Lloyds Bank International Limited

Annual Report 2017

LLOYDS
BANKING
GROUP

Lloyds Bank International Limited

Annual Report 2017

Contents

Corporate information

Directors	Timothy John Cooke **Chairman, Non-executive Director**[1]
	Michael Joseph Starkey
	Ross Davey Willcox
	Adrian David Lane
	Peter Hemingway Reid
	Gregor Dalgetty Allan **Non-executive Director**
	Richard John Musty
	Christopher John Howland **Non-executive Director**
	Michael David Chaytor
	Adrian Simon Prescott[2]
	David Stephenson[3]
Secretary	Marnie Martin
Registered office	P.O. Box 160 25 New Street St Helier Jersey JE4 8RG Channel Islands
Independent auditor	PricewaterhouseCoopers CI LLP 37 Esplanade St Helier Jersey JE1 4XA Channel Islands

[1] Executive Director to 31 December 2017 and Non-Executive Director from 1 January 2018.
[2] Resigned 30 June 2017.
[3] Resigned 2 February 2017.

Chairman's statement

I report that in 2017 Lloyds Bank International Limited (the 'Company') improved its profitability compared with 2016 and that pre-tax profit has increased 66%. The Company also ended the year with a strong capital base, demonstrating a robust overall financial performance. This is very encouraging to observe, especially when I consider the low interest rate environment in which the Company operates; this fittingly reflects the strength of the underlying business and its unerring focus on providing excellent service to all our customers.

The Company developed its product offering to reflect the increase in certain benchmark interest rates and to meet its customers' needs. There is a noticeable shift in transactions from counter to online due to our easy-to-use digital platform, demonstrating our commitment to the Group's vision of being the best bank for customers.

The financial services industry is ever changing and 2017 was no different. Our biggest challenge was, and will continue to be throughout 2018, our response to the requirements of Ring Fencing. Our colleagues have worked very hard to develop a compliant operating model while ensuring the Company continues to receive the vital support required from Lloyds Bank plc.

Further management changes were made in 2017 in preparation for the creation of the Non Ring Fenced Bank, Lloyds Bank Corporate Markets Limited ('LBCM'). On the 1st July, 2018 structural changes will take place to make the Company part of LBCM. The Company is in a strong position to deliver a strong financial performance within LBCM.

The Company won several awards in 2017, primarily in categories relating to great customer service. For its removal of sales targets, the Islands business won the 'Excellence in Customer Experience' category at the Financial Innovation Awards, an event that recognises financial institutions across the United Kingdom. These awards not only show that we have a successful business, but are a testament to the inspiring work that our colleagues do every day as they strive to fulfil our vision of becoming the best bank for customers.

As a Company we employ more than 900 people across Jersey, Guernsey, Alderney and the Isle of Man, and we continue to play an important role in the communities we serve. Collectively, our colleagues dedicate thousands of hours supporting local communities and hosting numerous fundraising events; this equates to a significant contribution to the wider community.

My own position has changed: at the end of the financial year I became Non-Executive Chairman. Richard Musty, a Director of the Company for a number of years, has been appointed Chief Executive for the Islands business.

On behalf of the Board, I would like to thank all colleagues for their continued dedication to the Company and their significant contribution to its current and future success.

Timothy Cooke (Chairman) 23 March 2018

Directors' report

The Directors submit their report and the audited financial statements for the year ended 31 December 2017.

Activities
Lloyds Bank International Limited is a limited company incorporated and domiciled in Jersey, and operates branches in Guernsey and the Isle of Man. The Company is licenced as a bank In Jersey, Guernsey and Isle of Man. The Company also holds a licence to carry on business in respect of Financial Advisory Services in South Africa.

The Company's revenue is earned through interest and fees on a wide range of financial services products, including current and savings accounts, personal loans, and mortgages within the retail market, loans and deposit products to commercial customers, private banking and asset management.

Profit and dividend
The profit attributable to the shareholder of the Company for the year ended 31 December 2017 was £63,406,000 (2016: £27,504,000). There were no dividends declared or paid for the year ended 31 December 2017 or 31 December 2016.

Pension
The Company is a participating employer in the Lloyds Offshore Pension Scheme (the "Scheme"). As at the 1 January 2017, the Scheme was in deficit and the Company made deficit clearance payments totalling £17,732,000 (2016: £nil) in accordance with undertakings previously given. It is intended to continue these deficit clearance payments in 2018.

During 2018, it is intended that the Company will cease to be a participating employer in the Scheme and, as a consequence of ceasing to be a participating employer; the Scheme will be transferred to Lloyds Bank plc as the new participating employer.

Business review
The environment within which the Company operates remains competitive. The Company has written a satisfactory level of new business in the year and this is expected to continue in the foreseeable future. The Directors are supporting a strategy designed to ensure that the Company's interest and other charges fully reflect the risks associated with its core products whilst maintaining competitiveness.

During 2017 the Company developed a new customer product offering for the private equity funds market which has resulted in loan commitments of £48m and drawn lending of £4m at 31 December 2017. During 2018 it is forecast that this product will materially increase the customer lending and consequently increase income.

As a result of the requirements of Ring-Fencing the Company will become part of the Non Ring-Fenced bank within Lloyds Banking Group. The Ring-Fencing requirements are set out in the Financial Services and Markets Act 2000 (as amended by Financial Services (Banking Reform) Act 2013), statutory instruments and associated rules and guidance set by the Prudential Regulatory Authority ("PRA") and Financial Conduct Authority ("FCA"), together, the "UK Ring-Fencing Regime". This may create new opportunities.

The Board monitors progress on the overall Company strategy together with the individual strategic elements of the business by reference to Key Performance Indicators ("KPI") outlined overleaf.

Directors' report (continued)

Business review (continued)

Performance during the year together with comparative historical data is set out in the table below

KPI	2017	2016	Definition, method of calculation and analysis
Deposit reduction/ growth	-9%	7%	Change in customer deposits in the year, 2017 being a reduction. The Company has selectively reduced its appetite for certain deposit segments in order to improve net interest margin.
Lending reduction/ growth	-9%	2%	Changes in net loans and advance to customers during the year. The decrease in lending by the Company is driven by reductions in certain significant loans during the year.
Lending Ratio	10%	10%	Ratio of external customer lending to external customer deposits. The lending ratio has remained static reflecting the strength of the Company's balance sheet
Net interest margin	0.85%	0.83%	Net interest margin, divided by average interest earning assets. A focus on certain business segments has resulted in a stable Net Interest Margin
Cost/income ratio	44%	56%	Operating expenses divided by total income. The Company consistently controlled recurring expenses. A significant one-off reduction in customer remediation provisions has contributed to the 2017 reduction.
Funds under management	£557,403,019	£582,295,126	Total managed funds. The Company has sought to maintain strong relationships with customers.
Core Tier 1 capital ratio	18.2%	15.1%	Regulatory core tier 1 capital after deductions, divided by risk weighted assets The Company has maintained its capital ratios in excess of internal limits and regulatory capital guidance. Continued profitability has driven the increase.
Asset Quality Ratio	0.34%	1.52%	Provision charge for the year divided by average lending. The decrease is driven by a significant reduction in impairment charge between 2016 and 2017.

Ownership

The ultimate holding company is Lloyds Banking Group plc (the "Group"), which is also the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member. Lloyds Bank plc is the parent undertaking of the smallest such group of undertakings. Lloyds Banking Group plc is registered in Scotland and Lloyds Bank plc is registered in England and Wales. The immediate holding company is Lloyds Holdings (Jersey) Limited, a company incorporated in Jersey, Channel Islands.

Directors' report (continued)

Directors
The present members of the Board are shown on page 1. The Directors have no interest in the shares of the Company.

Statement of Directors' responsibilities
The Directors are required by the Companies (Jersey) Law 1991, the Banking Business (Jersey) Law 1991, the Financial Services (Trust Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007, the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005, the Financial Advisory and Intermediary Services, Act 2002 [South Africa], and International Financial Reporting Standards, to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the Company as at the end of the financial year 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 judgments and accounting estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; 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 confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies (Jersey) Law 1991, the Banking Business (Jersey) Law 1991, the Financial Services (Trust Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007, the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005, the Financial Advisory and Intermediary Services, Act 2002 [South Africa], and International Financial Reporting Standards. They are also responsible for safeguarding the assets of the Company and for taking reasonable steps for the prevention and detection of fraud, and other irregularities.

A copy of these financial statements is placed on the website http://international.lloydsbank.com/legal-information/company-information. The Directors are responsible for the maintenance and integrity of information published in relation to the Company on that website. Legislation in Jersey governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

So far as the Directors are aware, there is no relevant audit information of which the Company's auditor 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 auditor is aware of that information.

Independent auditor
The independent auditor, PricewaterhouseCoopers CI LLP has indicated their willingness to continue in office.

By order of the Board

Marnie Martin (Secretary)
23 March 2018

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LLOYDS BANK INTERNATIONAL LIMITED

Report on the audit of the financial statements

Opinion

In our opinion, Lloyds Bank International Limited's ("the Company") financial statements (the "financial statements"):

- give a true and fair view of the state of the Company's affairs as at 31 December 2017 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 issued by the IASB; and
- have been prepared in accordance with the requirements of the Companies (Jersey) Law 1991, the Banking Business (Jersey) Law 1991, the Financial Services (Trust Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007 and Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005.

We have audited the financial statements, included within the Annual Report 2017 ("the Annual Report"), which comprise: the balance sheet as at 31 December 2017; the statement of comprehensive income, the statement of cash flows and 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 Auditor's 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 Jersey, 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

We have nothing to report in respect of the following matters in relation to which 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.

