Lloyds Bank International Limited

Annual Report 2018

LLOYDS
BANKING
GROUP

Lloyds Bank International Limited

Annual Report 2018

Contents

Lloyds Bank International Limited

Corporate information

Directors	Timothy John Cooke **Chairman, Non-executive Director**[1]
	Michael Joseph Starkey[2]
	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[3]
	Wendy Marie Leedham[4]
Secretary	Marnie Martin
Registered office	11-12 Esplanade St Helier Jersey JE2 3QA 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 22 August 2018
[3] Resigned 13 November 2018
[4] Appointed 11 March 2019

Chairman's statement

In 2018 Lloyds Bank International Limited (the "Company") reported satisfactory profitability and 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 and reflects the strength of the underlying business and its unerring focus on providing excellent service to all our customers.

The financial year was a time of significant change within the Company and it is a tribute to our colleagues that the various projects and initiatives have been delivered in a compliant manner and between them have provided a platform for the future evolution of the Company. Notable amongst the projects have been:

- Lending over £2bn under a new commercial product offering which has improved the Company's profitability and strengthened our balance sheet through a much greater diversity of income streams;
- Successfully implementing a new banking platform which has immediate benefits and also provides the tools to develop new products to meet the needs of our customers; and
- Changing the business to meet the requirements of Ring-Fencing with a compliant operating model whilst also ensuring that the Company continues to receive the support from the central functions of Lloyds Bank plc. As part of the changes made to meet the requirements of Ring-Fencing, on the 1 July, 2018 the Company's immediate parent company Lloyds Holdings (Jersey) Limited was acquired by Lloyds Bank Corporate Markets plc ("LBCM") the Lloyds Banking Group's Non Ring-Fenced Bank. The Company is a material part of LBCM and I anticipate more investment in the business over the next few years.

As a Company we employ more than 800 people across Jersey, Guernsey, Alderney and the Isle of Man, and we continue to play an important role in the communities we serve. Between them our colleagues make a significant contribution to the wider community dedicating thousands of hours supporting local charities and hosting numerous fundraising events. All of us are proud of the work of the Lloyds Bank Foundation for the Channel Islands which as a major grant-making charity is able to make a real difference to island based charities.

Annual reports and accounts often have a valedictory tone to them and in this instance I note the retirement of two long-standing directors of the Company in 2018. Michael Chaytor and Michael Starkey have both made distinctive contributions to the successful evolution of the business and have served on the Board for many years. I would like thank them both for their commitment and wish them a happy and fulfilling retirement.

On behalf of the Board, I would like to thank all colleagues for their continued dedication to the Company during a period of significant change and acknowledge with thanks and appreciation their contribution to its ongoing success.

Timothy Cooke (Chairman)

26 March 2019

Directors' report

The Directors submit their report and the audited financial statements for the year ended 31 December 2018.

Activities

Lloyds Bank International Limited is a limited company incorporated and domiciled in Jersey, and operates branches in Guernsey and the Isle of Man, and has a taxable presence in the United Kingdom. The Company is licenced as a bank In Jersey, Guernsey and Isle of Man. The Company also holds a license 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 2018 was £71,341,000 (2017: £63,406,000). The Directors declared and paid the dividends of £245,000,000 for the year ended 31 December 2018 (2017: £Nil).

Pension

During 2018, the Company ceased to be a participating employer in the Lloyds Bank Offshore Pension Scheme (the "Scheme"). All further liability to the Scheme has been apportioned to Lloyds Bank plc and, as a consequence, the Company no longer recognises the Scheme in its balance sheet.

Prior to cessation, the Company made deficit clearance payments totalling £6,400,000 (2017: £17,732,000) and a one off statutory debt clearance payment of £15,000,000 in accordance with undertakings previously given and requirements of the transfer.

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.

Tier 2 capital resources increased by £202,379,000 in the period, primarily reflecting the issuance of new dated subordinated liabilities to LBCM.

As a result of the requirements of Ring-Fencing the Company has 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".

The Company's priorities for risk management continue to be aligned to those of Lloyds Banking Group plc (the "Group") and a number of themes have been particularly prevalent in 2018, as detailed below.

European ("EU") Exit

The Company is part of the wider Lloyds Banking Group, and, at that level, consideration of many of the potential implications following the UK's vote to leave the EU has been undertaken. Work continues to assess the impact of the EU exit at the level of the Lloyds Banking Group, as well as for the Company, upon customers, colleagues and products. This assessment includes all legal, regulatory, tax, finance and capital implications.

Cyber

The policies of the Company on cyber security are aligned to those of the Group.

Sustainability

The policies of the Company on sustainability are aligned to those of the Group.

Directors’ report (continued)

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”).

