

25 Other reserves

Other reserves comprise the fair value movements for available-for-sale securities and the effective portion of changes in the fair value of cash flow hedges. 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.

	2009 £m	2008 £m
At 1 January	(61.6)	(8.0)
Net unrealised losses	64.8	(81.1)
Realised losses reclassified to the income statement on disposal	1.9	7.0
Tax effect of net losses	(18.5)	20.5
Balance at 31 December	(13.4)	(61.6)

Of the balances above £(10.9) million (2008: (£59.3) million) relates to the available-for-sale reserve and £(2.5) million (2008: £(2.2) 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 principal 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 2009							
Assets							
Cash and balances at central banks			159.8				159.8
Financial Investments - available for sale				451.6			451.6
Treasury bills				948.4			948.4
Investment securities							
Loans and advances to banks			1,642.3				1,642.3
Loans and advances to customers			2,155.8				2,155.8
Other assets			79.4				79.4
Prepayments and accrued income			14.9				14.9
Total financial assets	-	-	4,052.2	1,400.0	-	-	5,452.2
Total non-financial assets							19.3
Total assets							5,471.5
Liabilities							
Deposits by banks					1,216.7		1,216.7
Derivatives designated as cash flow hedging instruments					-	183.0	183.0
Customer accounts					3,701.2		3,701.2
Other liabilities					28.3		28.3
Accruals and deferred income					19.6		19.6
Other borrowed funds							
Dated loan capital					60.0		60.0
Undated loan capital					50.0		50.0
Total financial liabilities	-	-	-	-	5,075.8	183.0	5,258.8
Total non-financial liabilities							8.0
Total liabilities							5,266.8

26 Analysis of financial assets and liabilities by measurement basis continued

	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
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
Current 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					23.7		23.7
Provisions for liabilities and charges					5.0		5.0
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

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:

	2009 £m	2008 £m
Commitments to extend credit	29.1	16.6

Operating lease commitments

Total commitments under operating leases are as follows:

	2009 £m	2008 £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 market 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.

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 2009, 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.

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.

Maximum exposure

	2009 £m	2008 £m
Credit risk exposures relating to on-balance sheet		
Cash and balances at central banks	159.8	181.2
Treasury bills	451.6	308.7
Investment securities	948.4	1,126.3
Loans and advances to banks	1,642.3	1,457.0
Loans and advances to customers		
Unsecured	2,060.9	1,775.9
Secured	94.9	102.6
Derivative financial instruments	-	-
Other assets	79.4	122.2
Prepayments and accrued income	14.9	20.6
Credit risk exposures relating to off-balance sheet items		
Loans commitments and other related liabilities	29.1	16.6
Total credit risk exposure	5,481.3	5,111.1

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.

28 Financial risk management continued

Geographical sectors

	2009 £m	2008 £m
Maximum exposure		
United Kingdom	4,605.8	4,108.8
Countries in Europe adopting the Euro	802.4	929.6
Canada	58.2	58.7
Australia	14.9	14.0
Total	5,481.3	5,111.1

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

	2009 £m	2008 £m
Maximum exposure		
Corporate	-	-
Sovereign	454.2	311.4
Bank	2,821.0	2,878.2
Retail	2,206.1	1,921.5
Total	5,481.3	5,111.1

The maximum credit exposure to any client or counterparty as of 31 December 2009 was £1,405.6 million (2008: £1,287.6 million) before taking into account collateral or other credit enhancements of £763.8 million (2008: £1,092.2 million). This exposure was to Lloyd Banking Group plc and represents short-term interbank deposits and 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.

