Direction

To: On a solo basis:
   Abbey National plc
   Abbey National Treasury Services plc
   (the "principal firms")

   On a consolidated basis:
   Abbey National plc
   Cater Allen Ltd
   Abbey Stockbrokers Ltd
   James Hay WRAP Managers Ltd
   James Hay Administration Co. Ltd
   Abbey National Treasury Services plc
   Cater Allen International Ltd

   Each other firm in the Abbey Group (the "group") as at the date of this direction, that
   falls into BIPRU 8.1.1R (collectively the "firms")

Ref: 1119957

Of: 2-3 Triton Square
    London
    NW1 3AN

Date: 23 December 2009

Handbook Version as in force at the date of this Direction

Power

1.1 This direction is given by the FSA under section 148 of the Financial Services and

1.2 The direction number 1119957 transposes in the United Kingdom the Joint Decision

Duration

2. This direction takes effect on 30 June 2008.

Rules Waived/Modified

3. The FSA directs that the rules listed below and, where applicable, in Schedule 2 apply
   to the firms with the modifications shown or, where indicated, do not apply to the
   firms.
<table>
<thead>
<tr>
<th>Chapter/Rule</th>
<th>Modification/Waiver</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GENPRU 2.1.51R</strong></td>
<td>This <em>rule</em> is modified as follows:</td>
</tr>
<tr>
<td></td>
<td>A <em>BIPRU firm principal firm</em> must calculate its <em>credit risk capital requirement</em> as the sum of:</td>
</tr>
<tr>
<td></td>
<td>(1) the <em>credit risk capital component</em>;</td>
</tr>
<tr>
<td></td>
<td>(2) the <em>counterparty risk capital component</em>; and</td>
</tr>
<tr>
<td></td>
<td>(3) the <em>concentration risk capital component</em>;</td>
</tr>
<tr>
<td></td>
<td>subject to the following:</td>
</tr>
<tr>
<td></td>
<td>(4) for <em>exposures</em> covered by the IRB permission (as set out in Schedule 1 of the IRB permission), the principal firm must calculate its <em>credit risk capital requirement</em> and (to the extent that the relevant <em>Handbook provisions provide for the use of the IRB approach</em>) the <em>counterparty risk capital component</em> and the <em>concentration risk capital component</em> in accordance with the <em>IRB approach</em> and the IRB permission;</td>
</tr>
<tr>
<td></td>
<td>(5) the principal firm must comply with other requirements in the IRB permission; and</td>
</tr>
<tr>
<td></td>
<td>(6) the IRB permission means direction number 1119957 and a &quot;principal firm&quot; means the same thing as it does in that direction.</td>
</tr>
<tr>
<td><strong>BIPRU 3.1.1R</strong></td>
<td>The <em>rule</em> is modified by inserting after 'a <em>BIPRU firm</em>', the following:</td>
</tr>
<tr>
<td></td>
<td>&quot;but does not apply to a <em>firm</em> in relation to <em>exposures</em> to which the <em>IRB approach</em> is applied&quot;</td>
</tr>
<tr>
<td><strong>BIPRU 8.8</strong></td>
<td>The table inserted after <em>BIPRU 8.8.1R</em> by direction number 678354 is modified by adding the following provisions:</td>
</tr>
</tbody>
</table>
### Conditions

4.1 This direction applies to the firms for so long as they remain part of the Abbey Group.

4.2 This direction is subject to the following conditions being met by the firms during the roll-out of the Retail Mortgages Model (RMM) but not later than 31 December 2008:

(a) With regard to governance, the firms must:
i. finalise how and in what format they will report model output actual versus estimates to the Designated Committee; and

ii. incorporate the long-run PD estimates and results of stress testing into management reporting and include assessment of their position within the economic cycle.

(b) The firms must ensure that triggers and thresholds for ongoing monitoring of the PD in the RMM are appropriate and effective.

(c) With regard to the long-run average PD (LRPD), the firms must:

i. allocate grades and calculate grade-level LRPD after future scorecard recalibrations;

ii. include and consider the current economic conditions when assessing the accuracy of their rating systems;

iii. compare actual versus expected default rates at grade level, with triggers around expected levels of accuracy; and

iv. continue to assess the relationship between the grade level and portfolio level default rates over the economic cycle as new data becomes available; and

v. re-estimate the long-run grade level PDs if the assessment above indicates that the current assumption is not accurate (i.e. that the portfolio and grade level default rates will increase and decrease by a constant multiple).

(d) With regard to LGD, the firms must:

i. justify why a number of account balances increase > 25% before sale; and

ii. review the LGD estimates applied to pools of over-collateralised exposures, particularly with respect to the volatility of collateral recovery values and this review should not assume the continuation of a floor set only by the administration costs.

