










Sainsbury's Bank plc

Report and Accounts for the
12 month Period to 31st December 2008

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Report by the Board of Directors to the shareholders

The Directors have pleasure in submitting their report and the accounts of Sainsbury's Bank plc ('the Bank') for the 12-month period ended 31 December 2008 to the Annual General Meeting to be held on 16 April 2009.

Comparatives shown for the prior period are for the nine months to 31 December 2007 (audited) and a pro forma 12 months to December 2007 equivalent has been included where it is considered useful for comparison purposes.

Principal activities

The Bank provides banking services and related financial services wholly within the UK. During the period the Bank continued to develop its customer offer through sales of its core products: personal loans, savings accounts, credit cards, general and life insurance. The Bank is a joint venture between J Sainsbury plc and Bank of Scotland plc with a contractual arrangement in place to govern the sharing of joint control. Following the acquisition of HBOS plc by Lloyds TSB Group plc on 16 January 2009, Bank of Scotland plc became part of the Lloyds Banking Group plc. J Sainsbury plc and Bank of Scotland plc are incorporated and domiciled in England and Scotland respectively. Sainsbury's Bank plc is incorporated and domiciled in England.

Development and performance of the business

The Bank delivered a profit before tax of £5.9 million (12 months to December 2007: £9.6 million loss; nine months ending December 2007: £6.6 million loss). The Directors are pleased with the position, delivered through steady income growth and strong cost management within the context of a challenging economic climate. The directors remain confident in the long-term profitability of the business.

During the last 12 months, the Bank has achieved even greater integration with the Sainsbury's core brand, and has sought to reassure customers during these uncertain times by continuing to translate 'Great Products at Fair Prices' into a strong financial services proposition. Whilst the Bank continues to focus on risk prudence in both the wholesale and retail credit risk arenas, we will continue to drive even stronger integration with Sainsbury's, delivering a wealth of benefits to the Sainsbury's shopper and incremental value to our shareholders.

The underlying banking business has driven increased profitability through a rise in net interest income (enhanced asset pricing and reduced cost of funds) and strong cost management. The profit delivery is particularly strong given the challenges posed by a number of one-off items including the exceptional levies imposed by the Financial Services Compensation Scheme to fund the collapse of five other UK-based financial institutions (£5 million in 2008).

The Bank uses a variety of key performance measures to monitor progress against strategic objectives. These include product portfolio measures, financial measures and customer measures.

With an independent banking licence, the Bank continues to be regarded as a safe haven for customer deposits and we were pleased to attract a high number of new savings customers. Because the Bank has retail liabilities in excess of retail assets, it was in the fortunate position to not have to compete heavily for new savings balances in what became a highly competitive, high rate market. Overall savings balances decreased by 37 per cent over the year to £3.6 billion (12 months to December 2007: 141 per cent increase; nine months to December 2007: 141 per cent increase). As rates have normalised in 2009, we have seen a significant increase in new account volumes and the associated funding.

Total lending balances remained broadly flat, decreasing by 1 per cent (12 months to December 2007: decrease of 12 per cent; nine months to December 2007: increase of 9 per cent).

The Bank remains well-provided for in terms of coverage for non-performing assets on our unsecured personal lending book. Our aging mortgage book has been closed to new acquisition since 2004, is of high quality and it continues to run down. During 2008 we further tightened our retail risk appetite from an already conservative base. In particular we have tightened customer affordability and risk-based screening criteria, tightened our credit limit management practices and focused acquisition on higher credit-scoring customers. Impairment losses on loans and advances to customers reduced by 20 per cent to a level of £71 million for the 12 months to 31 December 2008, compared to the 12 months to 31 December 2007 (an increase of 19 per cent on the nine months to December 2007).

Principal risks and uncertainties

Through its normal operations the Bank is exposed to a number of risks including credit risk, liquidity risk and interest rate risk. Responsibility for managing exposure to such risks rests with the Risk Management Committee. Further details are provided in note 28.

In addition to financial risks, the Bank is also exposed to operational risks. The Bank identifies, evaluates and monitors operational risks through a number of core processes such as operational risk profiling, loss event reporting, the use of key risk indicators and regular control self assessments. Regular reports are provided to the Operational and Regulatory Risk Committee and other governance bodies.

The Financial Services Authority is the main regulator for the Bank. The Bank supports the FSA's Treating Customers Fairly initiative and has set clear principles for doing business. This is supported by ongoing maintenance of procedures across the Bank's operations, with associated enhancement and development where necessary. The objective is to meet the requirements of our shareholders through meeting the needs of our customers.

The Bank monitors regulatory change and utilises both in-house and centralised expertise within the Lloyds Banking Group plc and from external advisors, to:

- Identify, assess, respond to, and where possible influence, regulatory developments on behalf of the Bank, such as the new liquidity standards regime;
- Manage, support and co-ordinate the liaison and interaction with the Bank's regulatory stakeholders.

The management of regulatory change is reported to the Operational and Regulatory Risk Committee, the Risk Management Committee and ultimately to the Audit Committee and the Board.

During 2008 the widely reported 'credit crunch' had a significant impact on a number of financial institutions and has led to an increased focus on liquidity risk. The Bank has a robust risk management framework in place and the FSA requires the Bank to have a policy in place for the management of liquidity in both normal and abnormal circumstances. In line with this policy, the Bank maintains an FSA prescribed level of Sterling Stock Liquid Assets which comprises of high-quality assets that can be sold quickly for cash. The liquidity of the Bank continues to be prudently managed with the sterling stock liquidity ratio well in excess of the FSA requirement of 5 per cent at 14.54 per cent as at 31 December 2008. In addition to this, the Bank prepares both long-term and short-term forecasts to assess liquidity requirements. Short-term forecasting covers a rolling 12-month period and takes into account factors such as ATM cash management, investment maturities and customer deposit patterns and balances. These reports support daily liquidity management and are reviewed daily by senior management. At 31 December 2008 the Bank has assessed the fair value of its investment securities with reference to quoted market prices as outlined in its accounting policies.

In addition to forecast cash flow plans, the Bank's Individual Capital Adequacy Assessment Process (ICAAP) assesses liquidity risk under stressed conditions. This specifically considers scenarios such as a worsening of credit conditions, exceptional asset growth, worst case balance attrition, and restriction in funding sources.

This and ongoing scenario testing provides assurance that the Bank has sufficient liquid resources and that the contingency framework in place can generate sufficient additional liquidity to ensure the Bank can meet its liabilities as they fall due.

Capital management

The FSA sets and monitors capital requirements for the Bank. In implementing current capital requirements the FSA requires the Bank to maintain a prescribed level of capital with reference to risk weighted assets and the perceived risk management framework. Our submissions to the FSA in the period have shown that the Bank has complied with all externally imposed capital requirements. We have been in discussions with the FSA in respect of large exposure requirements during the period and are in the process of rectifying four minor breaches on Floating Rate Note holdings that have occurred due to movements in sterling relative to the euro.

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. The capital base has not changed materially in the 12 months to 31 December 2008.

The Bank's regulatory capital is analysed into two tiers. Tier 1 capital includes ordinary share capital and retained earnings after the deduction of intangible assets. Tier 2 capital includes dated and undated loan capital plus a collective impairment allowance. Various limits are applied to elements of the capital base. Tier 2 capital cannot exceed Tier 1, and lower Tier 2 capital cannot exceed 50 per cent of Tier 1 capital. The Bank meets both requirements.

On 1 January 2008 the Bank moved onto the new approach for the calculation of its capital requirements as introduced by the Capital Requirements Directive. The standardised approaches to credit risk and operational risk have been adopted by the Bank.

The Bank's regulatory capital position at 31 December 2008 and 31 December 2007 was as follows:

	31 December 2008 (unaudited) £m	31 December 2007 (unaudited) £m
Risk weighted assets	2,294.3	3,004.0
Core Tier 1 capital ratio	8.7%	6.6%
Total capital ratio	14.9%	11.5%

The table set out below forms an integral part of the audited financial statements as described in the Accounting Policies on pages 4 to 7.

	31 December 2008 (audited) £m	31 December 2007 (audited) £m
Tier 1 capital	199.3	198.1
Tier 2 capital	141.8	147.6
Total capital	341.1	345.7

End of information that forms an integral part of the audited financial statements.

It is anticipated that the Bank will disclose 'Pillar 3' information as required by the Capital Requirements Directive and FSA prudential sourcebook on the J Sainsbury plc external website during 2009.

Going concern and position of the Bank at the end of the financial period

The Directors believe that the Bank is in a stable financial position and is well placed to generate profits in the future. A profit was generated for the current year following a preceding year loss. The turmoil in the financial markets and the resulting low interest rates saw a reduction in retail deposits during the year. The Bank's business plan demonstrates future profitability through the management of these deposits as well as other product initiatives.

As discussed above, the risk management framework in place is considered adequate in managing liquidity risk in the current environment. For the avoidance of doubt, the Bank does not rely on short-term wholesale borrowing to fund retail activity. The Bank has strengthened its liquidity ratio (based on the sterling stock liquidity ratio) from 11.51 per cent at 31 December 2007 to 14.54 per cent at 31 December 2008.

In considering the appropriateness of preparing the accounts under the going concern basis the Bank has considered the going concern status of its parent companies J Sainsbury plc and Lloyds Banking Group plc and in neither case found cause for concern in relation to the Bank's own going concern status. The net exposure to J Sainsbury plc was a liability and, whilst the net exposure to HBOS plc was an asset, this is in the form of a collateralised loan.

Whilst the Bank outsources many of its operations to other partner providers, including parties within the Lloyds Banking Group plc, the Board does not consider these arrangements to be susceptible to those parties' going concern status. This is due to the likelihood of an orderly rundown in the event of administration, and the ability of the Bank to migrate operations as outlined in the terms of the agreements to alternative providers over a period of 12 months.

The Directors are satisfied that the Bank has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the accounts.

Issued and authorised share capital

The amount of issued share capital was unchanged from the previous year at £170 million (note 22).

Dividends

The profit after tax for the period attributable to the shareholders is £4.1 million (9 months to December 2007: £5.0 million loss). The Directors do not recommend payment of a dividend.

Directors

The Directors at 31 December 2008 were:

Mr Dan Watkins (Chairman)	Appointed 10 August 2007
Mr Darren Shapland (Deputy Chairman)	Appointed 17 July 2006
Ms Gwyn Burr	Appointed 18 September 2006
Mr Peter Jackson	Appointed 18 September 2006
Ms Imelda Walsh	Appointed 23 February 2007
Ms Hannah Bernard	Appointed 1 August 2007
Mr Neil Chandler (Chief Executive)	Appointed 1 May 2008
Mr Adam Seale	Appointed 27 October 2008

The Board comprises two Executive Directors and six Non-Executive Directors. Messers Watkins, Jackson, Chandler and Seale are employed and remunerated by HBOS plc. Mr Shapland, Ms Burr, Ms Walsh and Ms Bernard are employed and remunerated by J Sainsbury plc.

With the exception of Messers Chandler and Seale, who were appointed during the period, all of the Directors in office at the date of this report served throughout the period.

Other Directors who served during the period to 31 December 2008 were:

Mr Philip Grant Resigned 14 April 2008

Mr Robert Walker Resigned 1 May 2008
(Chief Executive)

No Director had an interest in the shares of the Bank.

The Bank has provided an indemnity for the benefit of all of its current Directors which is a qualifying third party indemnity provision for the purpose of the Companies Act 1985.

As a result of a change in the Companies Act no disclosure is made of the Directors' interests in the shares of J Sainsbury plc or HBOS plc.

