

Registered Number : 05941595

ARKLE FUNDING (NO.1) LIMITED
ANNUAL REPORT AND FINANCIAL STATEMENTS
YEAR ENDED 31 DECEMBER 2016



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

DIRECTORS

Martin C Schnaier
Beejadhursingh M Surnam

COMPANY SECRETARY

Sanne Group Secretaries (UK) Limited

REGISTERED OFFICE

Asticus Building
2nd Floor,
21 Palmer Street,
London
SW1H 0AD

INDEPENDENT AUDITORS

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

ARKLE FUNDING (NO.1) LIMITED
STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

The directors present their Strategic Report and audited financial statements of Arkle Funding (No.1) Limited (the "Company") for the year ended 31 December 2016.

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 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.

Under IAS39, 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 as the originator of the mortgage loans ("Originator"). The initial amount of the deemed loan to Originator corresponds to the consideration paid by the Company for the mortgage loans less the Z loan provided as part of the credit enhancement and any other subordinated loan granted by Lloyds.

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.

Business review

The results for the year are set out on page 11. The profit for the year amounted to £4k (2015: £4k). Total equity as at 31 December 2016 amounted to £50k (2015: £46k).

The directors do not recommend the payment of a dividend (2015: £ 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 £5k 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 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.

ARKLE FUNDING (NO.1) LIMITED
STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

Business review (continued)

During the year £1,250 million (2015: £3,766 million) of loans from Master Issuer were repaid with no requirement for Lloyds to provide re-financing contributions (2015: nil) to the Company to allow the payments to be made on the expected payment date. During the year no further Notes (2015: £nil) were issued by Master Issuer.

Since the year end, there have been £800m of Notes have repaid and no further Notes have been issued.

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

Key performance indicators (KPIs)

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.

In order to assist the directors to mitigate key risks, there is a monthly meeting with programme managers. This meeting analyses and discusses the trends for the month and identifies any issues or required changes. Any such issues are then reported, further discussed and collectively agreed in accordance with the programme documentation that governs the transaction.

The Board is responsible for assessing the risk of irregularities, where caused by fraud or error in the financial reporting and ensuring that the processes are in place for the timely identification of internal and external matters with a potential effect on financial reporting.

KPIs published in the monthly investor reports include the excess revenue receipts ("Excess Spread") on trust assets 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 cash flows against planned cash flows. All interest and principal due on the intercompany loans was received and paid on the expected date during 2016.

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 note holders 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 2016.

ARKLE FUNDING (NO.1) LIMITED
STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

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 environment and the UK housing market.

To mitigate this risk a subordinated Z loan ("Z Loan") of £1,439m (2015: £1,439m) and a general reserve fund of £291m (2015: £291m) 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 London Interbank Offered Rate (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.

ARKLE FUNDING (NO.1) LIMITED
STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

Interest rate risk (continued)

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. Sanne Group (UK) Limited were appointed on 8th August 2013 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. There are additional triggers including some which relate to the underlying performance of the mortgage pool. The occurrence of trigger events may lead to a different priority of payments of the Notes in accordance with established priorities. There have been no such trigger events since inception of the Programme

By order of the board



BEETA CHURSINGH SURNAM

Sanne Group Secretaries (UK) Limited
Secretary

Registered Office
Asticus Building
2nd Floor
21 Palmer Street,
London
SW1H 0AD
26 April 2017

ARKLE FUNDING (NO.1) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

The directors present their annual report and the audited financial statements for Company for the year ended 31 December 2016.

Directors and directors' interests

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

Martin C Schnaier
Beejadhursingh M Surnam

None of the directors had a beneficial interest in the shares of the Company, or of the ultimate holding company, Sanne Trustee Company UK Limited.

Beejadhursingh M Surnam and Martin C Schnaier are employees of Sanne Trustee Company UK Limited and are directors of Sanne Group Secretaries (UK) Limited and Sanne Group (UK) Limited. Sanne Group (UK) Limited provides administration services to the Company at commercial rates.

Jason Bingham resigned from the board on 2nd November 2016 and Beejadhursingh M Surnam was appointed on the same day.

Ian G Stewart resigned from the board on 31st December 2016.

Statement of directors' responsibilities in respect of 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.

