Sainsbury's Bank plc

Directors' Report and Financial Statements for the year ended 31 December 2010

Company number: 3279730

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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 year ended 31 December 2010 to the Annual General Meeting to be held on 2nd March 2011.

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. Bank of Scotland plc is a 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.

Developing the business

In 2010, the Bank has continued to successfully implement its growth strategy. Despite some signs of improvement in the economic environment, the Directors continue to monitor credit quality closely to ensure that the Bank trades profitably in uncertain market conditions.

As part of the 'Making Shopping More Rewarding' strategy, the Bank offers rewards when shopping in Sainsbury's supermarkets in conjunction with preferential product pricing for Sainsbury's shoppers. As a result of this strategy, insurance new business volumes and retention levels have substantially increased compared with the prior year.

Credit card sales have increased this year, with the focus being on providing benefits for Sainsbury's shoppers. In October, the Sainsbury's Bank Gold Credit card was launched to increase the product range, providing added insurance benefits and no-fee foreign currency exchange benefits as well as additional Nectar points on purchases.

The Bank's ATM network has expanded significantly and remains one of the busiest in the country. At the end of the year a total of 1,173 machines were in operation in the Sainsbury's estate (2009: 1,099).

The Travel Money channel has experienced increased business volumes in 2010, in part due to the increase in the number of the travel bureaux but also to changes in pricing and promotions. At the end of the year, 117 bureaux were in operation in Sainsbury's stores (2009: 74).

The Bank is committed to continually delivering, and constantly improving, excellent customer service, and this is incorporated into a clearly defined service strategy. This year the Bank has introduced a new dedicated banking product contact centre to provide a more consistent customer experience.

In the next financial year the Directors anticipate that there will continue to be a focus on delivering the existing suite of products to the Sainsbury's shopper base.

Financial performance and position

The Bank's 2010 performance is presented in the income statement on page 11. The Bank's profit before tax has increased by £10.5m compared to the previous period. The Directors are pleased with the position, delivered through steady income growth, and appropriate cost management within the context of a difficult economic climate. The Directors remain confident in the long term profitability of the business.

In the last 12 months, market conditions have remained challenging in the financial services sector. Although the economic environment has continued to recover in 2010 both the lending and savings markets have continued to remain extremely competitive in terms of pricing.

The Directors monitor the financial performance of the Bank and track a variety of key performance measures including Financial, Building the Business, Customer, Risk and People measures, including the following:

	2010	2009
Cost: income ratio	**52.27%**	48.40%
Net interest margin	**2.26%**	2.46%
Bad debt asset ratio	**2.60%**	4.09%
Core Tier 1 capital ratio	**8.3%**	7.2%
Total capital ratio	**13.4%**	12.3%

Total income increased by £3.9m compared to the prior year. Net interest income fell by £4.4m compared to the prior year (–4%) with rates associated with lending products remaining highly competitive in the market place whilst funding costs increased slightly reflecting continued savings acquisition.

Commission income increased by £8.3m compared to the prior year (9.3%). This included a one-off amount of £2.4m linked to the reassessment of historic profit share methodologies applied to Home and Creditor products.

Costs increased by £10.1m compared to the prior year (10.0%) largely via increased marketing costs linked to building the business.

The largest contributory factor to the Bank's strong performance is a reduction of impairments on customer debts, which have fallen by £16.8m in comparison to the prior year. This is driven by the Bank's conservative positioning strategy toward customer lending. Finally the Bank realised a loss on sale of securities of £12.7m (2009: £1.9m) previously accumulated in reserves.

The Bank continues to maintain a predominantly retail funded balance sheet with a high level of liquidity being maintained. Overall savings balances marginally decreased to a level of £3.6bn; tailoring the deposits inflow to the funding requirement of the business. Total lending to customers increased by £168.7m in the year (7.8%).

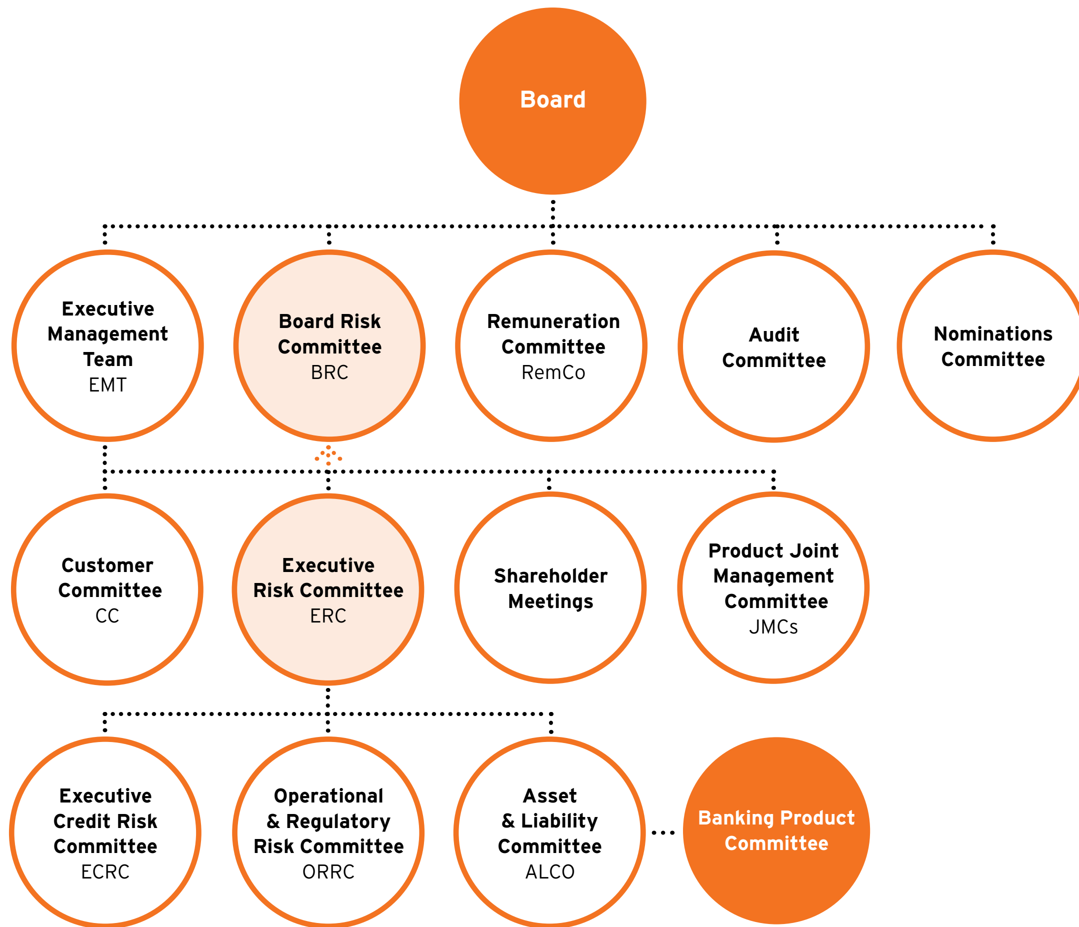
Risk management approach

The Bank aims to appropriately manage all risks that arise from its activities. Through its normal operations the principal risks to the Bank are credit risk, liquidity risk, interest rate risk and operational risk.

The Bank has established a risk framework and formal structure to monitor and manage risks across its operations. The Board has agreed statements of risk appetite and these are adhered to via detailed risk management policies and through reporting to the various governance structures. This is described in more detail on the following page and in note 29.

Risk governance structure

During the year changes were made to the governance structure as outlined below. Prior to this the structure included the Board, Audit Committee, Executive Committee, Risk Management Committee, Asset and Liability Committee and Operational and Regulatory Risk Committee. Changes were made to enhance the risk framework and to reflect the recommendations of the Walker Report.



The Board

The Board is the key governance body and is responsible for the overall strategy, performance of the business and management of risk. It has delegated responsibility for the day to day running of the business to the Chief Executive and the Executive Management Team through apportionment of responsibility and delegated authorities.

The Board meets at least nine times a year. It comprises key Executives members from the Bank and three Non-Executives Directors from each of the shareholders. A number of Board functions are delegated to four key sub-committees – the Board Risk Committee (BRC), The Audit Committee, Remuneration Committee (Remco) and the Nominations Committee.

Audit Committee

The Audit Committee's key responsibility is to advise the Board on the Bank's financial results, both interim and final, including systems and policy issues and relationships with internal and external auditors.

