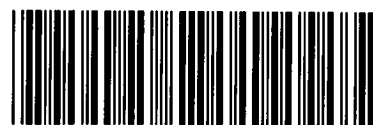


**HBOS UK LIMITED**  
**REPORT AND FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED**  
**31 DECEMBER 2016**

**Company Registration No. SC261259**  
**Incorporated in Scotland**

THURSDAY



\*S6FGR6ER\*

SCT

21/09/2017

#679

COMPANIES HOUSE

**HBOS UK LIMITED**

**REPORT AND FINANCIAL STATEMENTS**

For the year ended 31 December 2016

Registered in Scotland. No. SC261259

Registered office: The Mound, Edinburgh, EH1 1YZ.

**DIRECTORS**

S.J. Langan  
R.D. Shrimpton

**COMPANY SECRETARY**

M.A.A. Johnson

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

## **HBOS UK LIMITED**

### **STRATEGIC REPORT**

For the year ended 31 December 2016

The directors present their report and the audited financial statements of HBOS UK Limited (the "Company"), a private limited company incorporated in Scotland, for the year ended 31 December 2016.

### **BUSINESS REVIEW AND PRINCIPAL ACTIVITY**

The Company holds gilts as security against the Secured Unfunded Retirement Benefit Scheme ("SURBS") in the Company's immediate parent company, HBOS plc.

HBOS plc makes pension payments from the SURBS to employees on their retirement based on pre-agreed amounts, linked to inflation. The gilts held by the Company are also inflation linked and therefore are used as an effective long term tool for hedging the risk associated with the inflation linked pension liabilities.

The securities held by the Company comprise 2% "AAA" index linked gilts with a redemption date of January 2035. The gilts have a nominal value of £42,460,000 and were purchased in 2007, 2008 and 2011 at a total cost of £59,770,000. They were valued at a fair value of £113,513,000 at 31 December 2016 (2015: £95,518,000).

The profit for the year of £1,360,000 (2015: £1,147,000) is set out in the Statement of Comprehensive Income on page 8.

No dividends were paid during the year (2015: £15,000,000) (note 14).

A final dividend has been proposed by the directors for the year of £2,500,000 (2015: £Nil).

### **PRINCIPAL RISKS AND UNCERTAINTIES**

From the perspective of the Company, the principal risks and uncertainties are integrated with the principal risks of Lloyds Banking Group plc and are not managed separately. Full disclosure of the Company's financial risk management objectives and policies are given in note 17 to the financial statements.

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

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

On behalf of the board



R.D. Shrimpton  
DIRECTOR

Date: 12 September 2017

# **HBOS UK LIMITED**

## **DIRECTORS' REPORT**

For the year ended 31 December 2016

### **GOING CONCERN**

As at 31 December 2016 the Company's current liabilities exceeded its current assets by £75,627,000 (2015:£73,277,000). We note that the main current liability is group funding of £74,514,000 whilst the main asset is AFS bonds which are classified as non-current based on maturity.

The company has received commitment from the ultimate parent company, Lloyds Bank plc, of its ongoing support and funding to meet its obligations when they fall due covering HBOS plc and its subsidiaries. Moreover, the non-current assets held are liquid AFS government bonds which can be sold at any time, and are of greater value than the current liability amounts owed to the intermediate parent company.

After considering the above, the Directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

### **DIRECTORS**

The following changes to directors occurred throughout the year and up to the date of signing the financial statements.

J.M. Hallett	(Resigned 26 January 2016)
J. P. Bishop	(Resigned 28 March 2016)
S.J. Langan	(Appointed 26 January 2016)
R.D. Shrimpton	(Appointed 12 May 2016)

### **DIRECTORS' INDEMNITIES**

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

### **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

The directors are responsible for preparing the strategic report, the directors' report and the financial statements in accordance with applicable law and regulations.

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

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

**DIRECTORS' REPORT (CONTINUED)**

For the year ended 31 December 2016

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the directors, whose names are listed on page 1, confirms that, to the best of their knowledge:

- the 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 or loss of the Company; and
- the directors' report contained above includes 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.

