |
| Total taxation charge for the year | **32.8** | 69.0 |
| Effective tax rate (%) | **26.0** | 28.0 |

Deferred tax appropriately reflects the change to the standard rate of UK corporation tax from 30% to 28% which will become effective on 1 April 2008.

## 7. Earnings per share

| | Group 2007 pence | Group 2006 pence |
|---|---|---|
| Basic | **14.9** | 28.2 |
| Diluted | **14.9** | 28.1 |

Earnings per share is calculated using the following amounts of profit attributable to equity shareholders:

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Profit for the financial year | **93.2** | 177.7 |

Earnings per share is calculated using the number of ordinary shares as follows:

| | Group 2007 Shares (m) | Group 2006 Shares (m) |
|---|---|---|
| Weighted average number of ordinary shares in issue | **624.2** | 630.2 |
| Dilutive effect of ordinary shares issuable under Company share schemes | **0.8** | 2.0 |
| Diluted weighted average number of ordinary shares | **625.0** | 632.2 |

The diluted weighted average number of ordinary shares is calculated by assuming that all shares which could be issued as a result of existing share options and other share-based payment arrangements are in fact issued. Issuance of these additional shares would have no material impact on the Group's earnings. Shares acquired by employee share trusts, which are deducted from retained earnings, have been excluded from the calculation of earnings per share as they are cancelled until such time as they vest unconditionally to the employee.

## 8. Dividends

Group and Company dividends recognised in the year were as follows:

| | 2007 Pence per share | 2006 Pence per share | 2007 £m | 2006 £m |
|---|---|---|---|---|
| 2005 final dividend | - | 12.3 | - | 77.6 |
| 2006 interim dividend | - | 6.6 | - | 41.6 |
| 2006 final dividend | **13.4** | - | **84.7** | - |
| 2007 interim dividend | **6.7** | - | **41.8** | - |
| | **20.1** | 18.9 | **126.5** | 119.2 |
| Proposed final dividend (unaccrued) | **14.3** | 13.4 | **87.4** | 84.6 |

On 12 February 2008, the Directors proposed that a dividend of 14.3 pence per share (2006: 13.4 pence) be paid on 2 May 2008 to shareholders, on the Register at the close of business on 25 March 2008, making a total proposed dividend for the year of 21.0 pence (2006: 20.0 pence). A resolution to approve the payment of this dividend will be put to the shareholders at the Company's Annual General Meeting to be held on 22 April 2008. In accordance with IAS 10 'Events after the Balance Sheet Date' this proposed dividend has not been accrued in the Balance Sheet as it was not a liability at the Balance Sheet date.

## 9. Loans and advances to banks

| At 31 December | Group 2007 £m | Group 2006 £m | Company 2007 £m | Company 2006 £m |
|---|---|---|---|---|
| Items in the course of collection from other banks | **82.9** | 30.1 | **79.1** | 30.4 |
| Amounts due from banks | **2,309.2** | 3,271.3 | **1,822.8** | 2,383.1 |
| Total | **2,392.1** | 3,301.4 | **1,901.9** | 2,413.5 |

# Notes to the Financial Statements

## 10. Loans and advances to customers

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **£m** | £m | **£m** | £m |
| Net of impairment (see note 11) | | | | |
| - Advances secured on residential properties | **39,565.0** | 33,431.1 | **24,566.3** | 19,505.4 |
| - Other secured advances | **879.5** | 2,700.6 | **879.5** | 2,741.4 |
| - Amounts due from subsidiary undertakings | **-** | - | **25,989.6** | 19,648.7 |
| | **40,444.5** | 36,131.7 | **51,435.4** | 41,895.5 |

Loans and advances to customers include advances secured on residential properties that are securitised amounting to £19,844.9m (2006: £12,599.3m) for Group and £19,488.5m (2006: £12,133.9m) for Company which have been sold to bankruptcy remote special purpose vehicles whereby some of the risks and rewards of the portfolio are retained by the Group/Company. Accordingly, all these loans and advances are retained on the Group's/Company's Balance Sheet. Further details are provided in note 12.

Loans and advances to customers comprise the following product types:

| Group | **Balances At 31 December 2007** | | Balances At 31 December 2006 | |
|---|---|---|---|---|
| | **£m** | **%** | £m | % |
| **Residential** | | | | |
| **Originated** | | | | |
| - Buy-to-let | **20,960.8** | **67** | 16,962.4 | 65 |
| - Self-cert | **5,491.9** | **17** | 4,635.6 | 18 |
| - Standard and other specialist | **4,959.6** | **16** | 4,622.1 | 17 |
| **Total** | **31,412.3** | **100** | 26,220.1 | 100 |
| **Acquired** | | | | |
| - Buy-to-let | **2,172.1** | **27** | 1,225.9 | 25 |
| - Self-cert | **3,048.2** | **38** | 2,263.4 | 46 |
| - Standard and other specialist | **2,789.7** | **35** | 1,425.3 | 29 |
| **Total** | **8,010.0** | **100** | 4,914.6 | 100 |
| - Buy-to-let | **23,132.9** | **59** | 18,188.3 | 58 |
| - Self-cert | **8,540.1** | **22** | 6,899.0 | 22 |
| - Standard and other specialist | **7,749.3** | **19** | 6,047.4 | 20 |
| **Total residential** | **39,422.3** | **100** | 31,134.7 | 100 |
| Residential | **39,422.3** | **97** | 31,134.7 | 87 |
| Commercial property | **879.5** | **3** | 2,687.0 | 7 |
| Housing associations | **142.7** | **-** | 2,310.0 | 6 |
| **Total** | **40,444.5** | **100** | 36,131.7 | 100 |

| Company | **Balances At 31 December 2007** | | Balances At 31 December 2006 | |
|---|---|---|---|---|
| | **£m** | **%** | £m | % |
| **Residential** | | | | |
| **Originated** | | | | |
| - Buy-to-let | **16,765.1** | **69** | 11,401.0 | 66 |
| - Self-cert | **4,185.3** | **17** | 2,413.8 | 14 |
| - Standard and other specialist | **3,473.2** | **14** | 3,435.0 | 20 |
| **Total** | **24,423.6** | **100** | 17,249.8 | 100 |
| - Residential | **24,423.6** | **47** | 17,249.8 | 41 |
| - Commercial property | **879.5** | **2** | 2,687.0 | 6 |
| - Housing associations | **142.7** | **-** | 2,310.0 | 6 |
| - Group undertakings | **25,989.6** | **51** | 19,648.7 | 47 |
| **Total** | **51,435.4** | **100** | 41,895.5 | 100 |

## 11. Loan impairment

**Group**

| | On residential mortgages £m | On commercial property and housing associations £m | Total £m |
|---|---|---|---|
| Allowances have been made for credit losses against loans and advances to customers as follows: | | | |
| At 1 January 2007 | **47.8** | **1.6** | **49.4** |
| Write-offs | **(23.8)** | **-** | **(23.8)** |
| Impairment charge/(credit) | **30.4** | **(1.5)** | **28.9** |
| Discount unwind | **0.4** | **-** | **0.4** |
| | **7.0** | **(1.5)** | **5.5** |
| At 31 December 2007 | **54.8** | **0.1** | **54.9** |
| The Income Statement charge/(credit) comprised | | | |
| - Impairment charge/(credit) | **30.4** | **(1.5)** | **28.9** |
| - Recoveries | **(6.8)** | **-** | **(6.8)** |
| - Discount unwind | **0.4** | **-** | **0.4** |
| Total Income Statement charge/(credit) | **24.0** | **(1.5)** | **22.5** |
| Allowances have been made for credit losses against loans and advances to customers as follows: | | | |
| At 1 January 2006 | 46.1 | 2.3 | 48.4 |
| Write-offs | (13.9) | - | (13.9) |
| Impairment charge/(credit) | 15.4 | (0.7) | 14.7 |
| Discount unwind | 0.2 | - | 0.2 |
| | 1.7 | (0.7) | 1.0 |
| At 31 December 2006 | 47.8 | 1.6 | 49.4 |
| The Income Statement charge/(credit) comprised | | | |
| - Impairment charge/(credit) | 15.4 | (0.7) | 14.7 |
| - Recoveries | (7.5) | - | (7.5) |
| - Discount unwind | 0.2 | - | 0.2 |
| Total Income Statement charge/(credit) | 8.1 | (0.7) | 7.4 |

**Company**

| | On residential mortgages £m | On commercial property and housing associations £m | Total £m |
|---|---|---|---|
| Allowances have been made for credit losses against loans and advances to customers as follows: | | | |
| At 1 January 2007 | **11.4** | **1.6** | **13.0** |
| Write-offs | **(1.8)** | **-** | **(1.8)** |
| Impairment charge/(credit) | **6.0** | **(1.5)** | **4.5** |
| | **4.2** | **(1.5)** | **2.7** |
| At 31 December 2007 | **15.6** | **0.1** | **15.7** |
| The Income Statement charge/(credit) comprised | | | |
| - Impairment charge/(credit) | **6.0** | **(1.5)** | **4.5** |
| - Recoveries | **(4.5)** | **-** | **(4.5)** |
| Total Income Statement charge/(credit) | **1.5** | **(1.5)** | **-** |
| Allowances have been made for credit losses against loans and advances to customers as follows: | | | |
| At 1 January 2006 | 12.3 | 2.3 | 14.6 |
| Write-offs | (5.7) | - | (5.7) |
| Impairment charge/(credit) | 4.8 | (0.7) | 4.1 |
| | (0.9) | (0.7) | (1.6) |
| At 31 December 2006 | 11.4 | 1.6 | 13.0 |
| The Income Statement charge/(credit) comprised | | | |
| - Impairment charge/(credit) | 4.8 | (0.7) | 4.1 |
| - Recoveries | (5.0) | - | (5.0) |
| Total Income Statement credit | (0.2) | (0.7) | (0.9) |

In the Balance Sheet these impairment allowances are deducted from the carrying values of the impaired assets.

# Notes to the Financial Statements

## **11. Loan impairment** continued

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

| Group | At 31 December 2007 | | | At 31 December 2006 | | |
|---|---|---|---|---|---|---|
| | On residential mortgages £m | On commercial property and housing associations £m | Total £m | On residential mortgages £m | On commercial property and housing associations £m | Total £m |
| Neither past due nor impaired | **37,212.7** | **1,022.3** | **38,235.0** | 29,642.7 | 4,998.6 | 34,641.3 |
| Past due but not impaired | | | | | | |
| - up to 3 months | **1,436.2** | **-** | **1,436.2** | 988.2 | - | 988.2 |
| - 3 to 6 months | **464.6** | **-** | **464.6** | 372.8 | - | 372.8 |
| - 6 to 12 months | **208.2** | **-** | **208.2** | 98.3 | - | 98.3 |
| Individually impaired | **155.4** | **-** | **155.4** | 80.5 | - | 80.5 |
| | **39,477.1** | **1,022.3** | **40,499.4** | 31,182.5 | 4,998.6 | 36,181.1 |
| Impairment allowances | **(54.8)** | **(0.1)** | **(54.9)** | (47.8) | (1.6) | (49.4) |
| Loans and advances to customers net of impairment allowances | **39,422.3** | **1,022.2** | **40,444.5** | 31,134.7 | 4,997.0 | 36,131.7 |
| Impairment allowances | | | | | | |
| - individual | **20.0** | **-** | **20.0** | 16.9 | - | 16.9 |
| - collective | **34.8** | **0.1** | **34.9** | 30.9 | 1.6 | 32.5 |
| Total | **54.8** | **0.1** | **54.9** | 47.8 | 1.6 | 49.4 |

| Company | At 31 December 2007 | | | At 31 December 2006 | | |
|---|---|---|---|---|---|---|
| | On residential mortgages £m | On commercial property and housing associations £m | Total £m | On residential mortgages £m | On commercial property and housing associations £m | Total £m |
| Neither past due nor impaired | **23,494.2** | **1,022.3** | **24,516.5** | 16,745.5 | 4,998.6 | 21,744.1 |
| Past due but not impaired | | | | | | |
| - up to 3 months | **677.1** | **-** | **677.1** | 348.0 | - | 348.0 |
| - 3 to 6 months | **158.4** | **-** | **158.4** | 116.6 | - | 116.6 |
| - 6 to 12 months | **66.3** | **-** | **66.3** | 30.2 | - | 30.2 |
| Individually impaired | **43.2** | **-** | **43.2** | 20.9 | - | 20.9 |
| | **24,439.2** | **1,022.3** | **25,461.5** | 17,261.2 | 4,998.6 | 22,259.8 |
| Impairment allowances | **(15.6)** | **(0.1)** | **(15.7)** | (11.4) | (1.6) | (13.0) |
| Loans and advances to customers net of impairment allowances | **24,423.6** | **1,022.2** | **25,445.8** | 17,249.8 | 4,997.0 | 22,246.8 |
| Impairment allowances | | | | | | |
| - individual | **5.0** | **-** | **5.0** | 2.3 | - | 2.3 |
| - collective | **10.6** | **0.1** | **10.7** | 9.1 | 1.6 | 10.7 |
| Total | **15.6** | **0.1** | **15.7** | 11.4 | 1.6 | 13.0 |

No loans which would otherwise be presented as past due or impaired are excluded from those amounts presented above as a result of renegotiation.

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

| | Group | | Company | |
|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Neither past due nor impaired | **70,423.3** | 56,896.6 | **48,940.8** | 38,271.6 |
| Past due but not impaired | **3,278.5** | 2,396.9 | **1,650.5** | 1,069.1 |
| Individually impaired | **195.1** | 106.0 | **60.3** | 30.6 |
| | **73,896.9** | 59,399.5 | **50,651.6** | 39,371.3 |

## 11. Loan impairment continued

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

| | Group | | Company | |
|---|---|---|---|---|
| | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m |
| Neither past due nor impaired | 37,212.7 | 29,620.7 | 23,444.9 | 16,739.7 |
| Past due but not impaired | 2,107.8 | 1,456.7 | 901.5 | 494.7 |
| Individually impaired | 146.5 | 76.6 | 40.9 | 18.4 |
| | 39,467.0 | 31,154.0 | 24,387.3 | 17,252.8 |
| The individually impaired balances above include the following carrying amount of assets in possession | 88.1 | 49.0 | 21.5 | 12.9 |

The fair value of the collateral is estimated by taking the most recent valuation of the property and adjusting for house price inflation.

After a property has been taken into possession, the process for sale is designed to mitigate any loss or maximise any potential surplus for the borrower.

Typically the property is sold by private treaty, via a locally appointed agent, as quickly as possible and for the best price attainable, taking into consideration market, property and general economic conditions. If it becomes apparent that the property will not sell by private treaty, consideration is given to submitting the property to an auction, following an auction appraisal and a recommendation by the Company's appointed Asset Manager.

During 2007, arrears levels have increased as predicted following the effect of five 25bp base rate increases since August 2006 (base rates increased from 4.5% to 5.75% prior to the recent 25bp reduction on December 2007). The total number of cases three months or more in arrears and in possession has increased to 6,170 (2006: 4,337) amounting to 1.63% (2006: 1.30%) of the total book.

Indexed average loan to value (LTV)

| | Group | | Company | |
|---|---|---|---|---|
| | 2007 % | 2006 % | 2007 % | 2006 % |
| Neither past due nor impaired | **52.8** | 52.1 | **47.9** | 43.8 |
| Past due but not impaired | **64.3** | 60.9 | **54.6** | 46.3 |
| Individually impaired | **79.6** | 75.9 | **71.6** | 68.3 |
| Total book | **55.3** | 53.4 | **50.3** | 47.0 |

## 12. Secured funding

| **Group At 31 December 2007** | **Date of transaction** | **Securitised assets £m** | **Secured funding £m** |
|---|---|---|---|
| **Securitisations** | | | |
| Aire Valley Finance (No.2) plc | **October 2000** | **356.4** | **333.6** |
| Aire Valley Mortgages 2004-1 plc* | **October 2004** | **775.0** | **775.0** |
| Aire Valley Mortgages 2005-1 plc* | **April 2005** | **782.3** | **782.3** |
| Aire Valley Mortgages 2006-1 plc* | **August 2006** | **2,430.1** | **2,430.1** |
| Aire Valley Warehousing 3 Ltd* | **December 2006** | **1,000.0** | **1,000.0** |
| Aire Valley Mortgages 2007-1 plc* | **May 2007** | **2,495.1** | **2,495.1** |
| Aire Valley Mortgages 2007-2 plc* | **November 2007** | **1,156.3** | **1,156.3** |
| | | **8,995.2** | **8,972.4** |
| **Covered Bonds** | | | |
| Bradford & Bingley Covered Bonds LLP* | **May 2004** | **2,129.2** | **1,342.0** |
| Bradford & Bingley Covered Bonds LLP* | **May 2006** | **3,303.5** | **2,082.1** |
| Bradford & Bingley Covered Bonds LLP* | **June 2006** | **374.5** | **236.0** |
| Bradford & Bingley Covered Bonds LLP* | **October 2006** | **621.6** | **391.8** |
| Bradford & Bingley Covered Bonds LLP* | **June 2007** | **2,676.5** | **1,686.9** |
| Bradford & Bingley Covered Bonds LLP* | **July 2007** | **285.1** | **179.7** |
| Bradford & Bingley Covered Bonds LLP* | **September 2007** | **793.4** | **500.0** |
| Bradford & Bingley Covered Bonds LLP* | **October 2007** | **665.9** | **419.7** |
| | | **10,849.7** | **6,838.2** |
| **Total** | | **19,844.9** | **15,810.6** |

# Notes to the Financial Statements

## 12. Secured funding continued

Group

| At 31 December 2006 | Date of transaction | Securitised assets £m | Secured funding £m |
|---|---|---|---|
| Securitisations | | | |
| Aire Valley Finance (No.2) plc | October 2000 | 465.4 | 453.2 |
| Aire Valley Mortgages 2004-1 plc* | October 2004 | 1,775.0 | 1,775.0 |
| Aire Valley Mortgages 2005-1 plc* | April 2005 | 998.5 | 998.5 |
| Aire Valley Mortgages 2006-1 plc* | August 2006 | 2,430.1 | 2,430.1 |
| Aire Valley Warehousing 3 Ltd* | December 2006 | 1,000.0 | 1,000.0 |
| | | 6,669.0 | 6,656.8 |
| Covered Bonds | | | |
| Bradford & Bingley Covered Bonds LLP* | May 2004 | 1,945.7 | 1,342.0 |
| Bradford & Bingley Covered Bonds LLP* | May 2006 | 3,018.7 | 2,082.1 |
| Bradford & Bingley Covered Bonds LLP* | June 2006 | 351.9 | 242.7 |
| Bradford & Bingley Covered Bonds LLP* | October 2006 | 614.0 | 423.5 |
| | | 5,930.3 | 4,090.3 |
| Total | | 12,599.3 | 10,747.1 |

*The Company held £19,488.5m of mortgage assets as at 31 December 2007 (2006: £12,133.9m) within loans and advances to customers to secure funding of £15,477.0m (2006: £10,293.9m). The secured funding amounts above are the principal amounts calculated using the exchange rates at the date of issue. The carrying amount of this secured funding, including the hedge adjustments for hedged risk, is included in debt securities in issue (see note 22).

