

Notes on the accounts continued

9 Earnings per ordinary share

The earnings per share are based on the following:

	Group		
	2006 £m	2005 £m	2004 £m
Earnings:			
Profit attributable to ordinary shareholders	6,202	5,392	4,856
Add back dividends on dilutive convertible non-equity shares	64	65	66
Diluted earnings attributable to ordinary shareholders	6,266	5,457	4,922
Number of shares – millions			
Weighted average number of ordinary shares in issue during the year	3,185	3,183	3,085
Effect of dilutive share options and convertible non-equity shares	58	60	73
Diluted weighted average number of ordinary shares during the year	3,243	3,243	3,158

All convertible preference shares have a dilutive effect in 2006 and 2005 and have been included in the computation of diluted earnings per share. In 2004, US\$1,500 million of convertible preference shares were not included in the computation of diluted earnings per share as their effect was anti-dilutive.

10 Treasury and other eligible bills

	Group	
	2006 £m	2005 £m
Treasury bills and similar securities	5,407	5,402
Other eligible bills	84	136
	5,491	5,538
Held-for-trading	4,516	3,004
Available-for-sale	975	2,534
	5,491	5,538

11 Loans and advances to banks

	Group		Company	
	2006 £m	2005 £m	2006 £m	2005 £m
Held-for-trading	52,736	44,965	—	—
Designated as at fair value through profit or loss	376	282	—	—
Loans and receivables	29,494	25,340	7,252	9,122
	82,606	70,587	7,252	9,122
Amounts above include:				
Reverse repurchase agreements	54,152	41,804	—	—
Items in the course of collection from other banks	3,471	2,901	—	—
Due from subsidiaries	—	—	7,252	9,122

12 Loans and advances to customers

	Group		Company	
	2006 £m	2005 £m	2006 £m	2005 £m
Held-for-trading	72,462	53,963	—	—
Designated as at fair value through profit or loss	1,327	616	—	—
Loans and receivables	381,583	350,960	286	567
Finance leases	11,521	11,687	—	—
	466,893	417,226	286	567
Amounts above include:				
Reverse repurchase agreements	62,908	48,887	—	—
Due from subsidiaries	—	—	286	567

Securitisations and other asset transfers

The Group engages in securitisation transactions of its financial assets including commercial and residential mortgage loans, commercial and residential mortgage related securities, US Government agency collateralised mortgage obligations, and other types of financial assets. In such transactions, the assets, or interests in the assets, are transferred generally to a special purpose entity ("SPE") which then issues liabilities to third party investors.

Securitisations may, depending on the individual arrangement, result in continued recognition of the securitised assets; continued recognition of the assets to the extent of the Group's continuing involvement in those assets; or derecognition of the assets and the separate recognition, as assets or liabilities, of any rights and obligations created or retained in the transfer (see Accounting policy on page 135). The Group has securitisations in each of these categories.

Continued recognition

The table below sets out the asset categories together with the carrying amounts of the assets and associated liabilities.

Asset type	2006		2005	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Residential mortgages (1)	15,698	15,375	2,388	2,366
Finance lease receivables (2)	1,211	953	1,467	1,170
Other loans (3)	1,931	1,346	2,189	1,543
Credit card receivables (4)	2,891	2,585	2,891	2,836
Commercial paper conduits (5)	8,360	8,284	6,688	6,685

Notes:

- (1) Mortgages have been transferred to special purpose vehicles, held ultimately by charitable trusts, funded principally through the issue of floating rate notes. The Group has entered into arm's length fixed/floating interest rate swaps and cross-currency swaps with the securitisation vehicles and provides mortgage management and agency services to the vehicles. On repayment of the financing, any further amounts generated by the mortgages will be paid to the Group.
- (2) Certain finance lease receivables (leveraged leases) involve the Group as lessor obtaining non-recourse funding from third parties. This financing is secured on the underlying leases and the provider of the finance has no recourse whatsoever to the other assets of the Group.
- (3) Other loans originated by the Group have been transferred to special purpose vehicles funded through the issue of notes. Any proceeds from the loans in excess of the amounts required to service and repay the notes are payable to the Group after deduction of expenses.
- (4) Credit card receivables in the UK have been securitised. Notes have been issued by a special purpose vehicle. The note holders have a proportionate interest in a pool of credit card receivables that have been equitably assigned by the Group to a receivables trust. The Group continues to be exposed to the risks and rewards of the transferred receivables through its right to excess spread (after charge-offs).
- (5) The Group sponsors commercial paper conduits. Customer assets are transferred into an SPE which issues notes in the commercial paper market. The Group supplies certain services and contingent liquidity support to these vehicles on an arm's length basis as well as programme credit enhancement.

12 Loans and advances to customers *(continued)*

Continuing involvement

In certain US securitisations of residential mortgages, substantially all the risks and rewards have been neither transferred nor retained, but the Group has retained control, as defined by IFRS, of the assets and continues to recognise the assets to the extent of its continuing involvement which takes the form of retaining certain subordinated bonds issued by the securitisation vehicles. These bonds have differing rights and, depending on their terms, they may expose the Group to interest rate risk where they carry a fixed coupon or to credit risk depending on the extent of their subordination. Certain bonds entitle the Group to additional interest if the portfolio performs better than expected and others give the Group the right to prepayment penalties received on the securitised mortgages. At 31 December 2006, securitised assets were £37.3 billion (2005 – £39.8 billion); retained interests £930 million (2005 – £863 million); subordination assets £694 million (2005 – £609 million) and related liabilities £694 million (2005 – £609 million).

Derecognition

Other securitisations of the Group's financial assets in the US qualify for derecognition as substantially all the risks and rewards of the assets have been transferred. The Group continues to recognise any retained interests in the securitisation vehicles.

Disclosures are given below about those securitisations of financial assets undertaken by the Group that resulted in derecognition or recognition to the extent of continuing involvement.

The Group has classified these securitisations into three broad categories: US Agency, consumer, and commercial securitisations. During 2006, the Group received proceeds of approximately £45.6 billion (2005 – £46.3 billion; 2004 – £30.1 billion) from securitisation trusts in connection with new securitisations of Group assets and £10.7 billion (2005 – £9.6 billion; 2004 – £1.3 billion) in connection with securitisation of third-party assets.

The Group recognised net pre-tax gains of approximately £192 million (2005 – £182 million; 2004 – £111 million) relating to these securitisations. Net pre-tax gains are based on the difference between the sales prices and previous carrying values of assets prior to date of sale, are net of transaction costs, and exclude any results attributable to hedging activities, interest income, funding costs, and changes in asset values prior to, and in retained interest values subsequent to, the securitisation date.

At 31 December 2006, the fair value of the Group's retained interests, which are classified as held-for-trading, was approximately £2.1 billion (2005 – £2.1 billion). These retained interests comprise approximately £1,148 million (2005 – £1,179 million) in US Agency based retained interests, £818 million (2005 – £764 million) in consumer based retained interests and £113 million (2005 – £128 million) in commercial based retained interests. These retained interests primarily relate to mortgage loans and securities and arose from securitisations that have taken place in current and prior years. Cash flows received in 2006 from retained interests held at 31 December 2006 in connection with securitisations that took place in current and prior years amounted to £544 million (2005 – £481 million; 2004 – £383 million).

Key economic assumptions used in measuring the value of retained interests at the date of securitisation resulting from securitisations completed during the year were as follows:

Assumptions	US Agency retained interests	Consumer retained interests	Commercial retained interests
Prepayment speed	100 – 500 PSA	0 – 40% CPR ⁽¹⁾	0 – 50 CPY ⁽²⁾
Weighted average life	2 – 18 years	0 – 13 years	1 – 10 years
Cash flow discount rate	0 – 20%	6 – 55%	5 – 9%
Credit losses	N/A ⁽³⁾	0 – 2% CDR ⁽⁴⁾	0 – 2% CDR ⁽⁴⁾

Key economic assumptions and the sensitivity of the current fair value of retained interests at 31 December 2006 to immediate adverse changes, as indicated below, in those assumptions are as follows:

Assumptions/impact on fair value	US Agency retained interests	Consumer retained interests	Commercial retained interests
Fair value of retained interests at 31 December 2006 (£m)	1,148	818	113
Prepayment speed ⁽⁵⁾	10 – 32% CPR ⁽¹⁾	0 – 40% CPR ⁽¹⁾	0 – 100% CPY ⁽²⁾
Impact on fair value of 10% adverse change (£m)	2.1	15.3	0.1
Impact on fair value of 20% adverse change (£m)	3.7	29.3	0.1
Weighted average life	1 – 18 years	0 – 13 years	1 – 18 years
Cash flow discount rate	0 – 20%	6 – 73%	5 – 9%
Impact on fair value of 10% adverse change (£m)	23.8	23.7	3.3
Impact on fair value of 20% adverse change (£m)	46.5	46.0	6.4
Credit losses	N/A ⁽³⁾	0 – 3% CDR ⁽⁴⁾	0 – 2% CDR ⁽⁴⁾
Impact on fair value of 10% adverse change (£m)	N/A	36.2	0.1
Impact on fair value of 20% adverse change (£m)	N/A	50.8	0.1

Notes:

- (1) Constant prepayment rate ("CPR") – the CPR range represents the low and high points of a dynamic CPR curve.
- (2) CPR with yield maintenance provision and thus prepayment risk is limited.
- (3) US Agency retained interests are securities whose principal and interest have been guaranteed by various United States government sponsored enterprises ("GSEs"). These GSEs include the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Government National Mortgage Association ("Ginnie Mae"). Fannie Mae and Freddie Mac are federally regulated but are privately owned. These GSEs guarantee that the holders of their mortgage-backed securities will receive payments of interest and principal. Securities guaranteed by either of these two GSEs, although not formally rated, are regarded as having a credit rating equivalent to AAA. Ginnie Mae guarantees the timely payment of principal and interest on all of its mortgage-backed securities, and its guarantee is backed by the full faith and credit of the United States Government.
- (4) Constant default rate.
- (5) Prepayment speed has been stressed on an overall portfolio basis for US Agency retained interests due to the overall homogeneous nature of the collateral. Consumer and commercial retained interests have been stressed on a security level basis.

The sensitivities depicted in the preceding table are hypothetical and should be used with caution. The likelihood of those percent variations selected for sensitivity testing is not necessarily indicative of expected market movements because the relationship of the change in the assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of a retained interest is calculated without changing any other assumptions. This might not be the case in actual market conditions since changes in one factor might result in changes to other factors. Further, the sensitivities depicted above do not consider any corrective actions that the Group might take to mitigate the effect of any adverse changes in one or more key assumptions.

Mortgage-backed securities

The Group sells originated mortgage loans to US government sponsored enterprises in return for securities backed by these loans and guaranteed by the Agency whilst retaining the rights to service the mortgages. These securities may be subsequently sold. The purchaser has recourse to the Group for losses up to pre-determined levels on certain designated mortgages. The Group is not obliged, and does not intend, to support losses that may be suffered by the Agencies. Under the terms of the sale agreements, the Agencies have agreed to seek repayment only from the cash from the mortgage loans. Once the securities exchanged for the loans have been sold the Group's exposure is restricted to the amount of the recourse. At 31 December 2006 mortgages amounting to £144 million (2005 – £385 million) had been sold with recourse to US GSEs. These loans have been derecognised.