Remuneration Committee (RemCo)

The role of RemCo is to determine and agree with the Board the broad policy for remuneration and for compliance with the FSA Remuneration Code ('the Code') to the extent that the provisions apply to the Bank. RemCo is responsible for recommending, monitoring and noting the level and structure of remuneration for senior management (categorised as 'Code Staff' for the purposes of the Code) and senior risk management and compliance staff.

RemCo continually reviews and assesses the impact of remuneration policies on the risk profile of the Bank and employee behaviour. RemCo has oversight over appointment and severance terms for relevant employees (including payments of guaranteed remuneration for appointees and retention terms).

The Bank will publish Pillar 3 remuneration information as required by the Capital Requirements Directive and FSA prudential sourcebook on the J Sainsbury plc external website during 2011.

Nominations Committee

The Nominations Committee is responsible for reviewing the structure, size and composition of the Board. The committee is also responsible for succession planning into the Board and the Executive management team and for ensuring a formal, rigorous and transparent process for recommending appointments to the Board to the Bank's shareholders.

Board Risk Committee

The Board Risk Committee (BRC) is forward looking to anticipate future risks and is responsible for reviewing and reporting its conclusions to the Board on the Bank's risk appetite and the Bank's risk management framework.

Executive Risk Committee

The Executive Risk Committee (ERC) is a sub-committee of the Board Risk Committee. It is responsible for monitoring and exercising compliance of the Bank's activities to approved risk appetite statements and guidelines and limits of authority approved by the Board and Board Risk Committee. The committee also establish and maintain polices and methodologies for credit risk, market risk, liquidity risk, operational and regulatory risk and oversight of capital adequacy.

Operational and Regulatory Risk Committee

The Operational and Regulatory Risk Committee (ORRC) is a sub committee of the ERC. It assesses and considers the Bank's current performance in respect of Operational and Regulatory Risk and considers initiatives and actions designed to increase the effectiveness of the control environment in these areas.

The Retail Credit Risk Committee
The Retail Credit Risk Committee (RCRC) is a sub committee of the ERC. It is responsible for monitoring the performance of the retail lending book. This committee receives regular reports about the performance of all retail credit portfolios. This includes the credit cards and loans application process as well as collections and recoveries performance.

The Asset and Liability Committee
The Asset and Liability Committee (ALCO) is a sub-committee of the ERC. It is responsible for ensuring the Balance Sheet of the Bank is managed effectively with its main areas of responsibility being Interest Rate Risk, Wholesale Credit Risk, Liquidity, and capital adequacy.

The Banking Product Committee
The Banking Product Committee is a sub committee of the ALCO. It approves new products, pricing changes to products and all significant feature changes to banking products. The committee also considers transfer pricing impact, capital considerations as well as changes to features that are relevant for Interest Rate Risk.

Risk Appetite
The Bank's Board approves the Bank's strategic risk appetite, which defines the level of risk that the Bank is prepared to accept to achieve its strategic objectives. The Board Risk Committee approves the articulation of these risk appetite statements in relation to Retail Credit Risk, Wholesale Credit Risk, Market Risk (interest Rate Risk and Basis Risk), Prudential Risk, Liquidity Risk, Operational and Regulatory Risk, and Reputational Risk.

The Bank has a framework of policies in place, which are a manifestation of its risk appetite statements, to manage key risks. Each policy has an Executive owner who is responsible for maintenance of the policy and ensures it is reviewed at least annually and approved by the relevant governance committees.

Risk Model
The Sainsbury's Bank risk model consists of three layers or 'Three lines of defence'. The model is enhanced through access to, and leverage of, its joint venture partners' risk experiences and methodologies. The Board retains ultimate responsibility for risk management in the Bank.

- The first line of defence is responsible for execution of the Bank's strategy, business performance, setting and implementation of policy and management of risks and internal controls. This primarily lies with the Chief Executive and the entire Executive Management Team (EMT). The Bank's Head of Risk is an integral part of the EMT. On a day-to-day basis, management and control of risk in the business is owned by the individual business units. Escalation procedures exist such that any control failures are reported to the Bank's independent risk team, and to the Executive and relevant governance bodies.
- The second line of defence provides risk oversight, an independent and objective challenge to the first line of defence. The various committees in the risk governance structure challenge the main risk types, ensuring the risks are managed effectively in line with the risk appetite parameters. Representatives from both Joint Venture partners attend relevant risk committees.
- The third line of defence provides independent and objective assurance on the effectiveness of the Bank's risk management, internal control and governance. This is provided by LBG Internal Audit assisted where appropriate by the equivalent function in J Sainsbury plc.

As part of the second line of defence, risks are identified and managed by the Bank on an ongoing basis. The Bank's risks were reassessed in 2010 utilising a revised methodology, which is aligned to the three lines of defence model and the Bank's risk management framework.

Controls are implemented in the business to ensure that risks are effectively mitigated in line with the Bank's risk appetite and that a sound control environment is in place. A full Control Self Assessment (CSA) in the Bank is carried out at least annually and challenged by the ORRC. CSA is a technique whereby managers and staff systematically assess the controls within the areas for which they are responsible; to assess the extent to which they succeed in contributing to the achievement of business objectives and guarding against operational risks. The aim of the CSA is to provide positive assurance that management has an adequate level of control of the Bank's material risks, on the basis of both design and operation of controls.

Principal risks and uncertainties
The principal risks to the Bank are credit risk, liquidity risk, interest rate risk and operational risk. This is consistent with the assessment of top risks arising from the Bank's risk model as described on page 2 and page 28. These risks are considered in more detail in note 29. In addition to these risks further items are set out below that are assessed as being significant.

During the year there has been significant change to the UK regulatory landscape that will impact the Bank in the future. The Financial Services Act 2010 received Royal Assent on 8 April 2010 and this provides the FSA with a new financial stability statutory objective. It also provides powers to make rules on remuneration arrangements, living wills, and consumer redress schemes and extends its enforcement powers. In addition it has been announced that the Bank of England will obtain macro and micro prudential supervisory powers over UK regulated banks and that a new Customer Protection and Markets Authority (CPMA) will be created to take over the FSA's conduct of business supervisory role.

These changes are likely to impact the Bank, particularly in the areas of liquidity, capital requirements and remuneration.

In July 2010 the Basel Committee on Banking Supervision put forward proposals for a capital and liquidity reform package (Basel III) that in certain areas will require significant changes to UK regulations. Proposals include changes to the definition of 'capital', new definitions for the calculation of counterparty credit risk and leverage ratios, additional capital buffers and development of a global liquidity standard. The Bank continues to assess the possible impact of these proposals as well as the proposed response by the FSA to implementation. Implementation of any final proposals is likely to be between the end of 2012 and 2018.

In December 2010, the FSA published its Policy Statement – Revising the Remuneration Code (feedback on CP10/19 and final rules). The Code sets out rules on remuneration governance, policy and structures and came into force on 1 January 2011. The Code is subject to a four-tier proportionality framework and the Bank has assessed itself as a Tier 2 firm based on the code criteria.

The Bank is committed to ensuring that its remuneration practices are appropriate and compliance with the code will fall within the responsibilities of the Remuneration Committee as documented in the risk management section of the Directors' Report. The FSA has also brought in new rules on the disclosure of remuneration and these will be included in the Pillar 3 disclosures published by the Bank.

In 2010 the UK government announced that a bank levy would be imposed on large UK banks and foreign banks operating in the UK from 1 January 2011. The Bank will not be subject to the levy due to its size. During the year the UK government also announced its intention to examine the level of competition in retail banking as well as possible further measures to reform the banking system and promote stability. Whilst likely to be relevant for the general competitive environment, this is unlikely to have a direct impact on the Bank.

The International Accounting Standards Board (IASB) has in 2010 continued with its project to replace IAS 39. These proposals will have an impact on the classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting. Although the project is not complete the proposed scope of change will require the Bank to monitor change closely.

The Bank continues to support 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 economic environment has continued to recover over 2010 but is still considered to face considerable challenges in the years ahead. The Board continue to monitor the outlook on interest rates and credit quality closely in order to ensure that the Bank can continue to trade profitably in uncertain market conditions. The Bank will also monitor closely future arrangements for Financial Services Compensation Scheme (FSCS) costs.

Capital and liquidity

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.

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. Note 30 provides information on the capital resources of the Bank at the year end. The Bank's regulatory capital position at 31 December 2010 and 31 December 2009 was as follows:

	31 December 2010 (unaudited) £m	31 December 2009 (unaudited) £m
Risk weighted assets	**2,589.6**	2,848.0
Core Tier 1 capital ratio	**8.3%**	7.2%
Total capital ratio	**13.4%**	12.3%

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 2011.