Credit quality per class of financial asset

Loans and advances to customers

Loans and advances are summarised as follows:

	2009 £m	2008 £m
Impaired	196.3	192.3
Past due but not impaired	29.1	42.2
Neither past due nor impaired	2,087.3	1,802.7
Gross	2,312.7	2,037.2
Less: allowance for impairment	(156.9)	(158.7)
Net	2,155.8	1,878.5

Credit quality analysis - 31 December 2009:

	Unsecured lending 2009 £m	Secured lending 2009 £m	2009 £m
Impaired			
Less than three months, but impaired	4.1	-	4.1
Past due three to six months	24.9	1.0	25.9
Past due six to 12 months	0.4	0.4	0.8
Past due over 12 months	-	2.7	2.7
Recoveries	162.6	-	162.6
Possession	-	0.2	0.2
Total gross impaired loans	192.0	4.3	196.3
Past due but not impaired			
Past due up to three months but not impaired	26.5	2.6	29.1
Total gross past due but not impaired	26.5	2.6	29.1
Neither past due nor impaired*			
Not impaired	1,999.3	88.0	2,087.3
Total gross neither past due nor impaired	1,999.3	88.0	2,087.3
Total gross amount due	2,217.8	94.9	2,312.7
*Includes loans and advances that would have been past due or impaired had their terms not been renegotiated	2.3	-	2.3

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 £12.2 million (2008: £15.1 million). The fair value of collateral held against possession cases was £0.3 million (2008: £nil).

28 Financial risk management continued

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.

Credit quality analysis - 31 December 2008:

	Unsecured lending 2008 £m	Secured lending 2008 £m	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

Loans and advances to banks

The total gross amount of individually impaired loans and advances to banks as at 31 December 2009 was £nil (2008: £nil). The fair value of collateral held for loans and advances to banks was £763.8 million (2008: £1,092.2 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.

	2009 £m	2008 £m
Aaa to A3	1,642.3	1,457.0
Total	1,642.3	1,457.0

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 2009 was £nil (2008: £39.3 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 2009			
Aaa to A3	451.6	948.4	1,400.0
Baa1 to Baa3	-	-	-
Total	451.6	948.4	1,400.0

	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

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 linked to all aspects of the Bank's operations which are reviewed regularly by line management. The profile is reported to the Audit Committee and to the Board.

Internal Audit undertake reviews across the business throughout the year under a programme agreed with the Bank Audit Committee.

28 Financial risk management continued

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 2009 £m
At 31 December 2009						
Non-derivative liabilities						
Deposits by banks	16.8	175.5	255.9	809.2	44.0	1,301.4
Customer accounts	3,701.2	-	-	-	-	3,701.2
Other liabilities	36.3	-	-	-	-	36.3
Accruals	19.6	-	-	-	-	19.6
Other borrowed funds	-	0.4	1.4	72.4	50.0	124.2
	3,773.9	175.9	257.3	881.6	94.0	5,182.7
Derivative liabilities						
Outflow	0.5	46.3	164.6	525.5	119.2	856.1
Inflow	(0.3)	(35.2)	(125.6)	(417.2)	(91.3)	(669.6)
	0.2	11.1	39.0	108.3	27.9	186.5
Unrecognised loan commitments	29.1	-	-	-	-	29.1
	3,803.2	187.0	296.3	989.9	121.9	5,398.3
	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

28 Financial risk management continued

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 Asset and Liability Committee and the Risk Management Committee.

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 however more extreme scenarios are also considered. 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 2009.

	Sensitivity of net interest income £m	Sensitivity of equity £m
At 31 December 2009		
+50 increase in basis points	(4.0)	(2.3)
+25 increase in basis points	(2.0)	(1.2)
-25 decrease in basis points	0.4	1.2
-50 decrease in basis points	0.6	2.4

	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

The pricing of the retail deposit base is administered and the ability to re-price allows the Bank to actively manage and mitigate basis risk as well as the general sensitivity of net interest income to changes in the yield curve. The Asset and Liability Committee regularly reviews assumptions around pricing changes in response to differing interest rate scenarios.

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 2009 the EUR and USD notional value of the foreign investment securities was €834,635,000 and \$95,000,000 respectively (2008: €965,535,000 and \$95,000,000 respectively). This was exactly matched by the EUR and USD notional value of the derivative obligations.

29 Capital resources

The following table analyses the regulatory capital resources of the Bank at 31 December 2009:

	31 December 2009 £m	31 December 2008 £m
Tier 1 capital:		
Ordinary share capital	170.0	170.0
Reserves	34.9	30.9
Deduction for intangible assets	(1.3)	(1.6)
Total Tier 1 capital	203.6	199.3
Upper Tier 2 capital:		
Undated loan stock	50.0	50.0
Allowable element of provisions	35.6	31.8
Lower Tier 2 capital:		
Dated loan stock	60.0	60.0
Total Tier 2 capital	145.6	141.8
Total capital	349.2	341.1

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 an 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.