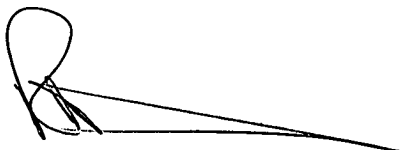
**INDEPENDENT AUDITORS AND AUDIT INFORMATION**

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

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

PricewaterhouseCoopers LLP are deemed to be re-appointed as auditors under section 487(2) of the Companies Act 2006.

On behalf of the board



R.D. Shrimpton  
DIRECTOR

Date: 12 September 2017

Company incorporated in Scotland, Company No. SC261259

## Report on the financial statements

---

### Our opinion

In our opinion, HBOS UK Limited's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2016 and of its profit and cash flows for the year then ended;
  - have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
  - have been prepared in accordance with the requirements of the Companies Act 2006.
- 

### What we have audited

The financial statements, included within the Report and Financial Statements (the "Annual Report"), comprise:

- the balance sheet as at 31 December 2016;
- the statement of comprehensive income for the year then ended;
- the cash flow statement for the year then ended;
- the statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

---

## Opinions on other matters prescribed by the Companies Act 2006

---

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

---

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

---

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

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

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

We have no exceptions to report arising from this responsibility.

---

### Directors' remuneration

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

---

## Responsibilities for the financial statements and the audit

---

### Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

---

### What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.



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

13 SEPTEMBER 2017



**HBOS UK LIMITED****STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2016

	Note	2016 £'000	2015 £'000
Interest and similar income	3	1,780	1,430
Interest and similar expense	3	<u>(400)</u>	<u>(386)</u>
Net interest income	3	1,380	1,044
Other income	4	175	-
Other expenses	5	<u>(19)</u>	<u>-</u>
<b>Profit before taxation</b>		1,536	1,044
Taxation	6	<u>(176)</u>	<u>103</u>
<b>Profit for the year</b>		<u><u>1,360</u></u>	<u><u>1,147</u></u>
<b>Other comprehensive income/(expense)</b>			
Movements in available-for-sale financial assets, net of tax:			
- change in fair value		<u>14,006</u>	<u>(2,988)</u>
<b>Total comprehensive income/(expense) for the year</b>		<u><u>15,366</u></u>	<u><u>(1,841)</u></u>

The accompanying notes on pages 12 to 22 form an integral part of the financial statements.

# HBOS UK LIMITED

## BALANCE SHEET

As at 31 December 2016

	Note	2016 £'000	2015 £'000
<b>Assets</b>			
<b>Non-current assets</b>			
Available-for-sale financial assets	7	<u>113,513</u>	<u>95,518</u>
<b>Total non-current assets</b>		<u>113,513</u>	<u>95,518</u>
<b>Current assets</b>			
Amounts owed by other group company	8	1,751	3,155
Other current assets	9	<u>555</u>	<u>549</u>
<b>Total current assets</b>		<u>2,307</u>	<u>3,704</u>
<b>Total assets</b>		<u><u>115,819</u></u>	<u><u>99,222</u></u>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Amounts owed to immediate parent company	8	74,514	74,514
Other current liabilities	10	55	79
Current tax payable	11	3,642	2,388
<b>Total liabilities</b>		<u>78,212</u>	<u>76,981</u>
<b>Equity</b>			
Share capital	12	50	50
Other reserves	13	34,947	20,941
Retained earnings		<u>2,610</u>	<u>1,250</u>
<b>Total equity</b>		<u>37,607</u>	<u>22,241</u>
<b>Total liabilities and equity</b>		<u><u>115,819</u></u>	<u><u>99,222</u></u>

The directors approved the financial statements on pages 8 to 22 on 12 September 2017



R.D. Shrimpton  
DIRECTOR

The accompanying notes on pages 12 to 22 form an integral part of the financial statements.