The funding and liquidity position of the Bank remained robust throughout the year with management focusing on implementing requirements stemming from new liquidity regulation. This is described in more detail in note 29. Customer deposits continued to be well in excess of customer lending and the stock of highly liquid assets held increased to £500.5m or 14.1% of retail deposits (2009: £451.6m, 12.2% of retail deposits).

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 as demonstrated through the 2009 and 2010 financial performance which has occurred against a challenging economic backdrop. In assessing whether the going concern basis continues to be appropriate, the Bank has considered the Financial Reporting Council's (FRC) guidance on assessing going concern and liquidity risk.

The risk management framework is considered adequate in managing liquidity and other key risks in the current environment. During the year the Bank has strengthened both its Capital and Liquidity position and has also been subject to review and challenge by the FSA as part of its remit as lead regulator of the Bank. Further information on the key financial risks of the business can be found in Note 29.

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 taking into account a range of possible operational and legal scenarios. Consequently the going concern basis continues to be appropriate in preparing the accounts.

Issued share capital

The amount of issued share capital was unchanged from the previous year at £170m (Note 24).

Dividends

The profit after tax for the period attributable to the shareholders is £20.6m (2009: £13.2m). The Directors do not recommend payment of a dividend.

Directors

The Directors at 31 December 2010 were:

Mr Darren Shapland (Chairman)	Appointed 17 July 2006
Ms Gwyn Burr	Appointed 18 September 2006
Ms Hannah Bernard	Appointed 1 August 2007
Mr Alasdair Lenman	Appointed 2 July 2009
Mr David Fisher (Chief Executive Officer)	Appointed 1 January 2010
Mr Ian Fox	Appointed 26 April 2010
Mr David Nicholson	Appointed 1 June 2010
Mr John Rogers	Appointed 28 October 2010

The Board comprises two executive Directors and six non-executive Directors. Messers Lenman, Fox and Nicholson are employed and remunerated by Lloyds Banking Group plc. Mr Shapland, Ms Burr, Ms Bernard, Mr Fisher and Mr Rogers are employed and remunerated by J Sainsbury plc.

With the exception of Mr Fox, Mr Nicholson and Mr Rogers, 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 2010 were:

Mr Peter Jackson	Resigned 18 March 2010
Mr Lindsay Mackay	Resigned 18 March 2010
Ms Imelda Walsh	Resigned 28 July 2010

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

Directors' indemnities

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 2006.

Charitable and other donations
During the period the Bank made charitable donations in the UK of £11,091 (2009: £26,914).

Employees
The Bank values the contribution of colleagues and recognises that business objectives cannot be achieved without attracting and developing high quality staff. The Bank is committed to being an equal opportunities employer and has in place a number of processes to ensure staff are engaged in the business and are able to develop over time. These range from a colleague forum, regular newsletters, updates on business performance, individual development plans and access to a wide range of training resources.

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 day's credit taken at 31 December 2010 was 26 days (2009: 18 days).

Statement as to disclosure of information to auditors
At the date of this report, each of the Directors in office has 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
2nd March 2011

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 2006 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 have been consistently applied to all periods presented in these financial statements. The Bank has considered the best practice disclosure principles within the British Bankers' Association Code on Financial Reporting Disclosure. Although the code has not been formally adopted information contained within the financial report is considered consistent with these principles and appropriate for the size and complexity of the Bank's activities.

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 short-term wholesale markets to fund retail activity.

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 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 loan's 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 uncollectable 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 Sainsbury's Bank customers, are recognised when earned by the customer. For certain insurance products double nectar points are awarded on spend in J Sainsbury's plc stores subject to a cap for 2 years provided there are no claims on the policy and that renewal occurs. The estimated annual cost of the points are recognised at the point of sale for the first year of the offer.

(k) Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, demand deposits, Treasury Bills and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

(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.

(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) Provisions

The Bank recognises a provision if there is a present obligation as a consequence of either a legal or a constructive obligation resulting from a past event. To recognise this it should be probable that an outflow of economic resources, that can be reliably measured, will be required to settle the obligation. Provisions are measured as the discounted expected future cash flows taking account of the risks and uncertainties associated with the specific liability where appropriate.

(r) New accounting standards

The following IFRS standards and International Financial Reporting Interpretations Committee ('IFRIC') interpretations have been applied in 2010:

IFRS 3 'Business combinations': The revised standard continues to require the use of the acquisition method of accounting for business combinations. The amendment has had no impact on the financial statements of the Bank.

IAS 27 'Consolidated and Separate Financial Statements': The amendment requires the effects of all transactions with non controlling interests to be recorded in equity if there has been no change in control. It also specifies the accounting when control is lost. The amendment has had no impact on the financial statements of the Bank.

IAS 39 and IFRIC 9 'Eligible hedged items' (July 2008): The amendment clarifies how the principles underlying hedge accounting should be applied in particular situations. The amendment has had no impact on the financial statements of the Bank.

'Improvements to IFRSs' (April 2009): Several small amendments have been made to a number of standards. None of these amendments have had an impact on the financial statements of the Bank.

IFRS 1 (revised) 'First time adoption of IFRS'. The standard now includes a limited exemption from IFRS 7 disclosures on adoption of IFRS, effective from 1 July 2010. This has no impact on the financial statements of the bank.

IFRS2 (revised) 'Share based payments'. This clarifies classification of share based payment awards in both consolidated and separate financial statements, incorporating IFRIC 8 and IFRIC 11 into the standard and removing inconsistencies within the standard regarding the treatment of equity instruments of other group entities. Effective from 1 January 2010 this has no impact on the financial statements of the Bank.

(s) Critical accounting judgements and estimates

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.

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.

Critical accounting judgements

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

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.

Deferred tax

Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing, nature and level of future taxable income. The recognition of deferred tax assets relating to tax losses carried forward relies on profit projections and taxable profit forecasts prepared by management, where a number of assumptions are required based on the levels of growth in profits and the reversal of deferred tax balances.

Critical accounting estimates

The critical accounting estimates made by the Bank are set out below. Disclosures about estimates and the related assumptions are also included in the appropriate Note to the Financial Statements.

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 2010 and 2009 all securities were valued from market prices or broker/dealer valuations. In the prior year investment securities with a value of £18.8m had valuations based on market observable inputs relating to suitable proxy bonds with similar credit and maturity profiles.

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.

Provisions and contingent liabilities
The Bank has acted as an introducer to Lloyds Banking Group ('LBG') in relation to the sale of certain past products. In the prior year the Bank recorded a provision to cover estimated costs to LBG in connection with these sales, capped in accordance with the commercial terms agreed. The level of provision has been estimated based on certain key assumptions in relation to cost emergence.

Commission claw back
Where the Bank receives insurance commission and 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. The principal assumptions underlying the level of deferred income relate to the volume of cancellation, write off or early settlement activity as well as the timing of this. Actual levels of claw back are regularly reviewed against model assumptions.

Financial Services Compensation Scheme
The ultimate liability for levies payable to the FSCS in respect of those financial institutions which collapsed during the 2008 financial year remains uncertain. The amount provided by the Bank is the latest estimate of the contribution required in respect of the period of the initial facility from HM Treasury. This contribution is dependent upon the following factors:

- Future interest rates;
- The Bank's share of industry protected deposits; and
- Finalisation of the principal balance of the HM Treasury loans, including the extent to which the FSCS can recover assets to fund their repayment.

The Bank is aware that further fees, in respect of any refinancing after the maturity of the initial loan facility or any compensation payments should the FSCS fail to recover sufficient funds to repay its loans, are possible but has not made any provision for them as they cannot be reliably estimated. The outstanding principal on the loans is due to be repaid from April 2012 and the FSCS have indicated that a repayment schedule will be agreed with HM Treasury reflective of market conditions nearer the time. The FSCS have estimated that a 0.5% increase in LIBOR would result in a £100m increase in the overall annual FSCS levy based on current borrowing levels. The Bank share of this based on the 31 December 2010 deposit level would be £0.3m. Further detail of the FSCS and the provision are included in note 21.

(t) 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 2010 and have not been applied in preparing the financial statements:

IAS 24 (revised) 'Related party disclosures'. The revised standard simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities. Effective from 1 January 2011, there would be no effect on the Bank.

IFRIC 14 'Prepayments of a minimum funding requirement'. This interpretation provides guidance on assessing the limit in IAS 19, 'Employee benefits', on the amount of the surplus that can be recognised as an asset and explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. Effective 1 January 2011, this would have no impact on the financial statements of the Bank.

