Registered Number : 05941595

ARKLE FUNDING (NO.1) LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2012

ARKLE FUNDING (NO.1) LIMITED
DIRECTORS AND COMPANY INFORMATION

DIRECTORS

Ahsan Iqbal
Neville D Scott
Ian G Stewart

COMPANY SECRETARY

State Street Secretaries (UK) Limited

REGISTERED OFFICE

20 Churchill Place
Canary Wharf
London
E14 5HJ

INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

Registered Number 05941595

ARKLE FUNDING (NO.1) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012

The directors have pleasure in presenting their annual report and the audited financial statements for Arkle Funding (No 1) Limited (the "Company") for the year ended 31 December 2012

Principal activities

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

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

The Company invests in the beneficial interests of the assets held by Arkle Finance Trustee Limited (the "Trust") These assets comprise mortgage loans secured on residential property originated by Lloyds The Company receives a share of income from the Trust in proportion to its share of the mortgage assets of the Trust

Arkle Funding (No 1) Limited is a limited company incorporated under the laws of England and Wales and was registered on 20 September 2006 The authorised share capital is £100 comprising of 100 ordinary shares of £1 each, 1 of which has been issued

Results and dividends

The results for the year are set out on page 10 The profit after taxation for the year amounted to £4,000 (2011 £3,000) The directors do not recommend the payment of a dividend (2011 £ nil)

Profits for the Company are determined under the Programme Documentation Under the terms of the securitisation the Company retains the right to a profit before tax of up to £5,000 from available revenue receipts from the beneficial interest in the Trust Cash flows in excess of those required by the Company to meet its liabilities accrue to Lloyds, the originator of the underlying mortgages (the "Originator")

The directors anticipate that the Company will be profitable over its lifetime

The Company's tax charge is based on the permanent tax regime for securitisation companies

Business review and future developments

During the year £2,537 million (2011 £4,584 million) of loans from Master Issuer were repaid, with Lloyds providing re-financing contributions to the value of £300 million (2011 £890 million) to the Company to allow the payments to be made on the expected payment date During the year a further £3,946 million (2011 £2,425 million) of Notes were issued by Master Issuer and subsequently intercompany loans were increased by the same value

Since the year end, there have been Note repayments of £1,686 million No further Notes have been issued

Business review and future developments (continued)

The Company will continue to receive the proceeds of new Note issuances from Master Issuer as intercompany loans

Key performance indicators (KPIs)

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

KPIs published in the monthly investor reports include the excess revenue receipts ("Excess Spread") available as the first line of credit enhancement to the Notes, the losses that have occurred, the level of arrears of the underlying mortgages, the rate of repayment of the loans within the Trust and an analysis of the characteristics of the underlying mortgages in the Trust

The key performance indicator used by management in assessing the performance of the Company is the monitoring of actual cashflows against planned cashflows All interest and principal due on the intercompany loans was received and paid on the expected date during 2012

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

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

The Company has made all necessary payments on the intercompany loans in accordance with the scheduled repayment dates for the year ended 31 December 2012

Policy and practice on payment of creditors

The majority of the Company's payments are in relation to the loans from Master Issuer and are due monthly or quarterly in accordance with the terms of the Notes Payments are subject to the receipt of principal and interest on the underlying mortgage pool All such payments were made on the due dates

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract

Directors

The directors of the Company at the end of the year were as follows

Ahsan Iqbal
Neville D Scott
Ian G Stewart

None of the directors had a beneficial interest in the shares of the Company, or of the ultimate holding company, Stanhope Gate Trustees Limited

Vincent M Rapley and Gary L Staines resigned from the Board on 2 February 2012 and Neville D Scott and Ian G Stewart were appointed on the same day Jason C Bingham resigned from the Board on 10 August 2012 and Ahsan Iqbal was appointed on the same day

Ian G Stewart is an employee of Bank of Scotland plc, a subsidiary of Lloyds Banking Group

Directors' indemnities

As permitted by the Articles of Association, the directors have the benefit of an indemnity which is a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006 The indemnity was in force throughout the last financial year and is currently in force

