

HBOS UK LIMITED
REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2017



HBOS UK LIMITED

REPORT AND FINANCIAL STATEMENTS

For the year ended 31 December 2017

Registered in Scotland. No. SC261259

Registered office: The Mound, Edinburgh, EH1 1YZ.

DIRECTORS

S.J. Langan
R.D. Shrimpton

COMPANY SECRETARY

P. Gittins (Appointed 29 November 2017)
M.A.A. Johnson (Resigned 29 November 2017)

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HBOS UK LIMITED

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HBOS UK LIMITED
STRATEGIC REPORT

For the year ended 31 December 2017

The directors present their report and the audited financial statements of HBOS UK Limited (the "Company"), a private limited company incorporated in Scotland, for the year ended 31 December 2017.

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

The Company holds gilts as security against the Secured Unfunded Retirement Benefit Scheme ("SURBS") in the Company's immediate parent company, HBOS plc.

HBOS plc makes pension payments from the SURBS to employees on their retirement based on pre-agreed amounts, linked to inflation. The gilts held by the Company are also inflation linked and therefore are used as an effective long term tool for hedging the risk associated with the inflation linked pension liabilities.

The securities held by the Company comprise 2% "AAA" index linked gilts with a redemption date of January 2035. The gilts have a nominal value of £42,460,000 and were purchased in 2007, 2008 and 2011 at a total cost of £59,770,000. They were valued at a fair value of £115,168,504 as at 31 December 2017 (2016: £113,513,000).

The profit for the year of £2,837,634 (2016: £1,360,000) is set out in the Statement of Comprehensive Income on page 8.

No dividends were paid during the year (2016: £Nil) (note 12).

PRINCIPAL RISKS AND UNCERTAINTIES

From the perspective of the Company, the principal risks and uncertainties are integrated with the principal risks of Lloyds Banking Group plc and are not managed separately. Full disclosure of the Company's financial risk management objectives and policies are given in note 15 to the financial statements.

KEY PERFORMANCE INDICATORS ("KPIs")

Given the straightforward nature of the business, the Company's directors are of the opinion that analysis using key performance indicators is not necessary for an understanding of the development, performance or position of the business.

On behalf of the board



R.D. Shrimpton
DIRECTOR

Date: 7th of August 2018

HBOS UK LIMITED

DIRECTORS' REPORT

For the year ended 31 December 2017

GOING CONCERN

As at 31 December 2017 the Company's current liabilities exceeded its current assets by £74,925,000 (2016: £75,906,000). We note that the main current liability is group funding of £75,349,000 whilst the main asset is AFS bonds which are classified as non-current based on maturity.

The company has received commitment from the ultimate parent company, Lloyds Bank plc, of its ongoing support and funding to meet its obligations when they fall due covering HBOS plc and its subsidiaries. Moreover, the non-current assets held are liquid AFS government bonds which can be sold at any time, and are of greater value than the current liability amounts owed to the intermediate parent company.

After considering the above, the Directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

DIRECTORS' INDEMNITIES

Lloyds Banking Group plc has granted to the Directors of the Company a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds were in force during the whole of the financial year and at the date of approval of the financial statements. The indemnities remain in force for the duration of a Director's period of office. The deeds indemnify the Directors to the maximum extent permitted by law. Deeds for existing Directors are available for inspection at the registered office of Lloyds Banking Group plc. In addition, the Group has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the strategic report, 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 year. 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 IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They 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.

HBOS UK LIMITED

DIRECTORS' REPORT (CONTINUED)

For the year ended 31 December 2017

Each of the directors, whose names are listed on page 1, confirms that, to the best of their knowledge:

- the financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and
- the directors' report contained above includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

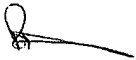
INDEPENDENT AUDITORS AND AUDIT INFORMATION

Each director in office at the date of this report confirms that, so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself 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.

PricewaterhouseCoopers LLP are deemed to be re-appointed as auditors under section 487(2) of the Companies Act 2006.