IAS 32 'Financial instruments: Presentation – Classification of Rights Issues'. This amendment requires rights issues denominated in a currency other than the functional currency of the issuer to be classified as equity regardless of the currency in which the exercise price is denominated. Effective for annual periods beginning on or after 1 February 2010 this is not expected to have an impact on the financial statements of the Bank.

IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments'. This interpretation clarifies the accounting for gains and losses arising from the renegotiation or extinguishment of an entities own debt. Effective for annual periods beginning on or after 1 July 2010 this is not expected to have a material impact on the financial statements 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 2010 and have not been applied in preparing the financial statements:

IFRS 7 (revised) 'Financial instruments: Disclosures'. These amendments relate to transfer of financial assets and their derecognition. They are designed to promote transparency in the reporting of transfer transactions and improve users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial assets. This is effective from 1 July 2011. Although not yet endorsed by the EU, early adoption is permitted. There would be no effect on the Bank of adopting the amended standard.

Improvements to IFRSs (issued May 2010). This sets out minor amendments to IFRS standards as part of the annual improvement process. The effective dates vary on a standard by standard basis but none are effective any earlier than annual periods beginning on or after 1 July 2010.

IAS 12 'Deferred Tax: Recovery of Underlying Assets'. This amendment provides guidance for measuring deferred tax liabilities and deferred tax assets when investment property is measured using the fair value model in IAS 40. This standard is not expected to have a material impact on the financial statements of the Bank.

IFRS 9, 'Financial instruments part 1: Classification and measurement'. IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification will depend on the approach taken by the Bank for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both the objective of the Bank's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest (that is, it has only 'basic loan features'). All other debt instruments are to be measured at fair value through profit or loss.

- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

IFRS 9 has not yet been endorsed by the EU. While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted. During the year the Bank has considered the possible impact of the standard on those instruments currently classified within the Available for Sale category. This will be influenced by the characteristics of financial instruments at the date of adoption and at this stage it is not considered possible to determine the overall impact on the financial statements of this change.

IFRS 9 is the initial stage of the project to replace IAS 39. Further stages exist to deal with changes to the classification and measurement of financial liabilities, impairment of financial assets measured at amortised cost and hedge accounting. As information becomes available the Bank will assess the impact of these changes on the financial statements.

Income statement

For the year to 31 December, 2010

	Note	31 December 2010 £m	31 December 2009 £m
Interest receivable	3	**218.3**	206.5
Interest payable	3	**(102.1)**	(85.9)
Net interest income		**116.2**	120.6
Fees and commissions receivable		**98.7**	90.9
Fees and commissions payable		**(1.4)**	(1.8)
Other operating income			
Net operating income		**213.5**	209.7
Administrative expenses	5	**(107.4)**	(96.8)
Depreciation and amortisation			
Property, plant and equipment	6	**(3.4)**	(3.4)
Intangible assets	7	**(0.8)**	(1.3)
		(111.6)	(101.5)
Impairment losses on financial assets	9	**(60.5)**	(88.1)
Losses realised on financial instruments	10	**(12.7)**	(1.9)
Profit before taxation	4	**28.7**	18.2
Tax on profit	11	**(8.1)**	(5.0)
Total profit attributable to equity holders of the Bank		**20.6**	13.2

The statement of accounting policies on pages 6 to 10 and the notes on pages 16 to 38 form part of these accounts.

Statement of comprehensive income

For the year to 31 December, 2010

	Note	31 December 2010 £m	31 December 2009 £m
Profit for the period		**20.6**	13.2
Other comprehensive income/(expense):			
Available for sale financial assets fair value movements		**(13.1)**	67.2
Cash flow hedges effective portion of fair value movements		**2.4**	(0.5)
Tax on items recognised directly in equity	11	**3.0**	(18.5)
Total other comprehensive income for the period net of tax		**(7.7)**	48.2
Total comprehensive income for the period		**12.9**	61.4

All amounts are attributable to members of the Company.

Balance sheet

As at 31 December, 2010

	Note	As at 31 December 2010 £m	As at 31 December 2009 £m
Assets			
Cash and balances at central banks		**210.5**	159.8
Financial Investments – Available for Sale			
Treasury bills	12	**500.5**	451.6
Investment securities	13	**544.8**	948.4
Loans and advances to banks	15	**1,599.0**	1,642.3
Loans and advances to customers	16	**2,324.5**	2,155.8
Property, plant and equipment	6	**15.9**	15.9
Intangible assets	7	**2.4**	1.3
Deferred tax asset	11	**1.5**	2.0
Other assets	17	**90.0**	79.4
Prepayments and accrued income		**13.2**	15.0
Total Assets		**5,302.3**	5,471.5
Liabilities			
Deposits by banks	18	**1,277.5**	1,216.7
Derivatives designated as cash flow hedging instruments	14	**108.9**	183.0
Customer accounts	19	**3,541.3**	3,701.2
Other liabilities	20	**17.6**	28.3
Current tax liabilities		**0.6**	2.5
Provisions for liabilities and charges	21	**2.9**	5.5
Accruals and deferred income	22	**25.9**	19.6
Other borrowed funds			
Dated loan capital	23	**60.0**	60.0
Undated loan capital	23	**50.0**	50.0
Total Liabilities		**5,084.7**	5,266.8
Equity			
Called up share capital	24	**170.0**	170.0
Retained earnings	25	**68.7**	48.1
Other reserves	26	**(21.1)**	(13.4)
Equity shareholders' funds		**217.6**	204.7
Total Equity and Liabilities		**5,302.3**	5,471.5

The financial statements on pages 6 to 38 were approved by the Board of Directors on 2 March 2011 and signed on its behalf by:

Hannah Bernard Director and Company Secretary
2 March 2011

David Fisher Director and Chief Executive
2 March 2011

The statement of accounting policies on pages 6 to 10 and the notes on pages 16 to 38 form part of these accounts.

Sainsbury's Bank plc – Company number 3279730

Statement of changes in equity

For the year to 31 December, 2010

At 31 December 2010	Share capital £m	Retained earnings £m	Other reserves £m	Total £m
At 1 January 2010	**170.0**	**48.1**	**(13.4)**	**204.7**
Profit for the period	**-**	**20.6**	**-**	**20.6**
Other comprehensive income/(expense):				
Available for sale financial assets fair value movements (net of tax)	**-**	**-**	**(9.4)**	**(9.4)**
Cash flow hedges effective portion of fair value movements (net of tax)	**-**	**-**	**1.7**	**1.7**
Total comprehensive income for the period	**-**	**20.6**	**(7.7)**	**(7.7)**
Additional share capital raised in the period	**-**	**-**	**-**	**-**
Balance at 31 December 2010	**170.0**	**68.7**	**(21.1)**	**217.6**

At 31 December 2009	Share capital £m	Retained earnings £m	Other reserves £m	Total £m
At 1 January 2009	170.0	34.9	(61.6)	143.3
Profit for the period	-	13.2	-	13.2
Other comprehensive income/(expense):				
Available for sale financial assets fair value movements (net of tax)	-	-	48.5	48.5
Cash flow hedges effective portion of fair value movements (net of tax)	-	-	(0.3)	(0.3)
Total comprehensive income for the period	-	13.2	48.2	61.4
Additional share capital raised in the period	-	-	-	-
Balance at 31 December 2009	170.0	48.1	(13.4)	204.7

All amounts are attributable to members of the Company.

The statement of accounting policies on pages 6 to 10 and the notes on pages 16 to 38 form part of these accounts.

Cash flow statement

For the year to 31 December, 2010

	Note	31 December 2010 £m	31 December 2009 £m
Cash flows from operating activities	33	**62.9**	313.5
Cash flows from investing activities	34	**(5.4)**	(4.2)
Cash flows from financing activities	35	**(1.6)**	(2.5)
Net increase in cash and cash equivalents		**55.9**	306.8
Opening cash and cash equivalents	36	**2,251.0**	1,944.2
Closing cash and cash equivalents	36	**2,306.9**	2,251.0

The statement of accounting policies on pages 6 to 10 and the notes on pages 16 to 38 form part of these 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 Lloyds Banking Group plc group of companies. The remuneration cost of these individuals is met by the joint venture. The average weekly number of staff working on the Bank's operations during the period is set out below.