Risk management

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

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

Credit risk

The intercompany loans are ultimately secured against a beneficial interest in a mortgage portfolio held in trust The performance of the mortgage loans, secured on UK residential properties, is influenced by the economic background and the UK housing market

To mitigate this risk a subordinated Z loan ("Z Loan") of £1,439m (2011 £1,244 m) and a general reserve fund of £291m (2011 £241m) are maintained subject to available cash receipts to ensure the Company can meet its obligations on the Notes The requirement to use this credit enhancement would only arise in the event that there was no longer sufficient Excess Spread available to cover principal losses

Liquidity risk

The ability of the Company to meet its obligations to make principal and interest payments on the intercompany loans and to meet its operating and administrative expenses is dependent on the amount and timing of the interest and principal repayments on the mortgage loans which underlay the loan to the originator The Company is only obliged to pay interest and principal to the extent that it has such amounts available to it Failure to pay the intercompany loan interest and principal will ultimately result in a deterioration of Master Issuer's position and affect the ability to meet obligations under the Notes issued.

Interest rate risk

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

The securitised mortgage loans comprise loans which are subject to variable rates of interest set by Lloyds based on general interest rates and competitive considerations, loans which track the Bank of England base rate and loans which are subject to fixed rates of interest To mitigate the changes in interest rate that would result in the interest cashflows from the mortgage pools being insufficient to meet the payments of LIBOR based interest due to intercompany loans, the Company entered into an interest rate basis swap with Lloyds The basis swap substantially eliminates the sensitivity to movements in interest rates This is not recognised in the Financial Statements as it is part of the deemed loan

To reflect the increased interest cost of the Notes issued in 2011 and 2012, a yield reserve is in place to partially fund the difference between the interest rate on the Notes and the yield on the underlying mortgage pool

Operational risk

The Company is also exposed to operational risks through a number of contracts with third parties who have agreed to provide operational support to the Company in accordance with the Programme Documentation State Street Administration Services (UK) Limited has been appointed to provide corporate services in accordance with a corporate services agreement The Company is bound by each intercompany loan agreement to make payments to meet the third party expenses of Master Issuer Lloyds was appointed on 12 October 2010 to act as cash manager on behalf of the Company

Business risks

The principal business risks of the Company are set out in a number of asset and non-asset trigger events in the Programme Documentation (Asset trigger Debit to AAA principal deficiency ledger, Non-asset triggers Minimum Seller share below that required, Insolvency of seller, Termination of servicer not replaced within 60 days and Minimum Trust Size breached) The occurrence of trigger events may lead to a different priority of payments There have been no such trigger events since inception of the Programme

Employees

The Company has employed no staff during the year ended 31 December 2012 (2011 Nil) None of the directors received any emoluments from the Company in the current year (2011 Nil)

Statement of directors' responsibilities

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

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

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

Disclosure of information to auditors

In accordance with Section 418, director's reports shall include a statement, in the case of each director in office at the date the directors' report is approved, that

- so far as a director is aware, there is no relevant audit information of which the Company's auditors are unaware, and
- he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information

ARKLE FUNDING (NO.1) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

Independent auditors

PricewaterhouseCoopers LLP have indicated their willingness to continue in office

Statement of going concern

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

By order of the board

State Street Secretaries (UK) Limited
Secretary

Registered Office
20 Churchill Place
Canary Wharf
London E14 5HJ

10 April 2013

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF ARKLE FUNDING (NO.1) LIMITED

We have audited the financial statements of Arkle Funding (No 1) Limited for the year ended 31 December 2012 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

Respective responsibilities of directors and auditors

As explained more fully in the Statement of directors' responsibilities set out on page 6 the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2012 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matters prescribed by the Companies Act 2006

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

ARKLE FUNDING (NO.1) LIMITED

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF ARKLE FUNDING (NO.1) LIMITED (continued)

Matters on which we are required to report by exception

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

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or

- the financial statements are not in agreement with the accounting records and returns, or

- certain disclosures of directors' remuneration specified by law are not made, or