**HBOS UK LIMITED****STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2016

	Share capital £'000	Other reserves £'000	Retained earnings £'000	Total Equity £'000
<b>Balance at 1 January 2015</b>	50	23,929	15,103	39,082
Movement in available-for-sale financial assets, net of taxation	-	(2,988)	-	(2,988)
Dividends paid	-	-	(15,000)	(15,000)
Profit for the year	-	-	1,147	1,147
<b>Balance at 31 December 2015</b>	50	20,941	1,250	22,241
Movement in available-for-sale financial assets, net of taxation	-	14,006	-	14,006
Profit for the year	-	-	1,360	1,360
<b>Balance at 31 December 2016</b>	<u>50</u>	<u>34,947</u>	<u>2,610</u>	<u>37,607</u>

The accompanying notes on pages 12 to 22 form an integral part of the financial statements.

# HBOS UK LIMITED

## CASH FLOW STATEMENT

For the year ended 31 December 2016

	Note	2016 £'000	2015 £'000
<b>Cash flows from operating activities</b>			
Profit before taxation		1,536	1,044
Adjustment for:			
Interest income	3	(1,780)	(1,430)
Interest expense	3	400	386
Operating profit/result before working capital changes		156	-
Increase in other debtors		-	-
Tax paid		(2,423)	-
Group relief received		-	448
<b>Net cash (used in)/generated from operating activities</b>		<b>(2,267)</b>	<b>448</b>
<b>Cash flows from investing activities</b>			
Interest received		1,287	1,593
Advanced to other group company	8	-	(3,155)
Repaid by other group company	8	1,404	-
<b>Net cash (used in)/generated from investing activities</b>		<b>2,691</b>	<b>(1,562)</b>
<b>Cash flows from financing activities</b>			
Received from immediate parent company	8	-	16,480
Repayment to immediate parent company	8	-	-
Interest paid		(424)	(366)
Dividends paid	14	-	(15,000)
<b>Net cash (used in)/ generated from financing activities</b>		<b>(424)</b>	<b>1,114</b>
Net change in cash and cash equivalents		-	-
Cash and cash equivalents at beginning of the year		-	-
<b>Cash and cash equivalents at end of the year</b>		<b>-</b>	<b>-</b>

The accompanying notes on pages 12 to 22 form an integral part of the financial statements.

**NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2016

**1. ACCOUNTING POLICIES****BASIS OF PREPARATION**

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been applied consistently for each of the periods presented, unless otherwise stated. The financial statements have been prepared on a going concern basis under the historical cost convention, in compliance with the requirements of the Companies Act 2006 and in accordance with the applicable International Financial Reporting Standards ("IFRS") as adopted by the European Union.

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

The financial statements have been prepared using the going concern basis. The Directors have reviewed the expected future cashflows and believe they are adequate to meet the anticipated payments.

The following pronouncement was effective during the year and relevant to the Company:

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

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

<b><u>Pronouncement</u></b>	<b><u>Nature of change</u></b>	<b><u>IASB effective date</u></b>
Amendment to IAS 1, 'Disclosure Initiative' (issued February 2016)	The amendments provide clarification of existing IAS 1 requirements on materiality and the presentation of the Annual periods beginning on or after 1 January 2017 financial statements and associated notes.  The Company is currently assessing the impact of IAS 1	Annual periods beginning on or after 1 January 2017
Amendments to IAS 7, 'Disclosure Initiative' (issued February 2016)	The amendments to IAS 7 introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendment is part of the IASB's Disclosure Initiative, which continues to explore how financial statement disclosure can be improved.  The company is currently assessing the impact of IAS 7	Annual periods beginning on or after 1 January 2017

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

For the year ended 31 December 2016

**1. ACCOUNTING POLICIES (CONTINUED)**

**BASIS OF PREPARATION (CONTINUED)**

IFRS 9 'Financial instruments'	This standard replaces the guidance in IAS 39. It includes requirements on the classification and measurement of financial assets and liabilities; it also includes an expected credit losses model that replaces the current incurred loss impairment model.	Annual periods beginning on or after 1 January 2018
--------------------------------	---	---

The Company is currently assessing the impact of IFRS 9

There are other pronouncements, new standards and amendments which were published in 2016 but are not relevant to the Company.

**(a) Revenue recognition**

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

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

Current income tax which is payable on taxable profits is recognised as an expense in the year in which the profits arise.

