ENGLISH

CLERICAL MEDICAL FINANCE PLC

ANNUAL REPORT

AND

FINANCIAL STATEMENTS

31 DECEMBER 2016

Member of Lloyds Banking Group plc

CONTENTS

COMPANY INFORMATION

Board of Directors

A M Parsons
S Lowther
M E Williams

Secretary

A D Yuille

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
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Bristol
BS2 0FR

Registered Office

33 Old Broad Street
London
EC2N 1HZ

Company Number

03850542

STRATEGIC REPORT

The directors present their strategic report on Clerical Medical Finance Plc ("the Company") for the year ended 31 December 2016.

As part of the Lloyds Banking Group ("LBG") Insurance Division strategy the Company provides finance to Scottish Widows Limited ("SWL"), formerly Clerical Medical Insurance Group Ltd, a life insurance company within the LBG. Listed subordinated debt raised by the Company is used to fund SWL's insurance and savings business. The funds loaned to SWL are on similar interest and repayment terms as those applied to the listed subordinated debt raised by the Company such that the Company returns a non significant pre tax profit.

Result for the year

The result of the Company for the year ended 31 December 2016 is a profit for the financial year of £91k (2015: profit of £193k), and this has been transferred to reserves.

The carrying value of the subordinated assets at the year end was £48.4m (2015: £48.4m). Interest income receivable on the subordinated assets as a percentage of the average subordinated asset in the year was 8.0% (2015: 4.96%).

The carrying value of the subordinated liabilities at the year end was £50.6m (2015: £50.5m). The interest expense payable on the subordinated liabilities as a percentage of the average subordinated liabilities in the year was 7.4% (2015: 4.97%).

Britain leaving the EU

The Company is part of the wider Lloyds Banking Group, and, at that level, consideration of many of the potential implications following the UK's vote to leave the European Union has been undertaken. Work continues to assess the impact of the EU exit at the level of the LBG, as well as for the Company and Group, upon customers, colleagues and products. This assessment includes all legal, regulatory, tax, finance and capital implications.

Key performance indicators

The Directors are of the opinion that the information presented in the financial statements provides the management information, necessary for the Directors to understand the development, performance and position of the business of the Company. The Company also forms part of the Insurance Division of LBG. The development, performance and position of this Division are discussed in LBG's annual report, which does not form part of this report.

Liquidity

The Company is dependent on the liquidity of SWL. SWL regularly monitors its liquidity position to ensure that, even under stressed conditions, it has sufficient liquidity to meet its obligations and remain within the approved risk appetite.

STRATEGIC REPORT (continued)

Review of the business

Litigation in Germany in relation to SWL branch business

The German industry-wide issue regarding notification of contractual 'cooling off' periods has continued to lead to an increasing number of claims in 2016. Accordingly, a provision increase of £94m has been recognised in the year giving a total provision of £639m (2015: £545m); the remaining unutilised provision as at 31 December 2016 is £168m (31 December 2015: £124m).

The validity of the claims facing the SWL depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved.

This ongoing matter has not resulted in any impact in these financial statements. The matter affects SWL and is included for reference here due to the loans receivable from SWL, see note 16.

Future outlook

The Directors consider that the Company's principal activities will continue unchanged in the foreseeable future.

Principal risks and uncertainties

The management of the business and the execution of the Company's strategy are subject to a number of risks. The financial risk management objectives and policies of the company and the exposure to market, credit, financial soundness and operational risks are set out in note 15.

In addition, the Company is also exposed to financial reporting risk, in particular the risk of reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial reporting and financial reporting fraud. The financial and risk management objectives and policies of the company in respect of financial reporting risk are also set out in note 15.

On behalf of the Board of Directors

S Lowther
Director
23 March 2017

DIRECTORS' REPORT

Principal activities and review of the business

The Directors present the audited financial statements of the Company. The Company is a limited liability Company domiciled and incorporated in the United Kingdom.

The Company is a subsidiary of HBOS Financial Services Limited. The company's ultimate parent company and ultimate controlling party is LBG.