On behalf of the board



R.D. Shrimpton

DIRECTOR

Date: 7th of August 2018

Company incorporated in Scotland, Company No. SC261259

Independent auditors' report to the members of HBOS UK Limited

Report on the financial statements

Our opinion

In our opinion, HBOS UK Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2017; the statement of comprehensive income; the cash flow statement; the statement of changes in equity for the year then ended 31 December 2017; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Independent auditors' report to the members of HBOS UK Limited (continued)

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on pages 5 and 6, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

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.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.



Jonathan Hinchliffe (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
7 August 2018

HBOS UK LIMITED

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2017

	Note	2017 £'000	2016 £'000
Interest and similar income	3	3,224	1,780
Interest and similar expense	3	<u>(260)</u>	<u>(400)</u>
Net interest income	3	2,964	1,380
Other income	4	35	175
Other expenses	5	<u>(21)</u>	<u>(19)</u>
Profit before taxation		2,978	1,536
Taxation	6	<u>(140)</u>	<u>(176)</u>
Profit for the year		<u>2,838</u>	<u>1,360</u>
Other comprehensive (expense)/income			
Movements in available-for-sale financial assets, net of tax:			
- change in fair value		<u>(201)</u>	<u>14,006</u>
Total comprehensive income for the year		<u>2,637</u>	<u>15,366</u>

The accompanying notes on pages 12 to 22 form an integral part of the financial statements.

HBOS UK LIMITED**BALANCE SHEET**

As at 31 December 2017

	Note	2017 £'000	2016 £'000
Assets			
Non-current assets			
Available-for-sale financial assets	7	<u>115,169</u>	<u>113,513</u>
Total non-current assets		<u>115,169</u>	<u>113,513</u>
Current assets			
Amounts owed by other group company	8	-	1,751
Other current assets	9	<u>574</u>	<u>555</u>
Total current assets		<u>574</u>	<u>2,306</u>
Total assets		<u>115,743</u>	<u>115,819</u>
Liabilities			
Current liabilities			
Amounts owed to immediate parent company	8	75,349	74,514
Other current liabilities	10	58	56
Current tax payable	11	92	3,642
Total liabilities		<u>75,499</u>	<u>78,212</u>
Equity			
Share capital	12	50	50
Other reserves	13	34,746	34,947
Retained earnings		<u>5,448</u>	<u>2,610</u>
Total equity		<u>40,244</u>	<u>37,607</u>
Total liabilities and equity		<u>115,743</u>	<u>115,819</u>

The directors approved the financial statements on pages 8 to 22 on 7th of August 2018.



R.D. Shrimpton
DIRECTOR

The accompanying notes on pages 12 to 22 form an integral part of the financial statements.

HBOS UK LIMITED

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

	Share capital £'000	Other reserves £'000	Retained earnings £'000	Total Equity £'000
Balance at 1 January 2016	50	20,941	1,250	22,241
Movement in available-for-sale financial assets, net of taxation	-	14,006	-	14,006
Profit for the year	-	-	1,360	1,360
Balance at 31 December 2016	50	34,947	2,610	37,607
Movement in available-for-sale financial assets, net of taxation	-	(201)	-	(201)
Profit for the year	-	-	2,838	2,838
Balance at 31 December 2017	<u>50</u>	<u>34,746</u>	<u>5,448</u>	<u>40,244</u>

The accompanying notes on pages 12 to 22 form an integral part of the financial statements.

HBOS UK LIMITED

CASH FLOW STATEMENT

For the year ended 31 December 2017

	Note	2017 £'000	2016 £'000
Cash flows from operating activities			
Profit before taxation		2,978	1,536
Adjustment for:			
Interest income	3	(3,224)	(1,780)
Interest expense	3	260	400
Operating profit before working capital changes		14	156
Increase in other debtors		-	-
Tax paid		(3,643)	(2,423)
Group relief received		-	-
Net cash used in operating activities		<u>(3,629)</u>	<u>(2,267)</u>
Cash flows from investing activities			
Interest received		1,300	1,287
Repaid by other group company	8	1,751	1,404
Net cash generated from investing activities		<u>3,051</u>	<u>2,691</u>
Cash flows from financing activities			
Received from immediate parent company	8	835	-
Interest paid		(257)	(424)
Dividends paid	12	-	-
Net cash generated from/(used in) financing activities		<u>578</u>	<u>(424)</u>
Net change in cash and cash equivalents		-	-
Cash and cash equivalents at beginning of the year		-	-
Cash and cash equivalents at end of the year		<u>-</u>	<u>-</u>

The accompanying notes on pages 12 to 22 form an integral part of the financial statements.

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

1. ACCOUNTING POLICIES

BASIS OF PREPARATION

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been applied consistently for each of the periods presented, unless otherwise stated. The financial statements have been prepared on a going concern basis under the historical cost convention modified by revaluation of financial assets and financial liabilities held at fair value, in compliance with the requirements of the Companies Act 2006 and in accordance with the applicable International Financial Reporting Standards ("IFRS") and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union.

The preparation of the financial statements necessarily requires the exercise of judgment both in the application of accounting policies which are set out in the sections below and in the selection of assumptions used in the calculation of estimates. These estimates and judgments are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. Actual results may differ from these estimates.

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.

(a) Revenue recognition

Interest income and expense are recognised in the Statement of Comprehensive Income for all interest-bearing financial instruments, 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 relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument to the net carrying amount of the financial asset or financial liability. The calculation includes all amounts paid or received by the Company that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Fees and commissions, which are not an integral part of the effective interest rate, are generally recognised when the service has been provided.

(b) Income taxes, including deferred income taxes

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or another tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are re-measured as required to reflect current information.

(c) Cash and cash equivalents

Cash and cash equivalents comprises cash on hand and demand deposits as well as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(d) Available-for-sale financial assets

The Company assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial asset is impaired. This assessment involves reviewing the current financial circumstances and future prospects of the issuer and assessing the future cash flows expected to be realised.

If an impairment loss has been incurred, the cumulative loss, measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value less any impairment loss on the asset previously recognised, is reclassified from equity to the income statement. If in a subsequent period, the fair value of a debt instrument classified as Available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, an amount not greater than the original impairment loss is credited to the income statement; any excess is taken to the statement of comprehensive income.

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

1. ACCOUNTING POLICIES (CONTINUED)

(e) Impairment

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 a financial asset has become impaired. If there is objective evidence that an impairment loss has been incurred, a provision is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate.

(f) Borrowings

Borrowings are stated at amortised cost using the effective interest method and are classified as financial liabilities. The coupon paid on these instruments is recognised in the Statement of Comprehensive Income as interest expense.

(g) Going concern

As at 31 December 2017 the Company's current liabilities exceeded its current assets by £74,925,000 (2016: £75,906,000). We note that the main current liability is a group funding of £75,349,000 while the main asset is AFS bonds which are classified as non-current based on maturity.

The company has received commitment from the parent company, HBOS plc of its ongoing support and funding to meets its obligations when they fall due. Moreover, the non-current assets held are liquid AFS government bonds which can be sold at any time, and are of greater value than the current liability amounts owed to the intermediate parent company.

After considering the above, the Directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The Company makes assumptions and estimates that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The accounting policies deemed critical to the Company's results and financial position, based upon materiality and significant judgements and estimates, are discussed below.

Impairment of available-for-sale debt securities

The Company determines that available-for-sale debt securities are impaired when the present value of the estimated future cash flows do not exceed their recoverable amount. Estimating the future cash flows requires a degree of judgement and may depend to a large extent on the selection of key assumptions about the future use.

3. NET INTEREST INCOME

	2017 £'000	2016 £'000
<i>Interest and similar Income</i>		
Amounts owed by other group company (note 8)	8	18
Available-for-sale investments	<u>3,216</u>	<u>1,762</u>
	<u>3,224</u>	<u>1,780</u>
<i>Interest and similar Expense</i>		
Amounts owed to immediate parent company (note 8)	<u>(260)</u>	<u>(400)</u>
	<u>(260)</u>	<u>(400)</u>
Net interest income	<u>2,964</u>	<u>1,380</u>

Statutory audit fees for the current year of £5,000 (2016: £5,000) were borne by Lloyds Bank plc. The number of persons employed by the Company during the year was nil (2016: nil).