	2010 Number	2009 Number
Full time	**599**	585
Part time	**45**	42
	644	627

Of the above, a total of 168 full time and 16 part time staff (2009: 153 full time, 11 part time) are directly seconded from the relevant members of the parent organisations to the Bank. The remaining 431 full time and 29 part time staff (2009: 432 full time, 31 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 incurs certain costs for members of staff who work for various entities within the LBG 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 Lloyds Banking Group plc. A total of 61 (2009: 60) employees participate in the defined benefit scheme, the HBOS Final Salary Pension Scheme (HBOS FSPS), 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 FSPS 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 defined benefit asset on the HBOS FSPS at 31 December 2010, valued on an IAS 19 basis, is £41m (2009: liability of £382m). The latest full actuarial valuation of the HBOS FSPS was carried out as at 31 December 2009 by a qualified independent actuary.

The Bank also incurs 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. The scheme, 'Sainsbury's' Pension Scheme', was formed during the year by the merger of the two pre-existing schemes ('J Sainsbury Pension and Death Benefit Scheme' and the 'J Sainsbury Executive Pension Scheme') as part of the settlement of the 2009 Triennial Actuarial Valuation for these schemes. A total of 15 (2009: 17) employees participate in the defined benefit scheme which was 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 £278,803 (2009: £337,504) for the defined contribution schemes and £656,691 (2009: £560,679) for the defined benefit schemes.

2 Directors' emoluments

	2010 £'000	2009 £'000
(i) Aggregate emoluments		
Aggregate emoluments	**669**	538
Aggregate amounts payable under long term incentive schemes	**115**	-

Retirement benefits have accrued or are accruing under either J Sainsbury plc's or Lloyds Banking Group plc's defined benefit schemes to 1 (2009: 2) Executive Director. In addition to the above, emoluments representing employer's pension contributions of £30k (2009: 72k) were made in the year.

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 plc or Lloyds Banking Group plc. The Bank is recharged emolument costs in accordance with and subject to the terms of arrangements agreed with the relevant employer.

There were no payments made to non-executive Directors who served during the period (2009: £nil). These non-executive Directors were paid by J Sainsbury plc or Lloyds Banking Group 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.

	2010 £'000	2009 £'000
(ii) Highest paid Director		
Aggregate emoluments	**409**	319
Aggregate amounts payable under long term incentive schemes	**115**	-

The retirement benefits accruing in relation to the highest paid Director were £nil (2009: £36,819).

3 Net interest income

	2010 £m	2009 £m
Interest income		
Interest income on loans and receivables	**214.0**	188.0
Interest income from available for sale financial instruments	**4.3**	18.5
Interest on derivative liabilities	**-**	-
	218.3	206.5
Interest expense		
Interest expense on loans and receivables	**(100.3)**	(82.7)
Interest expense on derivative liabilities	**(1.8)**	(3.2)
	(102.1)	(85.9)
Net interest income	**116.2**	120.6

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 2010 was £nil (2009: £nil).

4 Profit/loss before taxation

	2010 £m	2009 £m
Profit/(Loss) before taxation is stated after taking account of the following:		
Income:		
Interest on impaired loan balances	**2.2**	1.5
Expenses:		
Loss on disposal of fixed assets	**0.1**	0.3
Operating lease	**0.6**	0.6
Auditors' remuneration:		
Statutory audit of the Bank	**0.2**	0.1

5 Administrative expenses

	2010 £m	2009 £m
Staff costs	**12.8**	10.7
Marketing costs	**23.8**	19.3
Other administrative expenses	**70.8**	66.8
	107.4	96.8

6 Property, plant and equipment

	Equipment £m
31 December 2010	
Cost	
At 1 January 2010	**47.8**
Additions	**3.5**
Disposals	**(5.7)**
As at 31 December 2010	**45.6**
Depreciation	
At 1 January 2010	**31.9**
Charge for the period	**3.4**
Disposals	**(5.6)**
As at 31 December 2010	**29.7**
Net Book Value at 31 December 2010	**15.9**

	Equipment £m
31 December 2009	
Cost	
At 1 January 2009	45.7
Additions	3.2
Disposals	(1.1)
As at 31 December 2009	47.8
Depreciation	
At 1 January 2009	29.3
Charge for the period	3.4
Disposals	(0.8)
As at 31 December 2009	31.9
Net Book Value at 31 December 2009	15.9

7 Intangible assets

	Systems and Software Development £m
31 December 2010	
Cost	
At 1 January 2010	**14.0**
Additions	**1.9**
Disposals	**(1.5)**
As at 31 December 2010	**14.4**
Amortisation	
At 1 January 2010	**12.7**
Charge for the period	**0.8**
Disposals	**(1.5)**
As at 31 December 2010	**12.0**
Net Book Value at 31 December 2010	**2.4**

	Systems and Software Development £m
31 December 2009	
Cost	
At 1 April 2009	13.1
Additions	1.0
Disposals	(0.1)
As at 31 December 2009	14.0
Amortisation	
At 1 April 2009	11.5
Charge for the period	1.3
Disposals	(0.1)
As at 31 December 2009	12.7
Net Book Value at 31 December 2009	1.3

8 Capital commitments

	2010 £m	2009 £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	**0.9**	0.3
Software development	**-**	0.1
	0.9	0.4

9 Impairment losses on financial assets

	2010 £m	2009 £m
Loans and advances to customers	**60.5**	88.1

A reconciliation of impairment losses on loans and advances by class is set out on the following page:

	Unsecured lending £m	Secured lending £m	2010 Total £m
12 months to 31 December 2010			
At 1 January 2010	156.9	-	**156.9**
New impairment provisions less releases (net of recoveries)	60.5	-	**60.5**
Amounts written off	(93.3)	-	**(93.3)**
Discount unwind on impaired loans and advances to customers	(2.2)	-	**(2.2)**
Cumulative impairment provisions as at 31 December 2010	121.9	-	**121.9**
New impairment provisions less releases	66.0	-	**66.0**
Recoveries of amounts previously written off	(5.5)	-	**(5.5)**
Net charge to income statement	60.5	-	**60.5**
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	158.0	2.8	**160.8**

9 Impairment losses on financial assets continued

	Unsecured lending £m	Secured lending £m	2009 Total £m
12 months to 31 December 2009			
At 1 January 2009	158.7	–	158.7
New impairment provisions less releases (net of recoveries)	88.0	0.1	88.1
Amounts written off	(88.3)	(0.1)	(88.4)
Discount unwind on impaired loans and advances to customers	(1.5)	–	(1.5)
Cumulative impairment provisions as at 31 December 2009	156.9	–	156.9
New impairment provisions less releases	89.4	0.1	89.5
Recoveries of amounts previously written off	(1.4)	–	(1.4)
Net charge to income statement	88.0	0.1	88.1
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	192.0	4.3	196.3

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 Losses realised on financial instruments

The Bank sold a number of financial instruments in the year as an alternative to raising retail deposits. This also helped ensure the credit risk appetite of the Bank was maintained. This realised a loss of £12.7m (2009: £1.9m) previously accumulated in reserves.

11 Taxation

	2010 £m	2009 £m
(i) Taxation		
UK corporation tax on Profit/(Loss) for the period at 28% (2009: 28%)	**7.7**	2.5
Tax under/(over) provision for prior years	**-**	(1.8)
Current Tax	**7.7**	0.7
Deferred tax charge/(credit)	**0.4**	2.6
Tax under/(over) provision for prior years	**-**	1.7
Deferred Tax	**0.4**	4.3
Total Tax Charge/(Credit)	**8.1**	5.0

The taxation charge of £8,125,867 (2009: £5,042,263) represents 28.3% (2009: 27.7%) of pre-tax profits. The taxation charge incorporates a reduction in the deferred tax asset as a result of changes in the main rate of corporation tax from 28% to 27%. This change was substantively enacted in July 2010 and takes effect from 1 April 2011. Differences to the UK corporation tax rate for the period of 28% are explained below:

(ii) Reconciliation of effective tax rate

	2010 £m	2009 £m
Profit/(Loss) on ordinary activities before tax	**28.7**	18.2
Tax on ordinary activities at 28% (2009: 28%)	**8.0**	5.1
Effects:		
Change in tax rate	**0.1**	-
Adjustments in respect of prior periods	**-**	(0.1)
	8.1	5.0

(iii) Deferred taxation

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

	2010 £m	2009 £m
Deferred tax asset		
At 1 January	**2.0**	28.3
Movement in deferred tax asset	**(0.5)**	(26.3)
As at 31 December	**1.5**	2.0
Tax effect of timing differences due to:		
Accelerated capital allowances	**(0.1)**	-
Timing differences on impairment provisions	**1.6**	2.0
Deferred tax asset at 31 December	**1.5**	2.0

(iv) Other reserves

Tax recognised in equity relating to available-for-sale and cash flow reserve movements is as follows:

	2010 £m	2009 £m
Available for sale reserve - tax charge/(credit)	**(3.7)**	18.6
Cash flow reserve - tax charge/(credit)	**0.7**	(0.1)
	(3.0)	18.5

12 Treasury bills

	2010 £m	2009 £m
Treasury bills	**500.5**	451.6

	2010 £m	2009 £m
Of which:		
Maturing in three months or less	**229.8**	233.9
Maturing between three months and one year	**270.7**	217.7
	500.5	451.6

13 Investment securities

	2010 £m	2009 £m
Investment securities		
Unlisted – issued by banks and building societies	**544.8**	948.4
Of which:		
Maturing within one year	**61.2**	233.5
Between 1 and 5 years	**444.1**	605.4
After 5 years	**39.5**	109.5
	544.8	948.4

The fair value movement during the year on investment securities classified as available for sale is a loss of £13.1m (2009: a gain of £65.3m).