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

KPI	2018	2017	Definition, method of calculation and analysis
Deposit reduction/ growth	-2%	-9%	Change in customer deposits in the year, 2018 being a reduction. The Company has selectively reduced its appetite for certain deposit segments in order to improve net interest margin.
Lending reduction/ growth	181%	-9%	Changes in net loans and advance to customers during the year. The increase in lending by the Company is primarily driven by significant growth in the new commercial product offering.
Lending Ratio	28%	10%	Ratio of external customer lending to external customer deposits. The lending ratio has increased as a result of its increased lending, whilst deposits have remained largely stable.
Net interest margin	0.95%	0.85%	Net interest margin, divided by average interest earning assets. A focus on certain business segments and higher customer lending has resulted in improvements to Net Interest Margin.
Cost/income ratio	59%	44%	Operating expenses divided by total income. The Company consistently controlled recurring expenses. One-off costs relating to the pension scheme in 2018 combined with write back of customer remediation provisions in 2017 are the significant contributors to the increase in the ratio.
Funds under management	£491,296,911	£557,403,019	Total managed funds. Market movements in 2018 have been a significant driver in this reduction. Whilst the Company has sought to maintain strong relationships with customers, there was a sizeable portfolio outflow from a single client.
Total capital ratio	18.79%	18.20%	Regulatory core tier 1 and tier 2 capital after deductions, divided by risk weighted assets (“RWAs”). The Company has maintained its capital ratios in excess of internal limits and regulatory capital guidance. Continued profitability and the slight increase in RWAs due to the utilisation of Group placements to fund the new commercial product have driven the increase.
Asset Quality Ratio	-0.39%	0.34%	Provision charge for the year divided by average lending, with 2018 representing a credit. The credit in 2018 reflects significant recoveries against a previously impaired exposure.

Directors' report (continued)

Ownership

The ultimate holding company is Lloyds Banking Group plc , 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 Corporate Markets plc (previously Lloyds Bank Subsidiaries Limited) is the parent undertaking of the smallest such group of undertakings. Lloyds Banking Group plc is registered in Scotland and Lloyds Bank Corporate Markets plc is registered in England and Wales. The immediate holding company is Lloyds Holdings (Jersey) Limited, a company incorporated in Jersey, Channel Islands. Lloyds Bank Corporate Markets plc acquired Lloyds Holdings (Jersey) Limited on 1 July 2018 from Lloyds Bank Subsidiaries Limited, so that the company could form part of the Non Ring-Fenced Bank.

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)
26 March 2019

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 financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2018 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 2018 (the "Annual Report"), which comprise: the balance sheet as at 31 December 2018, the statement of comprehensive income, the statement of cash flows, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the 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 with SEC Independence Rules, and we have fulfilled our other ethical responsibilities in accordance with FRC's Ethical Standard.

Conclusions relating to going concern

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

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

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

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

Reporting on other information

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

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

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
26 March 2019

Statement of comprehensive income

For the year ended 31 December

	Note	**2018**	2017
		£000	£000
Interest and similar income	3	**184,716**	158,567
Interest and similar expense	3	**(57,028)**	(38,078)
Net interest income		**127,688**	120,489
Fee and commission income	4	**20,750**	17,922
Fee and commission expense	5	**(3,712)**	(1,563)
Net fee and commission income		**17,038**	16,359
Net trading income	6	**16,187**	17,200
Other operating income	7	**213**	207
Total other income		**33,438**	33,766
Total income		**161,126**	154,255
Operating expenses	8	**(92,452)**	(67,766)
Impairment	9	**8,281**	(4,439)
Profit before income tax		**76,955**	82,050
Income tax expense	10	**(6,914)**	(8,444)
Profit for the year		**70,041**	73,606
Other comprehensive income:			
Items that will not be reclassified to profit and loss			
Remeasurements of retirement benefit obligations	22.2	**1,300**	(10,200)
Total comprehensive income for the year		**71,341**	63,406

All items dealt with in arriving at the total comprehensive income for the years ended 31 December 2018 and 31 December 2017 relate to continuing operations.

The accompanying notes on pages 12 - 52 are an integral part of the financial statements.

Lloyds Bank International Limited

Balance sheet

As at 31 December

	Note	**2018** **£000**	2017 £000
Assets			
Cash		**7,400**	7,296
Items in the course of collection from banks		**2,437**	4,630
Derivative financial instruments	21	**2,593**	4,838
Loans and receivables			
Loans and advances to banks	11	**9,956,321**	12,401,730
Loans and advances to customers	12	**3,370,160**	1,197,770
		13,326,481	13,599,500
Property and equipment	14	**9,110**	15,546
Deferred tax assets	16	**2,491**	-
Current tax assets	17	**-**	375
Other assets	18	**10,051**	3,474
Total assets		**13,360,563**	13,635,659
Liabilities			
Deposits from banks	19	**130,035**	213,425
Items in course of transmission to banks	19	**3,659**	4,894
Customer deposits	20	**12,181,211**	12,399,386
Derivative financial instruments	21	**2,593**	4,838
Retirement benefit obligations	22.2	**-**	3,000
Current tax liabilities		**7,677**	10,048
Other liabilities	23	**17,991**	10,682
Provisions	24	**3,961**	3,298
Subordinated liabilities	25	**204,279**	-
Total liabilities		**12,551,406**	12,649,571
Equity			
Share capital	26	**536,852**	536,852
Share premium account	27	**14,985**	14,985
Retained profits		**257,320**	434,251
Total shareholder's equity		**809,157**	986,088
Total equity and liabilities		**13,360,563**	13,635,659

The accompanying notes on pages 12 - 52 are an integral part of the financial statements.