Capital management

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 2009. Capital adequacy is monitored on an ongoing basis by senior management, the Asset and Liability Committee, the Risk Management Committee and the Board. Our submissions to the FSA in the period have shown that the Bank has complied with all externally imposed capital requirements.

The Bank is currently considering the FSA's proposals for implementing changes that are required following amendments to the Capital Requirements' Directive in the UK.

30 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 2009 or 31 December 2008. The classification adopted by the Bank is shown in the following table:

IAS 39 Classification		Carrying value £m	Fair value £m
At 31 December 2009			
Assets:			
Cash and balances at central banks	Loans and receivables	159.8	159.8
Treasury bills	Available for sale	451.6	451.6
Loans and advances to banks	Loans and receivables	1,642.3	1,642.5
Loans and advances to customers	Loans and receivables	2,155.8	2,318.7
Investment securities	Available for sale	948.4	948.4
Liabilities:			
Deposits by banks	Financial liabilities at amortised cost	1,216.7	1,245.9
Derivative financial instruments	Fair value though income statement as modified by effective hedging relationship	183.0	183.0
Customer accounts	Financial liabilities at amortised cost	3,701.2	3,701.2
Other borrowed funds	Financial liabilities at amortised cost	110.0	110.4

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

Information on how fair values are calculated for the financial assets and liabilities noted above is explained on page 6 of the critical accounting estimates section.

31 Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, London Stock Exchange, Frankfurt Stock Exchange, New York Stock Exchange) and exchanges traded derivatives like futures.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg and Reuters.
- Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components. This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible.

The below table provides an analysis of the relevant fair value hierarchy:

At 31 December 2009

	Level 1 £m	Level 2 £m	Level 3 £m	Total 2009 £m
Financial Investments - available for sale				
Treasury bills	451.6	-	-	451.6
Investment securities	-	948.4	-	948.4
Total assets	451.6	948.4	-	1,400.0
Derivatives designated as cash flow hedging instruments	-	(183.0)	-	(183.0)
Total liabilities	-	(183.0)	-	(183.0)

32 Reconciliation of operating profit to net cash inflow/(outflow) from operating activities

	2009 £m	2008 £m
Profit before income tax	18.2	5.9
Non-cash items included in loss before tax		
Impairment losses on loans and advances	88.1	78.4
Depreciation on property, plant and equipment	3.4	3.8
Amortisation of intangible assets	1.3	2.0
Loss on disposal of fixed assets	0.3	0.3
Interest on borrowed funds	2.6	7.6
Change in operating assets and liabilities		
Net decrease/(increase) in loans and advances to customers	(365.5)	1,783.7
Net decrease/(increase) in investment securities	245.1	41.4
Net (increase) in derivative liabilities	(100.0)	(1.2)
Net decrease/(increase) in deferred tax assets	2.7	-
Net decrease/(increase) in other assets	42.8	65.2
Net decrease/(increase) in prepayments and accrued income	6.0	40.9
Net (decrease)/ increase in customer accounts	60.9	(2,094.6)
Net increase in borrowed funds	318.0	147.8
Net increase/(decrease) in other liabilities	7.6	8.5
Net increase in accruals and deferred income	(18.0)	0.2
	313.5	89.9
Income taxes received	-	-
Net cash flows from operating activities	313.5	89.9
Operational cash flows from interest		
Interest paid	(129.0)	(318.5)
Interest received	216.4	398.1

33 Analysis of cash flows relating to investing activities

	Note	2009 £m	2008 £m
Purchase of equipment	6	(3.2)	(3.3)
Purchase of intangibles	7	(1.0)	(0.2)
		(4.2)	(3.5)

34 Analysis of cash flow in respect of financing

	2009 £m	2008 £m
Interest paid on other borrowed funds	(2.5)	(7.5)

35 Cash and cash equivalents

	Note	2009 £m	2008 £m
Cash and balances at central banks		159.8	181.2
Balances at central banks		(2.7)	(2.7)
Cash		157.1	178.5
Loans and advances to other banks - repayable on demand	14	29.3	-
Loans and advances to other banks - repayable in less than three months	14	1,613.0	1,457.0
Treasury bills	11	451.6	308.7
		2,251.0	1,944.2

36 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.