Audit Committee

The members of the Audit Committee in office at the end of the period consisted of Mr Darren Shapland (Chairman, representing J Sainsbury plc), Mr Richard Fleming (representing J Sainsbury plc), Mr Adam Seale (representing HBOS plc) and Mr Peter Beddows (representing HBOS plc). Mr Richard Fleming and Mr Adam Seale were appointed on 7 November 2008. Mr Philip Grant and Mr John Rogers served as members of the Audit Committee until their resignation on 24 April 2008 and 7 November 2008 respectively.

Charitable and other donations

During the period the Bank made charitable donations in the UK of £91,756 (December 2007: £NIL).

Suppliers

The Bank recognises the importance of maintaining good business relationships with its suppliers and is committed to paying all invoices within agreed terms. The average number of days' credit taken at 31 December 2008 was 19 days (December 2007: 16 days).

Post balance sheet events

Details of post balance sheet events, including the acquisition of HBOS plc by Lloyds TSB Group plc, are given in Note 37 to the financial statements.

Statement as to disclosure of information to auditors

At the date of this report, each of the Directors in office have taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information. As far as each Director is aware, there is no relevant audit information of which the Bank's auditors are unaware.

By order of the Board and signed on its behalf by

Hannah Bernard
Company Secretary
London
16 April 2009

Accounting policies

(a) Statement of compliance

The Bank's accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The accounts also comply with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

(b) Basis of preparation

The accounts have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and financial assets and liabilities held at fair value through profit and loss.

The accounting policies explained below here have been consistently applied to all periods presented in these financial statements. Certain comparative amounts have been reclassified to conform to the current year's presentation.

During 2008, global financial markets experienced difficult conditions which have been characterised by a marked reduction in liquidity. As a consequence of this, governments and central banks carried out a series of actions to address the lack of liquidity within their respective banking systems.

The risk management framework in place for the Bank is considered adequate in managing liquidity risk in the current environment. For the avoidance of doubt, the Bank does not rely on the wholesale markets to fund retail activity. The Bank has strengthened its liquidity ratio (based on the sterling stock liquidity ratio) from 11.51 per cent at 31 December 2007 to 14.54 per cent at 31 December 2008.

In considering the appropriateness of preparing the accounts under the going concern basis the Bank has considered the going concern status of its parent companies J Sainsbury plc and Lloyds Banking Group plc and in neither case found cause for concern in relation to the Bank's own going concern status. The net exposure to J Sainsbury plc was a liability and, whilst the net exposure to HBOS plc was an asset, this is in the form of a collateralised loan.

The Bank outsources many of its operations to other partner providers, including parties within the Lloyds Banking Group plc. The Board has considered these arrangements and does not believe them to be susceptible to those parties' going concern status.

A profit was generated for the period and the Directors believe that the Bank is in a stable financial position and is well placed to generate profits in the future.

The Directors are satisfied that the Bank has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the accounts.

(c) Designation of financial instruments

The Bank has classified its financial instruments in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' as follows:

Non-derivative financial assets where there is no active market and which have fixed or determinable payments are classified as 'loans and receivables'. No assets are held for trading. Derivative instruments are automatically classified as 'at fair value through the income statement' unless they form part of an effective hedging relationship. No financial assets are designated as 'held to maturity'. All other financial assets are classified as 'available for sale'. All other financial liabilities are classified as 'at amortised cost'.

The resulting treatment of these financial instruments is set out in the accounting policies below.

(d) Loans and advances including impairment

Loans and advances are held at amortised cost, using the effective interest method, less provision for impairment and recognised on the balance sheet when cash is advanced.

For the Bank's portfolios of loans, such as credit card lending and personal loans, impairment provisions are calculated for groups of assets, otherwise impairment is identified at a counterparty specific level following objective evidence that a financial asset is impaired. Such evidence may include a missed interest or principal payment or the breach of a banking covenant. The present value of estimated cash flows recoverable is determined after taking into account any security held. The amount of impairment is calculated by comparing the present value of the cash flows discounted at the loans' original effective interest rate with the balance sheet carrying value. If impaired, the carrying value is adjusted and the difference charged to the income statement and a provision recognised in the balance sheet.

The written down value of the impaired loan is compounded back to the net realisable balance over time using an effective interest rate. This is reported through interest receivable within the income statement and represents the unwinding of the discount.

A write-off is made when all or part of a claim is deemed uncollectible or forgiven. Write-offs are charged against previously established provisions for impairment or directly to the income statement. Subsequent recoveries of amounts written off decrease the charge for loan impairment in the income statement.

An allowance for impairment losses is also maintained in respect of assets which are impaired at the balance sheet date but which have not been identified as such, based on historical loss experience and other relevant factors. The methodology and assumptions used are regularly reviewed to reduce any differences between estimates and actual results.

(e) Investment securities including impairment

These comprise debt securities and other fixed interest securities, including treasury and other eligible bills and are recognised on the date the contract is entered into. They are classified as 'available for sale' and carried on the balance sheet at fair value with unrealised gains or losses being recognised through reserves.

Income on available for sale debt securities is recognised on an effective interest rate basis and taken to interest receivable through the income statement. On sale, maturity or impairment deferred gains and losses arising from available for sale securities are recognised in other operating income.

Investment securities classified as available for sale are continually reviewed at the specific investment level for impairment. Impairment is recognised when there is objective evidence that a specific financial asset is impaired. Objective evidence of impairment might include a significant or prolonged decline in market value below the original cost of a financial asset and, in the case of debt securities, non-receipt of due interest or principal repayment, a breach of covenant within the security's terms and conditions or a measurable decrease in the estimated future cash flows since their initial recognition.

The disappearance of active markets, declines in market value and ratings downgrades do not in themselves constitute objective evidence of impairment and, unless a default has occurred on a debt security, the determination of whether or not objective evidence of impairment is present at the balance sheet date requires the exercise of management judgement.

(f) Property, plant and equipment

Property, plant and equipment includes fixtures and fittings, and computer hardware costs and is stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. The cost is written off, on a straight-line basis, over the expected lives of the assets, generally between one and ten years.

Property, plant and equipment are assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The depreciation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

(g) Intangible assets - software development costs

Computer Software & Systems

Purchased computer software licenses are capitalised on the basis of the costs incurred to acquire, and bring into use, the specific software. These costs are amortised, on a straight-line basis, over the expected useful lives of the assets (three to five years).

Internally Generated Computer Software & Systems (including website)

Costs directly associated with the production of identifiable and unique software products or systems that are considered likely to generate economic benefits, and are capable of operating in the manner intended by management, are recognised as intangible assets. Such intangible assets arising from development of software and/or systems are amortised, on a straight line basis, over their useful economic lives (not exceeding four years) from the date the product is available for use. Other expenditure, including software research development costs are expensed as incurred.

Capitalised development expenditure and purchased software is stated at cost less accumulated amortisation and impairment losses. Such assets are assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The depreciation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

Subsequent expenditure is only capitalised when it increases the future economic benefits embodied in the specific asset to which it relates.

(h) Income recognition

Interest income and expense are recognised in the income statement for all financial instruments measured at amortised cost using the effective interest method. This calculation takes into account all amounts that are integral to the yield as well as incremental transaction costs. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument to the net carrying amount of the financial asset or liability at initial recognition.

Fees and commissions, that are not integral to the effective interest rate calculation, are recognised in the income statement as services that are provided. Where in the case of insurance commissions the income comprises an initial commission and profit share, both are recognised on completion of the service to the extent reliably measurable. Where there is a risk of potential claw back, an appropriate element of the commission receivable is deferred and amortised over the life of the underlying loan or period of claw back.

(i) Taxation

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Taxation is determined using tax rates (and laws) enacted or substantially enacted at the balance sheet date. Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

(j) Nectar points

The cost of Nectar points, awarded as incentives to the Bank's customers, is recognised when earned by the customer. These costs are included within administrative expenses in the income statement.

(k) Cash and cash equivalents

Cash and cash equivalents are held for the purpose of meeting short-term cash commitments rather than investing or other purposes. Cash and cash equivalents consist of cash and balances with central banks that are freely available and non-equity investments with a maturity of three months or less from the date of acquisition.

(l) Other borrowed funds

Other borrowed funds comprise subordinated liabilities, which consist of dated and undated loan capital. These are held at amortised cost and the interest payable is recognised in the income statement through interest payable.

(m) financial liabilities

Financial liabilities comprise deposits from banks and customer accounts. All financial liabilities are measured at amortised cost using the effective interest rate method. A financial liability is derecognised from the balance sheet when the bank has discharged its obligations, the contract is cancelled or expires.

(n) Foreign currencies

The accounts are presented in sterling which is the Bank's functional and presentation currency.

Foreign currency transactions are translated into sterling at the exchange rate prevailing at the date of the transaction. Monetary assets and liabilities are translated at balance sheet date exchange rates. Exchange differences arising are recognised in the income statement except for differences related to cash flow hedges which are recognised directly in equity.

(o) Derivative instruments

During the period the Bank used cash flow hedging as a risk management tool for hedging foreign exchange rate risk on on-balance sheet assets.

Cash flow hedge accounting matches the cash flows of hedged items against the corresponding cash flow of the hedging derivative. The effective part of any gain or loss on a hedging instrument is recognised directly in equity in the cash flow hedge reserve and the hedged item is accounted for in accordance with the policy for that financial instrument. Any ineffective portion of the hedging instrument's fair value is recognised immediately in the income statement through net trading income.

The amount deferred in reserves remains until the designated transaction occurs at which time it is released and accounted for in the income statement in line with the treatment of the hedged item. Should circumstances arise where the hedge relationship subsequently proves ineffective, is early settled or is terminated the associated gains and losses that were recognised directly in reserves are reclassified to the income statement through net income.

(p) Marketing expenditure

All marketing and expenditure related to the acquisition of customer accounts is written off as incurred.

(q) New accounting standards

The following IFRS standards and International Financial Reporting Interpretations Committee ('IFRIC') interpretations have been applied in 2008:

Amendments to IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures'. The Bank has considered the option to re-classify FRNs from the available for sale category to loans and advances and decided that it is not appropriate to do so. The Bank has disclosed an expected maturity profile of its financial assets and liabilities in note 28.

(r) Critical accounting estimates and judgements

The preparation of accounts requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, most critically in respect of impairment losses on loans and advances, effective yield and the valuation of investment securities.

The prolonged period of turmoil affecting global financial markets has increased the need for banks to ensure that their financial statements provide a clear account of the impact of the current situation on their financial position. A report issued by the Financial Stability Forum (FSF) in April 2008 sets out recommendations for increasing the resilience of markets in the future and has improved the guidance and disclosures about valuations, methodologies and the uncertainty associated with valuations. Management has considered these guidelines in assessing the fair values of investment securities and loans and advances.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

The principal critical accounting judgements made by the Bank that have a material financial impact on the financial statements are as follows:

Active markets

An important factor in determining a valuation methodology is the existence of an active market. An active market is one where prices are readily and regularly available from an exchange, broker, pricing service, industry group or regulator and these prices represent actual and regularly occurring transactions on an arm's-length basis. Where there are no regular transactions occurring (significant liquid markets) the market is not described as active. A significant increase in the spread between the price sellers are 'asking' and buyers are 'bidding' or the presence of a relatively small number of 'bidding' parties, are indicators that a market may be inactive. The determination of whether a market is inactive requires judgement.

Impairment of investment securities

Investment securities classified as available for sale are continually reviewed at the specific investment level for impairment. Impairment is recognised when there is objective evidence that a specific financial asset is impaired. Objective evidence of impairment might include a significant or prolonged decline in market value below the original cost of a financial asset and, in the case of debt securities, non-receipt of due interest or principal repayment, a breach of covenant within the security's terms and conditions or a measurable decrease in the estimated future cash flows since their initial recognition.