14 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 £m	Assets £m	Liabilities £m
Currency swaps:			
At 31 December 2010	**401.4**	**-**	**108.9**
At 31 December 2009	618.6	-	183.0

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 2010 (2009: nil) as a result of the highly probable cash flows no longer being expected to occur.

15 Loans and advances to banks

	Note	2010 £m	2009 £m
Sterling loans and advances to banks		**1,599.0**	1,642.3
Repayable on demand (included in cash equivalents)	36	**-**	29.3
Other loans and advances repayable:			
In 3 months or less (included in cash equivalents)	36	**1,599.0**	1,613.0
Between 3 months and 1 year			-
Gross advances		**1,599.0**	1,642.3

16 Loans and advances to customers

	Note	2010 £m	2009 £m
Gross advances		**2,446.4**	2,312.7
Impairment losses on loans and advances	9	**(121.9)**	(156.9)
Loans and advances to customers		**2,324.5**	2,155.8
Repayable on demand		**718.3**	728.0
Other loans and advances repayable			
In 3 months or less		**119.4**	102.9
Between 3 months and 1 year		**351.1**	304.6
Between 1 and 5 years		**1,109.2**	1,000.1
After 5 years		**148.4**	177.1
Gross advances		**2,446.4**	2,312.7

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

	2010 £m	2009 £m
Individuals:		
Home Mortgages	**85.3**	94.9
Unsecured Personal Lending	**2,361.1**	2,217.8
Gross loans and advances to customers	**2,446.4**	2,312.7

17 Other assets

Included in other assets of £90.0m at 31 December 2010 is ATM cash in transit amounting to £54.6m (2009: £43.6m) and amounts due from Link settlements of £28.8m (2009: £26.8m). Other Assets have no fixed maturities but are expected to be realised within 12 months.

18 Deposits by banks

	2010 £m	2009 £m
Repayable		
On demand	**2.7**	-
Within 3 months	**98.4**	181.7
Between 3 months and 1 year	**292.2**	230.2
Between 1 and 5 years	**847.2**	761.8
More than five years	**37.0**	43.0
	1,277.5	1,216.7

19 Customer accounts

Customer accounts comprise sterling interest bearing deposits.

	2010 £m	2009 £m
Repayable		
On demand	**3,375.6**	3,701.2
Within 3 months	**-**	-
Between 3 months and 1 year	**61.2**	-
Between 1 and 5 years	**104.5**	-
More than five years	**-**	-
	3,541.3	3,701.2

20 Other liabilities

All Other Liabilities are expected to be settled within 3 months.

	2010 £m	2009 £m
Customer funds in course of settlement	**14.5**	20.5
Bank funds in course of settlement	**0.8**	2.8
Income tax collected on behalf of HMRC	**-**	0.1
Other liabilities	**2.3**	4.9
	17.6	28.3

All other liabilities are expected to be settled within 3 months.

21 Provisions for liabilities and charges

	FSCS £m	Other regulatory provisions £m	Total £m
2010			
At 1 January 2010	**4.2**	**1.3**	**5.5**
Charge to administrative expenses	**(0.1)**	**-**	**(0.1)**
Utilised in year	**(1.4)**	**(1.1)**	**(2.5)**
At 31 December 2010	**2.7**	**0.2**	**2.9**

	FSCS £m	Other regulatory provisions £m	Total £m
2009			
At 1 January 2009	5.0	-	5.0
Charge to administrative expenses	1.6	1.3	2.9
Utilised in year	(2.4)	-	(2.4)
At 31 December 2009	4.2	1.3	5.5

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (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 a number of banks whose depositors are protected by the scheme. In order to meet its obligations, the FSCS has borrowed funds from HM Treasury on an interest only basis until April 2012 when the first repayment has been scheduled. 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 April 2012 and will form part of future FSCS management expenses levies.

If the assets of the failed institutions are insufficient to repay the loan in 2012, 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 2010 financial statements is a net release of £0.1m (December 2009: charge of £1.6m). The closing provision represents the estimated share of levies that will be raised by the FSCS including the interest on the loan in respect of the levy years 2010/2011 and 2011/2012, 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. The net release of £0.1m comprises a charge of £1.5m for the levy year 2011/12 and a release of £1.6m in respect of the opening provision held for 2010/2011 due to changes in assumptions in the estimated interest on the loan based on forward LIBOR projections.

Other regulatory provisions

Other provisions have been made in prior periods in respect of a commercially agreed position between Lloyds Banking Group relating to various customer claims received by them as discussed in critical accounting estimates on page 8. It is expected the remainder of this liability will predominately crystallise over the next 12 months.

22 Accruals and deferred income

Included in accruals and deferred income at 31 December 2010 are amounts payable to J Sainsbury plc of £2.5m (December 2009: £2.7m) and amounts payable to Lloyds Banking Group plc of £8.3m (December 2009: £4.9m) in respect of management services and capital expenditure. Accruals and deferred income has no fixed maturity.

23 Other borrowed funds

	2010 £m	2009 £m
Dated loan capital – Repayable between 1 and 5 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 37 – '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. Interest on the £60 million Floating Rate subordinated loan dated 2016, is payable three months in arrears at LIBOR plus a margin of 0.60% per annum for the duration of the loan.

Undated Loan Capital

The undated subordinated loans are split in proportion to shareholder funding. See note 37 – '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 annum for the duration of the loan.

24 Called up share capital

	'A' Ordinary shares of £1	'B' Ordinary shares of £1	Total Ordinary shares of £1
Allotted, called up and fully paid			
At 1 January 2010	85.0	85.0	170.0
Issued Ordinary Shares	–	–	–
At 31 December 2010	**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.

25 Retained earnings

	2010 £m	2009 £m
At 1 January	**48.1**	34.9
Profit for the period to 31 December	**20.6**	13.2
At 31 December	**68.7**	48.1

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.

26 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 13.

	2010 £m	2009 £m
At 1 January	**(13.4)**	(61.6)
Net unrealised losses	**(23.4)**	64.8
Realised losses reclassified to the income statement on disposal	**12.7**	1.9
Tax effect of net losses	**3.0**	(18.5)
Balance at 31 December	**(21.1)**	(13.4)

Of the balances above £(20.3)m (2009: (£10.9)m) relates to the available for sale reserve and £(0.8)m (2009: £(2.5)m) to the cash flow hedge reserve. Those balances include tax of £8.2m in the available for sale reserve (2009: £4.6m) and £0.3m in the cash flow hedge reserve (2009: £1.0m).

27 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 6 to 10 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 2010							
Assets							
Cash and balances at central banks			**210.5**				**210.5**
Financial Investments – Available for Sale							
Treasury bills				**500.5**			**500.5**
Investment securities				**544.8**			**544.8**
Loans and advances to banks			**1,599.0**				**1,599.0**
Loans and advances to customers			**2,324.5**				**2,324.5**
Other assets			**90.0**				**90.0**
Prepayments and accrued income			**12.9**				**12.9**
Total financial assets	**-**	**-**	**4,236.9**	**1,045.3**	**-**	**-**	**5,282.2**
Total non-financial assets							**20.1**
Total Assets							**5,302.3**
Liabilities							
Deposits by banks					**1,277.5**		**1,277.5**
Derivatives designated as cash flow hedging instruments						**108.9**	**108.9**
Customer accounts					**3,541.3**		**3,541.3**
Other liabilities					**17.6**		**17.6**
Accruals and deferred income					**25.9**		**25.9**
Other borrowed funds							
Dated loan capital					**60.0**		**60.0**
Undated loan capital					**50.0**		**50.0**
Total financial liabilities	**-**	**-**	**-**	**-**	**4,972.3**	**108.9**	**5,081.2**
Total non-financial liabilities							**3.5**
Total Liabilities							**5,084.7**

27 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
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

28 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:

	2010 £m	2009 £m
Commitments to extend credit	**30.5**	29.1

Operating Lease Commitments

Total commitments under operating leases are as follows:

	2010 £m	2009 £m
Due within one year	**0.6**	0.6

29 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 overall risk management framework is described in detail on pages 1 to 3 of the Directors report.

