SCOTTISH WIDOWS SERVICES LIMITED

(SC189975)

ANNUAL REPORT

AND

FINANCIAL STATEMENTS

31 DECEMBER 2018

Member of Lloyds Banking Group plc

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COMPANY INFORMATION

Board of Directors

J Gomez-Reino
S W Lowther

Company Secretary

K J Mckay

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
2 Glass Wharf
Bristol
BS2 0FR

Registered Office

69 Morrison Street
Edinburgh
EH3 8YF

Company Number

SC189975

STRATEGIC REPORT

The Directors present their Strategic Report on Scottish Widows Services Limited ("the Company") for the year ended 31 December 2018.

The Company forms part of Lloyds Banking Group plc ("LBG" or the "Group").

The Company continues to act as a service provider to the LBG Insurance Division's subsidiary undertakings of Scottish Widows Group Limited ("SWG"). Additionally the Company acts as the employer for the Scottish Widows Retirement Benefit Scheme ("SWRBS"). As part of this arrangement all associated service costs occurring from the SWRBS are recharged to Insurance Division companies.

Result for the year

The result of the Company for the year ended 31 December 2018 is a loss before tax of £27.5m (2017: loss before tax of £63.6m). The variance is driven by a change in the recharge procedure for the remeasurement of the retirement benefit obligation and a mark-up now being applied to costs not attributable to the Insurance Division, as explained in more detail below. In addition, remeasurement of retirement benefit obligations resulted in a gain of £61.5m (2017: £52.8m). The total net assets of the Company at 31 December 2018 are £135.4m (2017: £95.4m).

Key performance indicators

Employee numbers and costs

The average monthly number of employees is 2,520 (2017: 2,506), whilst staff costs and other employee related costs have reduced by £8.2m to £181.9m (2017: £190.1m). This variance reflects simplifications as a consequence of projects entered into in 2017.

Pension scheme asset/liability

The defined benefit scheme has been recognised in the Company's balance sheet as £97.7m retirement benefit asset (2017: £77.3m retirement benefit liability). This result is mainly driven by £74.1m remeasurement effects recognised in other comprehensive income and £118.7m employer contributions during the year.

Liquidity

The Company regularly monitors its liquidity position to ensure that it has sufficient liquidity to meets its obligations.

The Directors are of the opinion that the information presented in the financial statements as a whole provides the management information necessary for the Directors to understand the development, performance and position of the business of the Company.

Review of the business

Ring-fenced Bank

Following the financial crisis, UK legislation was passed to better protect customers and the day-to-day banking services they rely on. The new rules mean large UK banks must separate personal banking services such as current and savings accounts, from risks in other parts of the business, like investment banking. This is called ring-fencing.

As a result of the requirements of the ring-fencing regulations, the ownership of the Company was transferred from Scottish Widows Limited ("SWL") to Lloyds Bank plc ("LB plc", a company within LBG's ring-fenced bank) on 2 May 2018. The principal financial impacts on the Company from this transaction are as follows:

Update to the cost charging methodology

A review of the cost and pension charging methodology across the Group has been undertaken to comply with the ring-fencing regulations. Effective from the date of transfer to LB plc, a cost mark-up has been applied to those costs that are not directly attributable to the Insurance Division, thus increasing profits for 2018 by £4.4m.

Tripartite agreement in respect of the SWRBS pension scheme

Until 1 May 2018, SWL guaranteed the Company's liabilities to the SWRBS pension scheme. On the transfer of ownership, the Company entered into a tripartite agreement with SWL and LB plc which required SWL to make a £284.0m risk premium payment to the Company, in exchange for LB plc bearing the exposure to volatility risks on the SWRBS.

The risk premium is initially held on the balance sheet of the Company as a contingent settlement provision and it will be adjusted over the life of the pension scheme for related actuarial gains and losses in the SWRBS. SWL will continue to pay ongoing pension service costs in respect of the employees recharged by the Company.

STRATEGIC REPORT (CONTINUED)

The United Kingdom leaving the European Union

The continued lack of clarity over the UK's eventual relationship with the EU has heightened risks in the Eurozone and raises uncertainty for the UK economic outlook. Leadership changes in the EU have contributed to further uncertainty. There is a risk of a no deal EU exit outcome, which could have a significant impact given the Insurance Division's UK-centric footprint. The Insurance Division's response to these risks includes internal contingency plans recalibrated and regularly reviewed for potential strategic, operational and reputational impacts and no deal EU exit outcome analysed to identify impacts and assess robustness of contingency plans. As a provider of services to the Insurance Division, any impact from Brexit will be recharged. While the impact on the Insurance Division could be significant, the impact on the Company is expected to be minimal.

Climate Change

As part of LBG, the Company is committed to supporting the UK to successfully engage with the opportunities and challenges created by climate change and the need to transition to a low carbon economy. LBG has set ambitions anchored to the goals laid out in the UK Government's Clean Growth Strategy, which align closely to LBG's business priorities. The ambition that is relevant to the Company is: be part of a leading UK bank in reducing our own carbon footprint and challenging our suppliers to ensure our own consumption of resources, goods and services is sustainable.

Further details of the LBG approach of transitioning to a low carbon economy can be found in the Lloyds Banking Group Annual Report and Accounts, which can be downloaded via www.lloydsbankinggroup.com.

Outlook

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

Principal risks and uncertainties

The management of the business and the execution of the Company's strategy are subject to a number of risks. In particular, ring-fencing regulations have placed an increased focus on governance and risk management, LBG and the Company have taken steps to ensure the control environment and governance structure support compliance. The financial risk management objectives and policies of the Company and the exposure to risks including market, credit, capital, liquidity and operational risks are set out in note 20.

On behalf of the Board of Directors

S W Lowther
Director
28 May 2019

DIRECTORS' REPORT

Principal activities

The Directors present the audited financial statements of the Company, a private company limited by shares, domiciled and incorporated in the United Kingdom whose principal activity is to act as a service provider to subsidiary undertakings of SWG. The Company is a wholly owned subsidiary of LB plc.

Results and dividend

The result of the Company for the year ended 31 December 2018 is a loss before tax of £27.5m (2017: loss before tax of £63.6m). The variance is driven by a change in the recharge procedure for the remeasurement of the retirement benefit obligation and a mark-up now being applied to costs not attributable to the Insurance Division, as explained in the Strategic Report. In addition, remeasurement of retirement benefit obligations resulted in a gain of £61.5m (2017: £52.8m). The total net assets of the Company at 31 December 2018 are £135.4m (2017: £95.4m).

During the year, £nil interim dividends (2017: £nil) were paid. Directors recommend no payment of a dividend in respect of the year ended 31 December 2018 (2017: £nil).

Directors

The names of the current Directors are listed on page 2. Changes in directorships during the year and since the end of year are as follows:

Directors:
None

Company secretary:

L C M Crane	(resigned 24 September 2018)
K J Mckay	(appointed 24 September 2018)

Particulars of the Directors' emoluments are set out in note 21.

Directors' indemnities

LBG has granted to the Directors of the Company a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements or from the date of appointment in respect of Directors who join 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 the Directors' periods of office. The deed indemnifies the Directors to the maximum extent permitted by law. Deeds for existing Directors are available for inspection at the registered office of LBG. In addition, LBG has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year. Qualifying pension scheme indemnities have also been granted to the Trustees of Lloyds Banking Group's Pension Schemes, which were in force for the whole of the financial year and remain in force as at the date of this report.

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 Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Employees

LBG, of which the Company is a part, is committed to providing employment practices and policies which recognise the diversity of the workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief. In the UK, LBG belongs to the major employer groups campaigning for equality for all staff, including Employers' Forum on Disability, Employers' Forum on Age and Stonewall. LBG is also represented on the Board of Race for Opportunity and the Equal Opportunities Commission. Involvement with these organisations enables LBG to identify and implement best practice for staff.

LBG encourages and gives full and fair consideration to job applications from people with a disability and are unbiased in the way it assesses, selects, appoints, trains and promotes people. LBG encourages job applications from those with a disability and continues to run a work experience programme with Remploy to support people with disabilities wanting to enter the workplace.

DIRECTORS' REPORT (CONTINUED)

LBG is committed to continuing the employment of, and for arranging appropriate training for, employees of the Company who have become disabled persons during the period when they were employed by the Company.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. These meetings, briefings and internal communications also serve to achieve a common awareness of the financial and economic factors that affect the performance of the Company. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions. Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in LBG.

Charitable and political contributions

During the year, the Company made contributions totalling £88.0k (2017: £1.6k) for charitable purposes. The Company made no political contributions during the year (2017: £nil).