- we have not received all the information and explanations we require for our audit

Scott Berryman (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

10 April 2013

ARKLE FUNDING (NO.1) LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 £'000	2011 £'000
Interest receivable and similar income	2	302,744	209,274
Interest payable and similar charges	3	(302,449)	(208,273)
Net interest income		295	1,001
Operating expenses	4	(290)	(996)
Profit before tax		5	5
Taxation	5	(1)	(2)
Profit for the year and total comprehensive income attributable to equity holders		4	3

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

There were no gains or losses other than those in the statement of comprehensive income

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

ARKLE FUNDING (NO.1) LIMITED
BALANCE SHEET
AS AT 31 DECEMBER 2012

	Notes	31 Dec 2012 £'000	31 Dec 2011 £'000
Assets			
Deemed loan to originator	6	10,095,487	9,697,018
Cash and cash equivalents		1,881,455	868,988
Total assets		11,976,942	10,566,006
Equity and liabilities			
Loans from related companies	7	11,976,882	10,565,240
Trade and other payables	8	25	734
Current tax liability		1	2
Total liabilities		11,976,908	10,565,976
Share capital	9	-	-
Retained profits		34	30
Shareholders' equity		34	30
Total equity and liabilities		11,976,942	10,566,006

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

The directors approved the financial statements on 10 April 2013

Neville D Scott
Director

Registered Number 05941595

ARKLE FUNDING (NO 1) LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2012

	Share capital £'000	Retained profits £'000	Total £'000
Balance at 1 January 2012	-	30	30
Profit for the year	-	4	4
Balance at 31 December 2012	-	34	34

	Share capital £'000	Retained profits £'000	Total £'000
Balance at 1 January 2011	-	27	27
Profit for the year	-	3	3
Balance at 31 December 2011	-	30	30

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

ARKLE FUNDING (NO 1) LIMITED
CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2012

	2012 £'000	2011 £'000
Operating activities		
Administration expenses	(265)	(967)
External audit fees paid	(25)	(30)
Tax paid	(1)	(2)
Net cash flows used in operating activities	(291)	(999)
Investing Activities		
Increase in deemed loan to originator	(3,946,278)	(2,424,538)
Principal repayments on deemed loan to originator	3,347,702	4,095,408
Subordinated loan within deemed loan to originator	170,449	(1,366,686)
Interest on deemed loan to originator	348,619	223,892
Bank interest received	9,652	12,284
Net cash flows (used in) / from investing activities	(69,856)	540,360
Financing Activities		
Increase in loans from related companies	3,946,278	2,424,538
Reduction in loans from related companies	(2,536,840)	(4,584,117)
Payment of issue costs	(10,709)	(7,322)
Repayment of unspent issue costs loan	1,935	217
Interest on loans from related companies	(318,050)	(205,976)
Net cash flows from / (used in) financing activities	1,082,614	(2,372,660)
Net increase / (decrease) in cash and cash equivalents	1,012,467	(1,833,299)
Change in cash and cash equivalents	1,012,467	(1,833,299)
Cash and cash equivalents at start of year	868,988	2,702,287
Cash and cash equivalents at end of year	1,881,455	868,988

The cash flow statement is presented using the direct method

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

1. SIGNIFICANT ACCOUNTING POLICIES

Arkle Funding (No 1) Limited is a company domiciled in England

(a) Statement of compliance

The financial statements for the year ended 31 December 2012 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union and effective at the date the financial statements are approved by the Board

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

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

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

(b) Interest receivable and payable

Interest receivable and similar income and interest payable have been calculated using the effective interest method The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument but not future credit losses

(c) Accrued interest

Accrued interest has been incorporated within the related financial instrument

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(d) Taxation

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

The Company's tax charge is based on the permanent tax regime for securitisation companies

(e) Financial instruments

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

(e)(i) Deemed loan

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

The initial amount of the deemed loan to originator corresponds to the consideration paid by the Company for the mortgage loans less the subordinated loans granted by Lloyds The Company recognises principal and interest cashflows from the underlying pool of mortgage loans only to the extent that it is entitled to retain such cashflows Cashflows attributable to Lloyds are not recognised by the Company Additionally, the directors of the Company consider that the subordinated loans does not meet the definition of a liability as the Company will repay the subordinated loans to Lloyds only if it first receives an equivalent amount from Lloyds