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.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditor's 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 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.

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 5, 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.

Auditor's 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 auditor's 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 auditor's report.

Use of this report

This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Article 113A of the Companies (Jersey) Law 1991 and for no other purpose. We do not, in giving this opinion, 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

Company Law exception reporting

Under the Companies (Jersey) Law 1991 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
- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records.

We have no exceptions to report arising from this responsibility.

Karl Hairon
For and on behalf of PricewaterhouseCoopers CI LLP
Chartered Accountants
Jersey, Channel Islands
23 March 2018

Statement of comprehensive income

For the year ended 31 December

	Note	2017 £000	2016 £000
Interest and similar income	3	**158,567**	171,596
Interest and similar expense	3	**(38,078)**	(51,076)
Net interest income		**120,489**	120,520
Fee and commission income	4	**17,922**	19,326
Fee and commission expense	5	**(1,563)**	(692)
Net fee and commission income		**16,359**	18,634
Net trading income	6	**17,200**	20,540
Other operating income	7	**207**	2,571
Total other income		**33,766**	41,745
Total income		**154,255**	162,265
Operating expenses	8	**(67,766)**	(91,675)
Impairment losses on loans and advances and other credit risk provisions	9	**(4,439)**	(21,216)
Profit before income tax		**82,050**	49,374
Income tax expense	10	**(8,444)**	(5,970)
Profit for the year		**73,606**	43,404
Other comprehensive income:			
Items that will not be reclassified to profit and loss			
Remeasurements of retirement benefit obligations	20.2	**(10,200)**	(15,900)
Total comprehensive income for the year		**63,406**	27,504

All items dealt with in arriving at the total comprehensive profit for the years ended 31 December 2017 and 31 December 2016 relate to continuing operations.

The accompanying notes on pages 12 - 50 are an integral part of the financial statements.

Balance sheet

As at 31 December

	Note	2017 £000	2016 £000
Assets			
Cash		**7,296**	10,213
Items in the course of collection from banks		**4,630**	3,732
Derivative financial instruments	19	**4,838**	10,156
Loans and receivables			
Loans and advances to banks	11	**12,401,730**	13,493,400
Loans and advances to customers	12	**1,197,770**	1,316,780
		13,599,500	14,810,180
Property and equipment	13	**15,546**	20,248
Current tax assets	15	**375**	381
Other assets	16	**3,474**	8,442
Total assets		**13,635,659**	14,863,352
Liabilities			
Deposits from banks	17	**213,425**	230,113
Items in course of transmission to banks	17	**4,894**	693
Customer deposits	18	**12,399,386**	13,659,927
Derivative financial instruments	19	**4,838**	10,156
Retirement benefit obligations	20.2	**3,000**	9,500
Current tax liabilities		**10,048**	1,613
Other liabilities	21	**10,682**	10,844
Provisions	22	**3,298**	17,824
Total liabilities		**12,649,571**	13,940,670
Equity			
Share capital	23	**536,852**	536,852
Share premium account	24	**14,985**	14,985
Retained profits		**434,251**	370,845
Total shareholder's equity		**986,088**	922,682
Total equity and liabilities		**13,635,659**	14,863,352

The accompanying notes on pages 12 - 50 are an integral part of the financial statements.

The financial statements on pages 8 - 50 were approved by the Board of Directors on 23 March 2018 and were signed on its behalf by:

Richard John Musty
Director

Adrian David Lane
Director

Statement of changes in equity

For the year ended 31 December

	Attributable to equity shareholders			
	Share capital £000	Share premium £000	Retained profits £000	Total £000
Balance at 1 January 2016 (see notes 23 and 24)	536,852	14,985	343,341	895,178
Other comprehensive income	-	-	(15,900)	(15,900)
Profit for the year	-	-	43,404	43,404
Balance at 31 December 2016	536,852	14,985	370,845	922,682
Balance at 1 January 2017 (see notes 23 and 24)	**536,852**	**14,985**	**370,845**	**922,682**
Other comprehensive income	**-**	**-**	**(10,200)**	**(10,200)**
Profit for the year	**-**	**-**	**73,606**	**73,606**
Balance at 31 December 2017	**536,852**	**14,985**	**434,251**	**986,088**

The accompanying notes on pages 12 - 50 are an integral part of the financial statements.

Statement of cash flows

For the year ended 31 December

	Note	2017 £000	2016 £000
Net cash generated in operating activities	30	**664,293**	964,091
Investing activities:			
Purchases of fixed assets	13	**(273)**	(1,353)
Net cash used in investing activities		**(273)**	(1,353)
Cash flow from financing activities:			
Dividends paid to equity shareholders		**-**	-
Net increase in cash and cash equivalents		**664,020**	962,738
Cash and cash equivalents at beginning of year		**7,362,346**	6,399,608
Cash and cash equivalents at end of year	30.1	**8,026,366**	7,362,346

The accompanying notes on pages 12 – 50 are an integral part of the financial statements.

Notes to the financial statements
For the year ended 31 December 2017

1. Summary of significant accounting policies

1.1. Basis of preparation

The financial information for the Company has been prepared under the historical cost convention, as modified by the revaluation of derivative contracts. The financial statements have been prepared under International Financial Reporting Standards ("IFRS"). IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board ("IASB") and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and its predecessor body.

The financial statements have been prepared on a going concern basis and under the historical cost convention, modified for the fair value of derivative contracts. The financial statements have been prepared on a going concern basis as the directors are satisfied that the Company has the resources to continue in business for the foreseeable future.

There are no new or amended accounting standards that have required a change to accounting policies for the 2017 financial year. Future accounting developments are disclosed in note 32.

1.2. Consolidation

Consolidated accounts are not prepared as the Company is itself a wholly owned subsidiary of Lloyds Bank plc, which prepares consolidated accounts, which are publicly available. The Company's investments in subsidiaries are held at cost less any provisions considered necessary to reflect a permanent impairment.

1.3. Revenue recognition

Interest income and expense are recognised in the statement of comprehensive income for all interest bearing financial instruments, except for those classified at fair value through profit or loss, using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. 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 recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

Net trading income comprise all gains and losses from changes in fair value of financial assets and liabilities held at fair value though profit or loss and all gains and losses from foreign exchange transactions.

Dividends from subsidiaries are recognised when the right to receive payment is established.

1. Summary of significant accounting policies (continued)

1.4. Financial assets and liabilities

On initial recognition, financial assets are classified into fair value through profit or loss, available-for-sale financial assets, or loans and receivables. Financial liabilities are classified into fair value through profit or lost or liabilities at amortised cost.

1.4.1. Financial instruments designated at fair value through profit or loss

Financial instruments are classified at fair value through profit or loss where they are designated at fair value through profit or loss upon initial recognition; or if they are derivatives.

1.4.1.1. Derivative financial instruments

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in fair value of derivatives are included in net trading income. Derivatives embedded in other financial instruments are treated as separate derivatives recorded at fair value if they meet the definition of a derivative (as defined above), their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit and loss.

1.4.2. Loans and receivables

Loans and receivables include loans and advances to banks and customers, debt securities and eligible assets. Loans and receivables are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs. Financial assets classified as loans and receivables are accounted for at amortised cost using the effective interest rate method (see 1.3 above) less provision for impairment (see 1.7 below). Regular way purchases and sales of financial assets are recognised at trade date, being the date that the Company is committed to purchase or sell an asset.

1.4.3. Borrowings

Borrowings (which include deposits from banks and customer deposits), are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method. Interest accrued but not yet payable is included within the liability balance.

1.4.4. Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the 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 they have been extinguished (i.e. when the obligation is discharged), cancelled or expired.

1.5. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

1. Summary of significant accounting policies (continued)

1.6. Impairment

Assets accounted for at amortised cost

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 or group of financial assets has become impaired. Evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the fact that the debt is being restructured to reduce the burden on the borrower.

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. For the Company's lending portfolios, provisions are established on a case-by-case basis. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the original effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised asset or group of assets reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

If there is no objective evidence of individual impairment, the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. Segmentation takes into account such factors as the type of asset, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with similar credit risk characteristics.

Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Company to reduce any differences between loss estimates and actual loss experience.

Subsequent to the recognition of an impairment loss on a financial asset or a group of financial assets, interest income continues to be recognised on an effective interest rate basis, on the asset's carrying value net of impairment provisions. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the allowance is adjusted and the amount of the reversal is recognised in the statement of comprehensive income.

Loan renegotiations and forbearance

In certain circumstances, the Company will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. Where the renegotiated payments of interest and principal will not recover the original carrying value of the asset, the asset continues to be reported as past due and is considered impaired. Where the renegotiated payments of interest and principal will recover the original carrying value of the asset, the loan is no longer reported as past due or impaired provided that payments are made in accordance with revised terms. Renegotiation may lead to the loan and associated provision being derecognised and a new loan being recognised initially at fair value.

1. Summary of significant accounting policies (continued)

1.6 Impairment (continued)

Collateral repossessed
In certain circumstances the Company takes physical possession of assets held as collateral against lending. In such cases, the assets are carried on the Company's balance sheet and are classified according to the Company's accounting policies for the asset category.

1.7. Recognition of the guarantees
Financial guarantees and loan commitments
Financial guarantees are contracts that require the Company to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of the debt instrument. Loan commitments are firm commitments to provide credit under pre-specified terms and conditions.