Financial risk management

Disclosures relating to financial risk management are included in note 20 to the financial statements and are therefore incorporated into this report by reference.

Independent auditors

PricewaterhouseCoopers LLP are deemed to be reappointed under section 487(2) of the Companies Act 2006.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulation.

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

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for 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.

Each of the Directors whose names are listed on page 2 confirms that, to the best of their knowledge:

- the Company financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and
- the Strategic Report on pages 3 to 4, and the Directors' Report on pages 5 to 6, include a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

On behalf of the Board of Directors

S W Lowther
Director
28 May 2019

Independent Auditors' Report to the members of Scottish Widows Services Limited

Report on the audit of the financial statements

Opinion

In our opinion, Scottish Widows Services Limited's financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2018 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.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2018; the statement of comprehensive income, the statement of cash flows, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the Company's trade, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Independent Auditors' Report to the members of Scottish Widows Services Limited (continued)

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the Directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities set out on page 6, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

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.

Other required reporting

Companies Act 2006 exception reporting

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 by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Neil Riches

Neil Riches (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol

28 May 2019

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 £000	2017 £000
Revenue	3	819,949	806,422
Staff costs and other employee related costs	4a	(181,934)	(190,123)
Operating expenses	5	(666,966)	(676,913)
Net interest on net defined benefit asset/liability	7	(400)	(3,400)
Operating loss		**(29,351)**	**(64,014)**
Investment income		1,808	391
Loss before tax		**(27,543)**	**(63,623)**
Taxation credit	8	6,021	10,790
Loss for the year		**(21,522)**	**(52,833)**
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Remeasurement of retirement benefits obligations, net of tax	15c	61,504	52,756
Other comprehensive income		**61,504**	**52,756**
Total comprehensive income/(loss) for the year		**39,982**	**(77)**

The notes set out on pages 13 to 39 are an integral part of these financial statements.

BALANCE SHEET AS AT 31 DECEMBER 2018

	Note	2018 £000	2017 £000
ASSETS			
Intangible assets	9	131,344	168,305
Deferred tax assets	10	11,887	31,339
Tangible fixed assets	11	-	-
Retirement benefit asset	15	97,700	-
Current tax assets	10	12,712	13,824
Financial assets:			
At amortised cost:			
Loans and other receivables	12	205,291	389,494
Cash and cash equivalents	13	149,914	98,913
Total assets		**608,848**	**701,875**
EQUITY AND LIABILITIES			
Capital and reserves attributable to Company's shareholder			
Share capital	14	81,000	81,000
Retained earnings		54,415	14,433
Total equity		**135,415**	**95,433**
LIABILITIES			
Contingent settlement provision	16	284,000	-
Accruals	17	70,299	92,626
Financial liabilities:			
Trade and other payables	18	119,134	436,516
Retirement benefit liability	15	-	77,300
Total liabilities		**473,433**	**606,442**
Total liabilities and equity		**608,848**	**701,875**

The notes set out on pages 13 to 39 are an integral part of these financial statements.

The financial statements on pages 9 to 39 were approved by the Board of Directors on 28 May 2019 and signed on its behalf by

S W Lowther
Director

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 £000	2017 £000
Cash flows from operating activities			
Loss before tax		(27,543)	(63,623)
Adjustments for:			
Depreciation of property and equipment	11	-	439
Amortisation of intangible assets	9	36,890	36,040
Intangible assets impairment loss	9	71	2,035
Investment income		(1,808)	-
Net movement in operating assets and liabilities	19	(330,506)	(165,687)
Remeasurement of net defined benefit obligations	15c	74,100	66,700
Taxation received/(paid)		13,989	(9,489)
Net cash used in operating activities		**(234,807)**	**(133,585)**
Cash flows from investing activities			
Investment income		1,808	-
Additions to intangible assets	9	-	(46,065)
Net cash used in investing activities		**1,808**	**(46,065)**
Cash flows from financing activities			
Risk premium	16	284,000	-
Net cash generated from financing activities		**284,000**	-
Net increase/(decrease) in cash and cash equivalents		51,001	(179,650)
Cash and cash equivalents at the beginning of the year		98,913	278,563
Cash and cash equivalents at the end of the year	13	**149,914**	**98,913**

The notes set out on pages 13 to 39 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital £000	Retained earnings £000	Total equity £000
Balance as at 1 January 2017	**81,000**	**14,510**	**95,510**
Loss for year	-	(52,833)	(52,833)
Other comprehensive income			
Remeasurements of retirement benefit obligations, net of tax (note 15c)	-	52,756	52,756
Total comprehensive loss for the year	-	(77)	(77)
Balance as at 31 December 2017	**81,000**	**14,433**	**95,433**
Loss for year	-	(21,522)	(21,522)
Other comprehensive income			
Remeasurements of retirement benefit obligations, net of tax (note 15c)	-	61,504	61,504
Total comprehensive income for the year	-	39,982	39,982
Balance as at 31 December 2018	**81,000**	**54,415**	**135,415**

All of the above amounts are attributable to the equity holder of the Company.

The notes set out on pages 13 to 39 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1. Accounting policies

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

(a) Basis of preparation

The financial statements of the Company have been prepared:

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

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

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

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

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

Standards and interpretations effective in 2018

The Company has adopted IFRS 9 "Financial Instruments" as at 1 January 2018. In accordance with the transitional provisions in IFRS 9.7.2.15, comparative figures have not been restated. The resulting changes to accounting policies are summarised in note 24(a). The adoption of IFRS 9 has not had a significant impact on the overall financial position of the Company. Further details are set out in note 24.

The Company has adopted IFRS 15 "Revenue from Contracts with Customers" as at 1 January 2018. The existing accounting policies are consistent with the requirements of IFRS 15. The application of this standard has not had a material impact on the Company.

(b) Financial assets and financial liabilities

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

On initial recognition, financial assets are classified as measured at amortised cost or fair value through profit or loss, depending on the Company's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest. The Company assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. The Company reclassifies financial assets when and only when its business model for managing those assets changes. A reclassification will only take place when the change is significant to the Company's operations and will occur at a portfolio level and not for individual instruments; reclassifications are expected to be rare.

The Company initially recognises loans and other receivables when the Company becomes a party to the contractual provisions of the instrument.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Company 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 Company has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

1. Accounting policies (continued)

(b) Financial assets and financial liabilities (continued)

Transaction costs incidental to the acquisition of a financial asset are expensed through the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss.

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

(c) Fair value methodology

All assets and liabilities carried at fair value, or for which a fair value measurement is disclosed, are categorised into a "fair value hierarchy" as follows:

(i) Level 1

Valued using quoted prices (unadjusted) in active markets for identical assets and liabilities to those being valued. An active market is one in which arm's length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an ongoing basis.

(ii) Level 2

Valued using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices). If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- Quoted prices for similar (but not identical) instruments in active markets;
- Quoted prices for identical or similar instruments in markets that are not active, where prices are not current, or price quotations vary substantially either over time or among market makers;
- Inputs other than quoted prices that are observable for the instrument (for example, interest rates and yield curves observable at commonly quoted intervals and default rates);
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means.

(iii) Level 3

Valued using inputs for the asset or liability that include significant unobservable inputs (inputs not based on observable market data). Unobservable inputs may have been used to measure fair value where observable inputs are not available. This approach allows for situations in which there is little, if any, market activity for the asset or liability at the measurement date (or market information for the inputs to any valuation models). Unobservable inputs reflect the assumptions the Company considers that market participants would use in pricing the asset or liability, for example certain private equity investments held by the Company.

(d) Revenue recognition

Revenue

Revenue consists of the management charges levied to other LBG companies. Revenue is recognised as the related expenses are incurred.

Investment income

Interest income for all interest bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within investment income.

(e) Expense recognition

Staff costs and other employee related costs

Staff costs and other employee related costs are recognised in the statement of comprehensive income as incurred, within staff costs and other employee related costs.

Net interest on net defined benefit asset/ liability

Other operating income reflects the extent to which interest income on plan assets is greater than the interest cost on defined benefit pension scheme obligations. Policy (n) sets out further information on the accounting for retirement benefit obligations.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

1. Accounting policies (continued)

(e) Expense recognition (continued)

Operating expenses

Operating expenses are recognised in the statement of comprehensive income as incurred, within operating expenses.

(f) Share-based payments

LBG operates a number of equity-settled, share-based compensation plans in respect of services received from certain of the Company's employees. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments. This expense is determined by LBG by reference to the fair value of the number of equity instruments that are expected to vest, and the appropriate proportion is recharged to, and recognised as an expense by, the Company.

