Santander UK plc

Interim Accounts

For the nine months ended 30 September 2018

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Company Income Statement

For the nine months ended 30 September 2018 and 2017

	Notes	Nine months ended 30 September 2018 £m	Nine months ended 30 September 2017 £m
Profit before tax		**2,135**	848
Tax on profit	3	**(345)**	(332)
Profit after tax for the period		**1,790**	516

Company Balance Sheet

At 30 September 2018 and 31 December 2017

	Notes	30 September 2018 £m	31 December 2017 £m
Assets			
Cash and balances at central banks		**26,821**	27,643
Trading assets		**8,138**	-
Derivative financial instruments		**4,691**	4,038
Other financial assets at fair value through profit or loss		**5,781**	793
Loans and advances to banks[1]		**3,900**	14,688
Loans and advances to customers[1]		**218,218**	206,157
Reverse repurchase agreements - non trading[1]		**15,055**	476
Financial investments		**23,353**	20,118
Interests in other entities	4	**1,614**	4,490
Intangible assets		**1,768**	1,677
Property, plant and equipment		**1,121**	1,181
Current tax assets		**276**	187
Retirement benefit assets		**858**	436
Other assets		**2,860**	1,637
Assets held for sale		**649**	-
Total assets		**315,103**	283,521
Liabilities			
Deposits by banks[1]		**22,567**	20,535
Deposits by customers[1]		**198,053**	198,419
Repurchase agreements - non trading[1]		**3,269**	7,988
Trading liabilities		**1,258**	-
Derivative financial instruments		**2,992**	2,244
Other financial liabilities at fair value through profit or loss		**18,039**	1,297
Debt securities in issue		**41,394**	32,048
Subordinated liabilities		**3,818**	3,870
Other liabilities		**2,926**	2,087
Provisions		**440**	514
Deferred tax liabilities		**154**	73
Retirement benefit obligations		**101**	286
Liabilities held for sale		**5,167**	-
Total liabilities		**300,178**	269,361
Equity			
Share capital		**3,119**	3,119
Share premium		**5,620**	5,620
Other equity instruments		**2,241**	2,281
Retained earnings		**4,072**	3,139
Other reserves		**(127)**	1
Total shareholders' equity		**14,925**	14,160
Total liabilities and equity		**315,103**	283,521

(1) From 1 January 2018, non-trading repurchase agreements and non-trading reverse repurchase agreements that are held at amortised cost are now presented as separate lines in the balance sheet, as described in Note 1. Comparatives are re-presented accordingly.

The unaudited and abridged Interim Accounts were approved and authorised for issue by the Board on 30 October 2018 and signed on its behalf by:

Nathan Bostock
Chief Executive Officer

Antonio Roman
Chief Financial Officer

Company Registered Number: 2294747

Company Statement of Changes in Equity

For the nine months ended 30 September 2018

				Other reserves				
	Share capital £m	Share premium £m	Other equity instruments £m	Available-for-sale £m	Fair value reserve £m	Cash flow hedging £m	Retained earnings £m	Total £m
At 31 December 2017	**3,119**	**5,620**	**2,281**	**68**		**(67)**	**3,139**	**14,160**
Adjustment for the adoption of IFRS 9 (see Note 2)	–	–	–	(68)	63	–	(153)	(158)
At 1 January 2018	**3,119**	**5,620**	**2,281**		**63**	**(67)**	**2,986**	**14,002**
Profit after tax	–	–	–		–	–	1,790	1,790
Other comprehensive income, net of tax:								
– Fair value reserve (debt instruments)	–	–	–		(22)	–	–	(22)
– Cash flow hedges	–	–	–		–	(101)	–	(101)
– Pension remeasurement	–	–	–		–	–	379	379
– Own credit adjustment	–	–	–		–	–	(29)	(29)
Total comprehensive income	–	–	–		(22)	(101)	2,140	2,017
Redemption of AT1 Capital Securities	–	–	(40)		–	–	–	(40)
Other	–	–	–		–	–	(45)	(45)
Dividends on ordinary shares	–	–	–		–	–	(918)	(918)
Dividends on preference shares and other equity instruments	–	–	–		–	–	(125)	(125)
Tax on other equity instruments	–	–	–		–	–	34	34
At 30 September 2018	**3,119**	**5,620**	**2,241**		**41**	**(168)**	**4,072**	**14,925**

Under English law, the amount available for distribution to shareholders is based upon the retained earnings reserve and is limited by statutory or other restrictions.