The disappearance of active markets, declines in market value and ratings downgrades do not in themselves constitute objective evidence of impairment and, unless a default has occurred on a

debt security, the determination of whether or not objective evidence of impairment is present at the balance sheet date requires the exercise of management judgement. This judgement is even more important and challenging in the current market conditions when market activity is significantly reduced.

Impairment losses on loans and advances

Impairment loss calculations involve the estimation of future cash flows of financial assets, based on observable data at the balance sheet date and historical loss experience for assets with similar credit risk characteristics. These calculations are undertaken on a portfolio basis using various statistical modelling techniques. Impairment models are continually reviewed to ensure data and assumptions are appropriate. However, the accuracy of any such impairment calculation will be affected by unexpected changes to the economic situation, and assumptions which differ from actual outcomes. As such, significant judgement is applied in selecting and updating impairment models.

Effective yield

In calculating the effective interest rate of a financial instrument the Bank takes into account all amounts that are integral to the yield of a financial instrument as well as incremental transaction costs. In the case of loans and advances significant judgement is applied in estimating the effect of various factors on future cash flows. In the case of insurance commissions income comprises an initial commission and profit share both of which are recognised on completion of the service to the extent reliably measurable. Where there is a risk of claw back judgement is applied in deferring an appropriate element of the commission receivable and amortising this over an expected average life.

Determining fair values

The determination of fair value for financial assets and liabilities, for which there is no observable market price, requires the use of various valuation techniques some of which require significant degrees of judgement.

The main methodologies and assumptions used in estimating the fair values of financial instruments are as follows:

- **Cash and balances with central banks**
Fair value approximates to carrying value because they have minimal credit losses and are either short term in nature or re-price frequently.
- **Loans and advances to customers**
The fair value of loans and advances is estimated by discounting anticipated cash flows, including interest, at a current market rate of interest.
- **Loans and advances to banks and deposits by banks**
The fair value of floating rate placements and overnight deposits is equal to carrying value. The fair value of fixed interest bearing deposits is based on cash flows discounted using current money market interest rates for debts with similar maturity and credit risk characteristics.
- **Customer accounts and other borrowings**
The fair value of customer deposits with no stated maturity date is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings with no quoted market price is calculated using a cash flow model discounted using interest rates for debts with similar maturity.
- **Investment securities**
Fair value is based on market prices or broker/dealer valuations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. In 2008 and 2007 all securities were valued from market prices or broker/dealer valuations. In a small number of cases (investment securities with a value of £48.7 million) valuations have been derived from suitable proxy bonds with similar credit and maturity profiles.

Accounting policies continued

The prevailing market conditions have made fair valuing investment securities more difficult than normal due to the reduced level of active trades. However, in valuing the investment securities portfolio, management has considered the guidance in the FSF report and judges that there is an active market for all bonds in the portfolio and all the bonds have been valued from market observable data.

Qualifying hedge relationships

In designating financial instruments as qualifying hedge relationships, the Bank has determined that it expects the hedge to be highly effective over the life of the hedging instrument. In accounting for derivatives as cash flow hedges, the Bank has determined that the hedged cash flow exposure relates to highly probable future cash flows.

(s) IFRS and IFRIC not yet applied

The following standards and interpretations have been adopted by the European Union but are not effective for the year ended 31 December 2008 and have not been applied in preparing the financial statements:

IFRS 8 'Operating Segments' which is effective for periods commencing on or after 1 January 2009. This standard replaces IAS 14 'Segmental Reporting' and its application will not have any impact upon the financial results of the Bank.

The following standards and interpretations have not yet been adopted by the European Union, are not effective for the year ended 31 December 2008 and have not been applied in preparing the financial statements. Where appropriate disclosures will be revised in the financial statements in the year in which the standard or interpretation becomes applicable.

Amendments to IAS 1 'Presentation of Financial Statements: A Revised Presentation' which is effective for periods commencing on or after 1 January 2009. The revised standard will affect the presentation of owner changes in equity and of comprehensive income. Adoption will not change the recognition, measurement or disclosure of specific transactions or events as required by other standards.

Amendment to IAS 23 'Borrowing Costs' which is applicable to borrowing costs related to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The application of this revised standard in 2008 would not have had a material impact on the financial statements.

Amendment to IFRS 2 'Share-based Payment: Vesting Conditions and Cancellations' which is effective for periods commencing on or after 1 January 2009. This defines 'non-vesting' conditions and clarifies the accounting. The application of this amendment would not have an impact upon the financial statements as it is not applicable to the Bank as it does not make share-based payments.

Amendments to IAS 32 and IAS 1 'Puttable Financial Instruments and Obligations Arising on Liquidation' which is effective for periods commencing on or after 1 January 2009. This amendment addresses the balance sheet classification of puttable financial instruments and obligations arising only on liquidation. Where these instruments represent a residual interest in the net assets of an entity and meet certain other conditions they should be classified as equity rather than liabilities. These amendments are not applicable to the Bank as it has no such instruments.

IFRS 1 'First-time adoption of IFRS' which is effective for periods commencing on or after 1 January 2009. As the Bank reports under IFRS, the application of this amendment in 2008 would not have any effect upon the financial statements.

Amendments to IAS 27 'Consolidated and Separate Financial Statements' which is effective for periods commencing on or after 1 January 2009. This is not applicable to the Bank.

IFRIC 12 'Service Concession Arrangements' which is effective for periods commencing on or after 1 January 2008. The application of this interpretation would not have affected the financial statements as it is not applicable to the Bank.

IFRIC 13 'Customer Loyalty Programmes' which is effective for periods commencing on or after 1 July 2008. This is not applicable to the Bank.

IFRIC 15 'Agreements for the Construction of Real Estate' which is effective for periods commencing on or after 1 January 2009. This is not applicable to the Bank.

IFRIC 16 'Hedges of a Net Investment in a Foreign Operation' which is effective for periods commencing on or after 1 October 2008. This is not applicable to the Bank.

IFRIC 17 'Distributions of Non Cash Assets to Owners' which is effective for periods commencing on or after 1 July 2009. The application of this interpretation would not have affected the financial statements as the Bank's accounting policy accords with the requirements.

IASB 'Improvements to IFRS 2008'. The majority of these improvements are effective for periods commencing on or after 1 January 2009 and their application would not have had a material effect upon the financial statements.

Amendments to IAS 39 'Financial Instruments: Recognition and Measurement: Eligible Hedged Items' which is effective for periods commencing on or after 1 July 2009. This amendment clarifies what can be designated as a hedged item in a hedge accounting relationship and application in 2008 would not have had a material impact upon the financial statements.

Revised IFRS 3 'Business Combinations' and amended IAS 27 'Consolidated and Separate Financial Statements'. These changes are effective for periods beginning on or after 1 July 2009 with the main effects being that the cost of investment will comprise the consideration paid to the vendors for equity with acquisition costs being expensed immediately; goodwill will be accounted for only upon the acquisition of a subsidiary as subsequent changes in interest will be recognised in equity and only upon the loss of control will any profit or loss be recognised in income. Further, any pre-existing stake held will, where control is subsequently gained, be revalued with any profit or loss arising being booked to income. These changes will affect the manner in which any acquisitions and disposals made by the Bank are accounted for after the implementation of the revised Business Combinations standard and related revisions to IAS 27. The application of this revised standard in 2008 would not have had an impact on the financial statements.

Income statement

for the year to 31 December, 2008

	Note	12 months to 31 December 2008 £m	9 months to 31 December 2007 £m
Interest receivable	3	373.9	246.9
Interest payable	3	(287.9)	(187.5)
Net interest income		86.0	59.4
Fees and commissions receivable		104.7	82.3
Fees and commissions payable		(2.1)	(2.0)
Other operating income		4.3	0.2
Net operating income		192.9	139.9
Administrative expenses	5	(102.8)	(80.3)
Depreciation and amortisation			
Property, plant and equipment	6	(3.8)	(3.8)
Intangible assets	7	(2.0)	(2.5)
		(108.6)	(86.6)
Impairment losses on financial assets	9	(78.4)	(59.9)
Profit/(loss) before taxation	4	5.9	(6.6)
Tax on profit/(loss)	10	(1.8)	1.6
Total profit/(loss) attributable to equity holders of the Bank		4.1	(5.0)

The statement of accounting policies on pages 4 to 7 and the notes on pages 12 to 37 form part of these accounts.

Balance sheet

as at 31 December, 2008

	Note	As at 31 December 2008 £m	As at 31 December 2007 £m
Assets			
Cash and balances at central banks		181.2	133.5
Financial investments - Available for sale			
- Treasury bills	11	308.7	199.8
- Investment securities	12	1,126.3	1,020.1
Loans and advances to banks	14	1,457.0	3,370.5
Loans and advances to customers	15	1,878.5	1,901.5
Property, plant and equipment	6	16.4	17.2
Intangible assets	7	1.5	3.3
Current tax asset		-	5.3
Deferred tax asset	10	28.3	4.3
Other assets	16	122.2	187.0
Prepayments and accrued income		21.0	61.9
Total assets		5,141.1	6,904.4
Liabilities			
Deposits by banks	17	898.7	750.8
Derivatives designated as cash flow hedging instruments	13	282.6	58.4
Customer accounts	18	3,640.2	5,734.8
Other liabilities	19	28.7	20.2
Current tax liabilities		-	-
Accruals and deferred income	20	37.6	37.4
Other borrowed funds			
Dated loan capital	21	60.0	60.0
Undated loan capital	21	50.0	50.0
Total liabilities		4,997.8	6,711.6
Equity			
Called up share capital	22	170.0	170.0
Retained earnings	23	34.9	30.8
Other reserves	25	(61.6)	(8.0)
Equity shareholders' funds	24	143.3	192.8
Total equity and liabilities		5,141.1	6,904.4

The financial statements on pages 8 to 37 were approved by the Board of Directors on 16 April 2009 and signed on its behalf by:

Hannah Bernard Director and Company Secretary
16 April 2009

Neil Chandler Director and Chief Executive

The statement of accounting policies on pages 4 to 7 and the notes on pages 12 to 37 form part of these accounts.

Statements of recognised income and expense

for the year to 31 December, 2008

	Note	12 months to 31 December 2008 £m	9 months to 31 December 2007 £m
Available for sale investments			
Net changes in fair value taken to equity	25	(74.3)	48.9
Cash flow hedges:			
Effective portion of changes in fair value	25	0.2	(60.7)
Tax on items recognised directly in equity	24	20.5	3.5
Income and expense recognised directly in equity	24	(53.6)	(8.3)
Profit/loss for the financial period		4.1	(5.0)
Total recognised income and expense for the financial period attributable to the equity holders of the bank	24	(49.5)	(13.3)

The statement of accounting policies on pages 4 to 7 and the notes on pages 12 to 37 form part of these accounts.

Cash flow statement

for the year to 31 December, 2008

	Note	12 months to 31 December 2008 £m	9 months to 31 December 2007 £m
Cash flows from operating activities	30	89.9	1,042.8
Cash flows from investing activities	31	(3.5)	(2.0)
Cash flows from financing activities	32	(7.5)	34.9
Net increase in cash and cash equivalents		78.9	1,075.7
Opening cash and cash equivalents	33	1,865.3	789.6
Closing cash and cash equivalents	33	1,944.2	1,865.3

The statement of accounting policies on pages 4 to 7 and the notes on pages 12 to 37 form part of these accounts.

Notes to the accounts

1 Staff

The nature of the joint venture is such that the Bank does not directly employ individuals. The individuals who work for the Bank have contracts of employment with either a member of the J Sainsbury plc group of companies or a member of the HBOS plc group of companies. Their remuneration cost is included in the financial statements of J Sainsbury plc or HBOS plc and is charged to the Bank as part of a management fee and the pension element of this is treated as a defined contribution charge. The average weekly number of staff working on the Bank's operations during the period is set out below.