(g) Intangible assets

Software development costs

Costs that are directly associated with the acquisition of software licences and the production of identifiable and unique software products controlled by the Company, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets, subject to de minimis limits. Direct costs include the software development team's employee costs and an appropriate portion of relevant overheads. All other costs associated with developing or maintaining computer software programmes are recognised through the statement of comprehensive income as an expense as incurred, within operating expenses.

Computer software development costs recognised as assets are valued at cost and amortised using the straight-line method over their expected useful lives, not exceeding a period of seven years. Subsequent expenditure is only capitalised when it increases the expected future economic benefits of the specific asset to which it relates.

The amortisation charge for the year in respect of software licences and software development costs is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the assets is tested for impairment at each reporting date. Further information on the Company's impairment policy is set out at policy (k).

(h) Tangible fixed assets

All fixtures and fittings are stated at cost less accumulated depreciation and any impairment in value. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Subsequent costs are included in an asset's carrying value only when it is probable that future economic benefits related to the asset will flow to the Company and such costs can be measured reliably.

Depreciation is calculated on a straight-line basis to allocate the difference between the cost and the estimated residual value over the estimated useful lives of these assets. The depreciation charge is recognised through the statement of comprehensive income, within operating expenses.

Fixtures and fittings are depreciated over 15 years as standard.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than the recoverable amount, it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

(i) Loans and receivables at amortised cost

Loans and receivables at amortised cost are financial assets, other than cash and cash equivalents that are held to collect contractual cash flows, where those cash flows represent solely payments of principal and interest. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Where the contractual cash flows introduce exposure to risks or volatility unrelated to a basic lending arrangement such as changes in equity prices or commodity prices, the payments do not comprise solely principal and interest.

Loans and receivables at amortised cost are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment. Further information on the Company's impairment policy is set out at policy (k).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

1. Accounting policies (continued)

(j) Cash and cash equivalents

Cash and cash equivalents include cash at bank and investments in liquidity funds, which are short-term highly liquid investments (excluding such investments as otherwise meet this definition but which are held for investment purposes rather than for the purposes of meeting short-term cash commitments).

Holdings in liquidity funds are measured at fair value through profit or loss, with income received recognised in investment income.

The fair value of holdings in liquidity funds is determined as the last published price applicable to the vehicle at the reporting date.

Holdings in liquidity funds are categorised as level 1 in the fair value hierarchy. These assets are valued using quoted prices in active markets for identical assets to those being valued. An active market is one in which similar arm's length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an ongoing basis.

(k) Impairment

Financial assets

Where an impairment charge arises in the statement of comprehensive income it includes the change in expected credit losses for financial assets held at amortised cost. Expected credit losses are calculated by using an appropriate probability of default and applying this to the estimated exposure of the Company at the point of default after taking into account the value of any collateral held or other mitigants of loss.

At initial recognition, allowance is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk, allowance is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses. In determining whether there has been a significant increase in credit risk, the Company uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings and other indicators of historic delinquency. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due.

Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since initial recognition, the asset is transferred back to Stage 1.

For financial instruments that are considered to have low credit risk, the credit risk is assumed to not have increased significantly since initial recognition. Financial instruments are considered to have low credit risk when the borrower is considered to have a low risk of default from a market perspective. Typically financial instruments with an external credit rating of investment grade are considered to have low credit risk.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The Company uses this 90 day backstop.

A loan or receivable is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the statement of comprehensive income.

Non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

1. Accounting policies (continued)

(k) Impairment (continued)

Non-financial assets (continued)

If there is objective evidence that an impairment loss has occurred, the amount of the loss is charged to the relevant line in the statement of comprehensive income in the period in which it occurs. Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(l) Taxes

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the statement of comprehensive income except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the statement of comprehensive income (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or another tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are re-measured as required to reflect current information.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences but not recognised for taxable temporary differences arising on investments in subsidiaries, associates and joint arrangements where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax liabilities are not recognised on temporary differences that arise from goodwill which is not deductible for tax purposes.

Deferred tax assets are recognised to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilised, and are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are not recognised in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. Deferred tax is not discounted.

(m) Share capital

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

(n) Retirement benefit obligations

Individuals employed by the Company may be members of the Scottish Widows Retirement Benefit Scheme ("SWRBS") or of other pension schemes administered by LBG. All schemes are funded through payments to trustee-administered funds, determined by periodic actuarial calculations.

The Company contributes to both defined benefit and defined contribution elements of the pension schemes in question. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan under which the Company pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

1. Accounting policies (continued)

(n) *Retirement benefit obligations (continued)*

(i) *Scottish Widows Retirement Benefit Scheme*

A full actuarial valuation of this defined benefit scheme is carried out at least every three years with interim reviews in the intervening years; the valuation is updated to 31 December each year by a qualified actuary. For the purposes of these annual updates, scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method by an independent, qualified actuary appointed by LBG.

The amount recognised in the balance sheet in respect of the defined benefit element of the pension scheme is the present value of the defined benefit obligation at the reporting date less the fair value of plan assets. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates equivalent to the market yields at the reporting date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity that are approximate to the terms of the related pension asset/liability.

A surplus is only recognised to the extent that it is recoverable through a right to make reduced contributions in the future or to receive a refund from the scheme. The Company recognises any change in the effect of the surplus that can be recognised in other comprehensive income within remeasurements of the retirement benefit asset.

The Company recognises in profit or loss the current service cost of providing pension benefits and the net interest on the net defined benefit obligation. The current service cost is recognised within operating expenses.

The net interest on the net defined benefit obligation is recognised within finance costs, and is determined by applying the discount rate used to measure the net defined benefit obligation at the beginning of the period to the net defined benefit obligation at that date, taking account of changes in the net defined benefit obligation during the period as a result of contributions and benefit payments.

Past service costs are changes in the defined benefit obligation arising from plan amendments or curtailments and are recognised immediately in profit or loss, within operating expenses, when the plan amendment or curtailment occurs. The Company recognises the gain or loss on a settlement of the defined benefit obligation immediately in profit or loss when the settlement occurs.

The Company recognises in other comprehensive income, within remeasurements of the retirement benefit obligations, actuarial gains and losses arising from experience adjustments and changes in the actuarial assumptions, and the return on plan assets excluding the net interest on the net defined benefit obligation that is recognised in profit or loss.

(ii) *Defined contribution schemes*

Contributions made by the Company to defined contribution arrangements, including Your Tomorrow, are recognised in the statement of comprehensive income as an employee benefit expense when they are due, within staff costs and other employee related costs.

(o) Contingent settlement provision

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, when it is probable that the obligation will result in an outflow of resources to settle the obligation and when a reliable estimate of the amount of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The value of amounts utilised is determined annually in line with the actuarial valuations of the retirement benefit obligation, as outlined in note (n).

(p) Trade and other payables

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

(q) Accruals

Accruals relates to expenses incurred in the year but not yet paid. A corresponding amount has been recognised in the statement of comprehensive income.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

2. Critical accounting estimates and judgments in applying accounting policies

The Company's management makes estimates and judgments that affect the reported amount of assets and liabilities. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

a) Retirement benefit obligations

The majority of the Company's employees who were a member of a defined benefit scheme were members of the SWRBS. Most of these members have now transferred to the Your Tomorrow defined contribution section of the LBG Pension Scheme No. 1.

The risks associated with the LBG Schemes are shared among various entities under common control of LBG. The Company's defined benefit obligation represents 100% of the SWRBS pension scheme due to the Company being principal employer and scheme guarantor. The accounting valuation of the Group's defined benefit pension schemes' liabilities requires management to make a number of assumptions. The key areas of estimation uncertainty are the discount rate applied to future cash flows and the expected lifetime of the schemes' members. The Group considers latest market practice and actual experience in determining the appropriate assumptions for both current mortality expectations and the rate of future mortality improvement. It is uncertain whether this rate of improvement will be sustained going forward and, as a result, actual experience may differ from current expectations. Further information on these liabilities is given in note 15.

b) Deferred tax

Estimation of income taxes includes the assessment of recoverability of deferred tax assets. Deferred tax assets are only recognised to the extent they are considered more likely than not to be recoverable based on existing tax laws and forecasts of future taxable profits against which the underlying tax deductions can be utilised.

c) Intangible assets

Intangible assets represent computer software development costs recognised as assets are valued at cost and amortised using the straight-line method over their expected useful lives, not exceeding a period of seven years. Management apply judgement in performing the annual impairment review as set out in note 1(k). Further information on these assets is given in note 9.

d) Fair value of financial instruments

In accordance with IFRS 7, the Company categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as Level 1 are valued using quoted market prices and therefore there is minimal judgement applied in determining fair value. However, the fair value of financial instruments categorised as Level 2 and, in particular, Level 3 is determined using valuation techniques. These valuation techniques involve management judgement and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information. Further details of these valuations are described in note 20.

e) Share based payments

The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments. This expense is determined by LBG by reference to the fair value of the number of equity instruments that are expected to vest, and the appropriate proportion is recharged to, and recognised as an expense by, the Company. Management apply judgement in determining the relevant expense using assumptions outlined in note 4.

