

**LBG CAPITAL NO. 2 LIMITED**  
**(formerly LBG CAPITAL NO. 2 PLC)**

**REPORT AND FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED**

**31 DECEMBER 2016**



# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **REPORT AND FINANCIAL STATEMENTS**

For the year ended 31 December 2016

Registered in England and Wales as a private limited company No.07045669

Registered office: 25 Gresham Street, London, United Kingdom EC2V 7HN.

### **DIRECTORS**

V. D. Savadia

R.D. Shrimpton

A.T. Rougier

### **COMPANY SECRETARY**

Lloyds Secretaries Limited

# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **Contents**

---

|                                   | Page |
|-----------------------------------|------|
| Strategic Report                  | 3    |
| Directors' Report                 | 4    |
| Independent Auditors' Report      | 6    |
| Statement of Comprehensive Income | 8    |
| Balance Sheet                     | 9    |
| Statement of Changes in Equity    | 10   |
| Cash Flow Statement               | 11   |
| Notes to the Financial Statements | 12   |

# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **STRATEGIC REPORT**

For the year ended 31 December 2016

### **PRINCIPAL OBJECTIVES AND STRATEGIES**

The Company was incorporated on 15 October 2009 as a company limited by shares. The Company's principal activity is to hold investments and issue capital securities on behalf of Lloyds Banking Group plc ("LBG" or the "Group").

### **BUSINESS MODEL**

The Company's assets consist of subordinated notes issued by Lloyds Bank plc and its liabilities are principally Enhanced Capital Notes ("ECNs") issued to market investors.

### **PERFORMANCE REVIEW**

The profit for the year of £428,835,000 (2015: £34,283,000) is set out in the Statement of Comprehensive Income on page 8. The dividends paid during the year were £503,223,000 (2015: £nil).

Total assets as at 31 December 2016 were £118,340,000 (2015: 2,569,666,000) with net assets of £8,225,000 (2015: £82,613,000).

In March 2014, LBG made an offer to Retail and Institutional investors to enable the Group to strengthen its capital position in line with regulatory requirements. The Group offered eligible Retail investors who held outstanding Sterling denominated Enhanced Capital Notes the opportunity to exchange their ECNs for cash. The Group also offered Institutional investors the opportunity to exchange ECNs, into a new instrument called Additional Tier 1 securities ("AT1"). The AT1 securities were issued by Lloyds Banking Group plc.

Approximately £21m was exchanged by Retail investors for cash. In addition, approximately £1.25bn ECNs held by Institutional investors was exchanged for approximately £1.33bn AT1s. The exchange resulted in a loss of £41,660,966. The company also sold a similar amount of intercompany debt securities to Lloyds Banking Group plc for a premium and this resulted in gain on sale of £545,943,797.

On 31 March 2015, the Lloyds Banking Group plc announced that it had received permission from the Prudential Regulation Authority (PRA) for the redemption of certain series of ECNs. It also confirmed that the Group had been notified by the Trustee that it would seek declaratory judgement in respect of the interpretation of certain terms of the ECNs. A judgement was handed down on 3 June 2015 and it concluded that despite the ECNs not being taken into account for the most recent stress test applied by the PRA, the ECNs might still be taken into account for future stress tests. As a result of the judgement, the Group sought permission to appeal to the Court of Appeal.

The Capital Disqualification Event ("CDE") determination was confirmed by a unanimous decision by the Court of Appeal on 10 December 2015 and on 29 January 2016 the Group announced the redemption of certain series of ECNs using the Regulatory Call Right. The Group also launched tender offers for the remaining series of ECNs on 29 January 2016. The Group redeemed those ECNs not validly tendered using the Regulatory Call Right. The result of the tender and Regulatory Call of the ECNs was a loss to the Company of £183m which included the write off of the discount and capitalised issuance costs. In addition, debt securities originally issued by Lloyds Bank plc (the "Debt Securities") were re-purchased resulting in a profit for the Company of £723m.

### **PRINCIPAL RISKS AND UNCERTAINTIES**

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

### **KEY PERFORMANCE INDICATORS ("KPIs")**

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

## **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

### **DIRECTORS' REPORT**

For the year ended 31 December 2016

### **DIRECTORS' REPORT**

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

### **DIRECTORS**

The names of the directors of the Company, all of whom served throughout the year and up to the date of signing the financial statements are shown on page 1.

The following changes have taken place during the year:

|               |                              |
|---------------|------------------------------|
| V. D. Savadia | (Appointed 29 February 2016) |
| E.F.G. Short  | (Resigned 31 January 2016)   |

### **COMPANY SECRETARY**

The following changes have taken place during the year and up to the date of signing of these financial statements:

|                            |                         |
|----------------------------|-------------------------|
| M.A.A. Johnson             | (Resigned 26 May 2017)  |
| Lloyds Secretaries Limited | (Appointed 26 May 2017) |

### **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 ("the EU"). 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, and IFRSs as issued by the International Accounting Standards Board (IASB), 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.

### **DIRECTORS' INDEMNITIES**

Lloyds Banking Group plc has granted to the Directors of the Company, a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements or from the date of appointment in respect of the director who joined the board of the Company during the financial year. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service. The indemnity remains in force for the duration of a Director's period of office. The deed indemnifies the Directors to the maximum extent permitted by law. The Deed for existing Directors is available for inspection at the registered office of Lloyds Banking Group plc. In addition, the Group has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

## **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

### **DIRECTORS' REPORT**

For the year ended 31 December 2016

#### **GOING CONCERN**

During 2016 the Company disposed of debt securities and redeemed its ECNs, leaving the balance sheet with cash balances, other current liabilities, a current tax liability and equity. It is the intention of the Group for the Company to be liquidated within 12 months from the date of signing this report.

As a result, the financial statements have been prepared on a basis other than going concern. In accordance with IAS 1 *Presentation of financial statements* and IAS 8 *Accounting policies, Changes in accounting estimates and Errors*, management have assessed the accounting policies which would be relevant to a liquidation basis and have determined that these do not differ from those required by IFRS, when the going concern assumption is relevant. No adjustments were necessary in these financial statements to reduce assets to their realisable values, to provide for liabilities arising from the decision or to reclassify fixed assets and long-term liabilities as current assets and liabilities. The comparatives continue to be prepared on a going concern basis.

#### **SUBSEQUENT EVENTS**

On 2 June 2017 the company was re-registered as a private company limited by shares and changed its name from LBG Capital No. 2 Plc to LBG Capital No. 2 Limited. There are no events after the balance sheet date that the directors are aware of that they require to bring to the attention of the users of the financial statements.