**(c) Cash and cash equivalents**

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

**(d) Available-for-sale financial assets**

The Company assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial asset is impaired. This assessment involves reviewing the current financial circumstances and future prospects of the issuer and assessing the future cash flows expected to be realised.

If an impairment loss has been incurred, the cumulative loss, measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value less any impairment loss on the asset previously recognised, is reclassified from equity to the income statement. If in a subsequent period, the fair value of a debt instrument classified as Available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, an amount not greater than the original impairment loss is credited to the income statement; any excess is taken to the statement of comprehensive income.

**(e) Debt securities**

Debt securities classified as available-for-sale are initially recognised at fair value and are subsequently carried on the balance sheet at fair value with unrealised gains or losses being recognised directly in equity, except for impairment losses, the retail price index movement on the par value, amortisation on the day one premium, and certain foreign exchange gains or losses, which are recognised immediately through the Statement of Comprehensive Income. Income (other than fair value gains and losses) on available-for-sale assets are recognised on an effective interest rate basis and taken to interest receivable through the Statement of Comprehensive Income. On sale or maturity, previously unrealised gains and losses are recognised in other operating income.

**(f) Impairment**

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

## HBOS UK LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2016

#### 1. ACCOUNTING POLICIES (CONTINUED)

##### (g) Borrowings

Borrowings are stated at amortised cost using the effective interest method and are classified as financial liabilities. The coupon paid on these instruments is recognised in the Statement of Comprehensive Income as interest expense.

##### (h) Going concern

As at 31 December 2016 the Company's current liabilities exceeded its current assets by £75,627,000 (2015: £73,277,000). We note that the main current liability is a group funding of £74,514,000 while the main asset is AFS bonds which are classified as non-current based on maturity.

The company has received commitment from the parent company, HBOS plc of its ongoing support and funding to meet its obligations when they fall due. Moreover, the non-current assets held are liquid AFS government bonds which can be sold at any time, and are of greater value than the current liability amounts owed to the intermediate parent company.

After considering the above, the Directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

#### 2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

The accounting policies deemed critical to the Company's results and financial position, based upon materiality and significant judgements and estimates, are discussed below.

##### Impairment of available-for-sale debt securities

The Company determines that available-for-sale debt securities are impaired when the present value of the estimated future cash flows do not exceed their recoverable amount. Estimating the future cash flows requires a degree of judgement and may depend to a large extent on the selection of key assumptions about the future use.

#### 3. NET INTEREST INCOME

	2016 £'000	2015 £'000
<i>Interest and similar Income</i>		
Amounts owed by other group company (note 8)	18	2
Available-for-sale investments	<u>1,762</u>	<u>1,428</u>
	<u>1,780</u>	<u>1,430</u>
<i>Interest and similar Expense</i>		
Amounts owed to immediate parent company (note 8)	<u>(400)</u>	<u>(386)</u>
	<u>(400)</u>	<u>(386)</u>
Net interest income	<u>1,380</u>	<u>1,044</u>

Statutory audit fees for the current year of £5,000 (2015: £5,000) were borne by Lloyds Bank plc. The number of persons employed by the Company during the year was nil (2015: nil).

#### 4. OTHER INCOME

	2016 £'000	2015 £'000
UK Pension Annual fees	35	-
UK Pension Annual fees – Prior Periods	<u>140</u>	<u>-</u>
	<u>175</u>	<u>-</u>

# HBOS UK LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2016

### 5. OTHER EXPENSES

	2016 £'000	2015 £'000
Custodian Fees	(19)	-
	<u>(19)</u>	<u>-</u>

### 6. TAXATION

#### (a) Analysis of credit/(charge) for the year

	2016 £'000	2015 £'000
UK Corporation tax - current year	(141)	(98)
UK Corporation tax - prior year adjustment	<u>(35)</u>	<u>201</u>
<b>Total taxation credit/(charge) for the year</b>	<b><u>(176)</u></b>	<b><u>103</u></b>