3. Revenue

	2018 £000	2017 £000
Management charges	817,615	803,514
Pension management income retained by the Company	2,334	2,908
Total	**819,949**	**806,422**

Management charges are offset by actuarial gains of £31.0m (2017: £56.0m) from the SWRBS Pension Scheme which the Company recharges to SWL. The recharge of actuarial gains or losses ceased when the ownership of the Company transferred to LB plc on 2 May 2018.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

4a. Staff costs and other employee related costs

	2018 £000	2017 £000
Wages and salaries	103,131	114,362
Share based payments	28,597	22,826
Social security costs	18,843	17,491
Service costs - defined benefit pension scheme (note 15a)	15,600	21,700
Other pension costs - defined contribution (note 15b)	15,763	13,744
Total	**181,934**	**190,123**

Share based payments

The charge to the statement of comprehensive income is as follows:

	2018 £000	2017 £000
Deferred bonus plan	20,615	15,375
Executive and SAYE plans	7,259	6,785
Share matching scheme	723	666
Total	**28,597**	**22,826**

During the year ended 31 December 2018, the Company received the above charges relating to share-based payment schemes. All share-based payment schemes are operated by LBG and are equity settled.

Deferred bonus plans

LBG operates a number of deferred bonus plans that are equity settled. Bonuses in respect of employee performance in 2018 have been recognised in the charge in line with the proportion of the deferral period completed.

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn schemes to save up to £500 per month and, at the expiry of a fixed term of three or five years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in LBG at a discounted price of no less than 80 per cent of the market price at the start of the invitation.

Other share option plans

Lloyds Banking Group Executive Share Plan 2003

The Plan was adopted in December 2003 and under the Plan share options may be granted to senior employees. Options under this plan have been granted specifically to facilitate recruitment and as such were not subject to any performance conditions. The Plan is used not only to compensate new recruits for any lost share awards but also to make grants to key individuals for retention purposes with, in some instances, the grant being made subject to individual performance conditions.

Lloyds Banking Group Long-Term Incentive Plan

The Long-Term Incentive Plan (LTIP) introduced in 2006 is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of LBG over a three year period. Awards are made within limits set by the rules of the LTIP, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary. In exceptional circumstances this may increase to four times annual salary.

Participants may be entitled to any dividends paid during the vesting period if the performance conditions are met. An amount equal in value to any dividends paid between the award date and the date the Remuneration Committee determine that the performance conditions were met may be paid, based on the number of shares that vest. The Remuneration Committee will determine if any dividends are to be paid in cash or in shares.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

4a. Staff costs and other employee related costs (continued)

Set out below is a summary of options granted under the plan:

	2018 Number of shares	2017 Number of shares
Outstanding at 1 January 2018	19,385,588	18,733,254
Granted	10,007,139	13,281,133
Vested	(5,411,927)	(5,859,020)
Forfeited	(2,100,643)	(6,952,862)
Dividend Award	198,717	183,083
Total	**22,078,874**	**19,385,588**

Awards in respect of the 2016 grant will vest in 2019 at a rate of 68.7 percent.

The weighted average fair value of awards granted in the year was £0.48 (2017: £0.57).

The fair value calculations as 31 December 2018 for grants made in the year, using Black-Scholes models and Monte-Carlo simulation, are based on the following assumptions:

	Save-as-you-earn	Executive Share Plan 2003	LTIP
Weighted average risk-free interest rate	0.96%	0.74%	0.94%
Weighted average expected life	3.3 years	1.3 years	3.7 years
Weighted average expected volatility	28%	21%	29%
Weighted average expected dividend yield	4.0%	4.0%	4.0%
Weighted average share price	£0.59	£0.58	£0.67
Weighted average exercise price	£0.48	nil	nil

Expected volatility is a measure of the amount by which LBG's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option. The historical volatility is compared to the implied volatility generated from market traded options in LBG's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

Matching shares

LBG undertakes to match shares purchased by employees up to the value of £45 per month; these matching shares are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves within this three year period for other than a 'good' reason, 100 per cent of the matching shares are forfeited. Similarly if the employees sell their purchased shares within three years, their matching shares are forfeited.

4b. Number of employees

The average monthly number of employees directly employed by the Company is as follows:

	2018 No.	2017 No.
UK	2,520	2,506
Total	**2,520**	**2,506**

The costs of employees in the above table are recharged to SWG companies.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

5. Operating expenses

	2018 £000	2017 £000
Sales and marketing	1,386	229
Computer costs	738	816
Professional fees	15,290	10,864
Outsourcing charges	53,273	8,007
Auditors' remuneration	5,990	5,744
Depreciation (note 11)	-	439
Amortisation of intangible assets (note 9)	36,890	36,040
Intangible assets impairment loss (note 9)	71	2,035
Group recharges from LBG	501,253	539,511
Industry Levy	23,482	26,839
Rectification expense	25,928	26,501
Other expenses	2,665	19,888
Total	**666,966**	**676,913**

6. Auditors' remuneration

	2018 £000	2017 £000
Fees payable to the Company's auditors for the audit of the Company's annual financial statements	37	37
Total	**37**	**37**

The auditors' remuneration disclosed in operating expenses includes amounts relating to and recharged to companies within the Insurance Division and disclosed in the financial statements of those companies.

During the year, the audit fee in respect of pension schemes was £44.0k (2017: £34.5k).

7. Net interest on net defined benefit asset/liability

	2018 £000	2017 £000
Expected return on defined benefit pension scheme assets	31,600	33,700
Interest cost on defined benefit pension scheme obligation	(32,000)	(37,100)
Total	**(400)**	**(3,400)**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

8. Taxation credit

(a) Current year tax credit

	2018 £000	2017 £000
Current tax:		
UK corporation tax	12,778	13,824
Adjustment in respect of prior years	99	837
Total current tax credit	**12,877**	**14,661**
Deferred tax:		
Temporary differences	(7,254)	(3,103)
Adjustment in respect of prior years	398	(768)
Total deferred tax charge	**(6,856)**	**(3,871)**
Total income tax credit	**6,021**	**10,790**

Corporation tax is calculated at a rate of 19.00% (2017: 19.25 %)

A reconciliation of the current taxation charge for the year to the charge that would result from applying the standard United Kingdom corporation taxation rate to profit before taxation is given below:

(b) Reconciliation of tax credit

	2018 £000	2017 £000
Loss before tax	(27,543)	(63,623)
Tax at 19.00% (2017: 19.25%)	5,233	12,247
Effects of:		
Disallowable expenses	(56)	(1,289)
Non-taxable items	1,159	-
Adjustment in respect of prior years	496	69
Rate change and related impacts	(811)	(237)
Total	**6,021**	**10,790**

The Finance Act 2016 reduced the main rate of corporation tax to 17% with effect from 1 April 2020.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

9. Intangible assets

Software development costs

	2018 £000	2017 £000
Cost		
At 1 January	275,952	282,676
Additions	-	46,065
Disposals	(28,746)	(35,146)
Write-downs of impaired assets	(292)	(17,643)
At 31 December	**246,914**	**275,952**
Accumulated amortisation		
At 1 January	107,647	122,361
Amortisation charge for the year	36,890	36,040
Amortisation on disposals	(28,746)	(35,146)
Amortisation on impaired assets	(221)	(15,608)
At 31 December	**115,570**	**107,647**
Carrying amount		
At 31 December	**131,344**	**168,305**

Of the above total for software development costs, £99.0m (2017: £136.3m) is expected to be amortised more than one year after the reporting date. Items fully amortised in the year have been written off as disposals. Following the annual impairment review, a number of the remaining items were written-down as impaired which resulted in a £0.1m (2017: £2.0m) impairment loss. There were no additions in the year (2017: £46.1m), due to assets now being administered by LBG and recharged to the Company through Group recharges from LBG in operating expenses, rather than being held at a legal entity level.

The movement during the financial year on assets in the course of construction, included in software development costs was as follows:

	2018 £000	2017 £000
At 1 January	39,007	25,458
Additions	-	46,065
Transfers to capitalised software	(35,884)	(32,516)
At 31 December	**3,123**	**39,007**

10. Tax assets and liabilities

	2018 £000	2017 £000
Current tax assets	12,712	13,824
Deferred tax assets	11,887	31,339
Total tax assets	**24,599**	**45,163**

Recognised deferred tax

	2018 £000	2017 £000
Deferred tax assets comprise:		
Income taxable in future periods	-	(66)
Pension and other post-retirement benefits	(16,609)	13,142
Accelerated capital allowances	13,290	18,521
Share based payments	1,186	(258)
Pension spreading	14,020	-
Total deferred tax assets	**11,887**	**31,339**

Of the above total £11.9m (2017: £31.3m) is expected to be recovered more than one year after the reporting date.

