

Registered Number 4441772

PERMANENT FUNDING (NO.2) LIMITED
ANNUAL REPORT AND ACCOUNTS
YEAR ENDED 31 DECEMBER 2011

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**PERMANENT FUNDING (NO.2) LIMITED
DIRECTORS AND COMPANY INFORMATION**

DIRECTORS

Claudia Wallace
SFM Directors Limited
SFM Directors (No 2) Limited

COMPANY SECRETARY

SFM Corporate Services Limited

REGISTERED OFFICE

35 Great St Helen's
London
EC3A 6AP

INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Benson House
33 Wellington Street
Leeds
LS1 4JP

PERMANENT FUNDING (NO 2) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011

The directors present their annual report and the audited financial statements for Permanent Funding (No 2) Limited (the "Company") for the year ended 31 December 2011

Principal activities

The principal activity of the Company is to acquire an interest in a portfolio of mortgage loans and to enter into financial arrangements with its related parties. No future changes in activity are envisaged.

The activities of the Company and the Permanent Holdings Limited Group (see below) are conducted primarily by reference to a series of securitisation transaction documents (the "Programme Documentation"). The securitisation structure has been established as a means of raising finance for Bank of Scotland plc ("BOS"), and subsequently Lloyds Banking Group plc ("LBG"). The Programme Documentation sets out the principal risks to the Noteholders of the publicly listed floating and fixed rate asset backed loan notes (the "Notes") issued by Permanent Master Issuer PLC (the "Issuer"). As such, these have not been reproduced in full in the financial statements.

The Company invests in the beneficial interests of the assets held by Permanent Mortgages Trustee Limited (the "Trust"). These assets comprise mortgage loans secured on residential property originated under the Halifax brand by BOS. The Company receives a share of income from the Trust in proportion to its share of the mortgage assets of the Trust.

The Company is a wholly owned subsidiary of Permanent Holdings Limited, a company registered in England and Wales. The shares of Permanent Holdings Limited are held on a discretionary trust basis by SFM Corporate Services Limited.

As at 31 December 2011 the Permanent Holdings Limited Group (the "Group") comprised Permanent Financing (No 3) PLC, Permanent Financing (No 4) PLC, Permanent Financing (No 5) PLC, Permanent Financing (No 6) PLC, Permanent Financing (No 7) PLC, Permanent Financing (No 8) PLC, Permanent Financing (No 9) PLC (together the "Financing companies"), Permanent Master Issuer PLC (the "Issuer"), Permanent Funding (No 1) Limited, Permanent Holdings Limited and the Company.

Results and dividends

The results for the year are set out on page 10. The profit after taxation for the year amounted to £483,000 (2010: £487,000). The directors do not recommend the payment of a dividend (2010: £ nil).

Profits for the Company are pre-determined under the Programme Documentation. Under the terms of the securitisation the Company retains the right to 0.01% of available revenue receipts from the beneficial interest in the mortgage loan portfolio. Surplus cashflows in excess of 0.01% accrue to BOS, the originator of the underlying mortgages.

PERMANENT FUNDING (NO.2) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

Business review and future developments

During the year £2,202m of inter-company loans were repaid on their expected payment dates following the receipt of the equivalent amount on the deemed loan to originator. During the year a further £6,762m of Notes were issued by the Issuer and subsequently inter-company loans were increased by the same value.

During the year Standard and Poor's ("S&P"), a Rating Agency rating the Notes held within the Group, published revised criteria for assessing counterparties to a structured finance transaction. In order for the Issuer to retain the "AAA" rating on the most senior Notes, a number of features of the transaction were restructured as noted below. The changes required to the programme were approved by the Noteholders at a series of Noteholder meetings.

The Company was required to release excess cash held in the Group and replace this with a subordinated loan in the form of an unrated Z loan from BOS. Using the unrated Z loan the Company purchased an additional share of the Trust property. The release of a substantial balance of the general reserve fund resulted in the partial repayment of the subordinated start-up loans held with BOS.

It was also necessary for Permanent Funding (No 1) Limited and the Company to enter into a new interest rate swap agreement with BOS and for the Issuer and Financing companies to enter into new cross currency swaps with BOS in place of swaps previously held with certain external swap providers. Interest rates were rebased to reflect current new mortgage pricing which is significantly higher than when the swaps were originally entered into.

The Company will continue to receive the proceeds as inter-company loans from the Issuer following future issuances.

Key performance indicators (KPIs)

The Company's directors are of the opinion that analysis using KPIs is not necessary for an understanding of the development, performance or position of the Company. However, a defined set of KPIs for the securitisation transaction are set out in the Programme Documentation and published as a monthly Investor Report. An extract of these is shown in note 10.

Performance against the KPIs include the yield on the Trust available as the first line of credit enhancement to the Notes, the losses that have occurred and the level of arrears in the underlying mortgages, the rate of repayment of the loans within the Trust and an analysis of the characteristics of the underlying mortgages in the Trust.

The key performance indicator used by management in assessing the performance of the Company is the monitoring of actual cashflows against planned cashflows.