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

4. OTHER INCOME

	2017	2016
	£'000	£'000
UK Pension Annual fees	35	35
UK Pension Annual fees – Prior Periods	-	140
	<u>35</u>	<u>175</u>

5. OTHER EXPENSES

	2017	2016
	£'000	£'000
Custodian Fees	(21)	(19)
	<u>(21)</u>	<u>(19)</u>

6. TAXATION

(a) Analysis of charge for the year

	2017	2016
	£'000	£'000
UK Corporation tax - current year	(140)	(141)
UK Corporation tax - prior year adjustment	-	(35)
Total taxation charge for the year	<u>(140)</u>	<u>(176)</u>

The tax charge on the Company's profit for the year is based on a UK corporation tax rate 19.25% (2016: 20.00%).

(b) Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to profit before tax to the tax charge for the year is given below:

	2017	2016
	£'000	£'000
Profit before taxation	<u>2,978</u>	<u>1,536</u>
Tax charge thereon at UK corporation tax rate of 19.25% (2016: 20.00%)	(573)	(307)
Factors affecting charges:		
Non-taxable items	433	166
Prior year adjustment	-	(35)
Total taxation charge	<u>(140)</u>	<u>(176)</u>
Effective rate	<u>4.70%</u>	<u>11.46%</u>

The Finance (No. 2) Act 2015 which was substantively enacted on 26 October 2015 reduced the main rate of corporation tax to 19% with effect from 1 April 2017 and 18% with effect from 1 April 2020.

The Finance Act 2016, which was substantively enacted on 6 September 2016, further reduced the corporate tax rate to 17% with effect from 1 April 2020.

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

7. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2017 £'000	2016 £'000
Available-for-sale financial assets:		
Index linked gilts	<u>115,169</u>	<u>113,513</u>
	<u>115,169</u>	<u>113,513</u>
	2017 £'000	2016 £'000
At beginning of the year	113,513	95,518
Change in fair value recognised directly in equity (note 13)	(249)	17,508
Change in fair value recognised in Statement of Comprehensive Income	<u>1,905</u>	<u>487</u>
At end of the year	<u>115,169</u>	<u>113,513</u>

A total nominal value of £42,460,000 'AAA' rated 2% Index Linked Treasury Stock 2035 were acquired at a cost of £59,770,000 in 2007, 2008 and 2011. These gilts are held as security against the SURBS in the Company's immediate parent company.

At 31 December 2017, £115,168,504 (2016: £113,513,000) of Available-for-sale financial assets had a contractual residual maturity of greater than one year.

8. RELATED PARTY TRANSACTIONS

The Company's immediate parent company is HBOS plc. The Company regarded by the directors as the ultimate parent company is Lloyds Banking Group plc, which is the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the Company is a member. HBOS plc is the parent undertaking of the smallest such group of undertakings. Copies of the group financial statements of HBOS plc and Lloyds Banking Group plc may be obtained from the Company secretary's office, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN. The Company's related parties include its ultimate parent company, fellow subsidiaries and pension schemes of the Company's ultimate parent company and the Company's key management personnel. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, which is determined to be the Company's directors.

Transactions with key management personnel

There were no transactions between the Company or its subsidiaries with key management personnel during the current year. Key management personnel and directors are employed by other companies in the Lloyds Banking Group and consider that their services to the Company are incidental to their other activities in the Group. The directors' emolument for 2017 was therefore Nil (2016: Nil).