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

#### (b) Factors affecting the tax credit/(charge) for the year

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

	2016 £'000	2015 £'000
Profit before taxation	<u>1,536</u>	<u>1,044</u>
Tax charge thereon at UK corporation tax rate of 20.00% (2015: 20.25%)	(307)	(212)
Factors affecting charges:		
Non-taxable items	166	114
Prior year adjustment	<u>(35)</u>	<u>201</u>
<b>Total taxation credit/(charge)</b>	<b><u>(176)</u></b>	<b><u>103</u></b>
<b>Effective rate</b>	<b><u>11.45%</u></b>	<b><u>(9.83)%</u></b>

The Finance (No. 2) Act 2015 which was substantively enacted on 26 October 2015 reduced the main rate of corporation tax to 19% with effect from 1 April 2017 and 18% with effect from 1 April 2020.

The Finance Act 2016, which was substantively enacted on 6 September 2016, further reduced the corporate tax rate to 17% with effect from 1 April 2020.

### 7. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2016 £'000	2015 £'000
Available-for-sale financial assets:		
Index linked gilts	<u>113,513</u>	<u>95,518</u>
	<b><u>113,513</u></b>	<b><u>95,518</u></b>
	2016 £'000	2015 £'000
At beginning of the year	95,518	99,182
Change in fair value recognised directly in equity (note 15)	17,508	(3,747)
Change in fair value recognised in Statement of Comprehensive Income	<u>487</u>	<u>83</u>
At end of the year	<b><u>113,513</u></b>	<b><u>95,518</u></b>



## HBOS UK LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2016

#### 7. AVAILABLE-FOR-SALE FINANCIAL ASSETS (CONTINUED)

A total nominal value of £42,460,000 'AAA' rated 2% Index Linked Treasury Stock 2035 were acquired at a cost of £59,770,000 in 2007, 2008 and 2011. These gilts are held as security against the SURBS in the Company's immediate parent company.

At 31 December 2016, £113,513,000 (2015: £95,518,000) of Available-for-sale financial assets had a contractual residual maturity of greater than one year.

#### 8. RELATED PARTY TRANSACTIONS

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

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

There were no transactions between the Company or its subsidiaries with key management personnel during the current year. Key management personnel and directors are employed by other companies in the Lloyds Banking Group and consider that their services to the Company are incidental to their other activities in the Group. The directors' emolument for 2016 was therefore Nil (2015: Nil).

##### *Amounts owed by other group company*

	2016 £'000	2015 £'000
At the beginning of the year	3,155	-
Advances during the year	-	3,155
Repayments during the year	(1,404)	-
At end of the year	<u>1,751</u>	<u>3,155</u>
Represented by:		
Non-current	1,751	3,155
Current	<u>-</u>	<u>-</u>
Representing:		
Bank of Scotland plc	<u>1,751</u>	<u>3,155</u>
Interest Income earned (note 3)	<u>18</u>	<u>2</u>
Interest Income receivable (note 10)	<u>1</u>	<u>2</u>

The amount owed by Bank of Scotland plc is a floating rate instrument, reset at three month intervals. The fair value of the loan at 31 December 2016 is approximately equal to its book value. The loan is repayable on demand with maturity date of 26 January 2035.

##### *Amount owed to immediate parent company*

	2016 £'000	2015 £'000
At beginning of the year	74,514	58,034
Advanced during the year	-	16,480
Repayment during the year	-	-
At end of the year	<u>74,514</u>	<u>74,514</u>

# HBOS UK LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2016

### 8. RELATED PARTY TRANSACTIONS (CONTINUED)

#### *Amount owed to immediate parent company (continued)*

Represented by:		
Non-current	74,514	74,514
Current	-	-
Representing:		
HBOS plc	74,514	74,514
Interest charge during the year (note 3)	400	386
Interest payable (note 11)	55	79

The amount owed to HBOS plc is a floating rate instrument, reset at three month intervals. The fair value of the deposit at 31 December 2016 is approximately equal to its book value. The deposit is repayable on demand with maturity date of 26 January 2035.