The financial statements on pages 8 - 52 were approved by the Board of Directors on 26 March 2019 and were signed on its behalf by:

Director 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 2017 (see notes 26 and 27)	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
Balance at 1 January 2018 (see notes 26 and 27)	**536,852**	**14,985**	**434,251**	**986,088**
Change in accounting policies (note 34)	**-**	**-**	**(3,272)**	**(3,272)**
	536,852	**14,985**	**430,979**	**982,816**
Other comprehensive income	**-**	**-**	**1,300**	**1,300**
Profit for the year	**-**	**-**	**70,041**	**70,041**
Dividends paid	**-**	**-**	**(245,000)**	**(245,000)**
Balance at 31 December 2018	**536,852**	**14,985**	**257,320**	**809,157**

The accompanying notes on pages 12 - 52 are an integral part of the financial statements.

Statement of cash flows

For the year ended 31 December

	Note	**2018** **£000**	2017 £000
Net cash (used in)/generated by operating activities	33	**(1,858,718)**	664,293
Investing activities:			
Purchases of fixed assets	14	**(356)**	(273)
Net cash used in investing activities		**(356)**	(273)
Cash flow from financing activities:			
Dividends paid to equity shareholders		**(245,000)**	-
Interest paid on subordinated liabilities	25	**(3,889)**	-
Proceeds from issue of subordinated liabilities	25	**200,241**	-
		(48,648)	-
Net (decrease)/increase in cash and cash equivalents		**(1,907,722)**	664,020
Cash and cash equivalents at beginning of year		**8,026,366**	7,362,346
Cash and cash equivalents at end of year	33.1	**6,118,644**	8,026,366

The accompanying notes on pages 12 – 52 are an integral part of the financial statements.

Notes to the financial statements
For the year ended 31 December 2018

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.

The Company has adopted IFRS 9 and IFRS 15 with effect from 1 January 2018.

IFRS 9 *Financial Instruments*

IFRS 9 replaces IAS 39 and addresses classification, measurement and derecognition of financial assets and liabilities, the impairment of financial assets measured at amortised cost or fair value through other comprehensive income and general hedge accounting.

Impairment: IFRS 9 replaced the IAS 39 'incurred loss' impairment approach with an 'expected credit loss' approach. The revised approach applies to financial assets including finance lease receivables, recorded at amortised cost or fair value through other comprehensive income; loan commitments and financial guarantees that are not measured at fair value through profit or loss are also in scope. The expected credit loss approach requires an allowance to be established upon initial recognition of an asset reflecting the level of losses anticipated over the life of the loan after having regard to, amongst other things, expected future economic conditions. Subsequently the amount of the allowance is affected by changes in the expectations of loss driven by changes in associated credit risk.

Classification and measurement: IFRS 9 requires financial assets to be classified into one of the following measurement categories: fair value through profit or loss, fair value through other comprehensive income and amortised cost. Classification is made on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to the Company's own credit risk is recorded in other comprehensive income. This requirement has had no impact on these financial statements.

IFRS 15 *Revenue from Contracts with Customers*

IFRS 15 has replaced IAS 18 Revenue and IAS 11 Construction Contracts. 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. The recognition of such revenue is in accordance with five steps to: identify the contract; identify the performance obligations; determine the transaction price; allocate the transaction price to the performance obligations; and recognise revenue when the performance obligations are satisfied.

Details of the impact of adoption of IFRS 9 are provided in Note 34. IFRS 15 had no impact on the Company.

Details of those IFRS pronouncements which will be relevant to the Company but which were not effective at 31 December 2018 and which have not been applied in preparing these financial statements are given in Note 36.

1.2 Consolidation

Until the 30 June 2018 the Company was a wholly owned of subsidiary of Lloyds Bank plc and from the 1 July 2018 the Company was a wholly owned subsidiary of Lloyds Bank Corporate Markets plc. Consolidated accounts are not prepared as the Company is itself a wholly owned subsidiary of companies which prepare consolidated accounts that are publicly available. The Company's investments in subsidiaries are held at cost less any provisions considered necessary to reflect a permanent impairment.

1. Summary of significant accounting policies (continued)

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 receivable which are not an integral part of the effective interest rate are recognised as income as the Company fulfils its performance obligation. The Company's principal performance obligations arising from contracts with customers are in respect of value added accounts and debit cards. These fees are received, and the Company provides the service, monthly; the fees are recognised in income on that basis. The Company also receives certain fees in respect of asset financing where its performance obligations are typically fulfilled towards the end of the customer contract; these fees are recognised in income on that basis. Where it is unlikely that the loan commitments will be drawn, loan commitment fees are recognised in fee and commission income over the life of the facility, rather than an adjustment to the effective interest rate for loans expected to be drawn. Incremental costs incurred to generate fees and commission income are charged to fees and commissions expenses as they are incurred.

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.

1.4 Financial assets and liabilities

On initial recognition, financial assets are classified as measured at amortised cost, fair value through profit or loss, or fair value through other comprehensive income. Financial liabilities are classified into fair value through profit or loss or liabilities at amortised cost. The Company initially recognises loans and advances, deposits and subordinated liabilities when it becomes party to the contractual provisions of the instrument.

1.4.1 Financial instruments designated at fair value through profit and 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

As permitted by IFRS 9, the Company continues to apply the requirements of IAS 39 to its hedging relationships. 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. Summary of significant accounting policies (continued)

1.4 Financial assets and liabilities (continued)

1.4.2 Financial instruments measured at amortised cost

Financial instruments measured at amortised cost include loans and advances to banks and customers 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 1.6 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, customer deposits and subordinated liabilities), are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently measured at amortised cost using the effective interest method. 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.

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.