As LBG is tax-paying the tax losses incurred by the Company will all be utilised by way of group relief surrender.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

10. Tax assets and liabilities (continued)

Recognised deferred tax (continued)

The movement in the deferred tax asset for the year ended 31 December is as follows:

	Total	Income taxable in future periods	Pension & other post retirement obligations	Accelerated capital allowances	Pension spreading	Share based payments
	£000	£000	£000	£000	£000	£000
Opening balance as at 1 January 2018	31,339	(66)	13,142	18,521	-	(258)
Prior year adjustment	398	66	-	(1,112)	-	1,444
(Charge) / credit to:						
- profit or loss	(7,254)	-	(17,155)	(4,119)	14,020	-
- other comprehensive income	(12,596)	-	(12,596)	-	-	-
Closing balance as at 31 December 2018	**11,887**	**-**	**(16,609)**	**13,290**	**14,020**	**1,186**

As at 31 December 2017:

	Total	Expenses deductible in future periods	Pension & other post retirement obligations	Accelerated capital allowances	Pension spreading	Share based payments
	£000	£000	£000	£000	£000	£000
Opening balance as at 1 January 2017	49,155	433	24,757	20,102	3,863	-
Prior year adjustment	(769)	(434)	-	(77)	-	(258)
(Charge) / credit to:						
- profit or loss	(3,103)	(65)	2,329	(1,504)	(3,863)	-
- other comprehensive income	(13,944)	-	(13,944)	-	-	-
Closing balance as at 31 December 2017	**31,339**	**(66)**	**13,142**	**18,521**	**-**	**(258)**

11. Tangible fixed assets

Fixtures and fittings

	2018	2017
	£000	£000
Cost		
At 1 January	-	10,910
Disposals	-	(10,910)
At 31 December	-	-
Accumulated depreciation		
At 1 January	-	10,471
Depreciation charge for the year	-	439
Depreciation on disposals	-	(10,910)
At 31 December	-	-
Carrying amount		
At 31 December	-	-

Depreciation expense of £nil (2017: £0.4m) has been charged within operating expenses. Items fully amortised in the prior year have been written off as disposals.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

12. Loans and other receivables

	2018 £000	2017 £000
Amounts due from Group undertakings	193,767	380,918
Accrued income	5,692	4,041
Other receivables	5,832	4,535
Total	**205,291**	**389,494**

None of the above balances are interest-bearing (2017: £nil). Of the above total £nil (2017: £nil) is expected to be recovered more than one year after the reporting date.

Information in respect of credit risk is given in note 20.

Further information relating to amounts due from Group undertakings is set out in note 21.

13. Cash and cash equivalents

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

	2018 £000	2017 £000
Cash at bank	149	641
Investment held through a liquidity fund	149,765	98,272
Total	**149,914**	**98,913**

14. Share capital

	2018 £000	2017 £000
Issued and fully paid share capital:		
81,000,000 (2017: 81,000,000) shares of £1 each	81,000	81,000
Total	**81,000**	**81,000**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

15. Retirement benefit asset/(liability)

The Company's employees may be members of the Scottish Widows Retirement Benefit Scheme (SWRBS), which provides mainly defined benefits, or members of LBG Schemes, which provide defined benefits and/or defined contribution benefits to the members of those schemes.

(a) Scottish Widows Retirement Benefits Scheme

(i) Characteristics of the SWRBS

The SWRBS is a funded scheme in the UK, operated as a separate legal entity under trust law by Scottish Widows Pension Trustees Limited until 31 December 2018 in compliance with the Pensions Act 2004. As at 1 January 2019, Scottish Widows Pension Trustees Limited was replaced by Lloyds Banking Group Pension Trustee Limited ("the Trustee"). A valuation exercise is carried out for the scheme at least every three years, whereby scheme assets are measured at market value and liabilities (technical provisions) are measured using prudent assumptions. If a deficit is identified a recovery plan is agreed between the Company and the Trustee and sent to the Pensions Regulator for review. The Company has not provided for these deficit contributions as the future economic benefits arising from these contributions are expected to be available to the Company.

The latest full valuation of the SWRBS was carried out as at 1 July 2016 and showed a deficit of £388.0m when comparing assets with technical provisions liabilities. The recovery plan provides for the Company to pay deficit contributions of £9.2m each month from January 2018 to June 2021. These deficit contributions are in addition to the regular contributions to meet the cost of benefits accruing over each year and the administration expenses of running the scheme.

The Company paid contributions of approximately £118.7m to the SWRBS in 2018 (2017: £12.6m). Employee contributions made during the year were £nil (2017: £nil).

The Company currently expects to pay contributions totalling £124.3m in 2019.

The technical provisions liabilities differ from the liabilities assessed under IAS19, with technical provisions typically being more prudent. The IAS19 liabilities in these financial statements have been calculated by an independent, qualified actuary appointed by LBG.

The responsibility for the governance of the SWRBS lies with the Trustees, whose role is to ensure that the SWRBS is administered in accordance with the SWRBS rules and relevant legislation, and to safeguard the assets in the best interests of all members and beneficiaries. The Trustees are solely responsible for setting investment policy and for agreeing funding requirements with the employer through the triennial valuation process. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the SWRBS's regulations.

(ii) Amounts in the Financial Statements of the SWRBS

The amounts recognised in the Company's balance sheet are as follows:

	2018	2017
	£000	£000
Fair value of scheme assets	1,205,600	1,170,900
Present value of defined benefit obligations	(1,107,900)	(1,248,200)
Surplus/(deficit) recognised in the balance sheet	**97,700**	**(77,300)**

Of the above, the surplus of £97.7m (2017: deficit of £77.3m) is expected to be settled in more than one year after the reporting date.

The following tables present a further analysis of the amounts recognised in the Company's balance sheet:

	2018	2017
	£000	£000
Net amount recognised in the balance sheet		
At 1 January	(77,300)	(130,300)
Service cost	(15,600)	(21,700)
Net interest on net defined benefit asset/liability	(400)	(3,400)
Remeasurement effects recognised in other comprehensive income	74,100	66,700
Employer contributions	118,700	12,600
Administration costs incurred during the year	(1,800)	(1,200)
At 31 December	**97,700**	**(77,300)**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

15. Retirement benefit asset/(liability) (continued)

(a) Scottish Widows Retirement Benefits Scheme (continued)

(ii) Amounts recognised in the Financial Statements of SWRBS (continued)

	2018 £000	2017 £000
Movements in the defined benefit obligation		
At 1 January	1,248,200	1,388,500
Current service cost	12,100	15,300
Interest expense	32,000	37,100
Remeasurements:		
Actuarial losses/(gains) – experience	9,800	(10,800)
Actuarial gains – demographic assumptions	(5,700)	(53,200)
Actuarial (gains)/losses – financial assumptions	(94,500)	41,700
Benefits paid	(97,500)	(176,800)
Past service cost - plan amendments	3,500	500
Past service cost – curtailments	-	5,900
At 31 December	**1,107,900**	**1,248,200**

In July 2018, a decision was sought from the High Court in respect of the requirement to equalise the Guaranteed Minimum Pension ("GMP") benefits accrued between 1990 and 1997 from contracting out of the State Earnings Related Pension Scheme. In its judgment handed down on 26 October 2018 the High Court confirmed the requirement to treat men and women equally with respect to these benefits and a range of methods that the Trustee is entitled to adopt to achieve equalisation. The Group continues to work with the Trustee on the detail of implementing this judgment and has recognised a past service cost of £3.4million for SWRBS consistent with the principles outlined within the judgment. This is based on a number of assumptions and the actual impact may be different.