Amounts owed by other group company

	2017 £'000	2016 £'000
At the beginning of the year	1,751	3,155
Advances during the year	-	-
Repayments during the year	<u>(1,751)</u>	<u>(1,404)</u>
At end of the year	<u>-</u>	<u>1,751</u>
Represented by:		
Non-current	-	-
Current	<u>-</u>	<u>1,751</u>
Representing:		
Bank of Scotland plc	<u>-</u>	<u>1,751</u>
Interest Income earned (note 3)	<u>8</u>	<u>18</u>
Interest Income receivable (note 9)	<u>-</u>	<u>1</u>

The amount owed by Bank of Scotland plc was repaid in 2017 as a result of tax paid.

HBOS UK LIMITED**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

For the year ended 31 December 2017

8. RELATED PARTY TRANSACTIONS (CONTINUED)*Amount owed to immediate parent company*

	2017 £'000	2016 £'000
At beginning of the year	74,514	74,514
Advanced during the year	835	-
Repayment during the year	-	-
At end of the year	<u>75,349</u>	<u>74,514</u>
Represented by:		
Non-current	-	-
Current	<u>75,349</u>	<u>74,514</u>
Representing:		
HBOS plc	<u>75,349</u>	<u>74,514</u>
Interest charge during the year (note 3)	<u>260</u>	<u>400</u>
Interest payable (note 10)	<u>58</u>	<u>55</u>

The amount owed to HBOS plc is a floating rate instrument, reset at three month intervals. The fair value of the deposit at 31 December 2017 is approximately equal to its book value. The deposit is repayable on demand with maturity date of 26 January 2035.

9. OTHER CURRENT ASSETS

	2017 £'000	2016 £'000
Interest receivable on amounts owed by other group company (note 8)	-	1
Interest receivable on available-for-sale investments	<u>574</u>	<u>554</u>
	<u>574</u>	<u>555</u>

10. OTHER CURRENT LIABILITIES

	2017 £'000	2016 £'000
Interest payable to amounts owed to immediate parent company (note 8)	<u>58</u>	<u>56</u>
	<u>58</u>	<u>56</u>

11. CURRENT TAX PAYABLE

	2017 £'000	2016 £'000
Corporation tax payable	<u>92</u>	<u>3,642</u>
	<u>92</u>	<u>3,642</u>

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

12. SHARE CAPITAL

	31 December 2017 £'000	31 December 2016 £'000
50,000 ordinary shares of £1 each	<u>50</u>	<u>50</u>
	2017 Number of shares	2016 Number of shares
	£	£
Issued and fully paid:		
At the beginning and end of the year	<u>50,000</u>	<u>50,000</u>

HBOS plc holds 49,999 of the shares of the Company and is deemed to be the immediate parent company. The remaining share is held by Bank of Scotland Edinburgh Nominees Limited. All ordinary shares rank pari passu in all respects including the right to receive all dividends and other distributions hereafter declared, made or paid on the ordinary share capital of the Company.

No dividends were paid during the year (2016: £Nil).

13. OTHER RESERVES

Available-for-sale reserves

	2017 £'000	2016 £'000
At beginning of the year	34,947	20,941
Changes in fair value of available-for-sale assets (note 7)	(249)	17,508
Tax charge in Statement of Changes in Equity	<u>48</u>	<u>(3,502)</u>
At end of the year - net of tax	<u>34,746</u>	<u>34,947</u>

14. CONTINGENT LIABILITIES AND COMMITMENTS

Tax authorities

The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law which might lead to additional tax. The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Group that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities for the company of approximately £698,000 (including interest). The Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

15. FINANCIAL RISK MANAGEMENT

The Company uses financial instruments to meet the financial needs of its counterparties and to reduce its own exposure to fluctuations in interest rates.

(a) Interest Rate Risk

Interest rate risk arises from the mismatch between interest rate sensitive liabilities and interest rate sensitive assets. From the perspective of the Company, the interest rate risks are integrated with the interest rate risks of the group and are not managed separately. The scenarios are run only for assets and liabilities that represent the major interest-bearing positions. Based on the simulations performed, the full year impact on post-tax profit of a 0.25% increase / decrease would be a

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Interest Rate Risk (continued)

maximum decrease / increase of approximately £66,395 (2016: £61,000).

The table below summarises the repricing mismatches of the Company's non-trading assets and liabilities. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. Expected repricing and maturity dates do not differ significantly from the contract dates.