1.8. Property and equipment
Property and equipment and purchased software are included at cost less accumulated depreciation and impairment. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):
- Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease.
- Leasehold improvements: shorter of 10 years or the remaining period of the lease.

Equipment:
- Equipment and motor vehicles: 3 - 8 years.
- Software up to 7 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet 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 its recoverable amount it is written down in the statement of comprehensive income immediately, the recoverable amount being the higher of value in use or fair value less cost to sell.

1.9. Leases
The leases entered into by the Company are all operating leases. Operating lease rentals are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

Leasehold premises that are included within property and equipment are recognised at cost and depreciated over the life of the lease after taking into account anticipated residual values.

The Company evaluates non-lease arrangements such as outsourcing and similar contracts to determine if they contain a lease which is then separately accounted for.

Notes to the financial statements (continued)
For the year ended 31 December 2017

1. Summary of significant accounting policies (continued)

1.10. Employee benefits

1.10.1. Pension Schemes

The Company operates a number of post-retirement benefit schemes for its employees including both defined benefit and defined contribution pension plans. A defined benefit pension scheme 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 into which the Company pays fixed contributions; there are no legal or constructive obligations to pay future contributions.

A full actuarial valuation of the Company's defined benefit scheme is carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries. For the purpose 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. The defined benefit scheme liabilities are discounted using rates equivalent to market yields at the balance sheet 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 approximating to the terms of the related pension liability.

The Company's statement of comprehensive income charge includes the current service cost of providing pension benefits, past service costs, net interest expense (income), and plan administration costs that are not deducted from the return on plan assets. Past service costs, which represents the change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment, are recognised when the plan amendment or curtailment occurs. Net interest expense (income) is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or assets.

Remeasurements, comprising actuarial gains and losses, the return on plan assets (excluding amounts included in net interest expense (income) and net of the cost of managing the plan assets), and the effect of changes to the asset ceiling are reflected immediately in the balance sheet with a charge or credit recognised in other comprehensive income in the period in which they occur. Remeasurements recognised in other comprehensive income are reflected immediately in retained profits and will not subsequently be reclassified to the statement of comprehensive income.

The Company's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The costs of the Company's and the Group's defined contribution plans are charged to the statement of comprehensive income in the period in which they arise/accrue.

Refer to note 20 for full details of the defined benefit pension scheme.

1. Summary of significant accounting policies (continued)

1.10 Employee benefits (continued)

1.10.2. Share-based compensation

Lloyds Banking Group operates a number of equity-settled, share based compensation plans in respect of services received from certain of its 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 with a corresponding increase in participation. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as Black- Scholes option pricing model or a Monte Carlo simulation. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement together with a corresponding adjustment to equity. Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Modifications are assessed at the date of modification and any incremental charges are charged to the income statement.

1.11. Income taxes, including deferred income taxes

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise. The tax is calculated based on applicable law and agreements with the tax authorities in the jurisdiction in which the profit was earned.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Income tax payable on profits is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

1.12. Foreign currency translation

1.12.1. Functional and presentation currency

Items included in the financial statements are measured in Pound Sterling being the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are also presented in Pound Sterling.

1.12.2. Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income. Non-monetary items that are measured at fair value are translated using the exchange rate at the date that the fair value was determined.

1. Summary of significant accounting policies (continued)

1.13. Provisions and contingent liabilities
Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

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

1.14. Share capital and share premium
Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of the consideration received over the par value of shares issued is recorded as share premium in equity.

1.15. Dividends
Dividends on ordinary shares are recognised as a movement in equity in the period in which they are proposed and approved.

1.16. Cash and cash equivalents
For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with original maturities of three months or less, including cash, loans and advances to banks and items in the course of collection from other banks.

1.17. Fiduciary assets
The Company provides investment services and other fiduciary services that result in the holding or investing of assets on behalf of its clients. Assets held in a fiduciary capacity, unless recognised, are not reported in the financial statements, as they are not assets of the Company.

2. Critical accounting estimates and judgments
The preparation of the Company's financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based on amounts which differ from those estimates. Estimates, judgments and assumptions 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 significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty in these financial statements, which together are deemed critical to the Company's financial results and position, are as follows:

2.1. Impairment of loans and advances to customers
The Company regularly reviews its loan portfolios to assess both collective and specific impairment. In determining whether an impairment loss should be recorded in the statement of comprehensive income, the Company makes judgments concerning whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. Such observable data includes whether there has been an adverse change in the payment status of borrowers as well as economic conditions that correlate with defaults on assets in the Company. The Company uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling future cash flows.

2. Critical accounting estimates and judgments (continued)

2.1. Impairment of loans and advances to customers (continued)

The methodology used to calculate the required provision varies according to the type of lending portfolio. For portfolios of smaller balance homogenous loans, such as residential mortgages, personal loans and credit card balances, specific provisions are calculated using formulae which take into account factors such as the length of time that the customer's account has been delinquent, historic loss rates and the value of any collateral held. The variables used in the formulae are kept under regular review to ensure that as far as possible they reflect the current economic circumstances, although actual experience may differ from that assumed.

For other lending portfolios, provisions are calculated with reference to expected future cash flows including those arising from the realisation of collateral. The determination of these provisions often requires the exercise of considerable judgment by management involving matters such as future economic conditions and the resulting trading performance of the customer and the value of collateral, for which there may not be a readily accessible market. As a result these provisions can be subject to significant variation as time progresses and the circumstances of the customer become clearer.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Refer to note 12 for analysis of loan book and impairment provisions.

2.2. Fair value of financial instruments

In accordance with IFRS 13, the Company categorises financial instruments, including derivatives, 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 unadjusted in active markets and, therefore, there is minimal judgment applied in determining fair value. For the fair value of financial instruments categorised as level 2, the inputs are observable and, in particular, level 3 inputs are unobservable and determined using valuation techniques including discounted cash flow analysis and valuation models. These require management judgment and contain significant estimation uncertainty. In particular, significant judgment is required by management in determining appropriate assumptions to be used for level 3 financial instruments.

Refer to note 29.2 for details of valuation hierarchy.

2.3. Retirement benefit obligations/assets

The value of the Company's defined benefit pension schemes liabilities requires significant management judgment in determining the appropriate assumptions to be used. The key areas of estimation uncertainty are the discount rate applied to future cash flows and the expected lifetime of the schemes members. The size of the deficit or surplus is sensitive to changes in the discount rate, which is affected by market conditions and, therefore, potentially subject to significant variation. The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience.

Assumptions used by management reflect recent longevity experience and extrapolation of the improving longevity trend.

The effects of changes to the principal actuarial assumptions on the gross defined benefit pension scheme asset or liability and on the pension charge in the Company's statement of comprehensive income are set out in note 20.

2. Critical accounting estimates and judgments (continued)

2.4. Provisions and other contingent liabilities

Provisions for liabilities and charges relate to anticipated compensation payments in respect of products sold in the past and in respect of leased premises surplus to requirements. Provisions are measured at the present value of the expenditure expected to be required to settle the obligation using a pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense

Compensation arises where customers have not received a fair outcome from their investments with the Company. Determining the amount of the provisions, which represent the management's best estimate of the cost of settling these issues, requires the exercise of significant judgement. It will often be necessary to form a view on matters which are inherently uncertain, such as the number of future complaints, the extent to which they will be upheld and the average cost of redress. Consequently the continued appropriateness of the underlying assumptions is reviewed on a regular basis against actual experience and the other relevant evidence and adjustments made to the provisions where appropriate. Refer to Notes 22 and Note 28.

The Company has leased premises where the lease is due to be terminated and the Company is liable for a dilapidations charge at termination of the lease. The amount payable in respect of dilapidations is subject to agreement and requires exercise of judgement in determining the final liability.

3. Net interest income

	2017	2016
	£000	£000
Interest and similar income:		
Loans and advances to customers	**37,354**	44,594
Loans and advances to fellow group companies	**121,213**	127,002
	158,567	171,596
Interest and similar expenses:		
Customer accounts	**(37,051)**	(50,644)
Payable to fellow group companies	**(1,027)**	(432)
	(38,078)	(51,076)
	120,489	120,520

4. Fee and commission income

	2017	2016
	£000	£000
Current account fees	**5,095**	4,965
Insurance broking commission	**3**	203
Card services	**3,737**	3,998
Asset management and related fees	**4,990**	5,829
Credit related fees and commissions	**738**	944
Other fees and commissions	**3,359**	3,387
	17,922	19,326

Included in fee and commission income in "other fees and commissions" are fees receivable of £86,000 (2016: £403,000) from fellow group companies.

5. Fee and commission expense

	2017 £000	2016 £000
Dealer commissions	**(681)**	(628)
Other	**(882)**	(64)
	(1,563)	(692)

6. Net trading income

	2017 £000	2016 £000
Profit on foreign exchange transactions	**17,200**	20,540

7. Other operating income

	2017 £000	2016 £000
Rents receivable	**203**	282
Other income	**4**	2,289
	207	2,571

8. Operating expenses

	2017 £000	2016 £000
Salaries	**(31,190)**	(35,451)
Social security contributions	**(2,505)**	(2,886)
Pensions	**(6,183)**	(9,440)
Other staff costs	**(4,073)**	(3,605)
Total staff costs	**(43,951)**	(51,382)
Depreciation	**(4,974)**	(5,245)
Operating lease rentals	**(3,692)**	(4,104)
Communications and data processing	**(5,656)**	(5,765)
Professional fees	**(1,006)**	(1,397)
Premises and equipment costs	**(4,626)**	(4,482)
Group recharges	**(8,742)**	(7,683)
Operational losses and customer remediation	**7,689**	(9,441)
Other	**(2,808)**	(2,176)
	(67,766)	(91,675)

Operating expenses include costs of £8,742,000 (2016: £7,683,000) paid to fellow group companies. This includes recharging the costs for the provision of Finance, Risk Management, Compliance, Human Resources and Information Technology services. Operational losses and customer remediation include £7,800,000 of customer remediation provision release. Refer to note 22 for the remediation provision.