1.6 Impairment of financial assets

The impairment charge in the income statement includes the change in expected credit losses. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets measured at fair value through other comprehensive income and loan commitments and financial guarantees. Expected credit losses are calculated by using an appropriate probability of default, adjusted to take into account a range of possible future economic scenarios, and applying this to the estimated exposure of the Company at the point of default after taking into account the value of any collateral held or other mitigation of loss and including the impact of discounting using the effective interest rate.

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

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward looking information consistent with that used in the measurement of expected credit losses. In determining whether there has been a significant increase in credit risk, the Company uses qualitative tests based on relative and absolute probability of default ("PD") movements linked to internal credit ratings together with qualitative indicators such as watchlists and other indicators of historic delinquency. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since origination, the asset is transferred back to Stage 1.

1. Summary of significant accounting policies (continued)

1.6 Impairments of financial assets (continued)

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

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. In the latter circumstances, the loan will remain classified as either Stage 2 or Stage 3 until the credit risk has improved such that it no longer represents a significant increase since origination (for a return to Stage 1), or the loan is no longer in default (for a return to Stage 2). Renegotiation may also lead to the loan and associated allowance being recognised and a new loan being recognised initially at fair value.

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

For both secured and unsecured retail balances, the write-off takes place only once an extensive set of collections processes have been completed or the status of the account reaches a point where Company policy dictates the continuing concessions are no longer appropriate. For Commercial lending, a write-off occurs if the loan facility with the customer is restructured, the asset is under administration and the only monies that can be received are the amounts estimated by the administrator, the underlying assets are disposed and a decision is made that no further settlement monies will be received, or external evidence (for example, third party valuations) is available that there has been an irreversible decline in expected cash flows.

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.

1. Summary of significant accounting policies (continued)

1.9 Leases (continued)

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.

1.10 Employee benefits

1.10.1 Pension schemes

The Company operated 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.

To comply with the requirements of Ring-Fencing, the Company ceased to be a participating company in the Lloyds Bank Offshore Pension Scheme on 30 April 2018 and all assets and liabilities of the scheme were transferred to Lloyds Bank plc.

In previous years, a full actuarial valuation of the Company’s defined benefit scheme was carried out every three years with interim reviews in the intervening years; these valuations were updated to 31 December each year by qualified independent actuaries. For the purpose of those prior years, scheme assets were included at their fair value and scheme liabilities were measured on an actuarial basis using the projected unit credit method. The defined benefit scheme liabilities were discounted using rates equivalent to market yields at the balance sheet date on high quality corporate bonds that were denominated in the currency in which the benefits would have been paid, and that have terms to maturity approximating to the terms of the related pension liability.

The Company’s statement of comprehensive income charge included the current service cost of providing pension benefits, past service costs, net interest expense (income), and plan administration costs that were not deducted from the return on plan assets.

Past service costs, which represented the change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment, were recognised when the plan amendment or curtailment occurred. Net interest expense (income) was calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or assets.

Remeasurements, that comprised 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 were reflected immediately in the balance sheet with a charge or credit recognised in other comprehensive income in the period in which they occurred. Remeasurements recognised in other comprehensive income were reflected immediately in retained profits and were not subsequently be reclassified to the statement of comprehensive income.

Up to the date of transfer, the Company’s balance sheet included 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 were 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 22 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 statement of comprehensive income.

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 Company 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.

1.18 Investment in subsidiaries

Subsidiaries are all entities over which the Company has control. The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity.

The investments in subsidiary undertakings and Investment in associated undertakings are stated in the Balance sheet at cost less any provision for impairment.

Investment for subsidiary undertakings and Investment in associated undertakings are reviewed for impairment losses at the end of each period and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised in the Statement of comprehensive income for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net realisable value and value in use.

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. Critical accounting estimates and judgments (continued)

2.1 Allowance for impairment losses

The calculation of the Company's expected credit losses ("ECL") allowances and provisions against loans, loan commitments and guarantees under IFRS 9 requires the Company to make a number of judgements, assumptions and estimates. The most significant are set our below.

Definition of default
The probability of default ("PD") of an exposure, both over a 12 month period and over its lifetime, is a key input to the measurement of the ECL allowance. Default has occurred when there is evidence that the customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due. The definition of default adopted by the Company is described in Note 1.6 Impairment of financial assets.

Lifetime of an exposure
The PD of a financial asset is dependent on expected life. A range of approaches, segmented by product type, has been adopted by the Company to estimate a product's expected life. These include using the full contractual life and taking into account behavioural factors such as early repayments and refinancing. For non-revolving Retail assets, the Company has assumed the expected life for each product to be the time taken for all losses to be observed and for a material proportion of the assets to fully resolve through either closure or write-off. For revolving products, the Company has considered the losses beyond the contractual term over which the Company is exposed to credit risk. For Commercial overdraft facilities, the average behavioural life has been used. Changes to the assumed expected lives of the Company's assets could have a material effect on the ECL allowance by the Company.

Significant increase in credit risk
Performing assets are classified as either Stage 1, or Stage 2. An ECL allowance equivalent to 12 month expected losses is established against assets in Stage1; assets classified as Stage 2 carry an ECL allowance equivalent to lifetime expected losses. Assets are transferred from Stage 1 to Stage 2 when there has been a significant increase in credit risk ("SICR") since initial recognition.