1. BASIS OF PREPARATION

These unaudited and abridged Interim Accounts have been prepared for the purposes of Section 838 of the UK Companies Act 2006 and do not constitute statutory accounts as defined in section 434 of the UK Companies Act 2006. Statutory accounts for the year ended 31 December 2017 have been delivered to the Registrar of Companies. The auditor's report on those accounts was unmodified, did not draw attention to any matters by way of emphasis and did not contain a statement under section 498(2) of the UK Companies Act 2006.

2. ACCOUNTING POLICIES

Except as noted below, the same accounting policies, presentation and methods of computation are followed in these Interim Accounts as were applied in the presentation of Santander UK plc's 2017 Annual Report.

IFRS 5 Non-current Assets Held for Sale
Non-current assets (or disposal groups) are classified as held for sale when their carrying amount is to be recovered principally through a sale transaction rather than continuing use. In order to be classified as held for sale, the asset must be available for immediate sale in its present condition subject only to terms that are usual and customary and the sale must be highly probable. Non-current assets (or disposal groups) held for sale are measured at the lower of carrying amount and fair value less cost to sell, with the exception of financial instruments which remain governed by the requirements of IFRS 9 'Financial Instruments' (IFRS 9), and are held at their IFRS 9 carrying value.

Recent accounting developments
On 1 January 2018, the Santander UK group adopted IFRS 9 and IFRS 15 'Revenue from Contracts with Customers' (IFRS 15). The new/revised accounting policies are set out below. Santander UK plc has decided to continue adopting IAS 39 hedge accounting and consequently there have been no changes to the hedge accounting policies and practices set out in the 2017 Annual Report following the adoption of IFRS 9.

The application of IFRS 9 decreased shareholders' equity at 1 January 2018 by £158m (net of tax), comprising a £25m decrease arising from the application of the new classification and measurement requirements for financial assets, and a £191m decrease arising from the application of the new ECL impairment methodology, these amounts being partially offset by the recognition of a deferred tax asset of £58m.

The accounting policy changes for IFRS 9, set out in section (i) below, have been applied from 1 January 2018. Comparatives have not been restated.

The classification and measurement changes to financial assets that arose on adoption of IFRS 9 have been aligned to the presentation in the balance sheet.

In addition, non-trading repurchase agreements and non-trading reverse repurchase agreements are now presented as separate lines in the balance sheet. Previously, non-trading reverse repurchase agreements were included in 'Loans and advances to banks' and 'Loans and advances to customers', and non-trading repurchase agreements were included in 'Deposits by banks' and 'Deposits by customers'. The new presentation, which is considered to be more relevant to an understanding of our financial position, was adopted with effect from 1 January 2018, and comparatives are re-presented accordingly.

The application of IFRS 15 had no material impact on Santander UK plc as there were no significant changes in the recognition of in scope income. The accounting policy changes for IFRS 15 are set out in section (ii) below.

i) IFRS 9 accounting policy changes

Interest income and expense
Interest and similar comprises interest income on financial assets measured at amortised cost, investments in debt instruments measured at fair value through other comprehensive income (FVOCI) and interest income on hedging derivatives. Interest expense and similar charges comprises interest expense on financial liabilities measured at amortised cost, and interest expense on hedging derivatives.

Interest income on financial assets measured at amortised cost, investments in debt instruments measured at FVOCI and interest expense on financial liabilities other than those at fair value through profit or loss (FVTPL) is determined using the effective interest rate method.

The effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the gross carrying amount of the financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument excluding expected credit losses (ECLs). The calculation includes all amounts paid or received by the Santander UK group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of the financial instrument and all other premiums or discounts.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for financial assets that have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the ECL provision).

Financial instruments
a) Initial recognition and measurement
Financial assets and liabilities are initially recognised when Santander UK plc becomes a party to the contractual terms of the instrument. Santander UK plc determines the classification of its financial assets and liabilities at initial recognition and measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at FVTPL are expensed in profit or loss. Immediately after initial recognition, an ECL allowance is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI.

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

b) Financial assets and liabilities

i) Classification and subsequent measurement

From 1 January 2018, Santander UK plc has applied IFRS 9 Financial Instruments and classifies its financial assets in the following measurement categories:

- Amortised cost;
- FVOCI;
- FVTPL.

Financial assets and financial liabilities are classified as FVTPL where there is a requirement to do so or where they are otherwise designated at FVTPL on initial recognition. Financial assets and financial liabilities which are required to be held at FVTPL include:

- Financial assets and financial liabilities held for trading (see below);
- Debt instruments that do not have solely payments of principal and interest (SPPI) characteristics. Otherwise, such instruments are measured at amortised cost or FVOCI; and
- Equity instruments that have not been designated as held at FVOCI.

Financial assets and financial liabilities are classified as held for trading if they are derivatives or if they are acquired or incurred principally for the purpose of selling or repurchasing in the near-term, or form part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

In certain circumstances other financial assets and financial liabilities are designated at FVTPL where this results in more relevant information. This may arise because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains or losses on them on a different basis, where the assets and liabilities are managed and their performance evaluated on a fair value basis or, in the case of financial liabilities, where it contains one or more embedded derivatives which are not closely related to the host contract.

The classification and measurement requirements for financial asset debt and equity instruments and financial liabilities are set out below.

a) Financial assets: debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans and government and corporate bonds. Classification and subsequent measurement of debt instruments depend on the Santander UK group's business model for managing the asset, and the cash flow characteristics of the asset.

Business model

The business model reflects how Santander UK plc manages the assets in order to generate cash flows and, specifically, whether Santander UK plc's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable, such as where the financial assets are held for trading purposes, then the financial assets are classified as part of 'Other' business model and measured at FVTPL. Factors considered by Santander UK plc in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the assets' performance is evaluated and reported to key management personnel and how risks are assessed and managed.

SPPI

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, Santander UK plc assesses whether the assets' cash flows represent SPPI. In making this assessment, Santander UK plc considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related asset is classified and measured at FVTPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are SPPI.

Based on these factors, Santander UK plc classifies its debt instruments into one of the following three measurement categories:

- Amortised cost – Financial assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL recognised and measured. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method. When the group revises the estimates of future cash flows, the carrying amount of the respective financial assets or financial liability is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in the income statement.
- FVOCI – Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are recognised in OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net trading and other income'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.
- FVTPL – Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt instrument that is subsequently measured at FVTPL, including any debt instruments designated at fair value, is recognised in profit or loss and presented in the income statement in 'Net trading and other income' in the period in which it arises.

Santander UK plc reclassifies financial assets when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent.

b) Financial assets: equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective being instruments that do not contain a contractual obligation to pay cash and that evidence a residual interest in the issuer's net assets. Santander UK plc subsequently measures all equity investments at FVTPL, except where management has elected, at initial recognition, to irrevocably designate an equity investment at FVOCI. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. ECLs (and reversal of ECLs) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when Santander UK group's right to receive payments is established. Gains and losses on equity investments at FVTPL are included in the 'Net trading and other income' line in the income statement.

c) Financial liabilities
Financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability) and partially in profit or loss (the remaining amount of change in the fair value of the liability);
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Santander UK group recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments.

ii) Impairment of debt instrument financial assets
Santander UK plc assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from financial guarantee contracts and loan commitments. Santander UK plc recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

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

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

Other contractual modifications are assessed on a case-by-case basis to establish whether or not the financial asset should be derecognised.

iv) Derecognition other than on a modification
Financial assets are derecognised when the rights to receive cash flows have expired or Santander UK plc has transferred its contractual right to receive the cash flows from the assets and either: (1) substantially all the risks and rewards of ownership have been transferred; or (2) Santander UK plc has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when extinguished, cancelled or expired.