The Company's principal activity is to act as a finance company for SWL a fellow subsidiary of LBG. Listed subordinated debt raised by the Company is loaned to SWL on similar interest and repayment terms as those applied to the listed subordinated debt raised by the Company.

Results and dividend

The result of the Company for the year ended 31 December 2016 is a profit for the financial year of £91k (2015: profit of £193k). No interim dividend was paid during the year (2015: £nil). The Directors do not recommend the payment of a final dividend (2015: £nil). Further information on the results of the Company is provided in the Strategic Report.

Post balance sheet events

No significant post balance sheet events have been identified affecting the Company's financial statements.

Directors

The directors of the company who were in office during the year and up to the date of signing the financial statements were:

A M Parsons
JE Clatworthy (resigned 29 February 2016)
J M Black (resigned 25 June 2016)
M E Williams (appointed 10 March 2016)
S Lowther (appointed 24 June 2016)

Particulars of the Directors' emoluments are set out in note 16.

Directors' indemnities

LBG 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 deed was in force during the whole of the financial year and at the date of approval of the financial statements. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service. The indemnity remains in force for the duration of a Director's period of office. The deed indemnifies the Directors to the maximum extent permitted by law. The Deed for existing Directors is available for inspection at the registered office of LBG. In addition, LBG has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

Corporate governance statement

In accordance with the Financial Conduct Authority's Disclosure and Transparency Rule ("DTR") 7.2.1, the disclosures required by DTR 7.2.5R are within note 15 to the financial statements and are therefore incorporated into this report by reference.

Disclosure of information to auditors

Each person who is a Director at the date of approval 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 ought to have taken as a Director to make himself 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 the Companies Act 2006.

Future developments

Details of future outlook are detailed in the Strategic Report. Details of future developments are detailed in note 18.

Political contributions

During the year, the Company made no political contributions (2015: £nil).

DIRECTORS' REPORT (continued)

Financial risk management

Disclosures relating to financial risk management are included in note 15 to the financial statements and are therefore incorporated into this report by reference.

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation. 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 the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- 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;
- make judgements and accounting estimates that are reasonable and prudent; and
- 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.

The directors 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.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names are listed on page 3, confirms that, to the best of their knowledge:

- the Company financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and

- the Strategic Report on pages 4 to 5 and the Directors' Report on pages 6 to 7 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.

On behalf of the Board of Directors

S Lowther
Director
23 March 2017

Independent auditors' report to the members of Clerical Medical Finance Plc

Report on the financial statements

Our opinion

In our opinion, Clerical Medical Finance Plc's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2016 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.

What we have audited

The financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), comprise:

- the Balance Sheet as at 31 December 2016;
- the Statement of Comprehensive Income for the year then ended;
- the Statement of Cash Flows for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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, 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.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities , 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) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Independent auditors' report to the members of Clerical Medical Finance Plc (continued)

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.

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). 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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

Joanne Leeson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol
23 March 2017

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 £ 000	2015 £ 000
Revenue			
Interest income	2	3,881	9,622
Other income	3	5	224
Total revenue		**3,886**	**9,846**
Expenses			
Finance costs	4	3,738	9,435
Other expenses	5	34	245
Total expense		**3,772**	**9,680**
Profit before tax		**114**	**166**
Taxation (charge)/credit	7	(23)	27
Profit for the financial year		**91**	**193**

There are no items of comprehensive income which have not already been presented in arriving at the profit for the year. Accordingly, the profit for the financial year is the same as total comprehensive income for the year.

The notes set out on pages 14 to 28 are an integral part of these financial statements.

BALANCE SHEET AS AT 31 DECEMBER 2016

	Note	2016 £ 000	2015 £ 000
ASSETS			
Financial assets:			
Loans and receivables	8	48,355	48,350
Other receivables	9	3,195	3,066
Cash and cash equivalents	10	4,888	4,899
Total assets		**56,438**	**56,315**
EQUITY AND LIABILITIES			
Capital and reserves attributable to Company's equity shareholder			
Share capital	11	225	225
Retained earnings		5,036	4,945
Total equity		**5,261**	**5,170**
Liabilities			
Financial liabilities:			
Subordinated liabilities	12	50,583	50,548
Other financial liabilities	13	571	563
Current tax liabilities	14	23	34
Total liabilities		**51,177**	**51,145**
Total equity and liabilities		**56,438**	**56,315**

The notes set out on pages 14 to 28 are an integral part of these financial statements.

The financial statements on pages 10 to 28 were approved by the Board of Directors on 23 March 2017 and signed on its behalf by:

Sean Lowther

S Lowther
Director

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 £ 000	2015 £ 000
Cashflow from operating activities			
Profit before tax		114	166
Adjusted for:			
Amortisation of finance costs on subordinated debt	5	34	21
Amounts received on redemption of sub debt from SWL		-	287,766
Movement in loans receivable	8	(5)	-
Movement in subordinated debt	12	1	-
Movement in other receivables	9	(129)	6,507
Movement in other liabilities	13	8	(6,650)
Taxation (paid)/ received		(34)	137
Net cash (outflow)/ inflow from operating activities		**(11)**	**287,947**
Cashflow from financing activities			
Redemption of subordinated debt		-	(287,766)
Net cash outflow from financing activities		**-**	**(287,766)**
Net (decrease)/increase in cash and cash equivalents		(11)	181
Cash and cash equivalents at the beginning of the year		4,899	4,718
Net cash and cash equivalents at the end of the year	10	**4,888**	**4,899**

The notes set out on pages 14 to 28 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

	Share capital £ 000	Retained earnings £ 000	Total equity £ 000
Balance as at 1 January 2015	**225**	**4,752**	**4,977**
Profit and total comprehensive income for the year	-	193	193
Balance as at 31 December 2015	**225**	**4,945**	**5,170**
Profit and total comprehensive income for the year	-	91	91
Balance as at 31 December 2016	**225**	**5,036**	**5,261**

The notes set out on pages 14 to 28 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

1. Accounting policies

The accounting policies adopted in the preparation of the financial statements, which have been consistently applied to all years presented in these financial statements unless stated otherwise, are set out below.

(a) Basis of preparation

The financial statements of the Company have been prepared:

(1) in accordance with the International Accounting Standards ("IASs") and International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board and the Standards and Interpretations ("SICs") and International Financial Reporting Interpretations ("IFRS ICs") issued by its International Financial Reporting Interpretations Committee, as endorsed by the European Union;

(2) in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRSs; and

(3) under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities at fair value through profit or loss as set out in the relevant accounting policies.

The Directors are satisfied that the Company has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements of the Company have been prepared on a going concern basis.

In accordance with IAS 1 "Presentation of Financial Statements", assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity. Analysis of the assets and liabilities of the Company into amounts expected to be received or settled within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in the notes.

Standards and interpretations effective in 2016

The Company has not adopted any new standards, amendments to standards and interpretations of published standards which became effective for financial years beginning on or after 1 January 2016, which have had a material impact on the Company.

Details of standards and interpretations in issue but which have not been adopted early are set out at note 18.

(b) Foreign currency translation

The financial statements are presented in sterling which is the Company's functional and presentation currency.

Foreign currency transactions are translated into sterling at the exchange rate prevailing at the date of the transaction.

Exchange gains and losses are recognised in the statement of comprehensive income as incurred, within other income or other expenses.

(c) Interest income

Interest income consists of interest receivable on subordinated assets. Interest income is recognised in the statement of comprehensive income as it accrues, using the effective interest method.

(d) Finance costs

Interest expense for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within finance costs, using the effective interest method.

(e) Dividends payable

Dividends payable on ordinary shares are recognised in equity in the year in which they are approved.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

1. Accounting policies (continued)

(f) Financial assets and financial liabilities

Management determines the classification of its financial assets and financial liabilities at initial recognition. Management's policies for the recognition of specific financial assets and financial liabilities, as identified on the balance sheet, are set out under the relevant accounting policies.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Company has transferred substantially all of the risks and rewards of ownership. Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

All financial assets and financial liabilities are designated at amortised cost (as described in note 1(g) and 1(m) below) with the exception of accrued interest on loans which is recognised using the effective interest rate method and other amount receivable from related party which is stated at fair value. The classification depends on the purpose for which the financial assets and financial liabilities were acquired.

No assets are classified as held-to-maturity, available-for-sale or for trading; no liabilities are classified as held for trading.

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

(g) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that are not designated as fair value through profit or loss at initial recognition.

Loans and receivables are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment, with the exception of accrued interest, which is accounted for at fair value, reflecting the amounts receivable at the year end.

A charge for impairment in respect of loans and receivables would be made in the statement of comprehensive income when there is objective evidence that the Company will not be able to collect all amounts due according to their original terms. The impairment charge would be recognised through operating expense in that part of the statement of comprehensive income in which the original transaction was reported. Further information on the Company's impairment policy is set out at policy (i).

(h) Cash and cash equivalents

Cash and cash equivalents includes cash at bank, short-term highly liquid investments with original maturities of three months or less (excluding such investments as otherwise meet this definition but which are held for investment purpose rather than for the purpose of meeting short-term cash commitments) and bank overdrafts where a legal right of set off exists.

(i) Impairment

Financial assets

The carrying value of all financial assets held at amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The identification of impairment and the determination of recoverable amounts is an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, observable fair prices and expected net selling prices. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

1. Accounting policies (continued)

(i) Impairment (continued)

Impairment process

Objective evidence that an asset or group of assets is impaired includes observable data that comes to the attention of the Company about the following events:

(i) significant financial difficulty of the issuer or debtor;
(ii) a breach of contract;
(iii) the disappearance of an active market for that asset because of financial difficulties; or
(iv) observable data indicating that there is a measurable decrease in the estimated future cashflow from a group of assets since the initial recognition of those assets, even where the decrease cannot yet be identified with the individual assets of the Company, including:
 - adverse changes in the payment status of issuers or receivables; or
 - national or local economic conditions that correlate with defaults on the assets in the Company.

The Company first assesses whether objective evidence of impairment exists individually for assets that are individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment. Those characteristics are relevant to the estimation of future cash flows for such groups as they are indicative of the issuers' ability to pay all amounts due under the contractual terms of the debt instrument being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

(j) Taxes

Tax on the profit or loss for the year is recognised in the statement of comprehensive income within taxation and comprises current and deferred tax.

Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates and legislation enacted or substantively enacted at the reporting date, together with adjustments to estimates made in prior years.

(k) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

(l) Subordinated liabilities

Subordinated liabilities comprise undated loan capital. They are recognised initially at fair value, being the issue proceeds net of transaction costs incurred. Subordinated liabilities are subsequently stated at amortised cost: any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of comprehensive income through amortisation of finance costs on subordinated debt over the period of the liabilities using the effective interest rate applicable to the instrument. Interest payable is recognised in the statement of comprehensive income, through finance costs (see 1(d)).

The subordinated guaranteed bonds were classified as a liability at the time that the instrument was issued on the basis of the existence of a capital disqualification event considered to be a genuine settlement provision.

(m) Other financial liabilities

Other financial liabilities are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost. In practice, the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within other financial liabilities.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

1. Accounting policies (continued)

(n) Effective interest rate

Revenue on financial instruments classified as loans and receivables and finance costs on financial liabilities at amortised cost, are recognised on an effective interest rate basis. This calculation takes into account interest received or paid and fees and commissions paid or received that are integral to the yield as well as incremental transaction costs and all other premiums and discounts. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial instrument at initial recognition.

2. Interest income

	2016 £ 000	2015 £ 000
Interest income on loans	3,881	9,622
Total	**3,881**	**9,622**

On 24 June 2015 the Company exercised its option to redeem €388m of 4.25% dated subordinated guaranteed bonds. The proceeds on original issue had been loaned to SWL on similar interest and repayment terms. SWL repaid this Euro loan on 24 June 2015.

3. Other income

	2016 £ 000	2015 £ 000
Other Income	5	224
Total	**5**	**224**

Other income includes amortisation of finance costs on the £sterling loan receivable (2015: £sterling and €Euro loans receivable).

4. Finance costs

	2016 £ 000	2015 £ 000
Interest payable on bond issues	3,738	9,435
Total	**3,738**	**9,435**

Finance costs relate to the interest payable on subordinated guaranteed bonds in the year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

5. Other expenses

	2016 £ 000	2015 £ 000
Amortisation of finance costs on subordinated debt	34	245
Total	**34**	**245**

Other expenses includes amortisation of finance costs on the pound subordinated liabilities (and in 2015 pound and euro subordinated liabilities and foreign exchange loss on the euro subordinated liabilities, arising as a result of movement in exchange rates).

No staff are employed directly by the Company (2015: none). All staff providing services to the Company are employed by other subsidiaries of LBG.

6. Auditors' remuneration

Audit fees are borne by another subsidiary within LBG and are as follows:

	2016 £	2015 £
Fees payable for the audit of the Company's current year annual report	8,283	2,605
Fees payable for other services:		
Other services - audit related	-	5,675
Total	**8,283**	**8,280**

7. Taxation (charge)/credit

a) Current year tax

	2016 £ 000	2015 £ 000
Current Tax:		
UK Corporation tax (charge)/credit	(23)	27
Total	**(23)**	**27**

b) Reconciliation of tax (charge)/credit

	2016 £ 000	2015 £ 000
Profit before tax	114	166
Tax at 20% (2015: 20.25%)	(23)	(34)
Prior year tax credit	-	61
Total (charge)/credit	**(23)**	**27**

The Finance Act 2013 was substantively enacted on 2 July 2013. The Act further reduced the main rate of corporation tax to 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

8. Loans and receivables

	2016 £ 000	2015 £ 000
Amounts owed by group undertakings	48,355	48,350
Total	**48,355**	**48,350**

The receivables relate to funds deposited with SWL (formerly Clerical Medical Investment Group Limited). The deposits bear nominal interest at 7.61% (2015: 7.61%), this income being received through the statement of comprehensive income. Further information in respect of amounts owed by group undertakings is given in note 16.

The balances above include £5k (2015: £224k) due from SWL in respect of amortised transaction costs.

9. Other receivables

	2016 £ 000	2015 £ 000
Accrued interest receivable	589	581
Other amount receivable from related party	2,606	2,485
Total	**3,195**	**3,066**

The above receivables are owed by group undertakings. Further information in respect of amounts owed by group undertakings is given in note 16.

10. Cash and cash equivalents

Cash and cash equivalents for use in the statement of cash flows include the following:

	2016 £ 000	2015 £ 000
Investments in a liquidity fund	4,888	4,899
Total	**4,888**	**4,899**

Investments in the liquidity funds are held for the purpose of meeting short-term cash commitments and are included in cash equivalents.

11. Share capital

	2016 £ 000	2015 £ 000
Issued and fully paid share capital:		
225,000 ordinary shares of £1 each	225	225
Total	**225**	**225**

There were no changes in ordinary share capital during the year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

12. Subordinated liabilities

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 and foreign currency risk, see note 15.

	2016 £ 000	2015 £ 000
Non-current liabilities		
Subordinated guaranteed bonds	50,583	50,548
Total	**50,583**	**50,548**

On 24 June 2015 the Company exercised its option to redeem €388m of 4.25% dated subordinated guaranteed bonds. The proceeds of which had been loaned to SWL on similar interest and repayment terms. The subordinated guaranteed bonds had a maturity date of 5 July 2023, but offered the Company the option to redeem the bonds from 5 July 2013, after which time if the bonds had not been redeemed a floating rate interest would have been payable. The sterling value of this redemption was £288m. Prior to repayment SWL repaid in full a corresponding amount to the Company. Further information on the Company's credit risk is available in note 15.

The subordinated guaranteed bonds are carried at amortised cost. The amortisation schedule is set out below:

	2016 £ 000	2015 £ 000
Nominal value	50,680	50,680
Amortisation in one year	(34)	(34)
Amortisation two to five years	(63)	(98)
As at 31 December	**50,583**	**50,548**

The debt repayment schedule for the subordinated guaranteed bonds (by nominal value) is set out below:

As at 31 December 2016

	Total £ 000	Less than 1 year £ 000	1-2 years £ 000	2-5 years £ 000	More than 5 years £ 000
Subordinated Guaranteed Bonds (nominal value):					
£51m – at 7.375%	50,680	-	-	-	50,680
Total	**50,680**	-	-	-	**50,680**

As at 31 December 2015

	Total £ 000	Less than 1 year £ 000	1-2 years £ 000	2-5 years £ 000	More than 5 years £ 000
Subordinated Guaranteed Bonds (nominal value):					
£51m – at 7.375%	50,680	-	-	-	50,680
Total	**50,680**	-	-	-	**50,680**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

12. Subordinated liabilities (continued)

Details of the terms for the subordinated guaranteed bonds are as follows:

£51m of 7.375% undated Subordinated Guaranteed Bonds, the redemption of which is at the option of the Company and is generally not allowable prior to 5 November 2019.

The bonds are guaranteed on a subordinated basis by SWL, a fellow subsidiary of LBG, after the claims of SWL senior creditors including all policyholders. The proceeds of each bond issue were loaned to SWL on similar interest, repayment and subordination terms as those applicable to the bonds as detailed in note 8.

Tranche	Original issue	Amount redeemed	Outstanding at 31 December 2016	Outstanding at 31 December 2015
7.375% originally issued: Nov 1999 / Dec 2000	£200m	£149m	£51m	£51m

13. Other financial liabilities

	2016 £ 000	2015 £ 000
Accrued interest on subordinated guaranteed bonds	571	563
Total	**571**	**563**

14. Current tax liabilities

	2016 £000	2015 £000
Current tax payable	23	34
Total	**23**	**34**

15. Risk management

The Company's principal activity is to act as a finance company for SWL, a fellow subsidiary undertaking. Subordinated debt raised by the Company is loaned to SWL on similar interest and repayment terms as those applied to the subordinated debt raised by the Company.

This note summarises risks and the way in which the Company manages them.

(a) Governance framework

The Company is part of LBG, which has established a risk management function with responsibility for implementing the LBG risk management framework within the Company.

Responsibility for the setting and management of risk appetite and risk policy resides with the Board, who manage risks in line with LBG risk policies. The Board has delegated operational implementation to the Insurance Risk Committee.

The approach to risk management ensures that there is effective independent checking or "oversight" of key decisions through the operation of a "three lines of defence" model. The first line of defence is line management, who have direct accountability for risk decisions. The Risk function provides oversight and challenge and forms the second line of defence. Group Audit constitutes the third line of defence, which provides the required independent assurance to the Audit Committee and the Board that risks within the Company are recognised, monitored and managed within acceptable parameters.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

15. Risk management (continued)

(a) Governance framework (continued)

An enterprise-wide risk management framework for the identification, assessment, measurement and management of risk is in place. The framework is in line with LBG's risk management principles and covers the full spectrum of risks that the Company is exposed to. Under this framework, risks are categorised according to an approved LBG risk language which has been adopted across the Company. This covers the principal risks faced by the Company, including the exposures to market, credit, financial soundness and operational risk.

(b) Risk Appetite

Risk appetite is the amount and type of risk that the Board is prepared to seek, accept or tolerate and is fully aligned to Insurance Division and LBG strategy. The Board has defined the methodology for the management of risk appetite and approved a set of risk appetite statements that cover financial risks (capital, credit, market and liquidity), operational risks, people risks, conduct risks, regulatory & legal risks, financial reporting risks and governance risks. The risk appetite statements set limits for exposures to the key risks faced by the business. Risk appetite is set at an Insurance Division level.

Experience against risk appetite is reported monthly (by exception) and quarterly (in full) to the Insurance Risk Committee, quarterly (by exception) to the Insurance Risk Oversight Committee (IROC), and twice yearly to the Board. Reporting focuses on ensuring and demonstrating to the Board, and their delegate the IROC, that the Company, as part of the Insurance Division is run in line with approved risk appetite. Any breaches of risk appetite require clear plans and timescales for resolution.

(c) Financial risks

The Company is exposed to a range of financial risks through its financial assets and financial liabilities.

The Company manages these risks in a numbers of ways, including monitoring of cash flow requirements.

Financial assets and financial liabilities are measured on an ongoing basis at amortised cost. The summary of significant accounting policies (note 1) describes how the class of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognised.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

15. Risk management (continued)

(c) Financial risks (continued)

The following tables analyse the carrying amount of assets and liabilities, with financial assets and financial liabilities being presented according to their IAS 39 classification:

	2016 £000	2015 £000
Financial assets		
Cash and cash equivalents	4,888	4,899
Other receivables	3,195	3,066
Amortised cost:		
Loans receivable	48,355	48,350
	56,438	**56,315**

	2016 £000	2015 £000
Financial liabilities		
Amortised cost:		
Subordinated liabilities	50,583	50,548
Other financial liabilities	571	563
	51,154	**51,111**
Other liabilities		
Current tax payable	23	34
Total liabilities	**51,177**	**51,145**

(1) Market risk

Market risk is defined as the risk that unfavourable market moves (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and/or value.

The fair values together with the carrying amounts of those assets and liabilities affected by market risk shown in the balance sheet are as follows:

	2016		2015	
	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000
Cash and cash equivalents	4,888	4,888	4,899	4,899
Loans to group undertaking	48,355	51,440	48,350	53,658
Subordinated guaranteed bonds	(50,583)	(51,440)	(50,548)	(53,658)

The carrying amount of Loans to group undertakings above includes £5k (2015: £224k) due from SWL in respect of amortised transaction cost.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

15. Risk management (continued)

c) Financial risks (continued)

1) Market risk (continued)

The carrying amount of Loans to group undertakings and subordinated guaranteed bonds above is recognised initially at fair value, being the issue proceeds net of transaction costs incurred, and subsequently stated at amortised cost using the effective interest method.

The fair value of Loans to group undertakings and subordinated guaranteed bonds above are based on the open market value of the Subordinated guaranteed bonds, excluding amortised transaction costs.

(i) Equity and property risk

The Company is not exposed to equity or property risk through its financial assets and financial liabilities.

(ii) Interest rate risk

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates and the shape of the yield curve.

Effective interest rates and re-pricing analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they re-price:

		2016				2015			
	Note	Effective Interest rate	Total £000	6 months or less £000	More than 5 years £000	Effective Interest rate	Total £000	6 months or less £000	More than 5 years £000
Cash and cash equivalents	10	0.5%	4,888	4,888	-	0.5%	4,899	4,899	-
Loans to group undertaking:									
GBP	8	7.8%	48,355	48,355	-	7.8%	48,350	48,350	-
Subordinated guaranteed bonds:									
GBP	12	7.6%	(50,583)	(50,583)	-	7.6%	(50,548)	(50,548)	-

Interest rates on interest-bearing financial assets and financial liabilities are closely matched. Any increase or decrease in interest rates would, therefore, not have a material impact on profit and loss.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

15. Risk management (continued)

c) Financial risks (continued)

2) Credit risk

Credit Risk is defined as the risk that parties with whom the Company has contracted fail to meet their financial obligations (both on or off balance sheet).

Credit risk is managed in line with the Insurance Credit Risk Policy and the wider LBG Credit Risk Policy.

Company is primarily exposed to credit risk through the subordinated guaranteed bonds loaned on to SWL. Accordingly the Company is dependent upon SWL to meet its commitments in respect of the subordinated guaranteed bonds issued. Management monitor closely the solvency position and the credit risk exposure of SWL and the Company. They are satisfied that, as a consequence of the risk management procedures in place, as set out in the financial statements of SWL, this risk is suitably managed.

There were no past due or impaired financial assets at 31 December 2016 (2015: none). No terms in respect of financial assets had been renegotiated at 31 December 2016 or 31 December 2015.

3) Financial soundness risk

Financial soundness risk covers the risk of financial failure, reputational loss or loss of earnings and/or value arising from a lack of liquidity, funding or capital and/or the inappropriate recording, reporting or disclosure of financial, taxation and regulatory information.

(i) Financial and regulatory reporting, tax and disclosure risks

Financial reporting risk is defined as the risk that the Company suffers reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over business or finance processes impacting financial, prudential regulatory, and tax reporting, failure to manage the associated risks of changes in taxation rates, law, corporate ownership or structure and the failure to disclose timely and appropriate information in accordance with regulatory requirements.