The Company uses a quantitative test together with qualitative indicators to determine to whether there has been a SICR for an asset. For Retail, a deterioration of four grades for personal loans and overdrafts, three grades for personal mortgages is treated as a SICR. For Commercial, a doubling of PD with a minimum increase in PD of 1 per cent and a resulting change in the underlying grade is treated as a SICR. All financial assets are assumed to have suffered a SICR if they are more than 30 days past due.

The setting of precise trigger points combined with the risk indicators requires judgements. The use of different trigger points may have a material impact upon the size of the ECL allowance.

Origination of PD
The assessment of whether there has been a SICR is a relative measure, dependent on the asset's PD at origination. For assets existing at 1 January 2018, the initial application date of IFRS 9, this information is not, generally, available and consequently management judgement has been used to determine a reasonable basis for estimating the original PD. Management use various information sources, including regulatory PDs and credit risk data available at origination, or where this is not available the first available data. In addition, the Company has not created a forward looking view of PDs at initial recognition for the back book as to do so would involve the use of hindsight and could introduce a risk of bias. The use of proxies and simplifications are not considered to materially impact the ECL allowance on transition.

Refer to note 13 for analysis of loan book and allowance for impairment losses.

2. Critical accounting estimates and judgments (continued)

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 32.2 for details of valuation hierarchy.

2.3 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.

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 24 and 31.

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

	2018 £000	2017 £000
Interest and similar income:		
Loans and advances to customers	**54,265**	37,354
Loans and advances to fellow group companies	**130,451**	121,213
	184,716	158,567
Interest and similar expenses:		
Customer accounts	**(49,238)**	(37,051)
Payable to fellow group companies	**(7,790)**	(1,027)
	(57,028)	(38,078)
	127,688	120,489

Included in interest and similar expenses to fellow group companies is £3,889,000 (2017: £Nil) of interest paid on subordinated liabilities.

4. Fees and commission income

	2018 £000	2017 £000
Current account fees	**4,799**	5,095
Insurance broking commission	**7**	3
Card services	**4,202**	3,737
Asset management and related fees	**6,061**	4,990
Credit related fees and commissions	**804**	738
Other fees and commissions	**4,877**	3,359
	20,750	17,922

Included in fee and commission income in “other fees and commissions” are fees receivable of £43,000 (2017: £86,000) from fellow group companies.

5. Fee and commission expense

	2018 £000	2017 £000
Dealer commissions	**(2,045)**	(681)
Other	**(1,667)**	(882)
	(3,712)	(1,563)

6. Net trading income

	2018 £000	2017 £000
Profit on foreign exchange transactions	**16,187**	17,200

Notes to the financial statements
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7. Other operating income

	2018	2017
	£000	£000
Rents receivable	**215**	203
Other income	**(2)**	4
	213	207

8. Operating expenses

	2018	2017
	£000	£000
Salaries	**(32,266)**	(31,190)
Social security contributions	**(2,885)**	(2,505)
Pensions	**(10,139)**	(6,183)
Other staff costs	**(4,894)**	(4,073)
Total staff costs	**(50,184)**	(43,951)
Depreciation	**(4,221)**	(4,974)
Operating lease rentals	**(3,915)**	(3,692)
Communications and data processing	**(5,180)**	(5,656)
Professional fees	**(1,420)**	(1,006)
Premises and equipment costs	**(7,100)**	(4,626)
Group recharges	**(11,817)**	(8,742)
Operational losses and customer remediation	**(4,822)**	7,689
Other	**(3,793)**	(2,808)
	(92,452)	(67,766)

Operating expenses include costs of £11,817,000 (2017: £8,742,000) paid to fellow group companies. This includes recharging the costs for the provision of centralised functions and intra group agreements. Operational losses and customer remediation include £221,000 of customer remediation provision release (2017: £7,800,000). Refer to note 24 for the remediation provision.

9. Impairment

	Stage 1 £000	Stage 2 £000	Stage 3 £000	**Total £000**
For the year ended 31 December 2018				
Impact of transfer between stages	**-**	**(8)**	**(32)**	**(40)**
Other changes in credit quality	**(27)**	**27**	**1,079**	**1,079**
(Additions)/repayments	**532**	**(1,412)**	**8,908**	**8,028**
Other items	**-**	**-**	**(786)**	**(786)**
Total impairment	**505**	**(1,393)**	**9,169**	**8,281**
In respect of:				
Loans and advances to banks	592	-	-	592
Loans and advances to customers	93	(1,393)	9,169	7,869
Financial assets at amortised cost	**685**	**(1,393)**	**9,169**	**8,461**
Loan commitments and financial guarantees	**(180)**	**-**	**-**	**(180)**
Total impairment	**505**	**(1,393)**	**9,169**	**8,281**

The Company's impairment credit comprises the following items:

Transfers between stages
The net impact on the impairment charge of transfers between stages.

Other changes in credit quality
Changes in loss allowance as a result of movements in probability of default ("PD") grades during the year, but which have not resulted in a transfer to a different stage. This also contains the impact on the impairment charge as a result of write-offs and recoveries, where the related loss allowances are reassessed to reflect ultimate realisable or recoverable value.