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e) Financial instruments (continued)

(e)(i) Deemed loan (continued)

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

Derivative financial instruments

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

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

On issuance of any Notes by Master Issuer, the Company may pay a premium to the swap provider funded through part of the proceeds of a subordinated loan Following such an event, the swap provider will make a payment of a fixed amount to the Company on the immediately following payment date in accordance with the terms of the swap agreement Payment of the swap premium and receipt of the fixed amount are also not recognised by the Company for accounting purposes

Impairment of financial assets

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

Delinquencies and defaults on the underlying securitised assets will not result in an impairment loss if the cashflows from the asset pool are still expected to be sufficient to meet the Company's obligations from Master Issuer Losses incurred on the securitised assets will not trigger an impairment as long as they do not exceed the credit enhancement granted by the originator

If there is objective evidence that an impairment loss has been incurred, an allowance account is established which is calculated as the difference between the balance sheet carrying value of the deemed loan asset and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at that loan's original effective interest rate based on Libor

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e)(ii) Cash and cash equivalents

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

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

(e)(iii) Loans from related companies

The loans from related companies are recognised initially at fair value less directly related incremental transaction costs Subsequent to initial recognition, these loans are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis

(f) Segment reporting

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

The directors of the Company consider that the entity has only one geographical and one business segment and therefore does not produce segmental disclosure

(g) Critical accounting estimates and judgements

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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(g) Critical accounting estimates and judgements (continued)

Effective interest rate method

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

For the purpose of the effective yield calculation, it has been assumed that the average expected life of the intercompany loans will follow the life of the Notes issued by the Master Issuer and will end at the date of the expected payment date (unless specified earlier in the Programme Documentation when the earlier date will be used), based on the payment experience to date This may not be the case in practice

Fair value

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

Impairment of deemed loan

The Company's accounting policy for losses arising on the deemed loan is described in note 1(e)(i) Impairment allowances are established to recognise incurred impairment losses in the Company's loan portfolios carried at amortised cost In determining whether impairment has occurred at the balance sheet date the Company considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows or their timings Where this is the case, the impairment loss is the difference between the carrying value of the loan and the present value of the estimated future cash flows discounted at the loan's original effective interest rate

At 31 December 2012, impairment allowances against the deemed loan totalled £nil (2011 £nil)

(h) Dividends

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

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	2012 £'000	2011 £'000
Interest receivable on deemed loan	293,061	196,991
Bank interest receivable	9,683	12,283
	302,744	209,274

3. INTEREST PAYABLE AND SIMILAR CHARGES

	2012 £'000	2011 £'000
Interest on loans from related companies	293,265	202,791
Amortisation of issue costs	9,184	5,482
	302,449	208,273

4. OPERATING EXPENSES

	2012 £'000	2011 £'000
Audit fees	25	30
Administration charges	265	966
	290	996

The Company has no employees (2011 Nil) The directors' emoluments are paid in the form of a management charge

Audit fees relate to the statutory audit There were fees payable to the auditors and their associates for services other than the statutory audit which amounted to £33,000 (2011 £102,000) Audit fees for Master Issuer and Arkle PECOH Holdings are borne by the Company

5. TAXATION

Current Tax	**2012 £'000**	**2011 £'000**
Corporation tax charge for the year at an average rate of 24 5% (2011 26 5%)	1	2
Total tax charge	1	2

Reconciliation of effective tax rate	**2012 £'000**	**2011 £'000**
The tax assessed for the year is equal to the average standard rate of corporation tax in the UK of 24 5% (2011 26 5%)		
Profit before tax	5	5
Profit before tax multiplied by the average standard rate of corporation tax in the UK of 24 5% (2011 26 5%)	1	2