(c) With regard to stress testing, the firms must:

i. consider the level of cyclical variation within underlying scorecards when estimating stressed PDs;

ii. ensure that the PDs used in stress testing of regulatory capital requirements are those the firms would expect to use in the event of the downturn scenario materialising; in this respect, the latest analysis assumes that the average PD in the first year of the downturn scenario (4.038%) is lower than the average PD currently being used (5.59%) and therefore, the firms must revisit and test the plausibility of this assumption;
iii. ensure that the LGDs used in its stress testing of regulatory capital requirements are the estimates appropriate for a downturn, and take full account of how those estimates will change in the event of the downturn scenario materialising.

(f) The firms' approach to converting stressed PDs into grade migration assumes that economic conditions will decrease the score of every account by an equal margin but as data becomes available, the firms must monitor the accuracy of this assumption and, where appropriate, alter the approach accordingly.

(g) With regard to the accuracy and integrity of the data, the firms must extend the pre-vetting and testing of data quality standards and reporting to cover all key data used and not limit testing to the fields that enter the RWA calculation.

(h) The firms must complete the documentation of the Use Test, including governance and triggers.

(i) With regard to the validation framework, the firms must deliver the bank accounts model validation and the stress testing validation reports promptly and confirm that the escalation procedures and corrective action plans and deliverables set out in the validation report recommendations are addressed and presented to the FSA no later that the end of June 2008.

4.3 This direction is subject to the following conditions being met by the firms during the roll-out of the Social Housing Model (SHM) but not later than 31 December 2008:

(a) With regard to LGD, the firms must apply a 10% floor to all LGD estimates.

(b) The firms must complete the introduction of standards and work programme for monitoring of ongoing performance of the rating system.

(c) With regard to the definition of default, the firms must:

   i. take account of the possible impact where government intervention is lost from a systemic, sectoral and idiosyncratic perspective; and

   ii. ensure that PD estimates reflect all aspects of the firms' definition of default.

(d) With regard to PD, the firms must:

   i. analyse how the their regional adjustment might vary under different (stressed) economic conditions;

   ii. revisit the parameter values employed in the Benjamin Cathcart Ryan (CBR) test and present the results to the FSA for review;
iii. ensure that the correlations used in the statistical test are appropriate for the portfolio; and

iv. not reduce the $PD$ calculation by, for example, the addition of more data to the CBR test, until a review under this condition has taken place.

(e) The firms must complete a process for ongoing validation of their $LGD$ methodology.

4.4 This direction is subject to the following conditions being met by the firms during the roll-out of the Banks Model:

(a) Regarding the rating system, the firms must:

i. given the difficulty in verifying the definition of default comprised in the CDS spread because it includes additional information (mainly liquidity) and the system’s assumption that the estimated relationship between the distance to default and the financial variables could be applied to the entities that do not have CDSs, the firms must continuously monitor the rating system, including evaluating its accuracy, its predictive power and how it compares with the external ratings at least twice a year;

ii. undertake analyses of the quality and accuracy of information used in assigning the rating;

iii. establish a system of alerts for analysing the divergences between observed values and assumed values and those proposed for the intermediate parameters; and

iv. evaluate the stability of the rating system over the business cycle.

(b) Regarding parameter estimates, the firms must:

i. ensure there is a well-documented definition of liquid counterparty as the definition of liquidity used by the firms to calculate the $PD$ seems to permit the use of counterparties whose spreads do not show sufficient liquidity;

ii. resolve the weaknesses in the documentation supporting the methodology;

iii. resolve the weaknesses in the programming of the calculation algorithms in the QRR application, which is the one supporting the creation and maintenance of these rating systems;

iv. continuously monitor the final estimates of $PD$ which are obtained by adjusting the $PD$ implicit in bond spreads to those published by external rating agencies;

v. ensure sufficient information to analyse the dynamics of the rating system in the estimation of average $PD$ of the cycle is stored; and
vi. not calculate an adjustment to the observed \textit{LGD} to obtain the downturn \textit{LGD}) and analyse the volatility of the \textit{LGD} parameter throughout the business cycle.

(c) In addition to the internal validation being carried out in terms of \textit{PD}, the firms must perform sensitivity and benchmarking analyses in terms of regulatory capital.

**Guidance**

5.1 The schedules to this direction in part contain requirements referred to in \textit{GENPRU} 2.1.51R (as modified), and provisions in \textit{BIPRU}, which the firm must comply with as rules. Schedule 2 sets out details of the how the \textit{IRB permission} applies for the purposes of \textit{BIPRU} 4.1.23R (1) to (6). The schedules also contain guidance for the firm and where this is the case this is indicated.