A 'special purpose vehicle' ('SPV') is a structure comprising one or more legal entities, set up to act as a trust for debt investors, with the aim of obtaining financing. A Group company sells to another entity the right to receive the cash flows arising on certain loans. However, the mortgage originator receives substantially all of the post-tax profit of that entity, and hence retains substantially all of the risks and rewards of the securitised loans. Hence the securitised loans are retained on the mortgage originator's Balance Sheet. For the same reason all SPVs to which the Group has transferred rights to mortgages are consolidated into the Group Financial Statements.

**(a) Aire Valley Finance (No.2) plc**
This SPV issued £1,000.0m of loan notes in October 2000 to purchase a £1,000.0m interest in mortgages. A start-up loan of £22.9m in the form of subordinated debt was provided by Bradford & Bingley plc. Securitised assets at 31 December 2007 were £356.4m (2006: £465.4m), loan notes £333.6m (2006: £453.2m) and subordinated debt £22.9m (2006: £22.9m).

**(b) Aire Valley Mortgages 2004-1 plc**
This SPV issued £2,000.0m of loan notes denominated in US Dollars, Euros and Sterling in October 2004 to purchase a £2,000.0m share in the Master Trust. £225.0m of loan notes were redeemed in September 2005, £500.0m in June 2007 and £500.0m in December 2007. At 31 December 2007 the value of the share in the Master Trust was £775.0m (2006: £1,775.0m).

**(c) Aire Valley Mortgages 2005-1 plc**
This SPV issued £998.5m of loan notes denominated in US Dollars, Euros and Sterling in April 2005 to purchase a £998.5m share in the Master Trust. In December 2007 £216.2m of loan notes were redeemed. At 31 December 2007 the value of the share in the Master Trust was £782.3m (2006: £998.5m)

**(d) Aire Valley Mortgages 2006-1 plc**
This SPV issued £2,430.1m of loan notes denominated in US Dollars, Euros and Sterling in August 2006 to purchase a £2,340.1m share in the Master Trust. At 31 December 2007 the value of the share in the Master Trust was £2,430.1m (2006: £2,430.1m).

**(e) Aire Valley Warehousing 3 Ltd**
This is a warehouse deal issued in December 2006 for £1,000.0m to purchase a £1,000.0m share in the Master Trust, and expected to mature in 2008. At 31 December 2007 the value of the share in the Master Trust was £1,000.0m (2006: £1,000.0m).

**(f) Aire Valley Mortgages 2007-1 plc**
This SPV issued £2,495.1m of loans notes denominated in US Dollars, Euros and Sterling in May 2007 to purchase a £2,495.1m share in the Master Trust. At 31 December 2007 the value of the share in the Master Trust was £2,495.1m.

**(g) Aire Valley Mortgages 2007-2 plc**
The SPV issued £1,156.3m of loan notes denominated in Euros and Sterling in November 2007 to purchase a £1,156.3m share in the Master Trust. At 31 December 2007 the value of the share in the Master Trust was £1,156.3m.

## 12. Secured funding continued

**(h) Bradford & Bingley Covered Bonds LLP**

A Euro 10,000.0m covered bond programme was launched in May 2004 with the issue of a Euro 2,000.0m note, with bullet maturity in May 2009. A covered bond is a full recourse debt instrument secured against a pool of eligible mortgages. Bradford & Bingley Covered Bonds LLP, a limited liability partnership, was formed, and a trustee was appointed to ensure compliance with the covered bond rules. The pool of mortgages remains on the Balance Sheet of the mortgage issuer. This covered bond structure represents a revolving credit agreement, the value of qualifying mortgages cannot fall below the value of the loan notes, and qualifying loans are taken into the partnership to ensure this. During 2006 the following loan notes were issued: In May 2006: Euro 1,000.0m with bullet maturity in May 2011 and Euro 2,000.0m with bullet maturity in May 2016. In June 2006: CHF 300.0m with bullet maturity in June 2012 and CHF 250.0m with bullet maturity in June 2016. In October 2006: CHF 250.0m with bullet maturity in October 2010, CHF 300.0m with bullet maturity in October 2013, CHF 250.0m with bullet maturity in October 2018, and CHF 200.0m with bullet maturity in October 2031.

During 2007 the covered bond programme issued the following series of loan notes:
In June 2007: Euro 1,250.0m with bullet maturity in June 2010 and Euro 1,250.0m with bullet maturity in June 2017. In July 2007: CHF 200.0m with bullet maturity in July 2011, CHF 150.0m with bullet maturity in July 2027 and CHF 200.0m with bullet maturity in July 2015. In September 2007: £500.0m with bullet maturity in September 2009. In October 2007: Euro £500.0m with bullet maturity in October 2008 and Euro £100.0m with bullet maturity in October 2010. In October 2007: CHF 75.0m of the October 2006 issue and CHF 75.0m of the July 2007 issue were repurchased and cancelled. In December 2007: CHF 15.0m of the June 2006 issue and CHF 35.0m of the July 2007 issue were repurchased and cancelled.

As at December 2007 the funding of £6,838.2m (2006: £4,090.3m) was secured against £10,849.7m (2006: £5,930.3m) of mortgages.

## 13. Debt securities

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m |
| Investment securities issued by public bodies | | | | |
| - Government securities | **1,518.8** | 425.3 | **1,518.8** | 425.3 |
| Investment securities issued by other issuers | | | | |
| - Bank and building society certificates of deposit | **1,223.6** | 1,092.9 | **1,171.5** | 861.5 |
| - Other debt securities | **4,036.3** | 3,781.7 | **4,707.9** | 3,554.1 |
| | **6,778.7** | 5,299.9 | **7,398.2** | 4,840.9 |
| Analysis of debt securities by listing status | | | | |
| - Listed | **6,145.2** | 4,133.0 | **6,092.0** | 3,905.4 |
| - Unlisted | **633.5** | 1,166.9 | **1,306.2** | 935.5 |
| | **6,778.7** | 5,299.9 | **7,398.2** | 4,840.9 |

Debt securities are carried at fair value, which has been calculated through reference to market price. Where no reliable market price exists an assessment has been made as to the value of the debt security. This assessment was based on modelling the present value of future expected cash flows, using a discount curve adjusted for credit spread and liquidity, utilising information from a number of sources, including fund manager expectations and the performance of other similar securities. In the case of structured investment vehicles, fair value also takes into account any published restructuring proposals.

Debt securities are treated as 'available-for-sale' with changes in fair value recorded as a movement in reserves or, in the case of embedded derivatives attached to collateralised debt obligations, through the Income Statement. Where fair value estimates show significant reductions in market price or where other indicators of potential impairment have occurred (for example, ratings downgrades, significant or prolonged decline in market price, or a failure of the vehicle to meet contractual liquidity requirements) impairment is assessed. Any reduction that is considered to be permanent is then taken as a charge through the investment impairment line on the income statement. Throughout 2007 all collateralised debt obligations and structured investment vehicles were tested for evidence of impairment. As a result a charge has been made to the Income Statement of £94.4m for asset impairment and £49.7m for reduction in the fair value of embedded derivatives.

# Notes to the Financial Statements

## 13. Debt securities continued

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

| Group<br>Wholesale assets<br>At 31 December | 2007<br>£m | Aaa<br>% | Aa<br>% | A<br>% | Baa1 to B3<br>% | Caa1 and below<br>% | 2006<br>£m |
|---|---|---|---|---|---|---|---|
| Cash and balances at central banks | **209.2** | 100 | - | - | - | - | 202.6 |
| Treasury bills | **185.0** | 100 | - | - | - | - | - |
| Loans and advances to banks: | | | | | | | |
| - Reverse repos | **253.4** | 100 | - | - | - | - | 0.5 |
| - Certificates of deposit | **1,344.6** | 15 | 82 | 3 | - | - | 2,043.6 |
| - Cash and other collateral | **794.1** | 24 | 76 | - | - | - | 1,257.3 |
| | **2,392.1** | 27 | 71 | 2 | - | - | 3,301.4 |
| Debt securities: | | | | | | | |
| Liquidity portfolio: | | | | | | | |
| - UK Government securities | **1,518.8** | 100 | - | - | - | - | 425.3 |
| - Bank and supranational bonds | **1,398.8** | 77 | 21 | 2 | - | - | 1,362.0 |
| - Bank certificates of deposit | **1,223.6** | 16 | 74 | 10 | - | - | 1,092.7 |
| - UK and European Aaa mortgage backed securities | **1,204.3** | 100 | - | - | - | - | 1,030.4 |
| - Other asset backed securities | **257.4** | 41 | 37 | 16 | 6 | - | 379.5 |
| | **5,602.9** | 73 | 23 | 4 | - | - | 4,289.9 |
| Investment portfolio: | | | | | | | |
| - Principal protected notes | **582.0** | 41 | 51 | 8 | - | - | 337.9 |
| - Collateralised debt obligations | **218.4** | 76 | 15 | 7 | 2 | - | 242.2 |
| - Collateralised loan obligations | **238.2** | 58 | 32 | 5 | 5 | - | 215.9 |
| - Structured investment vehicles | **63.5** | - | - | - | - | 100 | 135.7 |
| - Credit funds | **73.7** | - | 8 | 60 | 32 | - | 78.3 |
| | **1,175.8** | 46 | 35 | 10 | 4 | 5 | 1,010.0 |
| | **6,778.7** | 69 | 25 | 4 | 1 | 1 | 5,299.9 |
| Total | **9,565.0** | **59** | **36** | **3** | **1** | **1** | **8,803.9** |

Additional analysis of the underlying collateral within the investment portfolio by geographic region and by type of exposure is provided in the table below:

| Group<br>Investment portfolio<br>At 31 December | 2007<br>£m | Analysis of investment by geographic region<br>UK<br>% | Europe<br>% | US<br>% | Other<br>% | Total<br>% | Analysis of investment by type of asset<br>Mortgage backed securities<br>% | Asset backed securities<br>% | Corporate loans<br>% | Other<br>% | Total<br>% |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Principal protected notes | **582.0** | 48 | 48 | 3 | 1 | 100 | - | 3 | 62 | 35 | 100 |
| Collateralised debt obligations | **218.4** | - | 28 | 71 | 1 | 100 | 49 | - | 51 | - | 100 |
| Collateralised loan obligations | **238.2** | - | 57 | 43 | - | 100 | - | - | 100 | - | 100 |
| Structured investment vehicles | **63.5** | 21 | 19 | 52 | 8 | 100 | - | 100 | - | - | 100 |
| Credit funds | **73.7** | 9 | 91 | - | - | 100 | - | - | 74 | 26 | 100 |
| | **1,175.8** | | | | | 100 | | | | | 100 |

## 13. Debt securities continued

| Company<br>Wholesale assets<br>At 31 December | 2007<br>£m | Aaa<br>% | Aa<br>% | A<br>% | Baa1<br>to B3<br>% | Caa1 and<br>below<br>% | 2006<br>£m |
|---|---|---|---|---|---|---|---|
| Cash and balances at central banks | **209.2** | 100 | - | - | - | - | 202.6 |
| Treasury bills | **185.0** | 100 | - | - | - | - | - |
| Loans and advances to banks: | | | | | | | |
| - Reverse repos | **253.4** | 100 | - | - | - | - | 0.5 |
| - CDs | **1,344.6** | 15 | 82 | 3 | - | - | 2,043.6 |
| - Cash and other collateral | **303.9** | 35 | 65 | - | - | - | 369.4 |
| | **1,901.9** | 30 | 68 | 2 | - | - | 2,413.5 |
| Debt securities: | | | | | | | |
| Liquidity portfolio: | | | | | | | |
| - UK Government securities | **1,518.8** | 100 | - | - | - | - | 425.3 |
| - Bank and supranational bonds | **1,101.7** | 95 | 3 | 2 | - | - | 1,060.3 |
| - Bank CDs | **1,171.5** | 17 | 72 | 11 | - | - | 914.5 |
| - UK and European Aaa MBS | **1,660.0** | 100 | - | - | - | - | 1,030.4 |
| - Other asset backed securities | **555.2** | 20 | 43 | 7 | 30 | - | 379.5 |
| - Other | **215.2** | - | - | 100 | - | - | 20.9 |
| | **6,222.4** | 73 | 17 | 7 | 3 | - | 3,830.9 |
| Investment portfolio: | | | | | | | |
| - Principal protected notes | **582.0** | 41 | 51 | 8 | - | - | 337.9 |
| - CDOs | **218.4** | 76 | 15 | 7 | 2 | - | 242.2 |
| - CLOs | **238.2** | 58 | 32 | 5 | 5 | - | 215.9 |
| - SIVs | **63.5** | - | - | - | - | 100 | 135.7 |
| - Credit funds | **73.7** | - | 8 | 60 | 32 | - | 78.3 |
| | **1,175.8** | 46 | 35 | 10 | 4 | 5 | 1,010.0 |
| | **7,398.2** | 68 | 21 | 7 | 3 | 1 | 4,840.9 |
| Total | **9,694.3** | **62** | **29** | **4** | **2** | **3** | **7,457.0** |

At 31 December 2007 the Company's debt securities included £753.5m (2006: £nil) of loan notes issued by the Company's securitisation vehicles. Further information regarding the securitisation is provided in note 12.

## 14. Prepayments and accrued income

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | 2007<br>£m | 2006<br>£m | 2007<br>£m | 2006<br>£m |
| Commission receivable | **7.3** | 12.9 | **7.3** | 12.9 |
| Other | **21.2** | 12.1 | **14.8** | 7.5 |
| | **28.5** | 25.0 | **22.1** | 20.4 |

## 15. Shares in Group undertakings

| Company | 2007<br>£m | 2006<br>£m |
|---|---|---|
| At 1 January | **543.7** | 557.6 |
| Disposals | **-** | (13.9) |
| At 31 December | **543.7** | 543.7 |

During 2006 the Company disposed of its holdings in the following entities:
Bradford & Bingley Investments (Isle of Man) Ltd
Bradford & Bingley (Douglas) Ltd
Bradford & Bingley (PEPS) Ltd
Bradford & Bingley Properties Ltd
The disposal of these entities had no significant impact on the results of the Group or the Company.

# Notes to the Financial Statements

## 15. Shares in Group undertakings continued

The principal trading subsidiary undertakings of Bradford & Bingley plc at 31 December 2007 held directly or indirectly, all of which are fully consolidated into the Group Financial Statements, are listed below:

| | Country of incorporation | Major activity | Class of shares held | Interest |
|---|---|---|---|---|
| **Direct** | | | | |
| Bradford & Bingley International Ltd | Isle of Man | Offshore deposit-taking | Ordinary | 100% |
| Bradford & Bingley Investments | England | Holding company | Ordinary | 100% |
| Bradford & Bingley Treasury Services (Ireland) | England | Treasury activities | Ordinary | 100% |
| **Indirect** | | | | |
| Mortgage Express | England | Residential mortgage lending | Ordinary | 100% |

The following companies are SPVs established in connection with the Group's securitisation and covered bond programmes (see note 12). The Company has no ownership interest in these entities but they are regarded as subsidiaries as they are, in substance, controlled by the Company.

| | Country of incorporation | Major activity |
|---|---|---|
| **SPVs** | | |
| Aire Valley Finance (No.2) plc | England | Debt issuance |
| Aire Valley Mortgages 2004-1 plc | England | Debt issuance |
| Aire Valley Mortgages 2005-1 plc | England | Debt issuance |
| Aire Valley Mortgages 2006-1 plc | England | Debt issuance |
| Aire Valley Warehousing 3 Ltd | England | Debt issuance |
| Aire Valley Mortgages 2007-1 plc | England | Debt issuance |
| Aire Valley Mortgages 2007-2 plc | England | Debt issuance |
| Bradford & Bingley Covered Bonds LLP | England | Mortgage funding |

Bradford & Bingley Investments, Bradford & Bingley Treasury Services (Ireland) and Mortgage Express are all unlimited companies.
No fair value is provided in respect of shares in Group undertakings as these shares do not have a quoted market price.