9. Impairment losses on loans and advances and other credit risk provisions

	2017	2016
	£000	£000
Charge to the income statement specific provision (Note 12)	**(3,258)**	(21,423)
(Charge)/release to income statement collective provision (Note 12)	**(1,181)**	207
	(4,439)	(21,216)

10. Income tax expense

The Company is subject to Jersey income tax at 10% (2016: 10%). The Company's taxable profits arising in the Isle of Man are subject to tax at 10% (2016: 10%). The Company's taxable profits arising in Guernsey are subject to tax at 10% (2016: 10%) or 20% (2016: 20%) depending on the stream of income.

	2017	2016
	£000	£000
Analysis of (charge)/credit in the year:		
Jersey income tax charge at 10%	**(6,653)**	(5,042)
Adjustments in respect of prior years for Jersey	**1,613**	9
Adjustments in respect of prior years for Guernsey	**(2)**	-
Adjustments in respect of prior years for Isle of Man	**(3,397)**	(937)
Guernsey income tax charge 10%	**(5)**	-
Income tax expense	**(8,444)**	(5,970)

Factors affecting the tax (charge)/credit for the year		
Profit on ordinary activities before tax	**82,050**	49,374
Tax charge at standard rate of income tax applicable to the Company		
Tax rate effective in other jurisdictions		
Tax charge at the applicable tax rate of 10%	**(8,205)**	(4,937)
Adjusted for:		
Prior year adjustments	**(1,785)**	(928)
Guernsey income tax payment	**(5)**	-
Capital allowances in excess of depreciation	**(221)**	(105)
Additional allowances given in the year (pension)	**1,773**	-
Disallowable expenses	**(1)**	-
	(8,444)	(5,970)

11. Loans and advances to banks

	2017	2016
	£000	£000
Included in cash and cash equivalents (note 30.1)	**8,014,440**	7,348,401
Loans and advances to banks	**4,387,290**	6,144,999
Total loans and advances to banks	**12,401,730**	13,493,400

Included in the amounts above are £12,392,000,000 (2016: £13,488,000,000) of deposits with fellow group banks.

There is no impairment of loans and advances to banks.

12. Loans and advances to customers

	2017	2016
	£000	£000
Loans and advances to customers	**1,215,905**	1,382,577
Allowance for impairment losses	**(18,135)**	(65,797)
Net loans and advances to customers	**1,197,770**	1,316,780

Included in the amounts above are amounts due from fellow group companies of £85,000 (2016: £83,000). There have been no impairments to amounts due from fellow group companies during the year (2016: £Nil).

Allowance for impairment losses on loans and advances to customers

	2017	2016
	£000	£000
Specific provision		
At 1 January	**(65,078)**	(47,665)
Advances written off	**52,091**	3,255
Charge for the year	**(3,258)**	(21,423)
Exchange movements	**10**	755
At 31 December	**(16,235)**	(65,078)
Collective provision		
At 1 January	**(719)**	(926)
(Charge)/release for the year	**(1,181)**	207
At 31 December	**(1,900)**	(719)
Allowance for impairment losses	**(18,135)**	(65,797)

All impairment allowances are in respect of loans and advances to customers.

13. Property and equipment

	Premises £000	Equipment £000	Total £000
Cost:			
At 1 January 2016	25,213	51,021	76,234
Additions	1,283	70	1,353
Disposals	(157)	(106)	(263)
At 31 December 2016	**26,339**	**50,985**	**77,324**
Additions	**254**	**19**	**273**
Disposals	**(241)**	**(730)**	**(971)**
At 31 December 2017	**26,352**	**50,274**	**76,626**
Accumulated depreciation and impairment:			
At 1 January 2016	16,515	35,543	52,058
Depreciation charge	1,106	4,139	5,245
Disposals	(134)	(93)	(227)
At 31 December 2016	**17,487**	**39,589**	**57,076**
Depreciation charge	**1,147**	**3,827**	**4,974**
Disposals	**(240)**	**(730)**	**(970)**
At 31 December 2017	**18,394**	**42,686**	**61,080**
Net book value at 31 December 2017	**7,958**	**7,588**	**15,546**
Net book value at 31 December 2016	8,852	11,396	20,248

14. Investment in subsidiary undertakings

The Company owns 100% of the issued share capital of Nominees (Jersey) Limited of £121, a company incorporated and with a place of business in Jersey providing nominee services, as at years ended 31 December 2017 and 31 December 2016. There is no impairment of the investment in the subsidiary undertaking.

15. Current tax assets

	2017 £000	2016 £000
Current tax	**375**	381

16. Other assets

	2017 £000	2016 £000
Prepayments	**1,298**	6,236
Accrued fee income	**1,522**	1,531
Other assets	**654**	675
	3,474	8,442

17. Deposits from banks

	2017 £000	2016 £000
Interest bearing	**213,425**	230,113
Items in course of transmission to banks	**4,894**	693
Total deposits from banks	**218,319**	230,806

Included in the amounts above are £212,674,000 (2016: £173,772,000) due to fellow group banks.

18. Customer deposits

	2017 £000	2016 £000
Non-interest bearing current accounts	**1,534,044**	1,159,030
Interest bearing current accounts	**3,510,633**	4,025,284
Savings and investment accounts	**3,357,434**	3,436,001
Other customer deposits	**3,997,275**	5,039,612
Total customer deposits	**12,399,386**	13,659,927

Included in the amounts above are £51,655,000 (2016: £56,610,000) due to fellow group companies.

19. Derivative financial instruments

The principal derivatives used by the Company are exchange rate related contracts and equity linked options which are embedded as part of particular customer deposits with a market linked return. Particular attention is paid to the liquidity of the markets and products in which the Company trades to ensure that there are no undue concentrations of activity and risk.

Exchange rate related contracts include forward foreign exchange contracts only. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate.

Index-linked equity options are purchased which give the Company the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities in the form of published indices on or before a specified future date. They include embedded derivatives as matching deposits that are placed by the Company with its parent include equity contracts.

Except as below the Company does not take market risk in derivatives and therefore offsets their customer requirements for derivatives with Lloyds Bank plc. As a result the market risk is transferred to Lloyds Bank plc.

During 2017, the Company allowed certain customers to cancel products with embedded derivatives in advance of the contractual maturity as part of a customer remediation settlement. As a result of these cancellations the Company has a long equity option position at 31 December 2017, which is carried at a nil value with maturity in November 2018.

	Contract/notional amount £000	Fair value Assets £000	Liabilities £000
31 December 2017			
Forward foreign exchange contracts	**5,364**	**10**	**(10)**
Equity linked options	**47,562**	**4,828**	**(4,828)**
Total derivative assets/(liabilities)	**52,926**	**4,838**	**(4,838)**
31 December 2016			
Forward foreign exchange contracts	18,489	86	(86)
Equity linked options	101,290	10,070	(10,070)
Total derivative assets/(liabilities)	119,779	10,156	(10,156)

Included in the amounts reported above are amounts due to fellow group companies of £1,268,000 (2016: £2,819,000) and due from fellow group companies of £3,571,000 (2016: £7,337,000).

The notional value of derivatives is reducing as a result of reduced demand for the specific products utilising derivatives.

20. Retirement benefit obligations

The Company participates in a number of pension schemes operated by the Group. These are all umbrella schemes which have a combination of defined benefit and defined contribution elements. In respect of the Lloyds Group Pension Schemes No's 1 and 2 (the "Lloyds 1 and 2 Schemes"), the Company has no liability to the defined benefit section of the scheme and these are, therefore, accounted for wholly as a defined contribution plan and as a result no further disclosure is made.

20. Retirement benefit obligations (continued)
In addition, the Company is an employer in the Lloyds Bank Offshore Pension Scheme ("the Scheme"). This is a funded scheme providing retirements benefits calculated as a percentage of final pensionable salary depending upon the length of services. The Scheme operates as a separate legal entity under trust laws by trustees and the responsibility for governance lies with pension trustees.

The information set out below provides information of both the pension charge for the year and the value of the Scheme assets and liabilities and the resultant movement in the Scheme deficit.

The defined benefit element of the Scheme was closed to new members in 2002 and therefore the age profile of the active members is increasing and hence under the projected credit unit method, the current service cost will increase as the members of the Scheme approach retirement.

Full actuarial valuations of the Scheme are carried out every three years with interim reviews at each balance sheet date. The last full actuarial valuation of the scheme as at 31 December 2015 was approved by the Scheme trustee's in June 2017. This has been updated to 31 December 2017 by independent qualified actuaries Willis Towers Watson Limited.

20.1. Funded status	**2017**	2016
	£m	£m
Present value of defined benefit obligation	**(339.6)**	(361.4)
Assets at fair value	**336.6**	351.9
Funded status	**(3.0)**	**(9.5)**

20.2. Reconciliation of defined benefit asset/(liability)	**2017**	2016
	£m	£m
Defined benefit asset/(liability) at 1 January	**(9.5)**	5.3
Service cost	**(3.6)**	(3.9)
Net interest on defined benefit asset/(liability)	**(0.1)**	0.3
Remeasurement effects recognised in OCI	**(10.2)**	(15.9)
Employer contributions actually paid	**21.7**	5.7
Administration costs incurred during the period	**(1.3)**	(1.0)
Defined benefit liability at 31 December	**(3.0)**	(9.5)

20.3. Present value of defined benefit obligation	**2017**	2016	2015	2014
	£m	£m	£m	£m
Present value of defined benefit obligation at 1 January	**(361.4)**	(273.6)	(274.1)	(242.3)
Current service cost	**(3.4)**	(3.1)	(3.6)	(3.2)
Interest cost	**(9.7)**	(10.3)	(10.0)	(10.7)
Remeasurement:				
Experience loss	**(11.3)**	(12.6)	1.4	-
Gain/(loss) from change in demographic assumptions	**(3.2)**	1.6	(0.8)	-
Gain/(Loss) from change in financial assumptions	**(13.5)**	(79.2)	8.5	(34.7)
Actual benefit payments	**63.1**	16.6	12.3	8.6
Past service cost – plan amendments	**(0.2)**	(0.8)	(0.9)	(1.2)
Past service cost – curtailments	**-**	-	(6.4)	9.4
Present value of defined benefit obligation at 31 December	**(339.6)**	(361.4)	(273.6)	(274.1)

20. Retirement benefit obligations (continued)

20.4. Fair value of assets	**2017**	2016	2015	2014
	£m	£m	£m	£m
Fair value of scheme assets at 1 January	**351.9**	278.9	290.8	240.0
Interest income on plan assets	**9.6**	10.6	10.8	11.3
Return on plan assets greater than discount rate	**17.8**	74.3	(18.3)	28.1
Employer contributions	**21.7**	5.7	8.9	20.8
Benefits paid from fund	**(63.1)**	(16.6)	(12.3)	(8.6)
Administrative costs paid	**(1.3)**	(1.0)	(1.0)	(0.8)
Fair value of scheme assets at 31 December	**336.6**	351.9	278.9	290.8

20.5. Allocation of fair value of assets	**2017**	2016
	%	%
Equities funds	**22**	44
Bonds funds	**57**	55
Credit funds	**20**	-
Property funds	**1**	1
Total	**100**	100

20.6. Actuarial assumptions	**2017**	**2016**
	%	%
Discount rate	**2.59**	2.76
RPI inflation	**3.20**	3.23
CPI inflation	**2.15**	2.18
Rate of salary increase	**0**	0

20.7. Expected contributions and benefit payments		**Year commencing**
	1 Jan 2018	1 Jan 2017
	£m	£m
Current service cost	**(1.8)**	(3.4)
Net interest on net defined benefit asset/(liability)	**0.1**	(0.1)
Administration cost incurred during the period	**(1.3)**	(1.0)
Total pension expense	**(3.0)**	(4.5)

20. Retirement benefit obligations (continued)

20.8. Sensitivity analysis

The effect of reasonably possible changes in key assumptions on the value of scheme liabilities and the resulting change on the Company's net defined benefit pension scheme liability is set out below. The sensitivities provided assume that all other assumptions and the value of the schemes assets remain 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 correlation of assumptions, aggregating the effects of these isolated changes may not be a reasonable estimate of the actual effect of changes in multiple assumptions.

20.8.1 Discount rate
An increase of 0.1% (2016: 0.2%) per annum in the discount rate would decrease the combined defined benefit obligation by approximately 2% (2016: 3-4%).

20.8.2 Retail Price Index (RPI)
An increase of 0.1% (2016: 0.2%) per annum in the RPI assumption would increase the combined defined benefit obligation by approximately 1% (2016: 2-3%).

20.9. Risk exposure of defined benefit schemes

Whilst the Company is not exposed to any unusual, entity specific or scheme specific risks in its defined benefit pension schemes, it is exposed to a number of significant risks, detailed below.

Inflation rate risk: The majority of the plan'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 in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation.

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 partially be offset by an increase in the value of bond holdings.

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

Investment risk: Scheme 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.

21. Other liabilities

	2017	2016
	£000	£000
Accruals	**7,116**	**7,223**
Other liabilities	**3,566**	**3,621**
	10,682	**10,884**

22. Provisions

	2017	2016
	£000	£000
Opening balance	**17,824**	12,222
Provision made	**789**	9,161
Provision applied	**(7,515)**	(3,319)
Unused provision reversed	**(7,800)**	(240)
Closing balance	**3,298**	17,824

Included within provisions are amounts in respect of Payment Protection Insurance ("PPI") compensation, other customer redress claims and cost of the property lease cancelation referred to in note 28.3.

23. Share capital

	2017	2016
	£000	£000
Authorised		
1,000,000,000 ordinary shares of £1 each	**1,000,000**	1,000,000
Issued and fully paid		
Ordinary shares of £1 each	**536,852**	536,852

24. Share premium account

	2017	2016
	£000	£000
Share premium	**14,985**	14,985

25. Share based payments

During the year ended 31 December 2017, the Company's ultimate parent company operated a number of share based payments schemes in which employees of the Company participated. The Company's contribution to these schemes is based on a percentage of salary paid to employees. The employee costs, including a charge for share based payments of £791,000 (2016: £964,000) are recharged from other Group companies.

Employees of the Company participated in the following schemes:

Save-As-You-Earn: Eligible employees may enter into contracts 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 the Group at discounted price.

The Long-Term Incentive Plan (LTIP): Awards are made within the rules of the Plan, with 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 dividend paid between the award date the date the Remunerations Committee determine if any dividends are to be paid in cash or in shares.

Matching Shares: The group 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 employees' behalf, during which 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% of the matching shares are forfeited. Similarly if the employee sells their shares purchased within three years, the matching shares are forfeited.

25. Share based payments (continued)

Fixed share awards: The fixed share awards are delivered in Lloyds Banking Group plc shares, released over five years with 20% being released each year following the year of award. The fixed share award is not subject to any performance conditions, performance adjustment or claw back. On an employee leaving the Group, there is no change to the timeline for which shares will become unrestricted.

Full details of the schemes operated can be found in the 2017 annual report and accounts of the Company's ultimate parent company, as set out in note 27.

26. Related party transactions

Related party transactions not disclosed elsewhere in the notes to the financial statements are set out below. Transactions with fellow Group companies are disclosed in notes 3, 4, 8, and 20. Balances with fellow Group companies are disclosed in notes 11, 12, 17, 18, 19 and 20.

Key management compensation

The key management personnel of the Company are deemed to be the Directors.

	2017	2016
	£000	£000
Salaries and other short term benefits	**1,244**	**1,240**
Post-employment benefits	**183**	**200**
Share based payments	**60**	**221**
	1,487	**1,661**

Key management compensation includes the compensation of all directors paid directly by the Company and an imputed management recharge to the Company for the services of certain directors in relation to the Company even though there is no intention to recharge those costs.

Transactions with key management

	2017	2016
	£000	£000
Loans		
At 1 January	**1,697**	1,805
Advanced during the year	**100**	-
Interest charged during the year	**(10)**	12
Repayments during the year	**(692)**	(120)
At 31 December	**1,095**	1,697
Deposits		
At 1 January	**374**	321
Deposited during the year	**2,287**	2,104
Interest paid on deposits	**-**	1
Withdrawn during the year	**(2,284)**	(2,052)
At 31 December	**377**	374

Amounts advanced and deposited include the balances with directors appointed during the year at the date of appointment. Amounts repaid and withdrawn include the balances with directors resigning during the year at the date of resignation. No provisions for impairments of loans and advances to key management are held (2016: £Nil).

27. Ultimate parent undertaking

The immediate parent undertaking is Lloyds Holdings (Jersey) Limited.

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 Lloyds Bank plc head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

The ultimate parent company 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.

28. Contingent liabilities and commitments

28.1. Legal proceedings

The Company is periodically subject to potential and actual litigation, the outcome of which is frequently uncertain as to timing and whether any liability or asset exists. Management reviews the relevant cases and consults with in-house and external legal counsel, as appropriate.

There are claims and possible claims against the Company as at 31 December 2017. Due to inherent uncertainties involved in determining whether the Company has a present obligation and because the amount cannot be readily quantified, no further provisions are considered necessary except as disclosed in note 22.

Whilst the Directors consider that the liabilities are fairly stated on the basis of the information currently available to them, significant adjustments may be required as actual claims and possible claims develop.

28.2. Contingent liabilities and commitments arising from the banking business

Customer guarantees include standby letters of credit, bonds and other transaction related contingencies issued on behalf of customers, where the Company has an irrevocable obligation to pay a third party beneficiary if the customer fails to pay an outstanding commitment.

The table below shows the Company's maximum exposure to loss represented by the contractual nominal amount as at the balance sheet date. Consideration has not been taken of any possible recoveries from customers in respect of such guarantee under recourse provisions or from collateral held. It is not practicable to quantify any future financial effect.

Contingent liabilities	**2017** **£000**	2016 £000
Customer guarantees	**98,857**	83,957

Commitments	**2017** **£000**	2016 £000
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Not later than 1 year	**124,212**	69,800
Over 1 year	**1,768**	-
	125,980	69,800

Commitments in respect of forward foreign exchange contracts are disclosed in note 19.

28. Contingent liabilities and commitments (continued)

28.3. Operating lease commitments

The future minimum lease payments under non-cancellable premises and equipment operating leases are as follows:

	2017	2016
	£000	£000
Not later than 1 year	**3,625**	3,820
Later than 1 year and not later than 5 years	**9,136**	11,074
Later than 5 years	**11,461**	13,719
	24,223	28,613

The future minimum lease receipts under non-cancellable operating leases are as follows:

	2017	2016
	£000	£000
Not later than 1 year	**104**	131
Later than 1 year and not later than 5 years	**394**	413
Later than 5 years	**190**	275
	688	819

Operating lease payments represent rent payable by the Company for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses although the effect of these is not material. No arrangements have been entered into for contingent rental payments. There are no other restrictions imposed by leases that require disclosure in these financial statements.

The Company has ceased to occupy one building under an operating lease and given notice of cancellation under the terms of the lease. As disclosed in note 22, the Company has provided for the lease payments to the break date.

29. Financial risk management

The Board of Directors is responsible for identifying measuring, monitoring and controlling risks. The Directors and management of the Company, as the primary risk managers, are responsible for establishing proper control frameworks to ensure that the Company's business is conducted effectively and prudently. The management are responsible for ensuring that the risks within their business are identified, assessed, monitored, controlled and reported to the Board.

The Company uses financial instruments (including derivatives) to meet the financial needs of its customers, and to reduce its own exposure risk. The Company accepts deposits from and makes loans to commercial and retail customers at both fixed and floating rates and for various periods. Such exposures to customers involve both on-balance sheet loans and advances and guarantees and other commitments such as letters of credit and irrevocable commitments. The Company does not enter into the trading of financial instruments.

The primary risks affecting the Company through its use of financial instruments are: credit risk, interest rate risk, market risk, foreign exchange risk, liquidity risk and concentration risk.

Notes to the financial statements (continued)
For the year ended 31 December 2017

29. Financial risk management (continued)

29.1. Classification of financial assets and liabilities
The following table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

	Financial assets at amortised cost	Fair value through profit or loss	Financial liabilities at amortised cost	Total
	£000	£000	£000	£000
As at 31 December 2017				
Financial assets				
Cash balances	**7,296**	**-**	**-**	**7,296**
Items in the course of collection from banks	**4,630**	**-**	**-**	**4,630**
Derivative financial instruments	**-**	**4,838**	**-**	**4,838**
Loans and receivables:	**-**	**-**	**-**	
Loans and advances to banks	**12,401,730**	**-**	**-**	**12,401,730**
Loans and advances to customers	**1,197,770**	**-**	**-**	**1,197,770**
	13,599,500	**-**	**-**	**13,599,500**
	13,611,426	**4,838**	**-**	**13,616,264**
Financial liabilities				
Deposits from banks	**-**	**-**	**213,425**	**213,425**
Items in the course of collection from banks	**-**	**-**	**4,894**	**4,894**
Customer accounts	**-**	**-**	**12,399,386**	**12,399,386**
Derivative financial instruments	**-**	**4,838**	**-**	**4,838**
	-	**4,838**	**12,617,705**	**12,622,543**

	£000	£000	£000	£000
As at 31 December 2016				
Financial assets				
Cash balances	10,213	-	-	10,213
Items in the course of collection from banks	3,732	-	-	3,732
Derivative financial instruments	-	10,156	-	10,156
Loans and receivables:	-	-	-	-
Loans and advances to banks	13,493,400	-	-	13,493,400
Loans and advances to customers	1,316,780	-	-	1,316,780
	14,810,180	-	-	14,810,180
	14,824,125	10,156	-	14,834,281
Financial liabilities				
Deposits from banks	-	-	230,113	230,113
Items in the course of collection from banks	-	-	693	693
Customer accounts	-	-	13,659,927	13,659,927
Derivative financial instruments	-	10,156	-	10,156
	-	10,156	13,890,733	13,900,889

29. Financial risk management (continued)

29.2. Fair values of financial assets and liabilities

	Carrying value 2017 £000	Carrying value 2016 £000	**Fair value 2017 £000**	Fair value 2016 £000
Financial assets				
Derivative financial instruments	**4,838**	10,156	**4,838**	10,156
Loans and receivables:				
Loans and advances to banks	**12,401,730**	13,493,400	**12,403,631**	13,495,313
Loans and advances to customers	**1,197,770**	1,316,780	**1,189,230**	1,322,514
	13,599,500	14,810,180	**13,592,861**	14,817,827
	13,604,338	14,820,336	**13,597,699**	14,827,983
Financial liabilities				
Deposits from banks	**213,425**	230,113	**204,885**	235,849
Customer accounts	**12,399,386**	13,659,927	**12,400,419**	13,661,840
Derivative financial instruments	**4,838**	10,156	**4,838**	10,156
	12,617,649	13,900,196	**12,610,142**	13,907,845

The carrying amount of the following financial instruments is a reasonable approximation of fair value: cash and items in the course of collection from the banks, other assets and other liabilities.

29. Financial risk management (continued)

29.2. Fair values of financial assets and liabilities (continued)

Valuation hierarchy
The table below analyses the financial assets and liabilities of the Company which are carried at fair value. They are categorised into levels 1 to 3 based on the degree to which their fair value is observable. The fair value measurement approach is recurring in nature.

	Level 1	**Level 2**	**Level 3**	**Total**
	£000	**£000**	**£000**	**£000**
As at 31 December 2017				
Financial assets				
Derivative financial instruments	**-**	**4,838**	**-**	**4,838**
	-	**4,838**	**-**	**4,838**
Financial liabilities				
Derivative financial instruments	**-**	**4,838**	**-**	**4,838**
	-	**4,838**	**-**	**4,838**

	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
As at 31 December 2016				
Financial assets				
Derivative financial instruments	-	10,156	-	10,156
	-	10,156	-	10,156
Financial liabilities				
Derivative financial instruments	-	10,156	-	10,156
	-	10,156	-	10,156

Valuation classifications
Level 1
Level 1 valuations are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. The Company has no financial instruments classified as level 1.

Level 2
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 these techniques use inputs that are based significantly on observable market data.

Level 3
Level 3 valuations are those where at least one input which could have a significant effect on the instruments valuation, is not based on observable market data and are valued using valuation techniques that require significant management judgement in determining appropriate assumptions. The Company has no financial instruments classified as level 3.

There have been no transfers between valuation classification levels in the year.

29. Financial risk management (continued)

29.2. Fair values of financial assets and liabilities (continued)

Derivative financial instruments
Derivative financial instruments comprise forward foreign exchange contracts and equity linked options disclosed in note 19. The fair values are determined using valuation techniques including discounted cash flows and option pricing models, which, to the extent possible, use observable inputs from quoted market prices in active markets, including recent market transactions. These are classified as level 2 investments.

Loans and receivables
The Company provides loans and advances to commercial and personal customers at both fixed and variable rates. The carrying value of the variable rate loans is assumed to be their fair value.

For fixed rate lending, the fair value is estimated by discounting the anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Company. These are classified as level 2 investments.

Other assets
The fair value approximates to their carrying value due to their short term nature.

Deposits from banks and customers
The fair value of deposits repayable on demand or with no stated maturity is considered to be equal to their carrying value. The fair value of all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates of deposits of similar remaining maturities. These are classified as level 2 investments.

Other liabilities
The fair value approximates to their carrying value due to their short term nature.

29.3. Credit risk

Definition
Credit risk is the risk of reductions in earnings and/or value, through financial or reputational loss, as a result of the failure of the party with whom has been contracted to meet its obligations (both on and off-balance sheet).

Exposures
The principal sources of credit risk within the Company arise from loans and advances to banks and customers. Credit risk arises both from amounts lent and commitments to extend credit to a customer as required. These commitments can take the form of loans and overdrafts, or credit instruments such as guarantees and standby, documentary and commercial letters of credit.

Credit risk can also arise from debt securities, derivatives and foreign exchange activities. Note 19 to the financial statements shows the total notional principal amount of interest rate, exchange rate, equity and other contracts outstanding at 31 December 2017. The notional principal amount does not, however, represent the Company's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Company.

Measurement
In measuring the credit risk of loans and advances to customers and to banks at a counterparty level, the Company reflects three components (i) the 'probability of default' by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and their likely future development, from which the Company derives the 'exposure at default'; and (iii) the likely recovery ratio on the defaulted obligations (the 'loss given default').

29. Financial risk management (continued)

29.3. Credit risk (continued)

The Company assesses the probability of default of individual counterparties using internal rating models tailored to the various categories of counterparty. All rating models are authorised by executive management. They have been developed internally and use statistical analysis, combined, where appropriate, with external data and/or credit officer judgment. Each rating model is subject to a rigorous validation process, undertaken by independent, standalone internal risk teams.

Mitigation
The Company uses a range of approaches to mitigate credit risk in respect of both on and off-balance sheet exposures.

Counterparty limits: Credit risk in bank and corporate portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk.

Credit scoring: In its principal retail portfolios, the Company uses statistically-based decision techniques (primarily credit scoring). The risk department reviews scorecard effectiveness and changes are approved by the Credit Committee.

Cross-border and cross-currency exposures: Country limits are authorised and managed by a dedicated unit taking into account economic and political factors.

Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines that reflect risk appetite. Exposures are monitored to prevent excessive concentration of risk. The Company's large exposures are managed in accordance with regulatory requirements.

Specialist units: Credit quality is maintained by specialist units providing, for example, intensive management expertise in documentation for lending, sector-specific expertise and legal services.

Collateral
The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities; and
- Guarantees received from third parties.

The Company has guidelines on the acceptability of specific classes of collateral.

It is the Company's policy that collateral should always be realistically valued by an appropriately qualified source, independent of the customer, at the time of borrowing. Collateral is reviewed on a regular basis and in order to minimise the credit risk, the Company may seek additional collateral from the counterparty as soon as impairment indicators are identified for the relevant individual loans and advances.