	31 December 2008 Number	31 December 2007 Number
Full-time	640	638
Part-time	48	40
	688	678

Of the above, a total of 149 full-time and 11 part-time staff are directly seconded from the relevant members of the parent organisations to the Bank. The remaining 491 full-time and 37 part-time staff (December 2007: 483 full-time, 40 part-time) are involved in product processing activities. The costs relating to these staff are disclosed in other administrative expenses in note 5.

The Bank is recharged certain costs for members of staff who work for various entities within the HBOS plc group of companies in accordance with and subject to certain agreed principles. These entities are participating employers in both a defined contribution pension scheme and a defined benefit pension scheme based upon final pensionable pay, operated by HBOS plc Group. A total of 62 (December 2007: 71) employees participate in the defined benefit scheme, the HBOS Final Salary Pension Scheme (HBOS FSPPS), which was formed on 3 July 2006 following the merger of various other schemes within the HBOS plc group of companies.

As the Bank is not a participating employer in the HBOS FSPPS it does not have a share in the scheme assets and liabilities and as such the pension recharges are treated as a defined contribution charge. The current surplus net of deferred taxation on the HBOS FSPPS at 31 December 2008, valued on an IAS 19 basis, is £374 million (2007: deficit £189 million). The latest full actuarial valuation of the HBOS FSPPS was carried out as at 31 December 2007 by a qualified independent actuary.

The Bank is also recharged certain costs for members of staff who work for members of the J Sainsbury plc group of companies (some of these staff are members of a funded defined benefit scheme) in accordance with and subject to certain agreed principles. Two schemes exist, the J Sainsbury Pension and Death Benefit Scheme ('JSPDBS') and the J Sainsbury Executive Pension Scheme ('JSEPS'). A total of five (December 2007: 16) employees participate in the defined benefit schemes both of which were closed to new employees on 31 January 2002.

The pension cost recharge for the period represents contributions payable by the Bank to both types of pension scheme and amounted to £347,000 (December 2007: £148,000) for the defined contribution schemes and £631,000 (December 2007: £462,000) for the defined benefit schemes.

2 Directors' emoluments

	12 months to 31 December 2008 £000's	12 months to 31 December 2007 £000's
(i) Aggregate emoluments		
Aggregate emoluments	650	720
Aggregate amounts payable under long-term incentive schemes	30	150

Retirement benefits have accrued or are accruing under either J Sainsbury plc's or HBOS plc's defined benefit schemes to two (December 2007: one) Executive Directors.

The emoluments set out above include those Executive Directors who held office during the period, all of whom were employed by and paid by either J Sainsbury or HBOS plc. The Bank is recharged emolument costs in accordance with and subject to the terms of arrangements agreed with the relevant employer.

The aggregate amounts payable under long-term incentive schemes were in respect of the qualifying services of one Director who resigned during the period.

There were no payments made to Non-Executive Directors who served during the period (December 2007: £NIL). These Non-Executive Directors who served during the period were paid by J Sainsbury or HBOS plc, who made no recharge to the Bank as their emoluments are deemed to be wholly attributable to services to the respective shareholder companies. Accordingly, the above details include no emoluments in respect of these Non-Executive Directors.

	12 months to 31 December 2008 £000's	12 months to 31 December 2007 £000's
(ii) Highest-paid Director		
Aggregate emoluments	251	570
Aggregate amounts payable under long-term incentive schemes	-	150

The aggregate amounts payable under long-term incentive schemes were in respect of the qualifying services of one Director who resigned during the period. There are no long-term incentive scheme payments relating to the period ended 31 December 2008 for the highest-paid Director. Included in the aggregate emoluments for the nine months ending 31 December 2007 are payments of £164,712 relating to the period ended 31 March 2007 and £82,244 of long-term incentive scheme payment relating to the same period.

The highest-paid Director did not exercise any share options in the shares of their employing company during the period. The retirement benefits accruing in relation to the highest-paid Director were £40,668 (December 2007: £NIL).

3 Net interest income

	12 months to 31 December 2008 £m	9 months to 31 December 2007 £m
Interest income		
Interest income on loans and receivables	302.1	216.8
Interest income from available for sale financial instruments	69.8	26.0
Interest on derivative liabilities	2.0	4.1
	373.9	246.9
Interest expense		
Interest expense on loans and receivables	(287.9)	(187.5)
	(287.9)	(187.5)
Net interest income	86.0	59.4

Amounts relating to cash flow hedges transferred to profit or loss during the period are reflected as a component of interest income or expense. Net ineffectiveness recognised on cash flow hedges during 2008 was £NIL (2007: £NIL).

4 Profit/loss before taxation

	12 months to 31 December 2008 £m	9 months to 31 December 2007 £m
Profit/(loss) before taxation is stated after taking account of the following:		
Income:		
Interest on impaired loan balances	0.6	1.6
Expenses:		
Loss on disposal of fixed assets	0.3	0.3
Auditors' remuneration		
Statutory audit of the Bank	0.1	0.1
Tax services (compliance and advisory)	-	-

5 Administrative expenses

	12 months to 31 December 2008 £m	9 months to 31 December 2007 £m
Staff costs	9.9	7.1
Marketing costs	20.0	19.9
Other administrative expenses	72.9	53.3
	102.8	80.3

6 Property, plant and equipment

	Equipment £m
31 December 2008	
Cost	
At 1 January 2008	44.3
Additions	3.3
Disposals	(1.9)
As at 31 December 2008	45.7
Depreciation	
At 1 January 2008	27.1
Charge for the period	3.8
Disposals	(1.6)
As at 31 December 2008	29.3
Net book value at 31 December 2008	16.4
31 December 2007	
Cost	
At 1 April 2007	43.0
Additions	1.8
Disposals	(0.5)
As at 31 December 2007	44.3
Depreciation	
At 1 April 2007	23.5
Charge for the period	3.8
Disposals	(0.2)
As at 31 December 2007	27.1
Net book value at 31 December 2007	17.2

7 Intangible assets

Systems and
software
development
£m

31 December 2008

Cost	
At 1 January 2008	12.9
Additions	0.2
As at 31 December 2008	13.1
Amortisation	
At 1 January 2008	9.6
Charge for the period	2.0
As at 31 December 2008	11.6
Net book value at 31 December 2008	1.5

Systems and
software
development
£m

31 December 2007	
Cost	
At 1 April 2007	12.7
Additions	0.2
As at 31 December 2007	12.9
Amortisation	
At 1 April 2007	7.1
Charge for the period	2.5
As at 31 December 2007	9.6
Net book value at 31 December 2007	3.3

8 Capital commitments

31 December
2008
£m

31 December
2007
£m

There are commitments in respect of capital expenditure which has been authorised, but not provided for in the accounts, for which contracts have been entered into, on:

Property, plant and equipment	1.2	1.8
Software development	0.8	0.2
	2.0	2.0

9 Impairment losses on financial assets

	31 December 2008 £m	31 December 2007 £m
Loans and advances to customers	71.0	59.6
Investment securities - Available for sale realised losses	4.1	0.3
Investment securities - Available for sale unrealised losses	3.3	
	78.4	59.9

A reconciliation of impairment losses on loans and advances by class is as follows:

	Unsecured lending £m	Secured lending £m	2008 Total £m
12 months to 31 December 2008			
At 1 January 2008	172.7	-	172.7
New impairment provisions less releases (net of recoveries)	73.3	-	73.3
Amounts written off	(86.7)	-	(86.7)
Discount unwind on impaired loans and advances to customers	(0.6)	-	(0.6)
Cumulative impairment provisions as at 31 December 2008	158.7	-	158.7
New impairment provisions less releases	74.7	-	74.7
Recoveries of amounts previously written off	(3.7)	-	(3.7)
Net charge to income statement	71.0	-	71.0
Individual impairment	153.9	-	153.9
Collective impairment	4.8	-	4.8
	158.7	-	158.7
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	186.8	5.5	192.3
9 months to 31 December 2007			
At 1 April 2007	159.6	-	159.6
New impairment provisions less releases (net of recoveries)	59.6	-	59.6
Amounts written off	(44.9)	-	(44.9)
Discount unwind on impaired loans and advances to customers	(1.6)	-	(1.6)
Cumulative impairment provisions as at 31 December 2007	172.7	-	172.7
New impairment provisions less releases	67.7	-	67.7
Recoveries of amounts previously written off	(8.1)	-	(8.1)
Net charge to income statement	59.6	-	59.6
Individual impairment	165.2	-	165.2
Collective impairment	7.5	-	7.5
	172.7	-	172.7
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	204.5	4.0	208.5

Impairment loss calculations involve the estimation of future cash flows of financial assets, based on observable data at the balance sheet date and historical loss experience for assets with similar credit risk characteristics. Impairment models are continually reviewed to ensure data and assumptions are appropriate. However, the accuracy of any such impairment calculation will be affected by unexpected changes to the economic situation, and assumptions which differ from actual outcomes.

10 Taxation

	31 December 2008 £m	31 December 2007 £m
(i) Taxation		
UK corporation tax on profit/(loss) for the period at 28.5 per cent (December 2007: 30 per cent)	1.5	(1.8)
Tax underprovided for prior years	-	2.1
Current tax	1.5	0.3
Movement on deferred tax asset	0.3	(2.2)
Impact of change in UK corporation tax rate	-	0.3
Deferred tax	0.3	(1.9)
Total tax charge/(credit)	1.8	(1.6)

The rate of UK corporation tax reduced to 28 per cent from 30 per cent from 6 April 2008. The taxation charge/(credit) of £1,793,135 (December 2007: £1,625,000) represents 30.6 per cent (December 2007: 24.6 per cent) of pre-tax profits (2007: loss). In addition to this, a tax credit of £20,519,735 (December 2007: £3,546,082) relating to Available for Sale and Cash Flow reserves has been recognised in equity. Differences to the UK corporation tax rate for the period of 28.5 per cent are explained below:

(ii) Reconciliation of effective tax rate

	31 December 2008 £m	31 December 2007 £m
Profit/(loss) on ordinary activities before tax	5.9	(6.6)
Tax on ordinary activities at 28.5 per cent (30 per cent)	1.7	(2.0)
Effects:		
- Adjustments in respect of prior periods	0.1	0.1
- Other - effect of change in UK corporation tax rate on deferred tax	-	0.3
	1.8	(1.6)

(iii) Deferred taxation

The deferred tax asset, which is not wholly recoverable within one year, is in respect of timing differences which will reverse and result in a lower tax charge in future years and losses carried forward, is as follows:

	31 December 2008 £m	31 December 2007 £m
Deferred tax asset		
At 1 January/1 April	4.3	2.4
Movement in deferred tax asset	24.0	1.9
As at 31 December	28.3	4.3
Tax effect of timing differences due to:		
Accelerated capital allowances	0.2	0.1
Timing differences on impairment provisions	2.3	2.6
Losses carried forward	25.8	1.6
Deferred tax asset at 31 December	28.3	4.3

The deferred tax asset has been recognised on the basis that losses can be surrendered in full to other consortium companies and utilised against profits in those companies, or against future profits of the Bank. Deferred tax assets and liabilities are offset when there is a legally enforceable right to do so.

The losses carried forward at 31 December 2008 relate to fair value movements on available for sale securities £24.0 million and £1.8 million carried forward trading losses (December 2007: losses carried forward relate to trading losses £1.6 million).

11 Treasury bills

	31 December 2008 £m	31 December 2007 £m
Treasury bills	308.7	199.8
	308.7	199.8

All of the above Treasury bills are repayable within three months.

