# Fosse Funding (No.1) Limited

## Company Number 5925696

## Reports and Accounts
## For the year ended 31 December 2008

# Fosse Funding (No.1) Limited

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Registered Office:

35 Great St. Helen's, London, EC3A 6AP

# Fosse Funding (No.1) Limited

## Directors' Report
## For the year ended 31 December 2008

The Directors submit their report, together with the financial statements for the year ended 31 December 2008. The comparatives cover the period from incorporation on 5 September 2006 to 31 December 2007.

**Principal activity and business review**

Fosse Funding (No.1) Limited (the 'Company') was established as a special purpose company to (i) borrow funds from Fosse Master Issuer plc, funded by the issuing of debt securities (residential mortgage backed notes) (the 'Notes'), by Fosse Master Issuer plc in the international capital markets, and (ii) make such funds available to the Alliance & Leicester Group by purchasing a beneficial interest in a mortgage loan portfolio held by Fosse Trustee Limited (the 'Fosse Master Trust').

Payments of interest and principal on the loan from Fosse Master Issuer plc are made only to the extent that the Company has received sufficient funds from its beneficial interest in the underlying mortgage loans and after certain expenses have been met. Under the documents governing the transaction, Alliance & Leicester plc and its subsidiaries are not obliged to support any losses that may be suffered by holders of the Notes.

Securitisations of £2,505.4m in 2006, £2,502.3m in 2007 and a further £395.5m in 2008, were undertaken using the Fosse Master Trust.

| | Net interest (expense) 2008 £000 | Net interest income 2007 £000 | Cash and cash equivalents 2008 £000 | Cash and cash equivalents 2007 £000 |
|---|---|---|---|---|
| **Key Performance Indicators** | (19,538) | 13,939 | 323,072 | 330,523 |

The performance requirements of the Company are set out in the legal documents that govern the wider funding transaction of which it forms a part. To date it has complied with those requirements, principally the generation of adequate cashflows as shown in the Cash Flow Statement. The Alliance & Leicester plc Group manages its operations on a divisional basis. For this reason, the Company's Directors believe that further key performance indicators for the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The performance of the divisions of Alliance & Leicester plc, which include the Company, are discussed in the Group's Annual Report which does not form part of this Report.

**Results and dividend**

The loss after tax for the year ended 31 December 2008 was £72,494k (period ended 31 December 2007: £1,940k). The Directors do not recommend the payment of a dividend (period ended 31 December 2007: Nil).

**Post balance sheet event**

On 9 January 2009, ownership of Alliance & Leicester plc was transferred within the Santander Group from Banco Santander, S.A. to Abbey National plc.

**Directors**

The directors who served during the year were:

Mr I J Hares

Mr C R Annis*

SFM Directors Limited

SFM Directors (No.2) Limited

* Alternate Director to Mr I J Hares.

# Fosse Funding (No.1) Limited

## Directors' Report
## For the year ended 31 December 2008 (continued)

**Financial instruments**

The Company's financial instruments, other than derivatives, comprise loans to group undertakings, borrowings, cash and liquid resources, and various items, such as debtors and creditors that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Company's operations.

The Company also enters into derivatives transactions.

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments shall be undertaken.

All assets, liabilities and transactions are denominated in Sterling.

Further disclosures regarding financial risk management objectives and policies and the Company's exposure to principal risks can be found in note 15.

**Third party indemnities**

Alliance & Leicester plc, has made qualifying third party indemnity provisions for the benefit of Ian Hares and Chris Annis and Structured Finance Management Limited (SFM) has made qualifying third party indemnity provisions for the benefit of SFM Directors Limited and SFM Directors (No. 2) Limited. These indemnity provisions were made during the year and remain in force at the date of this report.

**Creditors payment policy**

It is the Company's policy to ensure payments are made in accordance with the terms and conditions agreed, except where the supplier fails to comply with those terms and conditions.

The Company's practice on payment of creditors has been quantified under the terms of the Companies Act 1985 (Directors' Report) (Statement Payment Practice) Regulations 1997. The number of days supplier invoices, which are included in trade creditors at 31 December 2008, is nil (2007: nil). Third party creditors of the Company are paid in accordance with the transaction documents to which the Company is a party.

**Statement of Going Concern**

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out above. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. The Company's objectives, policies and processes for managing its capital are described in note 16 to the financial statements.

Details of the Company's financial risk management objectives, its financial instruments and hedging activities; and its exposures to operational, liquidity risk and other risks are set out in note 15 to the financial statements.

The activities of the Company are dependent upon the future funding strategies within the Alliance & Leicester Group. There are no plans to terminate the operations of the Company within the next year.

The Company has adequate financial resources. As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

# Fosse Funding (No.1) Limited

## Directors' Report
## For the year ended 31 December 2008 (continued)

**Auditors**

In accordance with Sections 485 and 487 of the Companies Act 2006, Deloitte LLP is deemed to have been re-appointed as auditors of the Company.

Each of the persons who is a Director at the date of approval of this annual report confirms that:

- so far as each of the directors are aware, there is no relevant audit information (as defined in s234ZA of the Companies Act 1985) of which the Company's auditors are unaware; and
- each of the directors have taken all the steps that they ought to have taken as directors to make themselves aware of any relevant audit information (as defined in s234ZA of the Companies Act 1985) and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

**By Order of the Board**

**Per pro SFM Directors Limited,**
**As Director**
19 February 2009

# Fosse Funding (No.1) Limited

## Statement of Directors' Responsibilities
### For the year ended 31 December 2008

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

Company law requires that the Directors prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to be properly prepared in accordance with IFRSs as adopted by the European Union and the Companies Act 1985.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. However, Directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping proper accounting records that 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 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

# Independent Auditors' Report to the members of Fosse Funding (No.1) Limited

We have audited the financial statements of Fosse Funding (No.1) Limited for the year ended 31 December 2008 which comprise the Income Statement, the Statement of Changes in Equity, the Balance Sheet, the Cash Flow Statement and the related notes 1 to 20. These financial statements have been prepared under the accounting policies set out therein.

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

**Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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

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

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

**Basis of audit opinion**

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

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

**Opinion**

In our opinion:

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

**Separate opinion in relation to IFRSs**

As explained in Note 1 to the financial statements, the Company in addition to complying with IFRSs as adopted by the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board.

In our opinion the financial statements give a true and fair view, in accordance with IFRSs, of the state of the Company's affairs as at 31 December 2008 and of its loss for the year then ended.

Deloitte LLP

**Deloitte LLP**
Chartered Accountants and Registered Auditors
Birmingham, United Kingdom
On 24 February 2009

# Fosse Funding (No.1) Limited

## Income Statement
### For the year ended 31 December 2008

| | Note | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|---|
| Interest receivable | 3 | 250,739 | 267,067 |
| Interest payable | 4 | (270,277) | (253,128) |
| Net interest (expense)/income | | (19,538) | 13,939 |
| Other unrealised fair value gains and losses | 5 | (48,557) | (15,583) |
| Impairment | 10 | (2,451) | (235) |
| Administration expenses | 6 | (1,171) | (815) |
| **LOSS BEFORE TAX** | | **(71,717)** | **(2,694)** |
| Tax | 9 | (777) | 754 |
| **LOSS FOR THE YEAR / PERIOD ATTRIBUTABLE TO THE ORDINARY EQUITY SHAREHOLDER OF THE COMPANY** | **14** | **(72,494)** | **(1,940)** |

All results derive from continuing operations.

## Statement of Changes in Equity
### For the year ended 31 December 2008

| | Note | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|---|
| **Equity brought forward** | | **(1,940)** | **-** |
| Share capital raised | 13 | - | - |
| Loss for the year / period | 14 | (72,494) | (1,940) |
| **Equity at 31 December** | | **(74,434)** | **(1,940)** |

# Fosse Funding (No.1) Limited

## Balance Sheet
### As at 31 December 2008

| | Note | 31 December 2008 £000 | 31 December 2007 £000 |
|---|---|---|---|
| **NON CURRENT ASSETS** | | | |
| Financial assets: loans and receivables | 10 | 3,919,749 | 4,463,768 |
| Financial instruments: derivatives | | - | 56,265 |
| | | 3,919,749 | 4,520,033 |
| **CURRENT ASSETS** | | | |
| Financial assets: loans and receivables | 10 | 178,828 | 4,338 |
| Taxation | 9 | - | 764 |
| Cash and cash equivalents | 11 | 323,072 | 330,523 |
| | | 501,900 | 335,625 |
| **CURRENT LIABILITIES** | | | |
| Current tax | 9 | (23) | (10) |
| Accruals and deferred income | | (352) | (781) |
| Financial liabilities | 12 | (632,417) | (806,808) |
| | | (632,792) | (807,599) |
| **NET CURRENT ASSETS** | | **(130,892)** | **(471,974)** |
| **NON CURRENT LIABILIITES** | | | |
| Financial liabilities | 12 | (3,859,560) | (4,049,999) |
| Financial instruments: derivatives | | (3,731) | - |
| | | (3,863,291) | (4,049,999) |
| **NET LIABILITIES** | | **(74,434)** | **(1,940)** |
| **EQUITY** | | | |
| Called up share capital | 13 | - | - |
| Retained earnings | 14 | (74,434) | (1,940) |
| **TOTAL ORDINARY SHAREHOLDER'S DEFICIT** | | **(74,434)** | **(1,940)** |

The attached notes 1 to 20 form an integral part of the financial statements.

These financial statements were approved by the Board of Directors and authorised for issue on 19 February 2009. They were signed on their behalf by:

**Per pro SFM Directors Limited**
**As Director**

# Fosse Funding (No.1) Limited

## Cash Flow Statement
### For the year ended 31 December 2008

| | Note | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|---|
| **Operating activities** | | | |
| Loss before tax | | (71,717) | (2,694) |
| Tax paid | 9 | - | - |
| **Cash flows from operating losses before changes in operating assets and liabilities** | | **(71,717)** | **(2,694)** |
| Changes in operating assets and liabilities: | | | |
| Net decrease/increase in financial assets | | 369,530 | (4,468,106) |
| Net change in derivative financial instruments | | 59,996 | (56,265) |
| Net decrease in accruals and deferred income | | (429) | - |
| Net decrease/increaseincrease in financial liabilities | | (364,831) | 4,857,588 |
| | | 64,266 | 333,217 |
| **Net cash from operating activities** | | **(7,451)** | **330,523** |
| **Net cash from investing activities** | | **-** | **-** |
| **Financing activities** | | | |
| Proceeds on issue of ordinary shares | 13 | - | - |
| **Net cash from financing activities** | | **-** | **-** |
| **Net increase in cash and cash equivalents** | | **(7,451)** | **330,523** |
| Cash and cash equivalents at beginning of year / period | | 330,523 | - |
| **Cash and cash equivalents at end of year / period** | | **323,072** | **330,523** |

# Fosse Funding (No.1) Limited

## Notes to the Financial Statements
## For the year ended 31 December 2008

1. **Principal accounting policies**

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted for use in the European Union that are effective or available for early adoption at the Company's reporting date. The Company, in addition to complying with its legal obligation to comply with IFRSs as adopted for use in the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board.

These policies have been consistently applied during the current year and previous period unless otherwise stated.

a. **Accounting convention**

The Company prepares its accounts under the historical cost convention, except for derivative contracts and on the going concern basis as disclosed in the statement of going concern set out in the Report of the Directors.

b. **Presentation of income statement**

Due to the nature of the business, the directors are of the opinion that it is more appropriate to use 'Interest receivable' rather than 'Revenue' in presenting the Income Statement.

c. **Income recognition**

Interest income and expense on financial assets and liabilities held at amortised cost is measured using the effective interest rate method, which allocates the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument.

d. **Taxation**

The tax expense represents the sum of tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the period. Taxable profit differs from the 'Profit before tax' as reported in the Income Statement because it excludes items of income or expenditure that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. Taxable profit also includes items that are taxable or deductible that is not included in 'Profit before tax'. The Company's liability for current tax and deferred tax is calculated using tax rates that have been enacted or substantively enacted at the Balance Sheet date.

Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and interests in joint ventures, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset realised. Deferred tax is charged or credited in the Income Statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

e. **Financial assets**

The Company classifies its financial assets as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This category comprises 'Financial assets: loan and receivables' and 'Cash and cash equivalents'.

The Company does not apply hedge accounting.

f. **Financial liabilities**

Financial liabilities are held at amortised cost. Finance costs are charged to the Income Statement using the effective interest rate method.

**1. Principal accounting policies (continued)**

**g. Cash and cash equivalents**

For the purposes of the Balance Sheet and Cash Flow Statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks, amounts due from other banks and short term investments in securities.

**h. Derecognition**

As a result of IAS 39 "Financial Instruments: Recognition and Measurement" the legal transfer of the beneficial interest in the Trust mortgage portfolio from Alliance & Leicester plc to the Company fails the criteria for derecognition. As no transfer has occurred for accounting purposes the beneficial interest has not been recognised in the Company's financial statements and remains on the Balance Sheet of Alliance & Leicester plc.

The beneficial interest in the mortgage portfolio is replaced by a related party loan included in Loans and advances from related parties on the Company's Balance Sheet. The related party loan is recorded at the book value of the beneficial interest in the mortgage portfolio to Alliance & Leicester plc at the time of transfer less any subsequent transfers and repayments of capital. A provision for losses is maintained by the Company to cover default of these loans and subsequent reduction in interest receivable on the intercompany loan.

**i. Impairment of financial assets**

A financial asset or a company of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of events that occurred after the initial recognition of the asset (a 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or company of financial assets. Objective evidence that a financial asset or company of assets is impaired includes observable data that comes to the attention of the Company about the following loss events:

i. significant financial difficulty of the issuer or obligor;

ii. a breach of contract, such as a default or delinquency in interest or principal payments;

iii. the Company, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the Company would not otherwise consider;

iv. it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

v. the disappearance of an active market for that financial asset because of financial difficulties; or

vi. observable data indicating that there is a measurable decrease in the estimated future cash flows from a company of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Company, including:

1. adverse changes in the payment status of borrowers in the Company; or
2. national or local economic conditions that correlate with defaults on the assets in the Company.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If there is no objective evidence of impairment for an individually assessed financial asset it is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment.

Impairment is calculated based on the probability of default, exposure at default and the loss given default, using recent data. An adjustment is made for the effect of discounting cash flows.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's effective interest rate.

Financial assets are written off when it is reasonably certain that receivables are irrecoverable.

## Notes to the Financial Statements
## For the year ended 31 December 2008 (continued)

j. **Deferred consideration**

Under the terms of the mortgage sale agreement, Alliance & Leicester plc, as the originator of the mortgage loans, legally retains the right to receive excess income (deferred consideration) arising on those loans, after certain higher priority payments have been met. An accrual is recognised for these amounts.

k. **Derivative financial instruments**

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently remeasured at their fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

l. **Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the Balance Sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

m. **Related party transactions**

Alliance & Leicester plc, the Company's UK controlling undertaking is incorporated in Great Britain and registered in England and Wales. Alliance & Leicester plc performs the administration, operations, accounting, and financial reporting functions of the Company.

Related party transactions with group undertakings are detailed in their respective notes.

The Fosse securitisation transaction, of which the company forms a part, is described in more detail in the Alliance & Leicester plc accounts for the year ended 31 December 2008 (Note 17: Securitisation).

n. **Changes to IFRS not adopted in 2008 accounts**

The International Accounting Standards Board has published the following IAS's, IFRS's and International Financial Reporting Interpretations Committee (IFRIC) interpretations:

| Standard/Interpretation | | Issued | Effective for periods commencing on or after |
|---|---|---|---|
| IFRIC 13 | Customer loyalty programmes | 1 Oct 2007 | 1 July 2008 |
| IFRIC 15 | Amendments for the construction of real estate | 1 Jul 2008 | 1 Jan 2009 |
| IFRIC 16 | Hedges of net investment in foreign operation | 1 Jul 2008 | 1 Oct 2008 |
| Amendment to IAS 1 | Presentation of financial statements | 1 Sep 2007 | 1 Jan 2009 |
| Amendment to IAS 32 | Financial instruments: Presentation | 1 Feb 2008 | 1 Jan 2009 |
| Amendment to IAS 39 | Eligible hedged items | 1 Jul 2008 | 1 Jul 2009 |
| IAS 23 (revised) | Borrowing costs | 1 Mar 2007 | 1 Jan 2009 |
| IAS 27 (revised) | Consolidated and separate financial statements | 1 Jan 2008 | 1 Jul 2009 |
| IFRS 3 (revised) | Business combinations | 1 Jan 2008 | 1 Jul 2009 |

The Company has not elected to adopt these early in these financial statements. The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Company.

### 2. Segmental reporting

The Company operates in one business sector and all of the Company's activities are in the UK.

# Fosse Funding (No.1) Limited

## Notes to the Financial Statements
## For the year ended 31 December 2008 (continued)

**3. Interest receivable**

| | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|
| Interest on loan to fellow Group undertaking | 189,185 | 220,602 |
| Derivative interest | 46,840 | 36,353 |
| Other interest | 14,714 | 10,112 |
| | 250,739 | 267,067 |

**4. Interest payable**

| | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|
| On loans repayable after more than five years: | | |
| Interest on loans from fellow Group undertaking | 265,919 | 248,592 |
| Interest on subordinated loan from fellow Group undertaking | 4,358 | 4,536 |
| | 270,277 | 253,128 |

**5. Other unrealised fair value gains and losses**

| | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|
| Fair value movements of derivatives | 48,557 | 15,583 |

The fair value movements of future cash flows on derivatives are separately identified within 'Unrealised fair value gains and losses'. The interest flows on derivatives are included within 'Interest receivable'.

**6. Administrative expenses**

| | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|
| Professional fees | 100 | 37 |
| Administration fees and bank charges | 1,071 | 778 |
| | 1,171 | 815 |

### 7. Loss before tax

| | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|
| Loss before tax is stated after charging: | | |
| Fees payable to the Company's auditors for the audit of the Company's annual accounts (includes irrecoverable VAT) | 6 | 3 |

Fees payable to Deloitte LLP and their associates for non-audit services to the Company are not required to be disclosed because the Alliance & Leicester plc consolidated financial statements are required to disclose such fees on a consolidated basis.

### 8. Directors' emoluments

The directors received no emoluments from the Company in respect of qualifying services during the year (period ended 31 December 2007: £Nil).

Directors' emoluments for Mr I J Hares and Mr C R Annis are borne by the UK controlling undertaking, Alliance & Leicester plc. A charge of £1,250 was made to the Company by Structured Finance Management Limited for the provision of directors (period ended 31 December 2007: £8,500).

The Company has no employees (2007:Nil).

### 9. Corporation tax

| | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|
| **Current taxation** | | |
| Current year corporation tax expense | 13 | 10 |
| **Deferred taxation:** | | |
| Current year deferred tax credit | - | (764) |
| Prior Year Adjustment | 764 | - |
| Total Corporation tax expense/(credit) | 777 | (754) |

The corporation tax credit for the year is different from the standard rate of corporation tax in the UK (30% until 5 April 2008 and 28% from there onwards) where the Company generated its profits. The differences are explained below:

| | Year ended 31 December 2008 £000 | From 5 September 2006 to 31 December 2007 £000 |
|---|---|---|
| **Loss before tax** | (71,717) | (2,694) |
| Tax calculated at a rate of 28.5% (2007: 30%) | (20,439) | (809) |
| Non taxable income and disallowable expenses | 14,895 | - |
| Prior year adjustments | 764 | - |
| Less: Tax effect of impact of lower rate of tax (marginal relief) | 5,557 | - |
| Impact of Deferred Tax on change in rate of corporation tax | - | 55 |
| **Corporation tax expense/(credit)** | 777 | (754) |

**Deferred taxation**

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28%.

The movement on the deferred tax account is as follows:

| | 2008 £000 | 2007 £000 |
|---|---|---|
| Brought forward | (764) | - |
| Income Statement expense/(credit) | 764 | (764) |
| At 31 December | - | (764) |
| Deferred tax assets: other temporary differences | - | (764) |

## 10. Financial assets: loans and receivables

| | 31 December 2008 £000 | 31 December 2007 £000 |
|---|---|---|
| Loan to fellow Group undertaking: | | |
| **Non current** | | |
| Amortised cost | 3,922,435 | 4,464,002 |
| Impairment provision | (2,686) | (234) |
| Total | 3,919,749 | 4,463,768 |
| **Current** | | |
| Amortised cost | 178,831 | 4,339 |
| Impairment provision | (3) | (1) |
| Total | 178,828 | 4,338 |
| Brought forward | (235) | - |
| Income Statement debit | (2,451) | (235) |
| At 31 December | (2,686) | (235) |

## 11. Cash and cash equivalents

| | 31 December 2008 £000 | 31 December 2007 £000 |
|---|---|---|
| Deposits with Alliance & Leicester plc | 323,072 | 330,523 |

A cash deposit of £1 is held by SFM Corporate Services Limited in the name of and benefit for the Company, and is accessible by the Company on demand.

# Fosse Funding (No.1) Limited

## Notes to the Financial Statements
## For the year ended 31 December 2008 (continued)

**12. Financial liabilities**

| | Current £000 | Non-current £000 | Total £000 |
|---|---|---|---|
| **At 31 December 2008** | | | |
| Loan from fellow Group undertaking: | | | |
| Due within one year | 631,644 | - | 631,644 |
| Due after one year | - | 3,804,463 | 3,804,463 |
| | 631,644 | 3,804,463 | 4,436,107 |
| Subordinated loan from fellow Group undertaking: | | | |
| Due after one year | 773 | 55,097 | 55,870 |
| | 632,417 | 3,859,560 | 4,491,977 |
| **At 31 December 2007** | | | |
| Loan from fellow Group undertaking: | | | |
| Due within one year | 805,613 | - | 805,613 |
| Due after one year | - | 3,969,068 | 3,969,068 |
| | 805,613 | 3,969,068 | 4,774,681 |
| Subordinated loan from fellow Group undertaking: | | | |
| Due within one year | 1,195 | - | 1,195 |
| Due after one year | - | 80,931 | 80,931 |
| | 1,195 | 80,931 | 82,126 |
| | 806,808 | 4,049,999 | 4,856,807 |

**13. Share capital**

| | 31 December 2008 £ | 31 December 2007 £ |
|---|---|---|
| Authorised | | |
| 100 ordinary shares of £1 each | 100 | 100 |
| Issued, allotted and fully paid | | |
| 1 ordinary share of £1 each | 1 | 1 |

**14. Retained earnings**

| | 31 December 2008 £000 | 31 December 2007 £000 |
|---|---|---|
| Balance brought forward | (1,940) | - |
| Loss for the year / period | (72,494) | (1,940) |
| At 31 December | (74,434) | (1,940) |

**15. Risk management policy and control framework**

The Company was established as a special purpose company for the purposes of borrowing from fellow Group undertakings and investing in a portfolio of mortgage assets held by a fellow Group undertaking.

The principal objects of the Company are set out in its memorandum of association and include:

- carrying on business as a general commercial company;
- borrowing or raising money by any method and to obtain any form of credit or finance; and
- securing the payment of any monies, the discharge of any liabilities and the observance or performance of any kind of obligations by any charge over the whole or any part of its undertaking or assets.

The activities of the Company are limited to owning an interest in the mortgage portfolio, borrowing funds under the intercompany loan agreements and other activities reasonably incidental thereto by the terms and conditions of the transaction documents under which the Notes are issued.

The principal risks arising from the Company's financial instruments (both assets and liabilities) are operational risk, credit risk, interest rate risk, and liquidity risk. The principal nature of such risks are summarised below.

**Operational risk**

Operational risk is defined as 'the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events'. Operational services are provided by Alliance & Leicester plc. The Company places reliance upon the specific policies and procedures Alliance & Leicester plc has in place at group level to counteract this risk.

**Credit risk**

Credit risk is the risk of financial loss where counterparties are not able to meet their obligations as they fall due.

The Company's ability to make payments of principal and interest on the intercompany loan and to pay its operating and administrative expenses will depend primarily on payments received from the underlying mortgage loans held in the Fosse Master Trust for its benefit. The quality of the underlying mortgage loans is covered by eligibility criteria as set out in the transaction documents.

In addition, the Company relies on interest rate swaps to make payments on the intercompany loan.

The Company is not required to make payments under the intercompany loan agreement if it has insufficient resources to do so.

**Interest Rate Risk**

The Company's key interest rate risk is between GBP LIBOR based interest payable on the intercompany loans and the payments received from the mortgage portfolio where the underlying interest rates include amounts based on fixed interest rates, rates linked the Bank of England base rate and rates linked to Alliance & Leicester standard variable rate. This exposure is mitigated by an interest rate swap with a fellow Group undertaking. An increase or decrease in interest rates would not therefore have a material impact on the Company's operating results.

A Value at Risk (VaR) model has been used to measure the Company's total exposure to interest rate risks and to generate an economic capital estimate for interest rate risk. The VaR measurement methodology calculates the maximum amount likely to be lost, in market value terms, from existing risk positions as a result of movement in market interest rates.

The VaR model is based on historical volatility and correlation data, to a 95% confidence level over a 1 month holding period time horizon.

Although it is a useful tool in measuring Risk, VaR does contain some limitations:

- It does not accurately measure extreme events.
- The use of a 95% confidence level does not by definition include losses beyond this level of confidence.
- It relies on the historical volatility and correlation data being similar to the volatility and correlation positions going forward.

The Company's interest rate VaR exposure is immaterial.

# Fosse Funding (No.1) Limited

## Notes to the Financial Statements
## For the year ended 31 December 2008 (continued)

**Liquidity risk**

Liquidity risk is the risk that the Company, though solvent, either does not have sufficient financial resources available to meet its obligations as they fall due, or can only secure them at excessive cost. The Company's ability to meet its obligations will depend primarily on payments being received by it under the intercompany loan agreement. Such payments are held in cash or liquid assets in accordance with the terms of the transaction documents until paid to holders of the Notes.

The following tables analyse the Company's non-derivative liabilities into relevant maturity groupings based on the remaining period at the Balance Sheet date (to contractual maturity). These have been drawn on the undiscounted contractual maturities of financial liabilities including interest that will accrue to those liabilities except where the Company is entitled and intends to repay the liability before its maturity.

| | Less than one month £000 | One to three months £000 | Three to twelve months £000 | One to five years £000 | Over five years £000 | Total £000 |
|---|---|---|---|---|---|---|
| **2008** | | | | | | |
| Loans from fellow Group undertakings | (58,462) | - | (57,770) | (529,780) | (8,567,852) | (9,213,864) |
| Other amounts due from fellow Group undertakings | - | - | - | - | (55,298) | (55,298) |
| Accruals | | (352) | | | | (352) |
| | (58,462) | (352) | (57,770) | (529,780) | (8,623,150) | (9,269,514) |
| **2007** | | | | | | |
| Loans from fellow Group undertakings | (62,880) | - | (219,196) | (986,739) | (12,665,853) | (13,934,668) |
| Other amounts due from fellow Group undertakings | - | - | - | - | (30,139) | (30,139) |
| Accruals | - | (781) | - | - | - | (781) |
| | (62,880) | (781) | (219,196) | (986,739) | (12,695,992) | (13,965,588) |

These figures reflect the contractual maturity on securitisation to 2031 and 2054.

The following table gives the Company's contractual maturity for its derivative financial instruments. The table has been drawn up based on undiscounted net cash inflows/(outflows) on the derivative instruments which settle on a net basis and the undiscounted gross outflows on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amounts disclosed have been determined by reference to the projected interest rates as illustrated by the yield curves existing at the reporting date.

| | Less than one month £000 | One to three months £000 | Three to twelve months £000 | One to five years £000 | Over five years £000 | Total £000 |
|---|---|---|---|---|---|---|
| **2008** | | | | | | |
| Derivative financial instruments | | | | | | |
| Assets | - | - | - | - | - | - |
| Liabilities | 18,085 | - | (29,693) | 4,445 | - | (7,163) |
| **Total** | 18,085 | - | (29,693) | 4,445 | - | (7,163) |
| **2007** | | | | | | |
| Derivative financial instruments | | | | | | |
| Assets | 15,225 | - | 17,492 | 27,366 | 237 | 60,320 |
| Liabilities | - | - | - | - | - | - |
| **Total** | 15,225 | - | 17,492 | 27,366 | 237 | 60,320 |

# Fosse Funding (No.1) Limited

## Notes to the Financial Statements
## For the year ended 31 December 2008 (continued)

**Derivatives**

A derivative is an agreement which defines certain financial rights and obligations which are contractually linked to interest rates, exchange rates or other financial prices. Derivatives are used to manage interest and currency risks by the Company.

The use of derivatives is determined in the transaction documents at the time of issue of each series of notes.

**Carrying amounts and fair values**

The following table summarises the carrying amounts and fair values as at 31 December of those financial assets and liabilities not presented on the Company Balance Sheet at their fair value (loans and receivables and liabilities at amortised cost).

| | 31 December 2008 | | 31 December 2007 | |
|---|---|---|---|---|
| | Carrying value £000 | Fair value £000 | Carrying value £000 | Fair value £000 |
| **Financial assets** | | | | |
| Cash and cash equivalents | 323,072 | 323,072 | 330,523 | 330,523 |
| Loan to fellow Group undertaking | 4,098,577 | 4,153,840 | 4,468,106 | 4,462,025 |
| Total assets | 4,421,649 | 4,476,912 | 4,798,629 | 4,792,548 |
| **Financial liabilities** | | | | |
| Accruals & deferred income | (362) | (362) | (781) | (781) |
| Loans from fellow Group undertakings | (4,491,977) | (3,914,437) | (4,856,807) | (4,717,652) |
| Total liabilities | (4,492,339) | (3,914,799) | (4,857,588) | (4,718,433) |

*Loans and advances to fellow Group undertaking and due from banks*

Floating rate loans and advances and deposits are recorded in the Balance Sheet using the effective interest rate method, less provisions for impairment. This value is considered to be a good approximation for fair value. For fixed rate loans and advances and deposits the fair value is calculated by discounting expected future cash flows on the instruments at current market interest rates.

**16. Capital management and financial resources**

Capital held by the Company and managed centrally as part of the Alliance & Leicester group, comprises share capital and reserves.

Capital is managed by way of processes set up at inception of the Company and subsequently there is no active process for managing its own capital. The Company is designed to hold minimum reserves once all amounts due have been received and amounts owing have been paid. The Company's capital is not externally regulated.

**17. Related party transactions**

During the period, fees of £10,000 (period ended 31 December 2007: £8,500) were paid by the Company to Structured Finance Management Limited in respect of corporate services fees, including fees for providing directors to the Company.

SFM Corporate Services Limited is a wholly owned subsidiary of Structured Finance Management Limited.

There have been no transactions with key management personnel during the period, other than those disclosed elsewhere in these accounts in respect of transactions with Structured Finance Management Limited.

**Related party transactions (continued)**

During the year the Company has been charged the following amounts by Alliance & Leicester plc:

| | Year ended 31 December 2008 £000 | 5 September 2006 to 31 December 2007 £000 |
|---|---|---|
| Derivative interest receivable | 46,840 | 36,353 |
| Start up loan interest payable | (4,358) | (4,535) |
| Administration fees payable | (1,071) | (778) |
| | 41,411 | 31,040 |

The Fosse securitisation transaction, of which the company forms a part, is described in more detail in the Alliance & Leicester plc accounts for the year ended 31 December 2008 (Note 17: Securitisation).

**18. Ultimate and immediate parent companies**

The Company is a wholly owned subsidiary undertaking of Fosse (Master Issuer) Holdings Limited which is the immediate controlling entity. The shares in Fosse (Master Issuer) Holdings Limited are held by SFM Corporate Services Limited, a wholly owned subsidiary of Structured Finance Management Limited, on a discretionary trust basis for charitable purposes.

In accordance with SIC 12 "Consolidation – Special Purpose Entities", the Company is controlled by Alliance & Leicester plc and is therefore consolidated in the Alliance & Leicester Group accounts. Alliance & Leicester plc is incorporated in Great Britain and is registered in England and Wales.

The Company's ultimate parent and controlling party is Banco Santander, S.A, a company incorporated in Spain.

The smallest group in which the 2008 results of the Company are consolidated is the Alliance & Leicester Group; these accounts may be obtained from the Group's registered office at Carlton Park, Narborough, Leicester, LE19 0AL.

The largest group in which the 2008 results of the Company are consolidated is the group accounts of Banco Santander, S.A., copies of which may be obtained from Abbey Secretariat, Abbey National House, 2 Triton Square, Regent's Place, London, NW1 3AN.

**19. Critical accounting estimates and areas of significant management judgement**

Some asset and liability amounts reported in the accounts are based on management judgements, estimates and assumptions. There is therefore a risk of significant changes to the carrying amounts for these assets and liabilities within the next financial year.

**Valuation of financial instruments**

The values of financial instruments that are classified at fair value through profit or loss and all derivatives are stated at fair value. Fair values are calculated using valuation techniques, including discounted cash flow models, where market values are not available. Changes in assumptions used in the models could affect the reported fair value of financial instruments.

**Impairment provisions**

The level of potential credit losses on the loan to a fellow Group undertaking is linked to the credit quality of the underlying mortgage book. It is uncertain and depends on a number of factors such as unemployment levels, interest rates, house price levels and other general economic conditions. The Group bases impairment provisions on estimates based on historical loss experience.

Actual cash flows on financial assets may differ from management judgements and estimates, resulting in an increase or decrease in impairment charges and provisions. These models used in calculating the impairment provisions do not contain judgemental inputs, but judgement and knowledge is needed in selecting the statistical methods to use when the models are developed or revised.

To the extent that actual losses incurred differ from that estimated by +/-10%, the impairment provisions on loans and advances would change by an estimated £118k higher or £118k lower respectively (period ended 31 December 2007: £24k higher or £24k lower respectively).

# Fosse Funding (No.1) Limited

## Notes to the Financial Statements
## For the year ended 31 December 2008 (continued)

**20. Post balance sheet event**

On 9 January 2009, ownership of Alliance & Leicester plc was transferred within the Santander Group from Banco Santander, S.A. to Abbey National plc.