At the time of issue each series and class of Notes in issue and attached to an inter-company loan is assigned a credit rating which reflects the likelihood of full and timely payment to the Noteholders of interest on each interest payment date and the payment of principal on the final maturity date. A rating may be subject to revision, suspension or withdrawal at any time by the rating agencies if the Issuer's circumstances change.

PERMANENT FUNDING (NO.2) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

Key performance indicators (KPIs) (continued)

Any change in the credit rating assigned to a Note would be used as an indicator as to the performance of the inter-company loan attached to that Note and therefore, the Company No downgrade in credit ratings has been applied to the Issuer's Notes in the year under review and subsequently up to the date of approval of these financial statements

The Company has made all necessary payments on the inter-company loans in accordance with the scheduled repayment dates for the year ended 31 December 2011

The Company's tax charge is based on the permanent tax regime for securitisation companies Tax is assessed on the cash retained as profit in the Company

Policy and practice on payment of creditors

The Company had no trade creditors as at 31 December 2011 or as at 31 December 2010

Directors

The directors who served during the year and up to the date of signing the financial statements were as follows

Claudia Wallace
SFM Directors Limited
SFM Directors (No 2) Limited

Claudia Wallace, SFM Directors Limited and SFM Directors (No 2) Limited are also directors of the Group None of the directors has any beneficial interest in the ordinary share capital of the Company None of the directors had any interest in any material contract or arrangement with the Company either during or at the end of the year

Third Parties Indemnities

The Company has made qualifying third party indemnity provisions for the benefit of Claudia Wallace, SFM Directors Limited and SFM Directors (No 2) Limited Enhanced indemnities are provided to the directors by Structured Finance Management Limited ("SFM") against liabilities and associated costs which they could incur in the course of their duties to the Company These indemnity provisions remain in force at the date of this report

Risk Management

The majority of the Company's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments Presentation" The Company's financial instruments comprise a deemed loan to the originator, cash and liquid resources, inter-company loans from the Issuer and various other payables

The principal risks and uncertainties for the Company arise from the Company's financial instruments These are credit risk, liquidity risk and interest rate risk These and other risks which may affect the Company's performance are detailed below Further analysis of the risks facing the Company in relation to its financial instruments and the Company's financial risk management policies is provided in note 10

PERMANENT FUNDING (NO.2) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

Risk Management (continued)

Credit risk

The inter-company loans are ultimately secured against a beneficial interest in a mortgage portfolio held in trust. The performance of the mortgage loans, secured on UK residential properties, is influenced by the economic background and the UK housing market. A continuing faltering economic recovery and slow growth in the UK housing market means that interest rates are likely to remain low for an extended period of time, aiding affordability for mortgage customers. Despite the economic conditions, arrears remain low.

As part of the restructure (see Business Review above) the Company has increased its share of the Trust property and in turn increased the excess spread available to meet its obligations under the inter-company loan agreements. This will reduce the Company's exposure to credit risk and help to ensure it can make all necessary payments of interest and principal as they fall due.

Excess spread is the remaining income from the deemed loan after all interest is paid on the inter-company loans and third party expenses have been settled and is payable to BOS as deferred consideration.

There is a yield reserve (included as part of the subordinated loan from BOS) to pay margins on the inter-company loans above a certain level in line with the Programme Documentation.

There is also a fully funded general reserve balance that provides a level of credit enhancement to the Notes. However, the primary function of this reserve is to provide liquidity to the bullet and scheduled redemption Notes.

Liquidity risk

The ability of the Company to meet its obligations to make principal and interest payments on the inter-company loans and to meet its operating and administrative expenses is dependent on the amount and timing of the interest and principal repayments on the mortgage loans which underlie the loan to the originator. The Company is only obliged to pay interest and principal to the extent that it has such amounts available to it. Failure to pay the inter-company loan interest and principal to the Issuer will ultimately result in a deterioration of the Issuer's position and affect the ability to meet obligations under the Notes issued. To the extent that the income on the deemed loan does not provide sufficient funds to recover the Company's investment in the mortgage portfolio, the Company has no claim on the assets of the originator.

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at different times. All of the Company's financial assets and liabilities are denominated in Sterling and are linked to Sterling three month LIBOR either directly or via the use of derivative instruments.

As part of the financing arrangement the Company acquires a beneficial interest in mortgage loans and enters into an interest rate swap with BOS under which it exchanges the fixed rate, variable rate and tracker rate income received on the mortgages for a LIBOR-based interest flow in order to settle interest due on the inter-company loans with the Issuer. As such the Company has provided certainty in terms of amounts due on the inter-company loans and avoids fluctuations in payments.

PERMANENT FUNDING (NO.2) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

Risk Management (continued)

Business risks

The principal business risks of the Company are set out in a number of asset and non-asset trigger events in the Programme Documentation. The occurrence of trigger events may lead to a different priority of payments of the Notes in accordance with established priorities. There have been no such trigger events since inception of the Programme.

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 the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements.

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 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.

Statement of disclosure of information to auditors

So far as the directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and the directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information 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 section 418 of the Companies Act 2006.

PERMANENT FUNDING (NO.2) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

Employees

The Company has employed no staff during the year ended 31 December 2011 or the previous year. None of the directors received any emoluments from the Company in the current or previous year.

Independent Auditors

Pursuant to section 487 of the Companies Act 2006, auditors duly appointed by the members of the Company shall, subject to any resolution to the contrary, be deemed to be reappointed for the next financial year and PricewaterhouseCoopers LLP, having expressed their willingness, will therefore continue in office.

Statement of Going Concern

The directors are satisfied that the Company has adequate resources to continue to operate for the foreseeable future and is financially sound. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

By Order of the Board



Claudia Wallace
Per pro SFM Corporate Services Limited
Secretary

Registered Office
35 Great St Helen's
London
EC3A 6AP

DATE 21 March 2012

**PERMANENT FUNDING (NO.2) LIMITED
INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF PERMANENT FUNDING (NO.2) LIMITED**

We have audited the financial statements of Permanent Funding (No 2) Limited for the year ended 31 December 2011 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cashflow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 6, 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 Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**PERMANENT FUNDING (NO.2) LIMITED
INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF PERMANENT FUNDING (NO.2) LIMITED (CONTINUED)**

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 2011 and of its profit and cashflows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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



Mark Hannam (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds

Date 21 March 2012

PERMANENT FUNDING (NO.2) LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2011

	Notes	2011 £'000	2010 £'000
Interest receivable and similar income	2	367,047	241,263
Interest payable and similar charges	3	(365,320)	(240,333)
Net interest income		<u>1,727</u>	<u>930</u>
Operating expenses	4	(1,070)	(253)
Profit before tax		<u>657</u>	<u>677</u>
Taxation	5	(174)	(190)
Profit / total comprehensive income attributable to equity holders		<u>483</u>	<u>487</u>

The profit shown above is derived from continuing operations. The Company operates in a single business segment and all of the Company's activities are in the UK.

There was no income or expense recognised directly in equity in the current year or preceding year.

The accompanying notes on pages 14 to 31 are an integral part of the financial statements.

PERMANENT FUNDING (NO 2) LIMITED
BALANCE SHEET
AS AT 31 DECEMBER 2011

		2011 £'000	2010 £'000
	Notes		
Assets			
Cash and cash equivalents		2,192,840	3,073,033
Deemed loan to originator	6	17,530,731	12,057,663
Total assets		<u>19,723,571</u>	<u>15,130,696</u>
Equity and liabilities			
Loans from Group companies	7	19,722,046	15,129,560
Trade and other payables	8	44	34
Current tax liability		86	190
Total liabilities		<u>19,722,176</u>	<u>15,129,784</u>
Share capital	9	-	-
Retained profits		1,395	912
Shareholders' equity		<u>1,395</u>	<u>912</u>
Total equity and liabilities		<u>19,723,571</u>	<u>15,130,696</u>

The directors approved the financial statements on 21 March 2012



Claudia Wallace
Per pro SFM Directors Limited
As Director

The accompanying notes on pages 14 to 31 are an integral part of the financial statements

PERMANENT FUNDING (NO.2) LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2011

	Share capital £'000	Retained profits £'000	Total £'000
Balance at 1 Jan 2011	-	912	912
Profit / total comprehensive income for the year	-	483	483
	<hr/>	<hr/>	<hr/>
Balance at 31 Dec 2011	-	1,395	1,395
	<hr/>	<hr/>	<hr/>
	Share capital £'000	Retained profits £'000	Total £'000
Balance at 1 Jan 2010	-	425	425
Profit / total comprehensive income for the year	-	487	487
	<hr/>	<hr/>	<hr/>
Balance at 31 Dec 2010	-	912	912
	<hr/>	<hr/>	<hr/>

The accompanying notes on pages 14 to 31 are an integral part of the financial statements

PERMANENT FUNDING (NO.2) LIMITED
CASHFLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2011

	2011 £'000	2010 £'000
Operating Activities		
Administration expenses paid	(1,030)	(222)
External audit fees paid	(28)	(27)
Tax paid	(278)	(86)
	<hr/>	<hr/>
Net cashflows from operating activities	(1,336)	(335)
	<hr/>	<hr/>
Investing Activities		
(Decrease) / increase in deemed loan to originator	(5,126,737)	1,798,726
Bank interest received	20,714	11,149
	<hr/>	<hr/>
Net cashflows from investing activities	(5,106,023)	1,809,875
	<hr/>	<hr/>
Financing Activities		
Increase / (reduction) in loans from Group companies	4,560,248	(1,886,540)
Payment of issue costs	(15,853)	(25,863)
Interest on loans from Group companies	(317,229)	(219,584)
	<hr/>	<hr/>
Net cashflows from financing activities	4,227,166	(2,131,987)
	<hr/>	<hr/>
Net decrease in cash and cash equivalents	(880,193)	(322,447)
	<hr/>	<hr/>
Change in cash and cash equivalents	(880,193)	(322,447)
Cash and cash equivalents at start of year	3,073,033	3,395,480
	<hr/>	<hr/>
Cash and cash equivalents at end of year	2,192,840	3,073,033
	<hr/>	<hr/>

The cashflow statement is presented using the direct method

The accompanying notes on pages 14 to 31 are an integral part of the financial statements

**PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011**

1. SIGNIFICANT ACCOUNTING POLICIES

Permanent Funding (No 2) Limited is a company domiciled in England

1(a) Statement of compliance

The financial statements for the year ended 31 December 2011 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union. The standards applied by the Company are those endorsed by the European Union and effective at the date the financial statements are approved by the Board. The financial statements comply with IFRSs.

The Company has adopted the following new and relevant IFRS pronouncements which became effective for financial years beginning on or after 1 January 2011. None of these standards or amendments had a material impact on these company financial statements.

- Improvements to IFRSs (issued May 2010) Amends IFRS 7 Financial Instruments Disclosure to require further disclosures in respect of collateral held by the Company as security for financial assets and sets out minor amendments to other IFRS standards as part of the annual improvements process,
- IAS 24 Related Party Disclosures (Revised) Simplifies the definition of a related party and provides a partial exemption from the requirement to disclose transactions and outstanding balances with the government and government-related entities

The financial statements also comply with the relevant provisions of Part 15 of the Companies Act 2006.

The financial statements have been prepared using the going concern basis. The directors have reviewed the expected future cashflows and believe they are adequate to meet the anticipated payments due in accordance with the Programme Documentation. The directors believe that the Company has additional safeguards in place to cover any unexpected issues which may arise in light of the recent market turbulence including access to a general cash reserve and the ability to defer payment in certain circumstances.

The financial statements are presented in sterling which is the Company's functional and presentation currency and have been prepared on the historical cost basis.

1(b) Revenue recognition

Interest receivable and similar income have been calculated using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cashflows are estimated after considering all the contractual terms of the instrument.

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1(c) Accrued interest

Accrued interest has been incorporated within the deemed loan to originator and the outstanding balance of loans from Group companies on the balance sheet. An analysis of principal on the loans and accrued interest can be found in notes 6 and 7 respectively.

1(d) Taxation

Current tax which is payable on taxable profits is recognised as an expense in the year in which the profits arise.

The Company's tax charge is based on the permanent tax regime for securitisation companies. Tax is calculated based on cash reserves maintained throughout the year.

1(e) Financial instruments

The Company's financial instruments comprise a deemed loan to BOS, cash and liquid resources, loans from Group companies and various other payables that arise directly from its operations. The main purpose of these financial instruments is to raise finance for BOS. These financial instruments are classified in accordance with the principles of IAS 39 as described below.

1(e)(i) Deemed loan to originator

Under IFRS, if a transferor retains substantially all the risks and rewards associated with the transferred assets, the transaction is accounted for as a financing transaction, notwithstanding that it is a sale transaction from a legal perspective. The directors of the Company have concluded that BOS has retained substantially all the risks and rewards of the pool of mortgage loans and as a consequence, the Company does not recognise the mortgage loans on its balance sheet but rather a deemed loan to originator, where recourse to BOS is limited to the cashflows from the mortgage loans and any additional credit enhancement provided by BOS.

The initial amount of the deemed loan to originator corresponds to the consideration paid by the Company for the mortgage loans less the Z loan and any other subordinated loan granted by BOS. The Company recognises principal and interest cashflows from the underlying pool of mortgage loans only to the extent that it is entitled to retain such cashflows. Cashflows attributable to BOS are not recognised by the Company.

The deemed loan to originator is classified within "loans and receivables" and is stated at amortised cost. Where cash has been accumulated by the Company to fund the future repayment of its inter-company loans, the Company's share of the interest arising on the beneficial interest in the mortgage portfolio is adjusted.

**PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1(e) Financial instruments (continued)

1(e)(i) Deemed loan to originator (continued)

Derivative financial instruments

Interest rate risk associated with the deemed loan to originator is managed by means of an interest rate swap with BOS, which requires the Company to pay the effective yield on the beneficial interest in the mortgage portfolio and receive payments based on a rate linked to the three-month Sterling LIBOR

This swap is not recognised separately as a financial instrument as the amounts payable under the swap reflect interest flows from the mortgage loans which are not recognised by the Company for accounting purposes. Instead, the deemed loan to BOS is recognised with an effective interest rate which reflects the amount received or paid under the swap

Impairment of financial assets

At each balance sheet date the Company assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that the deemed loan to originator has become impaired

Delinquencies and defaults on the underlying securitised assets will not result in an impairment loss if the cashflows from the asset pool are still expected to be sufficient to meet obligations under the limited recourse loan

If there is objective evidence that an impairment loss has been incurred, an allowance account is established which is calculated as the difference between the balance sheet carrying value of the deemed loan asset and the present value of estimated future cashflows discounted at that loan's original effective interest rate

1(e)(ii) Cash and cash equivalents

The Company holds deposits with the provider of a guaranteed investment contract ("GIC") and a transaction bank account with the same provider. For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months. As the cash can only be used to meet certain specific liabilities and is not available to be used with discretion, it is viewed as restricted cash

These bank accounts are classified within "loans and receivables" in accordance with IAS 39 and income is being recorded using the effective interest method

**PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1(e) Financial instruments (continued)

1(e)(iii) Loans from Group companies

The inter-company loans are recognised initially at fair value less directly related incremental transaction costs. These loans are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

1(f) Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

The directors of the Company consider that the entity has only one geographical and one business segment and therefore is not required to produce additional segmental disclosure.

1(g) Critical accounting estimates and judgements

The preparation of the financial statements necessarily requires the exercise of judgement both in the application of accounting policies and in the selection of assumptions used in the calculation of accounting estimates. These judgements are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. The most significantly affected components of the financial statements and associated critical judgements are as follows:

Effective interest rate method

In calculating the effective interest rate of financial instruments the Company takes into account interest received or paid, fees and commissions paid or received, expected early redemptions and related penalties and premiums and discounts on acquisition or issue that are integral to the yield as well as incremental transaction costs.

For the purpose of the effective yield calculation, it has been assumed that the average expected life of the inter-company loans will follow the life of the Notes issued by the Issuer and will end at the date of the first step-up or step-down in interest rates (unless specified earlier in the Programme Documentation when the earlier date will be used), based on the payment experience to date. This may not be the case in practice.

Fair value calculations

All assets and liabilities are recognised on an amortised cost basis that is considered to be a close approximation to fair value.

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1(g) Critical accounting estimates and judgements (continued)

Impairment of deemed loan

The Company's accounting policy for losses arising on the deemed loan to originator classified as loans and receivables is described in note 1(e)(i). The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date. In determining whether impairment has occurred at the balance sheet date the Company considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cashflows or their timings. Where this is the case, the impairment loss is the difference between the carrying value of the loan and the present value of the estimated future cashflows discounted at the loan's original effective interest rate.

At 31 December 2011, impairment allowances against the deemed loan totalled £nil (2010 £nil)

1(h) Dividends

Dividends on ordinary shares are recognised in equity in the year in which they are paid

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	2011 £'000	2010 £'000
Interest receivable on deemed loan to originator	346,333	230,114
Bank interest receivable	20,714	11,149
	<u>367,047</u>	<u>241,263</u>

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

3. INTEREST PAYABLE AND SIMILAR CHARGES

	2011 £'000	2010 £'000
Interest on loans from Group companies	352,403	231,808
Amortisation of issue costs	12,917	8,525
	<u>365,320</u>	<u>240,333</u>

4. OPERATING EXPENSES

	2011 £'000	2010 £'000
Audit fees	35	29
Administration charges	1,035	224
	<u>1,070</u>	<u>253</u>

Audit fees relate to the statutory audit Fees of £22,000 net of VAT are payable to PricewaterhouseCoopers LLP for work performed in the year on behalf of the Company (2010 £15,000) and £8,000 net of VAT will be payable for fees relating to the Issuer (2010 £8,000) There are no fees payable to the auditors and their associates for services other than the statutory audit

The Company has no employees (2010 Nil) and none of the directors received any emoluments from the Company in the current or previous year

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

5. TAXATION

	2011 £'000	2010 £'000
Current Tax		
Corporation tax charge for the year at a rate of 26.5% (2010: 28%)	174	190
	<hr/>	<hr/>
Total tax charge	174	190
	<hr/>	<hr/>
Reconciliation of effective tax rate		
Profit before tax	657	677
	<hr/>	<hr/>
Profit before tax multiplied by the standard rate of corporation tax in the UK of 26.5% (2010: 28%)	174	190
	<hr/>	<hr/>
Total tax charge	174	190
	<hr/>	<hr/>

The standard rate of Corporation Tax in the UK changed from 28% to 26% with effect from 1 April 2011. Accordingly, the Company's profits for this accounting period are taxed at an effective rate of 26.5%.

6. DEEMED LOAN TO ORIGINATOR

	2011 £'000	2010 £'000
Principal	17,590,118	12,149,084
Interest	(59,387)	(91,421)
	<hr/>	<hr/>
TOTAL	17,530,731	12,057,663
	<hr/>	<hr/>

The mortgage portfolio, which is accounted for as a deemed loan to originator, is held on trust for the Company and the originator of the mortgage loans by Permanent Mortgages Trustee Limited (the "Trust"). The mortgage loans are secured on residential property in England, Wales and Scotland. Mortgages in the pool have to fulfil certain criteria. If they fail to do so they are removed from the pool and the pool is replenished.

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

7. LOANS FROM GROUP COMPANIES

	2011 £'000	2010 £'000
Principal		
Loans from Group companies	19,678,212	15,117,964
Deferred issue costs	(47,839)	(44,903)
	<u>19,630,373</u>	<u>15,073,061</u>
Interest		
Interest payable to Group companies	<u>91,673</u>	<u>56,499</u>
TOTAL	<u>19,722,046</u>	<u>15,129,560</u>

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings. For more information about the Company's exposure to interest rate risk, see note 10.

Interest and principal payable relate to the amounts due to the Issuer under the inter-company loan agreements and are aligned to the proceeds of the Notes in issue.

Interest payable on the inter-company loan agreements is based on Sterling three month LIBOR plus a margin as set out in the Programme Documentation.

The final repayment date of each inter-company loan will be the final maturity date of the corresponding class of Notes. Payments are made in accordance with the prescribed timetable set out in the legal agreements.

There have been no defaults in the payment of principal and interest or other breaches with respect to liabilities in the year or the previous year.

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

8 TRADE AND OTHER PAYABLES

	2011 £'000	2010 £'000
Amounts due to Group companies	9	6
Audit fee accrual	35	28
	<hr/> 44	<hr/> 34
	<hr/>	<hr/>

9 SHARE CAPITAL

	2011 £	2010 £
ISSUED, ALLOTTED AND PAID UP		
1 ordinary share of £1	1	1
	<hr/>	<hr/>

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

10. MANAGEMENT OF RISK

The principal risks arising from the Company's financial instruments are credit risk, liquidity risk and interest rate risk. However, considerable resource is given to maintaining effective controls to manage, measure and mitigate each of these risks. Further detailed analysis of the risks facing the Company in relation to its financial instruments is provided below.

The directors do not consider there is a capital management risk as adequate solvency and capital levels are maintained.

The Company's exposure to risk on its financial instruments and the management of such risk is largely determined at the inception of the securitisation transaction. The Company's activities and the role of each party to the transaction are clearly defined and documented. Cashflow modelling, including multiple stress scenarios, is carried out as part of the structuring of the transaction, and as such is required by the rating agencies. In addition an interest rate swap is entered into with the originator as part of the securitisation transaction to hedge interest rate risk arising in the transaction including the obligations under the inter-company loan agreements. The derivative counterparty is selected as a highly rated, regulated financial institution and this reduces the risk of default and loss for the Company.

10(a) Credit risk

Credit risk arises where there is a possibility that a counterparty may default on its financial obligations resulting in a loss to the Company.

The ability of the Company to meet its obligations to make principal and interest payments on the inter-company loans and to meet its operating and administrative expenses is dependent on funds being received on the deemed loan to originator. The primary credit risk of the Company therefore relates to the credit risk associated with the securitised pool of mortgages originated by BOS. The likelihood of defaults in the mortgage pool and the amounts that may be recovered in the event of default are related to a number of factors and may vary according to characteristics and product type. Significant changes in the economy, or in the health of a particular geographical zone that represents a concentration in the securitised assets, could also affect the cashflows from the mortgage pool.

To mitigate this risk, credit enhancement is provided by way of excess spread, an unrated Z loan and a reserve fund as explained below.

Following the revised criteria set out by the rating agent, S&P, the amount of cash that can be held with the current account bank, BOS, is limited to 5% of the outstanding Notes in issuance. As much of the credit enhancement available was provided in the form of a cash reserve, it was necessary to replace a significant proportion of this with a subordinated loan in the form of an unrated Z loan from BOS.

The remaining reserve fund can be used in certain circumstances to meet any deficit in revenue or to repay amounts of principal. As a result of the reduction in the overall cash held this allowed the partial repayment of the subordinated start-up loan due to BOS. The remaining reserve balance as at 31 December 2011 was £363.9m (2010: £1,706.9m).

The Z loan is subordinated to the general reserve fund in the revenue priority of payments and as such may not be fully repaid if the losses on the underlying mortgages are higher than the excess spread and yield reserve. Non payment of interest or principal on the unrated Z loan does not constitute an event of default on the Company. This unrated Z loan amounted to £2,978.0m at 31 December 2011.

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

10(a) Credit risk (continued)

The unrated Z loan was used to purchase an additional share of the Trust property and as a result increases the amount of the excess spread the Company receives. The Company's share of the income on the mortgage pool exceeds the interest payable on the inter-company loans from the Issuer. This excess spread is available to make good any reduction in the principal balance of the mortgage pool as a result of defaults by customers. Therefore, delinquencies and defaults on the underlying securitised assets will not result in a default on the inter-company loan as long as they do not exceed the credit enhancement provided by the excess spread, unrated Z loan and the reserve fund. The Company's share of losses in the mortgage pool covered by excess spread in the year to 31 December 2011 was £7,041,000 (2010 £7,004,000).

The Company has a concentration of risk to the originator. The underlying mortgage assets of the securitisation are all in the UK market. The nature of the residential mortgage portfolio means there is no significant counterparty credit risk in relation to the underlying mortgage pool.

An impairment charge on the deemed loan to originator will only be considered when all the excess spread and yield reserve available has been utilised to cover the mortgage losses. Until that point, any specific mortgage losses will be netted against the mortgage interest from the Trust, with a corresponding adjustment to the deferred consideration. Therefore, there is no effect on the overall yield on the deemed loan to originator. The directors consider that the Company's share of mortgage loans in the Trust will be sufficient to recover the full amount of this deemed loan.

To the extent that the income on the deemed loan does not provide sufficient funds to recover the Company's investment in the mortgage portfolio, the Company has no claim on the assets of BOS.

The Company assesses its counterparties for credit risk before contracting with them. Credit rating is the main method used to measure credit risk. In accordance with the criteria of the rating agencies that rate the Notes and by association the inter-company loans, the Programme Documentation contains various rating triggers linked to each counterparty, which require certain actions to be taken if triggers are breached, including the posting of collateral or the replacement of a swap counterparty.

Counterparty		Rating as at 31 Dec 2011	Rating as at date of approval of financial statements
		S&P	S&P
Account bank	Bank of Scotland PLC	Long Term A	Long Term A
Servicer	Bank of Scotland PLC	Long Term A	Long Term A
Interest rate swap provider	Bank of Scotland PLC	Long Term A	Long Term A

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

10(a) Credit risk (continued)

Financial assets subject to credit risk

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date equates to carrying value. At the balance sheet date all financial assets subject to credit risk were neither past due nor impaired.

Securitised mortgage assets

Securitised mortgage loans can be analysed according to the rating systems used by the Company and originator when assessing customers and counterparties. The full mortgage Trust portfolio balance against which the inter-company loans are ultimately secured has been analysed below.

For the purposes of the Company's disclosures regarding credit quality, securitised mortgage loans subject to credit risk have been analysed as follows:

	2011 £'000	2010 £'000
Neither past due nor impaired	31,917,558	36,008,557
Past due but not impaired	985,810	1,102,822
Impaired	410,799	409,739
	<u>33,314,167</u>	<u>37,521,118</u>

Securitized loans and advances which are past due but not impaired

	2011 £'000	2010 £'000
0-30 days	431,401	556,692
30-60 days	200,714	212,512
60-90 days	117,898	111,206
90-180 days	235,797	222,412
Over 180 days	-	-
	<u>985,810</u>	<u>1,102,822</u>

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

**PERMANENT FUNDING (NO 2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

10. MANAGEMENT OF RISK (CONTINUED)

10(a) Credit risk (continued)

The number and value of loans currently in arrears will have a bearing on the receipt of cash by the Company. Key indicators are as follows:

- At 31 December 2011 a total of 7,239 accounts were in arrears by three or more months which represented 2.29% of the mortgage pool (31 December 2010: 6,971 accounts, 1.98%)
- At 31 December 2011 the number of properties in possession amounted to 230 (31 December 2010: 222 properties)

Collateral held against retail mortgage lending principally comprises residential properties

10(b) Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at different times.

The deemed loan to originator, the inter-company loans and the cash and cash equivalents are exposed to cashflow interest rate risk caused by floating interest rates that are reset periodically. The underlying mortgage pool comprises loans which are subject to variable rates of interest set by the servicer, loans which track the Bank of England Base Rate and loans which bear a fixed rate of interest. To mitigate the changes in interest rate that would result in the interest cashflows from the mortgage pools being insufficient to meet the payments on the inter-company loans, the Company entered into an interest rate swap with BOS to manage the Company's exposure to interest rate risk.

Under the terms of the swap, the Company pays the interest received from the mortgage pool and receives a LIBOR based rate for three-month Sterling deposits.

The interest rate swap substantially eliminates the sensitivity to movements in interest rates. The swap is not separately recognised in the financial statements as it forms part of the deemed loan to originator.

10(c) Liquidity risk

The Company's ability to meet payments on the inter-company loans and its other expenses as they fall due is dependent on the timely receipt of funds from the deemed loan to originator which may be delayed due to the level of repayment on the underlying mortgage portfolio (see 10(d) Prepayment risk below).

The Company will seek to accumulate funds from its share of the Trust property over a specified period as set out in the Programme Documentation in order to repay the inter-company loans to the Issuer in accordance with the expected maturity dates. If sufficient revenue funds are unavailable, the interest is capitalised.

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

10(c) Liquidity risk (continued)

If insufficient funds are received by the Company to repay the inter-company loans, these loans may not be paid in full and a part may be deferred to subsequent periods. Such deferred amounts will be due but not payable until funds are available in accordance with the relevant priority of payments as set out in the Programme Documentation.

Having met all necessary payments as prescribed in accordance with the priority of payments the Company returns any surplus cashflows to BOS.

The liquidity tables reflect the undiscounted cash payments which will fall due if the structure continues until the step-up date or step-down date as defined in the Programme Documentation (unless it is known that a Note will be repaid prior to this date and subsequently the inter-company loans when the earlier date will be used). The step-up or step-down date is the earliest date on which the Company could be required to repay the liability and commercially the most likely.

It is anticipated that the interest and principal received on the deemed loan to originator will be sufficient to allow repayment of the inter-company loans by the step-up or step-down date and thereby avoid the increase in the interest rate margin payable on the inter-company loans.

2011	Carrying Value	Contractual repayment value	<1 Month	1-3 Months	3 Months – 1 Year	1-5 Years	> 5 Years
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Principal							
Loans from Group companies	19,630,373	20,073,650	500,000	-	-	18,073,650	1,500,000
Trade and other payables	44	44	-	44	-	-	-
Interest payable							
Interest payable to Group companies	91,673	1,650,924	127,760	-	382,141	1,061,994	79,029
	<u>19,722,090</u>	<u>21,724,618</u>	<u>627,760</u>	<u>44</u>	<u>382,141</u>	<u>19,135,644</u>	<u>1,579,029</u>
2010	Carrying Value	Contractual repayment value	<1 Month	1-3 Months	3 Months – 1 Year	1-5 Years	> 5 Years
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Principal							
Loans from Group companies	15,073,061	15,117,965	-	-	-	12,625,901	2,492,064
Trade and other payables	34	34	-	-	34	-	-
Interest payable							
Interest payable to Group companies	56,499	926,228	59,227	-	175,751	647,001	44,249
	<u>15,129,594</u>	<u>16,044,227</u>	<u>59,227</u>	<u>-</u>	<u>175,785</u>	<u>13,272,902</u>	<u>2,536,313</u>

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

10(d) Prepayment risk

In the normal course of business a proportion of borrowers repay their loan in advance of the contractual maturity. As a result the weighted average life of the deemed loan to originator and of the Notes is likely to be significantly less than that implied by the contractual maturity dates of the mortgage pool.

Payments on the Notes and inter-company loans will only be made to the extent that sufficient cashflows have been received from the Company's assets.

The rate of prepayment of loans is influenced by a wide variety of economic, social and other factors, including prevailing mortgage market interest rates, the availability of alternative financing programmes, local and regional economic conditions and homeowner mobility. In the event that prepayment rates on the mortgage pool reduce, principal repayments on the deemed loan to originator and on the Notes may be spread over a longer period.

The Principal Prepayment Rate ("PPR") for the underlying mortgage pool as detailed within the Trustee Report is as follows:

	Monthly PPR %	1-month annualised %	3-month annualised %	12-month annualised %
31 December 2011	1.68	18.42	19.88	17.26
31 December 2010	1.47	16.30	15.98	15.20

10(e) Fair values

All assets and liabilities within the balance sheet are recognised on an amortised cost basis that is considered to be a close approximation to fair value.

11. RELATED PARTY TRANSACTIONS

A number of transactions are entered into with related parties as part of the Company's normal business.

The related parties are BOS, LBG, the Issuer and SFM by virtue of their various roles and inputs into securitisation arrangements to which the Company is a party.

BOS provides cash management services defined under the Programme Documentation in respect of the Issuer and the Company, which amounted to £4,288,000 in the year (2010: £3,815,000).

Corporate service expenses are borne by the Company in respect of the Issuer and the Company and are payable to SFM and amounted to £29,000 in the year (2010: £30,000).

PERMANENT FUNDING (NO 2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

11. RELATED PARTY TRANSACTIONS (CONTINUED)

Other transactions include a loan from the Issuer and a loan from BOS. BOS is also counterparty to an interest rate swap agreement.

During the year, the Company undertook the following transactions with companies within the LBG group:

	LBG and Subsidiary Undertakings	LBG and Subsidiary Undertakings
	2011 £'000	2010 £'000
Interest receivable and similar income		
Interest receivable on deemed loan to originator	346,333	230,114
Bank interest receivable	20,714	11,149
Interest payable and similar charges		
Interest on loans from Group companies	352,403	231,808
Operating expenses		
Fees payable to Group companies	35	-
Assets		
Cash and cash equivalents	2,192,840	3,073,033
Deemed loan to originator	17,530,731	12,057,663
Liabilities		
Loans from Group companies	19,678,212	15,117,964
Interest payable to Group companies	91,673	56,499
Trade and other payables		
Amounts due to Group undertakings	9	6

Permanent Holdings Limited holds one fully paid £1 ordinary share in Permanent Funding (No 2) Limited. This is the entire issued share capital of Permanent Funding (No 2) Limited.

PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)

12. FUTURE ACCOUNTING PRONOUNCEMENTS

The following pronouncements will be relevant to the Company but are not applicable for the year ending 31 December 2011 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Company.

Pronouncement	Nature of change	IASB effective date
IFRS 9 <i>Financial Instruments</i> ⁽¹⁾	Replaces those parts of IAS 39 <i>Financial Instruments Recognition and Measurement</i> relating to the classification, measurement and derecognition of financial assets and liabilities. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cashflow characteristics of the instrument. The available-for-sale financial asset and held-to-maturity investment categories in existing IAS 39 will be eliminated. The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39.	Annual periods beginning on or after 1 January 2015
IFRS 10 <i>Consolidated Financial Statements</i>	Supersedes IAS 27 <i>Consolidated and Separate Financial Statements</i> and SIC-12 <i>Consolidation – Special Purpose Entities</i> and establishes principles for the preparation of consolidated financial statements when an entity controls one or more entities.	Annual periods beginning on or after 1 January 2013
IFRS 12 <i>Disclosure of Interests in Other Entities</i>	Requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cashflows.	Annual periods beginning on or after 1 January 2013
IFRS 13 <i>Fair Value Measurement</i>	The standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. It applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements.	Annual periods beginning on or after 1 January 2013

At the date of this report, these pronouncements are awaiting EU endorsement.

⁽¹⁾ IFRS 9 is the initial stage of the project to replace IAS 39. Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39.

**PERMANENT FUNDING (NO.2) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

13. PARENT UNDERTAKING AND CONTROLLING PARTY

The Company is a wholly owned subsidiary of Permanent Holdings Limited, a company registered in England and Wales. The shares of Permanent Holdings Limited are held on a discretionary trust basis by SFM Corporate Services Limited.

The Company meets the definition of a special purpose entity under IFRSs. In accordance with the requirements of SIC 12 "Consolidation – Special Purpose Entities", the Company's financial statements are consolidated within the group financial statements of Lloyds Banking Group plc for the year ended 31 December 2011.

The company regarded by the directors as the ultimate controlling party under IFRSs at 31 December 2011 was Lloyds Banking Group plc, a limited liability company incorporated and domiciled in Scotland, which was also the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and in which the Company's financial statements are included. Bank of Scotland plc was the parent undertaking of the smallest such group of undertakings. Copies of the annual report and accounts of Lloyds Banking Group plc may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.