12 Investment securities

	31 December 2008 £m	31 December 2007 £m
Investment securities		
Unlisted - issued by banks and building societies	1,126.3	1,020.1
	1,126.3	1,020.1
Of which:		
Maturing within one year	72.3	29.4
Maturing in more than one year	1,054.0	990.7
	1,126.3	1,020.1

The movement on investment securities is as follows:

	31 December 2008 £m	31 December 2007 £m
At 1 January/1 April	1,020.1	100.3
Additions	39.8	880.5
Maturities and disposals	(74.9)	(11.5)
Changes in value taken to equity	142.3	50.7
Amortisation	(1.0)	0.1
At 31 December	1,126.3	1,020.1

13 Derivative financial instruments

As part of its asset and liability management the Bank uses derivatives for hedging purposes in order to reduce its exposure to market risks. This is achieved by hedging specific forecast transactions against balance sheet exposures. The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the fair value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk.

Derivatives held as cash flow hedges

	Notional amount 2008	Assets £m	Liabilities £m
Currency swaps	707.3	-	282.6

Cash flow hedges

The Bank is exposed to foreign exchange risks from cash flows arising on some of its available for sale investment securities. These forecast transactions in foreign currencies are hedged with currency swaps. The cash flows on the currency swaps substantially match the cash flow profile of the hedged investment securities.

There were no transactions for which cash flow hedge accounting had to be ceased in 2008 (2007: nil) as a result of the highly probable cash flows no longer being expected to occur.

14 Loans and advances to banks

	Note	31 December 2008 £m	31 December 2007 £m
Sterling loans and advances to banks		1,457.0	3,370.5
Repayable on demand (included in cash equivalents)	33	-	-
Other loans and advances repayable			
In three months or less (included in cash equivalents)	33	1,457.0	1,535.0
Between three months and one year		-	1,835.5
Gross advances		1,457.0	3,370.5

15 Loans and advances to customers

	Note	31 December 2008 £m	31 December 2007 £m
Gross advances		2,037.2	2,074.2
Impairment losses on loans and advances	9	(158.7)	(172.7)
Loans and advances to customers		1,878.5	1,901.5
Repayable on demand		746.7	789.6
Other loans and advances repayable			
In three months or less		85.6	85.7
Between three months and one year		245.9	249.4
Between one and five years		782.2	767.4
After five years		176.8	182.1
Gross advances		2,037.2	2,074.2

The Bank's gross lending exposure before deduction of impairment provisions is analysed below:

	31 December 2008 £m	31 December 2007 £m
Individuals:		
Home mortgages	102.6	120.2
Unsecured personal lending	1,934.6	1,954.0
Gross loans and advances to customers	2,037.2	2,074.2

16 Other assets

Included in other assets at 31 December 2008 is ATM cash in transit amounting to £85.7 million (December 2007: £169.5 million) and amounts due from link settlements of £22.4 million (December 2007: £NIL).

Other assets have no fixed maturities but are expected to be realised within 12 months.

17 Deposits by banks

	31 December 2008 £m	31 December 2007 £m
Repayable		
Within three months	70.3	92.3
Between three months and one year	168.6	210.4
Between one and five years	621.5	439.8
More than five years	38.3	8.3
	898.7	750.8

18 Customer accounts

Customer accounts comprise sterling interest bearing deposits.

	31 December 2008 £m	31 December 2007 £m
Repayable on demand	3,640.2	5,714.6
Repayable		
Within three months	-	20.2
Customer accounts	3,640.2	5,734.8

19 Other liabilities

All other liabilities are expected to be settled within three months.

	31 December 2008 £m	31 December 2007 £m
Customer funds in course of settlement	11.8	5.6
Bank funds in course of settlement	0.5	2.0
Income tax collected on behalf of HMRC	6.7	8.9
Financial Services Compensation Scheme levy	5.0	-
Other liabilities	4.7	3.7
	28.7	20.2

Other liabilities include an accrual for levies to be made by the Financial Services Compensation Scheme (FSCS) based on draft guidance issued by The Financial Services Authority. The FSCS is funded by levies on firms authorised by the FSA, based on their level of deposits taken at 31 December each year. The Bank, as a regulated deposit taker, is subject to levies imposed by the FSCS whose costs are made up of management expenses and compensation payments. As the UK's statutory fund of last resort for customers of domestic financial institutions, the FSCS stepped in during 2008 to provide significant funding in relation to the bail out of five banks whose depositors are protected by the scheme. In order to meet its obligations, the FSCS has borrowed £19.7 billion from HM Treasury on an interest only basis until September 2011. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the institutions assisted. This has resulted in an additional levy being set by the FSCS to cover the interest on this loan. Interest will continue to accrue on the HM Treasury loan to the FSCS until September 2011 and will form part of future FSCS management expenses levies. If the assets of the failed institutions are insufficient to repay the loan in 2011, the FSCS will agree a schedule of repayments with HM Treasury which will be recouped from the industry in the form of additional levies. At the date of these financial statements, it is not possible to estimate whether there will ultimately be additional levies on the industry, or the effect of these upon the future financial statements of the Bank.

The impact of this levy in the 2008 financial statements is an accrual of £5.0 million for its share of levies that will be raised by the FSCS including the interest on the loan in respect of the levy years to 31 March 2010, based on an estimate of the interest that the FSCS will pay on the loan and an estimate of the Bank's market participation in the relevant periods. It is estimated to be £1.9 million and £1 million for 2009 and 2010 respectively.

20 Accruals and deferred income

Included in accruals and deferred income at 31 December 2008 are amounts payable to J Sainsbury plc of £4.6 million (December 2007: £5.6 million) and amounts payable to HBOS plc group of £20.0 million (December 2007: £17.0 million) in respect of management services and capital expenditure. Accruals and deferred income has no fixed maturity.

21 Other borrowed funds

	31 December 2008 £m	31 December 2007 £m
Dated loan capital - Repayable after five years		
£60 million Floating Rate subordinated loan 2014	60.0	60.0
Undated loan capital		
£50 million Floating Rate subordinated loan - undated	50.0	50.0

Dated loan capital

The dated subordinated loan is split in proportion to shareholder funding. See note 34 - 'Parent Company'. No repayment, for whatever reason, of dated subordinated debt prior to its stated maturity may be made without the consent of the Financial Services Authority. On a winding up of the Bank, the claims of the holders of dated subordinated debt shall be subordinated in right of payment to the claims of all depositors and creditors of the Bank other than creditors whose claims are expressed to rank pari passu with or junior to the claims of the holders of the dated subordinated debt.

On 30 November 2008, a deed was made among Sainsbury's Bank, J Sainsbury plc and Bank of Scotland plc to extend the term of each loan by one calendar year to 2 December 2014. This was pre-approved by the Financial Services Authority on 12 November 2008.

Interest on the £60 million Floating Rate subordinated loan dated 2014, is payable three months in arrears at LIBOR plus a margin of 0.60 per cent per annum for the duration of the loan.

Undated loan capital

The undated subordinated loans are split in proportion to shareholder funding. See note 34 - 'Parent Company'. The undated subordinated loan capital shall be repaid on such date as the Financial Services Authority shall agree in writing for such repayment (following a request by either the Lender or Borrower) and in any event not less than five years and one day from the dates of drawdown. On a winding up of the Bank, the claims of the holders of undated subordinated debt shall be subordinated in right of payment to the claims of all depositors and creditors of that company other than creditors whose claims are expressed to rank pari passu with or junior to the claims of the holders of the undated subordinated debt.

Interest on the £50 million Floating Rate undated loan capital is payable three months in arrears at LIBOR plus a margin of 1.0 per cent per annum for the duration of the loan.

22 Called up share capital

	Ordinary shares 31 December 2008 £m	Ordinary shares 31 December 2007 £m	
Authorised			
At 1 January/1 April	200.0	200.0	
	'A' Ordinary shares of £1	'B' Ordinary shares of £1	Total Ordinary shares of £1
Allotted, called up and fully paid			
At 1 January 2008	85.0	85.0	170.0
Issued Ordinary Shares	-	-	-
At 31 December 2008	85.0	85.0	170.0

The share capital is divided into class 'A' and class 'B' Ordinary shares which rank pari passu in all respects.

23 Retained earnings

	31 December 2008 £m	31 December 2007 £m
At 1 January/1 April	30.8	35.8
Profit/(loss) for the period to 31 December	4.1	(5.0)
At 31 December	34.9	30.8

The shareholders' agreement prescribes that a distribution of profits may not be made if the distribution would result in the Bank being in regulatory test deficit, the distribution would or would be likely to result in a breach of any covenant to any lender, or if a distribution would not be prudent having regard to the future outlook and performance of the Bank.

24 Statement of changes in equity

	Share capital £m	Retained earnings £m	Other reserves* £m	Total £m
At 31 December 2008				
At 1 January 2008	170.0	30.8	(8.0)	192.8
Net unrealised gains/(losses)	-	-	(81.0)	(81.0)
Realised gains/(losses) reclassified to the income statement.	-	-	7.0	7.0
Tax on items recognised directly in equity	-	-	20.5	20.5
Net income/(expense) recognised directly in equity	-	-	(53.5)	(53.5)
Profit for the period	-	4.1	-	4.1
Total recognised income and expense for the period	-	4.1	(53.5)	(49.4)
Balance at 31 December 2008	170.0	34.9	(61.5)	143.3

	Share capital £m	Retained earnings £m	Other reserves* £m	Total £m
At 31 December 2007				
At 1 April 2007	140.0	35.8	0.3	176.1
Net unrealised gains/(losses)	-	-	(12.1)	(12.1)
Realised gains/(losses) reclassified to the income statement	-	-	0.3	0.3
Tax on items recognised directly in equity	-	-	3.5	3.5
Net income/(expense) recognised directly in equity	-	-	(8.3)	(8.3)
Loss for the period	-	(5.0)	-	(5.0)
Total recognised income and expense for the period	-	(5.0)	(8.3)	(13.3)
Additional share capital raised in the period	30.0	-	-	30.0
Balance at 31 December 2007	170.0	30.8	(8.0)	192.8

* Other reserves comprise the fair value movements for available for sale securities. The effective portion of changes in the fair value of cash flow hedges are also recorded in other reserves.

25 Other reserves

Other reserves comprise the fair value movements for available for sale securities. The effective portion of changes in the fair value of cash flow hedges are also recorded in other reserves. Both the available for sale reserve and cash flow reserve will unwind in line with the maturity profile of the underlying investment securities. The maturity profile of the investment securities is highlighted in note 12.

	31 December 2008 £m	31 December 2007 £m
At 1 January 2008		
Net unrealised losses	(8.0)	0.3
Realised losses reclassified to the income statement on disposal	(81.0)	(12.1)
Tax effect of net losses	7.0	0.3
	20.5	3.5
Balance at 31 December 2008	(61.5)	(8.0)

Of the balances above £(59.3) million (December 2007: £34.5 million) relates to the available for sale reserve and £(2.2) million (December 2007: £(42.5) million) to the cash flow hedge reserve.