The following tables provide an analysis of the SWRBS assets:

	2018 £000	2017 £000
Changes in the fair value of scheme assets		
At 1 January	1,170,900	1,258,200
Return on plan assets (less)/greater than discount rate	(16,300)	44,400
Interest income	31,600	33,700
Employer contributions	118,700	12,600
Benefits paid	(97,500)	(176,800)
Administrative costs paid	(1,800)	(1,200)
	1,205,600	**1,170,900**

	2018			2017		
	Fair value of assets with quoted prices £000	Fair value of assets with unquoted prices £000	Total £000	Fair value of assets with quoted prices £000	Fair value of assets with unquoted prices £000	Total £000
Debt instruments	589,500	-	589,500	461,400	-	461,400
Pooled investment vehicles	259,900	339,600	599,500	132,400	540,000	672,400
Derivatives	(1,500)	200	(1,300)	37,200	-	37,200
Money market instruments, derivatives cash and other assets and liabilities	5,500	12,400	17,900	2,700	(2,800)	(100)
Total fair value of scheme assets	**853,400**	**352,200**	**1,205,600**	**633,700**	**537,200**	**1,170,900**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

15. Retirement benefit asset/(liability) (continued)

(a) Scottish Widows Retirement Benefits Scheme (continued)

(ii) Amounts recognised in the Financial Statements of SWRBS (continued)

An analysis of the SWRBS' debt securities is provided below:

2018	Total	AAA	AA	A	BB or lower	BBB or lower	Not rated
	£000	£000	£000	£000	£000	£000	£000
Government bonds	190,200	-	190,200	-	-	-	-
Index linked government bonds	399,300	-	399,300	-	-	-	-
Total fair value of scheme assets	**589,500**	-	**589,500**	-	-	-	-

2017	Total	AAA	AA	A	BB or lower	BBB or lower	Not rated
	£000	£000	£000	£000	£000	£000	£000
Government bonds	154,800	-	154,800	-	-	-	-
Index linked government bonds	306,600	-	306,600	-	-	-	-
Total fair value of scheme assets	**461,400**	-	**461,400**	-	-	-	-

The SWRBS' pooled investment vehicles comprise:

	2018	2017
	£000	£000
Equity investment funds	131,200	242,900
Bond funds	117,600	100,400
Private equity funds	2,500	4,300
Property funds	61,700	123,500
Alternative credit funds	203,500	120,000
Cash funds	83,000	81,300
At 31 December	**599,500**	**672,400**

The expense recognised in the statement of comprehensive income for the year ended 31 December comprises:

	2018	2017
	£000	£000
Current service cost	12,100	15,300
Past service cost - plan amendments	3,500	500
Past service cost - curtailments	-	5,900
Net interest amount	400	3,400
Plan administration costs incurred in the year	1,800	1,200
Net expense recognised	**17,800**	**26,300**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

15. Retirement benefit asset/(liability) (continued)

(a) *Scottish Widows Retirement Benefits Scheme (continued)*

(ii) Amounts recognised in the Financial Statements of SWRBS (continued)

The principal actuarial and financial assumptions used in valuations of the SWRBS were as follows:

	2018 %	2017 %
Discount rate	2.90%	2.59%
Rate of inflation:		
Retail Prices Index	3.20%	3.20%
Consumer Price Index	2.15%	2.15%
Rate of salary increases	0.00%	0.00%

	2018 Years	2017 Years
Life expectancy for member aged 60, on the valuation date:		
Men	27.2	27.3
Women	29.4	29.5
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	28.3	28.4
Women	30.6	30.7

(iii) Amount, timing and uncertainty of future cash flows

Risk exposure of SWRBS

SWRBS is exposed to a number of risks, detailed below. There are two specialist pension committees that govern and monitor the risk exposed to SWRBS.

Inflation rate risk: the SWRBS's benefit obligations are linked to inflation both in deferment and once in payment. Higher inflation will lead to higher liabilities although this will be partially offset by holdings of inflation-linked gilts and inflation swaps.

Interest rate risk: The defined benefit obligation is determined using a discount rate derived from yields on AA-rated corporate bonds. A decrease in corporate bond yields will increase plan liabilities although this will be partially offset by an increase in the value of bond holdings and derivatives.

Longevity risk: The SWRBS obligations are to provide benefits for the life of the members so increases in life expectancy will result in an increase in the scheme's liabilities.

Investment risk: SWRBS assets are invested in a diversified portfolio of debt securities, equities and other return-seeking assets. If the assets underperform the discount rate used to calculate the defined benefit obligation, it will reduce the surplus or increase the deficit. Volatility in asset values and the discount rate will lead to volatility in the net pension liability on the Company's balance sheet and in other comprehensive income. To a lesser extent this will also lead to volatility in the IAS 19 pension expense in the Company's statement of comprehensive income.

The ultimate cost of the defined benefit obligations will depend upon actual future events rather than the assumptions made. The assumptions made are unlikely to be borne out in practice and as such the cost may be higher or lower than expected.

Details of the guarantee to the trustees of the SWRBS are provided below which clarify the Company's exposure to entity specific or scheme specific risks in relation to the SWRBS.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

15. Retirement benefit asset/(liability) (continued)

(a) Scottish Widows Retirement Benefits Scheme (continued)

(iii) Amount, timing and uncertainty of future cash flows (continued)

Sensitivity analysis

The effect of reasonably possible changes in key assumptions on the value of SWRBS liabilities and the resulting pension charge in the Company's statement of comprehensive income and on the net defined benefit pension scheme asset is set out below. The sensitivities provided assume that all other assumptions and the value of the SWRBS' assets remaining unchanged, and are not intended to represent changes that are at the extremes of possibility. The calculations are approximate in nature and full detailed calculations could lead to a different result. It is unlikely that isolated changes to individual assumptions will be experienced in practice. Due to the correlation of assumptions, aggregating the effects of these isolated changes may not be a reasonable estimate of the actual effect of simultaneous changes in multiple assumptions.

	Effect of reasonably possible alternative assumptions			
	Income statement charge		Net defined benefit pension scheme Asset/(liability)	
	2018	2017	2018	2017
	£000	£000	£000	£000
Central Basis	(6,400)	(13,700)	97,700	(77,300)
Inflation:				
Increase of 0.1 per cent	(700)	(900)	(20,500)	(23,400)
Decrease of 0.1 per cent	800	800	20,000	23,000
Discount rate:				
Increase of 0.1 per cent	1,200	1,000	24,200	27,800
Decrease of 0.1 per cent	(1,100)	(1,200)	(24,900)	(28,500)
Expected life expectancy of members:				
Increase of one year	(1,900)	(2,100)	(52,000)	(60,300)
Decrease of one year	1,800	1,900	49,400	57,400

Sensitivity analysis method and assumptions

The inflation assumption sensitivity applies to both the assumed rate of increase in the Consumer Prices Index (CPI) and the Retail Prices Index (RPI). The assumed pension increases before and after retirement are linked to inflation (either CPI or RPI) subject to certain minimum and maximum limits. The inflation assumption sensitivity allows for a corresponding impact of changing the inflation assumption as the assumed pension increases both before and after retirement.

The sensitivity analysis does not include the impact of any possible change in the rate of salary increases as pensionable salaries have been frozen since 2 April 2014.

The life expectancy assumption has been applied by allowing for an increase/decrease in life expectation from age 60 of one year, based upon the approximate weighted average age. Whilst this is an approximate approach and will not give the same result as a one year increase in life expectancy at every age, it provides an appropriate indication of the potential impact on the schemes from changes in life expectancy.

There was no change in the methods and assumptions used in preparing the sensitivity analysis from the prior year.

Asset-liability matching strategies

The SWRBS investment strategy is determined by the Trustee in consultation with the Company and LBG. It is regularly reviewed and developed. A principal element of the strategy is to hold matching assets in respect of the liabilities of the SWRBS represented by pensions in payment and a proportion of deferred pension liabilities. The objective is to reduce the volatility of the SWRBS funding position caused by changes in market expectations of interest rates and inflation and the assets are structured to take into account the profile of the SWRBS liabilities. Credit default swaps and corporate bonds provide a credit overlay to these matching assets, which in total comprise approximately 60% of the SWRBS assets. The remaining assets are invested in diversified return-seeking assets including equities (both listed and private) and property.

Maturity profile of defined benefit obligation

The weighted average duration of the defined benefit pension obligation is 25 years (2017: 25 years).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

15. Retirement benefit asset/(liability) (continued)

(a) Scottish Widows Retirement Benefits Scheme (continued)

(iii) Amount, timing and uncertainty of future cash flows (continued)

Guarantee to the trustees of SWRBS

Until 1 May 2018, SWL guaranteed the Company's liabilities to the SWRBS Pension Scheme. On the transfer of ownership, the Company entered into a tripartite agreement with SWL and LB plc which required SWL to make a £284.0m risk premium payment to the Company in exchange for LB plc agreeing to take on exposure to the volatility risks on the SWRBS. As a result, the Company will be liable up to a maximum of the Company's contingent settlement provision (£284.0m at 31 December 2018) to its proportionate share of the deficit in the SWRBS at the relevant time (calculated as the cost of securing benefits with an insurer) in the event that SWRBS is wound up; the employer becomes insolvent; or an employer ceases to employ active members of SWRBS at a time when another employer continues to do so, but the associated debt is not apportioned to another employer. Any share of the deficit in excess of the contingent settlement provision is indemnified by LB plc.