Additions and repayments
Expected loss allowances are recognised on origination of new loans or further drawdowns of existing facilities. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

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10. Income tax expense

The Company is subject to Jersey income tax at 10% (2017: 10%). The Company's taxable profits arising in the Isle of Man are subject to tax at 10% (2017: 10%). The Company's taxable profits arising in Guernsey are subject to tax at 10% (2017: 10%) or 20% (2017: 20%) depending on the stream of income. The Company's taxable profits arising in the United Kingdom are subject to tax at 19%, which is in excess of the tax rate applicable in Jersey.

	2018 £000	2017 £000
Analysis of charge in the year:		
Jersey income tax charge at 10%	**(6,774)**	(6,653)
Adjustments in respect of prior years for Jersey	**(120)**	1,613
Adjustments in respect of prior years for Guernsey	**3**	(2)
Adjustments in respect of prior years for Isle of Man	**(10)**	(3,397)
Adjustments in respect of prior years for UK	**(8)**	-
Guernsey income tax charge 10%	**(5)**	(5)
Income tax expense	**(6,914)**	(8,444)
Factors affecting the tax charge for the year		
Profit on ordinary activities before tax	**76,955**	82,050
Tax charge at standard rate of income tax applicable to the Company (10%)	**(7,696)**	(8,205)
Tax rate effective in other jurisdictions	**(4,897)**	-
Tax charge at the applicable tax rate of 10%	**4,192**	-
	(8,401)	(8,205)
Adjusted for:		
Prior year adjustments	**(132)**	(1,785)
Guernsey income tax payment	**-**	(5)
Capital allowances in excess of depreciation	**(270)**	(221)
Additional allowances deferred to future years (pension)	**1,605**	886
Additional allowances given in the year (pension)	**535**	887
Loss on disposal of fixed assets	**(257)**	-
Isle of Man interest payment	**10**	-
Disallowable expenses	**(4)**	(1)
	(6,914)	(8,444)

11. Loans and advances to banks

	Stage 1 £000	Stage 2 £000	Stage 3 £000	**Total £000**
Gross balance at 31 December 2017				**12,401,730**
Gross balance at 1 January 2018	**12,401,730**	**-**	**-**	**12,401,730**
Transfer to Stage 1	-	-	-	**-**
Transfer to Stage 2	-	-	-	**-**
Transfer to Stage 3	-	-	-	**-**
	-	**-**	**-**	**-**
Net increase/(decrease) in loans and advances to banks	**(2,443,024)**	-	-	**(2,443,024)**
Gross balance at 31 December 2018	**9,958,706**	**-**	**-**	**9,958,706**
Allowance for impairment losses (Note 13)	**(2,385)**	**-**	**-**	**(2,385)**
Loans and advances to banks	**9,956,321**	**-**	**-**	**9,956,321**

11.1 Loans and advances to banks

	2018 £000	2017 £000
Included in cash and cash equivalents (note 33.1)	**6,108,807**	8,014,440
Loans and advances to banks	**3,847,514**	4,387,290
Total loans and advances to banks	**9,956,321**	12,401,730

Included in the amounts above are £9,950,345,000 (2017: £12,392,153,000) of deposits with fellow group banks.

12. Loans and advances to customers

	Stage 1 £000	Stage 2 £000	Stage 3 £000	**Total £000**
Gross balance at 31 December 2017				**1,215,905**
Gross balance at 1 January 2018	**1,111,144**	**58,667**	**46,094**	**1,215,905**
Exchange and other movements	**6,391**	**-**	**(870)**	**5,521**
Transfer to Stage 1	2,869	(2,538)	(331)	-
Transfer to Stage 2	(1,473)	3,447	(1,974)	-
Transfer to Stage 3	(413)	(186)	599	-
	983	**723**	**(1,706)**	**-**
Net increase/(decrease) in loans and advances to customers	**2,227,258**	**(49,431)**	**(19,119)**	**2,158,708**
Financial assets that have been written off during the year			**(418)**	**(418)**
Gross balance at 31 December 2018	**3,345,776**	**9,959**	**23,981**	**3,379,716**
Allowance for impairment losses (Note 13)	**(1,606)**	**(1,435)**	**(6,515)**	**(9,556)**
Loans and advances to customers	**3,344,170**	**8,524**	**17,466**	**3,370,160**

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13. Analysis of movement in the allowance for impairment losses by stage

	Stage 1 £000	Stage 2 £000	Stage 3 £000	**Total £000**
In respect of drawn balances				
Balance at 31 December 2017				**18,135**
Adjustment on adoption of IFRS 9 (Note 34.2)				**3,272**
Balance at 1 January 2018	**4,664**	**47**	**16,696**	**21,407**
Transfer to Stage 1	14	(5)	(9)	-
Transfer to Stage 2	(1)	4	(3)	-
Transfer to Stage 3	(1)	(3)	4	-
	12	**(4)**	**(8)**	**-**
(Credit)/Charge to the income statement (Note 9)	**(685)**	**1,393**	**(9,169)**	**(8,461)**
Allowances written off			**(111)**	**(111)**
Recoveries of advances written off in previous years			**1,045**	**1,045**
Exchange and other adjustments	**-**	**-**	**(1,939)**	**(1,939)**
Balance at 31 December 2018	**3,991**	**1,436**	**6,514**	**11,941**
In respect of undrawn balances				
Balance at 31 December 2017				**-**
Adjustment on adoption of IFRS 9 (Note 34.2)				**-**
Balance at 1 January 2018	**-**	**-**	**-**	**-**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
	-	**-**	**-**	**-**
Charge to the income statement (Note 9)	**180**	**-**	**-**	**180**
Balance at 31 December 2018	**180**	**-**	**-**	**180**
Total	**4,171**	**1,436**	**6,514**	**12,121**
In respect of:				
Loans and advances to banks	2,385	-	-	2,385
Loans and advances to customers	1,606	1,436	6,514	9,556
Financial assets at amortised cost	**3,991**	**1,436**	**6,514**	**11,941**
Other assets	**-**	**-**	**-**	**-**
Provisions in relation to loan commitments and financial guarantees	**180**	**-**	**-**	**180**
Total	**4,171**	**1,436**	**6,514**	**12,121**

All impairment allowances in 2017 were in respect of loans and advances to customers.

Notes to the financial statements
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14. Property and equipment

	Premises £000	Equipment £000	Total £000
Cost:			
As at 1 January 2017	26,339	50,985	77,324
Additions	254	19	273
Disposals	(241)	(730)	(971)
As at 31 December 2017	26,352	50,274	76,626
Additions	**331**	**25**	**356**
Disposals	**(5,420)**	**(2,331)**	**(7,751)**
Write downs	**(11,399)**	**(23,343)**	**(34,742)**
As at 31 December 2018	**9,864**	**24,625**	**34,489**
Accumulated depreciation and impairment:			
As at 1 January 2017	17,487	39,589	57,076
Depreciation charge	1,147	3,827	4,974
Disposals	(240)	(730)	(970)
As at 31 December 2018	18,394	42,686	61,080
Depreciation charge	**906**	**3,315**	**4,221**
Disposals	**(2,878)**	**(2,302)**	**(5,180)**
Write downs	**(11,399)**	**(23,343)**	**(34,742)**
As at 31 December 2018	**5,023**	**20,356**	**25,379**
Net book value as at 31 December 2018	**4,841**	**4,269**	**9,110**
Net book value as at 31 December 2017	7,958	7,588	15,546

Included in the 2018 disposals is the loss on disposal of 23 New Street which amounted to £2,571,000.

15. 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 2018 and 31 December 2017. There is no impairment of the investment in the subsidiary undertaking.

16. Deferred tax assets

	2018 £000	2017 £000
Temporary timing differences	**2,491**	-

17. Current tax assets

	2018 £000	2017 £000
Current tax asset	**-**	375

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18. Other assets

	2018 £000	2017 £000
Prepayments	**7,389**	1,298
Accrued fee income	**1,523**	1,522
Other assets	**1,139**	654
	10,051	3,474

19. Deposits from banks

	2018 £000	2017 £000
Interest bearing	**130,035**	213,425
Items in course of transmission to banks	**3,659**	4,894
Total deposits from banks	**133,694**	218,319

Included in the amounts above are £129,238,000 (2017: £212,674,000) due to fellow group banks.

20. Customer deposits

	2018 £000	2017 £000
Non-interest bearing current accounts	**1,495,503**	1,534,044
Interest bearing current accounts	**3,129,629**	3,510,633
Savings and investment accounts	**3,028,699**	3,357,434
Other customer deposits	**4,527,380**	3,997,275
Total customer deposits	**12,181,211**	12,399,386

Included in the amounts above are £66,971,000 (2017: £51,655,000) due to fellow group companies.

21. 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. such as 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.

21. Derivative financial instruments (continued)

	Contract/notional amount	Fair value Assets	Fair value Liabilities
	£000	£000	£000
As at 31 December 2018			
Forward foreign exchange contracts	**2,146**	**-**	**-**
Equity linked options	**29,166**	**2,593**	**(2,593)**
Total derivative assets/(liabilities)	**31,312**	**2,593**	**(2,593)**
As at 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)

Included in the amounts reported above are amounts due to fellow group companies of £353,000 (2017: £1,268,000) and due from fellow group companies of £2,240,000 (2017: £3,571,000).

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

22. 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.

Until 30 April 2018, the Company was an employer in the Lloyds Bank Offshore Pension Scheme ("the Scheme"). This was a funded scheme providing retirements benefits calculated as a percentage of final pensionable salary depending upon the length of services. The Scheme operated as a separate legal entity under trust laws by trustees and the responsibility for governance lay with pension trustees.

To meet the requirements of Ring-Fencing on the 30 April 2018, the Company entered into a deed of apportionment with Lloyds Bank plc, under the terms of which the Company ceased to be a participating employer in the Scheme. The Company's withdrawal from the Scheme gave rise to a statutory debt of £15,000,000 which was settled by the Company prior to entering into the deed. The Company transferred the Scheme at the IAS19 valuation on the date of transfer and Lloyds Bank plc paid £16,700,000 consideration for the transfer. The Scheme valuation and the calculation of statutory debt were calculated by the Scheme Actuary Willis Towers Watson.

To allow for the transfer of the Scheme, the employer of members that wished to continue to accrue service within the Scheme changed from the Company to Lloyds Bank plc and the cost of their current service thereafter recharged back to the Company by way of a management recharge that includes pension costs.

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 Company no longer recognises the Scheme in its balance sheet.

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.