### 9. OTHER CURRENT ASSETS

	2016	2015
	£'000	£'000
Interest receivable on amounts owed by other group company (note 8)	1	2
Interest receivable on available-for-sale investments	554	547
	<u>555</u>	<u>549</u>

### 10. OTHER CURRENT LIABILITIES

	2016	2015
	£'000	£'000
Interest payable to amounts owed to immediate parent company (note 8)	55	79
	<u>55</u>	<u>79</u>

### 11. CURRENT TAX PAYABLE

	2016	2015
	£'000	£'000
Corporation tax payable	3,642	2,388
	<u>3,642</u>	<u>2,388</u>

### 12. SHARE CAPITAL

	As at 31 December 2016 £'000	As at 31 December 2015 £'000
50,000 ordinary shares of £1 each	<u>50</u>	<u>50</u>

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

## HBOS UK LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2016

#### 12. SHARE CAPITAL (CONTINUED)

HBOS plc holds 49,999 of the shares of the Company and is deemed to be the immediate parent company. The remaining share is held by Bank of Scotland Edinburgh Nominees Limited. All ordinary shares rank pari passu in all respects including the right to receive all dividends and other distributions hereafter declared, made or paid on the ordinary share capital of the Company.

No dividends were paid during the year (2015: £15,000,000).

#### 13. OTHER RESERVES

##### Available-for-sale reserves

	2016	2015
	£'000	£'000
At beginning of the year	20,941	23,929
Changes in fair value of available-for-sale assets (note 7)	17,508	(3,747)
Tax charge in Statement of Changes in Equity	(3,502)	759
At end of the year - net of tax	<u>34,947</u>	<u>20,941</u>

#### 14. CONTINGENT LIABILITIES AND COMMITMENTS

##### *Tax authorities*

The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law which might lead to additional tax. The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Group that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities for the company of approximately £683,000 (including interest). The Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

#### 15. FINANCIAL RISK MANAGEMENT

The Company uses financial instruments to meet the financial needs of its counterparties and to reduce its own exposure to fluctuations in interest rates.

##### (a) Interest Rate Risk

Interest rate risk arises from the mismatch between interest rate sensitive liabilities and interest rate sensitive assets. From the perspective of the Company, the interest rate risks are integrated with the interest rate risks of the group and are not managed separately. The scenarios are run only for assets and liabilities that represent the major interest-bearing positions. Based on the simulations performed, the full year impact on post-tax profit of a 0.25% increase / decrease would be a maximum decrease / increase of approximately £61,000 (2015: £58,000).

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

**HBOS UK LIMITED**
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

For the year ended 31 December 2016

**15. FINANCIAL RISK MANAGEMENT (CONTINUED)**
**(a) Interest Rate Risk (continued)**

As at 31 December 2016	1 month or less £'000	3 months or less but over 1 month £'000	1 year or less but over 3 months £'000	5 years or less but over 1 year £'000	Over 5 years £'000	Non- interest bearing £'000	Total £'000
<i>Assets:</i>							
Non-current assets							
Available-for-sale financial assets	113,513	-	-	-	-	-	113,513
Current assets							
Amounts owed by other group company	1,751	-	-	-	-	-	1,751
Other current assets	-	-	-	-	-	555	555
Total Assets	<u>115,264</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,481</u>	<u>115,819</u>
<i>Liabilities:</i>							
Current liabilities:							
Amounts owed to immediate parent company	74,514	-	-	-	-	-	74,514
Current tax payable	-	-	-	-	-	3,642	3,642
Other current liabilities	-	-	-	-	-	55	55
Total Liabilities	<u>74,514</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,345</u>	<u>78,212</u>
Total interest sensitivity gap	<u>40,750</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,864)</u>	<u>37,601</u>
As at 31 December 2015							
	1 month or less £'000	3 months or less but over 1 month £'000	1 year or less but over 3 months £'000	5 years or less but over 1 year £'000	Over 5 years £'000	Non- interest bearing £'000	Total £'000
<i>Assets:</i>							
Non-current assets							
Available-for-sale financial assets	95,518	-	-	-	-	-	95,518
Current assets							
Amounts owed by other group company	3,155	-	-	-	-	-	3,155
Other current assets	-	-	-	-	-	549	549
Total Assets	<u>98,673</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>549</u>	<u>99,222</u>
<i>Liabilities:</i>							
Current liabilities:							
Amounts owed to immediate parent company	74,514	-	-	-	-	-	74,514
Other current liabilities	-	-	-	-	-	79	79
Current tax payable	-	-	-	-	-	2,388	2,388
Total Liabilities	<u>74,514</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,467</u>	<u>76,981</u>
Total interest sensitivity gap	<u>24,159</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,918)</u>	<u>22,241</u>