(b) Defined contribution schemes

The SWRBS also includes a defined contribution section; most of the members have now transferred to the Your Tomorrow defined contribution section of the LBG Pension Scheme No. 1. During the year ended 31 December 2018, the charge to the Company's statement of comprehensive income in respect of the defined contributions schemes was £15.8m (2017: £13.7m), representing the contributions payable by the Company in accordance with the scheme's rules. There were no outstanding or prepaid contributions at 31 December 2018.

(c) Amounts recognised in other comprehensive income for total defined benefit schemes

Remeasurement effects recognised in other comprehensive income for the year ended 31 December are reconciled to the analyses of amounts recognised in the Company balance sheet as follows:

	2018			2017		
	Before tax £000	Tax expense £000	After tax £000	Before tax £000	Tax expense £000	After tax £000
SWRBS	74,100	(12,596)	61,504	66,700	(13,944)	52,756
Total	**74,100**	**(12,596)**	**61,504**	**66,700**	**(13,944)**	**52,756**

16. Contingent settlement provision

	2018 £000	2017 £000
At 1 January	-	-
Contingent settlement provision	284,000	-
Movement on contingent settlement provision	-	-
At 31 December	**284,000**	-

Until 1 May 2018, SWL guaranteed the Company's liabilities to the SWRBS Pension Scheme and the Company recharged movements with respect to actuarial gains and losses to SWL (£31.0m for the four months to 1st May 2018).

On the transfer of ownership, the Company entered into a tripartite agreement with SWL and LB plc which required SWL to make a £284.0m risk premium payment to the Company, in exchange for LB plc bearing the exposure to volatility risks on the SWRBS.

The risk premium is initially held on the balance sheet of the Company as a contingent settlement provision and is released to the statement of comprehensive income over the life of the SWRBS pension scheme against cumulative remeasurement losses charged to other comprehensive income. Cumulative remeasurement gains will continue to be retained as a benefit to the Company. Any balance remaining on the provision at the end of the life of the SWRBS pension scheme will be repaid to LB plc, capped at £284.0m. In the event that the cumulative remeasurement losses exceed £284.0m, the excess is indemnified by, and will be reimbursed by, LB plc.

At 31 December 2018, the cumulative remeasurements since 2 May 2018 are a gain of £43.1m.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

16. Contingent settlement provision (continued)

Due to the long term nature of the defined benefit obligation and the inherent uncertainty of future actuarial movements it is not possible to determine the date that the provision will ultimately be utilised. The average duration of the defined benefit obligation is 25 years.

17. Accruals

Accruals at the year-end comprise liabilities in respect of various operational activities.

	2018 £000	2017 £000
Accruals	70,299	92,626
Total	**70,299**	**92,626**

None of the above balances (2017: £nil) are expected to be settled in more than one year after the reporting date.

18. Trade and other payables

	2018 £000	2017 £000
Amounts due to Group undertakings	111,268	429,251
Other payables	7,866	7,265
Total	**119,134**	**436,516**

None of the above balances are interest bearing (2017: £nil) nor expected to be settled in more than one year after the reporting date.

Further information relating to amounts due to group undertakings is set out in note 21.

19. Net movement in operating assets and liabilities

	2018 £000	2017 £000
Decrease/(increase) in operating assets:		
Retirement benefit asset	(97,700)	-
Loans and other receivables	184,203	(4,077)
Net movement in operating assets	**86,503**	**(4,077)**
Decrease in operating liabilities:		
Retirement benefit liability	(77,300)	(53,000)
Trade and other payables	(317,382)	(112,308)
Accruals	(22,327)	3,698
Net movement in operating liabilities	**(417,009)**	**(161,610)**
Net movement in operating assets and liabilities	**(330,506)**	**(165,687)**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

20. Risk management

The Company is a service provider to subsidiary undertakings of Scottish Widows Group Limited. This note summarises the risks associated with the activities of the Company and the way in which the Company manages them.

(a) Governance framework

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

This enterprise-wide risk management framework for the identification, assessment, measurement and management of risk covers the full spectrum of risks that the Company is exposed to, with risks categorised according to an approved LBG risk language. This covers the principal risks faced by the Company.

The performance of the Company depends on its ability to manage these risks.

(b) Risk appetite

Risk appetite is the amount and type of risk that the Company Board is prepared to seek, accept or tolerate and is fully aligned to LBG strategy. Principal risks and uncertainties are reviewed and reported regularly.

(c) Financial risks

The Company is exposed to a range of financial risks through its financial assets and financial liabilities. In particular, the key financial risk is that there are insufficient assets to meet pension scheme obligations as these fall due. The most important components of financial risk are credit, market, liquidity and capital risk.

The financial risk that the Company primarily faces due to the nature of its financial assets is market risk. The Company manages these risks in a number of ways, including monitoring of cash flow requirements and the use of financial instruments. The Company also has indirect exposure to fluctuations in value of the SWRBS defined benefit obligation. There are two specialist pension committees that govern and monitor the risks that SWRBS is exposed to.

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

The timing of the unwind of the deferred tax assets is dependent on the timing of the unwind of the temporary timing differences, arising between the tax bases of the assets and liabilities and their carrying amounts for financial reporting purposes, to which these balances relate.

The sensitivity analysis given in this note in respect of interest rate risk is based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur as changes in assumptions may be correlated. The sensitivity analysis presented also represents, in accordance with the requirements of IFRS 7 "Financial Instruments: Disclosures", management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

20. Risk management (continued)

(c) Financial risks (continued)

(1) *Credit risk*

The risk that counterparties with whom we have contracted, fail to meet their financial obligations, resulting in loss to the Company.

Credit risk is managed in line with the LBG Credit Risk Policy which set out the principles of the credit control framework.

Credit risk to the Company arises primarily from exposure to trade debtors and financial assets at fair value through profit or loss. Exposure to trade debtors is assessed on a case by case basis, using a credit rating agency where appropriate.

The following table sets out details of financial assets that are neither past due nor impaired:

	2018 £000	2017 £000
Amounts due from Group undertakings	193,767	380,918
Other receivables	5,832	4,535
Cash and cash equivalents	149,914	98,913
Total assets bearing credit risk	**349,513**	**484,366**

The tables below analyse financial assets subject to credit risk using Standard & Poor's rating or equivalent.

As at 31 December 2018

	Total £000	AAA £000	AA £000	A £000	BBB or lower £000	Not rated £000
Stage 1 assets						
Other receivables	5,832	-	-	-	-	5,832
Cash and cash equivalents	149	-	-	149	-	-
Exposure to credit risk	5,981	-	-	149	-	5,832
Simplified approach						
Amounts due from Group undertakings	193,767	-	-	177,946	-	15,821
Exposure to credit risk	193,767	-	-	177,946	-	15,821
Asset at FVTPL						
Cash and cash equivalents	149,765	149,765	-	-	-	-
Total	**349,513**	**149,765**	-	**178,095**	-	**21,653**

As at 31 December 2017

	Total £000	AAA £000	AA £000	A £000	BBB or lower £000	Not rated £000
Amounts due from Group undertakings	380,918	-	-	326,840	-	54,078
Other receivables	4,535	-	-	-	-	4,535
Cash and cash equivalents	98,913	98,272	-	641	-	-
Total	**484,366**	**98,272**	-	**327,481**	-	**58,613**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

20. Risk management (continued)

(c) Financial risks (continued)

(2) Liquidity risk

Liquidity risk is the risk that the Company has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or from the inability to generate cash inflows as anticipated.

Liquidity risk has been analysed as arising from the settlement of balances owed to other Group undertakings of £111.3m (2017: £429.3m) and other payables of £7.9m (2017: £7.3m). These amounts are all contractually due within one month from the reporting date.

(3) Capital risk

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

The Company's objectives when managing capital are to have sufficient capital to safeguard the Company's ability to continue as a going concern.

The Company manages the capital structure and makes adjustments to reflect changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company returns capital to the shareholder, issues new shares or sells assets.

The Company's capital comprises all components of equity, movements in which are set out in the statement of changes in equity. The Company receives most of its funding from its parent and does not raise funding externally.

(4) Market risk

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

Investments in liquidity funds are categorised as level 1 in the fair value hierarchy.

(5) Interest rate risk

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates and the shape of the yield curve. Interest rate risk arises in respect of cash balances which are either held on deposit or invested in a liquidity fund. None of the other financial assets or financial liabilities of the Company are interest-bearing.