## 16. Other assets

| | Group 2007 £m | Group 2006 £m | Company 2007 £m | Company 2006 £m |
|---|---|---|---|---|
| Consideration due in respect of sale of assets | **645.9** | - | **645.9** | - |
| Deposits by banks awaiting settlement | **-** | 16.8 | **-** | 16.8 |
| Other | **5.7** | 4.5 | **4.3** | 3.1 |
| Available-for-sale equity investments | **2.1** | - | **2.1** | - |
| | **653.7** | 21.3 | **652.3** | 19.9 |

## 17. Deferred taxation

The net deferred taxation asset is attributable to the following:

| Group | Assets 2007 £m | Assets 2006 £m | Liabilities 2007 £m | Liabilities 2006 £m | Net 2007 £m | Net 2006 £m |
|---|---|---|---|---|---|---|
| Change in accounting basis on adoption of IFRS | **14.1** | 17.0 | **(19.2)** | (23.1) | **(5.1)** | (6.1) |
| Cash flow hedge | **23.4** | - | **-** | (8.9) | **23.4** | (8.9) |
| Accelerated tax depreciation | **3.7** | 4.6 | **-** | (3.6) | **3.7** | 1.0 |
| Other | **1.2** | 7.0 | **(2.5)** | (1.8) | **(1.3)** | 5.2 |
| Employee benefits | **27.6** | 24.8 | **(24.5)** | (7.4) | **3.1** | 17.4 |
| Taxation value of losses carried forward | **-** | - | **-** | (2.9) | **-** | (2.9) |
| | **70.0** | 53.4 | **(46.2)** | (47.7) | **23.8** | 5.7 |
| Offset | **(46.2)** | (47.7) | **46.2** | 47.7 | **-** | - |
| | **23.8** | 5.7 | **-** | - | **23.8** | 5.7 |

## 17. Deferred taxation continued

**Company**

| | Assets | | Liabilities | | Net | |
|---|---|---|---|---|---|---|
| | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m |
| Change in accounting basis on adoption of IFRS | **8.5** | 10.2 | **(14.7)** | (17.7) | **(6.2)** | (7.5) |
| Cash flow hedge | **23.4** | - | **-** | (8.9) | **23.4** | (8.9) |
| Accelerated tax depreciation | **1.5** | 3.4 | **-** | - | **1.5** | 3.4 |
| Other | **-** | 3.5 | **-** | 0.1 | **-** | 3.6 |
| Employee benefits | **27.6** | 24.8 | **(24.5)** | (7.4) | **3.1** | 17.4 |
| Taxation value of losses carried forward | **-** | | **-** | - | **-** | - |
| | **61.0** | 41.9 | **(39.2)** | (33.9) | **21.8** | 8.0 |
| Offset | **(39.2)** | (33.9) | **39.2** | 33.9 | **-** | - |
| | **21.8** | 8.0 | **-** | - | **21.8** | 8.0 |

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

| | **At 1 January 2007 £m** | **Recognised in income £m** | **Recognised in equity £m** | **At 31 December 2007 £m** |
|---|---|---|---|---|
| Change in accounting basis on adoption of IFRS | **(6.1)** | **1.0** | **-** | **(5.1)** |
| Cash flow hedge | **(8.9)** | **-** | **32.3** | **23.4** |
| Accelerated tax depreciation | **1.0** | **2.7** | **-** | **3.7** |
| Other | **5.2** | **(6.5)** | **-** | **(1.3)** |
| Employee benefits | **17.4** | **2.6** | **(16.9)** | **3.1** |
| Taxation value of losses carried forward | **(2.9)** | **2.9** | **-** | **-** |
| | **5.7** | **2.7** | **15.4** | **23.8** |

| | At 1 January 2006 £m | Recognised in income £m | Recognised in equity £m | At 31 December 2006 £m |
|---|---|---|---|---|
| Change in accounting basis on adoption of IFRS | (6.8) | 0.7 | - | (6.1) |
| Cash flow hedge | - | - | (8.9) | (8.9) |
| Accelerated tax depreciation | 1.5 | (0.5) | - | 1.0 |
| Other | (2.2) | 0.8 | 6.6 | 5.2 |
| Employee benefits | 38.1 | (15.2) | (5.5) | 17.4 |
| Taxation value of losses carried forward | (2.9) | - | - | (2.9) |
| | 27.7 | (14.2) | (7.8) | 5.7 |

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

| | **At 1 January 2007 £m** | **Recognised in income £m** | **Recognised in equity £m** | **At 31 December 2007 £m** |
|---|---|---|---|---|
| Change in accounting basis on adoption of IFRS | **(7.5)** | **1.3** | **-** | **(6.2)** |
| Cash flow hedge | **(8.9)** | **-** | **32.3** | **23.4** |
| Accelerated tax depreciation | **3.4** | **(1.9)** | **-** | **1.5** |
| Other | **3.6** | **(3.6)** | **-** | **-** |
| Employee benefits | **17.4** | **2.6** | **(16.9)** | **3.1** |
| | **8.0** | **(1.6)** | **15.4** | **21.8** |

| | At 1 January 2006 £m | Recognised in income £m | Recognised in equity £m | At 31 December 2006 £m |
|---|---|---|---|---|
| Change in accounting basis on adoption of IFRS | (8.3) | 0.8 | - | (7.5) |
| Cash flow hedge | - | - | (8.9) | (8.9) |
| Accelerated tax depreciation | 3.4 | - | - | 3.4 |
| Other | (9.0) | 6.0 | 6.6 | 3.6 |
| Employee benefits | 38.1 | (15.2) | (5.5) | 17.4 |
| | 24.2 | (8.4) | (7.8) | 8.0 |

Deferred taxation appropriately reflects the change to the standard rate of UK corporation tax from 30% to 28% which will become effective on 1 April 2008.

# Notes to the Financial Statements

## 18. Property, plant and equipment

| Group | Land and buildings £m | Equipment, fixtures and vehicles £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2007 | **99.8** | **94.6** | **194.4** |
| Additions | **1.1** | **28.2** | **29.3** |
| Disposals | **(6.3)** | **(15.1)** | **(21.4)** |
| At 31 December 2007 | **94.6** | **107.7** | **202.3** |
| **Depreciation** | | | |
| At 1 January 2007 | **30.1** | **73.5** | **103.6** |
| Depreciation charge for the year | **1.1** | **6.6** | **7.7** |
| Disposals | **(3.1)** | **(12.4)** | **(15.5)** |
| At 31 December 2007 | **28.1** | **67.7** | **95.8** |
| **Net book value** | | | |
| At 1 January 2007 | **69.7** | **21.1** | **90.8** |
| At 31 December 2007 | **66.5** | **40.0** | **106.5** |

| Group | Land and buildings £m | Equipment, fixtures and vehicles £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2006 | 103.3 | 105.5 | 208.8 |
| Additions | 0.2 | 7.7 | 7.9 |
| Disposals | (3.7) | (18.6) | (22.3) |
| At 31 December 2006 | 99.8 | 94.6 | 194.4 |
| **Depreciation** | | | |
| At 1 January 2006 | 31.2 | 84.7 | 115.9 |
| Depreciation charge for the year | 1.3 | 5.7 | 7.0 |
| Disposals | (2.4) | (16.9) | (19.3) |
| At 31 December 2006 | 30.1 | 73.5 | 103.6 |
| **Net book value** | | | |
| At 1 January 2006 | 72.1 | 20.8 | 92.9 |
| At 31 December 2006 | 69.7 | 21.1 | 90.8 |

Sale proceeds from asset disposals were £4.4m (2006: £1.9m) resulting in a loss on sale of £0.2m (2006: £0.2m). In addition, sale proceeds from the sale and leaseback of land and buildings were £10.1m (2006: £6.6m) resulting in a profit of £8.8m (2006: £5.7m) which has been included in the Income Statement in non-operating income.

There are no restrictions on the Group's title to any of its property, plant and equipment, and none of the Group's property, plant and equipment has been pledged as security.

## 18. Property, plant and equipment continued

| Company | Land and buildings £m | Equipment, fixtures and vehicles £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2007 | **93.1** | **82.7** | **175.8** |
| Additions | **1.1** | **25.7** | **26.8** |
| Disposals | **(6.2)** | **(8.9)** | **(15.1)** |
| At 31 December 2007 | **88.0** | **99.5** | **187.5** |
| **Depreciation** | | | |
| At 1 January 2007 | **29.0** | **67.3** | **96.3** |
| Depreciation charge for the year | **1.0** | **6.1** | **7.1** |
| Disposals | **(3.0)** | **(8.7)** | **(11.7)** |
| At 31 December 2007 | **27.0** | **64.7** | **91.7** |
| **Net book value** | | | |
| At 1 January 2007 | **64.1** | **15.4** | **79.5** |
| At 31 December 2007 | **61.0** | **34.8** | **95.8** |
| **Cost** | | | |
| At 1 January 2006 | 96.6 | 92.7 | 189.3 |
| Additions | 0.2 | 5.7 | 5.9 |
| Disposals | (3.7) | (15.7) | (19.4) |
| At 31 December 2006 | 93.1 | 82.7 | 175.8 |
| **Depreciation** | | | |
| At 1 January 2006 | 30.3 | 77.7 | 108.0 |
| Depreciation charge for the year | 1.1 | 5.2 | 6.3 |
| Disposals | (2.4) | (15.6) | (18.0) |
| At 31 December 2006 | 29.0 | 67.3 | 96.3 |
| **Net book value** | | | |
| At 1 January 2006 | 66.3 | 15.0 | 81.3 |
| At 31 December 2006 | 64.1 | 15.4 | 79.5 |

Sale proceeds from asset disposals were £2.1m (2006: £0.5m) resulting in a loss on sale of £nil (2006: £nil). In addition, sale proceeds from the sale and leaseback of land and buildings were £10.1m (2006: £6.6m) resulting in a profit of £8.8m (2006: £5.7m) which has been included in the Income Statement in non-operating income.

# Notes to the Financial Statements

## 19. Intangible assets

| | Group £m | Company £m |
|---|---|---|
| **Cost** | | |
| At 1 January 2007 | **114.3** | **66.9** |
| Additions | **5.0** | **0.1** |
| Disposals | **(9.3)** | **(9.3)** |
| At 31 December 2007 | **110.0** | **57.7** |
| **Amortisation** | | |
| At 1 January 2007 | **59.1** | **45.0** |
| Amortisation charge for the year | **14.9** | **5.1** |
| Disposals | **(5.0)** | **(5.0)** |
| At 31 December 2007 | **69.0** | **45.1** |
| **Net book value** | | |
| At 1 January 2007 | **55.2** | **21.9** |
| At 31 December 2007 | **41.0** | **12.6** |
| **Cost** | | |
| At 1 January 2006 | 102.8 | 62.6 |
| Additions | 18.7 | 11.5 |
| Disposals | (7.2) | (7.2) |
| At 31 December 2006 | 114.3 | 66.9 |
| **Amortisation** | | |
| At 1 January 2006 | 55.3 | 48.9 |
| Amortisation charge for the year | 11.0 | 3.3 |
| Disposals | (7.2) | (7.2) |
| At 31 December 2006 | 59.1 | 45.0 |
| **Net book value** | | |
| At 1 January 2006 | 47.5 | 13.7 |
| At 31 December 2006 | 55.2 | 21.9 |

Intangible software with a book value of £4.3m (2006: £nil) has been written off by the Group and Company during the year due to the software being of no continuing use to the business.

## 20. Deposits by banks

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m |
| Items in the course of transmission | **30.5** | 106.7 | **29.1** | 105.0 |
| Other amounts due to banks | **2,043.9** | 1,405.7 | **1,629.4** | 780.8 |
| | **2,074.4** | 1,512.4 | **1,658.5** | 885.8 |

## 21. Customer Accounts

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m |
| Amounts due to subsidiary undertakings | **-** | - | **22,420.9** | 15,334.9 |
| Amounts due to customers | **24,152.6** | 22,201.0 | **21,180.9** | 19,207.9 |
| | **24,152.6** | 22,201.0 | **43,601.8** | 34,542.8 |

## 22. Debt securities in issue

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m |
| Bonds and medium term notes | **12,668.8** | 10,296.0 | **13,175.3** | 10,296.0 |
| Other debt securities in issue | **9,639.3** | 7,545.3 | **1,233.8** | 950.5 |
| | **22,308.1** | 17,841.3 | **14,409.1** | 11,246.5 |

The Group and Company issue debt securities to securitise loans and advances to customers through special purpose vehicles as described in note 12. These debt securities are included in the amounts above. Certain debt securities in issue, including those issued through SPVs, are subject to fair value hedge designation and are adjusted to reflect the fair value of the risk being hedged.

## 23. Other liabilities

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Income tax | **56.0** | 42.5 | **54.6** | 41.3 |
| Surplus conversion shares | **25.7** | 26.2 | **25.7** | 26.2 |
| Other creditors | **59.5** | 46.9 | **47.8** | 40.4 |
| | **141.2** | 115.6 | **128.1** | 107.9 |

The income tax liability comprises taxes deducted at source from interest paid to investors and from remuneration of employees and Directors.

## 24. Accruals and deferred income

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Accrued interest on subordinated liabilities | **32.1** | 19.6 | **37.7** | 25.8 |
| Accrued interest on other capital instruments | **5.6** | 6.1 | **-** | - |
| Deferred income | **2.1** | 2.8 | **2.1** | 2.8 |
| Other | **44.3** | 55.9 | **45.6** | 55.5 |
| | **84.1** | 84.4 | **85.4** | 84.1 |

## 25. Post-retirement benefit obligations

**(a) Pension schemes**
The Group operates a closed defined benefit staff pension scheme, the Bradford & Bingley Staff Pension Scheme ('the principal scheme'), which is administered by trustees. The funds are independent from those of the Group. The normal pension age of employees in the scheme is 65.

The Group also operates a defined contribution scheme, the Bradford & Bingley Group Pension Plan. The funds of this scheme are independent from those of the Group. The Group and Company had no liabilities or prepayments associated with the defined contribution scheme at 31 December 2007 (2006: £nil). The cost in the year to the Group of the defined contribution scheme was £1.4m (2006: £1.2m) and the cost to the Company was £1.0m (2006: £0.9m).

**(b) Other post-retirement benefits**
The Group provides healthcare benefits to some of its pensioners. The healthcare benefits are provided through a post-retirement medical scheme into which the Company contributes 100% towards the cost of providing medical expense benefits for members who retired before 1 January 1996 and 50% for members who retired after this date. The total number of members of the scheme as at 31 December 2007 was 515 (2006: 557). Private medical costs are assessed in accordance with the advice of a qualified actuary.

**(c) Accounting treatment**
The Group accounts for post-retirement benefit costs in accordance with IAS 19. The full net actuarial deficit is carried on the Group and Company Balance Sheets, and actuarial gains and losses are taken to Group and Company retained earnings rather than being charged or credited in the Income Statement. The actuarial gain recognised in the Group and Company retained earnings during the year was £53.3m (2006: £20.1m).

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

**(d) Employee benefit obligations**
The amounts carried in the Group and Company Balance Sheets are as follows:

| | Defined benefit pension plans | | Post-retirement medical benefits | | Total | |
|---|---|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Present value of funded obligations | **586.8** | 621.9 | **11.0** | 10.6 | **597.8** | 632.5 |
| Fair value of plan assets | **(575.8)** | (549.3) | **-** | - | **(575.8)** | (549.3) |
| Net liability | **11.0** | 72.6 | **11.0** | 10.6 | **22.0** | 83.2 |
| Amounts carried in the Balance Sheet: | | | | | | |
| - Liabilities | **11.0** | 72.6 | **11.0** | 10.6 | **22.0** | 83.2 |

# Notes to the Financial Statements

## 25. Post-retirement benefit obligations continued

**(d) Employee benefit obligations** continued

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

| | Defined benefit pension plans | | Post-retirement medical benefits | | Total | |
|---|---|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Current service cost | 7.5 | 7.5 | 0.1 | 0.1 | 7.6 | 7.6 |
| Interest on plan obligations | 29.9 | 28.3 | 0.5 | 0.4 | 30.4 | 28.7 |
| Expected return on plan assets | (34.4) | (29.1) | - | - | (34.4) | (29.1) |
| | 3.0 | 6.7 | 0.6 | 0.5 | 3.6 | 7.2 |
| Actual return on plan assets | 27.5 | 45.7 | - | - | 27.5 | 45.7 |

All amounts above have also been recognised in the Company Income Statement with the exception of £1.4m (2006: £1.7m) of the current service cost which has been recognised within other Group companies.

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

| | Defined benefit pension plans | | Post-retirement medical benefits | | Total | |
|---|---|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Opening defined benefit obligations | 621.9 | 604.2 | 10.6 | 8.7 | 632.5 | 612.9 |
| Current service cost | 7.5 | 7.5 | 0.1 | 0.1 | 7.6 | 7.6 |
| Contributions by employees | 0.9 | 0.9 | - | - | 0.9 | 0.9 |
| Interest on plan obligations | 29.9 | 28.3 | 0.5 | 0.4 | 30.4 | 28.7 |
| Actuarial (gain)/loss | (60.4) | (5.3) | 0.2 | 1.8 | (60.2) | (3.5) |
| Benefits paid | (13.0) | (13.7) | (0.4) | (0.4) | (13.4) | (14.1) |
| Closing defined benefit obligations | 586.8 | 621.9 | 11.0 | 10.6 | 597.8 | 632.5 |

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

| | Defined benefit pension plans | | Post-retirement medical benefits | | Total | |
|---|---|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Opening fair value of plan assets | 549.3 | 500.7 | - | - | 549.3 | 500.7 |
| Expected return on plan assets | 34.4 | 29.1 | - | - | 34.4 | 29.1 |
| Contributions by employing entities | 11.0 | 14.9 | 0.4 | 0.4 | 11.4 | 15.3 |
| Contributions by employees | 0.9 | 0.9 | - | - | 0.9 | 0.9 |
| Actuarial (loss)/gain | (6.9) | 16.6 | - | - | (6.9) | 16.6 |
| Benefits paid | (12.9) | (12.9) | (0.4) | (0.4) | (13.3) | (13.3) |
| Closing fair value of plan assets | 575.8 | 549.3 | - | - | 575.8 | 549.3 |

The Group expects to contribute £10.1m to its defined benefit pension plans in 2008.

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

| | 2007 | 2006 |
|---|---|---|
| Equities | 44% | 47% |
| Property | 15% | 15% |
| Bonds | 27% | 7% |
| Gilts | 6% | 26% |
| Cash and other | 8% | 5% |
| | 100% | 100% |

## 25. Post-retirement benefit obligations continued

**(d) Employee benefit obligations** continued

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

| | 2007 | 2006 |
|---|---|---|
| **To determine benefit obligations** | | |
| Discount rate at 31 December | **5.8%** | 5.1% |
| Future pension increases | **3.4%** | 3.1% |
| Rate of salary increase | **5.4%** | 5.1% |
| **To determine the net pension cost** | | |
| Expected return on plan assets | **6.3%** | 5.8% |
| Discount rate | **5.1%** | 4.7% |
| Rate of salary increase | **5.1%** | 4.8% |
| **For post-retirement medical plan** | | |
| Discount rate | **5.8%** | 5.1% |
| Inflation | **3.4%** | 3.1% |
| Medical cost trend for 2007 | **6.5%** | 7.3% |
| Medical cost trend falling linearly for 2008-2009 | **6.5% to 5.5%** | 7.3% to 4.5% |
| Medical cost trend falling linearly for 2010-2011 | **5.5%** | 5.9% to 4.5% |
| Medical cost trend from 2012 | **5.5%** | 4.5% |

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

The principal assumption made on life expectancy for active and retired members was to use PA92 (YOB) base rated up by 2 years. As an illustration of the mortality rates used, the future life expectancies from age 60 are shown below:

| | Males | Females |
|---|---|---|
| Non-retired members' life expectancy* | 25.9 | 28.7 |
| Retired members' life expectancy** | 23.8 | 26.8 |

* based on 1965 year of birth

** based on 1935 year of birth

**Sensitivity**

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

| Assumption | Change in assumption | Impact on benefit obligation |
|---|---|---|
| Discount rate | Decrease by 0.5% | Increase by 11.9% |
| Inflation | Increase by 0.5% | Increase by 10.4% |
| Salary growth above inflation | Increase by 0.5% | Increase by 1.8% |
| Mortality | Decrease by 1 year | Increase by 2.3% |

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

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

| | 2007 £m | 2006 £m |
|---|---|---|
| Effect on the aggregate of service cost and interest cost | **0.1** | 0.1 |
| Effect on defined benefit obligations | **1.9** | 1.9 |

| | 2007 £m | 2006 £m |
|---|---|---|
| Experience adjustments on post-retirement medical plan liabilities: reduction in liability of | **0.1** | 0.1 |

## 26. Provisions

| Group and Company | Empty leasehold premises £m | Compensation claims £m | Restructuring costs £m | Pension review £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2007 | **2.7** | **84.9** | **7.1** | **0.1** | **94.8** |
| Charged in the year | **0.3** | **-** | **5.7** | **-** | **6.0** |
| Utilised in the year | **(2.1)** | **(34.2)** | **(4.7)** | **(0.1)** | **(41.1)** |
| At 31 December 2007 | **0.9** | **50.7** | **8.1** | **-** | **59.7** |

# Notes to the Financial Statements

## 26. Provisions continued

**Empty leasehold premises**
The empty leasehold premises provision relates to properties which, as at the Balance Sheet date, were no longer used for trading but were subject to a lease agreement. The provision is based on either known or forecast future rental expenditure; the rental payments are due to be made during the period 2008 to 2017.