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

For the year ended 31 December 2016

**15. FINANCIAL RISK MANAGEMENT (CONTINUED)**
**(b) Fair Value of Financial Assets and Liabilities**

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

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

**(c) Measurement Basis of Financial Assets and Liabilities**

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

As at 31 December 2016	Available- for-sale £'000	Held at amortised cost £'000	Total £'000
<i>Assets:</i>			
Available-for-sale financial assets	113,513	-	113,513
Amounts owed by other group company	-	1,751	1,751
Other current assets	-	555	555
Total financial assets	<u>113,513</u>	<u>2,306</u>	<u>115,819</u>

<i>Liabilities:</i>			
Amounts owed to immediate parent companies	-	74,514	74,514
Other current liabilities	-	55	55
Total financial liabilities	<u>-</u>	<u>74,569</u>	<u>74,569</u>

As at 31 December 2015	Available- for-sale £'000	Loans and receivables £'000	Held at amortised cost £'000	Total £'000
<i>Assets:</i>				
Available-for-sale financial assets	95,518	-	-	95,518
Amounts owed by other group company	-	3,155	-	3,155
Other current assets	-	-	549	549
Total financial assets	<u>95,518</u>	<u>3,155</u>	<u>549</u>	<u>99,222</u>

<i>Liabilities:</i>				
Amounts owed to immediate parent companies	-	-	74,514	74,514
Other current liabilities	-	-	79	79
Total financial liabilities	<u>-</u>	<u>-</u>	<u>74,593</u>	<u>74,593</u>

## HBOS UK LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2016

#### (d) Credit Risk

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

	2016	2015
	£'000	£'000
Available-for-sale financial assets	113,513	95,518
Amounts owed by other group company	1,751	3,155
Other current assets	555	549
Total credit risk exposure	<u>115,819</u>	<u>99,222</u>

The current rating of Lloyds Bank Plc is A1 (2015: A1) as per Moody's.

The current rating of the available-for-sale index linked gilt assets are AA1 (2015: AA1) as per Moody's.

None of the above assets are past due or impaired.

#### (e) Liquidity Risk

All liabilities of the Company would be classified as on demand on an undiscounted future cash flows basis according to contractual maturity.

#### (f) Capital Risk Management

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

#### (g) Fair value estimation

The fair value of available-for-sale debt securities is based on quoted market prices or broker/dealer valuations. Where this is not available, the fair value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics or similar valuation models.

##### Level 1 portfolios

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise treasury bills and other government securities.

##### Level 2 portfolios

Level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where techniques use inputs that are based significantly on observable market data, the instrument is considered to be level 2. Examples of such instruments include most over the counter derivatives financial institution issued securities, certificates of deposits and certain asset backed securities. There are no level 2 assets at the balance sheet date.

##### Level 3 portfolios

Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments could include venture capital and unlisted equity investments which are valued using various valuation techniques that require significant management judgement in determining appropriate assumptions, including earnings multiples and estimated future cash flows. There are no level 3 assets at the balance sheet date.

## HBOS UK LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2016

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

##### (g) Fair value estimation (continued)

##### Valuation Hierarchy

At 31 December 2016	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Available-for-sale assets	<u>113,513</u>	<u>-</u>	<u>-</u>	<u>113,513</u>

At 31 December 2015	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Available-for-sale assets	<u>95,518</u>	<u>-</u>	<u>-</u>	<u>95,518</u>

The valuation of financial instruments has been classified into three levels according to the quality and reliability of information used to determine the fair values.

#### 16. EVENTS AFTER BALANCE SHEET DATE

There are no events after the Balance Sheet that the directors are aware of and require to bring to the attention of the users of financial statements.