ARKLE FUNDING (NO.1) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

Disclosure of information to auditors

In accordance with Section 418(2) of the Companies Act 2006, in the case of each director in office at the date the report is approved:

- So far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- The directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Directors' indemnities

Qualifying third party indemnity provisions for the benefit of the directors were in force during the year under review and remain in force as at the date of approval of the annual report and financial statements.

Future developments

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

Dividends

The directors did not recommend the payment of a dividend during the year or at 31 December 2016 (2015: £nil).

Risk management

Further details on the risks facing the Company and how these risks are managed are detailed in the Strategic Report.

Employees

The Company had employed no staff during the year ended 31 December 2016 or the previous year.

None of the directors received any emoluments from the Company in the current or previous year.

ARKLE FUNDING (NO.1) LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)


Independent auditors

PricewaterhouseCoopers LLP have indicated their willingness to continue in office until the next annual general meeting. Pursuant to section 489 of the Companies Act, a resolution for the re-appointment of PricewaterhouseCoopers LLP as auditors of the Company will be proposed at the forthcoming annual general meeting.

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:

 **BERNADINE SINGH** **SURNAM**

Sanne Group Secretaries (UK) Limited
Secretary

Registered Office
Asticus Building
2nd Floor
21 Palmer Street,
London
SW1H 0AD

26 April 2017

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

Report on the financial statements

Our opinion

In our opinion, Arkle Funding (No.1) Limited'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 Cash Flow Statement 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.

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

Adequacy of accounting records and information and explanations received (continued)

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.

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.



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

27th April 2017

ARKLE FUNDING (NO.1) LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2016

| | Note | 2016 £'000 | 2015 £'000 |
|---|------|---------------|---------------|
| Interest receivable and similar income | 2 | 52,123 | 112,001 |
| Interest payable and similar charges | 3 | (51,758) | (111,250) |
| | | <hr/> | <hr/> |
| Net interest income | | 365 | 751 |
| Operating expenses | 4 | (360) | (746) |
| | | <hr/> | <hr/> |
| Profit before tax | | 5 | 5 |
| Taxation | 5 | (1) | (1) |
| | | <hr/> | <hr/> |
| Profit for the year and total comprehensive income | | 4 | 4 |
| | | <hr/> | <hr/> |

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.

The accompanying notes on pages 15 to 33 are an integral part of the financial statements.

ARKLE FUNDING (NO.1) LIMITED
BALANCE SHEET
AS AT 31 DECEMBER 2016

| | | 2016 £'000 | 2015 £'000 |
|-------------------------------------|-------------|---------------|---------------|
| Assets | Note | | |
| Deemed loan to originator | 6 | 503,288 | 2,104,115 |
| Cash and cash equivalents | | 1,200,379 | 852,406 |
| | | <hr/> | <hr/> |
| Total assets | | 1,703,667 | 2,956,521 |
| | | <hr/> | <hr/> |
| Equity and liabilities | | | |
| Loans from related companies | 7 | 1,703,583 | 2,956,441 |
| Trade and other payables | 8 | 33 | 33 |
| Current tax liability | | 1 | 1 |
| | | <hr/> | <hr/> |
| Total liabilities | | 1,703,617 | 2,956,475 |
| | | <hr/> | <hr/> |
| Share capital | 9 | - | - |
| Retained profits | | 50 | 46 |
| | | <hr/> | <hr/> |
| Total equity | | 50 | 46 |
| | | <hr/> | <hr/> |
| Total equity and liabilities | | 1,703,667 | 2,956,521 |
| | | <hr/> | <hr/> |

The accompanying notes on pages 15 to 33 are an integral part of the financial statements.

The financial statements on pages 11 to 33 were approved by the directors on 26 April 2017 and signed on their behalf by



Beejadhursingh M Surnam
Director
26 April 2017

ARKLE FUNDING (NO.1) LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2016

| | Share capital £'000 | Retained profits £'000 | Total equity £'000 |
|---|---------------------------|------------------------------|--------------------------|
| Balance at 1 January 2016 | - | 46 | 46 |
| Profit for the year and total comprehensive income | - | 4 | 4 |
| | <hr/> | <hr/> | <hr/> |
| Balance at 31 December 2016 | - | 50 | 50 |
| | <hr/> | <hr/> | <hr/> |
| | Share capital £'000 | Retained profits £'000 | Total equity £'000 |
| Balance at 1 January 2015 | - | 42 | 42 |
| Profit for the year and total comprehensive income | - | 4 | 4 |
| | <hr/> | <hr/> | <hr/> |
| Balance at 31 December 2015 | - | 46 | 46 |
| | <hr/> | <hr/> | <hr/> |

The accompanying notes on pages 15 to 33 are an integral part of the financial statements.