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 Assets and Liability Committee and Executive Risk Committee as required. Derivatives are subject to the same credit risk control procedures as are applied to other wholesale market instruments.

Retail credit risk
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 Retail Credit Risk Committee ensures that appropriate policies are established and adhered to and this is subject to further oversight from the Executive Risk Committee. Internal Audit teams carry out regular reviews of credit risk processes and policies on an annual basis.

At 31 December 2010, 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 15, 16 and 28, respectively. No account is taken of any collateral held and the maximum exposure to loss is considered to be the instrument's 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

	2010 £m	2009 £m
Credit risk exposures relating to on-balance sheet		
Cash and balances at central banks	**210.5**	159.8
Treasury bills	**500.5**	451.6
Investment securities	**544.8**	948.4
Loans and Advances to banks	**1,599.0**	1,642.3
Loans and Advances to customers		
Unsecured	**2,239.2**	2,060.9
Secured	**85.3**	94.9
Derivative financial instruments	**-**	-
Other assets	**90.0**	79.4
Prepayments and accrued income	**13.2**	14.9
Credit risk exposures relating to off-balance sheet items		
Loans commitments and other related liabilities	**30.5**	29.1
Total credit risk exposure	**5,313.0**	5,481.3

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). Consideration is also given to geographical sector and in the case of wholesale credit risk the strength of the relevant sovereign.

29 Risk management continued

Geographical sectors

	2010 £m	2009 £m
Maximum exposure		
United Kingdom	**4,768.2**	4,605.8
Countries in Europe adopting the Euro	**483.8**	802.4
Canada	**61.0**	58.2
Australia	**-**	14.9
Total	**5,313.0**	5,481.3

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

	2010 £m	2009 £m
Maximum exposure		
Corporate	**-**	-
Sovereign		
UK	**503.6**	454.2
Non UK	**-**	-
Bank	**2,429.5**	2,821.0
Retail	**2,379.9**	2,206.1
Total	**5,313.0**	5,481.3

The maximum credit exposure to any client or counterparty as of 31 December 2010 was £1,357.8m (2009: £1,405.6m) before taking into account of collateral or other credit enhancements of £642.6m (2009: £763.8m). 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% 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:

	2010 £m	2009 £m
Impaired	**160.8**	196.3
Past due but not impaired	**26.4**	29.1
Neither past due nor impaired	**2,259.2**	2,087.3
Gross	**2,446.4**	2,312.7
Less: allowance for impairment	**(121.9)**	(156.9)
Net	**2,324.5**	2,155.8

Credit quality analysis – 31 December 2010:

	Unsecured lending 2010 £m	Secured lending 2010 £m	2010 £m
Impaired			
Less than 3 months, but impaired	**5.9**	**-**	**5.9**
Past due 3 to 6 months	**19.5**	**0.6**	**20.1**
Past due 6 to 12 months	**0.3**	**0.3**	**0.6**
Past due over 12 months	**-**	**1.7**	**1.7**
Recoveries	**132.3**	**-**	**132.3**
Possession	**-**	**0.2**	**0.2**
Total gross impaired loans	**158.0**	**2.8**	**160.8**
Past due but not impaired			
Past due up to 3 months but not impaired	**23.7**	**2.7**	**26.4**
Total gross past due but not impaired	**23.7**	**2.7**	**26.4**
Neither past due nor impaired*			
Not impaired	**2,179.4**	**79.8**	**2,259.2**
Total gross neither past due nor impaired	**2,179.4**	**79.8**	**2,259.2**
Total gross amount due	**2,361.1**	**85.3**	**2,446.4**
*Includes loans and advances that would have been past due or impaired had their terms not been renegotiated	**2.5**	**-**	**2.5**

29 Risk management continued

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 £11.1m (2009: £12.2m). The fair value of collateral held against possession cases was £0.2m (2009: £0.3m).

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 2009:

	Unsecured lending 2009 £m	Secured lending 2009 £m	2009 £m
Impaired			
Less than 3 months, but impaired	4.1	–	4.1
Past due 3 to 6 months	24.9	1.0	25.9
Past due 6 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 3 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

Loans and advances to banks

The total gross amount of individually impaired loans and advances to banks as at 31 December 2010 was £nil (2009: £nil). The fair value of collateral held for loans and advances to banks was £642.6m (2009: £763.8m). 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

	2010 £m	2009 £m
Aaa to A3	**1,599.0**	1,642.3
Total	**1,599.0**	1,642.3

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 2010 was £nil (2009: £nil). 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 2010			
Aaa to A3	**500.5**	**500.8**	**1001.3**
Baa1 to Baa3	**-**	**44.0**	**44.0**
Total	**500.5**	**544.8**	**1045.3**

	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

29 Risk management continued

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'.

As highlighted on page 3, the Bank's risks were reassessed in 2010 utilising a revised methodology which is aligned to the three lines of defence model and the Bank's risk management framework. The key risks assessed were credit risk, liquidity risk, interest rate risk and operational risk (including outsourcing risk).

In addition to the Control Self Assessment process described on page 3 and regular reporting to the operational and regulatory risk committee (ORRC), a strategic risk map is also maintained. This provides details of the current impact and likelihood assessments of the key strategic risks of the Bank, along with a forward looking assessment of risks. This is reported to the Board Risk Committee with any significant change in assessments from the last meeting being highlighted. More recently the Board Risk Committee has also considered potential linkages between the key strategic risks in order to identify 'combined risks'.

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

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. During the year management have focused on implementing requirements stemming from new liquidity regulation. PS09/16 *Strengthening Liquidity Standards* has led the Bank to implement a new liquidity risk appetite as well as improving systems for measuring and managing liquidity risk.

As required by the new regulations the Bank has completed an Individual Liquidity Adequacy Assessment (ILAA). This allows the Bank to demonstrate that it understands the liquidity risks it is running and has appropriate controls in place to mitigate them. A new risk appetite as well as the establishment of limits stemming from the ILAA process has led to an increase in the minimum level of liquidity held. Limits are informed by a number of stress scenarios that assess the survival period of the Bank.

In meeting internal limits as well as FSA requirements 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 as outlined in the ILAA and by the Financial Services Authority.

In addition to this, the Bank prepares both long term and short term forecasts to assess liquidity requirements. Short term forecasting covers a rolling twelve 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 along with other early warning indicators.

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 2010 £m
At 31 December 2010						
Non-derivative liabilities						
Deposits by banks	36.1	71.3	314.9	888.5	37.6	1,348.4
Customer accounts	3,376.0	0.9	65.1	107.5	-	3,549.5
Other liabilities	20.2	-	-	-	-	20.2
Accruals	25.9	-	-	-	-	25.9
Other borrowed funds	-	0.4	1.3	70.8	62.3	134.8
	3,458.2	72.6	381.3	1,066.8	99.9	5,078.8
Derivative liabilities						
Outflow	20.2	0.9	41.4	361.4	44.1	468.0
Inflow	(15.8)	(0.5)	(32.2)	(280.4)	(34.6)	(363.5)
	4.4	0.4	9.2	81.0	9.5	104.5
Unrecognised loan commitments	30.5	-	-	-	-	30.5
	3,493.1	73.0	390.5	1,147.8	109.4	5,213.8

29 Risk management continued

	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

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 16) 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 19) 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 15) and bank deposits (note 18) 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 Board Risk Committee using fixed rate funding. These exposures are monitored by the Asset and Liability Committee and the Board Risk 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 2010.

	Sensitivity of net interest income £m	**Sensitivity of equity £m**
At 31 December 2010		
+ 50 increase in basis points	**(3.6)**	**(1.3)**
+ 25 increase in basis points	**(1.5)**	**(0.6)**
– 25 decrease in basis points	**-**	**0.6**
– 50 decrease in basis points	**0.2**	**1.3**

	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

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.

29 Risk management continued

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 2010 the EUR and USD notional value of the foreign investment securities was €521,060,000 and $95,000,000 respectively (2009: €834,635,000 and $95,000,000 respectively). This was exactly matched by the EUR and USD notional value of the derivative obligations.