29. Financial risk management (continued)

29.3. Credit risk (continued)

Mortgages
An analysis by loan-to-value ratio of the Company's residential mortgage lending is provided below. The value of collateral used in determining the loan-to-value ratios has been estimated based upon the last actual valuation.

	2017	2016
	£000	£000
Less than 70 per cent	**372,140**	367,010
70 per cent to 80 per cent	**105,310**	108,568
80 per cent to 90 per cent	**150,000**	150,156
90 per cent to 100 per cent	**17,470**	10,770
Greater than 100 per cent	**2,797**	15,379
Total	**647,717**	651,883

Non-mortgage lending
At 31 December 2017, the net non-mortgage lending amounted to £554,289,000 (2016: £664,897,000). In determining the value of collateral, no specific amounts have been attributed to the costs of realisation and the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Company's exposure.

Unsecured lending
No collateral is held in respect of overdrafts, or unsecured personal loans which amounted to £83,938,000 (2016: £109,249,000).

Derivatives
Credit risk exposure on individual derivative transactions is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Monitoring
Credit risk is monitored through:

- *Portfolio monitoring and reporting:* Portfolios of credit and related risk exposures are identified and defined by the Company, along with key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure;

- *Risk assurance and oversight:* The Credit Risk Committee monitors credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Company; and

- *Term to maturity:* The Company monitors the term to maturity of credit commitments because longer term commitments inherently have a greater degree of credit risk than shorter term commitments.

The maximum credit risk of the Company in the event of other parties failing to perform their obligations is as follow:

- The balance sheet value of assets.
- For guarantees and commitments the off-balance sheet exposure detailed in note 28
- Forward foreign exchange contracts detailed in note 19.

No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount.

29. Financial risk management (continued)

29.3. Credit risk (continued)

Loans and advances	31 December 2017		31 December 2016	
	Loans and advances to customers £000	**Loans and advances to banks £000**	Loans and advances to customers £000	Loans and advances to banks £000
Good quality	**1,164,787**	**12,401,730**	1,193,126	13,493,400
Lower quality but not impaired	**14,359**		42,945	-
Lower quality impaired	**18,624**		80,709	-
	1,197,770	**12,401,730**	1,316,780	13,493,400
Neither past due nor impaired	**1,176,168**		1,230,740	13,493,400
Past due up to 30 days	**662**		328	-
Past due 30-60 days	**1,036**		1,035	-
Past due 60-90 days	**117**		1,081	-
Past due 90-180 days	**5,837**		589	-
Past due over 180 days	**5,004**		3,017	-
Past due but not impaired	**12,656**		6,050	-
Impaired	**27,081**		145,787	-
Gross	**1,215,905**	**12,401,730**	1,382,577	13,493,400
Less: allowance for impairment	**(18,135)**	**-**	(65,797)	-
Net	**1,197,770**	**12,401,730**	1,316,780	13,493,400

Good quality lending comprises lending with the lowest probability of default, special mention identifies potential problems which may result in deterioration of repayment prospects, and lower quality reflects progressively higher risk of default.

Loans and advances to customers which are neither past due nor impaired

	2017 £000	2016 £000
Good quality	**1,164,787**	1,193,126
Special mention	**1,697**	1,672
Lower quality	**9,684**	35,942
Total	**1,176,168**	1,230,740

Gross loans and advances to customers which are impaired

		2017 £000	2016 £000
Companies	- Property	**669**	3,029
	- Construction	**22,241**	133,834
	- Other	**2,393**	6,138
Personal	- House purchase	**1,577**	2,454
	- Other	**201**	332
Total		**27,081**	145,787

29. Financial risk management (continued)

29.3. Credit risk (continued)

Lending concentration

	31 December 2017		
	Gross loans	**Provisions**	**Loans and advances to customers**
	£000	**£000**	**£000**
Non-personal			
Property companies	**392,139**	**(1,042)**	**391,097**
Construction	**57,933**	**(13,240)**	**44,693**
Other	**93,763**	**(2,300)**	**91,463**
	543,835	**(16,582)**	**527,253**
Personal			
House purchase	**648,365**	**(648)**	**647,717**
Other advances	**23,705**	**(905)**	**22,800**
	672,070	**(1,553)**	**670,517**
Total loans and advances to customers	**1,215,905**	**(18,135)**	**1,197,770**

	31 December 2016		
	Gross loans	Provisions	Loans and advances to customers
	£000	£000	£000
Non-personal			
Property companies	412,055	(3,269)	408,786
Construction	169,675	(59,023)	110,652
Other	117,754	(1,223)	116,531
	699,484	(63,515)	635,969
Personal			
House purchase	652,938	(1,055)	651,883
Other advances	30,155	(1,227)	28,928
	683,093	(2,282)	680,811
Total loans and advances to customers	1,382,577	(65,797)	1,316,780

29. Financial risk management (continued)

29.4. Market risk

Definition
Market risk is the risk to earnings, value and/or reserves through financial or reputational loss, arising from unexpected changes in financial prices including interest rates, and exchange rates.

29.4.1. Interest rate risk
Interest rate risk arises primarily from the Company's exposure to interest rate fluctuations whilst offering customer products which are at a fixed interest rate. The Company manages its interest rate risk within strict limits and over the short-term to limit the adverse effect of defined rate movements on the consistency of the Company's net interest income.

Measurement
Interest rate risk is managed by the Company's treasury department, but monitored on a daily basis by the middle office function within the finance department using One-Year Equivalent (OYE). OYE is a measure of interest rate risk. The methodology is to express the portfolio in terms of a one year equivalent position between the interest bearing assets and liabilities. If the interest rate increases by 1%, the impact on statement of comprehensive income will equate to 1% of the OYE. This approach is used to estimate the sensitivity of a portfolio to movements in interest rates. The limit is set by the Directors and is aligned with the Company's risk appetite.

	2017	2016
	£000	£000
OYE	**5,232**	10,820
OYE limit	**30,000**	58,000

29. Financial risk management (continued)

29.4. Market risk (continued)

29.4.1. Interest rate risk (continued)

Interest rate sensitivity gap analysis

The following table summarises the re-pricing mismatches of the Company's financial assets and liabilities at 31 December:

As at 31 December 2017	**Less than 3 months**	**3-12 months**	**1-4 years**	**Over 4 years**	**Non interest bearing**	**Total**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Financial assets						
Loans and advances to banks	**11,823,871**	**396,604**	**141,435**	**39,820**	**-**	**12,401,730**
Loans and advances to customers	**767,229**	**77,262**	**303,274**	**50,005**	**-**	**1,197,770**
Other assets	**10**	**838**	**3,990**	**-**	**14,478**	**19,316**
	12,591,110	**474,704**	**448,699**	**89,825**	**14,478**	**13,618,816**
Financial liabilities						
Deposits from banks and customers	**11,503,025**	**513,332**	**507,208**	**89,246**	**-**	**12,612,811**
Other liabilities	**10**	**838**	**3,990**	**-**	**28,923**	**33,761**
	11,503,035	**514,170**	**511,198**	**89,246**	**28,923**	**12,646,572**
Interest rate re-pricing gap	**1,088,075**	**(39,466)**	**(62,499)**	**579**	**(14,445)**	**972,244**

As at 31 December 2016	Less than 3 months	3-12 months	1-4 years	Over 4 years	Non interest bearing	Total
	£000	£000	£000	£000	£000	£000
Financial assets						
Loans and advances to banks	12,525,119	688,365	234,198	45,718	-	13,493,400
Loans and advances to customers	899,466	74,360	171,353	171,601	-	1,316,780
Other assets	86	1,756	8,314	-	16,534	26,690
	13,424,671	764,481	413,865	217,319	16,534	14,836,870
Financial liabilities						
Deposits from banks and customers	12,527,454	733,833	411,426	217,327	-	13,890,040
Other liabilities	86	1,756	8,314	-	30,974	41,130
	12,527,540	735,589	419,740	217,327	30,974	13,931,170
Interest rate re-pricing gap	897,131	28,892	(5,875)	(8)	(14,440)	905,770

29. Financial risk management (continued)

29.4. Market risk (continued)

29.4.2. Foreign exchange risk

The Company incurs foreign exchange risk in the course of providing services to their customers. The Company manages its foreign exchange risk within strict limits to limit the adverse effect of defined rate movements on the consistency of the Company's income.

Measurement

Foreign exchange risk is managed by the Company's treasury department, but monitored on a daily basis by the middle office function within the finance department using Open Exchange Positions (OEP). At 31 December 2017 the Company's aggregate net OEP limit, either long or short, was £1,000,000 (2016: £1,000,000). The table below indicates maximum net positions, either long or short, for individual currencies.

	2017	2016
	£000	£000
	Long/(short)	Long/(short)
OEP expressed in GBP equivalent		
USD	**305**	220
EUR	**86**	137
Other Currencies	**(350)**	(84)
Total	**41**	273

Monitoring

Market risk is monitored through the Assets and Liabilities Committee ("ALCO") on a monthly basis and the Board of Directors on a quarterly basis. This includes the monitoring of compliance with internal limits which are aligned with the Company's risk appetite.

29.4.3. Equity price risk

The Company is exposed to equity price risk through market-linked deposits offered to customers, which have returns linked to stock-market performance and a guaranteed minimum return. The Company's policy is to minimise the risk by fully matching the liabilities with equity options held with Lloyds Bank plc. The Company does not retain any significant exposure to equity price risk with exception outlined in note 19, regarding the one-off on the long option, and accordingly no quantitative analysis of such exposures is presented.

29.5. Liquidity risk

Definition

Liquidity risk is the risk that the Company does not have sufficient financial resources to meet its commitments when they fall due.

Exposure

Liquidity exposure represents the amount of potential outflows in any future period less committed inflows in that period such that the Company is unable to meet its financial obligations as they fall due, or can secure them only at excessive cost. These obligations include the repayment of deposits on demand or at their contractual maturity, the repayment of loan capital and borrowings as they mature the payment of operating expenses and taxation, the ability to fund new and existing loan commitments, and the ability to take advantage of new business opportunities.

29. Financial risk management (continued)

29.5. Liquidity risk (continued)

Measurement

The Company manages the liquidity profile of the balance sheet through both short term liquidity management and long term strategic funding. Short term liquidity management is considered from two perspectives; business as usual and crisis liquidity, both of which relate to funding in the less than one year time horizon. Longer term funding is used to manage the Company's strategic liquidity profile which is determined by the Company's balance sheet structure, and decided by the Company. Longer term is defined as an original maturity of more than one year.

The table below analyses financial liabilities of the Company, on an undiscounted future cash flows basis according to contractual maturity into relevant maturity groupings based on the remaining period at the balance sheet date.

As at 31 December 2017	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Financial liabilities						
Deposits from banks and customers	**10,670,141**	**382,500**	**1,312,226**	**247,944**	**-**	**12,612,811**
Derivative financial instruments	**10**	**-**	**903**	**3,925**	**-**	**4,838**
Other liabilities	**28,923**	**-**	**-**	**-**	**-**	**28,923**
	10,699,074	**382,500**	**1,313,129**	**251,869**		**12,646,572**

As at 31 December 2016	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	£000	£000	£000	£000	£000	£000
Financial liabilities						
Deposits from banks and customers	11,331,454	1,593,455	679,599	248,774	36,758	13,890,040
Derivative financial instruments	30	56	1,756	8,314	-	10,156
Other liabilities	30,974	-	-	-	-	30,974
	11,362,458	1,593,511	681,355	257,088	36,758	13,931,170

29. Financial risk management (continued)

29.5. Liquidity risk (continued)

Geographical analysis of deposits from banks and customers

	2017 £000	2016 £000
Jersey, Guernsey, and Isle of Man	**6,467,450**	6,787,785
United Kingdom	**2,281,972**	3,100,617
Other EU	**523,600**	651,321
European non-EU	**265,434**	342,609
Middle East	**689,060**	510,816
Far East	**337,310**	514,787
North America	**1,062,941**	592,825
Other	**985,044**	1,389,280
Total	**12,612,811**	13,890,040

Mitigation
A significant part of the liquidity of the Company's banking businesses arises from its ability to generate customer deposits. A substantial proportion of the customer deposit base is made up of current and savings accounts which, although repayable on demand, have traditionally in aggregate provided a stable source of funding.

Monitoring
Liquidity is monitored at the end of day and reported to senior management and to Group on a daily basis. Liquidity is also monitored on a monthly basis by ALCO and on a quarterly basis by the Board of Directors.

Off-balance sheet items
Loan commitments
The dates of the contractual amounts of the Company's off-balance sheet financial instruments that commit it to extend credit to customers and other facilities are disclosed in note 28.

29.6. Capital management

Definition
Capital risk is defined as the risk that the Company has insufficient capital to provide a stable resource to absorb any losses or that the capital structure is inefficient.

Exposure
Capital exposure arises should the Company have insufficient capital resources to support its strategic objectives and plans, and meet external stakeholder requirements and expectations. Capital is considered from an internal, regulatory and rating agency perspective.

Measurement
For the banking businesses the international standard for measuring capital adequacy is the risk asset ratio, which relates regulatory capital to balance sheet assets and off-balance sheet exposures weighted according to broad categories of risk as defined by the Basel II framework.

The Company's capital comprises entirely of equity, movements in which appear in the statement of changes in equity on page 10. The Company receives its funding requirements from its parent and does not raise funding externally.

The Company is in compliance with the minimum requirements of the Jersey Financial Services Commission. The Basel II Ratio at 31 December 2017 was 18.2% (2016: 15.1%).

29. Financial risk management (continued)

29.6. Capital Management (continued)

The Company's objectives when managing capital are to safeguard the entity's ability to continue as; a going concern; provide an adequate return to its shareholders through pricing products and services commensurately with the level of risk and for the benefit of our customers. Indirectly, to support the Group's regulatory capital requirements.

29.7. Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Company's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of good corporate behaviour. Operational risk arises from all of the Company's operations and is faced by all business entities.

All areas of the business are responsible for identifying risks, reporting to an Executive Committee, whose role is to define, promote, and implement a policy for operational risk management which is consistent with the approach, aims and strategic goals of the Company, and is designed to safeguard the Company's assets while allowing sufficient operational freedom to earn a satisfactory return to shareholders. This is monitored by the group audit department of Lloyds Banking Group, within group wide standards of control.

30. Notes to the statement of cash flows

		2017	2016
		£000	£000
Reconciliation of profit to net cash flow from operating activities			
Profit before tax		**82,050**	49,374
Adjustments for non cash items included in profit			
Loss on disposal of fixed assets	(Note 13)	**-**	37
Depreciation of fixed assets	(Note 13)	**4,974**	5,245
Adjustments for net cash movements in balance sheet			
Movement in loans and advances to banks		**1,757,709**	179,109
Movement in loans and advances to customers		**119,010**	(29,030)
Movement in derivative assets		**5,318**	11,250
Movement in other assets		**4,968**	3,230
Movement in deposits from banks		**(12,487)**	(123,663)
Movement in customer accounts		**(1,260,541)**	876,934
Movement in derivative liabilities		**(5,318)**	(11,250)
Movement in other liabilities		**(14,688)**	5,342
Movement in retirement benefit obligations		**(6,500)**	14,800
Income tax paid		**(2)**	(1,319)
Other non cash movements		**(10,200)**	(15,968)
Total adjustments for non cash items		**582,243**	914,717
Net cash generated by operating activities		**664,293**	964,091

30. Notes to the statement of cash flows (continued)

30.1 Analysis of cash as shown in the balance sheet	2017 £000	2016 £000
Cash balances	**7,296**	10,213
Items in the course of collection from banks	**4,630**	3,732
Loans and advances to banks included within cash and cash equivalents (note 11)	**8,014,440**	7,348,401
Total cash and cash equivalents	**8,026,366**	7,362,346

31. Post balance sheet events

The Company will cease to be a participating employer the Lloyds Offshore Pension Scheme during 2018 and as a result the scheme will be transferred to Lloyds Bank plc.

The company will move within the Group structure during 2018 to become a subsidiary of Lloyds Bank Corporate Markets plc in order for the Group to meet the requirements of Ring-Fencing.

32. Future accounting developments

The following pronouncements are not applicable for the year ended 31 December 2017 and have not been applied in preparing these financial statements. Save as disclosed below, the impact of these accounting changes is still being assessed by the Company and reliable estimates cannot be made at this stage.

IFRS 9 Financial Instruments
IFRS 9 replaces IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for annual periods beginning on or after 1 January 2018. The Company has chosen 1 January 2018 as its initial application date of IFRS 9 and will not restate comparative periods.

Classification and measurement
IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income or amortised cost. Financial assets will be measured at amortised cost if they are held within a business model the objective of which is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent solely payments of principal and interest. Financial assets will be measured at fair value through other comprehensive income if they are held within a business model the objective of which is achieved by both collecting contractual cash flows and selling financial assets and their contractual cash flows represent solely payments of principal and interest. Financial assets not meeting either of these two business models; and all equity instruments (unless designated at inception to fair value through other comprehensive income); and all derivatives are measured at fair value through profit or loss. An entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch.

Impairment
IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss ("ECL") model resulting in earlier recognition of credit losses compared with IAS 39. The ECL model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk since initial recognition (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39.

The new impairment methodology results in higher impairment provisions of £0.2m, in respect of Loans and Advances to Customers, recognised on the Company's balance sheet. The total net of tax impact on retained profits is a £0.2m. The impairment of Group assets under IFRS 9 would also results in a reduction to the carrying value of financial assets of approximately £5m and on basis that the new parent, LBCM, has not being assessed this amount will not be reflected in the Company accounts. With the expected restructure to meet the requirements of ring-fencing, the credit risk of LBCM will be continually assessed in the future.

IFRS 15 Revenue from Contracts with Customers
IFRS 15 replaces IAS 18 'Revenue' and is effective for annual periods beginning on or after 1 January 2018. The core principle of IFRS 15 is that revenue reflects the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled. In all cases the Company's current accounting policy is materially consistent with the requirements of IFRS 15 and no transition adjustments are required.

IFRS 16 Leases
IFRS 16 replaces IAS 17 'Leases' and is effective for annual periods beginning on or after 1 January 2019. IFRS 16 requires lessees to recognise a right of use asset and a liability for future payments arising from a lease contract. Lessees will recognise a finance charge on the liability and a depreciation charge on the asset which could affect the timing of the recognition of expenses on leased assets. Lessor accounting requirements remain aligned to the current approach under IAS 17.

32. Future accounting developments (continued)

Minor amendments to other accounting standards

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2018 (including IFRS 2 Share-based Payment and IAS 40 Investment Property) and effective 1 January 2019 (including IAS 12 Income Taxes and IFRIC 23 Uncertainty over Income Tax Treatments). These revised requirements are not expected to have a significant impact on the Company.