#### **INDEPENDENT AUDITORS AND AUDIT INFORMATION**

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

This confirmation is given, and should be interpreted, in accordance with the provisions of section 418 of the Companies Act 2006.

On behalf of the board

V.D. Savadia  
Director

Date: ~~26 JUNE~~ 2017



Company Registration No : 07045669

# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

For the year ended 31 December 2016

## ***Independent auditors' report to the members of LBG Capital No. 2 Limited***

### **Report on the financial statements**

---

#### **Our opinion**

In our opinion, LBG Capital No. 2 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.
- 

#### **Emphasis of matter - Basis of preparation**

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in note 1 to the financial statements concerning the basis of preparation. The entity ceased trading during the financial year and the directors intend to liquidate the company during the next financial year. Accordingly, the going concern basis of preparation is no longer appropriate and the financial statements have been prepared on a basis other than going concern as described in note 1 to the financial statements. No adjustments were necessary in these financial statements to reduce assets to their realisable values, to provide for liabilities arising from the decision or to reclassify fixed assets and long-term liabilities as current assets and liabilities.

---

#### **What we have audited**

The financial statements, included within the 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.

## **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

For the year ended 31 December 2016

---

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

---

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

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

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

We have no exceptions to report arising from this responsibility.

---

#### **Directors' remuneration**

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

---

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

---

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

As explained more fully in the Statement of Directors' Responsibilities 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 & 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. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.



Jonathan Hinchliffe (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London

27 June 2017



# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2016

|  | Note | 2016<br>£'000         | 2015<br>£'000        |
|--|------|-----------------------|----------------------|
| Interest and similar income                    |      | 35,643                | 238,400              |
| Interest and similar expense                   |      | <u>(28,491)</u>       | <u>(201,460)</u>     |
| <b>Net interest income</b>                     | 3    | 7,152                 | 36,940               |
| Net trading (expense) / income                 | 4    | (6,965)               | 6,529                |
| Other operating income                         | 5    | 537,808               | -                    |
| Administration Expense                         | 6    | <u>(1,936)</u>        | <u>-</u>             |
| <b>Profit before taxation</b>                  |      | 536,059               | 43,469               |
| Taxation                                       | 7    | <u>(107,224)</u>      | <u>(9,186)</u>       |
| <b>Profit for the year</b>                     |      | <u><u>428,835</u></u> | <u><u>34,283</u></u> |
| <b>Total comprehensive income for the year</b> |      | <u><u>428,835</u></u> | <u><u>34,283</u></u> |

All activities are discontinued.

The accompanying notes on pages 12 to 26 form an integral part of the financial statements.

# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **BALANCE SHEET**

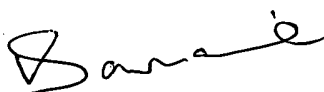
As at 31 December 2016

|   |      | 2016<br>£'000  | 2015<br>£'000    |
|---|------|----------------|------------------|
| <b>ASSETS</b>   |      |                |                  |
|   | Note |                |                  |
| Cash and cash equivalents   | 14   | 118,340        | 294,590          |
| Other current assets  | 8    | -              | 114,396          |
| Amounts owed by other group companies - debt securities held as loans and receivables | 14   | -              | 2,160,680        |
| <b>Total assets</b>   |      | <b>118,340</b> | <b>2,569,666</b> |
| <b>LIABILITIES</b>  |      |                |                  |
| Subordinated liabilities  | 9    | -              | 2,363,012        |
| Other current liabilities   | 11   | 2,675          | 114,576          |
| Current tax liabilities   | 10   | 107,440        | 9,249            |
| Deferred taxation   | 12   | -              | 216              |
| <b>Total liabilities</b>  |      | <b>110,115</b> | <b>2,487,053</b> |
| <b>EQUITY</b>   |      |                |                  |
| Share capital   | 13   | 50             | 50               |
| Retained earnings   |      | 8,175          | 82,563           |
| <b>Total equity</b>   |      | <b>8,225</b>   | <b>82,613</b>    |
| <b>Total liabilities and equity</b>   |      | <b>118,340</b> | <b>2,569,666</b> |

The financial statements were approved by the Board of Directors on ~~26 June~~ 2017 and signed on its behalf by:

V.D. Savadia

Director



The accompanying notes on pages 12 to 26 form an integral part of the financial statements.

## **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

### **STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2016

|  | <b>Share Capital</b> | <b>Retained</b> | <b>Total</b>  |
|--|----------------------|-----------------|---------------|
|  | <b>£'000</b>         | <b>Earnings</b> | <b>Equity</b> |
|  | <b>£'000</b>         | <b>£'000</b>    | <b>£'000</b>  |
| <b>Balance at 1 January 2015</b>                   | 50                   | 48,280          | 48,330        |
| Profit and total comprehensive income for the year | -                    | 34,283          | 34,283        |
| <b>Balance at 31 December 2015</b>                 | 50                   | 82,563          | 82,613        |
| Profit and total comprehensive income for the year | -                    | 428,835         | 428,835       |
| Dividends paid                                     | -                    | (503,223)       | (503,223)     |
| <b>Balance at 31 December 2016</b>                 | <u>50</u>            | <u>8,175</u>    | <u>8,225</u>  |

The accompanying notes on pages 12 to 26 form an integral part of the financial statements.

# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **CASH FLOW STATEMENT**

For the year ended 31 December 2016

|   | Note | 2016<br>£'000             | 2015<br>£'000           |
|---|------|---------------------------|-------------------------|
| <b>Cash flows from operating activities</b>                   |      |                           |                         |
| Profit before taxation  |      | 536,059                   | 43,469                  |
| <u>Adjustment for:</u>  |      |                           |                         |
| Interest income   | 3    | (35,643)                  | (238,400)               |
| Interest expense  | 3    | 28,491                    | 201,460                 |
| Foreign exchange loss/(gain)                                  |      | 7,179                     | (6,600)                 |
| Net result on securities                                      | 5    | <u>(540,127)</u>          | <u>-</u>                |
| Operating (loss) before working capital changes               |      | (4,041)                   | (71)                    |
| Increase in other current liabilities                         |      | 2,578                     | -                       |
| Taxation paid   |      | <u>(9,248)</u>            | <u>(10,383)</u>         |
| <b>Net cash generated from/(used in) operating activities</b> |      | <u><b>(10,711)</b></u>    | <u><b>(10,454)</b></u>  |
| <b>Cash flows from investing activities</b>                   |      |                           |                         |
| Proceeds from disposal of debt securities                     |      | 2,933,607                 | 26,832                  |
| Advances to group companies                                   | 14   | -                         | (18,858)                |
| Interest received   |      | <u>153,739</u>            | <u>239,119</u>          |
| <b>Net cash provided by investing activities</b>              |      | <u><b>3,087,346</b></u>   | <u><b>247,093</b></u>   |
| <b>Cash flows from financing activities</b>                   |      |                           |                         |
| Repayment of subordinated liabilities                         |      | (2,597,961)               | -                       |
| Dividends paid  |      | (503,223)                 | -                       |
| Interest paid   |      | <u>(151,139)</u>          | <u>(245,846)</u>        |
| <b>Net cash used in financing activities</b>                  |      | <u><b>(3,252,323)</b></u> | <u><b>(245,846)</b></u> |
| Changes in cash and cash equivalents                          |      | (175,688)                 | (9,207)                 |
| Effects of exchange rate changes on cash and cash equivalents |      | (562)                     | -                       |
| Cash and cash equivalents at beginning of the year            |      | <u>294,590</u>            | <u>303,797</u>          |
| <b>Cash and cash equivalents at end of the year</b>           |      | <u><b>118,340</b></u>     | <u><b>294,590</b></u>   |

The accompanying notes on pages 12 to 26 form an integral part of the financial statements.

# LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2016

### 1. ACCOUNTING POLICIES

#### BASIS OF PREPARATION

The financial statements have been prepared under the historical cost convention, in compliance with the requirements of the Companies Act 2006 and in accordance with the applicable International Financial Reporting Standards ("IFRSs") as adopted by the European Union and interpretations issued by the IFRS Interpretations Committee (IFRS IC).

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

During 2016 the Company disposed of debt securities and redeemed its ECNs, leaving the balance sheet with cash balances, other current liabilities, a current tax liability and equity. It is the intention of the Group for the Company to be liquidated within 12 months from the date of signing this report.

As a result, the financial statements have been prepared on a basis other than going concern. In accordance with IAS 1 *Presentation of financial statements* and IAS 8 *Accounting policies, Changes in accounting estimates and Errors*, management have assessed the accounting policies which would be relevant to a liquidation basis and have determined that these do not differ from those required by IFRS, when the going concern assumption is relevant. No adjustments were necessary in these financial statements to reduce assets to their realisable values, to provide for liabilities arising from the decision or to reclassify fixed assets and long-term liabilities as current assets and liabilities. The comparatives continue to be prepared on a going concern basis.

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

The following pronouncements were effective during the year and relevant to the Company:

| <b><u>Pronouncement</u></b>  | <b><u>Nature of change</u></b>   | <b><u>IASB effective date</u></b>                   |
|--|--|---|
| Amendment to IAS 1, 'Disclosure Initiative' (issued December 2014) | The amendments provide clarification of existing IAS 1 requirements on materiality and the presentation of the financial statements and associated notes | Annual periods beginning on or after 1 January 2016 |
| Annual improvements to IFRSs (issued December 2013)                | The amendments include changes from the 2010-12 cycle of the annual improvements projects  | On or after 1 January 2016                          |
| Annual improvements to IFRSs (issued September 2014)               | The amendments include changes from the 2012-14 cycle of the annual improvements projects  | On or after 1 January 2016                          |

# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **Notes to the Financial Statements (continued)**

For the year ended 31 December 2016

### **1. ACCOUNTING POLICIES (CONTINUED)**

The following pronouncements will be relevant to the Company but were not effective as at 31 December 2016:

| <b><u>Pronouncement</u></b>   | <b><u>Nature of change</u></b>  | <b><u>IASB effective date</u></b>                   |
|---|---|---|
| Amendment to IAS 1, 'Disclosure Initiative' (issued February 2016)  | The amendments provide clarification of existing IAS 1 requirements on materiality and the presentation of the Annual periods beginning on or after 1 January 2017 financial statements and associated notes.<br><br>The company is currently assessing the impact of IAS 1   | Annual periods beginning on or after 1 January 2017 |
| Amendments to IAS 7, 'Disclosure Initiative' (issued February 2016) | The amendments to IAS 7 introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendment is part of the IASB's Disclosure Initiative, which continues to explore how financial statement disclosure can be improved.<br><br>The company is currently assessing the impact of IAS 7 | Annual periods beginning on or after 1 January 2017 |
| IFRS 9 'Financial Instruments'                                      | This standard replaces the guidance in IAS 39. It includes requirements on the classification and measurement of financial assets and liabilities; it also includes an expected credit losses model that replaces the current incurred loss impairment model  | Annual periods beginning on or after 1 January 2018 |

There are other pronouncements, new standards and amendments which were published in 2015 but are not relevant to the Company.

#### **(a) Revenue recognition**

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

#### **(b) Income taxes, including deferred income taxes**

Current income tax which is payable on taxable profits is recognised as an expense in the year in which the profits arise. Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Company's financial statements. Deferred tax is determined using tax rates that have been enacted or announced by the balance sheet date that are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled. Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

#### **(c) Cash and cash equivalents**

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

#### **(d) Loans and receivables**

Loans and receivables are accounted for at amortised cost using the effective interest method. Loans and receivables are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs.

## **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

### **Notes to the Financial Statements (continued)**

For the year ended 31 December 2016

#### **1. ACCOUNTING POLICIES (CONTINUED)**

##### **(e) Debt securities held as loans and receivables**

Debt securities held as loans and receivables are initially recognised at fair value plus directly related transaction costs and are subsequently carried on the balance sheet at amortised cost using the effective interest method less provision for impairment.

##### **(f) Impairment**

At each balance sheet date the Company assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset has become impaired. If there is objective evidence that an impairment loss has been incurred, a provision is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate.

##### **(g) Derecognition of financial assets and liabilities**

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either: substantially all of the risks and rewards of ownership have been transferred; or the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation is discharged), cancelled or expire.

##### **(h) Borrowings**

Borrowings (which include amounts from group companies, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently measured at amortised cost using the effective interest method. The coupons paid on these instruments are recognised in the statement of comprehensive income as interest expense

##### **(i) Foreign currency translation**

Foreign currency transactions are translated into sterling 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.