On 21 March 2012, the Government announced a reduction in the rate of corporation tax to 24% with effect from 1 April 2012 This reduction was enacted under the Provisional Collection of Taxes Act 1968 on 26 March 2012 In addition, the Finance Act 2012, which passed into law on 3 July 2012, included legislation to reduce the main rate of corporation tax from 24% to 23% with effect from 1 April 2013

6. DEEMED LOAN TO ORIGINATOR

	2012 £'000	**2011 £'000**
Principal	10,076,316	9,675,044
Interest	19,171	21,974
TOTAL	10,095,487	9,697,018

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

7. LOAN FROM RELATED COMPANIES

	2012 £'000	2011 £'000
Principal		
Loans from Master Issuer	11,960,353	10,550,915
Deferred issue costs	(12,868)	(13,987)
	11,947,485	10,536,928
Interest		
Interest payable to Master Issuer	29,397	28,312
TOTAL	11,976,882	10,565,240

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

Interest and principal payable relate to the amounts due to Master Issuer under the intercompany loan agreements and are aligned to the proceeds of the Notes in issue

Interest payable on the intercompany loan agreements is based on Sterling three month Libor plus a margin as set out in the Programme Documentation

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

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

8. TRADE AND OTHER PAYABLES

	2012 £'000	2011 £'000
Audit fee accrual	25	25
Other payables	-	709
	25	734

9. SHARE CAPITAL

	2012 £	2011 £
AUTHORISED		
100 ordinary shares of £1 each	100	100
ALLOTTED AND PAID UP		
1 ordinary shares of £1 each	1	1

10. MANAGEMENT OF RISK

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

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

The Company's exposure to risk on its financial instruments and the management of such risk is largely determined at the inception of the securitisation transaction The Company's activities and the role of each party to the transaction are clearly defined and documented Cashflow modelling, including multiple stress scenarios, is carried out as part of the structuring of the transaction, and as such is required by the rating agencies In addition an interest rate swap is entered into with the originator as part of the securitisation transaction to hedge interest rate risk arising in the transaction including the obligations under the intercompany loan agreements

10(a) Credit risk

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

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

To mitigate this risk, credit enhancement is provided to the Company in the form of Excess Spread, a reserve fund and a Z Loan This credit enhancement is available to make good any reduction in the principal balance of the mortgage pool as a result of defaults by customers

In addition, Lloyds has provided start up loans and Z Loans to the Company to provide credit enhancement which can be used in certain circumstances to meet any deficit in revenue or to repay amounts of principal Therefore, delinquencies and defaults on the underlying securitised assets will not result in a default on the intercompany loan as long as they do not exceed the credit enhancement provided The Company's share of losses in the mortgage pool covered by Excess Spread in the year to 31 December 2012 was £5,787k (2011 £5,732k) There have been no principal drawings on the reserve fund or subordinated Z Loan which are fully funded and at 31 December 2012 was £1,729,900k (2011 £1,484,900k)

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

10. MANAGEMENT OF RISK (CONTINUED)

10(a) Credit risk (continued)

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

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

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

	Counterparty	Rating as at 31 Dec 2012 (Moody's/S&P/ Fitch)	Rating as at date of approval of financial statements Moody's/S&P/ Fitch)
Account bank	Lloyds TSB Bank plc	P-1/A-1/F1 A2/A/A	P-1/A-1/F1 A2/A/A
Swap provider	Lloyds TSB Bank plc	P-1/A-1/F1 A2/A/A	P-1/A-1/F1 A2/A/A

Financial assets subject to credit risk

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

	2012 £'000	2011 £'000
Assets held at amortised cost:		
Deemed loan to Originator	10,095,487	9,697,018
Cash and cash equivalents	1,881,455	868,988
	11,976,942	10,566,006

10. MANAGEMENT OF RISK (CONTINUED)

10(a) Credit risk (continued)

The Company meets its obligation on the intercompany loans from the cashflows it receives from the Deemed Loan These represent the only recourse for the Company As a consequence, the credit quality of the mortgage loans indicates the capacity of the Company to service its payments, although the mortgages remain on the balance sheet of Lloyds and the structure of the securitisation provides for other credit enhancements