5.2 As set out in \textit{SUP} 8, the firm must notify the \textit{FSA} immediately if it becomes aware of any matter which could affect the continuing relevance or appropriateness of this \textit{waiver}. In particular any material change to the models needs to be reported to the \textit{FSA} by the firms.

5.3 Any changes to any of Schedules 1 to 3 of this direction will require a variation of this direction.

5.4 As part of the supervisory process, the \textit{FSA} will from time to time reissue Schedule 5. This does not represent a variation of this direction. Instead it is a process for recording in one place cumulative changes to the matters set out in the Schedules.

5.5 \textit{BIPRU} 8 has already been amended by direction number 678354 to allow a firm to use an \textit{advanced prudential calculation approach} for the purposes of consolidated requirements. This direction further modifies \textit{BIPRU} 8 to require a firm to use the \textit{IRB approach} on a consolidated basis.

**Interpretation**

6 Interpretative provisions of the \textit{Handbook} apply to this direction in the same way they apply to the \textit{Handbook}.

Relationship Management Team
Major Retail Groups Division
Financial Services Authority
Schedule 1 – High level scope and coverage of IRB permission granted

The FSA has granted an IRB permission for the categories of exposure identified in table 1 below (boxes containing a tick) with the exception of the permanent exemptions in table 2. Exposures that are not applicable to the firm are left blank.

Table 1

<table>
<thead>
<tr>
<th>IRB exposure classes*</th>
<th>Sub-classes</th>
<th>Advanced IRB approach</th>
<th>All countries</th>
<th>UK only</th>
<th>Geographies (by domicile of obligor)</th>
<th>(Further column on a case by case basis)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims or contingent claims on central governments and <em>central banks</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims or contingent claims on <em>institutions</em></td>
<td></td>
<td></td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims or contingent claims on corporates</td>
<td>Secured/ Development and investment lending on real estate</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other Corporate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail claims or contingent retail claims</td>
<td>Mortgage (Prime)</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Mortgage (sub prime/ non-performing/ Buy-to-let/ Others)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Qualifying revolving retail exposure</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Retail SME</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other Retail</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity claims</td>
<td>Securitisation positions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Non credit-obligation assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Portfolios permanently exempted from the IRB approach for application of the standardised approach (As referred to in BIPRU 4.2.26 R)

<table>
<thead>
<tr>
<th>Category</th>
<th>Exposure class</th>
<th>Portfolio</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Permanent exemptions for sovereigns, churches, religious communities, and institutions (As referred to in BIPRU 4.1.23 R (1), BIPRU 4.2.26 R (2) and BIPRU 4.2.26 R (3))</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Non-significant business units and immaterial exposure classes (As referred to in BIPRU 4.1.23 R (1) and BIPRU 4.2.26 R (4))</td>
<td>Retail</td>
<td>• Other Retail</td>
<td>• Permanently standardised Residential Mortgages</td>
</tr>
<tr>
<td></td>
<td>Corporate</td>
<td>• Loan to Porterbrook</td>
<td>• Abbey sold Porterbrook to a consortium but still has a loan to them associated with the sale</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Social Housing</td>
<td>• Social Housing relates to bonds issued by counterparties</td>
</tr>
<tr>
<td>Other (As referred to in BIPRU 4.1.23 R (1) and BIPRU 4.2.26 R (5)-(10))</td>
<td>Not applicable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Schedule 2:

This Schedule sets out details of the requirements in respect of how the IRB permission applies for the purposes of BIPRU 4.1.23R (1) to (6). The notes in this schedule are guidance only.

For firms using their own estimates of LGD and conversion factors

1. The firm may take into account unfunded credit protection to reduce LGD in the following manner:

N/A

Note. If the firm uses its own estimates of LGD and conversion factors it may only take into account unfunded credit protection to reduce LGD in the manner set out in its IRB permission (see BIPRU 4.1.23 R (3)).

2. The firm may only recognise the effects of financial collateral under BIPRU 10.6.17 R in the following manner:

N/A

Note. As set out in BIPRU 10.6.17R, in calculating the value of its exposures to a counterparty or to a group of connected clients the firm, within the scope of its IRB permission, the firm must satisfy the FSA that the effects of financial collateral can be separately estimated from other LGD aspects, and must be able to demonstrate the suitability of the estimates produced. (see BIPRU 4.1.23 R (4)).

For all firms with IRB permission

3. The firm must deal with equity exposures in the following manner (see BIPRU 4.1.23 R (5) and BIPRU 4.7.3 R):

1) The simple risk weight approach (see BIPRU 4.7.8 R);

4. The firm may recognise as eligible collateral a physical item of a type other than those types indicated in BIPRU 4.10.6R - BIPRU 4.10.12R (Eligibility of real estate collateral) and if the conditions in BIPRU 4.10.16R are met.