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

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and
- The premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

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

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

ii) IFRS 15 accounting policy changes

Revenue recognition: fee and commission income and expense
Fees and commissions that are not an integral part of the effective interest rate are recognised when the service is performed. For retail and corporate products, fee and commission income consists principally of collection services fees, commission on foreign currencies, commission and other fees received from retailers for processing credit card transactions, fees received from other credit card issuers for providing cash advances for their customers through the Santander UK group's branch and ATM networks, annual fees payable by credit card holders and fees for non-banking financial products.

For insurance products, fee and commission income consists principally of commissions and profit share arising from the sale of building and contents insurance and life protection insurance. Commissions arising from the sale of buildings and contents insurance are recognised over the period of insurance cover, adjusted to take account of cancelled policies. Profit share income from the sale of buildings and contents insurance which is not subject to any adjustment is recognised when the profit share income is earned. Commissions and profit share arising from the sale of life protection insurance is subject to adjustment for cancellations of policies within 3 years from inception.

Fee and commission income which forms an integral part of the effective interest rate of a financial instrument (e.g. certain loan commitment fees) is recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.

The majority of fee and commission income is recognised at a point in time. Certain commitment, upfront and management fees are recognised over time but are not material.

3. TAXATION

	Nine months ended 30 September 2018 £m	Nine months ended 30 September 2017 £m
Profit before tax	**2,135**	848
Tax calculated at a tax rate of 19% (2017: 19.25%)	**406**	163
Bank surcharge on profits at 8%	**171**	68
Non-taxable dividends	**(1,005)**	-
Impairment of investments	**681**	(1)
Other disallowable items and non-taxable income	**92**	113
Adjustment to prior year provisions	**-**	(11)
Tax charge	**345**	332

4. INTERESTS IN OTHER ENTITIES

	30 September 2018 £m	31 December 2017 £m
Subsidiaries	**1,611**	4,487
Joint ventures	**3**	3
	1,614	4,490

Interests in subsidiaries

The movement in interests in subsidiaries was as follows:

	Cost £m	Impairment £m	Net book value £m
At 1 January 2018	**4,819**	**(332)**	**4,487**
Additions	**66**	**(45)**	**21**
Change in carrying value of investment in Abbey National Services plc ('ANTS plc') as a result of implementation of ring-fencing	**–**	**(2,512)**	**(2,512)**
Reversal	**–**	**3**	**3**
Dissolution/disposal	**(2,072)**	**2,021**	**(51)**
Reclassification to held for sale	**(337)**	**–**	**(337)**
At 30 September 2018	**2,476**	**(865)**	**1,611**

During the nine months ended 30 September 2018, as part of our ring-fencing plans, the prohibited business of ANTS plc was transferred to Banco Santander SA, save for a small pool of residual assets, and the permitted business of ANTS plc was transferred to Santander UK plc. In addition, ANTS plc paid Santander UK plc dividends of £3,546m relating to these transfers.

Following these dividends, at 30 September 2018 the carrying value of the investment in ANTS plc was reduced by £2,512m to £337m (2017: £2,849m), reflecting the net assets of ANTS plc. In addition, at 30 September 2018, management considered it highly probable that Santander UK Group Holdings plc will acquire 100% of the ordinary share capital of ANTS plc from Santander UK plc, which resulted in Santander UK plc's interest in ANTS plc being reclassified in the balance sheet as held for sale.