Securitised mortgage assets

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

	2012 £'000	2011 £'000
Neither past due, nor impaired	19,620,153	22,531,596
Past due, but not impaired	474,499	489,608
Impaired	221,358	271,950
	20,316,010	23,293,154

Securitised loans and advances which are past due, but not impaired

	2012 £'000	2011 £'000
0-30 days	238,327	247,826
30-60 days	98,903	96,440
60-90 days	54,611	60,778
90-180 days	82,658	84,564
Over 180 days	-	-
	474,499	489,608

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

10. MANAGEMENT OF RISK (CONTINUED)

10(a) Credit risk (continued)

Securitised mortgage assets (continued)

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

- o At 31 December 2012 2,766 accounts were in arrears by three or more months which represented 1 58% of the mortgage pool (31 December 2011 3,237 accounts, 1 32%)
- o At 31 December 2012 the number of properties in possession amounted to 101 (31 December 2011 119 properties)

Collateral held against retail mortgage lending comprises residential properties

10(b) Interest rate risk

Interest rate risk is the possibility that changes in interest rates will result in higher financing costs and/or reduced income from the Company's interest bearing financial assets and liabilities

The securitised mortgage loans comprise loans which are subject to variable rates of interest set by Lloyds based on general interest rates and competitive considerations, loans which track the Bank of England base rate and loans which are subject to fixed rates of interest To mitigate the changes in interest rate that would result in the interest cashflows from the mortgage pools being insufficient to meet the payments of LIBOR based interest due on the intercompany loans, the Company has entered into an interest rate Basis Swap with Lloyds The Basis Swap substantially eliminates the sensitivity to movements in interest rates This is not recognised in the financial statements as it is part of the deemed loan

To reflect the increased interest cost of the Notes issued in 2011 and 2012, a yield reserve has been established to support payment of the difference between the interest rate on the Notes and the yield on the underlying mortgage pool The yield reserve amount at 31 December 2012 was £446,679k (2011 £299,551k)

10(c) Liquidity risk

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

The Company will seek to accumulate principal receipts from the Trust over a specified period as set out in the Programme Documentation in order to repay the intercompany loans to Master Issuer in accordance with the expected maturity dates

10. MANAGEMENT OF RISK (CONTINUED)

10(c) Liquidity risk (continued)

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

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

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

2012	Carrying Value	Contractual repayment value	<1 Month	1-3 Months	3 Months-1 Year	1-5 Years	> 5 Years
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Principal							
Loans from related companies	11,947,485	11,960,353	-	1,686,313	1,785,571	8,288,469	200,000
Trade and other payables	25	25	-	25	-	-	-
Interest payable							
Interest on loan from related companies	29,397	676,107	-	62,724	158,989	436,044	18,350
	11,976,907	12,636,485	-	1,749,062	1,944,560	8,724,513	218,350

2011	Carrying Value	Contractual repayment value	<1 Month	1-3 Months	3 Months-1 Year	1-5 Years	> 5 Years
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Principal							
Loans from related companies	10,536,928	10,550,915	-	196,765	2,340,075	6,814,075	1,200,000
Trade and other payables	734	734	-	734	-	-	-
Interest payable							
Interest payable to related companies	28,312	673,175	-	57,617	159,315	442,992	13,251
	10,565,974	11,224,824	-	255,116	2,499,390	7,257 067	1,213,251

10 MANAGEMENT OF RISK (CONTINUED)

10(d) Prepayment risk

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

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

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

	Monthly PPR %	1-month annualised %	3-month annualised %	12-month annualised %
31 December 2012	1 04	11 83	12 60	12 81
31 December 2011	1 18	13 23	13 64	14 42

11. RELATED PARTY TRANSACTIONS

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

The related parties are Lloyds, Master Issuer and State Street Administration Services (UK) Limited by virtue of their various roles and inputs into securitisation arrangements to which the Company is a party

Corporate service expenses are borne by the Company in respect of Master Issuer and the Company and are payable to State Street Administration Services (UK) Limited and amounted to £36,000 in the year (2011 £50,000)