26 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The principle accounting policies on pages 4 to 7 describe how financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the balance sheet by the class of financial instrument to which they are assigned, and therefore by the measurement basis:

	Held for trading £m	Held to maturity securities £m	Loans and receivables £m	Available-for-sale securities £m	Financial assets and liabilities at amortised cost £m	Derivatives designated as cash flow hedging instruments £m	Total £m
At 31 December 2008							
Assets							
Cash and balances at central banks			181.2	-			181.2
Financial investments - Available for sale							
Treasury bills				308.7			308.7
Investment securities				1,126.3			1,126.3
Loans and advances to banks			1,457.0				1,457.0
Loans and advances to customers			1,878.5				1,878.5
Deferred tax asset			28.3				28.3
Other assets			122.2				122.2
Prepayments and accrued income			20.6				20.6
Total financial assets	-	-	3,687.8	1,435.0	-	-	5,122.8
Total non-financial assets							18.3
Total assets							5,141.1
Liabilities							
Deposits by banks					898.7		898.7
Derivatives designated as cash flow hedging instruments						282.6	282.6
Customer accounts					3,640.2		3,640.2
Other liabilities					28.7		28.7
Accruals and deferred income					37.6		37.6
Other borrowed funds							
Dated loan capital					60.0		60.0
Undated loan capital					50.0		50.0
Total financial liabilities	-	-	-	-	4,715.2	282.6	4,997.8
Total non-financial liabilities							-
Total liabilities							4,997.8

	Held for trading £m	Held to maturity securities £m	Loans and receivables £m	Available-for-sale securities £m	Financial assets and liabilities at amortised cost £m	Derivatives designated as cash flow hedging instruments £m	Total £m
At 31 December 2007							
Assets							
Cash and balances at central banks			133.5	-			133.5
Financial investments - Available for sale							
Treasury bills			-	199.8			199.8
Investment securities			-	1,020.1			1,020.1
Loans and advances to banks			3,370.5	-			3,370.5
Loans and advances to customers			1,901.5	-			1,901.5
Current tax asset			5.3	-			5.3
Other assets			187.0	-			187.0
Prepayments and accrued income			61.4	-			61.4
Total financial assets	-	-	5,659.2	1,219.9	-	-	6,879.1
Total non-financial assets							25.3
Total assets							6,904.4
Liabilities							
Deposits by banks					750.8	-	750.8
Derivatives designated as cash flow hedging instruments					-	58.4	58.4
Customer accounts					5,734.8	-	5,734.8
Other liabilities					20.2	-	20.2
Accruals and deferred income					37.4	-	37.4
Other borrowed funds						-	-
Dated loan capital					60.0	-	60.0
Undated loan capital					50.0	-	50.0
Total financial liabilities	-	-	-	-	6,653.2	58.4	6,711.6
Total non-financial liabilities							-
Total liabilities							6,711.6

27 Loan and operating lease commitments

Loan commitments

The contractual amount of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers is as follows:

	31 December 2008 £m	31 December 2007 £m
Commitments to extend credit	16.6	27.1

The prior period figure has been adjusted to remove undrawn lines on credit cards. This credit line may be revoked at any time and is not considered to meet the definition of a commitment.

Operating lease commitments

Total commitments under operating leases are as follows:

	31 December 2008 £m	31 December 2007 £m
Due within one year	0.6	0.6

28 Financial risk management

Through its normal operations, the Bank is exposed to a number of risks, the most significant of which are credit risk, operational risk, liquidity risk and interest rate risk. The following paragraphs explain these risks and how they are managed by the Bank.

Responsibility for the control of risk within the Bank is vested in the Risk Management Committee ('RMC'), a sub-committee of the Board of Directors reporting directly to the Board. The RMC establishes the strategy, policies and procedures for managing risk within the Bank. These policies are ratified by the Board.

Strategy for using financial instruments

In the course of normal business, the Bank uses fixed rate borrowings for interest rate risk management purposes. The fixed term borrowing is invested in accordance with Treasury strategy to manage liquidity. The Bank's exposure to interest rate risk is regularly reviewed by the RMC.

Credit risk

Credit risk is the risk of financial loss arising from the failure of customers or other counterparties to settle their financial obligations to the Bank as they fall due.

Wholesale and derivative credit risk

The Bank lends surplus funds to the inter-bank market. Limits have been established for all counterparties based on their respective financial strength and credit ratings. The limits and proposed counterparties are reviewed and approved by the RMC and Board annually, or as required. Derivatives are subject to the same credit risk control procedures as are applied to other wholesale market instruments.

Management of credit risk in respect of retail customers makes use of credit scoring techniques for new applications. In addition, behavioural scoring is used to assess the conduct of customers' accounts when granting initial credit limits and extensions to limits. Underwriting is undertaken by specialist teams in operational areas. The RMC ensures that appropriate policies are established and adhered to. Internal Audit teams carry out annual reviews of all credit sanctioning areas within the Bank.

At 31 December 2008, the maximum credit exposure of the Bank in the event of other parties failing to perform their obligations is equal to the sum of loans and advances to banks, loans and advances to customers and credit lines and other commitments to lend. These are set out in notes 14, 15 and 27, respectively. No account is taken of any collateral held and the maximum exposure to loss is considered to be the instruments' balance sheet carrying amount.

Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of collateral agreements.

28 Financial risk management continued**Maximum exposure**

	31 December 2008 £m	31 December 2007 £m
Credit risk exposures relating to on-balance sheet		
Cash and balances at central banks	181.2	133.5
Treasury bills	308.7	199.8
Investment securities	1,126.3	1,020.1
Loans and advances to banks	1,457.0	3,370.5
Loans and advances to customers		
- Unsecured	1,775.9	1,781.4
- Secured	102.6	120.1
Derivative financial instruments	-	-
Other assets	122.2	187.0
Prepayments and accrued income	20.6	61.4
Credit risk exposures relating to off-balance sheet items		
Loans commitments and other related liabilities	16.6	27.1
Total credit risk exposure	5,111.1	6,900.9

Risk concentrations of the maximum exposure to retail and wholesale credit risk

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed according to client or counterparty (and their respective credit qualities) as opposed to geographical region or industry sector.

Geographical sectors

	31 December 2008 £m	31 December 2007 £m
Maximum exposure		
United Kingdom	4,108.8	6,100.8
Euroland	929.6	737.9
Canada	58.7	47.1
Australia	14.0	15.1
Total	5,111.1	6,900.9

Concentration by location for loans and advances is measured based on the location of the Bank's operations, which has a high correlation with the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security.

Industry sectors

	31 December 2008 £m	31 December 2007 £m
Maximum exposure		
Corporate	-	-
Sovereign	311.4	202.8
Bank	2,878.2	4,745.4
Retail	1,921.5	1,952.7
Total	5,111.1	6,900.9

The maximum credit exposure to any client or counterparty as of 31 December 2008 was £1,287.6 million (2007: £3,419.1 million) before taking into account collateral or other credit enhancements of £1,092.2 million (2007: £3,370.5 million). This exposure was to HBOS plc and primarily represents lending under a reverse repo arrangement which is supported by 150 per cent AAA-rated collateral. The existence of collateral helps the Bank manage concentration risk and credit risk. Amounts are invested in the repo facility up to a maximum of a year with varying maturities depending on forecast liquidity requirements.

28 Financial risk management continued**Credit quality per class of financial asset****Loans and advances to customers**

Loans and advances are summarised as follows:

	31 December 2008 £m	31 December 2007 £m
Impaired	192.3	208.5
Past due but not impaired	42.2	47.6
Neither past due nor impaired	1,802.7	1,818.1
Gross	2,037.2	2,074.2
Less: allowance for impairment	(158.7)	(172.7)
Net	1,878.5	1,901.5

Credit quality analysis - 31 December 2008:

	2008 £m Unsecured lending	2008 £m Secured lending	2008 £m
Impaired			
Less than three months, but impaired	2.5	-	2.5
Past due three to six months	23.6	1.9	25.5
Past due six to 12 months	0.3	1.4	1.7
Past due over 12 months		2.2	2.2
Recoveries	160.4	-	160.4
Possession	-	-	-
Total gross impaired loans	186.8	5.5	192.3
Past due but not impaired			
Past due up to three months but not impaired	37.0	5.2	42.2
Total gross past due but not impaired	37.0	5.2	42.2
Neither past due nor impaired*			
Not impaired	1,710.8	91.9	1,802.7
Total gross neither past due nor impaired	1,710.8	91.9	1,802.7
Total gross amount due	1,934.6	102.6	2,037.2
*Includes loans and advances that would have been past due or impaired had their terms not been renegotiated	1.6	-	1.6

Mortgages held over residential properties represent the only collateral held by the Bank for retail exposures. The fair value of collateral held for impaired loans and loans past due but not impaired was £15.1 million (31 December 2007: £19.9 million). The fair value of collateral held against possession cases was £NIL (31 December 2007: £0.5 million).

Where the arrears status of a customer deteriorates and there is a failure to respond to correspondence or an acceptable repayment proposal, including notice of default, the customer balance will fall into 'recoveries'. Recoveries will take steps to recover the debt, using their expertise to determine the optimum recovery strategy. Instigation of legal action will depend upon the anticipated recoveries and costs.

28 Financial risk management continued

Credit quality analysis - 31 December 2008:

	2007 £m Unsecured lending	2007 £m Secured lending	2007 £m
Impaired			
Less than three months, but impaired	14.4	-	14.4
Past due three to six months	25.1	2.0	27.1
Past due six to 12 months	0.3	1.4	1.7
Past due over 12 months	-	0.2	0.2
Recoveries	164.7	-	164.7
Possession	-	0.4	0.4
Total gross impaired loans	204.5	4.0	208.5
Past due but not impaired			
Past due up to three months but not impaired	42.2	5.4	47.6
Total gross past due but not impaired	42.2	5.4	47.6
Neither past due nor impaired*			
Not impaired	1,707.4	110.7	1,818.1
Total gross neither past due nor impaired	1,707.4	110.7	1,818.1
Total gross amount due	1,954.1	120.1	2,074.2
*Includes loans and advances that would have been past due or impaired had their terms not been renegotiated	2.9	-	2.9

Loans and advances to banks

The total gross amount of individually impaired loans and advances to banks as at 31 December 2008 was £NIL (31 December 2007: £NIL). The fair value of collateral held for loans and advances to banks was £1,092.2 million (31 December 2007: £3,327.8 million). Collateral takes the form of security over AAA-rated debt securities. The table below presents an analysis of lending to banks by rating agency designation, based on Moody's ratings:

	31 December 2008 £m	31 December 2007 £m
Aa2	1,457.0	3,370.5
Total	1,457.0	3,370.5

Debt securities, treasury bills and other eligible bills

The total gross amount of individually impaired debt securities, treasury bills and other eligible bills as at 31 December 2008 was £39.3 million (31 December 2007: £36.5 million). No collateral is held regarding these assets. The tables below present an analysis of treasury bills and investment securities by market value, by rating agency designation, based on Moody's ratings:

	Treasury bills £m	Investment securities £m	Total £m
At 31 December 2008			
Aaa to A3	308.7	1,126.3	1,435.0
Baa1 to Baa3	-	-	-
Total	308.7	1,126.3	1,435.0

	Treasury bills £m	Investment securities £m	Total £m
At 31 December 2007			
Aaa to A3	199.8	1,005.6	1,205.4
Baa1 to Baa3	-	14.5	14.5
Total	199.8	1,020.1	1,219.9

a) Operational risk

The Bank has adopted the industry standard definition of operational risk from the Basel Committee on Banking Supervision. This is 'the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events'.

Identification, assessment and control of risk are an intrinsic part of every manager's role. The Bank uses a process of risk self-assessment to compile a profile of risks and controls which are reviewed regularly by line management. The profile is reported to the Audit Committee and to the Board.

28 Financial risk management continued

b) Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its financial commitments as they fall due without an adverse impact on funding costs or profitability. To manage the risk, the Bank maintains a stock of high-quality liquid assets that can be readily sold to meet the Bank's obligations to depositors and other creditors. The portfolio of assets is managed on a daily basis and within the framework set by the supervising authority, the Financial Services Authority. Our policy is to ensure that the Bank's funding requirements can be met at all times and at an acceptable cost.