If interest rates were to increase or decrease by 25 basis points, the impact on profit or loss after tax would be an increase or decrease respectively of £302.3k (2017: increase or decrease respectively of £198.3k) in respect of interest-bearing financial assets and financial liabilities.

(d) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. There are a number of secondary categories of operational risk including the undernoted:

Financial crime and fraud risk

Financial crime concerns activity related to money laundering, sanctions, terrorist financing and bribery. Fraud covers acts intended to defraud, misappropriate property or circumvent the law. These activities could give rise to risk of reduction in earnings and/or value, through financial or reputational loss. Losses may include censure, fines or the cost of litigation.

Information security and physical security risk

Information security risk relates to the risk of reductions in earnings and/or value, through financial or reputational loss, resulting from theft of or damage to the security of the Company's information and data. Physical security risk relates to the risk to the security of people and property.

Operational resilience risk

Operational resilience risk covers the risk or instances of interruptions to business operations (including critical buildings, critical and core infrastructure and IT systems, suppliers and colleagues), as a consequence of external or internal events due to insufficient resilience, inadequate recovery strategies and/or continuity systems and controls.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

20. Risk management (continued)

(d) Operational risk (continued)

Change risk

Change risk is related to the management of change - designing and implementing key projects or programme. Potential loss could arise from failure to manage requirements, budget or timescales; failure to implement change effectively; or failure to realise desired benefits.

Sourcing and service provision risk

Sourcing risk covers the risk of reductions in earnings and/or value through financial or reputational loss from risks associated with activity related to the agreement and management of services provided by third parties including outsourcing.

Service provision risk covers the risks associated with provision of services to a third party and with the management of internal intra-group service arrangements.

IT Systems risk

The risk of reductions in earnings and/or value through financial or reputational loss resulting from the failure to develop, deliver or maintain a resilient IT solution or protect against cyber-attack and other system disruption. A risk framework has been embedded and this is monitored to ensure its effective operation across the Insurance Division.

People risk

The risk that the Company fails to lead, manage and enable colleagues to deliver to customers, shareholders and regulators leading to reductions in earnings and/or value.

Regulatory and Legal risk

Regulatory and legal risk is defined as the risk that the Company is exposed to fines, censure, legal or enforcement action, civil or criminal proceedings in the courts (or equivalent) and risk that the Company is unable to enforce its rights as anticipated.

Regulators aim to protect the rights of customers, ensuring firms satisfactorily manage their affairs for the benefit of customers and that they retain sufficient capital and liquidity. The Company has embedded a risk framework to closely monitor and manage its legal and regulatory risks, and maintains regular interaction with its regulators.

Financial reporting risk

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

Governance risk

The risk that the Company's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively. Against a background of increased focus on governance and risk management, LBG and the Company have taken steps to ring-fence core UK financial services and activities within LBG from other activities, establishing an appropriate control environment and governance structure to ensure compliance.

(e) UK political uncertainties including EU exit

The continued lack of clarity over the UK's eventual relationship with the EU has heightened risks in the Eurozone and raises uncertainty for the UK economic outlook. Leadership changes in the EU have contributed to further uncertainty. There is a risk of a no deal EU exit outcome, which could have a significant impact given our UK-centric footprint. LBG's response to these risks and uncertainty is as follows:

- Internal contingency plans recalibrated and regularly reviewed for potential strategic, operational and reputational impacts;
- As part of LBG, engagement with politicians, officials, media, trade and other bodies to reassure our commitment to helping Britain prosper;
- Committed investments to establish a new entity in the EU to ensure continuity of certain business activities, and contingency planning in relation to wider areas of impact; and
- No deal EU exit outcome analysed to identify impacts and assess robustness of contingency plans.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

20. Risk management (continued)

(f) Economic risk

UK economic growth remains muted and there are signs of pressure in business investment and consumer related sectors. High levels of credit market liquidity have reduced spreads and weakened terms in some sectors, creating a potential under-pricing of risk and heightened risk of a market correction. LBG's response to these risks is as follows:

- Internal contingency plans recalibrated and regularly reviewed for potential strategic, operational and reputational impacts, with a plan specifically for working through the potential impacts of the EU exit on LBG;
- Wide array of risks considered in setting strategic plans;
- Capital and liquidity is reviewed regularly through committees, ensuring compliance with risk appetite and regulatory requirements;
- LBG has a robust through-the-cycle credit risk appetite, including individual limit guidelines, specific sector appetite statements and policies, and affordability and indebtedness controls at origination. In addition to ongoing focused monitoring, we conduct portfolio deep dives and larger exposure reviews. We have enhanced our use of early warning indicators including sector specific indicators.

21. Related party transactions

(a) Ultimate parent and shareholding

On 2 May 2018, the immediate parent of the Company changed from Scottish Widows Limited to Lloyds Bank plc.

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 Bank plc may be obtained from Group Secretariat, 25 Gresham Street, London EC2V 7HN.

The ultimate parent undertaking and controlling party is Lloyds Banking Group plc, which is the parent undertaking of the largest group to consolidate these financial statements. Copies of the consolidated Annual Report and Accounts of Lloyds Banking Group plc may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

(b) Transactions and balances with related parties

Transactions between the Company and other companies in the Lloyds Banking Group

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

	2018			
	Income during year	**Expenses during year**	**Payable at year end**	**Receivable at year end**
	£000	**£000**	**£000**	**£000**
Relationship				
Parent (SWL for first 4 months of the year)	163,160	-	-	-
Parent (LB plc for remaining months)	-	309,250	56,747	76,078
Other related parties	656,789	192,003	54,521	117,689

	2017			
	Income during year	**Expenses during year**	**Payable at year end**	**Receivable at year end**
	£000	**£000**	**£000**	**£000**
Relationship				
Parent	507,118	-	-	230,805
Other related parties	299,304	539,511	429,251	150,113

The above balances are unsecured in nature and are expected to be settled in cash.

Transactions between the Company and key management

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.

The Directors consider that they receive no remuneration for their services to the Company (2017: nil).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

22. Future accounting developments

There are no standards or interpretations that exist or are not yet effective and that would be expected to have a material impact on the Company.

23. Post balance sheet events

There are no events after the reporting date.

24. Adoption of IFRS 9

On 1 January 2018, the Company adopted IFRS 9 "Financial Instruments", which replaced IAS 39 "Financial Instruments: Recognition and Measurement". Adoption of this standard has had the following impacts on the financial statements:

(a) Changes to accounting policies

The new accounting policies, as amended for IFRS 9, are set out in note 1 (b), (i), (j) and (k). A summary of the changes is as follows:

(i) Financial assets and financial liabilities

The classification of financial assets has changed such that the assessment is based on the Company's business model for managing the financial assets and whether cash flows represent solely payments of principal and interest. All other financial assets held in a business model that is managed and whose performance is evaluated on a fair value basis are held at fair value through profit or loss and those that are held in a business model that is held to collect contractual cash flows are classified as amortised cost. See note 1(b) for more detail.

(ii) Loans and other receivables at amortised cost

Under IAS 39, loans and other receivables were held at amortised cost. Under IFRS 9, loans and other receivables continue to be held at amortised cost. The classification is dependent on whether those loans and receivables are held in a business model whose purpose is to hold assets to collect the contractual cash flows and where the cash flows represent solely payments of principal and interest (resulting in amortised cost classification) or where the assets are held in a business model that is managed and whose performance is evaluated on a fair value basis (resulting in a mandatory fair value through profit or loss classification). See note 1(i) for more detail.

Loans and receivables at amortised cost continue to be subject to impairment. However, the "incurred loss" approach under IAS 39 has been replaced with an "expected credit losses" approach under IFRS 9, as described in note 1(k).

(iii) Cash and cash equivalents

Cash and cash equivalents include investments in liquidity funds, which were previously designated at fair value through other comprehensive income under IAS 39 and are now mandatorily at fair value through profit or loss. For more detail see note 1(j).

(iv) Impairment

IFRS 9 results in changes to the impairment approach for financial assets at amortised cost. Under IAS 39, an "incurred loss" approach was used, which required a charge for impairment when events or circumstances indicated that amounts were not recoverable. The approach under IFRS 9 is an "expected credit loss" approach, which requires an assessment of expected future losses on initial recognition. For more detail see note 1(k).

(b) Opening reserves on transition

There were no changes to opening reserves at the time of transition.

(c) Classification of financial assets and liabilities on initial application of IFRS 9

There are no differences between the IAS 39 carrying amounts for financial assets at 31 December 2017 and the IFRS 9 carrying amounts at 1 January 2018.

(d) Loss allowance on transition

At 31 December 2017, the IAS 39 allowance for impairment losses for loans and receivables was £nil. At 1 January 2018, the IFRS 9 loss allowance was £nil.