Note. A firm may only recognise such collateral as eligible if its IRB permission provides that the firm may treat collateral of that type as eligible and if the firm is able to demonstrate the following (see BIPRU 4.1.23 (6) and BIPRU 4.10.16 R):

1) the existence of liquid markets for disposal of the collateral in an expeditious and economically efficient manner;

2) the existence of well-established, publicly available market prices for the collateral; and
3) there is no evidence that the net prices it receives when collateral is realised deviates significantly from the market prices referred to in (b).
# Schedule 3: Roll-out plan

This is the table referred to in BIPRU 4.1.23 R (1) and BIPRU 4.2.18R- BIPRU 4.2.19R (detailed implementation plan of the IRB approach coming within the scope of this direction). Firms should inform the FSA as soon as possible should they think they are not able to roll out in accordance with the plan before the end of window.

<table>
<thead>
<tr>
<th>Exposure Class</th>
<th>Portfolio</th>
<th>Description</th>
<th>Planned Window</th>
<th>Implementation Window</th>
<th>For Information: Review* by regulator to take place before roll-out (Tick if applicable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>Residential Mortgages</td>
<td></td>
<td>1/1/08</td>
<td>2008</td>
<td>✓</td>
</tr>
<tr>
<td>Retail</td>
<td>Mortgage Offers</td>
<td></td>
<td>1/1/08</td>
<td>2008</td>
<td>✓</td>
</tr>
<tr>
<td>Retail</td>
<td>Customer Bank Accounts (Overdrafts)</td>
<td></td>
<td>1/1/08</td>
<td>2008</td>
<td>✓</td>
</tr>
<tr>
<td>Retail</td>
<td>Unsecured Personal Loans</td>
<td></td>
<td>1/1/08</td>
<td>2008</td>
<td>✓</td>
</tr>
<tr>
<td>Retail</td>
<td>Business Banking</td>
<td></td>
<td>2010</td>
<td>2011</td>
<td>✓</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>Inter-Bank Exposures</td>
<td>Santander Group AIRB model</td>
<td>1/1/08</td>
<td>2008</td>
<td>✓</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>Non Banking Financial Institutions</td>
<td></td>
<td>2010</td>
<td>2011</td>
<td>✓</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>Securities Financing Transactions</td>
<td></td>
<td>2009</td>
<td>2010</td>
<td>✓</td>
</tr>
<tr>
<td>Corporate</td>
<td>Social Housing</td>
<td>Abbey AIRB UK model</td>
<td>1/1/08</td>
<td>2008</td>
<td>✓</td>
</tr>
<tr>
<td>Corporate</td>
<td>Corporates</td>
<td></td>
<td>2010</td>
<td>2011</td>
<td>✓</td>
</tr>
<tr>
<td>Corporate</td>
<td>Commercial Mortgages</td>
<td></td>
<td>2010</td>
<td>2011</td>
<td>✓</td>
</tr>
</tbody>
</table>

* By the Banco de Espana and/or the FSA.
Schedule 4: Reporting Requirements

This Schedule sets out reporting requirements for the firm for the purposes of GENPRU 2.1.51R as modified.

Reporting requirements

The firm must keep the FSA informed about its IRB rating systems and the environment within which they are being operated. The firm must provide information to the FSA in a manner that allows the FSA to exercise adequate oversight of the firm's IRB approach. In particular the firm is required to provide reports to the FSA in accordance with the requirements below.

1. The firm must inform the FSA in advance of significant events affecting the operation of ratings, such as:

- introduction of new rating systems,
- significant changes to rating systems,
- significant changes to governance or senior management arrangements,
- any other significant event affecting the rating systems.

Any material changes to one or more of the above must be notified to the FSA as soon as practicable. Detailed information should be provided on quantitative and qualitative aspects of the change.

Where changes to rating systems are involved the firm must report these changes to be reported in advance of their occurring in order to allow the FSA to review the rating system prior to live introduction.

2. In addition the firm must provide the FSA with details of any other changes relating to approved rating systems. This information may be provided after the event occurs.
Schedule 5 (Version control)

*Guidance* – this table is used to maintain an audit trail of the evolution this direction. A new version number should be created each time a schedule to the direction is amended, whether or not the direction itself is formally revoked and reissued.

<table>
<thead>
<tr>
<th>Version</th>
<th>Comment</th>
<th>Authorisation</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Waiver direction issued.</td>
<td>Matthew Tagg</td>
<td>23/12/2009</td>
</tr>
</tbody>
</table>