In addition to this, the Bank prepares both long-term and short-term forecasts to assess liquidity requirements. Short-term forecasting covers a rolling 12-month period and takes into account factors such as ATM cash management, investment maturities and customer deposit patterns and balances. These reports support daily liquidity management and are reviewed daily by senior management. The individual capital adequacy assessment process (ICAAP) also assesses liquidity risk under stressed conditions. This specifically considers scenarios such as a worsening of credit conditions, exceptional asset growth, worst case balance attrition, and restriction in funding sources.

The table below shows the undiscounted cash flows on the Bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The Bank's expected cash flows on these instruments vary significantly from this analysis. The disclosure for derivatives shows a gross inflow and outflow amount. As derivatives have a simultaneous gross settlement it is not considered representative to show only the outflow amount.

Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Residual contractual maturities of financial liabilities

	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total 2008 £m
At 31 December 2008						
Non-derivative liabilities						
Deposits by banks	26.6	53.7	197.9	668.4	39.6	986.2
Customer accounts	3,640.2	-	-	-	-	3,640.2
Other liabilities	28.7	-	-	-	-	28.7
Accruals	37.6	-	-	-	-	37.6
Other borrowed funds	-	1.0	2.9	15.6	140.2	159.7
	3,733.1	54.7	200.8	684.0	179.8	4,852.4
Derivative liabilities						
Outflow	3.8	6.6	89.9	730.2	274.4	1,104.9
Inflow	(3.1)	(4.7)	(62.0)	(523.8)	(196.6)	(790.2)
	0.7	1.9	27.9	206.4	77.8	314.7
Unrecognised loan commitments	16.6	-	-	-	-	16.6
	3,750.4	56.6	228.7	890.4	257.6	5,183.7
	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total 2007 £m
At 31 December 2007						
Non-derivative liabilities						
Deposits by banks	28.0	47.2	232.8	470.7	8.7	787.4
Customer accounts	5,734.8	-	-	-	-	5,734.8
Other liabilities	20.2	-	-	-	-	20.2
Accruals	37.4	-	-	-	-	37.4
Other borrowed funds	-	1.8	5.6	29.8	130.8	168.0
	5,820.4	49.0	238.4	500.5	139.5	6,747.8
Derivative liabilities						
Outflow	2.8	6.9	56.7	594.6	293.2	954.2
Inflow	(3.4)	(8.5)	(57.1)	(564.9)	(271.2)	(905.1)
	(0.6)	(1.6)	(0.4)	29.7	22.0	49.1
Unrecognised loan commitments	27.1	-	-	-	-	27.1
	5,846.9	47.4	238.0	530.2	161.5	6,824.0

28 Financial risk management continued

The expected maturity of financial assets and liabilities is shown below:

Expected maturity	Less than 12 months £m	More than 12 months £m	Total 2008 £m	Less than 12 months £m	More than 12 months £m	Total 2007 £m
Assets						
Cash and balances at central banks	181.2	-	181.2	133.5	-	133.5
Treasury bills	308.7	-	308.7	199.8	-	199.8
Investment securities	72.3	1,054.0	1,126.3	29.4	990.7	1,020.1
Loans and advances to banks	1,457.0	-	1,457.0	3,370.5	-	3,370.5
Loans and advances to customers	694.5	1,184.0	1,878.5	590.0	1,311.5	1,901.5
Other assets	122.2	-	122.2	187.0	-	187.0
Prepayments and accrued income	21.0	-	21.0	61.9	-	61.9
	2,856.9	2,238.0	5,094.9	4,572.1	2,302.2	6,874.3
Liabilities						
Deposits by banks	238.9	659.8	898.7	302.7	448.1	750.8
Derivatives	21.3	261.3	282.6	2.5	55.9	58.4
Customer accounts	1,213.0	2,427.2	3,640.2	1,248.4	4,486.4	5,734.8
Other borrowed funds	-	110.0	110.0	-	110.0	110.0
Other liabilities	28.7	-	28.7	20.2	-	20.2
Accruals	37.6	-	37.6	37.4	-	37.4
	1,539.5	3,458.3	4,997.8	1,611.4	5,100.2	6,711.6
	1,317.4	(1,200.3)	97.1	2,960.7	(2,798.0)	162.7

c) Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates or foreign exchange rates. The Bank does not have a trading book. Non-trading book positions are managed and monitored using sensitivity analysis to minimise earnings volatility, taking into account expected future business flows. Foreign exchange rate risk is fully hedged.

Interest rate risk

The Bank offers lending and savings products with varying interest rate features and maturities which create potential interest rate risk exposures. Interest rate risk is the risk to earnings and capital arising from timing differences on the re-pricing of the Bank's loans and deposits, and unexpected changes to the slope and shape of the yield curve. The Bank assumes interest rate risk through dealings with retail customers as well as through lending in the wholesale market. The Bank's unsecured retail lending (note 15) comprises of fixed rate products with exposure to fair value interest rate risk and variable rate products with exposure to cash flow interest rate risk. The Bank's retail deposits (note 18) comprise of variable rate savings products which are exposed to fair value interest rate risk and cash flow interest rate risk respectively. On the wholesale side, both lending to banks (note 14) and bank deposits (note 17) are exposed to fair value interest rate risk. Sensitivity analysis is used to assess the effect on earnings of interest rate fluctuations and to determine the extent of measures required to mitigate the risk arising from mismatches in the Bank's business.

The systems developed by the Bank enable this risk to be measured and facilitate pro-active management of the interest rate exposures facing the Bank. Where possible, the Bank takes advantage of natural hedging opportunities between fixed rate assets and liabilities with similar re-pricing dates. Net re-pricing gaps are managed within limits set by the Risk Management Committee using fixed rate funding. These exposures are monitored by the Risk Management Committee.

Market events and the high spreads between the Bank Rate and LIBOR have benefited the Bank over the last 12 months given its portfolio of investment securities and its placement of cash with other bank counterparties. These spreads and the underlying exposures have given rise to a LIBOR exposure which is reported on a monthly basis in the limit management reports to the Asset and Liability Committee.

The current basis risk is generated between an assumed Base-linked pricing of our retail deposit base and LIBOR linked cash deposits and investment securities. The pricing of our retail deposit base is administered and the ability to reprice gives the Bank the ability to actively manage and mitigate basis risk.

Sensitivity to interest rate movements is shown on the table on page 30. This provides the period-end repricing profile for the Bank's financial assets and liabilities. Additional information on the sensitivity of the Bank's assets and liabilities to interest rate scenarios is shown on page 31.

28 Financial risk management continued

Interest rate sensitivity

Sensitivity to movements in interest rates is shown in the following table, which discloses the interest rate re-pricing profile of assets and liabilities at the period end. An asset (or positive) gap position exists when assets re-price more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment. A liability (or negative) gap exists when liabilities re-price more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment. Items are allocated to time bands by reference to the earlier of the next contractual interest rate re-pricing date and the maturity date.

	Up to 3 months £m	3 to 6 months £m	6 to 12 months £m	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Non- interest bearing £m	Total £m
At 31 December 2008								
Assets:								
Cash and balances at central banks	-	-	-	-	-	-	181.2	181.2
Treasury bills	308.7	-	-	-	-	-	-	308.7
Investment securities	1,126.3	-	-	-	-	-	-	1,126.3
Loans and advances								
To banks	1,457.0	-	-	-	-	-	-	1,457.0
Loans and advances								
To customers	827.6	80.6	153.8	272.6	473.2	70.7	-	1,878.5
Other assets	-	-	-	-	-	-	189.4	189.4
Total assets	3,719.6	80.6	153.8	272.6	473.2	70.7	370.6	5,141.1
Liabilities and equity:								
Deposits by banks	70.3	73.6	95.0	318.0	303.4	38.4	-	898.7
Derivatives	282.6	-	-	-	-	-	-	282.6
Customer accounts	3,640.2	-	-	-	-	-	-	3,640.2
Other liabilities	-	-	-	-	-	-	66.3	66.3
Other borrowed funds	110.0	-	-	-	-	-	-	110.0
Shareholders' funds	-	-	-	-	-	-	143.3	143.3
Total liabilities and equity	4,103.1	73.6	95.0	318.0	303.4	38.4	209.6	5,141.1
Interest rate sensitivity gap	(383.5)	7.0	58.8	(45.4)	169.8	32.3	161.0	-
Cumulative gap	(383.5)	(376.5)	(317.7)	(363.1)	(193.3)	(161.0)	-	-

	Sensitivity of net interest income £m	Sensitivity of equity £m
At 31 December 2008		
+50 increase in basis points	(2.3)	(1.8)
+25 increase in basis points	(0.9)	(0.9)
-25 decrease in basis points	0.2	0.9
-50 decrease in basis points	0.1	1.8

28 Financial risk management continued

	Up to 3 months £m	3 to 6 months £m	6 to 12 months £m	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Non- interest bearing £m	Total £m
At 31 December 2007								
Assets:								
Cash and balances at central banks	-	-	-	-	-	-	133.5	133.5
Treasury bills	199.8	-	-	-	-	-	-	199.8
Investment securities	1,020.1	-	-	-	-	-	-	1,020.1
Loans and advances	1,535.0	624.0	1,211.5	-	-	-	-	3,370.5
To banks								
Loans and advances To customers	892.9	80.1	153.2	268.6	448.8	57.9	-	1,901.5
Other assets	-	-	-	-	-	-	279.0	279.0
Total assets	3,647.8	704.1	1,364.7	268.6	448.8	57.9	412.5	6,904.4
Liabilities and equity:								
Deposits by banks	92.3	66.7	143.7	238.0	201.8	8.3	-	750.8
Derivatives	58.4	-	-	-	-	-	-	58.4
Customer accounts	5,734.8	-	-	-	-	-	-	5,734.8
Other liabilities	-	-	-	-	-	-	57.6	57.6
Other borrowed funds	110.0	-	-	-	-	-	-	110.0
Shareholders' funds	-	-	-	-	-	-	192.8	192.8
Total liabilities and equity	5,995.5	66.7	143.7	238.0	201.8	8.3	250.4	6,904.4
Interest rate sensitivity gap	(2,347.7)	637.4	1,221.0	30.6	247.0	49.6	162.1	-
Cumulative gap	(2,347.7)	(1,710.3)	(489.3)	(458.7)	(211.7)	(162.1)	-	-

	Sensitivity of net interest income £m	Sensitivity of equity £m
At 31 December 2007		
+50 increase in basis points	8.8	(0.9)
+25 increase in basis points	4.6	(0.4)
-25 decrease in basis points	(3.8)	0.4
-50 decrease in basis points	(8.0)	0.8

The Bank monitors the sensitivity of financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a monthly basis include a 50 basis point rise or fall of all yield curves. The sensitivity of the income statement is the effect of the above changes in basis points on the net interest income for one year, based on the floating rate financial assets and liabilities held at 31 December 2008. The sensitivity of equity is calculated by revaluing fixed rate available for sale financial assets and swaps designated as cash flow hedges at 31 December 2008.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to foreign exchange risks from cash flows arising on some of its available for sale investment securities. These forecast transactions in foreign currencies are hedged with currency swaps. The cash flows on the currency swaps substantially match the cash flow profile of the hedged investment securities. At the end of December 2008 the EUR and USD notional value of the foreign investment securities was €965,535,000 and \$95,000,000 respectively (December 2007: €1,009,335,000 and \$95,000,000 respectively). This was exactly matched by the EUR and USD notional value of the derivative obligations.

Capital management

The Bank's approach to capital management is set out in the Report by the Board of Directors to the Shareholders on pages 1 to 3.