**Compensation claims**
Compensation claims relate to potential payments to customers for business written in the past by the Group's independent advisory business. The provision is calculated on the basis of a reasonable estimate of the size and expected timing of claims. External factors such as the performance of the stock market and market agitation could influence both the size and timing of payments.

**Restructuring costs**
Other restructuring costs relate to redundancies and contract terminations which had occurred by the Balance Sheet date. The provision represents amounts expected to be paid in 2008. It also includes a provision for an insurance premium to cover the professional indemnity liability associated with businesses disposed of during 2004; the liability will run off over the next three years.

**Pension review**
The pension review provision was established to cover compensation payable in connection with phases one and two of the pension review and also a review of free-standing additional voluntary contributions. The provision was fully expensed during the year.

## 27. Subordinated liabilities

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m |
| Dated | | | | |
| - Sterling subordinated notes due 2010 | **128.1** | 128.5 | **128.1** | 128.5 |
| - Sterling perpetual subordinated notes due 2013 | **243.6** | 240.0 | **243.6** | 240.0 |
| - Sterling fixed rate step-up subordinated notes due 2018 | **249.2** | 246.2 | **249.2** | 246.2 |
| - Sterling perpetual subordinated notes due 2019 | **202.4** | 202.4 | **202.4** | 202.4 |
| - Sterling fixed rate step-up subordinated notes due 2022 | **198.9** | 198.2 | **198.9** | 198.2 |
| - Sterling subordinated notes due 2023 | **126.5** | 126.7 | **126.5** | 126.7 |
| - Sterling perpetual subordinated notes due 2032 | **-** | - | **161.6** | 165.2 |
| - Sterling subordinated notes due 2054 | **-** | - | **150.0** | 149.6 |
| | **1,148.7** | 1,142.0 | **1,460.3** | 1,456.8 |
| Undated | | | | |
| - 13% sterling perpetual subordinated bonds | **55.0** | 55.0 | **55.0** | 55.0 |
| - 11.625% sterling perpetual subordinated bonds | **50.0** | 50.0 | **50.0** | 50.0 |
| | **1,253.7** | 1,247.0 | **1,565.3** | 1,561.8 |

The carrying values of the liabilities are on an EIR basis which takes into account issue costs. The carrying value of individually hedged items also includes hedge accounting adjustments to reflect changes in fair value of hedged risks.

The sterling subordinated notes due 2010 pay interest at a rate of 7.625% per annum until their maturity. The sterling perpetual subordinated notes due 2013 pay interest at a rate of 5.625% per annum until their maturity and are redeemable by the issuer at its option on 20 December 2013 and on each fifth anniversary thereafter. The sterling fixed rate step-up subordinated notes due 2018 pay interest at a rate of 5.5% per annum until 15 January 2013 when the Company may either redeem them or pay interest at a rate of 0.83% above the three month GBP LIBOR. The sterling perpetual subordinated notes due 2019 pay interest at a rate of 6% per annum until their maturity and are redeemable by the issuer at its option on 10 December 2019 and on each fifth anniversary thereafter. The sterling fixed rate step-up subordinated notes due 2022 pay interest at a rate of 5.75% per annum until 12 December 2017 when the Company may either redeem them, or pay a rate of interest 2% above the relevant five year gilt. The sterling subordinated notes due 2023 pay interest at a rate of 6.625% until their maturity. The sterling perpetual subordinated notes due 2032 pay interest at a rate of 6.462% until 2 June 2032 when the Company may either redeem them, or pay interest at a rate 2.3% above the relevant five year gilt. The sterling subordinated notes due 2054 pay interest quarterly at a rate of 1.3% above the three month GBP LIBOR, and can be redeemed at the option of the Company on the March 2015 interest payment date or any subsequent interest payment date. The interest on both issues of perpetual subordinated bonds, which have no maturity date, is payable half-yearly in arrears. Interest incurred by the Group in 2007 with respect to subordinated liabilities was £82.0m (2006: £79.9m) and by the Company was £91.7m (2006: £98.6m).

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

## 28. Other capital instruments

| At 31 December | Group | |
|---|---|---|
| | **2007 £m** | 2006 £m |
| Perpetual preferred securities | **161.6** | 165.2 |
| | **161.6** | 165.2 |

The carrying values of these liabilities are on an EIR basis which takes into account issue costs. The carrying value of individually hedged items also includes hedge accounting adjustments to reflect changes in the fair value of hedged risks.

On 29 May 2002, £150.0m (£148.5m net of expenses) of 6.462% guaranteed, non-voting, non-cumulative, perpetual preferred securities, Series A, were issued through Bradford & Bingley Capital Funding L.P., a Jersey based Limited Partnership. These securities are not subject to any mandatory redemption provisions and qualify as tier 1 regulatory capital; they are redeemable by the issuer at its option on 2 June 2032 and on each fifth anniversary thereafter. They have a fixed coupon and, if not redeemed in 2032, the coupon will be reset at a rate equal to the sum of the relevant five year benchmark gilt rate plus a margin of 2.3% per annum. The Group is not obliged to, and will not, make any payments to the holders of the preferred securities other than those to which the holders of these securities are entitled under the terms of the preferred securities. Interest incurred in 2007 in respect of these securities was £9.7m (2006: £9.7m).

## 29. Share capital

Group and Company ordinary shares of 25p each:

| | 2007 Number of shares (m) | 2006 | 2007 £m | 2006 £m |
|---|---|---|---|---|
| Ordinary shares authorised as at 1 January and 31 December | **882.0** | 882.0 | **220.5** | 220.5 |
| Ordinary shares issued and fully paid as at 1 January | **634.4** | 634.4 | **158.6** | 158.6 |
| Ordinary shares repurchased and cancelled during the year | **(16.7)** | - | **(4.2)** | - |
| Ordinary shares issued and fully paid as at 31 December | **617.7** | 634.4 | **154.4** | 158.6 |

The issued share capital has reduced as a result of a share buy back programme approved by the shareholders at the Annual General Meeting in 2007. During 2007 16,750,000 shares were purchased for cancellation at a cost of £58.6m including commissions and Stamp Duty.

At 31 December 2007 the closing market price of Bradford & Bingley plc shares was 268.00p (2006: 470.25p).

As at 31 December 2007 6,630,132 of the Company's shares (2006: 3,547,889) were held by trusts for the purpose of satisfying the obligations of incentive plans; further details of these incentive plans are given below. The cost to the Group of these shares is accounted for as a deduction from retained earnings of £23.9m (2006: £10.4m). The Company has one class of shares: ordinary shares of 25p each, ranking equally in respect of rights attaching to voting, dividends and in the event of a winding-up.

**Bradford & Bingley Employees' Share Trust**

On 3 October 2000 the Company established an offshore employee share trust, the Bradford & Bingley Employees' Share Trust, for the purpose of receiving monies and acquiring shares to be used in conjunction with any employee share schemes established by the Company. At 31 December 2007 the trustee of this trust, Halifax EES Trustees International Limited, held 6,630,132 (2006: 3,320,380) shares to satisfy share awards and options which have been made or are to be made in accordance with the rules of the employee share schemes established by the Company.
The trust has waived in full its rights to receive dividends on the shares held except in respect of the Executive Incentive Plan where dividends are received in full by the trust and distributed to the underlying beneficial holders of the shares. This trust currently holds shares relating to the Executive Share Option Scheme, the Sharesave Scheme, the Employees' Restricted Share Bonus Plan and the Executive Incentive Plan which are detailed in note 31. During the year the Company provided £18.7m (2006: £nil) in funds to purchase 4,500,000 (2006: nil) shares.

**Executive Share Option Scheme**

Grants of approved and unapproved share options were made under the rules of the Bradford & Bingley 2000 Share Option Scheme as detailed in note 31. The shares are exercisable subject to the achievement of a performance target linked to an increase in the Company's earnings per share. The options over shares are exercisable over the period of three to ten years after the date of the grant. At the year end there were options outstanding over 635,620 shares (2006: 772,222).

**Sharesave Scheme**

The Company operates the Bradford & Bingley 2000 Sharesave Scheme, an Inland Revenue approved all-employee Save As You Earn share option scheme. Grants of share options under this scheme were made as detailed in note 31. The option prices represent a 20% discount to the market price on the date of the grant. There were 1,431 three year and 492 five year savings contracts in place at the end of 2007 represented by a total of 2,010,331 shares under option (2006: 2,355,725). A further invitation to participate in the scheme will be issued in February 2008.

On 8 December 2000 the Bradford & Bingley Qualifying Employee Share Ownership Trust was established to acquire shares for employees, including Directors, to satisfy options exercised under the Sharesave Scheme. Once the total shares held by the trust had been used the trust was terminated and at 31 December 2007 the trust held no shares (2006: 227,509) to satisfy options. In respect of dividends arising on the shares held, the trust waived its rights to all but 0.0001 pence per share. The duty to provide shares to satisfy Sharesave Scheme exercises was assumed by the Bradford & Bingley Employees' Share Trust.

**Employees' Restricted Share Bonus Plan**

In April 2002 the Employees' Restricted Share Bonus Plan was established to allocate shares to employees following the achievement of specified performance measures. The shares will be released to the individuals in tranches annually in the three years following the allocation or on the third anniversary of the award, depending on the conditions under which they were awarded, and subject to them remaining employed by the Company on the anniversary dates. At the year end there were 4,620 share allocations outstanding (2006: 126,080).

**Performance Share Plan**

Shares were awarded under the rules of the Bradford & Bingley 2000 Performance Share Plan as detailed in note 31. The shares awarded under this plan have been released and no further awards have been made. There were no outstanding share awards at 31 December 2007 (2006: 1,034,950).

**Executive Incentive Plan**

The Executive Incentive Plan was established to provide a replacement to the short and long-term incentive plans for senior executives. The short term element consists of a cash payment based on the achievement of pre-determined short term performance measures and an equivalent amount of deferred shares that are held in trust for three years. Dividends receivable on the deferred shares are paid to the underlying beneficial owners of the shares. After three years the long-term element of the scheme may be applied in the form of an additional award of matching shares subject to earnings per share growth. Matching share awards will be made when compound earnings per share growth is between RPI plus 3% and RPI plus 8%. The maximum number of matching shares will be three matching shares for each deferred share. At 31 December 2007 there were 965,410 deferred shares held in trust (2006: 586,088).

# Notes to the Financial Statements

## 30. Reconciliation of changes in equity

| Group | Share capital £m | Share premium reserve £m | Capital redemption reserve £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Retained earnings £m | Attributable to equity holders £m |
|---|---|---|---|---|---|---|---|
| At 1 January 2007 | **158.6** | **4.9** | **25.0** | **(1.5)** | **20.6** | **1,212.3** | **1,419.9** |
| Net change in available-for-sale instruments | - | - | - | **(60.4)** | - | - | **(60.4)** |
| Net change in cash flow hedges | - | - | - | - | **(81.0)** | - | **(81.0)** |
| Actuarial gains on post-retirement benefit obligations | - | - | - | - | - | **37.9** | **37.9** |
| Net (losses)/gains not recognised in the Income Statement | - | - | - | **(60.4)** | **( 81.0)** | **37.9** | **(103.5)** |
| Profit for the financial year | | | | - | - | **93.2** | **93.2** |
| Total recognised (expense)/income | - | - | - | **(60.4)** | **(81.0)** | **131.1** | **(10.3)** |
| Dividends | - | - | - | - | - | **(126.5)** | **(126.5)** |
| Use of own shares on exercise of employee options and for other employee share plans | - | - | - | - | - | **5.2** | **5.2** |
| Fair value of share options taken to share option reserve | - | - | - | - | - | **4.6** | **4.6** |
| Deficit on share option exercises | - | - | - | - | - | **(4.8)** | **(4.8)** |
| Purchase of own shares held to satisfy employee share plans | - | - | - | - | - | **(18.7)** | **(18.7)** |
| Purchase and cancellation of own shares | **(4.2)** | - | **4.2** | - | - | **(58.6)** | **(58.6)** |
| At 31 December 2007 | **154.4** | **4.9** | **29.2** | **(61.9)** | **(60.4)** | **1,144.6** | **1,210.8** |

| Group | Share capital £m | Share premium reserve £m | Capital redemption reserve £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Retained earnings £m | Attributable to equity holders £m |
|---|---|---|---|---|---|---|---|
| At 1 January 2006 | 158.6 | 4.9 | 25.0 | 6.2 | 15.8 | 1,129.8 | 1,340.3 |
| Net change in available-for-sale instruments | - | - | - | (7.7) | - | - | (7.7) |
| Net change in cash flow hedges | - | - | - | - | 4.8 | - | 4.8 |
| Actuarial gains on post-retirement benefit obligations | - | - | - | - | - | 14.1 | 14.1 |
| Net (losses)/gains not recognised in the Income Statement | - | - | - | (7.7) | 4.8 | 14.1 | 11.2 |
| Profit for the financial year | - | - | - | - | - | 177.7 | 177.7 |
| Total recognised (expense)/income | - | - | - | (7.7) | 4.8 | 191.8 | 188.9 |
| Dividends | - | - | - | - | - | (119.2) | (119.2) |
| Use of own shares on exercise of employee options and for other employee share plans | - | - | - | - | - | 7.8 | 7.8 |
| Fair value of share options taken to share option reserve | - | - | - | - | - | 4.6 | 4.6 |
| Deficit on share option exercises | - | - | - | - | - | (2.5) | (2.5) |
| At 31 December 2006 | 158.6 | 4.9 | 25.0 | (1.5) | 20.6 | 1,212.3 | 1,419.9 |

| Company | Share capital £m | Share premium reserve £m | Capital redemption reserve £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Retained earnings £m | Attributable to equity holders £m |
|---|---|---|---|---|---|---|---|
| At 1 January 2007 | **158.6** | **4.9** | **25.0** | **(1.4)** | **20.6** | **981.4** | **1,189.1** |
| Net change in available-for-sale instruments | - | - | - | **(60.5)** | - | - | **(60.5)** |
| Net change in cash flow hedges | - | - | - | - | **(81.0)** | - | **(81.0)** |
| Actuarial gains on post-retirement benefit obligations | - | - | - | - | - | **37.9** | **37.9** |
| Net (losses)/gains not recognised in the Income Statement | - | - | - | **(60.5)** | **(81.0)** | **37.9** | **(103.6)** |
| Profit for the financial year | - | - | - | - | - | **38.2** | **38.2** |
| Total recognised (expense)/income | - | - | - | **(60.5)** | **(81.0)** | **76.1** | **(65.4)** |
| Dividends | - | - | - | - | - | **(126.5)** | **(126.5)** |
| Use of own shares on exercise of employee options and for other employee share plans | - | - | - | - | - | **5.2** | **5.2** |
| Fair value of share options taken to share option reserve | - | - | - | - | - | **4.6** | **4.6** |
| Deficit on share option exercises | - | - | - | - | - | **(4.8)** | **(4.8)** |
| Purchase of own shares held to satisfy employee share plans | - | - | - | - | - | **(18.7)** | **(18.7)** |
| Purchase and cancellation of own shares | **(4.2)** | - | **4.2** | - | - | **(58.6)** | **(58.6)** |
| At 31 December 2007 | **154.4** | **4.9** | **29.2** | **(61.9)** | **(60.4)** | **858.7** | **924.9** |

## 30. Reconciliation of changes in equity continued

| Company | Share capital £m | Share premium reserve £m | Capital redemption reserve £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Retained earnings £m | Attributable to equity holders £m |
|---|---|---|---|---|---|---|---|
| As at 1 January 2006 | 158.6 | 4.9 | 25.0 | 6.2 | 15.8 | 925.2 | 1,135.7 |
| Net change in available-for-sale instruments | - | - | - | (7.6) | - | - | (7.6) |
| Net change in cash flow hedges | - | - | - | - | 4.8 | - | 4.8 |
| Actuarial losses on post-retirement benefit obligations | - | - | - | - | - | 14.1 | 14.1 |
| Net (losses)/gains not recognised in the Income Statement | - | - | - | (7.6) | 4.8 | 14.1 | 11.3 |
| Profit for the financial year | - | - | - | - | - | 151.4 | 151.4 |
| Total recognised (expense)/income | - | - | - | (7.6) | 4.8 | 165.5 | 162.7 |
| Dividends | - | - | - | - | - | (119.2) | (119.2) |
| Use of own shares on exercise of employee options and for other employee share plans | - | - | - | - | - | 7.8 | 7.8 |
| Fair value of share options taken to share option reserve | - | - | - | - | - | 4.6 | 4.6 |
| Deficit on share option exercises | - | - | - | - | - | (2.5) | (2.5) |
| As at 31 December 2006 | 158.6 | 4.9 | 25.0 | (1.4) | 20.6 | 981.4 | 1,189.1 |

The share premium reserve represents the excess of the consideration received for issued shares over the nominal value of those shares, net of transaction costs.
The capital redemption reserve was created on the sale of surplus conversion shares and to maintain the total amount of capital when shares were repurchased by the Company.
The available-for-sale reserve represents cumulative fair value movements on assets which are still held at the Balance Sheet date and are classified as available-for-sale.
The cash flow hedge reserve represents cumulative fair value movements on financial instruments which are still held at the Balance Sheet date and are effective cash flow hedges.