##### **(j) Dividend receivable and payable**

Dividends on ordinary and preference shares treated as equity are recognised in equity in the year in which they are paid. Dividends in respect of investment in ordinary shares are recognised as income in the year in which they are received.

##### **(k) Segment reporting**

The chief operating decision maker is the board of directors. The board of directors manages the business as a single operating segment.

##### **(l) Contingent liabilities**

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

#### **2. CRITICAL ACCOUNTING JUDGEMENTS**

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

## LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)

### Notes to the Financial Statements (continued)

For the year ended 31 December 2016

#### 3. NET INTEREST INCOME

|   | 2016<br>£'000       | 2015<br>£'000        |
|---|---------------------|----------------------|
| <i>Interest Income</i>                                      |                     |                      |
| Amount owed by other group companies - debt securities held | 34,121              | 237,207              |
| Cash balance with other group companies                     | <u>1,522</u>        | <u>1,193</u>         |
|   | <b>35,643</b>       | <b>238,400</b>       |
| <i>Interest Expense</i>                                     |                     |                      |
| Subordinated liabilities                                    | <u>28,491</u>       | <u>201,460</u>       |
|   | <b>28,491</b>       | <b>201,460</b>       |
| Net interest income   | <u><b>7,152</b></u> | <u><b>36,940</b></u> |

#### 4. NET TRADING (EXPENSE)/INCOME

|                                 | 2016<br>£'000  | 2015<br>£'000 |
|---------------------------------|----------------|---------------|
| Foreign exchange (losses)/gains | <u>(6,965)</u> | <u>6,529</u>  |
|                                 | <b>(6,965)</b> | <b>6,529</b>  |

#### 5. OTHER OPERATING INCOME

|                        | 2016<br>£'000  | 2015<br>£'000 |
|------------------------|----------------|---------------|
| Net gain on securities | <u>537,808</u> | <u>-</u>      |
|                        | <b>537,808</b> | <b>-</b>      |

On 29 January 2016 the Group announced the redemption of certain series of ECNs using the Regulatory Call Right. The Group also launched tender offers for the remaining series of ECNs on 29 January 2016. The Group redeemed those ECNs not validly tendered using the Regulatory Call Right. The result of the tender and Regulatory Call of the ECNs was a loss to the Company of £183m which included the write off of the premium and capitalised issuance costs. In addition, debt securities originally issued by Lloyds Bank plc (the "Debt Securities") were re-purchased resulting in a profit for the Company of £723m.



# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **Notes to the Financial Statements (continued)**

For the year ended 31 December 2016

### **6. ADMINISTRATION EXPENSE**

|                            | 2016<br>£'000  | 2015<br>£'000 |
|----------------------------|----------------|---------------|
| Legal Fees for ECN buyback | (1,936)        | -             |
| Statutory audit fee        | -              | -             |
|                            | <u>(1,936)</u> | <u>-</u>      |

The number of persons employed by the Company during the year was nil (2015: nil). Statutory audit fees for the current year of £15,000 (2015: £15,000) were borne by Lloyds Bank plc.

### **7. TAXATION**

#### **(a) Analysis of tax (charge) for the year**

|  | 2016<br>£'000    | 2015<br>£'000  |
|--|------------------|----------------|
| UK Corporation tax - current year          | (107,440)        | (9,132)        |
| UK Corporation tax - prior year adjustment | -                | (117)          |
| Deferred taxation (Note 12)                | 216              | 63             |
| <b>Total taxation for the year</b>         | <u>(107,224)</u> | <u>(9,186)</u> |

The tax (charge) on the company's profit for the year is based on a UK corporation tax rate 20.00% (2015: 20.25%).

#### **(b) Factors affecting the tax (charge) for the year**

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

|   | 2016<br>£'000    | 2015<br>£'000  |
|---|------------------|----------------|
| Profits before taxation                                     | <u>536,059</u>   | <u>43,469</u>  |
| Tax charge UK corporation tax rate of 20.00% (2015: 20.25%) | (107,212)        | (8,802)        |
| Deferred tax rate change                                    | (12)             | 11             |
| UK Corporation tax-prior year adjustment                    | -                | (117)          |
| Disallowed and non-taxable items                            | -                | (278)          |
| <b>Total taxation (charge)</b>                              | <u>(107,224)</u> | <u>(9,186)</u> |
| <b>Effective rate</b>                                       | <u>20.00%</u>    | <u>21.13%</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.

### **8. OTHER CURRENT ASSETS**

|  | 2016<br>£'000 | 2015<br>£'000  |
|--|---------------|----------------|
| Interest receivable from other group companies - debt securities | <u>-</u>      | <u>114,396</u> |
|  | <u>-</u>      | <u>114,396</u> |

# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **Notes to the Financial Statements (continued)**

For the year ended 31 December 2016

### **9. SUBORDINATED LIABILITIES**

| (a)   | 2016<br>£'000        | 2015<br>£'000        |
|---|----------------------|----------------------|
| Enhanced Capital Notes (refer to b below)     | -                    | 2,383,203            |
| Capitalised issuance costs (refer to c below) | -                    | (20,191)             |
|   | <u>-</u>             | <u>2,363,012</u>     |
| (b)   | ECN<br>2016<br>£'000 | ECN<br>2015<br>£'000 |
| Enhanced Capital Notes:                       |                      |                      |
| At beginning of the year                      | 2,383,203            | 2,478,624            |
| Repayments during the year                    | (2,171,502)          | -                    |
| Net accretion of (discounts)/premium          | (270,554)            | (48,204)             |
| Foreign exchange movement                     | <u>58,854</u>        | <u>(47,217)</u>      |
|   | -                    | 2,383,203            |
| Accrued Interest                              | -                    | 114,520              |
| At end of the year (refer to d below)         | <u>-</u>             | <u>2,497,723</u>     |
| (c)   | 2016<br>£'000        | 2015<br>£'000        |
| Capitalised issuance costs:                   |                      |                      |
| At beginning of the year                      | (20,191)             | (24,769)             |
| Amortised during the year                     | <u>20,191</u>        | <u>4,578</u>         |
| At end of the year                            | -                    | (20,191)             |

(d) Details of the Enhanced Capital Notes are provided in the table below:

| Rates   | Product Name                    | Series | Notional<br>at 31/12/16<br>(million) | 2016<br>Carrying<br>Value<br>£'000 | 2015<br>Carrying<br>Value<br>£'000 |
|---------|---------------------------------|--------|--------------------------------------|------------------------------------|------------------------------------|
| 8.875%  | Enhanced Capital Notes due 2020 | 12     | €0                                   | -                                  | 101,643                            |
| 9.334%  | Enhanced Capital Notes due 2020 | 14     | £0                                   | -                                  | 22,743                             |
| 6.385%  | Enhanced Capital Notes due 2020 | 18     | €0                                   | -                                  | 439,842                            |
| 15.000% | Enhanced Capital Notes due 2019 | 21     | £0                                   | -                                  | 904,824                            |
| 15.000% | Enhanced Capital Notes due 2019 | 22     | €0                                   | -                                  | 466,497                            |
| 15.000% | Enhanced Capital Notes due 2029 | 23     | £0                                   | -                                  | 105,099                            |
| 9.125%  | Enhanced Capital Notes due 2020 | 27     | £0                                   | -                                  | 49,005                             |
| 11.125% | Enhanced Capital Notes due 2020 | 31     | £0                                   | -                                  | 4,520                              |
| 12.750% | Enhanced Capital Notes due 2020 | 34     | £0                                   | -                                  | 15,791                             |
| 7.625%  | Enhanced Capital Notes due 2019 | 39     | £0                                   | -                                  | 38,760                             |
| 9.000%  | Enhanced Capital Notes due 2019 | 40     | £0                                   | -                                  | 15,857                             |
| 14.500% | Enhanced Capital Notes due 2022 | 42     | £0                                   | -                                  | 19,894                             |
| 9.875%  | Enhanced Capital Notes due 2023 | 44     | £0                                   | -                                  | 5,828                              |
| 11.250% | Enhanced Capital Notes due 2023 | 45     | £0                                   | -                                  | 22,127                             |
| 10.500% | Enhanced Capital Notes due 2023 | 46     | £0                                   | -                                  | 9,675                              |
| 11.875% | Enhanced Capital Notes due 2024 | 47     | £0                                   | -                                  | 19,570                             |
| 9.000%  | Enhanced Capital Notes due 2029 | 49     | £0                                   | -                                  | 646                                |
| 8.500%  | Enhanced Capital Notes due 2032 | 50     | £0                                   | -                                  | 3,506                              |
| 16.125% | Enhanced Capital Notes due 2024 | 52     | £0                                   | -                                  | 20,972                             |
| 7.875%  | Enhanced Capital Notes due 2020 |        | \$0                                  | -                                  | 230,924                            |
|         |                                 |        |                                      | <u>-</u>                           | <u>2,497,723</u>                   |

## **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

### **Notes to the Financial Statements (continued)**

For the year ended 31 December 2016

#### **9. SUBORDINATED LIABILITIES (CONTINUED)**

In March 2014, Lloyds Banking Group plc made an offer to Retail and Institutional investors to buy back Enhanced Capital Notes (ECNs) to enable the Group to strengthen its capital position. From the offers accepted, ECNs held by retail investors were exchanged for cash while those held by Institutional investors were exchanged into a new instrument called Additional Tier 1 securities ("AT1"). The AT1 securities were issued by the ultimate parent company.

The ECNs contained an equity conversion feature that required them to convert into ordinary shares if the consolidated core tier 1 ratio of Lloyds Banking Group plc fell below 5 per cent (based on a fixed definition as defined by the Financial Services Authority in May 2009). The conversion feature met the definition of an embedded derivative and was recorded separately as a derivative asset in the ultimate parent company and consolidated financial statements of Lloyds Banking Group plc. The conversion feature reflected the value to Lloyds Banking Group plc from the equity conversion feature contained within the ECNs. Only the liability component was held by the Company.

The ECNs issued by the Company were guaranteed by Lloyds Banking Group plc. Lloyds Banking Group plc had irrevocably and unconditionally guaranteed the due and punctual payment of all principal, premium and interest and any other sums, from time to time, expressed to be payable by the Company in respect of the ECNs, the related coupons and under Trust Deeds dated 1 December 2009 in respect thereof. The obligations under the guarantee constituted direct and unsecured obligations of Lloyds Banking Group plc, subordinated as described in the conditions of the ECNs set out in the Trust Deeds dated 1 December 2009.

In the event that Lloyds Banking Group plc published consolidated Core Tier 1 ratio fell below 5% the Company would pay to the ECN holders any accrued unpaid interest in respect of the ECNs and would redeem the ECNs at a price equal to their principal amount. ECN holders would be deemed irrevocably to have directed and authorised the Company to pay the principal amount to Lloyds Banking Group plc as consideration for Lloyds Banking Group plc agreement to issue ordinary shares and the obligations of the Company to pay principal on the relevant ECNs to holders should be discharged by the Company's obligation to pay the principal amount to Lloyds Banking Group plc.

Following a relevant change of law event or certain disqualifying event, the Company might elect to redeem the ECNs for their principal amount together with accrued but unpaid interest (or such other amount specified in the relevant contractual terms).

The ECNs would, in the event of the winding-up of the Company, be subordinated to the claims of depositors and all other creditors of Lloyds Banking Group plc, other than creditors whose claims ranked equally with, or were junior to, the claims of the holders of the subordinated liabilities. The subordination of specific subordinated liabilities was determined in respect of the Company and any guarantors of that liability. The claims of holders of preferred shares and securities were generally junior to those of the holders of undated subordinated liabilities, which in turn were junior to the claims of holders of the dated subordinated liabilities. The subordination of the ECNs ranked equally with that of the dated subordinated liabilities. No repayment or purchase by the issuer of the subordinated liabilities could be made prior to their stated maturity without the consent of the Financial Services Authority.

In 2015, the Group participated in the UK-wide concurrent stress testing run by the Bank of England; the Enhanced Capital Notes (ECNs) in issue were not taken into account for the purposes of core capital in the PRA stress tests and the Group had determined that a Capital Disqualification Event (CDE), as defined in the conditions of the ECNs, had occurred.

On 31 March 2015, Lloyds Banking Group plc announced that it had received permission from the Prudential Regulation Authority (PRA) for the redemption of certain series of ECNs. It also confirmed that the Group had been notified by the Trustee that it would seek declaratory judgement in respect of the interpretation of certain terms of the ECNs. A judgement was handed down on 3 June 2015 and it concluded that despite the ECNs not being taken into account for the most recent stress test applied by the PRA, the ECNs might still be taken into account for future stress tests. As a result of the judgement, the Group sought permission to appeal to the Court of Appeal.

The CDE determination was confirmed by a unanimous decision by the Court of Appeal on 10 December 2015 and on 29 January 2016 the Group announced the redemption of certain series of ECNs using the Regulatory Call Right. The Group also launched tender offers for the remaining series of ECNs on 29 January 2016. The Group redeemed those ECNs not validly tendered using the Regulatory Call Right. The result of the tender and Regulatory Call of the ECNs was a loss to the Company of £183m which included the write off of the premium and capitalised issuance costs. In addition, debt securities originally issued by Lloyds Bank plc (the 'Debt Securities') were re-purchased resulting in a profit for the Company of £723m.

## LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)

### Notes to the Financial Statements (continued)

For the year ended 31 December 2016

The trustee of the ECNs had been granted leave by the Supreme Court to appeal the Court of Appeal decision. On 16 June the Supreme Court decided in respect of the interpretation of certain terms of the ECN's and found in the Group's favour. The Court held that a CDE, as defined in the conditions of the ECN's had occurred. As a result, the Supreme Court approved the Group's redemption of all series of ECNs using the Regulatory Call Right in early 2016.

#### 10. CURRENT TAX LIABILITIES

|                         | 2016           | 2015         |
|-------------------------|----------------|--------------|
|                         | £'000          | £'000        |
| Corporation tax payable | <u>107,440</u> | <u>9,249</u> |
|                         | <u>107,440</u> | <u>9,249</u> |

#### 11. OTHER CURRENT LIABILITIES

|  | 2016         | 2015           |
|--|--------------|----------------|
|  | £'000        | £'000          |
| Interest payable on enhanced capital notes | -            | 114,520        |
| Interest payable to other group companies  | 97           | 56             |
| Legal Fees for ECN buyback                 | <u>2,578</u> | <u>-</u>       |
|  | <u>2,675</u> | <u>114,576</u> |

#### 12. DEFERRED TAXATION

|  | 2016         | 2015        |
|--|--------------|-------------|
|  | £'000        | £'000       |
| At beginning of the year                           | 216          | 279         |
| Deferred tax rate change                           | 12           | (11)        |
| Deferred tax adjustment in respect of current year | <u>(228)</u> | <u>(52)</u> |
| At end of the year                                 | <u>-</u>     | <u>216</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.

#### 13. SHARE CAPITAL

|                              | 2016             | 2015             | 2016          | 2015          |
|------------------------------|------------------|------------------|---------------|---------------|
|                              | Number of shares | Number of shares | £             | £             |
| Issued and fully paid:       |                  |                  |               |               |
| At the beginning of the year | <u>50,000</u>    | <u>50,000</u>    | <u>50,000</u> | <u>50,000</u> |
| At the end of the year       | <u>50,000</u>    | <u>50,000</u>    | <u>50,000</u> | <u>50,000</u> |

The holder is entitled to 100% of the voting rights.

There is no contractual requirement to make dividend payments on the A ordinary share; hence they are classified as equity in line with IAS 32.

During 2016, an interim dividend of £10,064.46 per ordinary share amounting to £503,223,000 was paid to the parent company by LBG Capital No. 2 plc. No final dividend was proposed by the directors in respect of the year ending 31 December 2016 (2015: nil). No interim dividend was paid during 2015.

## LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)

### Notes to the Financial Statements (continued)

For the year ended 31 December 2016

#### 14. RELATED PARTY TRANSACTIONS

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

##### *Transactions with key management personnel*

There were no transactions between the Company or its subsidiaries with key management personnel during the current year. Key management personnel and directors are employed by other companies in the Group and consider that their services to the Company are incidental to their other activities with the Group. Directors emoluments for the year is therefore nil (2015: nil).

##### *Other transactions with other group companies*

|                                | 2016           | 2015           |
|--------------------------------|----------------|----------------|
|                                | £'000          | £'000          |
| Lloyds Bank plc – Cash at Bank | 118,340        | 294,590        |
| Interest received (note 3)     | <u>(1,522)</u> | <u>(1,193)</u> |

##### *Amounts owed by other group companies - debt securities held as loans and receivables*

|                                     | 2016          | 2015             |
|-------------------------------------|---------------|------------------|
|                                     | £'000         | £'000            |
| At beginning of the year            | 2,160,680     | 2,208,779        |
| Advances during the year            | -             | 18,858           |
| Repayments during the year          | (2,221,243)   | (26,832)         |
| Foreign exchange movement           | <u>60,563</u> | <u>(40,125)</u>  |
|                                     | <u>-</u>      | <u>2,160,680</u> |
| Representing:                       |               |                  |
| Lloyds Bank plc                     | <u>-</u>      | <u>2,160,680</u> |
|                                     | <u>-</u>      | <u>2,160,680</u> |
| Interest Income earned (note 3)     | 34,121        | 237,207          |
| Interest Income receivable (note 8) | <u>-</u>      | <u>114,396</u>   |

The debt securities held were initially recorded at fair value at acquisition and subsequently measured at amortised cost.

## LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)

### Notes to the Financial Statements (continued)

For the year ended 31 December 2016

#### 15. FINANCIAL RISK MANAGEMENT

The Company uses financial instruments to meet the financial needs of its counterparties and to reduce its own exposure to fluctuations in interest rates. The Company makes loans to other Lloyds Banking Group plc. companies at fixed rates and for various years.

##### (a) Interest Rate Risk

Interest rate risk arises from the mismatch between interest rate sensitive liabilities and interest rate sensitive assets. From the perspective of the Company, the interest rate risks are integrated with the interest rate risks of the group and are not managed separately. The scenarios are run only for assets and liabilities that represent the major interest-bearing positions. Based on the simulations performed, the full year impact on post-tax profit of a 0.25% shift would be an increase or decrease of approximately £236,680 (2015: £183,940).

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

As at 31 December 2016

|   | 1 month<br>or less | 3 months<br>or less<br>but over<br>1 month | 1 year<br>or less<br>but over<br>3 months | 5 years<br>or less<br>but over<br>1 year | Over 5<br>years | Non-<br>interest<br>bearing | Total          |
|---|--------------------|--|---|--|-----------------|-----------------------------|----------------|
|   | £'000              | £'000                                      | £'000                                     | £'000                                    | £'000           | £'000                       | £'000          |
| <i>Assets:</i>  |                    |  |   |  |                 |                             |                |
| Amounts owed by group companies - debt securities held as loans and receivables | -                  | -  | -   | -  | -               | -                           | -              |
| Cash and cash equivalents   | 118,340            | -  | -   | -  | -               | -                           | 118,340        |
| Other current assets  | -                  | -  | -   | -  | -               | -                           | -              |
| <b>Total financial assets</b>   | <b>118,340</b>     | <b>-</b>                                   | <b>-</b>                                  | <b>-</b>                                 | <b>-</b>        | <b>-</b>                    | <b>118,340</b> |
| <i>Liabilities:</i>   |                    |  |   |  |                 |                             |                |
| Subordinated liabilities  | -                  | -  | -   | -  | -               | -                           | -              |
| Other current liabilities   | -                  | -  | -   | -  | -               | 2,675                       | 2,675          |
| Current tax liabilities   | -                  | -  | -   | -  | -               | 107,440                     | 107,440        |
| <b>Total financial liabilities</b>  | <b>-</b>           | <b>-</b>                                   | <b>-</b>                                  | <b>-</b>                                 | <b>-</b>        | <b>110,115</b>              | <b>110,115</b> |
| <b>Total interest sensitivity gap</b>   | <b>118,340</b>     | <b>-</b>                                   | <b>-</b>                                  | <b>-</b>                                 | <b>-</b>        | <b>(110,115)</b>            | <b>8,225</b>   |

# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **Notes to the Financial Statements (continued)**

For the year ended 31 December 2016

### **15. FINANCIAL RISK MANAGEMENT (CONTINUED)**

As at 31 December 2015

|   | 1 month<br>or less | 3 months<br>or less<br>but over<br>1 month | 1 year<br>or less<br>but<br>over<br>3<br>months | 5 years<br>or less<br>but over<br>1 year | Over 5<br>years | Non-<br>interest<br>bearing | Total            |
|---|--------------------|--|---|--|-----------------|-----------------------------|------------------|
|   | £'000              | £'000                                      | £'000   | £'000                                    | £'000           | £'000                       | £'000            |
| <i>Assets:</i>  |                    |  |   |  |                 |                             |                  |
| Amounts owed by group companies - debt securities held as loans and receivables | -                  | 2,160,680                                  | -   | -  | -               | -                           | 2,160,680        |
| Cash and cash equivalents   | 294,590            | -  | -   | -  | -               | -                           | 294,590          |
| Other current assets  | -                  | -  | -   | -  | -               | 114,396                     | 114,396          |
| <b>Total financial assets</b>   | <b>294,590</b>     | <b>2,160,680</b>                           | <b>-</b>  | <b>-</b>                                 | <b>-</b>        | <b>114,396</b>              | <b>2,569,666</b> |
| <i>Liabilities:</i>   |                    |  |   |  |                 |                             |                  |
| Subordinated liabilities  | -                  | 2,363,012                                  | -   | -  | -               | -                           | 2,363,012        |
| Other current liabilities   | -                  | -  | -   | -  | -               | 114,576                     | 114,576          |
| Current tax liabilities   | -                  | -  | -   | -  | -               | 9,249                       | 9,249            |
| <b>Total financial liabilities</b>  | <b>-</b>           | <b>2,363,012</b>                           | <b>-</b>  | <b>-</b>                                 | <b>-</b>        | <b>123,825</b>              | <b>2,486,837</b> |
| <b>Total interest sensitivity gap</b>   | <b>294,590</b>     | <b>(202,332)</b>                           | <b>-</b>  | <b>-</b>                                 | <b>-</b>        | <b>(9,429)</b>              | <b>82,829</b>    |

### **(b) Foreign Exchange Risk**

The Company is exposed to currency risk (or foreign exchange risk) through its subordinated liabilities and its loans and deposits to group companies. The Company's policy is to match its exposure to foreign currencies with equivalent currency-denominated loans from, or deposits with, its fellow subsidiary company, Lloyds Bank plc. Some residual currency exposure arises from slight mismatches in the funding held and from timing differences in arranging funding. The Company's level of exposure to currency risk is monitored according to the LBG's policies.

The Company's principal net exposures are to the Euro and US Dollar.

The Company's foreign currency exposure as at 31 December 2016 is as follows:

| <b>Gross Exposures</b> | <b>2016<br/>£'000</b> | <b>2015<br/>£'000</b> |
|------------------------|-----------------------|-----------------------|
| EUR                    | 0                     | (109,387)             |
| USD                    | (7)                   | (22,083)              |

If Sterling had been weaker against the Euro or US Dollar by 10% at 31 December 2016 (10% at 31 December 2015) the impact would be approximately £nil (2015: £10,938,735 loss for EUR exposure and £2,208,341 for the USD exposure).

# LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)

## Notes to the Financial Statements (continued)

For the year ended 31 December 2016

### 15. FINANCIAL RISK MANAGEMENT (CONTINUED)

The following significant exchange rates applied during the year:

|            | Average rate |        | Reporting date spot rate |        |
|------------|--------------|--------|--------------------------|--------|
|            | 2016         | 2015   | 2016                     | 2015   |
| EUR to GBP | 1.2186       | 1.3824 | 1.1665                   | 1.3600 |
| USD to GBP | 1.3451       | 1.5258 | 1.2287                   | 1.4814 |

#### (c) Fair Value of Financial Assets and Liabilities

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

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

The Company provides loans and advances to other LBG companies at fixed and floating rates. The fair value for these loans and advances as disclosed in note 15 were estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. The fair values are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

Debt securities held by the Company are initially recorded at fair value and subsequently as loans and receivables at amortised cost.

#### Valuation hierarchy

The table below analyses the fair values of the financial assets and liabilities of the Group which are carried at amortised cost. They are categorised into levels 1 to 3 based on the degree to which their fair value is observable.

##### Level 1

Level 1 fair value measurements are those derived from unadjusted quote prices in active markets for identical assets or liabilities.

##### Level 2

Level 2 valuations are those where quoted market prices are not available, for example where an instrument is traded in a market that is not considered to be active or valuation techniques are used to determine the fair value and where these techniques use inputs that are based significantly on observable market data.

##### Level 3

Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data.

|  | Carrying value |           | Fair value      |                 |
|--|----------------|-----------|-----------------|-----------------|
|  | 2016           | 2015      | Level 2<br>2016 | Level 2<br>2015 |
|  | £'000          | £'000     | £'000           | £'000           |
| <b>Financial assets</b>  |                |           |                 |                 |
| Amount owed by other group companies - debt securities held as loans and receivables | -              | 2,160,680 | -               | 2,990,904       |
| <b>Financial liabilities</b>   |                |           |                 |                 |
| Subordinated liabilities   | -              | 2,363,012 | -               | 2,697,075       |



# **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

## **Notes to the Financial Statements (continued)**

For the year ended 31 December 2016

### **15. FINANCIAL RISK MANAGEMENT (CONTINUED)**

#### **(d) Measurement Basis of Financial Assets and Liabilities**

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

| <b>As at 31 December 2016</b>                                | <b>Loans and<br/>receivables<br/>£'000</b> | <b>Held at amortised<br/>cost<br/>£'000</b> | <b>Total<br/>£'000</b> |
|--|--|---|------------------------|
| <i>Assets:</i>   |  |   |                        |
| Amounts owed by other group companies - debt securities held | -  | -   | -                      |
| Cash and cash equivalents                                    | 118,340                                    | -   | 118,340                |
| Other current assets   | -  | -   | -                      |
| <b>Total financial assets</b>                                | <b>118,340</b>                             | <b>-</b>                                    | <b>118,340</b>         |
| <i>Liabilities:</i>  |  |   |                        |
| Subordinated liabilities                                     | -  | -   | -                      |
| Other current liabilities                                    | -  | 2,675                                       | 2,675                  |
| <b>Total financial liabilities</b>                           | <b>-</b>                                   | <b>2,675</b>                                | <b>2,675</b>           |

| <b>As at 31 December 2015</b>                                | <b>Loans and receivables<br/>£'000</b> | <b>Held at amortised<br/>cost<br/>£'000</b> | <b>Total<br/>£'000</b> |
|--|--|---|------------------------|
| <i>Assets:</i>   |  |   |                        |
| Amounts owed by other group companies - debt securities held | 2,160,680                              | -   | 2,160,680              |
| Cash and cash equivalents                                    | 294,590                                | -   | 294,590                |
| Other current assets   | -                                      | 114,396                                     | 114,396                |
| <b>Total financial assets</b>                                | <b>2,455,270</b>                       | <b>114,396</b>                              | <b>2,569,666</b>       |
| <i>Liabilities:</i>  |  |   |                        |
| Subordinated liabilities                                     | -                                      | 2,363,012                                   | 2,363,012              |
| Other current liabilities                                    | -                                      | 114,576                                     | 114,576                |
| <b>Total financial liabilities</b>                           | <b>-</b>                               | <b>2,477,588</b>                            | <b>2,477,588</b>       |

## LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)

### Notes to the Financial Statements (continued)

For the year ended 31 December 2016

#### 15. FINANCIAL RISK MANAGEMENT (CONTINUED)

##### (e) Credit Risk

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

|   | 2016<br>£'000  | 2015<br>£'000    |
|---|----------------|------------------|
| Amounts owed by other group companies - debt securities held as loans and receivables | -              | 2,160,680        |
| Cash and cash equivalent  | 118,340        | 294,590          |
| Other current assets  | -              | 114,396          |
| Total credit risk exposure  | <u>118,340</u> | <u>2,569,666</u> |

The current rating of the ultimate parent company, Lloyds Banking Group plc, is Baa1 (2015: Baa1), and the current rating of Lloyds Bank plc, is A1 (2015: A1) as per Moody's. None of the assets is past due nor impaired.

##### (f) Liquidity Risk

The table below analyse liabilities of the Company on an undiscounted future cash flow basis according to contractual or actual maturity date into relevant maturity groupings based on the remaining period at the balance sheet date. Due to the ECNs repurchase transaction described in Note 9, the comparatives for subordinated liabilities have been included in the 1-3 months category.

| As at 31 December 2016    | On demand<br>£'000 | Up to 1 month<br>£'000 | 1 - 3 months<br>£'000 | 3 - 12 months<br>£'000 | 1 - 5 years<br>£'000 | Over 5 years<br>£'000 | Total<br>£'000   |
|---------------------------|--------------------|------------------------|-----------------------|------------------------|----------------------|-----------------------|------------------|
| Subordinated liabilities  | -                  | -                      | -                     | -                      | -                    | -                     | -                |
| Other current liabilities | 2,675              | -                      | -                     | -                      | -                    | -                     | 2,675            |
| Total Liabilities         | <u>2,675</u>       | <u>-</u>               | <u>-</u>              | <u>-</u>               | <u>-</u>             | <u>-</u>              | <u>2,675</u>     |
| As at 31 December 2015    | On demand<br>£'000 | up to 1 month<br>£'000 | 1 - 3 months<br>£'000 | 3 - 12 months<br>£'000 | 1 - 5 years<br>£'000 | Over 5 years<br>£'000 | Total<br>£'000   |
| Subordinated liabilities  | -                  | -                      | 2,324,320             | -                      | -                    | -                     | 2,324,320        |
| Other current liabilities | 55                 | 75,474                 | 16,551                | 22,494                 | -                    | -                     | 114,574          |
| Total Liabilities         | <u>55</u>          | <u>75,474</u>          | <u>2,340,871</u>      | <u>22,494</u>          | <u>-</u>             | <u>-</u>              | <u>2,438,894</u> |

##### (g) Capital Risk Management

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

## **LBG CAPITAL NO. 2 LIMITED (formerly LBG CAPITAL NO. 2 PLC)**

### **Notes to the Financial Statements (continued)**

For the year ended 31 December 2016

#### **15. FINANCIAL RISK MANAGEMENT (CONTINUED)**

The company monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt (including 'current and non-current borrowings' as shown in the balance sheet) divided by total capital. Total capital is calculated as 'equity' as shown in the balance sheet plus net debt.

|                                 | <b>2016</b>      | <b>2015</b>      |
|---------------------------------|------------------|------------------|
|                                 | <b>£'000</b>     | <b>£'000</b>     |
| Total liabilities               | <b>110,115</b>   | <b>2,487,053</b> |
| Less: cash and cash equivalents | <b>(118,340)</b> | <b>(294,590)</b> |
| Net debt                        | <b>(8,225)</b>   | <b>2,192,463</b> |
| Total equity                    | <b>8,225</b>     | <b>82,613</b>    |
| <b>Total capital</b>            | <b>-</b>         | <b>2,275,076</b> |
| <b>Gearing ratio</b>            | <b>-</b>         | <b>96 %</b>      |

#### **16. SUBSEQUENT EVENTS**

On 2 June 2017 the company was re-registered as a private company limited by shares and changed its name from LBG Capital No. 2 Plc to LBG Capital No. 2 Limited. There are no events after the balance sheet date that the directors are aware of that they require to bring to the attention of the users of the financial statements.