ARKLE FUNDING (NO.1) LIMITED
CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2016

| | 2016 £'000 | 2015 £'000 |
|---|-----------------------------|-----------------------------|
| Operating activities | | |
| Administration expenses | (327) | (1,106) |
| External audit fees paid | (33) | (33) |
| Tax paid | (1) | (1) |
| | <hr/> | <hr/> |
| Net cash flows used in operating activities | (361) | (1,140) |
| Investing Activities | | |
| Principal repayments on deemed loan to originator | 1,614,171 | 2,121,079 |
| Subordinated loan within deemed loan to originator | (12,294) | - |
| Interest on deemed loan to originator | 67,083 | 118,396 |
| Bank interest received | 4,659 | 7,314 |
| | <hr/> | <hr/> |
| Net cash flows generated from investing activities | 1,673,619 | 2,246,789 |
| Financing Activities | | |
| Reduction in loans from related companies | (1,250,000) | (3,766,158) |
| Interest on loans from related companies | (75,285) | (141,247) |
| | <hr/> | <hr/> |
| Net cash flows used in financing activities | (1,325,285) | (3,907,405) |
| | <hr/> | <hr/> |
| Net increase (decrease) in cash and cash equivalents | 347,973 | (1,661,756) |
| | <hr/> | <hr/> |
| Change in cash and cash equivalents | 347,973 | (1,661,756) |
| Cash and cash equivalents at start of year | 852,406 | 2,514,162 |
| | <hr/> | <hr/> |
| Cash and cash equivalents at end of year | 1,200,379 | 852,406 |
| | <hr/> | <hr/> |

The cash flow statement is presented using the direct method.

The accompanying notes on pages 15 to 33 are an integral part of the financial statements.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016

1. SIGNIFICANT ACCOUNTING POLICIES

Arkle Funding (No.1) Limited is a limited liability company domiciled in England and incorporated in England and Wales.

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

(a) Basis of preparation

The financial statements for the year ended 31 December 2016 have been prepared in accordance with EU adopted International Financial Reporting Standards (IFRSs) and interpretations issued by the IFRS Interpretations Committee (IFRS IC). The standards applied by the Company are those endorsed by the European Union and effective at the date the financial statements are approved by the Board. All accounting policies have been consistently applied in the financial statements.

There are no new or amended accounting standards that have required a change to accounting policies for the year.

The financial statements have been prepared in accordance with the Companies Act 2006 as applicable to companies using IFRS and comply with the relevant provisions of Part 15 of the Companies Act 2006.

The financial statements have been prepared using the going concern basis. The directors have reviewed the expected future cash flows 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.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

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 Originator, where recourse to Lloyds is limited to the cash flows 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 Z loan and any other subordinated loan granted by Lloyds. The Company recognises principal and interest cash flows from the underlying pool of mortgage loans only to the extent that it is entitled to retain such cash flows. Cash flows attributable to Lloyds are not recognised by the Company.

The deemed loan to originator is classified within "loans and receivables" and is stated at amortised cost. Where cash has been accumulated by the Company to fund the future repayment of its 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.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e)(i) Deemed loan (continued)

Derivative financial instruments

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.

e)(ii) Cash and cash equivalents

The Company holds 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 Statement of Comprehensive Income over the period of the borrowings on an effective interest basis.

**ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)**

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(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:

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 2016, impairment allowances against the deemed loan totalled £nil (2015: £nil).

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(h) Dividends

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

(i) Capital Management

The Company is not subject to externally imposed capital requirements in the current and prior year. The Company manages its ordinary share capital in order that there is sufficient capital, in the opinion of the directors, to support the transactions and level of business undertaken by the Company.

2. INTEREST RECEIVABLE AND SIMILAR INCOME

| | 2016 £'000 | 2015 £'000 |
|------------------------------------|-----------------------------|-----------------------------|
| Interest receivable on deemed loan | 47,464 | 104,687 |
| Bank interest receivable | 4,659 | 7,314 |
| | <u>52,123</u> | <u>112,001</u> |

3. INTEREST PAYABLE AND SIMILAR CHARGES

| | 2016 £'000 | 2015 £'000 |
|--|-----------------------------|-----------------------------|
| Interest on loans from related companies | 50,963 | 109,191 |
| Amortisation of issue costs | 795 | 2,059 |
| | <u>51,758</u> | <u>111,250</u> |

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

4. OPERATING EXPENSES

| | 2016 | 2015 |
|------------------------|--------------|--------------|
| | £'000 | £'000 |
| Audit fees | 34 | 34 |
| Administration charges | 326 | 712 |
| | <u>360</u> | <u>746</u> |

The Company has no employees (2015: Nil). The directors' emoluments are paid in the form of a management charge.

Audit fees relate to the statutory audit. During the year there were no further fees payable to the auditors or their associates for services other than the statutory audit (2015: £nil). The fee for the Company for the current year was £11k net of VAT (2015: £11k). Audit fees for Master Issuer and Arkle PECOH Holdings are borne by the Company.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

5. TAXATION

| | 2016 £'000 | 2015 £'000 |
|---|-----------------------------|-----------------------------|
| Current Tax | | |
| Corporation tax charge for the year at an average rate of 20%. (2015: 20.25%) | 1 | 1 |
| Total tax charge | <u>1</u> | <u>1</u> |

| | 2016 £'000 | 2015 £'000 |
|--|-----------------------------|-----------------------------|
| Reconciliation of effective tax rate | | |
| The tax assessed for the year is equal (2015: equal) to the average standard rate of corporation tax in the UK of 20% (2015: 20.25%) | | |
| Profit before tax | 5 | 5 |
| | <u>5</u> | <u>5</u> |
| Profit before tax multiplied by the average standard rate of corporation tax in the UK of 20% (2015: 20.25%) | 1 | 1 |
| | <u>1</u> | <u>1</u> |

The Finance Act 2013 which was substantively enacted on 2 July 2013 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.

6. DEEMED LOAN TO ORIGINATOR

| | 2016 £'000 | 2015 £'000 |
|--------------------|-----------------------------|-----------------------------|
| Non-current | | |
| Principal | 499,344 | 2,096,533 |
| Current | | |
| Interest | 3,944 | 7,582 |
| | <u>3,944</u> | <u>7,582</u> |
| TOTAL | <u>503,288</u> | <u>2,104,115</u> |

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

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

6. DEEMED LOAN TO ORIGINATOR (CONTINUED)

pool have to fulfil certain criteria. If they fail to do so they are removed from the pool and the pool may be replenished.

The loan is expected to be repaid on the final maturity date of the Notes and is therefore deemed as non-current.

7. LOANS FROM RELATED COMPANIES

| | 2016 £'000 | 2015 £'000 |
|-----------------------------------|---------------|---------------|
| Non Current | | |
| Loans from Master Issuer | 200,000 | 1,700,000 |
| Deferred issue Costs | (381) | (1,177) |
| Current | | |
| Loans from Master Issuer | 1,500,000 | 1,250,000 |
| Interest payable to Master Issuer | 3,964 | 7,618 |
| | <hr/> | <hr/> |
| TOTAL | 1,703,583 | 2,956,441 |
| | <hr/> | <hr/> |

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.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

8. TRADE AND OTHER PAYABLES

| | 2016 £'000 | 2015 £'000 |
|-------------------|---------------|---------------|
| Audit fee accrual | 33 | 33 |
| Trade creditors | - | - |
| | <hr/> 33 | <hr/> 33 |
| | <hr/> | <hr/> |

9. SHARE CAPITAL

| | 2016 £ | 2015 £ |
|--|-----------|-----------|
| AUTHORISED | | |
| 100 (2015:1) ordinary shares of £1 each | 100 | 100 |
| | <hr/> | <hr/> |
| ALLOTTED AND PAID UP | | |
| 1 (2015:1) fully paid ordinary share of £1 | 1 | 1 |
| | <hr/> | <hr/> |

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 and therefore there is minimal sensitivity to risk. 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.

**ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)**

10. MANAGEMENT OF RISK (CONTINUED)

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 performance 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. For December 2016, the post interest rate swap was 1.92% (2015: 1.92%).

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 2016 was £nil (2015: £0.188m). There have been no principal drawings on the reserve fund or deficiency on the subordinated Z Loan which are fully funded and at 31 December 2016 was £1,729.9m (2015: £1,729.9m). The subordinated Z loan nets out within the deemed loan to originator on the Balance Sheet.

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

An impairment charge on the deemed loan 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.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

10(a) Credit risk (continued)

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 2016 | Rating as at date of approval of financial statements |
|-----------------------------------|-----------------|-----------------------------|---|
| | | (Moody's/S&P/ Fitch) | Moody's/S&P/ Fitch) |
| Account bank and swap provider | Lloyds Bank plc | P-1/A-1/F1 A1/A/A+ | P-1/A-1/F1 A1/A/A+ |

An additional GIC account for the Company benefits from collateral provided by Lloyds and secured in favour of the Company with such collateral to be posted to a custody account held with Bank of New York Mellon, London Branch and marked to market on a daily basis. The cash held in the collateralised GIC at 31 December 2016 was £1,180.2m (2015: £832.2m).

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.

| | 2016 £'000 | 2015 £'000 |
|---------------------------------------|-----------------------|-----------------------|
| Assets held at amortised cost: | | |
| Deemed loan to Originator | 503,288 | 2,104,115 |
| Cash and cash equivalents | 1,200,379 | 852,406 |
| | <hr/> 1,703,667 <hr/> | <hr/> 2,956,521 <hr/> |

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

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.

| | 2016 £'000 | 2015 £'000 |
|--------------------------------|-----------------------------|-----------------------------|
| Neither past due, nor impaired | 10,629,997 | 12,577,903 |
| Past due, but not impaired | 113,758 | 181,144 |
| Impaired | - | 355 |
| | <u>10,743,755</u> | <u>12,759,402</u> |

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

| | 2016 £'000 | 2015 £'000 |
|---------------|-----------------------------|-----------------------------|
| Days past due | | |
| 0-30 days | 84,769 | 127,813 |
| 30-60 days | 22,958 | 45,706 |
| 60-90 days | 6,031 | 7,625 |
| 90-180 days | - | - |
| | <u>113,758</u> | <u>181,144</u> |

In respect of LBG's secured mortgage portfolio, 'past due' is when a borrower has failed to make a payment when contractually due. The definition of impaired loans refers to those which are six months or more in arrears (or certain cases where the borrower is bankrupt or is in possession).

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

10(a) Credit risk (continued)

Securitised mortgage assets (continued)

LBG has an option to repurchase mortgage loans from the programme which are greater than or equal to 3 months in arrears. The value of loan repurchases in the year amounted to £104m (2015: £309m).

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

- At 31 December 2016, 61 accounts were in arrears by three or more months which represented 0.05% of the mortgage pool (31 December 2015: 88 accounts, 0.06%).
- At 31 December 2016 the number of properties in possession amounted to nil. (31 December 2015: 1 property).

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.

In light of the increased interest cost of the Notes issued in 2010, 2011 and 2012, a yield reserve has been established solely 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 2016 was £343.1m (2015: £355.5m).

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

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.

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 cash flows 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.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

10(c) Liquidity risk (continued)

| 2016 | 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 | 1,699,619 | 1,700,000 | - | 800,000 | 700,000 | 200,000 | - |
| Trade and other payables | 33 | 33 | - | 33 | - | - | - |
| Interest payable | | | | | | | |
| Interest on loan from related companies | 3,964 | 37,913 | - | 8,071 | 12,415 | 17,427 | - |
| | <u>1,703,616</u> | <u>1,737,946</u> | <u>-</u> | <u>808,104</u> | <u>712,415</u> | <u>217,427</u> | <u>-</u> |
| | | | | | | | |
| 2015 | 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 | 2,948,823 | 2,950,000 | - | - | 1,250,000 | 1,500,000 | 200,000 |
| Trade and other payables | 33 | 33 | - | 33 | - | - | - |
| Interest payable | | | | | | | |
| Interest payable to related companies | 7,618 | 95,740 | - | 15,473 | 39,415 | 36,631 | 4,221 |
| | <u>2,956,474</u> | <u>3,045,773</u> | <u>-</u> | <u>15,506</u> | <u>1,289,415</u> | <u>1,536,631</u> | <u>204,221</u> |
| | | | | | | | |

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

10. MANAGEMENT OF RISK (CONTINUED)

10(d) Prepayment risk

In the normal course of business a proportion of borrowers repay their loan in advance of 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 2016 | 1.30 | 14.54 | 15.57 | 15.82 |
| 31 December 2015 | 1.49 | 16.50 | 16.50 | 16.57 |

10(e) Fair Values

The fair values of the Company's main financial instruments are detailed below:

Financial assets and liabilities carried at amortised cost

Deemed loan to Originator

The carrying value of the variable rate loans is assumed to be their fair value. The deemed loan to Originator includes an interest rate swap which is not recognised separately. The swap accrual is based on variable rates (three-month LIBOR rates). For these reasons, the carrying value of the deemed loan to Originator is considered to be a close approximation to fair value.

Loans from related company

The carrying value of the variable rate loans is assumed to be their fair value. The loans to related company are all denominated in Sterling and are at variable rates of interest (LIBOR), therefore these loans are considered to be a close approximation to fair value.

Trade and other payables

Trade and other payables are recognised on an amortised cost basis that is considered to be a close approximation to fair value due to short nature of these liabilities.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

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 Sanne Group (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 associated companies. Total corporate service expenses payable to Sanne Group (UK) Limited during the year amounted to £65k (2015: £53k).

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

| At 31 December or for the year then ended | Parent | Other Related Parties | Parent | Other Related Parties |
|---|---------------|-----------------------|---------------|-----------------------|
| | 2016 £'000 | 2016 £'000 | 2015 £'000 | 2015 £'000 |
| Interest receivable and similar income | | | | |
| Interest receivable on deemed loan | 47,464 | - | 104,687 | - |
| Bank interest receivable | 4,659 | - | 7,314 | - |
| Interest payable and similar charges | | | | |
| Interest on loans from related companies | - | 50,963 | - | 109,191 |
| Assets | | | | |
| Deemed loan to originator | 503,288 | - | 2,104,115 | - |
| Cash and cash equivalents | 1,200,379 | - | 852,406 | - |
| Liabilities | | | | |
| Loans from related companies | - | 1,700,000 | - | 2,950,000 |
| Interest payable to related companies | - | 3,964 | - | 7,618 |

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

12. FUTURE ACCOUNTING PRONOUNCEMENTS

The following pronouncements are not applicable for the year ended 31 December 2016 and have not been applied in preparing these financial statements. Save as disclosed below, the full impact of these accounting changes is being assessed by the Company.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or 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. These changes are not expected to have a significant impact on the Company.

IFRS 9 also replaces the existing 'incurred loss' impairment approach with an expected credit loss approach. This change in approach is not expected to have a significant impact on the Company.

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. The revised requirements are not expected to have a significant impact on the Company.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018. This standard was endorsed in November 2016.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 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 Company.

IFRS 15 is effective for annual periods beginning on or after 1 January 2018. As at March 2017, this standard is awaiting EU endorsement.

ARKLE FUNDING (NO.1) LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

13. PARENT UNDERTAKING AND CONTROLLING PARTY

The immediate parent undertaking is Arkle Holdings Limited, a company registered in England and Wales. The shares of Arkle Holdings Limited are held on a discretionary trust basis by Sanne Trustee Company UK Limited.

The Company meets the definition of a special purpose entity under IFRSs. In accordance with IFRS 10 Consolidated Financial Statements, the Company's financial statements are consolidated within the group financial statements of LBG for the year ended 31 December 2016.

The parent undertaking, which is the parent undertaking of the smallest group to consolidate these financial statements is Lloyds. Copies of the consolidated annual report and financial statements of Lloyds may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

For accounting purposes the ultimate parent undertaking and controlling party is LBG, which is the parent undertaking of the largest group to consolidate these financial statements. Copies of the consolidated annual report and financial statements of LBG may be obtained from LBG's plc head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.