## 31. Share-based payments

During the year, the Group had five share-based payment schemes with employees. These are all accounted for by the Group and Company as follows:

| Arrangement | Executive Share Option Scheme | | Sharesave Scheme | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Nature of the arrangement | Grant of share option | Grant of share options | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme | 'Save As You Earn' Scheme |
| Date of grant | 25/2/03 | 14/8/03 | 20/3/03 | 20/3/03 | 18/3/04 | 18/3/04 | 24/3/05 | 24/3/05 | 17/3/06 | 17/3/06 | 15/3/07 | 15/3/07 |
| Number of instruments granted | 1,368,230 | 59,608 | 1,366,351 | 789,338 | 1,832,649 | 427,490 | 510,251 | 155,307 | 419,466 | 300,192 | 645,928 | 201,219 |
| Exercise price | £2.82 | £3.07 | £2.24 | £2.24 | £2.45 | £2.45 | £2.58 | £2.58 | £3.72 | £3.72 | £3.73 | £3.73 |
| Quoted share price at grant date | £2.77 | £3.09 | £2.98 | £2.98 | £3.05 | £3.05 | £3.06 | £3.06 | £5.22 | £5.22 | £4.38 | £4.38 |
| Contractual life (years) | 10.0 | 10.0 | 3.5 | 5.5 | 3.5 | 5.5 | 3.5 | 5.5 | 3.5 | 5.5 | 3.5 | 5.5 |
| Vesting conditions | Earnings per share growth over a 3 year period exceeds the growth in the Retail Price Index over the same period by a minimum of 9% | Earnings per share growth over a 3 year period exceeds the growth in the Retail Price Index over the same period by a minimum of 9% | Three-year service period and savings requirement | Five-year service period and savings requirement | Three-year service period and savings requirement | Five-year service period and savings requirement | Three-year service period and savings requirement | Five-year service period and savings requirement | Three-year service period and savings requirement | Five-year service period and savings requirement | Three-year service period and savings requirement | Five-year service period and savings requirement |
| Settlement | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares |
| Expected volatility | 32% | 31% | 32% | 32% | 29% | 29% | 27% | 27% | 22% | 26% | 24% | 27% |
| Expected life at grant date (years) | 5.0 | 5.0 | 3.1 | 5.1 | 3.1 | 5.1 | 3.1 | 5.1 | 3.1 | 5.1 | 3.1 | 5.1 |
| Risk-free interest rate | 3.8% | 4.4% | 4.0% | 4.2% | 4.5% | 4.5% | 4.6% | 4.6% | 4.4% | 4.4% | 5.2% | 5.0% |
| Expected dividend (dividend yield) | 4.9% | 4.8% | 4.6% | 4.6% | 5.0% | 5.0% | 5.6% | 5.6% | 3.3% | 3.3% | 4.3% | 4.3% |
| Expected annual departures | 5% | 5% | 15% | 10% | 15% | 10% | 10% | 5% | 10% | 5% | 10% | 5% |
| Fair value per granted instrument determined at grant date | £0.55 | £0.65 | £0.87 | £0.91 | £0.76 | £0.79 | £0.64 | £0.67 | £1.60 | £1.75 | £0.97 | £1.11 |
| Valuation model | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology |

# Notes to the Financial Statements

## 31. Share-based payments continued

| Arrangement | Employees' Restricted Share Bonus Plan | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Nature of the arrangement | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares |
| Date of grant | 1/1/03 | 1/1/04 | 1/1/04 | 1/1/04 | 12/3/04 | 1/1/05 | 1/1/05 | 1/1/05 | 1/1/06 | 1/1/06 | 1/1/06 | 1/1/07 |
| Number of instruments granted | 56,966 | 2,101 | 2,101 | 2,101 | 93,192 | 1,299 | 1,299 | 1,304 | 1,299 | 1,299 | 1,304 | 41,379* |
| Exercise price | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Quoted share price at grant date | £2.90 | £3.05 | £3.05 | £3.05 | £3.04 | £3.36 | £3.36 | £3.36 | £4.11 | £4.11 | £4.11 | £4.79 |
| Contractual life (years) | 4.2 | 2.2 | 3.2 | 4.2 | 3.0 | 2.2 | 3.2 | 4.2 | 2.2 | 3.2 | 4.2 | 4.2 |
| Vesting conditions | Achievement of individual performance targets in 2003 and still a member of staff at the fourth anniversary of date of grant | Achievement of individual performance targets in 2004 and still a member of staff at the second anniversary of date of grant | Achievement of individual performance targets in 2004 and still a member of staff at the third anniversary of date of grant | Achievement of individual performance targets in 2004 and still a member of staff at the fourth anniversary of date of grant | Still a member of staff at the third anniversary of date of grant | Achievement of individual performance targets in 2005 and still a member of staff at the second anniversary of date of grant | Achievement of individual performance targets in 2005 and still a member of staff at the third anniversary of date of grant | Achievement of individual performance targets in 2005 and sti l a member of staff at the fourth anniversary of date of grant | Achievement of individual performance targets in 2006 and still a member of staff at the second anniversary of date of grant | Achievement of individual performance targets in 2006 and still a member of staff at the third anniversary of date of grant | Achievement of individual performance targets in 2006 and sti l a member of staff at the fourth anniversary of date of grant | Achievement of individual performance targets in 2007 and still a member of staff at the fourth anniversary of date of grant |
| Settlement | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares |
| Expected volatility | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Expected life at grant date (years) | 4.2 | 2.2 | 3.2 | 4.2 | 3.0 | 2.2 | 3.2 | 4.2 | 2.2 | 3.2 | 4.2 | 4.2 |
| Risk-free interest rate | 4.1% | 4.3% | 4.5% | 4.6% | 4.4% | 4.3% | 4.3% | 4.3% | 4.2% | 4.2% | 4.2% | 5.0% |
| Expected dividend (dividend yield) | 4.7% | 5.0% | 5.0% | 5.0% | 5.1% | 5.0% | 5.0% | 5.0% | 4.2% | 4.2% | 4.2% | 4.0% |
| Expected annual departures | 15% | 10% | 10% | 10% | 5% | 10% | 10% | 10% | 10% | 10% | 10% | 0% |
| Fair value per granted instrument determined at grant date | £2.41 | £2.76 | £2.63 | £2.50 | £2.61 | £3.04 | £2.90 | £2.76 | £3.75 | £3.59 | £3.44 | £4.06 |
| Valuation model | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology | Black-Scholes methodology |

*Estimate to be finalised in 2008

## 31. Share-based payments continued

| Arrangement | Performance Share Plan | | Executive Incentive Plan | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Nature of the arrangement | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares | Grant of shares |
| Date of grant | 23/2/04 | 23/2/04 | 28/2/05 | 28/2/05 | 28/2/06 | 28/2/06 | 22/2/07 | 22/2/07 | 22/2/08 | 22/2/08 |
| Number of instruments granted | 871,577 | 506,666 | 341,990 | 341,990 | 339,111 | 339,111 | 490,469 | 490,469 | 541,791* | 541,791* |
| Exercise price | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Quoted share price at grant date | £3.10 | £3.10 | £3.23 | £3.23 | £4.71 | £4.71 | £4.60 | £4.60 | £2.68* | £2.68* |
| Contractual life (years) | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 |
| Vesting conditions | Total shareholder return of Bradford & Bingley plc compared to a peer group of companies | Total shareholder return of Bradford & Bingley plc compared to a peer group of companies | Achievement of individual performance targets and Group profit in 2004 and still a member of staff at the third anniversary of date of grant | Earnings per share growth of Bradford & Bingley plc over a three year period exceeds annual RPI growth by 3% | Achievement of individual performance targets and Group profit in 2005 and still a member of staff at the third anniversary of date of grant | Earnings per share growth of Bradford & Bingley plc over a three year period exceeds annual RPI growth by 3% | Achievement of individual performance targets and Group profit in 2006 and still a member of staff at the third anniversary of date of grant | Earnings per share growth of Bradford & Bingley plc over a three year period exceeds annual RPI growth by 3% | Achievement of individual performance targets and Group profit in 2007 and still a member of staff at the third anniversary of date of grant | Earnings per share growth of Bradford & Bingley plc over a three year period exceeds annual RPI growth by 3% |
| Settlement | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares | Shares |
| Expected volatility | 30% | 30% | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Expected life at grant date (years) | 3 | 3 | n/a | 3 | n/a | 3 | n/a | n/a | n/a | n/a |
| Risk-free interest rate | 4.5% | 4.5% | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Expected dividend (dividend yield) | 5.0% | 5.0% | 5.3% | 5.3% | 3.7% | 3.7% | 4.1% | 4.1% | 4.1%* | 4.1%* |
| Expected annual departures | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Fair value per granted instrument determined at grant date | £1.40 | £1.15 | £3.23 | £2.77 | £4.71 | £4.20 | £4.60 | £4.06 | £2.68* | £2.37* |
| Valuation model | Monte Carlo simulation model | Monte Carlo simulation model | Share price at the date the shares are a located | Black-Scholes methodology | Share price at the date the shares are a located | Black-Scholes methodology | Share price at the date the shares are allocated | Black-Scholes methodology | Estimated share price at the date the shares are allocated | Black-Scholes methodology |

*Estimate based on share price as at 31 December 2007, to be finalised in 2008.

A Monte Carlo simulation model is used to determine the Performance Share Plan fair value as the arrangements include market-based performance conditions, and to assist in assessing an appropriate expected vesting period for the Executive Share Option Scheme. For other share schemes a Black-Scholes methodology is used to value options.

The expected volatility of share price applied in the option pricing models is based on historic Bradford & Bingley plc share price data over a period equivalent to the expected life of the scheme or since the date of flotation (4 December 2000) if shorter.

Awards granted under the Executive Incentive Plan are granted based on performance in the preceding financial year. The performance criteria include qualitative elements which are not determined until the award date, that is, after the end of the relevant financial year. The grant date therefore occurs after the employees to whom the award is made have begun providing services. In accordance with IFRS 2 'Share-based Payment' the grant date fair value is initially estimated for the purposes of recognising the services received during the period between service commencement date and grant date. The fair value is then revised once the actual grant date has been established.

The following information applies to options outstanding at 31 December 2007 and 31 December 2006:

| | At 31 December 2007 | | | | At 31 December 2006 | | | |
|---|---|---|---|---|---|---|---|---|
| **Range of exercises prices** | **Weighted average exercise price** | **Number of exercisable options (000s)** | **Weighted average remaining life (years) Expected** | **Contractual** | Weighted average exercise price | Number of exercisable options (000s) | Weighted average remaining life (years) Expected | Contractual |
| **£2.00 - £3.00** | **£2.8526** | **326,230** | **0.11** | **4.69** | £2.8378 | 399,633 | 0.16 | 5.74 |

The movements in the number of share options (Executive Share Option Scheme and the Sharesave Scheme) can be summarised as follows:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | **Number of options** | **Weighted average exercise price** | Number of options | Weighted average exercise price |
| Total number of options outstanding at 1 January | **2,583,487** | **£2.8456** | 2,793,592 | £2.5194 |
| Granted | **847,654** | **£3.7273** | 719,658 | £3.7166 |
| Exercised | **(759,614)** | **£2.4917** | (696,698) | £2.4809 |
| Forfeited | **(187,477)** | **£3.3056** | (81,053) | £2.6381 |
| Effect of modifications and cancellations | **(26,626)** | **£2.8170** | (132,819) | £2.7474 |
| Expired | **(148,215)** | **£3.5938** | (19,193) | £2.8167 |
| **Total number of options outstanding at 31 December** | **2,309,209** | **£3.2006** | 2,583,487 | £2.8456 |
| Exercisable at 31 December | **326,230** | **£2.8526** | 399,633 | £2.8378 |

In addition to the above option schemes, the Group has several pre-2003 schemes which are still to mature, namely Executive Share Option Scheme 2001 and 2002 schemes (336,742 options outstanding at 31 December 2007 (2006: 400,701)). The Sharesave 2002 (5 year) scheme fully matured during 2007.

# Notes to the Financial Statements

## 31. Share-based payments continued

The amount recognised in staff costs for share-based payment transactions with employees may be summarised as follows:

| | Group | |
|---|---|---|
| | 2007 £m | 2006 £m |
| Sharesave Scheme | **0.6** | 0.5 |
| Employees' Restricted Share Bonus Plan | **0.1** | 0.1 |
| Performance Share Plan | **-** | 0.1 |
| Executive Incentive Plan | **3.9** | 3.9 |
| | **4.6** | 4.6 |

The fair value of the shares for the arrangements in which shares are granted was based on the quoted share price.

## 32. Capital commitments

| At 31 December | Group and Company | |
|---|---|---|
| | 2007 £m | 2006 £m |
| Capital expenditure contracted for but not provided for | 6.6 | 1.1 |

## 33. Operating lease commitments

| At 31 December | Group and Company | |
|---|---|---|
| | 2007 £m | 2006 £m |
| The amounts of rentals payable under non-cancellable operating leases are as follows: | | |
| Payable in less than one year | **8.1** | 7.6 |
| Payable in between one and five years | **27.3** | 24.5 |
| Payable after more than five years | **35.9** | 35.9 |
| Total payable | **71.3** | 68.0 |

These operating leases relate to land and buildings and equipment.

## 34. Other commitments

| At 31 December | Group | | Company | |
|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Irrevocable undrawn loan facilities | **1,900.7** | 2,305.7 | **75.7** | 522.0 |

Irrevocable undrawn loan facilities include lifetime mortgages for which the commitment reflects an estimate of the interest expected to roll up on the loans until redemption; there is no commitment to advance further cash in respect of these loans.

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

## 35. Events after the Balance Sheet date

As shown in note 8, on 12 February 2008 the Directors proposed the payment of a dividend of 14.3 pence per share. On 25 January 2008, £645.9m was received in respect of the asset sale described in note 2.

## 36. Related party disclosures

The key management personnel of the Group and Company are the Company's Executive and Non-Executive Directors and senior managers. The Group and Company have related party relationships with the key management personnel and with the Group's pension schemes. In addition, the Company has related party relationships with its subsidiary undertakings; the Company's principal subsidiaries are listed in note 15, and transactions between the Company and its subsidiaries are on 'arms' length' terms.

A summary of the remuneration of the key management personnel is as follows; these amounts include the remuneration of the Directors which is set out in detail on pages 33 to 39. This gives details of the Company's Directors' salaries, fees, pension entitlements, share options, share plans, other incentives and other benefits. Further details of the accounting treatment of pensions are given in note 25, and further details of the accounting treatment of share-based payments in note 31. The Directors' interests in the Company's shares are shown on page 24, and the Directors were paid the declared dividends in respect of those shares.

Details of the Group's and Company's transactions and balances with the Group's pension schemes are given in note 25. There were no amounts due to or from the schemes at 31 December 2007 (2006: £nil).

| Group and Company | 2007 £000 | 2006 £000 |
|---|---|---|
| Salaries and other short-term benefits | **4,144** | 3,850 |
| Termination benefits | **-** | 434 |
| Post-employment benefits | **98** | 226 |
| Share-based payment | **1,731** | 1,425 |
| Total (included within note 5) | **5,973** | 5,935 |

## 36. Related party disclosures continued

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

| Group | Key personnel 2007 £000 | Key personnel 2006 £000 |
|---|---|---|
| Debtors outstanding at 1 January | **232** | 292 |
| Net movement over the year | **(159)** | (60) |
| Debtors outstanding at 31 December | **73** | 232 |
| Interest earned | **12** | 13 |

| Company | Subsidiaries 2007 £m | Subsidiaries 2006 £m | Key personnel 2007 £000 | Key personnel 2006 £000 |
|---|---|---|---|---|
| Debtors outstanding at 1 January | **19,648.7** | 15,633.8 | **-** | 26 |
| Net movement over the year | **6,340.9** | 4,014.9 | **-** | (26) |
| Debtors outstanding at 31 December | **25,989.6** | 19,648.7 | **-** | - |
| Interest earned | **1,110.0** | 972.5 | **-** | - |

The balances with key personnel are mortgages issued on the Group's usual commercial terms, included within 'loans and advances to customers'. The debtors due from subsidiary undertakings are generally repayable on demand, pay interest at a commercial LIBOR-related rate, and are included within 'loans and advances to customers'. No impairment has been recognised on any of these balances.

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

| Group | Key personnel 2007 £000 | Key personnel 2006 £000 |
|---|---|---|
| Creditors outstanding at 1 January | **341** | 540 |
| Net movement over the year | **706** | (199) |
| Creditors outstanding at 31 December | **1,047** | 341 |
| Interest expense | **23** | 16 |

| Company | Subsidiaries 2007 £m | Subsidiaries 2006 £m | Key personnel 2007 £000 | Key personnel 2006 £000 |
|---|---|---|---|---|
| Creditors outstanding at 1 January | **15,334.9** | 8,237.5 | **341** | 540 |
| Net movement over the year | **7,086.0** | 7,097.4 | **706** | (199) |
| Creditors outstanding at 31 December | **22,420.9** | 15,334.9 | **1,047** | 341 |
| Interest expense | **479.4** | 336.5 | **23** | 16 |

The balances with key personnel are savings products issued on the Group's usual commercial terms, included within 'customer accounts'.
The creditors due to subsidiary undertakings are generally repayable on demand, bear interest at a commercial LIBOR-related rate, and are included within 'customer accounts'.

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

| | 2007 £m | 2006 £m |
|---|---|---|
| Dividend income | **1.0** | 39.6 |
| Management charges | **2.0** | 2.1 |
| Other | **3.2** | 1.4 |
| | **6.2** | 43.1 |

The Company had the following transactions and balances with securitisation vehicles and Bradford & Bingley Covered Bonds LLP:

| Company | 2007 £m | 2006 £m |
|---|---|---|
| Debtors | **11,577.3** | 6,274.0 |
| Creditors | **(19,348.8)** | (11,958.2) |
| Derivative liabilities | **(44.2)** | (36.4) |
| | | |
| Net interest expense | **441.6** | 241.5 |
| Management and servicing fee income | **3.2** | 2.8 |

At 31 December 2007 the Company held £753.5m (2006: £nil) of loan notes issued by the Group's securitisation vehicles on which it earned interest of £14.1m during 2007 (2006: £nil). At 31 December 2007 another Group entity held £500.0m (2006: £nil) of loan notes issued under the Covered Bond programme, on which it earned interest of £8.5m during 2007 (2006: £nil). Loans and advances to customers of £8,117.3m (2006: £7,414.7m) were securitised during the year. Further information regarding the securitisations is provided in note 12.

# Notes to the Financial Statements

## 37. Critical accounting judgements and estimates

In preparation of the Group's and Company's Financial Statements, estimates are made which affect the reported amounts of assets and liabilities; estimates are kept under continuous evaluation. Estimates and judgements are based on historical experience, expectations of future events and other factors.

**Judgements:**

**Financial instrument designation**

Upon initial designation, a certain amount of judgement is required in ascertaining within which category, as prescribed in IAS 39, a financial instrument should be designated. The IAS 39 categories are detailed in the accounting policies set out in note 1 and the designation is based on the criteria specified in IAS 39. We note that where financial instruments contain an embedded derivative we have not opted to designate the whole instrument as 'at fair value through profit and loss' which is permissible under the standard.

**Qualifying hedge relationships**

In designating a financial instrument as part of a qualifying hedge relationship the Group and Company have determined that the hedge is expected to be highly effective over the life of the hedging instrument. In accounting for a derivative as a cash flow hedge the Group and Company have determined that the hedged cash flow exposure relates to highly probable future cash flows.

**Impairment of debt securities**

Critical judgement is applied in determining whether a debt security is impaired. The factors considered in determining whether an asset is impaired are detailed in note 13.

**Securitisations**

In applying the Group's policies on securitised financial assets, the Group and Company have considered both the degree of transfer of risks and rewards on assets transferred to another entity and the degree of control exercised by the Group over the other entity:

- When the Group, in substance, controls the entity to which financial assets have been transferred, the entity is included in these consolidated Financial Statements and the transferred assets continue to be recognised in the Group's Balance Sheet.
- When the Company or another Group entity has transferred financial assets to another entity, but has not transferred substantially all of the risks and rewards relating to the transferred assets, the assets continue to be recognised in the transferring entity's Balance Sheet.

Details of the Group's securitisation activities are given in note 12.

**Estimates:**

**Fair value of debt securities**

Debt securities are carried at fair value. The method for calculating fair value of debt securities is described in note 13. For the vast majority of debt securities a reliable market price was available at the year end and has been used as the fair value. For those debt securities where a model has been used rather than the quoted market price there are a number of assumptions used in determining the fair value. If the value of these debt securities, excluding synthetic CDOs, used were to increase or decrease by 10% there would be a £2.7m positive or £2.7m negative impact respectively on the Income Statement. For the debt securities that contain an embedded derivative (the synthetic CDOs), a model has been used in certain cases to determine the fair value of the embedded derivative. A number of assumptions are used in determining the fair value. If the value of these embedded derivatives were to increase or decrease by 10% there would be a £10.3m positive or £10.3m negative impact respectively on the Income Statement.

**Effective interest rate**

Loans and advances to customers are accounted for on an effective interest rate basis, under which the income is spread over the loan's expected life. On a quarterly basis, models are reviewed to re-assess expected life by portfolio of products based upon actual redemptions by product. If the estimated average life of a loan were increased or reduced by one month the Balance Sheet amount of loans and advances to customers at 31 December 2007 would be higher by £3.6m or lower by £3.8m respectively.

**Loan impairment**

The Group reviews its loan impairment on a quarterly basis. Impairment models use historical loss experience to provide both probabilities of defaults and property forced sale discounts across a portfolio of products. In addition, management applies a risk weighted view on additional factors, such as specific fraud cases. If average house prices were to increase or decrease by 5% the reported impairment at 31 December 2007 would be £9.8m lower or £11.6m higher respectively.

**Post-retirement benefit obligations**

The net deficit in respect of post-retirement benefit obligations is carried on the Balance Sheet. The value of these obligations is calculated by the Group's actuaries using the assumptions set out in note 25. Note 25 also discloses the impact on the benefit obligations of changes in certain key assumptions.

**Provisions**

Provisions are carried in respect of certain known or forecast future expenditure, as described in note 26.

## 38. Capital structure

| At 31 December | Group 2007 £m | 2006 £m |
|---|---|---|
| Tier 1 | | |
| Share capital and reserves | **1,210.8** | 1,419.9 |
| Adjustments | **81.3** | (74.4) |
| Net pension deficit | **(4.0)** | 50.8 |
| Innovative tier 1 | **148.8** | 148.8 |
| Total tier 1 capital | **1,436.9** | 1,545.1 |
| Upper tier 2 capital | **580.1** | 583.8 |
| Lower tier 2 capital | **647.0** | 671.7 |
| Total tier 2 capital | **1,227.1** | 1,255.5 |
| Deductions | **(146.7)** | (97.2) |
| Total capital | **2,517.3** | 2,703.4 |

Innovative tier 1 and tier 2 subordinated liabilities exclude any fair value adjustments arising from the hedging of these instruments that are included in the Balance Sheet.

The primary objectives of the banks capital management are to ensure that the bank complies with externally imposed capital requirements, maintains capital ratios to support development of the business and to cover risks inherent in its activities, to maximise shareholder value and to keep strong credit ratings. The Group defines Equity, Subordinated Liabilities and Other Capital Instruments as capital. The bank manages its capital structure in response to changes in the nature of the banks' activities and economic conditions. The bank may return capital to shareholders, adjust the level of dividend or issue capital securities. During the year the bank commenced a share buy back programme to rebalance the mix of capital by changing the proportions of equity and interest bearing tier 1 capital; this was suspended in the later part of the year due to market conditions.

During the year the Group moved from a Basel I method of assessment to a Basel II Standardised regime. The bank's regulatory capital position is shown above. Tier 1 capital excludes statutory accounting deductions for available-for-sale assets and the cash flow hedge reserve but includes a regulatory deduction for intangible assets. Tier 2 capital reflects amortisation of subordinated debt. The Group's capital adequacy and capital resources are managed and monitored in accordance with the regulatory capital rules of the FSA, the UK regulator. The bank must at all times monitor and demonstrate compliance with the relevant regulatory capital requirements of the FSA. The bank has put in place processes and controls to monitor and manage the bank's capital adequacy and no breaches were reported to the FSA during the year.

The Company capital is represented by the capital and reserves attributable to equity holders and is sufficient to meet the needs of the Company in its operations and in payment of dividends.

## 39. Financial instruments

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

| Group At 31 December 2007 Financial assets | Available-for-sale £m | Assets at fair value through profit or loss - on initial recognition £m | Assets at fair value through profit or loss - held for trading £m | Loans and receivables £m | Hedging adjustments £m | Total carrying value £m | Fair value £m | If fair values increased by 1% £m |
|---|---|---|---|---|---|---|---|---|
| Cash and balances at central banks | - | - | - | 209.2 | - | 209.2 | 209.2 | 2.1 |
| Treasury bills | 185.0 | - | - | - | - | 185.0 | 185.0 | 1.9 |
| Loans and advances to banks | - | - | - | 2,392.1 | - | 2,392.1 | 2,392.1 | 23.9 |
| Loans and advances to customers | - | - | - | 40,444.5 | - | 40,444.5 | 40,407.2 | 404.1 |
| Fair value adjustments on portfolio hedging | - | - | - | - | (53.8) | (53.8) | - | - |
| Debt securities | 6,778.7 | - | - | - | - | 6,778.7 | 6,778.7 | 67.8 |
| Derivative financial instruments | - | 1,175.4 | - | - | - | 1,175.4 | 1,175.4 | 11.8 |
| Other financial assets | 2.1 | - | - | 658.9 | - | 661.0 | 661.0 | 6.6 |
| **Total financial assets** | **6,965.8** | **1,175.4** | **-** | **43,704.7** | **(53.8)** | **51,792.1** | **51,808.6** | **518.2** |

# Notes to the Financial Statements

## 39. Financial instruments continued

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

| Financial liabilities | Liabilities at fair value through profit or loss - on initial recognition £m | Liabilities at fair value through profit or loss - held for trading £m | Liabilities at amortised cost £m | Hedging adjustments £m | Total carrying value £m | Fair value £m | If fair values increased by 1% £m |
|---|---|---|---|---|---|---|---|
| Deposits by banks | - | - | 2,074.3 | 0.1 | 2,074.4 | 2,074.4 | 20.7 |
| Customer accounts | - | - | 24,152.6 | - | 24,152.6 | 24,155.1 | 241.6 |
| Fair value adjustments on portfolio hedging | - | - | - | (5.9) | (5.9) | - | - |
| Derivative financial instruments | 498.6 | - | - | - | 498.6 | 498.6 | 5.0 |
| Debt securities in issue | - | - | 21,652.6 | 655.5 | 22,308.1 | 21,914.6 | 219.1 |
| Subordinated liabilities | - | - | 1,249.2 | 4.5 | 1,253.7 | 1,168.9 | 11.7 |
| Other capital instruments | - | - | 148.9 | 12.7 | 161.6 | 117.5 | 1.2 |
| Other financial liabilities | - | - | 141.4 | - | 141.4 | 141.4 | 1.4 |
| **Total financial liabilities** | **498.6** | **-** | **49,419.0** | **666.9** | **50,584.5** | **50,070.5** | **500.7** |

| Group<br>At 31 December 2006<br>Financial assets | Available-for-sale £m | Assets at fair value through profit or loss - on initial recognition £m | Assets at fair value through profit or loss - held for trading £m | Loans and receivables £m | Hedging adjustments £m | Total carrying value £m | Fair value £m | If fair values increased by 1% £m |
|---|---|---|---|---|---|---|---|---|
| Cash and balances at central banks | - | - | - | 202.6 | - | 202.6 | 202.6 | 2.0 |
| Loans and advances to banks | - | - | - | 3,301.4 | - | 3,301.4 | 3,301.4 | 33.0 |
| Loans and advances to customers | - | - | - | 36,131.7 | - | 36,131.7 | 35,985.3 | 359.9 |
| Fair value adjustments on portfolio hedging | - | - | - | - | (70.4) | (70.4) | - | - |
| Debt securities | 5,299.9 | - | - | - | - | 5,299.9 | 5,299.9 | 53.0 |
| Derivative financial instruments | - | 291.0 | - | - | - | 291.0 | 291.0 | 2.9 |
| Other financial assets | - | - | - | 34.2 | - | 34.2 | 34.2 | 0.3 |
| Total financial assets | 5,299.9 | 291.0 | - | 39,669.9 | (70.4) | 45,190.4 | 45,114.4 | 451.1 |

| Financial liabilities | Liabilities at fair value through profit or loss - on initial recognition £m | Liabilities at fair value through profit or loss - held for trading £m | Liabilities at amortised cost £m | Hedging adjustments £m | Total carrying value £m | Fair value £m | If fair values increased by 1% £m |
|---|---|---|---|---|---|---|---|
| Deposits by banks | - | - | 1,512.4 | - | 1,512.4 | 1,512.4 | 15.1 |
| Customer accounts | - | - | 22,201.1 | (0.1) | 22,201.0 | 22,189.6 | 221.9 |
| Derivative financial instruments | 493.4 | - | - | - | 493.4 | 493.4 | 4.9 |
| Debt securities in issue | - | - | 18,059.5 | (218.2) | 17,841.3 | 17,844.7 | 178.4 |
| Subordinated liabilities | - | - | 1,248.2 | (1.2) | 1,247.0 | 1,385.9 | 13.9 |
| Other capital instruments | - | - | 148.9 | 16.3 | 165.2 | 162.2 | 1.6 |
| Other financial liabilities | - | - | 128.5 | - | 128.5 | 128.5 | 1.3 |
| Total financial liabilities | 493.4 | - | 43,298.6 | (203.2) | 43,588.8 | 43,716.7 | 437.1 |

| Company<br>At 31 December 2007<br>Financial assets | Available-for-sale £m | Assets at fair value through profit or loss - on initial recognition £m | Assets at fair value through profit or loss - held for trading £m | Loans and receivables £m | Hedging adjustments £m | Total carrying value £m | Fair value £m | If fair values increased by 1% £m |
|---|---|---|---|---|---|---|---|---|
| Cash and balances at central banks | - | - | - | 209.2 | - | 209.2 | 209.2 | 2.1 |
| Treasury bills | 185.0 | - | - | - | - | 185.0 | 185.0 | 1.9 |
| Loans and advances to banks | - | - | - | 1,901.9 | - | 1,901.9 | 1,901.9 | 19.0 |
| Loans and advances to customers | - | - | - | 51,435.4 | - | 51,435.4 | 51,417.7 | 514.2 |
| Fair value adjustments on portfolio hedging | - | - | - | - | (53.8) | (53.8) | - | - |
| Debt securities | 7,398.2 | - | - | - | - | 7,398.2 | 7,398.2 | 74.0 |
| Derivative financial instruments | - | 468.6 | - | - | - | 468.6 | 468.6 | 4.7 |
| Other financial assets | 2.1 | - | - | 657.5 | - | 659.6 | 659.6 | 6.6 |
| **Total financial assets** | **7,585.3** | **468.6** | **-** | **54,204.0** | **(53.8)** | **62,204.1** | **62,240.2** | **622.5** |

## 39. Financial instruments continued

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

| Financial liabilities | Liabilities at fair value through profit or loss - on initial recognition £m | Liabilities at fair value through profit or loss - held for trading £m | Liabilities at amortised cost £m | Hedging adjustments £m | Total carrying value £m | Fair value £m | If fair values increased by 1% £m |
|---|---|---|---|---|---|---|---|
| Deposits by banks | - | - | **1,658.5** | - | **1,658.5** | **1,658.5** | **16.6** |
| Customer accounts | **19,279.0** | - | **24,322.8** | - | **43,601.8** | **43,604.3** | **436.0** |
| Fair value adjustments on portfolio hedging | - | - | - | **(5.9)** | **(5.9)** | - | - |
| Derivative financial instruments | **483.2** | - | - | - | **483.2** | **483.2** | **4.8** |
| Debt securities in issue | - | - | **13,897.9** | **511.2** | **14,409.1** | **14,205.4** | **142.1** |
| Subordinated liabilities | - | - | **1,548.1** | **17.2** | **1,565.3** | **1,437.1** | **14.4** |
| Other financial liabilities | - | - | **131.0** | - | **131.0** | **131.0** | **1.3** |
| **Total financial liabilities** | **19,762.2** | - | **41,558.3** | **522.5** | **61,843.0** | **61,519.5** | **615.2** |

| Company<br>At 31 December 2006<br>Financial assets | Available-for-sale £m | Assets at fair value through profit or loss - on initial recognition £m | Assets at fair value through profit or loss - held for trading £m | Loans and receivables £m | Hedging adjustments £m | Total carrying value £m | Fair value £m | If fair values increased by 1% £m |
|---|---|---|---|---|---|---|---|---|
| Cash and balances at central banks | - | - | - | 202.6 | - | 202.6 | 202.6 | 2.0 |
| Loans and advances to banks | - | - | - | 2,413.5 | - | 2,413.5 | 2,413.5 | 24.1 |
| Loans and advances to customers | - | - | - | 41,895.5 | - | 41,895.5 | 41,874.4 | 418.7 |
| Fair value adjustments on portfolio hedging | - | - | - | - | (70.4) | (70.4) | - | - |
| Debt securities | 4,840.9 | - | - | - | - | 4,840.9 | 4,840.9 | 48.4 |
| Derivative financial instruments | - | 278.2 | - | - | - | 278.2 | 278.2 | 2.8 |
| Other financial assets | - | - | - | 40.3 | - | 40.3 | 40.3 | 0.4 |
| Total financial assets | 4,840.9 | 278.2 | - | 44,551.9 | (70.4) | 49,600.6 | 49,649.9 | 496.4 |

| Financial liabilities | Liabilities at fair value through profit or loss - on initial recognition £m | Liabilities at fair value through profit or loss - held for trading £m | Liabilities at amortised cost £m | Hedging adjustments £m | Total carrying value £m | Fair value £m | If fair values increased by 1% £m |
|---|---|---|---|---|---|---|---|
| Deposits by banks | - | - | 885.8 | - | 885.8 | 885.8 | 8.9 |
| Customer accounts | 11,919.3 | - | 22,623.6 | (0.1) | 34,542.8 | 34,531.6 | 345.3 |
| Derivative financial instruments | 408.8 | - | - | - | 408.8 | 408.8 | 4.1 |
| Debt securities in issue | - | - | 11,538.7 | (292.2) | 11,246.5 | 11,241.3 | 112.4 |
| Subordinated liabilities | - | - | 1,546.7 | 15.1 | 1,561.8 | 1,698.1 | 17.0 |
| Other financial liabilities | - | - | 121.7 | - | 121.7 | 121.7 | 1.2 |
| Total financial liabilities | 12,328.1 | - | 36,716.5 | (277.2) | 48,767.4 | 48,887.3 | 488.9 |

Neither the Group nor the Company recognised any 'day one gains or losses' during the year (2006: £nil).

Cash and balances at central banks and loans and advances to banks: the fair value is their carrying amount.

Loans and advances to customers: where floating rate loans and advances to customers have been issued at market rates we have assumed fair value approximates to book value. Given current market conditions, it is not known whether these fair values are reflective of prices that could be achieved on the open market; however, there is no intent to sell these loans. Fixed rate mortgage balances, within loans and advances to customers, are fair valued using discounted cash flow models, using prevailing market rates, with underlying assumptions based on current market conditions.

Debt securities and treasury bills: fair value has been estimated through reference to market price or specific restructuring proposals. Where no market price exists an assessment has been made as to the value of the security. This assessment is based on modelling the present value of future expected cash flows, using a discount curve adjusted for credit spread and liquidity, utilising information from a number of sources, including fund manager expectations and the performance of other similar securities.

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

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

Debt securities in issue, subordinated liabilities and other capital instruments: the fair value is based upon quoted market prices in active markets or discounted expected cash flows using market rates applicable to the credit quality and maturity of the instrument.

Other financial liabilities: the fair value is their carrying amount.

No financial assets were reclassified during 2007 or 2006 by the Group or Company between amortised cost and fair value categories.

### (b) Trading book

During the year the Group commenced trading activities in derivatives. The net trading income for the year, which is all included in the Income Statement within 'realised gains less losses on financial instruments', was £1.0m.

The fair value of these held for trading derivatives at 31 December 2007 was not material and therefore does not appear in note 39a.

# Notes to the Financial Statements

## 39. Financial instruments continued

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

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

| | Group 2007 £m | Group 2006 £m |
|---|---|---|
| Interest income | **2,967.5** | 2,383.0 |
| Interest expense | **(2,419.8)** | (1,872.8) |
| Net interest income | **547.7** | 510.2 |

The above includes interest on derivatives which are effective hedging instruments.

### (d) Impaired financial assets

Allowance accounts for credit losses in respect of impairment of loans and advances to customers are detailed in note 11, and in respect of debt securities in note 13.

No impairment loss has been recognised in respect of any other class of financial asset, and no other class of financial asset includes assets that are past due.

### (e) Derecognition of financial assets

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

| Group | 2007 Carrying amount of assets £m | 2007 Carrying amount of associated liabilities £m | 2006 Carrying amount of assets £m | 2006 Carrying amount of associated liabilities £m |
|---|---|---|---|---|
| Repurchase agreements (see also note 39f) | **794.0** | **744.4** | 128.4 | 128.5 |
| Other arrangements | **168.9** | **170.8** | 281.3 | 281.5 |
| | **962.9** | **915.2** | 409.7 | 410.0 |

| Company | 2007 Carrying amount of assets £m | 2007 Carrying amount of associated liabilities £m | 2006 Carrying amount of assets £m | 2006 Carrying amount of associated liabilities £m |
|---|---|---|---|---|
| Repurchase agreements (see also note 39f) | **1,721.4** | **1,645.9** | 628.4 | 628.5 |
| Other arrangements | **168.9** | **170.8** | 281.3 | 281.5 |
| | **1,890.3** | **1,816.7** | 909.7 | 910.0 |

In addition, loans to customers which have been securitised are not derecognised from the Balance Sheet as the originator of the loans retains substantially all of the risks and rewards of the securitised loans (see note 12).

### (f) Collateral

All loans and advances made by the Group are secured on property. The secured property can be repossessed in the event of borrower default, in which case the carrying value of the loan is reduced if the estimated recoverable amount is lower than the outstanding balance owed, in accordance with the accounting policy described in note 1. The repossessed property is carried on the Balance Sheet within loans and advances to customers.

A credit exposure could arise in respect of derivative contracts entered into by the Group if the counterparty were unable to fulfil its contractual obligations. The Group addresses the risks associated with these activities by monitoring counterparty credit exposure and requiring additional collateral to be posted or returned as necessary. The only forms of collateral accepted by the Group are cash and government securities. Derivatives are transacted under ISDA with CSA annexes and as such may require collateral to be posted from time to time.

Fair value of collateral which we hold which we can sell or repledge in the absence of default by the owner of the collateral:

| | Group 2007 £m | Group 2006 £m | Company 2007 £m | Company 2006 £m |
|---|---|---|---|---|
| Assets under reverse repurchase agreements | **253.4** | 0.5 | **253.4** | 0.5 |
| Cash collateral which we have received in respect of derivatives contracts | **45.2** | 123.2 | **67.3** | 410.5 |
| | **298.6** | 123.7 | **320.7** | 411.0 |

None of the above collateral has been sold or repledged.

## 39. Financial instruments continued

**(f) Collateral** continued

Carrying amount of financial assets which we have pledged as collateral:

| | Group 2007 £m | Group 2006 £m | Company 2007 £m | Company 2006 £m |
|---|---|---|---|---|
| Assets under repurchase agreements (see also note 39e) | **794.0** | 128.4 | **1,721.4** | 628.4 |
| Cash Ratio Deposit with the Bank of England | **38.2** | 34.8 | **38.2** | 34.8 |
| Cash collateral which we have provided in respect of derivative contracts | **90.9** | 79.6 | **90.9** | 79.6 |
| | **923.1** | 242.8 | **1,850.5** | 742.8 |

In addition, certain loans to customers have been securitised, as detailed in note 12. These loans, and also the other financial assets shown above which we have pledged, are carried on the Group's and Company's Balance Sheets.

**(g) Hedge accounting**

The Group had the following types of hedges:

| | 2007 Nominal amounts £m | 2007 Fair value hedges £m | 2007 Cash flow hedges £m | 2007 Non-hedging £m | 2007 Total £m | 2006 Nominal amounts £m | 2006 Fair value hedges £m | 2006 Cash flow hedges £m | 2006 Total £m |
|---|---|---|---|---|---|---|---|---|---|
| Exchange rate contracts | **12,119.7** | **903.5** | **-** | **-** | **903.5** | 9,656.2 | 33.5 | - | 33.5 |
| Interest rate contracts | **24,359.5** | **225.4** | **40.4** | **-** | **265.8** | 25,673.8 | 231.6 | 19.0 | 250.6 |
| Other derivatives | **16.8** | **6.1** | **-** | **-** | **6.1** | 316.8 | 6.9 | - | 6.9 |
| Total asset balances | **36,496.0** | **1,135.0** | **40.4** | **-** | **1,175.4** | 35,646.8 | 272.0 | 19.0 | 291.0 |
| Exchange rate contracts | **3,432.8** | **135.9** | **-** | **-** | **135.9** | 1,439.3 | 325.1 | - | 325.1 |
| Interest rate contracts | **20,782.8** | **165.7** | **141.5** | **-** | **307.2** | 2,686.9 | 156.4 | 3.2 | 159.6 |
| Other derivatives | **222.6** | **5.8** | **-** | **49.7** | **55.5** | 184.6 | 8.1 | 0.6 | 8.7 |
| Total liability balances | **24,438.2** | **307.4** | **141.5** | **49.7** | **498.6** | 4,310.8 | 489.6 | 3.8 | 493.4 |
| Fair value of hedging instruments | **12,057.8** | **827.6** | **(101.1)** | **-** | **676.8** | 31,336.0 | (217.6) | 15.2 | (202.4) |

The Company had the following types of hedges:

| | 2007 Nominal amounts £m | 2007 Fair value hedges £m | 2007 Cash flow hedges £m | 2007 Non-hedging £m | 2007 Total £m | 2006 Nominal amounts £m | 2006 Fair value hedges £m | 2006 Cash flow hedges £m | 2006 Total £m |
|---|---|---|---|---|---|---|---|---|---|
| Exchange rate contracts | **2,957.5** | **196.4** | **-** | **-** | **196.4** | 3,642.7 | 20.8 | - | 20.8 |
| Interest rate contracts | **23,130.3** | **225.7** | **40.4** | **-** | **266.1** | 24,824.3 | 231.5 | 19.0 | 250.5 |
| Other derivatives | **16.8** | **6.1** | **-** | **-** | **6.1** | 316.8 | 6.9 | - | 6.9 |
| Total asset balances | **26,104.6** | **428.2** | **40.4** | **-** | **468.6** | 28,783.8 | 259.2 | 19.0 | 278.2 |
| Exchange rate contracts | **935.0** | **80.0** | **-** | **-** | **80.0** | 93.6 | 203.4 | - | 203.4 |
| Interest rate contracts | **36,185.0** | **205.6** | **141.5** | **-** | **347.1** | 2,686.9 | 193.5 | 3.2 | 196.7 |
| Other derivatives | **222.6** | **6.4** | **-** | **49.7** | **56.1** | 184.6 | 8.1 | 0.6 | 8.7 |
| Total liability balances | **37,342.6** | **292.0** | **141.5** | **49.7** | **483.2** | 2,965.1 | 405.0 | 3.8 | 408.8 |
| Fair value of hedging instruments | **(11,238.0)** | **136.2** | **(101.1)** | **-** | **(14.6)** | 25,818.7 | (145.8) | 15.2 | (130.6) |

The Group and Company undertake derivative transactions to hedge risk exposures, and manage risk by use of fair value hedges and cash flow hedges. For those transactions which qualify and are designated as fair value or cash flow hedges, hedge accounting treatment is applied.

Fair value hedges are primarily used to hedge against changes in fair value of fixed rate products due to movements in market interest rates. For the year ended 31 December 2007, the Group recognised fair value losses of £23.5m (2006: gains of £0.3m), representing the ineffective portion of the fair value hedges.

Cash flow hedges are used to hedge the risk of exposure to variability of cash flows attributable to a particular risk associated with a recognised asset or liability, or a forecast transaction. Any gains or losses on cash flow hedges are recorded in equity until the hedged cash flow occurs, whereupon they are transferred to profit or loss for the period. As at 31 December 2007, net losses accumulated in equity were £60.4m (2006: gains of £20.6m).

Hedge effectiveness is measured and assessed on an ongoing basis and was determined to be actually effective throughout the year. Changes in fair values and cash flows of the hedged items were almost fully offset by changes in fair values and cash flows of the hedging instruments, and actual effectiveness was within a range of 80% to 125%.

The Group has recognised embedded derivatives within certain products and has classified them with derivatives in accordance with IAS 39.

Forward starting swaps are entered into, in anticipation of the take up of fixed rate mortgages. These are treated as cash flow hedges. Cash flow ineffectiveness testing incorporates testing for forecast transactions which are no longer expected to occur.

# Notes to the Financial Statements

## 39. Financial instruments continued

**(g) Hedge accounting** continued

Fair value movements on financial instruments recognised in the Income Statement comprised the following:

| | Group | |
|---|---|---|
| | **2007 £m** | 2006 £m |
| Net (losses)/gains on fair value hedging instruments | **(372.6)** | 9.9 |
| Net gains/(losses) on fair value hedged items | **349.2** | (9.6) |
| Ineffectiveness on cash flow hedges | **(0.1)** | - |
| Total hedge ineffectiveness | **(23.5)** | 0.3 |
| Net loss in fair value on embedded derivatives | **(49.7)** | (0.1) |
| Total fair value movements recognised in the Income Statement | **(73.2)** | 0.2 |

Realised gains less losses on financial instruments recognised in the Income Statement comprised the following:

| | Group | |
|---|---|---|
| | **2007 £m** | 2006 £m |
| Realised gains on available-for-sale instruments | **4.5** | 2.1 |
| Realised gains on instruments at amortised cost | **1.0** | - |
| Realised gains on instruments at fair value through profit or loss | **1.0** | - |
| Total realised gains less losses on financial instruments recognised in the Income Statement | **6.5** | 2.1 |

## 40. Risk management

**(a)** A description of the principal risks to which the Group and Company are exposed is provided on pages 18 to 21.

The following table describes the significant activities undertaken by the Group, the risks associated with such activities and the types of derivatives which are typically used in managing such risks.

| Activity | Risk | Type of derivative instrument used |
|---|---|---|
| Fixed rate savings products and funding activities in Sterling involving either fixed rate instruments or instruments with embedded options | Sensitivity to changes in interest rates | Interest rate swaps and interest rate futures |
| Fixed and capped rate mortgage lending and investment activities involving either fixed rate instruments or instruments with embedded options | Sensitivity to changes in interest rates | Interest rate swaps and options |
| Investment and funding in foreign currencies | Sensitivity to changes in foreign exchange rates | Cross-currency interest rate swaps and foreign exchange contracts |
| Equity-linked investment products | Sensitivity to changes in equity indices | Equity-linked swaps |
| Variable rate products | Sensitivity to changes in interest rates | Interest rate swaps |

The accounting policy for derivatives and hedge accounting is described in note 1.

**(b) Credit risk**

Before taking account of any collateral, the maximum exposure to credit risk at 31 December was:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007 £m** | 2006 £m | **2007 £m** | 2006 £m |
| Cash and balances at central banks | **209.2** | 202.6 | **209.2** | 202.6 |
| Treasury bills | **185.0** | - | **185.0** | - |
| Loans and advances to banks | **2,392.1** | 3,301.4 | **1,901.9** | 2,413.5 |
| Loans and advances to customers | **40,444.5** | 36,131.7 | **51,435.4** | 41,895.5 |
| Debt securities | **6,778.7** | 5,299.9 | **7,398.2** | 4,840.9 |
| Derivative financial instruments | **1,175.4** | 291.0 | **468.6** | 278.2 |
| Other financial assets | **661.0** | 34.2 | **659.6** | 40.3 |
| **Total on - Balance Sheet** | **51,845.9** | 45,260.8 | **62,257.9** | 49,671.0 |
| Irrevocable undrawn loan facilities (off - Balance Sheet) (see note 34) | **1,900.7** | 2,305.7 | **75.7** | 522.0 |
| **Total maximum exposure to credit risk** | **53,746.6** | 47,566.5 | **62,333.6** | 50,193.0 |

In respect of loans and advances to banks and customers and derivative financial instruments the Group and Company may hold reverse repurchase agreements and may also hold cash as security (see notes 39e and 39f). Loans and advances to customers are secured on property.

In respect of Lifetime mortgages, the irrevocable undrawn loan facility is calculated using actuarial assumptions. There is no commitment to advance further cash; the commitment reflects interest expected to roll up on the loans until redemption.

## 40. Risk management continued

### (c) Liquidity risk

It should be noted that many financial instruments are settled earlier than their contractual maturity dates; in particular, many mortgage loans are repaid early in full or in part.

The Group closely monitors its liquidity position against the Board's liquidity policy. This policy sets out elements of available and required liquidity through reference to and modelling of net lending commitments, short and medium term wholesale commitments, liquidity reserves, retail deposit growth and the requirement for other payments (e.g. dividends and tax). From this, minimum and target liquidity levels are established. Furthermore, liquidity is also measured in proportion to the total Balance Sheet and is subject to trigger levels; these determine the appropriate levels of escalation in order to address any actual or forecast shortfalls. The liquidity policy also requires stress testing through modelling and assessment of any emerging and potentially extreme funding conditions.

The contractual maturities of financial assets and liabilities were as follows:

| Group<br>At 31 December 2007 | On demand £m | In not more than three months £m | In more than three months but not more than one year £m | In more than one year but not more than five years £m | In more than five years £m | Total £m |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash and balances at central banks | 21.0 | - | - | - | 188.2 | 209.2 |
| Treasury bills | 185.0 | - | - | - | - | 185.0 |
| Loans and advances to banks | 576.3 | 1,561.2 | 54.8 | 73.2 | 126.6 | 2,392.1 |
| Loans and advances to customers | - | 66.9 | 364.9 | 1,295.3 | 38,717.4 | 40,444.5 |
| Fair value adjustments on portfolio hedging | (53.8) | - | - | - | - | (53.8) |
| Debt securities | - | 2,020.3 | 283.6 | 1,228.8 | 3,246.0 | 6,778.7 |
| Derivative financial instruments | - | 64.3 | 81.2 | 775.0 | 254.9 | 1,175.4 |
| Other financial assets | 2.1 | 658.9 | - | - | - | 661.0 |
| **Total financial assets** | 730.6 | 4,371.6 | 784.5 | 3,372.3 | 42,533.1 | 51,792.1 |
| **Financial liabilities** | | | | | | |
| Deposits by banks | 361.5 | 667.1 | 331.8 | 714.0 | - | 2,074.4 |
| Customer accounts | 15,325.7 | 1,239.7 | 5,329.3 | 2,257.9 | - | 24,152.6 |
| Fair value adjustments on portfolio hedging | (5.9) | - | - | - | - | (5.9) |
| Derivative financial instruments | - | 8.5 | 64.9 | 287.8 | 137.4 | 498.6 |
| Debt securities in issue | - | 447.1 | 5,283.9 | 13,336.1 | 3,241.0 | 22,308.1 |
| Subordinated liabilities | - | - | - | 128.1 | 1,125.6 | 1,253.7 |
| Other capital instruments | - | - | - | - | 161.6 | 161.6 |
| Other financial liabilities | - | 141.4 | - | - | - | 141.4 |
| **Total financial liabilities** | 15,681.3 | 2,503.8 | 11,009.9 | 16,723.9 | 4,665.6 | 50,584.5 |
| **Group net liquidity gap** | (14,950.7) | 1,867.8 | (10,225.4) | (13,351.6) | 37,867.5 | 1,207.6 |
| Group financial assets at 31 December 2006 | 1,113.9 | 3,037.5 | 1,029.2 | 3,734.8 | 36,275.0 | 45,190.4 |
| Group financial liabilities at 31 December 2006 | 16,823.7 | 5,616.0 | 6,192.9 | 10,913.8 | 4,042.4 | 43,588.8 |
| Group net liquidity gap at 31 December 2006 | (15,709.8) | (2,578.5) | (5,163.7) | (7,179.0) | 32,232.6 | 1,601.6 |

# Notes to the Financial Statements

## 40. Risk management continued

**(c) Liquidity risk** continued

| Company<br>At 31 December 2007 | On demand £m | In not more than three months £m | In more than three months but not more than one year £m | In more than one year but not more than five years £m | In more than five years £m | Total £m |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash and balances at central banks | 21.0 | - | - | - | 188.2 | 209.2 |
| Treasury bills | 185.0 | - | - | - | - | 185.0 |
| Loans and advances to banks | 340.8 | 1,561.1 | - | - | - | 1,901.9 |
| Loans and advances to customers | 25,981.6 | 97.5 | 234.0 | 1,115.3 | 24,007.0 | 51,435.4 |
| Fair value adjustments on portfolio hedging | (53.8) | - | - | - | - | (53.8) |
| Debt securities | - | 1,960.5 | 278.7 | 1,803.9 | 3,355.1 | 7,398.2 |
| Derivative financial instruments | - | 57.4 | 60.1 | 288.3 | 62.8 | 468.6 |
| Other financial assets | 2.1 | 657.5 | - | - | - | 659.6 |
| **Total financial assets** | 26,476.7 | 4,334.0 | 572.8 | 3,207.5 | 27,613.1 | 62,204.1 |
| **Financial liabilities** | | | | | | |
| Deposits by banks | 115.8 | 554.2 | 781.3 | 207.2 | - | 1,658.5 |
| Customer accounts | 35,691.3 | 1,038.5 | 5,220.8 | 1,651.2 | - | 43,601.8 |
| Fair value adjustments on portfolio hedging | (5.9) | - | - | - | - | (5.9) |
| Derivative financial instruments | - | 30.0 | 65.4 | 258.1 | 129.7 | 483.2 |
| Debt securities in issue | - | - | 3,371.4 | 7,766.0 | 3,271.7 | 14,409.1 |
| Subordinated liabilities | - | - | - | 128.1 | 1,437.2 | 1,565.3 |
| Other financial liabilities | - | 131.0 | - | - | - | 131.0 |
| **Total financial liabilities** | 35,801.2 | 1,753.7 | 9,438.9 | 10,010.6 | 4,838.6 | 61,843.0 |
| **Company net liquidity gap** | (9,324.5) | 2,580.3 | (8,866.1) | (6,803.1) | 22,774.5 | 361.1 |
| Company financial assets at 31 December 2006 | 19,966.1 | 2,866.0 | 881.9 | 3,156.0 | 22,730.6 | 49,600.6 |
| Company financial liabilities at 31 December 2006 | 29,428.5 | 4,787.6 | 3,557.3 | 7,274.4 | 3,719.6 | 48,767.4 |
| Company net liquidity gap at 31 December 2006 | (9,462.4) | (1,921.6) | (2,675.4) | (4,118.4) | 19,011.0 | 833.2 |

The contractual undiscounted cash flows associated with financial liabilities were as follows:

| Group<br>Financial liabilities<br>At 31 December 2007 | On demand £m | In not more than three months £m | In more than three months but not more than one year £m | In more than one year but not more than five years £m | In more than five years £m | Total £m |
|---|---|---|---|---|---|---|
| Deposits by banks | 361.5 | 690.7 | 374.9 | 792.5 | - | 2,219.6 |
| Customer accounts | 15,325.7 | 1,361.1 | 5,642.3 | 2,506.3 | - | 24,835.4 |
| Derivative financial instruments | - | 41.7 | 118.7 | 90.3 | (317.4) | (66.7) |
| Debt securities in issue | - | 753.8 | 6,185.7 | 15,516.1 | 5,647.4 | 28,103.0 |
| Subordinated liabilities | - | 17.2 | 51.7 | 389.8 | 1,632.9 | 2,091.6 |
| Other capital instruments | - | 2.2 | 6.7 | 35.6 | 365.2 | 409.7 |
| Other financial liabilities | - | 141.4 | - | - | - | 141.4 |
| Irrevocable undrawn loan facilities | 312.3 | - | - | - | - | 312.3 |
| **Total** | 15,999.5 | 3,008.1 | 12,380.0 | 19,330.6 | 7,328.1 | 58,046.3 |

Included in the above are the following expected cash flows arising on cash flow hedges (positive = outflow); no impact is anticipated on the Income Statement due to the hedging in place.

| | | | | | | |
|---|---|---|---|---|---|---|
| Cash flow hedges | - | 0.2 | (15.1) | (51.0) | (8.3) | (74.2) |

## 40. Risk management continued

### (c) Liquidity risk continued

| Group Financial liabilities At 31 December 2006 | On demand £m | In not more than three months £m | In more than three months but not more than one year £m | In more than one year but not more than five years £m | In more than five years £m | Total £m |
|---|---|---|---|---|---|---|
| Deposits by banks | 358.1 | 522.3 | 330.1 | 374.6 | - | 1,585.1 |
| Customer accounts | 16,465.6 | 2,396.5 | 1,675.4 | 2,048.5 | 1.1 | 22,587.1 |
| Derivative financial instruments | - | 77.2 | 178.9 | 556.1 | 243.0 | 1,055.2 |
| Debt securities in issue | - | 2,873.2 | 4,791.8 | 9,716.1 | 4,503.8 | 21,884.9 |
| Subordinated liabilities | - | 15.6 | 46.8 | 365.1 | 1,705.3 | 2,132.8 |
| Other capital instruments | - | 2.1 | 6.2 | 33.0 | 375.7 | 417.0 |
| Other financial liabilities | - | 128.5 | - | - | - | 128.5 |
| Irrevocable undrawn loan facilities | 985.0 | - | - | - | - | 985.0 |
| **Total** | 17,808.7 | 6,015.4 | 7,029.2 | 13,093.4 | 6,828.9 | 50,775.6 |

Included in the above are the following expected cash flows arising on cash flow hedges (positive = outflow); no impact is anticipated on the Income Statement due to the hedging in place.

| | | | | | | |
|---|---|---|---|---|---|---|
| Cash flow hedges | - | 4.7 | (2.9) | 3.6 | (5.5) | (0.1) |

| Company Financial liabilities At 31 December 2007 | On demand £m | In not more than three months £m | In more than three months but not more than one year £m | In more than one year but not more than five years £m | In more than five years £m | Total £m |
|---|---|---|---|---|---|---|
| Deposits by banks | **115.8** | **575.4** | **822.1** | **230.0** | **-** | **1,743.3** |
| Customer accounts | **35,691.3** | **1,147.3** | **5,504.3** | **1,832.8** | **-** | **44,175.7** |
| Derivative financial instruments | **-** | **60.0** | **180.7** | **154.3** | **(333.8)** | **61.2** |
| Debt securities in issue | **-** | **198.1** | **3,965.8** | **9,340.0** | **5,700.9** | **19,204.8** |
| Subordinated liabilities | **-** | **21.5** | **64.6** | **458.4** | **2,171.1** | **2,715.6** |
| Other financial liabilities | **-** | **131.0** | **-** | **-** | **-** | **131.0** |
| Irrevocable undrawn loan facilities | **75.7** | **-** | **-** | **-** | **-** | **75.7** |
| **Total** | **35,882.8** | **2,133.3** | **10,537.5** | **12,015.5** | **7,538.2** | **68,107.3** |

Included in the above are the following expected cash flows arising on cash flow hedges (positive = outflow); no impact is anticipated on the Income Statement due to the hedging in place.

| | | | | | | |
|---|---|---|---|---|---|---|
| Cash flow hedges | **-** | **0.2** | **(15.1)** | **(51.0)** | **(8.3)** | **(74.2)** |

| Company Financial liabilities At 31 December 2006 | On demand £m | In not more than three months £m | In more than three months but not more than one year £m | In more than one year but not more than five years £m | In more than five years £m | Total £m |
|---|---|---|---|---|---|---|
| Deposits by banks | 152.6 | 422.7 | 331.7 | - | - | 907.0 |
| Customer accounts | 29,275.9 | 2,144.4 | 1,534.4 | 1,950.9 | - | 34,905.6 |
| Derivative financial instruments | - | 45.3 | 159.4 | 392.2 | 82.0 | 678.9 |
| Debt securities in issue | - | 2,290.8 | 2,075.8 | 6,144.7 | 3,748.8 | 14,260.1 |
| Subordinated liabilities | - | 19.5 | 58.6 | 428.0 | 2,261.6 | 2,767.7 |
| Other financial liabilities | - | 121.7 | - | - | - | 121.7 |
| Irrevocable undrawn loan facilities | 522.0 | - | - | - | - | 522.0 |
| **Total** | 29,950.5 | 5,044.4 | 4,159.9 | 8,915.8 | 6,092.4 | 54,163.0 |

Included in the above are the following expected cash flows arising on cash flow hedges (positive = outflow); no impact is anticipated on the Income Statement due to the hedging in place.

| | | | | | | |
|---|---|---|---|---|---|---|
| Cash flow hedges | - | 4.7 | (2.9) | 3.6 | (5.5) | (0.1) |

The above amounts differ from the Balance Sheet carrying values because the Balance Sheet amounts are based on discounted cashflows, and also because the above amounts include associated cashflows including interest; future interest payments have been estimated based on the Bank of England base rate at the Balance Sheet date of 5.50% (2006: 5.00%).

Subordinated liabilities include perpetual instruments as detailed in note 27. The amounts above assume these instruments will be redeemed on 31 December 2032.

# Notes to the Financial Statements

## 40. Risk management continued

**(d) Interest rate risk**
Market risk is the potential adverse change in Group income or Group net worth arising from movements in interest rates, exchange rates or other market prices. Effective identification and management of market risk is essential for maintaining stable net interest income.

The most significant form of market risk to which the Group is exposed is interest rate risk. This typically arises from mismatches between the re-pricing dates of the interest-bearing assets and liabilities on the Group's Balance Sheet, and from the investment profile of the Group's capital and reserves. Treasury is responsible for managing this exposure within the risk exposure limits set out in the Balance Sheet Management policy, as approved by ALCO and the Board. This policy sets out the nature of the market risks that may be taken along with aggregate risk limits, and stipulates the procedures, instruments and controls to be used in managing market risk.

It is ALCO's responsibility to approve strategies for managing market risk exposures and to ensure that Treasury implements the strategies so that the exposures are managed within the Group's approved policy limits.

The Group assesses its exposure to interest rate movements using a number of techniques. However, there are two principal methods:
a) a static framework that considers the impact on the current Balance Sheet of an immediate movement of interest rates; and
b) a dynamic modelling framework that considers the projected change to both the Balance Sheet and product (mortgage and savings) rates over the following year under various interest rate scenarios.
The results of these analyses are presented to senior management in order to identify, measure and manage the Group's exposure to interest rate risk. The Group remained within all its interest rate risk exposure limits during the year and preceding year.

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

Interest rate risk exposure is predominantly managed through the use of interest rate derivatives, principally interest rate swaps and interest rate futures contracts. Interest rate swaps are over-the-counter arrangements with highly rated banking counterparties, while futures contracts are transacted through regulated Futures Exchanges. The Group also uses asset and liability positions to offset exposures naturally wherever possible to minimise the costs and risks of arranging transactions external to the Group.

In general, swaps which have been taken out to manage Group interest rate risk are held by the Company even where the related financial instruments are held by other Group entities. In these cases, the Company's interest rate risk is managed by either creating swaps between the Company and the entities which hold the instruments or by setting the interest rate terms on loan balances between the Company and those entities, in each case in order to reduce the Company's interest rate risk to a low and acceptable level.

Interest rate sensitivities are reported to ALCO monthly and are calculated using a range of interest rate scenarios, including non parallel shifts in the yield curve. The sensitivities below are based upon reasonably possible changes in interest rates and they assume parallel shifts in the yield curve. At the Balance Sheet date a 1% increase or decrease in interest rates compared to actual rates would improve/(reduce) annual net interest income by the following amounts, prior to mitigation:

| | Group | |
|---|---|---|
| | **2007 £m** | 2006 £m |
| 1% increase | **4.4** | 0.7 |
| 1% decrease | **(8.2)** | 4.2 |

At the Balance Sheet date a 1% increase or decrease in interest rates compared to actual rates would increase/(decrease) equity by the following amounts, prior to mitigation:

| | Group | |
|---|---|---|
| | **2007 £m** | 2006 £m |
| 1% increase | **(16.0)** | (19.2) |
| 1% decrease | **17.1** | 2.6 |

In January 2007, the Group and Company established a modest trading book, which is subject to a risk limit framework that is reported daily. The trading book held no significant interest rate risk as at 31 December 2007.

## 40. Risk management continued

**(e) Foreign currency risk**

The Group's policy is to hedge all material foreign currency exposures. Due to the use of derivatives, at 31 December 2007 and 31 December 2006 the Group and Company had no net material exposure to foreign exchange fluctuations or changes in foreign currency interest rates. The impact on the Group's profit and equity of reasonably possible changes in exchange rates compared to actual rates would have been immaterial at 31 December 2007 and 31 December 2006.

Excluding the effects of derivatives, the amounts of financial assets and liabilities denominated in foreign currencies were:

| Group<br>At 31 December 2007 | Sterling<br>£m | Euro<br>£m | US$<br>£m | Other<br>£m | Total<br>£m |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and balances at central banks | **209.2** | **-** | **-** | **-** | **209.2** |
| Treasury bills | **185.0** | **-** | **-** | **-** | **185.0** |
| Loans and advances to banks | **2,203.5** | **123.6** | **65.0** | **-** | **2,392.1** |
| Loans and advances to customers | **40,444.5** | **-** | **-** | **-** | **40,444.5** |
| Fair value adjustments on portfolio hedging | **(53.8)** | **-** | **-** | **-** | **(53.8)** |
| Debt securities | **4,308.5** | **1,867.9** | **602.3** | **-** | **6,778.7** |
| Derivative financial instruments | **1,129.4** | **42.4** | **1.6** | **2.0** | **1,175.4** |
| Other financial assets | **657.1** | **3.3** | **0.6** | **-** | **661.0** |
| **Total financial assets** | **49,083.4** | **2,037.2** | **669.5** | **2.0** | **51,792.1** |
| **Financial liabilities** | | | | | |
| Deposits by banks | **1,118.9** | **759.0** | **196.5** | **-** | **2,074.4** |
| Customer accounts | **23,936.2** | **127.2** | **89.2** | **-** | **24,152.6** |
| Fair value adjustments on portfolio hedging | **(5.9)** | **-** | **-** | **-** | **(5.9)** |
| Derivative financial instruments | **448.5** | **37.5** | **9.1** | **3.5** | **498.6** |
| Debt securities in issue | **5,830.6** | **12,779.9** | **2,541.9** | **1,155.7** | **22,308.1** |
| Subordinated liabilities | **1,253.7** | **-** | **-** | **-** | **1,253.7** |
| Other capital instruments | **161.6** | **-** | **-** | **-** | **161.6** |
| Other financial liabilities | **119.1** | **18.6** | **-** | **3.7** | **141.4** |
| **Total financial liabilities** | **32,862.7** | **13,722.2** | **2,836.7** | **1,162.9** | **50,584.5** |
| **Net financial assets/(liabilities)** | **16,220.7** | **(11,685.0)** | **(2,167.2)** | **(1,160.9)** | **1,207.6** |

| Group<br>At 31 December 2006 | Sterling<br>£m | Euro<br>£m | US$<br>£m | Other<br>£m | Total<br>£m |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and balances at central banks | 202.6 | - | - | - | 202.6 |
| Loans and advances to banks | 2,997.0 | 176.5 | 127.9 | - | 3,301.4 |
| Loans and advances to customers | 36,131.7 | - | - | - | 36,131.7 |
| Fair value adjustments on portfolio hedging | (70.4) | - | - | - | (70.4) |
| Debt securities | 3,136.5 | 1,384.5 | 778.9 | - | 5,299.9 |
| Derivative financial instruments | 264.0 | 22.1 | 4.0 | 0.9 | 291.0 |
| Other financial assets | 16.0 | 18.2 | - | - | 34.2 |
| **Total financial assets** | 42,677.4 | 1,601.3 | 910.8 | 0.9 | 45,190.4 |
| **Financial liabilities** | | | | | |
| Deposits by banks | 751.5 | 352.9 | 408.0 | - | 1,512.4 |
| Customer accounts | 21,793.0 | 237.2 | 170.8 | - | 22,201.0 |
| Derivative financial instruments | 469.1 | 22.9 | 1.4 | - | 493.4 |
| Debt securities in issue | 5,621.6 | 9,219.7 | 1,950.2 | 1,049.8 | 17,841.3 |
| Subordinated liabilities | 1,247.0 | - | - | - | 1,247.0 |
| Other capital instruments | 165.2 | - | - | - | 165.2 |
| Other financial liabilities | 112.5 | 13.8 | - | 2.2 | 128.5 |
| **Total financial liabilities** | 30,159.9 | 9,846.5 | 2,530.4 | 1,052.0 | 43,588.8 |
| **Net financial assets/(liabilities)** | 12,517.5 | (8,245.2) | (1,619.6) | (1,051.1) | 1,601.6 |

# Notes to the Financial Statements

## 40. Risk management continued

### (e) Foreign currency risk

| Company<br>At 31 December 2007 | Sterling<br>£m | Euro<br>£m | US$<br>£m | Other<br>£m | Total<br>£m |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and balances at central banks | **209.2** | - | - | - | **209.2** |
| Treasury bills | **185.0** | - | - | - | **185.0** |
| Loans and advances to banks | **1,713.3** | **123.6** | **65.0** | - | **1,901.9** |
| Loans and advances to customers | **46,314.4** | **4,304.7** | - | **816.3** | **51,435.4** |
| Fair value adjustments on portfolio hedging | **(53.8)** | - | - | - | **(53.8)** |
| Debt securities | **4,928.0** | **1,867.9** | **602.3** | - | **7,398.2** |
| Derivative financial instruments | **422.6** | **42.4** | **1.6** | **2.0** | **468.6** |
| Other financial assets | **655.7** | **3.3** | **0.6** | - | **659.6** |
| **Total financial assets** | **54,374.4** | **6,341.9** | **669.5** | **818.3** | **62,204.1** |
| **Financial liabilities** | | | | | |
| Deposits by banks | **737.0** | **746.5** | **175.0** | - | **1,658.5** |
| Customer accounts | **43,474.1** | **97.1** | **30.6** | - | **43,601.8** |
| Fair value adjustments on portfolio hedging | **(5.9)** | - | - | - | **(5.9)** |
| Derivative financial instruments | **433.1** | **37.5** | **9.1** | **3.5** | **483.2** |
| Debt securities in issue | **2,825.3** | **10,082.1** | **346.0** | **1,155.7** | **14,409.1** |
| Subordinated liabilities | **1,565.3** | - | - | - | **1,565.3** |
| Other financial liabilities | **108.7** | **18.6** | - | **3.7** | **131.0** |
| **Total financial liabilities** | **49,137.6** | **10,981.8** | **560.7** | **1,162.9** | **61,843.0** |
| **Net financial assets/(liabilities)** | **5,236.8** | **(4,639.9)** | **108.8** | **(344.6)** | **361.1** |

| Company<br>At 31 December 2006 | Sterling<br>£m | Euro<br>£m | US$<br>£m | Other<br>£m | Total<br>£m |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and balances at central banks | 202.6 | - | - | - | 202.6 |
| Loans and advances to banks | 2,109.1 | 176.5 | 127.9 | - | 2,413.5 |
| Loans and advances to customers | 37,814.2 | 3,427.1 | - | 654.2 | 41,895.5 |
| Fair value adjustments on portfolio hedging | (70.4) | - | - | - | (70.4) |
| Debt securities | 2,677.5 | 1,384.5 | 778.9 | - | 4,840.9 |
| Derivative financial instruments | 251.2 | 22.1 | 4.0 | 0.9 | 278.2 |
| Other financial assets | 22.1 | 18.2 | - | - | 40.3 |
| **Total financial assets** | 43,006.3 | 5,028.4 | 910.8 | 655.1 | 49,600.6 |
| **Financial liabilities** | | | | | |
| Deposits by banks | 165.7 | 327.6 | 392.5 | - | 885.8 |
| Customer accounts | 34,226.9 | 202.4 | 113.5 | - | 34,542.8 |
| Derivative financial instruments | 384.5 | 22.9 | 1.4 | - | 408.8 |
| Debt securities in issue | 2,383.1 | 6,874.9 | 938.7 | 1,049.8 | 11,246.5 |
| Subordinated liabilities | 1,561.8 | - | - | - | 1,561.8 |
| Other liabilities | 105.7 | 13.8 | - | 2.2 | 121.7 |
| **Total financial liabilities** | 38,827.7 | 7,441.6 | 1,446.1 | 1,052.0 | 48,767.4 |
| **Net financial assets/(liabilities)** | 4,178.6 | (2,413.2) | (535.3) | (396.9) | 833.2 |

### (f) Concentrations of risk

The Group operates primarily in the UK and adverse changes to the UK economy could impact all areas of the Group's business. Loans and advances to customers are all secured on property in the UK. 59% (2006: 58%) of loans and advances to customers are concentrated in the buy-to-let market; the remaining balances are mainly secured on residential owner-occupied properties.

The Group has investments in a range of debt securities issued by government bodies, banks and building societies, and in asset-backed securities, in both the UK and overseas. UK government securities, bank and supranational securities and bank certificates of deposit comprise 61% (2006: 55%) of debt securities held. 68% (2006: 67%) of the asset-backed securities are UK invested.

Customer accounts comprise investment and savings accounts held by customers. 20% of these (2006: 20%) were opened through direct channels and 11% (2006: 15%) through Bradford & Bingley International Ltd, the Group's deposit taker on the Isle of Man. Debt securities in issue represent bonds, medium term notes and other debt securities issued in a range of countries and currencies with no significant investment by any individual counterparty.