11. RELATED PARTY TRANSACTIONS (CONTINUED)

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

	LBG and Subsidiary Undertakings 2012 £'000	LBG and Subsidiary Undertakings 2011 £'000
Interest receivable and similar income		
Interest receivable on deemed loan	293,061	196,991
Bank interest receivable	9,683	12,283
Interest payable and similar charges		
Interest on loans from related companies	293,265	202,791
Assets		
Deemed loan to originator	10,095,487	9,697,018
Cash and cash equivalents	1,881,455	868,988
Liabilities		
Loans from related companies	11,960,353	10,550,915
Interest payable to related companies	29,397	28,312

12. FUTURE ACCOUNTING PRONOUNCEMENTS

The following pronouncements will be relevant to the Company but are not applicable for the year ending 31 December 2012 and have not been applied in preparing these financial statements The full impact of these accounting changes is currently being assessed by the Company

Pronouncement	Nature of change	IASB effective date
Amendments to IAS 1 Presentation of Financial Statements – *'Presentation of Items of other Comprehensive Income'*	Requires entities to group items presented in other income on the basis of whether they are potentially reclassified to profit or loss subsequently	Annual periods beginning on or after 1 July 2012
Amendments to IFRS 7 *Financial Instruments Disclosures – Offsetting Financial Assets and Financial Liabilities (1)*	Requires an entity to disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's balance sheet	Annual periods beginning on or after 1 January 2013
IFRS 10 *Consolidated Financial Statements(1)*	Supersedes IAS 27 *Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purpose Entities* and establishes the principles for when the Group controls another entity and therefore is required to consolidate the other entity in the Group's financial statements	Annual periods beginning on or after 1 January 2013
IFRS 12 Disclosure of Interests in Other Entities (1)	Requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows	Annual periods beginning on or after 1 January 2013
IFRS 13 *Fair Value Measurement*	Defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements It applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements	Annual periods beginning on or after 1 January 2013
Amendment to IAS 32 *Financial Instruments Presentation – 'Offsetting Financial Assets and Financial Liabilities' (1)*	Inserts application guidance to address inconsistencies identified in applying the offsetting criteria used in the standard Some gross settlement systems may qualify for offsetting where they exhibit certain characteristics akin to net settlement	Annual periods beginning on or after 1 January 2014

12. FUTURE ACCOUNTING PRONOUNCEMENTS (CONTINUED)

Pronouncement	Nature of change	IASB effective date
IFRS 9 *Financial Instruments* *(1), (2)*	Replaces those parts of IAS 39 *Financial Instruments Recognition and Measurement* relating to the classification, measurement and derecognition of financial assets and liabilities IFRS 9 requires financial assets to be classified into two measurements categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments and eliminated the available-for-sale financial asset and held-to-maturity investment categories in IAS 39 The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39	Annual periods beginning on or after 1 January 2014

(1) As at 28 February 2013, these pronouncements with the exception of IFRS 9 have all received EU endorsement
(2) IFRS 9 is the initial stage of the project to replace IAS39 Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting, as well as a reconsideration of classification and measurement Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS39

13. PARENT UNDERTAKING AND CONTROLLING PARTY

The Company is a wholly owned subsidiary of Arkle Holdings Limited, a company registered in England and Wales The shares of Arkle Holdings Limited are held on a discretionary trust basis by Stanhope Gate Trustees Limited

The Company meets the definition of a special purpose entity under IFRSs In accordance with the requirements of SIC12 "Consolidation – Special Purpose Entities", the Company's financial statements are consolidated within the group financial statements of Lloyds Banking Group plc for the year ended 31 December 2012

The company regarded by the directors as the ultimate controlling party under IFRSs at 31 December 2012 was Lloyds Banking Group plc, a limited liability company incorporated and domiciled in Scotland, which was the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and in which the Company's financial statements are included Lloyds TSB Bank plc was the parent undertaking of the smallest such group of undertakings Copies of the annual report and accounts of Lloyds Banking Group plc may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN