

27 APR 2016

## **Arkle Master Issuer plc**

### **Annual report and financial statements for the year ended 31 December 2015**

#### **Registered office**

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

#### **Registered number**

05941709

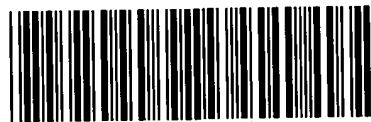
#### **Directors**

Jason C Bingham  
Martin C Schnaier  
Ian G Stewart

#### **Company Secretary**

Sanne Group Secretaries (UK) Limited

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# Strategic Report

For the year ended 31 December 2015

The directors present their Strategic Report and the audited financial statements of Arkle Master Issuer plc ("the Company") for the year ended 31 December 2015.

## Principal activities

The principal activity of the Company is the investment of the proceeds of the issue of publicly listed floating and fixed rate asset backed loan notes in the international capital markets which are denominated in a number of currencies (the "Notes"). These proceeds have been invested in loans to Arkle Funding (No.1) Limited ("Funding 1"). 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 Notes. As such, these have not been reproduced in full in the financial statements.

The Company was incorporated under the laws of England and Wales and registered as a public limited company. Arkle PECO Holdings Limited holds 49,999, £1 ordinary shares in the Company partly paid to £0.25 and one £1 ordinary share which is fully paid. Sanne Group Nominees 1 (UK) Limited holds one £1 ordinary share in the Company fully paid as nominee for Arkle PECO Holdings Limited. These shares comprise the entire issued share capital of the Company.

The Company has no direct employees (2014: nil). All staff are employed by an intermediate parent undertaking, Lloyds Bank Asset Finance Limited, and all staff costs are recharged to the Company. Full details of policies relating to disabled persons, together with details of actions taken regarding the provision of information to employees, their consultation and involvement, are shown in the Annual Report and Accounts of the Group.

## Business review

The results for the year are set out on page 8. The loss after taxation for the financial year amounted to £3,174,000 (2014: profit of £21,588,000). Total equity at 31 December 2015 was £16,248,000 (2014: £19,422,000). The directors do not recommend the payment of a dividend (2014: £nil).

As required under International Financial Reporting Standards (IFRSs), the profit for the year includes a fair value loss on financial instruments of £6,159k (2014: profit of £6,936k) which reflects the movement in the market value of the derivatives and swap interest payable. The Notes issued were economically hedged using derivative contracts and so gains or losses recognised to date are expected to

Underlying profits for the Company, excluding fair value gains or losses on financial instruments, are pre-determined under the Programme Documentation. Under the terms of the intercompany loans, the Company has the right to a profit before tax of £5k from available revenue receipts per accounting year.

During the year £3,766 million (2014: £824 million) of Notes were repaid on their expected payment dates and no Notes ahead of their expected payment dates (2014: £450 million) following the receipt of the equivalent amount on the loans to the Funding Company. No further Notes were issued during the year (2014: £nil).

Certain amendments were made in 2014 to the Arkle Programme to ensure it remains compliant with all the necessary legal and regulatory requirement and is a cost efficient method of raising funding for LBG. The amendments were approved by Note holder vote on 4 December 2014. There was no negative rating impact as a result of the amendments as confirmed by the rating agencies.

The principal amendments included an arrears repurchase option, amendments to the bank account ratings requirements and the establishment of an additional GIC account in the Company which will benefit from collateral provided by LBG.

Since the year end, there have been no Note repayments and no further Notes have been issued.

The Company will continue to issue Notes and invest the proceeds as intercompany loans to Funding 1. The directors anticipate that the Company will be profitable over its lifetime.

## 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 on the LBG investor returns website ([www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com)). An extract of these is shown in note 13(a) - credit risk and 13(d) - prepayment risk of the financial statements.

In order to assist the directors to mitigate key risks, there is Board representation at 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, whether 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.

## **Strategic Report (continued)**

For the year ended 31 December 2015

### **Key Performance Indicators (KPIs) (continued)**

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 the interest and principal due on the intercompany loans and Notes was received and paid on or before the expected dates during 2015.

At the time of issue each series and class of Notes is assigned a credit rating which reflects the likelihood of full and timely payment to the holders of the Notes 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 Company. No downgrade in credit ratings has been applied to the Company's Notes in the period under review and subsequently up to the date of approval of these financial statements.

Company's Notes in the year under review and subsequently up to the date of approval of these financial statements.

In relation to the Company's principal outflows (interest and principal payments on the Notes) the Company has hedged the risk of exchange rate fluctuations using a series of derivative contracts, providing certainty over the amounts due.

### **Taxation**

The Company's tax charge is based on the permanent tax regime for securitisation companies. All fair value adjustments on derivative contracts are ignored for taxation purposes as tax is assessed on the cash retained as profit in the Company.

### **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 loans to the Funding company, Notes issued in the capital markets, derivatives ("swaps"), various other receivables and payables and cash and liquid resources.

The principal risks and uncertainties for the Company arise from the Company's financial instruments. These are credit risk, liquidity risk, interest rate risk and currency 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 12 of the financial statements.

#### **Credit Risk**

The intercompany loans are ultimately secured against a beneficial interest in a mortgage portfolio held in trust for Funding 1. The performance of the mortgage loans, secured on UK residential properties, is influenced by the economic environment and the UK housing

To mitigate this risk, credit enhancement is provided to Funding 1 in the form of excess revenue receipts ("Excess Spread"), a subordinated Z loan ("Z Loan") and a general reserve.

#### **Liquidity risk**

The ability of the Company to meet its obligations to make principal and interest payments on the Notes and to meet its operating and administrative expenses is dependent on funds being received under the intercompany loans held with Funding 1. Funding 1 is only obliged to pay interest and principal to the Company to the extent that it has such amounts available to it. The Company has recourse to the other assets of Funding 1 for any shortfall in receipts due under the intercompany loan agreement.

The Company has received all necessary payments on the intercompany loans with Funding 1, in accordance with the expected repayment dates for the year ended 31 December 2015.

#### **Interest rate risk**

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at different times. The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of the intercompany loans and the Notes (its principal assets and liabilities) are similar; where this is not possible the Company uses derivative contracts to mitigate any residual interest rate risk.

#### **Currency risk**

The Company has issued certain Notes denominated in US Dollars, Japanese Yen and Euros ("Currency Notes"). All the Company's assets and its other liabilities are denominated in Sterling. The Company's policy is to eliminate all exposures arising from movements in exchange rates by the use of interest rate related contracts to hedge payments of interest and principal on the Currency Notes. No Currency Notes and their associated interest rate related contracts were outstanding at the year end.

## Strategic Report (continued)

For the year ended 31 December 2015

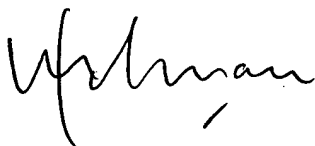
### Operational risks

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 provides corporate services in accordance with a corporate services agreement. Other third parties who have agreed to provide services with respect to the Notes include the paying agents, derivative contract providers and the agent bank. Lloyds has been appointed to act as account bank and 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.

As approved by the Board of Directors and signed by order of the Board:



**MARTIN SCHNAIER**  
Sanne Group Secretaries (UK) Limited  
Company Secretary

Registered office  
Asticus Building  
2nd Floor  
21 Palmer Street  
London  
SW1H 0AD  
18 April 2016

## Directors' Report

For the year ended 31 December 2015

The directors present their Annual Report and the audited financial statements for Arkle Master Issuer plc ("the Company") for the year ended 31 December 2015.

### Directors and directors' interests

The directors of the Company who were in office during the year and up to the date of signing the financial statements are shown on the cover.

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.

Jason C Bingham 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

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

### Statement of directors' responsibilities

The directors are responsible for preparing the Strategic Report, 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 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 has taken all the steps that they ought to have taken as a director 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 issue Notes and invest the proceeds as loans to the Funding company.

## Directors' Report (continued)

For the year ended 31 December 2015

### Policy and practice on payment of creditors

The majority of the Company's payments are in relation to the Notes 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 and the subsequent payment of the intercompany loans. 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.

### Corporate governance

The Directors have been charged with governance in accordance with the Programme Documentation detailing the structure and operation of the transaction. The governance structure of the Company is such that the key policies have been predetermined at the time of issuance and the operational roles have been assigned to third parties with their roles strictly governed by the Programme Documentation.

The Programme Documentation provides for procedures that have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for the reliability and usefulness of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives whilst enabling them to comply with the regulatory obligations.

Due to the nature of the securities which have been issued, the Company is largely exempt from the requirements of the Financial Conduct Authority Disclosure and Transparency Rules (DTR) and detailed in DTR 7.1 audit committees and 7.2 corporate governance statements (save for the rule DTR 7.2.5 requiring descriptions of the features of the internal control and risk management systems), which would otherwise require the Company respectively, to have an audit committee in place and include a corporate governance statement in the report of the directors. The directors are therefore satisfied that there is no requirement for an audit committee or a supervisory body entrusted to carry out the functions of an audit committee or to publish a corporate governance statement.

### Dividends

The directors did not recommend the payment of a dividend during the year or at 31 December 2015 (2014: £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 no employees during the year ended 2015 or the previous year.

None of the directors received any emoluments from the Company in the current or previous year in respect of qualifying services provided to the Company (2014: nil).

### 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. This report has been prepared in accordance with the special provisions relating to small companies within Part 15 of the Companies Act

As approved by the Board of Directors and by order of the Board:



MARTIN SCHNAIER

Sanne Group Secretaries (UK) Limited  
Company Secretary

Asticus Building  
2nd Floor  
21 Palmer Street  
London  
SW1H 0AD  
18 April 2016

# **Independent auditors' report to the members of Arkle Master Issuer plc**

## **Report on the financial statements**

### **Our opinion**

In our opinion, Arkle Master Issuer plc's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2015 and of its loss 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 2015;
- the Statement of comprehensive income for the year then ended;
- the Cash flow statement for the year then ended; and
- 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.

### **Opinion on other matter prescribed by the Companies Act 2006**

In our opinion 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.

### **Other matters on which we are required to report by exception**

#### **Adequacy of accounting records and information and explanations received**

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

#### **Directors' remuneration**

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

## **Independent auditors' report to the members of Arkle Master Issuer plc (continued)**

### **Responsibilities for the financial statements and the audit**

#### **Our responsibilities and those of directors**

As explained more fully in the Statement of Directors' Responsibilities set out on page 4, 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 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.

#### **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.

D Brydon

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

18 April 2016



## Statement of comprehensive income

For the year ended 31 December 2015

	Note	2015 £'000	2014 £'000
Interest receivable and similar income	2	109,191	162,357
Interest payable and similar charges	3	(105,716)	(146,973)
<b>Net interest income</b>		<b>3,475</b>	<b>15,384</b>
Fair Value (losses) / gain	4	(6,159)	6,936
Operating expenses	5	(489)	(731)
<b>(Loss)/profit before tax</b>		<b>(3,173)</b>	<b>21,589</b>
Taxation	6	(1)	(1)
<b>(Loss)/profit for the financial year attributable to owners , being total comprehensive (expense)/income</b>		<b>(3,174)</b>	<b>21,588</b>

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

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

The accompanying notes on pages 11 to 24 are an integral part of the financial statements.

## Balance sheet

As at 31 December 2015

	Note	2015 £'000	2014 £'000
<b>Assets</b>			
Cash and cash equivalents		59	55
Loans to related company	7	2,957,618	6,734,703
Derivative financial assets	8	26,687	54,607
Trade and other receivables	9	37	37
<b>Total assets</b>		<b>2,984,401</b>	<b>6,789,402</b>
<b>Liabilities</b>			
Debt securities in Issue	10	2,968,116	6,458,645
Derivative financial liabilities	8	-	311,251
Current tax liability		1	1
Trade and other payables	11	36	83
<b>Total liabilities</b>		<b>2,968,153</b>	<b>6,769,980</b>
<b>Equity</b>			
Share capital	12	50	50
Accumulated profit / loss		16,198	19,372
<b>Total equity</b>		<b>16,248</b>	<b>19,422</b>
<b>Total equity and liabilities</b>		<b>2,984,401</b>	<b>6,789,402</b>

The accompanying notes on pages 11 to 24 are an integral part of the financial statements.

The financial statements on pages 8 to 24 were approved by the board of directors on and were signed on its behalf by:



Martin C Schnaier  
Director  
18 April 2016

## Statement of changes in equity

For the year ended 31 December 2015

	Share capital £'000	Retained earnings £'000	Total £'000
<b>At 1 January 2015</b>	50	19,372	19,422
Loss for the year being total comprehensive expense	-	(3,174)	(3,174)
<b>At 31 December 2015</b>	50	16,198	16,248
<b>At 1 January 2014</b>	50	(2,216)	(2,166)
Profit for the year being total comprehensive income	-	21,588	21,588
<b>At 31 December 2014</b>	50	19,372	19,422

The accompanying notes on pages 11 to 24 are an integral part of the financial statements.

## Cash flow statement

For the year ended 31 December 2015

	Note	2015 £'000	2014 £'000
<b>Cash flows used in operating activities</b>			
Tax paid		(1)	(1)
<b>Net cash used in operating activities</b>		(1)	(1)
<b>Cash flows from investing activities</b>			
Repayment of loans to funding 1		3,766,158	824,431
Interest received on loan to Funding 1		120,118	165,208
<b>Net cash from investing activities</b>		3,886,276	989,639
<b>Cash flows used in financing activities</b>			
Principal repayment of debt securities		(3,766,158)	(824,431)
Interest paid on debt securities		(112,712)	(149,668)
Net interest paid on derivatives		(6,865)	(14,792)
Administration charges		(536)	(744)
<b>Net cash used in financing activities</b>		(3,886,271)	(989,635)
<b>Change in cash and cash equivalents</b>		4	3
Cash and cash equivalents at beginning of year		55	52
<b>Cash and cash equivalents at end of year</b>		59	55

The cash flow statement is presented using the direct method

The accompanying notes on pages 11 to 24 are an integral part of the financial statements.

## Notes to the financial statements

For the year ended 31 December 2015

### 1. Significant Accounting policies

Arkle Master Issuer plc ("the Company") is a public 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 in both years presented, unless otherwise stated.

#### (a) Statement of Compliance

The financial statements for the year ended 31 December 2015 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 the 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 Company manages its capital to provide an appropriate return for its shareholders.

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 a general cash reserve and the ability to defer payment in certain circumstances.

The financial statements are presented in Sterling which is the Company's functional and presentation currency and have been prepared on the historical cost basis (except that derivative financial instruments are stated at their fair value).

#### (b) Interest receivable and payable

Interest receivable and similar income and interest payable and similar charges 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 loans to Related Company and within outstanding balance of debt securities in issue on the balance sheet. An analysis of principal and accrued interest can be found in note 7 and note 9.

#### (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. As such, deferred tax is not recognised on the difference between the accounting recognition of the mark to market fair value movement and the tax non-recognition of the movement. Therefore a 'tax base' under IAS12 is not generated and hence deferred tax is not recognised on the difference between the tax and accounting treatment.

#### (e) Financial instruments

The Company's financial instruments comprise intercompany loans to Funding 1, Notes issued in the capital markets, derivative contracts, other receivables and payables and cash and liquid resources. The main purpose of these financial instruments is to raise finance for Lloyds and LBG. These financial instruments are classified in accordance with the principles of IAS 39 as described below.

##### (e)(i) Loans to related company

The loans to Funding 1 are classified within "loans and receivables". The initial measurement is at fair value with subsequent measurement being 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.

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### (e)(ii) Derivative financial instruments

All derivatives are recognised at their fair value. Fair values are obtained where possible from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of any derivative instrument to which hedge accounting as permitted by IAS 39 is not applied are recognised immediately in the Statement of Comprehensive Income.

The fair value of derivative contracts is the estimated amount that the Company would receive or pay to terminate the swap at the Balance Sheet date, taking into account current interest rates and exchange rates.

### (e)(iii) Cash & cash equivalents

The Company holds a transaction bank account. For the purposes of the cash flow statement, cash and cash equivalents comprise cash 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. This bank account is classified within "loans and receivables" in accordance with IAS 39.

### (e)(iv) 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 intercompany loans to Funding 1 have become impaired.

Delinquencies and defaults on the underlying securitised assets will not result in an impairment loss if the cash flows from the asset pool are still expected to be sufficient to meet the Company's obligations under the Notes, taking into account the other credit enhancement available. 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 intercompany 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.

### (e)(v) Debt securities in issue

Debt securities in issue are recognised initially at fair value less directly related incremental transaction costs. Subsequent to initial recognition, debt securities in issue 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.

### (e)(vi) Foreign currency translation

Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Statement of Comprehensive Income.

### (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 is subject to risks and returns that are different from those of segments operating in other economic environments.

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

### (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:

#### Fair value calculations

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty. Fair value is based where available on quoted market prices and upon cash flow models which use, wherever possible, independently sourced market parameters such as interest rate yield curves and currency rates. Other factors are also considered, such as counterparty credit quality and liquidity.

## Notes to the financial statements (continued)

For the year ended 31 December 2015

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

#### Impairment of intercompany loans

The Company's accounting policy for losses arising on the intercompany loans is described in note 1(g). 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 2015, impairment allowances against the loans to related company totalled £nil (2014: £nil).

### (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

	2015 £'000	2014 £'000
Interest receivable from loans related to company	109,191	162,357
	<u>109,191</u>	<u>162,357</u>

## 3 Interest payable and similar charges

	2015 £'000	2014 £'000
Interest payable on debt securities in issue	(105,716)	(146,973)
	<u>(105,716)</u>	<u>(146,973)</u>

## 4 Fair Value (losses) / gain

	2015 £'000	2014 £'000
(Loss)/ gain on retranslation of Euro loan notes to Sterling	(178,698)	124,083
Gain / (loss) on retranslation of US\$ loan notes to GBP	13,027	(69,376)
(Loss) on retranslation of YEN loan notes to GBP	(116,954)	(35,029)
<b>Net foreign exchange (loss) / gain</b>	<u>(282,625)</u>	<u>19,678</u>
Fair value gain / (loss) on Euro currency swap	171,180	(133,744)
Fair value (loss) / gain on US\$ currency swap	(14,331)	66,273
Fair value gain on YEN currency swap	115,529	32,602
Fair value gain on GBP currency swap	4,088	22,127
<b>Net fair value on currency swap derivatives</b>	<u>276,466</u>	<u>(12,742)</u>
<b>Fair Value (loss) / gain</b>	<u>(6,159)</u>	<u>6,936</u>

Fair value movements have arisen on the re-valuation of currency swaps into Sterling using exchange rates as at the Balance Sheet date.

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 5. Operating expenses

	2015 £'000	2014 £'000
Administration Charges	489	731
	<u>489</u>	<u>731</u>

The Company had no employees during the year (2014: Nil). No management fee is charged to the Company for the services of the directors. A management fee for administration services is charged.

Corporate service expenses are borne by Arkle Funding (No.1) Limited in respect of the Company and are payable to Sanne Group (UK) Limited.

Audit fees for the Company are borne for by Funding 1. The fee for the current year was £16k net of VAT (2014: £16k).

### 6. Taxation

	2015 £'000	2014 £'000
<b>Current Tax</b>		
Corporation tax charge for the year at a rate of 20.25% (2014: 21.50%)	1	1
	<u>1</u>	<u>1</u>
<b>Total tax charge</b>	<u>1</u>	<u>1</u>
<b>Reconciliation of effective tax rate</b>		
The tax assessed for the year is equal to the standard average rate of corporation tax in the UK of 20.25% (2014: 21.50%)		
Profit / (Loss) before tax	(3,173)	21,588
	<u>(3,173)</u>	<u>21,588</u>
Profit/(Loss) before tax multiplied by the standard average rate of corporation tax in the UK of 20.25% (2014: 21.50%)	(643)	4,641
	<u>(643)</u>	<u>4,641</u>
<b>Effects of:</b>		
Items not allowable under permanent tax regime for securitisation companies	644	(4,640)
	<u>644</u>	<u>(4,640)</u>
<b>Total tax expense in the Statement of Comprehensive Income</b>	<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.

On 16 March 2016, the Government announced that the corporation tax rate applicable from 1 April 2020 would be 17%. The proposed reductions in the rate of corporation tax are expected to be enacted, and the impact accounted for, during 2016.

### 7. Loans to related company

	2015 £'000	2014 £'000
<b>Intercompany loans to Funding 1</b>		
<b>Non Current</b>		
Principal	1,700,000	2,950,000
<b>Current</b>		
Principal	1,250,000	3,766,158
Interest	7,618	18,545
	<u>2,957,618</u>	<u>6,734,703</u>

The intercompany loans to Funding 1 are all denominated in sterling and are at variable rates of interest, based on the London Interbank Offered Rate (LIBOR) for three-month sterling deposits. Such loans have ultimately been secured against a beneficial interest in a mortgage portfolio held in trust on behalf of Funding 1.

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 7. Loans to related company (continued)

Funding 1's ability to pay amounts due on the intercompany loans will depend mainly upon it receiving sufficient revenue and principal receipts from the mortgage portfolio; receiving the required funds from the Funding 1 swap provider. In the case of a shortfall, holders of the Notes may, subject to what other sources of funds are available to the Company, receive less than the full interest and/or principal than would otherwise be due on the Notes. The repayment of the intercompany loans will coincide with the repayment of the Notes.

### 8. Derivatives

The principal derivatives used by the Company are exchange rate and interest rate contracts.

These contracts include forward exchange contracts including interest rate basis swaps. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal is actual.

The principal amount of the contract does not represent the Company's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Company should the counterparty default. To reduce credit risk the Company only deals with highly rated counterparties and uses credit enhancement techniques such as collateralisation, where security is provided against the exposure. No collateral is currently being held as the swap conditions are met. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate.

The notional principal amount and fair value of instruments entered into was:

	2015 £'000	2014 £'000
<b>Exchange and / or Interest Rate contracts:</b>		
Notional principal amount	800,000	4,132,824
<b>Fair value</b>		
Assets	26,687	54,607
Liabilities	-	(311,251)
	<u>26,687</u>	<u>(256,644)</u>

The expected payment date of the contract is more than 12 months.

### 9. Trade and other receivables

	2015 £'000	2014 £'000
Unpaid share capital	37	37
	<u>37</u>	<u>37</u>

The Company has issued share capital of £50k comprising 50,000 ordinary shares of £1 each, of which 49,999 were partly paid to £0.25 each.



## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 10. Debt securities in Issue

	2015 £'000	2014 £'000
<b>Non Current</b>		
<b>Principal -</b>		
GBP Fixed	800,000	800,000
GBP - priced against 3 month GBP LIBOR	900,000	2,150,000
USD - priced against 3 month USD LIBOR	-	-
EUR - priced against 3 month EURIBOR	-	-
JPY - priced against 3 month JPY LIBOR	-	-
	<u>1,700,000</u>	<u>2,950,000</u>
<b>Current</b>		
<b>Principal -</b>		
GBP Fixed	-	-
GBP - priced against 3 month GBP LIBOR	1,250,000	433,333
USD - priced against 3 month USD LIBOR	-	1,028,795
EUR - priced against 3 month EURIBOR	-	1,806,537
JPY - priced against 3 month JPY LIBOR	-	214,868
	<u>1,250,000</u>	<u>3,483,533</u>
<b>Interest</b>		
Interest payable on debt securities	18,116	25,112
	<u>2,968,116</u>	<u>6,458,645</u>

Debt securities in issue at 31 December 2015 comprise of floating and fixed rate Notes with scheduled maturity dates between August 2016 and November 2021. The final legal maturity date is May 2060. The Notes are issued by the Company in connection with the securitisation of mortgages originated within Lloyds and are shown net of retranslation adjustments. For more information about the Company's exposure to risk, see note 13(a).

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.

### 11. Trade and other payables

	2015 £'000	2014 £'000
Amounts owed to related parties	36	83
	<u>36</u>	<u>83</u>

All amounts due to the related company are repayable with 12 months of the balance sheet date

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 12. Share capital

	2015 £'000	2014 £'000
<b>Authorised</b>		
50,000 ordinary shares of £1 each	50	50
	<hr/>	<hr/>
	2015 £'000	2014 £'000
<b>Allotted</b>		
1 fully paid ordinary share of £1	-	-
49,999 quarter paid ordinary shares of 1 each	50	50
	<hr/>	<hr/>
	50	50
	<hr/>	<hr/>

### 13. Management of risk

The principal risks arising from the Company's financial instruments are credit risk, interest rate risk, currency risk and liquidity 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. Cash flow 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, derivative contracts are entered into as part of the securitisation transaction to hedge all interest rate and currency risk arising in the transaction including the obligations under the Notes.

The derivative counterparties are selected as highly rated, regulated financial institutions and this reduces the risk of default and loss for the Company.

#### 13a. 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 Notes and to meet its operating and administrative expenses is dependent on funds being received under the intercompany loans held with Funding 1. The primary credit risk of the Company therefore relates to the default on the intercompany loan with Funding 1. The primary credit risk of Funding 1 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 characteristics and product type. Significant changes in the economy, or in the performance of a particular geographical region that represents a concentration in the securitised assets, could also affect the cash flows from the mortgage pool.

To mitigate this risk, credit enhancement is provided to the transaction within Funding 1 in the form of Excess Spread, a reserve fund and a Z Loan. Funding 1's share of the income on the mortgage pool is expected to exceed the interest payable on the loan from Arkle Master Issuer plc. This Excess Spread is available to make good any reduction in the principal balance of the mortgage pool as a result of defaults by customers. For December 2015, the post interest rate swap yield was 1.92% (2014: 1.93%).

In addition, Lloyds has provided start up loans and Z Loans to Funding 1 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. Funding 1's share of losses in the mortgage pool covered by Excess Spread in the year to 31 December 2015 was £0.188m (2014: £1.617m). 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 2015 was £1,729.9m (2014: £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 Lloyds. 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.

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 13a. 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, the Programme Documentation contains various rating triggers linked to each counterparty, which require certain actions to be taken if triggers are breached.

In the event that a swap counterparty is downgraded by a rating agency below the rating(s) specified in the relevant swap agreement, the relevant swap provider will be required to take certain remedial measures as defined in that agreement which may include providing collateral for its obligations under the relevant swap, arranging for its obligations to be transferred to an entity with sufficient rating, or taking such other action as it may agree with the relevant rating agency.

	Counterparty	Rating as at Date 31 December 2015  (Moody's/S&P/ Fitch)	Rating as at date of Approval of Financial statements  (Moody's/S&P/ Fitch)
Account bank and currency swap provider	Lloyds Bank Plc	P-1/A-1/F1 A1/A/A	P-1/A-1/F1 A1/A/A

Bank account rating requirements were made in the year to bring the Bank Account Agreement for the Company in line with the latest ratings criteria of the Rating Agencies (including variations that are appropriately mitigated to the requirement of the Rating Agencies).

An additional GIC account for Funding 1 was established in the year which will benefit from collateral provided by Lloyds and secured in favour of Funding 1 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 2015 was £832.2m (2014: £2,473m).

#### 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.

	2015	2014
<b>Assets Held at amortised cost</b>		
Loans to related company	2,957,618	6,734,703
Trade and other receivables	37	37
Cash and cash equivalents	59	55
<b>Assets held at fair value</b>		
Derivative assets	26,687	54,607
	<hr/> 2,984,401	<hr/> 6,789,402

The Company meets its obligation on the Notes issued from the cash flows it receives from Funding 1. 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.

# Notes to the financial statements (continued)

For the year ended 31 December 2015

## 13a. Credit risk (continued)

### Securitised mortgage assets

Securitised mortgage loans can be analysed according to the rating systems used by Lloyds when assessing customers and counterparties. The total mortgage book held in trust against which the intercompany loans are ultimately secured has been analysed below.

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

	2015 £'000	2014 £'000
Neither past, due nor impaired	12,577,903	14,839,554
Past due, but not impaired	181,144	356,439
Impaired	355	103,619
	<hr/>	<hr/>
	12,759,402	15,299,612
	<hr/>	<hr/>

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

Past due 0-30 days	127,813	182,338
Past due 30 to 60 days	45,706	77,463
Past due 60 to 90 days	7,625	47,374
Past due 90 to 180 days	-	49,264
	<hr/>	<hr/>
	181,144	356,439
	<hr/>	<hr/>

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).

As part of the arrears repurchase option included in the programme amendments on 4 December 2014, there was an option for LBG to repurchase mortgage loans from the programme which are greater than or equal to 3 months in arrears. The option required the first repurchase to be within 3 months from the date of implementation. Thereafter, LBG has the option to offer further repurchases on an on-going basis. The requirement was met with further purchases occurring during the year. The value of loan repurchases in the year amounted to £309m (2014: £nil).

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 2015 88 accounts were in arrears by three or more months which represented 0.06% of the mortgage pool (31 December 2014: 1,788 accounts, 1.25%).
- At 31 December 2015 the number of properties in possession amounted to 1 (31 December 2014: 64 properties).

Collateral held against retail mortgage lending comprises residential properties.

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 13b. Foreign currency and interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at different times. The Company's principal assets are denominated in floating rate Sterling. However, during the year, the Company had fixed and floating interest rate Notes denominated in Sterling and also US Dollars, Euros and Japanese Yen. It is therefore exposed to interest rate and currency risk as the value of the Notes will fluctuate due to changes in foreign currency exchange rates and in Sterling, US dollar, Euro and Yen LIBOR rates.

The Company's policy is to eliminate all exposures arising from movements in exchange rates and interest rates by the use of derivative contracts to hedge payments of interest and principal on the Notes.

The effect of currency and interest rate movements has no bearing on the results of the Company due to the use of the derivative contracts. However, the Company is exposed to volatility in the fair value of the derivative contracts which is shown below. This fair value will reverse over the life of the derivative contracts to nil.

The Company's elimination of foreign currency and interest rate risk is as follows:

	US Dollar Floating £'000	Euro Floating £'000	Yen Floating £'000	Sterling Fixed £'000	Sterling Floating £'000	Total £'000
<b>2015</b>						
Debt Securites in issue	-	-	-	(813,012)	(2,155,104)	(2,968,116)
<b>Derivatives</b>						
Derivatives notional balance	-	-	-	813,012		
Net fair value of derivative contracts	-	-	-	16,151		
Valuation Difference	-	-	-	16,151		
<b>2014</b>						
Debt Securites in issue	(1,031,041)	(1,809,942)	(215,231)	(812,917)	(2,589,515)	(6,458,645)
<b>Derivatives</b>						
Derivatives notional balance	1,018,013	1,988,640	332,185	812,917		
Net fair value of derivative contracts	12,528	(183,606)	(118,958)	26,741		
Valuation Difference	(500)	(4,908)	(2,004)	26,741		
Mark to market volatility	500	4,908	2,004	(10,590)		(3,178)

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 13c. Liquidity Risk

The Company's ability to meet payments on the Notes as they fall due is dependent on the timely receipt of funds under the intercompany loan agreements which may be delayed due to the level of repayment on the underlying mortgage portfolio (see 12(d) prepayment risk below). If insufficient funds are received by Funding 1 to repay the intercompany loans, then the Notes may not be paid in full and a part of the Notes may be deferred to subsequent years. 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. Variations in the rate of repayment of principal on the mortgage loans may affect each series and class of Notes differently.

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

It is anticipated that the interest and principal received on the intercompany loans will be sufficient to allow repayment of the Notes by the expected payment date and thereby avoid any increase in the interest rate margin payable on the Notes.

	Carrying Value	Contractual repayment value	<1 month	1-3 months	3 months - 1 year	1-5 years	>5 years
2015	£'000	£'000	£'000	£'000	£'000	£'000	£'000
<b>Principal</b>							
Debt securities in issue	2,950,000	2,950,000	-	-	1,250,000	1,500,000	200,000
Trade and other payables	36	36	-	36	-	-	-
Derivative liability	-	-	-	-	-	-	-
<b>Interest payable</b>							
Interest payable on debt securities in issue	18,116	122,316	-	20,261	53,657	44,166	4,233
Interest payable on derivative liabilities	-	-	-	-	-	-	-
	2,968,152	3,072,352	0	20,297	1,303,657	1,544,166	204,233
2014	£'000	£'000	£'000	£'000	£'000	£'000	£'000
<b>Principal</b>							
Debt securities in issue	6,433,533	6,433,533	-	763,534	2,719,999	2,750,000	200,000
Trade and other payables	83	83	-	83	-	-	-
Derivative liability	307,814	300,871	-	59,605	241,266	-	-
<b>Interest payable</b>							
Interest payable on debt securities in issue	25,112	238,642	-	42,266	71,433	115,915	9,028
Interest payable on derivative liabilities	3,437	17,756	-	7,027	10,729	-	-
	6,769,979	6,990,885	-	872,515	3,043,427	2,865,915	209,028

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 13d. Prepayment risks

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

The term of the Notes specifies that payments on the Notes will only be made to the extent that sufficient cash flows have been received from the Company's assets. The terms of the derivative contracts also specify that the principal amounts of the derivative contracts will amortise to match the outstanding amount of the Notes to which they relate.

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

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

	Monthly PPR %	1 month annualised %	3 month annualised %	12 month annualised %
31 December 2015	1.49	16.50	16.70	16.57
31 December 2014	1.40	15.54	14.71	15.04

### 13e. Fair values

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

#### Financial assets and liabilities carried at fair value

The financial instruments below are analysed by valuation method. The different levels are defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

#### Derivatives

Fair value of derivative assets and liabilities is based, where available, on quoted market prices and upon cash flow models which use, wherever possible, independently sourced market parameters such as interest rate yield curves and currency rates. Other factors are also considered, such as counterparty credit quality and liquidity. The valuation method is consistent with commonly used market techniques. For this reason, in accordance with "IFRS 7 Financial Instruments: Disclosures", the fair value measurement is considered to be Level 2 in the Fair Value Hierarchy.

#### Financial assets and liabilities carried at amortised cost

##### Loans to 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 the short nature of these liabilities.

## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 13e. Fair values (continued)

#### Debt securities in issue

The book value as at 31 December 2015 was £2,950m (2014: £6,716m) and the fair value as at 31 December 2015 was £3,000m (2014: £6,566m). The Notes have been valued where possible based on quoted market prices in active markets, including recent market transactions. However, notes held within LBG cannot be valued in this way using observable inputs.

For this reason, in accordance with "IFRS 7 Financial Instruments: Disclosures" and "IFRS 13 Fair Value Measurement", the debt securities in issue are considered to be Level 3 in the Fair Value Hierarchy.

### 14. 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 Funding 1, LBG, Lloyds, Sanne Group (UK) Limited, Sanne Group Secretaries (UK) Limited and Sanne Trustee Company UK Limited by virtue of their various roles and inputs into securitisation arrangements to which the Company is a party.

Jason C Bingham and Martin C Schnaier as directors of the Company 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.

Lloyds provides cash management services defined under the Programme Documentation, services. Fees for these services amounted to £489k in the year (2014: £731k).

Total corporate service expenses payable during the year amounted to £53k (2014: £54k). These fees are paid on behalf of the Company and associated companies by Funding 1.

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

At 31 December 2015 or for the year then ended	Parent 2015 £'000	Related 2015 £'000	Parent 2014 £'000	Related 2014 £'000
<b>Interest receivable and similar income</b>				
Interest on intercompany loans	-	109,191	-	162,357
<b>Interest payable and similar charges</b>				
Interest payable on Notes held by LBG and subsidiary undertakings	37,074	-	41,985	-
<b>Fair value (losses) / profit</b>	(4,770)	-	8,442	-
<b>Operating expenses</b>				
Administration charges – Lloyds	489	-	731	-
<b>Assets</b>				
Loans to related company	-	2,950,000	-	6,716,158
Interest receivable on loans to related company	-	7,618	-	18,545
Derivatives	26,687	-	54,607	-
Cash and cash equivalents	59	-	55	-
<b>Liabilities</b>				
Notes held by LBG and subsidiary undertakings	1,948,177	-	1,972,317	-
Interest payable on Notes held by LBG and subsidiary undertakings	4,656	-	4,720	-
Trade and other payables	36	-	83	-



## Notes to the financial statements (continued)

For the year ended 31 December 2015

### 15. Future Accounting Pronouncements

The following pronouncements are not applicable for the year ended 31 December 2015 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. As at April 2016, this standard is awaiting EU endorsement.

#### 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 April 2016, this standard is awaiting EU endorsement.

### 16. Ultimate parent undertaking and controlling party

The immediate parent company is Arkle PECO Holdings Limited for which Sanne Trustee Company UK Limited holds the shares in trust for the benefit of certain discretionary objects (which do not include Lloyds or any entity connected with Lloyds).

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 2015.

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

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 accounts of LBG may be obtained from LBG's head office at 25 Gresham Street, London EC2V 7HN or downloaded via [www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com).