As at 31 December 2017	1 month or less £'000	3 months or less but over 1 month £'000	1 year or less but over 3 months £'000	5 years or less but over 1 year £'000	Over 5 years £'000	Non- interest bearing £'000	Total £'000
<i>Assets:</i>							
Non-current assets							
Available-for-sale financial assets	115,169	-	-	-	-	-	115,169
Current assets							
Amounts owed by other group company	-	-	-	-	-	-	-
Other current assets	-	-	-	-	-	574	574
Total Assets	115,169	-	-	-	-	574	115,743

<i>Liabilities:</i>							
Current liabilities:							
Amounts owed to immediate parent company	75,349	-	-	-	-	-	75,349
Current tax payable	-	-	-	-	-	92	92
Other current liabilities	-	-	-	-	-	58	58
Total Liabilities	75,349	-	-	-	-	150	75,499
Total interest sensitivity gap	39,820	-	-	-	-	424	40,244

As at 31 December 2016	1 month or less £'000	3 months or less but over 1 month £'000	1 year or less but over 3 months £'000	5 years or less but over 1 year £'000	Over 5 years £'000	Non- interest bearing £'000	Total £'000
<i>Assets:</i>							
Non-current assets							
Available-for-sale financial assets	113,513	-	-	-	-	-	113,513
Current assets							
Amounts owed by other group company	1,751	-	-	-	-	-	1,751
Other current assets	-	-	-	-	-	555	555
Total Assets	115,264	-	-	-	-	555	115,819

<i>Liabilities:</i>							
Current liabilities:							
Amounts owed to immediate parent company	74,514	-	-	-	-	-	74,514
Other current liabilities	-	-	-	-	-	56	56
Current tax payable	-	-	-	-	-	3,642	3,642
Total Liabilities	74,514	-	-	-	-	3,698	78,212
Total interest sensitivity gap	40,750	-	-	-	-	(3,143)	37,607

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Fair Value of Financial Assets and Liabilities

Financial instruments include financial assets and financial liabilities. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Wherever possible, fair values have been estimated using quoted market prices for instruments held. Where market prices are not available, fair values have been estimated using quoted values for instruments with either identical or similar characteristics. In certain cases, where no ready markets currently exist, various techniques (such as discounted cash flows or observations of similar recent market transactions) have been developed to estimate what the approximate fair value of such instruments might be. These estimation techniques are necessarily subjective in nature and involve several assumptions.

The accounting policies in note 1 describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

As at 31 December 2017	Available- for-sale £'000	Held at amortised cost £'000	Total £'000
<i>Assets:</i>			
Available-for-sale financial assets	115,169	-	115,169
Amounts owed by other group company	-	-	-
Other current assets	-	574	574
Total financial assets	<u>115,169</u>	<u>574</u>	<u>115,743</u>
<i>Liabilities:</i>			
Amounts owed to immediate parent companies	-	75,349	75,349
Other current liabilities	-	58	58
Total financial liabilities	<u>-</u>	<u>75,407</u>	<u>75,407</u>
As at 31 December 2016	Available- for-sale £'000	Held at amortised cost £'000	Total £'000
<i>Assets:</i>			
Available-for-sale financial assets	113,513	-	113,513
Amounts owed by other group company	-	1,751	1,751
Other current assets	-	555	555
Total financial assets	<u>113,513</u>	<u>2,306</u>	<u>115,819</u>
<i>Liabilities:</i>			
Amounts owed to immediate parent company	-	74,514	74,514
Other current liabilities	-	56	56
Total financial liabilities	<u>-</u>	<u>74,570</u>	<u>74,570</u>

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Credit Risk

The maximum credit risk exposure of the Company in the event of other parties failing to perform their obligations is detailed below. The maximum exposure to loss is considered to be the balance sheet carrying amount as at the year end.

	2017 £'000	2016 £'000
Available-for-sale financial assets	115,169	113,513
Amounts owed by other group company	-	1,751
Other current assets	574	555
Total credit risk exposure	<u>115,743</u>	<u>115,819</u>

The current rating of Lloyds Bank Plc is A3 (2016: A1) as per Moody's.

The current rating of the available-for-sale index linked gilt assets are Aa2 (2016: Aa1) as per Moody's.

None of the above assets are past due or impaired.

(d) Liquidity Risk

All liabilities of the Company would be classified as on demand on an undiscounted future cash flows basis according to contractual maturity.

(e) Capital Risk Management

The Company's objectives when managing capital are to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

(f) Fair value estimation

The fair value of available-for-sale debt securities is based on quoted market prices or broker/dealer valuations. Where this is not available, the fair value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics or similar valuation models.

Level 1 portfolios

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise treasury bills and other government securities.

Level 2 portfolios

Level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where techniques use inputs that are based significantly on observable market data, the instrument is considered to be level 2. Examples of such instruments include most over the counter derivatives financial institution issued securities, certificates of deposits and certain asset backed securities. There are no level 2 assets at the balance sheet date.

Level 3 portfolios

Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments could include venture capital and unlisted equity investments which are valued using various valuation techniques that require significant management judgement in determining appropriate assumptions, including earnings multiples and estimated future cash flows. There are no level 3 assets at the balance sheet date.

HBOS UK LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

(g) Fair value estimation (continued)

Valuation Hierarchy

At 31 December 2017	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Available-for-sale assets	<u>115,169</u>	<u>-</u>	<u>-</u>	<u>115,169</u>
At 31 December 2016	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Available-for-sale assets	<u>113,513</u>	<u>-</u>	<u>-</u>	<u>113,513</u>

The valuation of financial instruments has been classified into three levels according to the quality and reliability of information used to determine the fair values.

16. FUTURE ACCOUNTING DEVELOPMENTS

The following pronouncements may have a significant effect on the Company's financial statements but are not applicable for the year ending 31 December 2017 and have not been applied in preparing these financial statements. Save as disclosed below, the full impact of these accounting changes is being assessed by the Company

<u>Pronouncement</u>	<u>Nature of change</u>	<u>IASB effective date</u>
IFRS 9 'Financial instruments'	<p>Replaces IAS 39 <i>Financial Instruments: Recognition and Measurement</i>.</p> <p>IFRS 9 requires financial assets to be classified into three measurement categories, fair value through profit and loss, fair value through other comprehensive income and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to the entity's own credit risk is recorded in other comprehensive income.</p> <p>IFRS 9 also replaces the existing IAS 39 'incurred loss' impairment approach with an expected credit loss approach. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope. Those changes may result in an increase in the Company's balance sheet provisions for credit losses depending upon the composition of the Company's amortised cost financial assets, as well as the general economic conditions and the future outlook.</p>	Annual periods beginning on or after 1 January 2018

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2017

16. FUTURE ACCOUNTING DEVELOPMENTS (CONTINUED)

<u>Pronouncement</u>	<u>Nature of change</u>	<u>IASB effective date</u>
IFRS 9 'Financial instruments' (Continued)	<p>The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. There is an option to retain the existing IAS 39 hedge accounting requirements until the IASB completes its project on macro hedging</p> <p>The Company has conducted an analysis of these changes and does not consider there to be any significant impact of applying IFRS 9. The Company has chosen 1 January 2018 as its initial application date of IFRS9 and will not restate comparative periods.</p>	Annual periods beginning on or after 1 January 2018
IFRS 15 <i>Revenue from Contracts with Customers</i>	Replaces IAS 18 Revenue and IAS 11 Construction Contracts. IFRS 15 establishes principles for reporting useful information about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised at an amount that reflects the consideration to which the entity expects to be entitled in exchange for goods and services. Financial instruments, leases and insurance contracts are out of scope and so this standard does not have a significant impact on the Company	Annual periods beginning on or after 1 January 2018

17. EVENTS AFTER BALANCE SHEET DATE

There are no events after the Balance Sheet that the directors are aware of and require to bring to the attention of the users of financial statements.