The Company has developed procedures to ensure that compliance with both current and potential future requirements are understood and that policies are aligned to its risk appetite. The Company maintains a system of internal controls, consistently applied, providing reasonable assurance that transactions are recorded and undertaken in accordance with delegated authorities that permit the preparation and disclosure of financial statements and tax returns in accordance with IFRSs and statutory requirements.

The Company undertakes a programme of work designed to support an annual assessment of the effectiveness of internal controls over financial reporting, to identify tax liabilities and to assess emerging legislation and regulation.

(ii) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet its financial commitments as they fall due, or can secure them only at an excessive cost. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or from a liability falling due for payment earlier than expected; or from the inability to generate cash inflows as anticipated.

Liquidity risk is managed in line with the LBG Funding and Liquidity Risk Policy, see Strategic Report.

Liquidity risk has been analysed as arising from the settlement of balances from other group undertakings of £51,550,000 (2015: £51,416,000) which in turn is used to settle balances owed on subordinated guaranteed bonds.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

15. Risk management (continued)

c) Financial risks (continued)

3) Financial soundness risk (continued)

(iii) Capital risk

Capital risk is defined as the risk that the Company has a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across the Company.

The Company's objectives when managing capital is to have sufficient capital to safeguard the Company's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders.

4) Operational risks

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. A risk framework is embedded and monitored within the LBG to mitigate these.

16. Related party transactions

(a) Ultimate parent and shareholding

The Company's immediate parent undertaking is HBOS Financial Services Limited, a company registered in the United Kingdom. HBOS Financial Services Limited has taken advantage of the provisions of the Companies Act 2006 and has not produced consolidated financial statements.

The Company's ultimate parent company and ultimate controlling party is LBG plc, which is also 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.

Lloyds Bank plc is the parent undertaking of the smallest such group of undertakings for which group Financial Statements are drawn up and of which the Company is a member. Copies of the LBG plc financial statements in which the Company is consolidated can be obtained from the Group Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

16. Related party transactions (continued)

(b) Transactions and balances with related parties

Transactions between the Company and other companies in the LBG

The Company has entered into the following transactions with other related parties during the year and holds the following balances with other related parties at the end of the year:

	2016			
	Income during year £000	Expenses during year £000	Payable at year end £000	Receivable at year end £000
Relationship				
Other related parties	3,881	-	-	51,550

	2015			
	Income during year £000	Expenses during year £000	Payable at year end £000	Receivable at year end £000
Relationship				
Other related parties	9,622	-	-	51,416

All the transactions summarised above were entered into on an arm's length basis. The amounts outstanding at the end of the year are included in other receivables / payables as appropriate and are repayable on demand unless otherwise specified in the relevant note. The Company paid no dividends to its parent company in the year ended 31 December 2016 (2015: nil).

Transactions between the Company and key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company which, for the Company, are the Directors.

The Directors consider that they receive no remuneration for their services to the Company.

17. Contingent Liability

The Company 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. A number of LBG companies, including the Company, have an open matter in relation to a claim for group relief of losses incurred in a former Irish banking subsidiary of the LBG, which ceased trading on 31 December 2010. In the second half of 2013 HMRC informed the LBG that their interpretation of the UK rules, permitting the offset of such losses, denies these claims; if HMRC's position is found to be correct, management estimate that this would result in an increase in the Company's current tax liability of approximately £72,000. The LBG 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 on the Company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

18. Future accounting developments

The following pronouncement may have an impact on the Company's financial statements but are not applicable for the year ended 31 December 2016 and have not been applied in preparing these financial statements. Except as disclosed below, the full impact of these accounting changes is being assessed by the Company.

Pronouncement	Nature of change	IASB effective date
IFRS 9 "Financial Instruments" [1]	Replaces IAS 39 "Financial Instruments: Recognition and Measurement." 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. 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. 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. IFRS 9 is not expected to have a significant financial impact on the financial results or position of the Company.	Annual periods beginning on or after 1 January 2018
IFRS 15 "Revenue from Contracts with Customers"[1]	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 is not expected to have a significant impact on the financial results or position of the Company.	Annual periods beginning on or after 1 January 2018