29. Fair value of financial instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged or settled in a transaction at the balance sheet date between knowledgeable willing parties, in an arm's-length transaction. The fair values of financial instruments are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or reprice frequently, fair value approximates to carrying value. The fair value information presented does not represent the fair value of the Bank as a going concern at 31 December 2008 or 31 December 2007. The classification adopted by the Bank is shown in the following table:

IAS 39 Classification		Carrying value £m	Fair value £m
At 31 December 2008			
Assets:			
Cash and balances at central banks	Loans and receivables	181.2	181.2
Treasury bills	Available for sale	308.7	308.7
Loans and advances to banks	Loans and receivables	1,457.0	1,457.7
Loans and advances to customers	Loans and receivables	1,878.5	1,973.7
Investment securities	Available for sale	1,126.3	1,126.3
Liabilities:			
Deposits by banks	Financial liabilities at amortised cost	898.7	936.1
Derivative financial instruments	Fair value though income statement as modified by effective hedging relationship	282.6	282.6
Customer accounts	Financial liabilities at amortised cost	3,640.2	3,640.2
Other borrowed funds	Financial liabilities at amortised cost	110.0	110.8

IAS 39 Classification		Carrying value £m	Fair value £m
At 31 December 2007			
Assets:			
Cash and balances at central banks	Loans and receivables	133.5	133.5
Treasury bills	Available for sale	199.8	199.8
Loans and advances to banks	Loans and receivables	3,370.5	3,375.5
Loans and advances to customers	Loans and receivables	1,901.5	1,983.7
Investment securities	Available for sale	1,020.1	1,020.1
Liabilities:			
Deposits by banks	Financial liabilities at amortised cost	750.8	752.7
Derivative financial instruments	Fair value though income statement as modified by effective hedging relationship	58.4	58.4
Customer accounts	Financial liabilities at amortised cost	5,734.8	5,734.8
Other borrowed funds	Financial liabilities at amortised cost	110.0	115.0

30. Reconciliation of operating profit/(loss) to net cash inflow/(outflow) from operating activities

	31 December 2008 £m	31 December 2007 £m
Profit/(loss) before income tax	5.9	(6.6)
Non-cash items included in loss before tax		
Impairment losses on loans and advances	78.4	67.7
Depreciation on property, plant and equipment	3.8	3.8
Amortisation of intangible assets	2.0	2.5
Loss on disposal of fixed assets	0.3	0.3
Interest on borrowed funds	7.6	5.1
Change in operating assets and liabilities		
Net decrease/(increase) in loans and advances to banks	1,783.7	(1,411.7)
Net decrease/(increase) in investment securities	41.4	(869.2)
Net (increase) in derivative liabilities	(1.2)	(4.3)
Net decrease/(increase) in other assets	65.2	(114.0)
Net decrease/(increase) in prepayments and accrued income	40.9	(41.9)
Net (decrease)/increase in customer accounts	(2,094.6)	3,358.3
Net increase in borrowed funds	147.8	56.1
Net increase/(decrease) in other liabilities	8.5	(6.1)
Net increase in accruals and deferred income	0.2	-
	89.9	1,040.0
Income taxes received	-	2.8
Net cash flows from operating activities	89.9	1,042.8
Operational cash flows from interest		
Interest paid	(318.5)	(108.1)
Interest received	398.1	196.6

31. Analysis of cash flows relating to investing activities

	Note	31 December 2008 £m	31 December 2007 £m
Purchase of equipment	6	(3.3)	(1.8)
Purchase of intangibles	7	(0.2)	(0.2)
		(3.5)	(2.0)

32. Analysis of cash flow in respect of financing

	31 December 2008 £m	31 December 2007 £m
Proceeds from issue of share capital	-	30.0
Proceeds from issue of loan capital	-	10.0
Interest paid on other borrowed funds	(7.5)	(5.1)
	(7.5)	34.9

33. Cash and cash equivalents

	Note	31 December 2008 £m	31 December 2007 £m
Cash and balances at central banks		181.2	133.5
Balances at central banks		(2.7)	(3.0)
Cash		178.5	130.5
Loans and advances to other banks - repayable on demand	14	-	-
Loans and advances to other banks - repayable in less than three months	14	1,457.0	1,535.0
Treasury bills	11	308.7	199.8
Investment securities - repayable in less than three months	12	-	-
		1,944.2	1,865.3

34. Parent company

J Sainsbury plc and Bank of Scotland plc each hold 50 per cent of the issued share capital of the Bank, with a contractual arrangement in place to share joint control. Consequently there is no ultimate parent company.

35. Related party transactions

The Bank has identified the following transactions, which fall to be disclosed under the terms of IAS 24:

The Bank is a joint venture between the shareholders, J Sainsbury plc and Bank of Scotland plc (part of the HBOS plc group of companies).

	12 months to December 2008 £m	9 months to December 2007 £m
Transactions during the period: J Sainsbury plc		
Services and loans provided by J Sainsbury plc:		
Management services	18.4	12.1
Interest expense paid in respect of interest-bearing loans	3.8	2.6
Total loans and advances given during the period	-	5.0
Balances at 31 December		
Payables:		
Management services	4.6	5.6
Interest payable	-	-
Subordinated dated loan capital	30.0	30.0
Subordinated undated loan capital	25.0	25.0

In the same period companies within the HBOS plc group provided both management and banking services to the Bank. The Bank also entered into financial transactions with, and earned commission from, companies within the HBOS plc group of companies, all under normal commercial terms.

None of the loans and advances to related parties was impaired at the balance sheet date. Furthermore, no expenses were recognised during the period in respect of impairment losses on loans and advances to related parties.

35. Related party transactions continued

	12 months to December 2008 £m	9 months to December 2007 £m
Transactions during the period: HBOS plc		
Services and loans provided by HBOS plc group of companies:		
Management and banking services	35.8	30.9
Interest expense paid in respect of subordinated loan capital	3.8	2.6
Deposits by banks:		
Short term	-	-
Fixed term	658.0	273.5
Deposits repaid during the period	(484.2)	(243.1)
Net interest paid in respect of interest rate swaps, loans and advances	46.0	25.9
Loans given to and commission received from HBOS plc group of companies:		
Total loans and advances made during the period	11,908.0	13,253.2
Loans and advances repaid during the period	(14,007.5)	(10,781.7)
Net interest received in respect of interest rate swaps, loans and advances	128.2	69.0
Commission income earned	19.5	9.6
Balances at 31 December		
Receivables:		
Loans and advances	1,271.0	3,370.5
Interest receivable	1.4	42.4
Commission receivable	15.1	6.2
Payables:		
Management and banking services	19.9	17.0
Interest payable	2.8	3.0
Deposits by banks	897.9	749.6
Subordinated dated loan capital	30.0	30.0
Subordinated undated loan capital	25.0	25.0

The loans and advances figures above are largely collateralised under a reverse repo arrangement which is supported by 150 per cent AAA-rated collateral.

36. Transactions with key management personnel

For the purposes of IAS 24 'Related party disclosures', key management personnel comprise members of the Sainsbury's Bank Board and the Executive Committee of the Bank, who held office during the period.

Remuneration and other compensation

	12 months to December 2008 £m	9 months to December 2007 £m
Total emoluments	1.5	1.1
Total amounts payable under long-term incentive schemes	-	0.2
Total	1.5	1.3

Product transactions

Details of transactions, under terms and conditions available to all members of staff, between the Bank and key management personnel are provided below. For this purpose, key management personnel include Sainsbury's Bank key management personnel and members of their close families. Following the change in shareholding during the previous financial year, key management personnel of J Sainsbury plc are not considered to be key management personnel of Sainsbury's Bank. Therefore, this note does not include key management personnel of J Sainsbury plc.

36. Transactions with key management personnel continued**Transactions with key management personnel**

	Number of key management personnel	Directors £'000	Others £'000
Mortgages, credit cards and term loans			
At 31 March 2007	5	5	17
Resignations during 2007	(1)	(1)	-
Amounts advanced during the year		33	3
Interest charged		-	-
Amounts repaid during the year		(29)	(9)
At 31 December 2007	4	8	11
Resignations during 2008	(2)	(1)	(11)
Appointments/new accounts during 2008	4	3	4
Amounts advanced during the period		90	8
Interest charged		-	-
Amounts repaid during the period	(2)	(86)	(11)
At 31 December 2008	4	14	1

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 31 December 2008 was £14k (December 2007: £10k).

	Number of key management personnel	Directors £'000	Others £'000
Savings and deposit accounts			
At 31 March 2007	3	127	1
Resignations during 2007	(1)	(66)	-
Appointments/new accounts during 2007	2	76	-
Amounts deposited during the year		231	5
Interest deposited		1	-
Amounts withdrawn during the year		(6)	(5)
At 31 December 2007	4	363	1
Resignations during 2008	(2)	(294)	(1)
Appointments/new accounts during 2008	3	49	-
Amounts deposited during the period		100	5
Interest deposited		5	-
Amounts withdrawn during the period		(83)	(5)
At 31 December 2008	5	140	-

37. Post balance sheet event

On 18 September 2008, with the support of the UK Government, the boards of HBOS plc ('HBOS') and Lloyds TSB Group plc ('Lloyds TSB') announced that they had reached agreement on the terms of the recommended acquisition of HBOS by Lloyds TSB. The terms of the acquisition were subsequently amended, as announced on 13 October 2008, at the same time as the announcement of the participation by HBOS and Lloyds TSB in the Government's action plan to recapitalise some of the major UK banks. The acquisition was to be implemented by means of a scheme of arrangements with a separate scheme of arrangements in relation to preference shares, under sections 895 to 899 of the Companies Act 2006.

On 12 January 2009 the Court of Session in Edinburgh, Scotland made an order sanctioning the scheme of arrangement for the acquisition and the preference share scheme of arrangement. The last day of trading in HBOS ordinary and preference shares was 14 January 2009.

On 15 January 2009 HBOS raised £11.5 billion of capital (before costs and expenses) through an issue of £8.5 billion of new ordinary shares under a placing with HM Treasury subject to clawback by existing shareholders, and an issue to HM Treasury of £3 billion of new preference shares. Lloyds TSB raised £4.5 billion (before costs and expenses) through an issue of £3.5 billion of new ordinary shares under a placing with HM Treasury subject to clawback by existing shareholders, and an issue to HM Treasury of £1 billion of new preference shares.

On 16 January 2009 the Lloyds TSB acquisition of HBOS completed following final court approval and Lloyds TSB was renamed Lloyds Banking Group plc. The exchange of HBOS shares for Lloyds Banking Group plc shares took place at an exchange ratio of 0.605 of a new Lloyds Banking Group plc share for every one HBOS share held. As a result, the UK Government through HM Treasury owned approximately 43.4 per cent of the enlarged ordinary share capital of Lloyds Banking Group plc. In addition, each class of preference share issued by HBOS, including the preference shares issued to HM Treasury in the capital raising was replaced with an equal number of new Lloyds Banking Group plc preference shares.

HBOS ordinary and preference shares were de-listed from the Official List of the UK Listing Authority and admission to trading on the London Stock Exchange was cancelled on 19 January 2009 when trading in the new Lloyds Banking Group plc shares commenced.

38. Approval of accounts

The accounts were approved by the Board of Directors on 16 April 2009.

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare accounts for each financial period. Under that law they have elected to prepare the accounts in accordance with IFRS as adopted by the EU.

The accounts are required by law to present fairly the financial position and performance of the Company; the Companies Act 1985 provides in relation to such accounts that references in the relevant part of that Act to accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing those accounts, the Directors are required to:

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

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Bank and to enable them to ensure that the accounts comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

By order of the Board and signed on its behalf by

Hannah Bernard
Company Secretary
London
16 April 2009

Independent Auditor's report to the shareholders of Sainsbury's Bank plc

We have audited the financial statements of Sainsbury's Bank plc for the year ended 31 December 2008 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 38.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Directors' Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2008 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc

Chartered Accountants
Registered Auditor
Edinburgh
16 April 2009