37 Related party transactions

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

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

	2009 £m	2008 £m
Transactions during the period: J Sainsbury plc		
Services and loans provided by J Sainsbury plc:		
Management services	18.4	18.4
Interest expense paid in respect of interest-bearing loans	1.3	3.8
Total loans and advances given during the period		-
Balances at 31 December		
Payables:		
Management services	2.7	4.6
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 Lloyds Banking Group 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 Lloyds Banking Group 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.

37 Related party transactions continued

	2009 £m	2008 £m
Transactions during the period: HBOS plc		
Services and loans provided by HBOS plc group of companies:		
Management and banking services	27.3	35.8
Interest expense paid in respect of subordinated loan capital	1.3	3.8
Deposits by banks:		
Fixed term	556.6	658.0
Deposits repaid during the period	(237.2)	(484.2)
Net interest paid in respect of interest rate swaps, loans and advances	45.3	46.0
Loans given to and commission received from HBOS plc group of companies:		
Total loans and advances made during the period	9,584.9	11,908.0
Loans and advances repaid during the period	(9,450.9)	(14,007.5)
Net interest received in respect of interest rate swaps, loans and advances	11.7	128.2
Commission income earned	11.4	19.5
Balances at 31 December		
Receivables:		
Loans and advances	1,434.3	1,271.0
Interest receivable	0.6	1.4
Commission receivable	5.7	15.1
Payables:		
Management and banking services	4.9	19.9
Interest payable	2.5	2.8
Deposits by banks	1,216.4	897.9
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.

38 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

	2009 £m	2008 £m
Total emoluments	1.6	1.5

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. This note does not include key management personnel of J Sainsbury plc or Lloyds Banking Group plc as they are not considered to be key management personnel of Sainsbury's Bank.

Transactions with key management personnel

	Number of key management personnel	Directors £'000	Others £'000
Mortgages, credit cards and term loans:			
At 1 January 2008	4	8	11
Resignations during 2008	(2)	(1)	(11)
Appointments/new accounts during 2009	4	3	4
Amounts advanced during the year	–	90	8
Amounts repaid during the year	(2)	(86)	(11)
At 31 December 2008	4	14	1
Resignations during 2009	(1)	(2)	–
Appointments/new accounts during 2009	1	–	2
Amounts advanced during the period		70	18
Amounts repaid during the period		(70)	(17)
At 31 December 2009	4	12	4
Savings and deposit accounts:			
At 1 January 2008	4	363	1
Resignations during 2008	(2)	(294)	(1)
Appointments/new accounts during 2008	3	49	–
Amounts deposited during the year	–	100	5
Interest deposited	–	5	–
Amounts withdrawn during the year	–	(83)	(5)
At 31 December 2008	5	140	–
Resignations during 2009	(1)	(2)	–
Appointments/new accounts during 2009		–	–
Amounts deposited during the period		(904)	(6)
Interest charged		4	–
Amounts withdrawn during the period		832	17
At 31 December 2009	4	70	11

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 31 December 2009 was £nil (2008: £14k).

39 Approval of accounts and other information

The accounts were approved by the Board of Directors on 4th March 2010. Sainsbury's Bank plc registered office is 33 Holborn, London EC1N 2HT and its principal executive office is located at Keith House, Redheughs Rigg, South Gyle Crescent, Edinburgh EH12 9DG.

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company 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
4 March 2010

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 2009 set out on pages 4 to 35. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditors' 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

As explained more fully in the Directors' Responsibilities Statement set out on page 36, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/UKNP.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2009 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Jonathan Bingham

Senior Statutory Auditor
for and on behalf of KPMG Audit Plc Statutory Auditor

KPMG Audit Plc

Chartered Accountants
Registered Auditor
Edinburgh
4 March 2010