30 Capital resources

The following table analyses the regulatory capital resources of the Bank at 31 December 2010:

	31 December 2010 £m	31 December 2009 £m
Tier 1 capital:		
Ordinary share capital	**170.0**	170.0
Reserves	**48.1**	34.9
Deduction for intangible assets	**(2.4)**	(1.3)
Total Tier 1 capital	**215.7**	203.6
Upper Tier 2 capital:		
Undated loan stock	**50.0**	50.0
Allowable element of provisions	**32.4**	35.6
Lower Tier 2 capital:		
Dated loan stock	**48.0**	60.0
Total Tier 2 capital	**130.4**	145.6
Total capital	**346.1**	349.2

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% 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 2010. Capital adequacy is monitored on an ongoing basis by senior management, the Asset and Liability Committee, the Executive Risk Committee and the Board Risk Committee. Our submissions to the FSA in the period have shown that the Bank has complied with all externally imposed capital requirements.

As highlighted on page 3 there are a number of regulatory developments currently being monitored by the Bank that will be relevant for future capital management.

31 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 re-price 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 2010 or 31 December 2009. The classification adopted by the Bank is shown in the following table:

	IAS 39 Classification	Carrying Value £m	Fair Value £m
At 31 December 2010			
Assets:			
Cash and balances at central banks	Loans and Receivables	**210.5**	**210.5**
Treasury bills	Available for Sale	**500.5**	**500.5**
Loans and advances to banks	Loans and Receivables	**1,599.0**	**1,599.0**
Loans and advances to customers	Loans and Receivables	**2,324.5**	**2,520.2**
Investment securities	Available for Sale	**544.8**	**544.8**
Liabilities:			
Deposits by banks	Financial Liabilities at amortised cost	**1,277.5**	**1,300.5**
Derivative financial instruments	Fair value though income statement as modified by effective hedging relationship	**108.9**	**108.9**
Customer accounts	Financial Liabilities at amortised cost	**3,541.3**	**3,545.9**
Other borrowed funds	Financial Liabilities at amortised cost	**110.0**	**111.5**

	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

Information on how fair values are calculated for the financial assets and liabilities noted above is explained on pages 8 to 9 of the critical accounting estimates section.

32 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 2010

	Level 1 £m	Level 2 £m	Level 3 £m	Total 2010 £m
Financial Investments – Available for Sale				
Treasury Bills	**500.5**	**-**	**-**	**500.5**
Investment securities	**-**	**544.8**	**-**	**544.8**
Total assets	**500.5**	**544.8**	**-**	**1,045.3**
Derivatives designated as cash flow hedging instruments	**-**	**(108.9)**	**-**	**(108.9)**
Total liabilities	**-**	**(108.9)**	**-**	**(108.9)**

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)

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

	2010 £m	2009 £m
Profit before income tax	**28.7**	18.2
Non-cash items included in loss before tax		
Impairment losses on loans and advances	**60.5**	88.1
Depreciation on property, plant and equipment	**3.4**	3.4
Amortisation of intangible assets	**0.8**	1.3
Loss on disposal of fixed assets	**0.1**	0.3
Interest on borrowed funds	**1.6**	2.6
Change in operating assets and liabilities		
Net decrease/(increase) in loans and advances to customers	**(229.3)**	(365.5)
Net decrease/(increase) in investment securities	**390.5**	245.1
Net (increase) in derivative liabilities	**(71.7)**	(100.0)
Net decrease/(increase) in deferred tax assets	**-**	2.7
Net decrease/(increase) in other assets	**(11.0)**	42.8
Net decrease/(increase) in prepayments and accrued income	**1.8**	6.0
Net (decrease)/ increase in customer accounts	**(159.9)**	60.9
Net increase in borrowed funds	**60.8**	318.0
Net increase/(decrease) in other liabilities	**(19.6)**	7.6
Net increase in accruals and deferred income	**6.2**	(18.0)
	62.9	313.5
Income taxes received	**-**	-
Net cash flows from operating activities	**62.9**	313.5
Operational cash flows from interest		
Interest paid	**(92.6)**	(129.0)
Interest received	**218.4**	216.4

34 Analysis of cash flows relating to investing activities

	Note	2010 £m	2009 £m
Purchase of equipment	6	**(3.5)**	(3.2)
Purchase of intangibles	7	**(1.9)**	(1.0)
		(5.4)	(4.2)

35 Analysis of cash flow in respect of financing

	2010 £m	2009 £m
Interest paid on other borrowed funds	**(1.6)**	(2.5)

36 Cash and cash equivalents

	Note	2010 £m	2009 £m
Cash and balances at central banks		**210.5**	159.8
Balances at central banks		**(3.1)**	(2.7)
Cash		**207.4**	157.1
Loans and advances to other banks – repayable on demand	15	**-**	29.3
Loans and advances to other banks – repayable in less than three months	15	**1,599.0**	1,613.0
Treasury bills	12	**500.5**	451.6
		2,306.9	2,251.0

37 Parent company

J Sainsbury plc and Bank of Scotland plc each hold 50% 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.

38 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:

	2010 £m	2009 £m
Transactions during the period: J Sainsbury plc		
Services and loans provided by J Sainsbury plc:		
Management services	**25.3**	18.4
Interest expense paid in respect of interest bearing loans	**0.8**	1.3
Total loans and advances given during the period	**-**	-
Balances at 31 December		
Payables:		
Management services	**2.5**	2.7
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.

	2010 £m	2009 £m
Transactions during the period: HBOS plc		
Services and loans provided by HBOS plc group of companies:		
Management and banking services	**31.2**	27.3
Interest expense paid in respect of subordinated loan capital	**0.8**	1.3
Deposits by banks:		
Fixed term	**470.0**	556.6
Deposits repaid during the period	**(409.2)**	(237.2)
Net interest paid in respect of interest rate swaps, loans and advances	**41.4**	45.3
Loans given to and commission received from HBOS plc group of companies:		
Total loans and advances made during the period	**8,824.0**	9,584.9
Loans and advances repaid during the period	**(8,872.0)**	(9,450.9)
Net interest received in respect of interest rate swaps, loans and advances	**9.9**	11.7
Commission income earned	**10.8**	11.4
Balances at 31 December		
Receivables:		
Loans and advances	**1,357.0**	1,434.3
Interest receivable	**0.8**	0.6
Commission receivable	**3.6**	5.7
Payables:		
Management and banking services	**8.3**	4.9
Interest payable	**1.9**	2.5
Deposits by banks	**1,277.5**	1,216.4
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% AAA rated collateral.

39 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

	2010 £m	2009 £m
Aggregate emoluments	**1.8**	1.6
Aggregate amounts payable under long term incentive schemes	**0.1**	-

In addition to the above, emoluments representing employer's pension contributions of £142k (2009: 176k) were made in the year. Termination payments of £30k included under aggregate emoluments were made during the year (2009: nil).

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 2009	4	14	1
Resignations during 2009	(1)	(2)	-
Appointments/New accounts during 2009	1	-	2
Amounts advanced during the year	-	70	18
Amounts repaid during the year	-	(70)	(17)
At 31 December 2009	4	12	4
Resignations during 2010	(2)	-	(4)
Appointments/ New accounts during 2010	1	-	-
Amounts advanced during the period		75	2
Amounts repaid during the period		(79)	(2)
At 31 December 2010	**3**	**8**	**-**
Savings and deposit accounts:			
At 1 January 2009	5	140	-
Resignations during 2009	(1)	(2)	-
Appointments/New accounts during 2009	-	-	-
Amounts deposited during the year		(904)	(6)
Interest paid		4	-
Amounts withdrawn during the year		832	17
At 31 December 2009	4	70	11
Resignations during 2010	(2)	(33)	(11)
Appointments/ New accounts during 2010	1	38	-
Amounts deposited during the period		(37)	-
Interest paid		2	-
Amounts withdrawn during the period		37	-
At 31 December 2010	**3**	**77**	**-**

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 31 December 2010 was £nil (2009: £nil).

40. Events after the balance sheet date
In line with its normal business operations the Bank entered into contracts with various debt management companies post year end for the sale of debt deemed uneconomical to collect. Total proceeds from these contracts will amount to £3.0m. This had no impact on the year end credit provisioning position.

41. Approval of accounts and other information
The accounts were approved by the Board of Directors on 2 March 2011. 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 9DQ.

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 judgments 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
2 March 2011

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 2010 set out on pages 6 to 38. 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 auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 39, 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, and express an opinion on, 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 web-site 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 2010 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 matters 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
2 March 2011