22. Retirement benefit obligations (continued)

22.1 Funded status

	2018	2017
	£m	£m
Present value of defined benefit obligation	**-**	(339.6)
Assets at fair value	**-**	336.6
Funded status	**-**	(3.0)

22.2 Reconciliation of defined benefit liability

	2018	2017
	£m	£m
Defined benefit liability as at 1 January	**(3.0)**	(9.5)
Service cost	**(2.6)**	(3.6)
Net interest on defined benefit asset/(liability)	**-**	(0.1)
Remeasurement effects recognised in OCI	**1.3**	(10.2)
Employer contributions actually paid	**21.4**	21.7
Administration costs incurred during the period	**(0.4)**	(1.3)
	16.7	(3.0)
Transfer out	**(16.7)**	-
Defined benefit liability as at 31 December	**-**	(3.0)

22.3 Present value of defined benefit obligations

	2018	2017	2016	2015
	£m	£m	£m	£m
Present value of defined benefit obligation as at 1 January	**(339.6)**	(361.4)	(273.6)	(274.1)
Current service cost	**(0.6)**	(3.4)	(3.1)	(3.6)
Interest cost	**(2.9)**	(9.7)	(10.3)	(10.0)
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**	(13.5)	(79.2)	8.5
Actual benefit payments	**23.9**	63.1	16.6	12.3
Past service cost – plan amendments	**-**	(0.2)	(0.8)	(0.9)
Past service cost – curtailments	**(2.0)**	-	-	(6.4)
Transfer out	**307.7**	-	-	-
Present value of defined benefit obligation as at 31 December	**-**	(339.6)	(361.4)	(273.6)

22.4 Fair value of assets

	2018	2017	2016	2015
	£m	£m	£m	£m
Fair value of scheme assets as at 1 January	**336.6**	351.9	278.9	290.8
Interest income on plan assets	**2.9**	9.6	10.6	10.8
Return on plan assets greater than discount rate	**(12.2)**	17.8	74.3	(18.3)
Employer contributions	**21.4**	21.7	5.7	8.9
Benefits paid from fund	**(23.9)**	(63.1)	(16.6)	(12.3)
Administrative costs paid	**(0.4)**	(1.3)	(1.0)	(1.0)
Transfer out	**(324.4)**	-	-	-
Fair value of scheme assets as at 31 December	**-**	336.6	351.9	278.9

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22. Retirement benefit obligations (continued)

22.5 Allocation of fair value of assets

	2018	2017
	%	%
Equities funds	**-**	22
Bonds funds	**-**	57
Credit funds	**-**	20
Property funds	**-**	1
Total	**-**	100

22.6 Actuarial assumptions

	2018	2017
	%	%
Discount rate	**-**	2.59
RPI inflation	**-**	3.20
CPI inflation	**-**	2.15
Rate of salary increase	**-**	0

22.7 Expected contributions and benefit payments

Year commencing

	1 Jan 2019	1 Jan 2018
	£m	£m
Current service cost	**-**	(1.8)
Net interest on net defined benefit asset/(liability)	**-**	0.1
Administration cost incurred during the period	**-**	(1.3)
Total pension expense	**-**	(3.0)

23. Other liabilities

	2018	2017
	£000	£000
Accruals	**11,913**	7,116
Other liabilities	**6,078**	3,566
	17,991	10,682

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24. Provisions

	2018 £000	2017 £000
Opening balance	**3,298**	17,824
Provision made	**1,045**	789
Provision applied	**-**	(7,515)
Unused provision reversed	**(382)**	(7,800)
Closing balance	**3,961**	3,298

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 31.3.

25. Subordinated liabilities

	2018 £000	2017 £000
As at 1 January	**-**	-
Issued during the year	**200,241**	-
Accrued interest	**112**	-
Foreign exchange movements	**3,926**	-
As at 31 December	**204,279**	-
Dated Subordinated liabilities		
Floating Rate Subordinated Callable Notes 2028	**204,279**	-

During the year £3,889,000 (2017: £Nil) of interest was paid to LBCM. These subordinated liabilities will, in the event of the winding-up of the Company be subordinated to the claims of the depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of the specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The Company has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the year.

26. Share capital

	2018 £000	2017 £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

27. Share premium account

	2018 £000	2017 £000
Share premium	**14,985**	14,985

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For the year ended 31 December 2018

28. Share based payments

During the year ended 31 December 2018, the Company's ultimate parent company operated a number of share based payments schemes in which eligible 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 £907,000 (2017: £791,000) 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 LTIP 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.

Fixed share awards: The fixed share awards are delivered in Lloyds Banking Group plc shares, released over five years with 20 per cent 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 2018 annual report and accounts of the Company's ultimate parent company, as set out in note 45.

29. 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, 13 and 21. Balances with fellow Group companies are disclosed in notes 11, 12, 19, 20, 21 and 25.

Key management compensation

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

	2018 **£000**	2017 £000
Salaries and other short term benefits	**1,130**	1,244
Post-employment benefits	**144**	183
Share based payments	**99**	60
	1,373	1,487

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.

29. Related party transactions (continued)

Transactions with key management

	2018	2017
	£000	£000
Loans		
As at 1 January	**1,115**	1,697
Advanced during the year	**816**	100
Interest charged during the year	**11**	10
Repayments during the year	**(870)**	(692)
	1,072	1,115
Deposits		
As at 1 January	**377**	374
Deposited during the year	**3,196**	2,287
Interest paid on deposits	**1**	-
Withdrawn during the year	**(3,328)**	(2,284)
As at 31 December	**246**	377

Amounts repaid and withdrawn include the balances with directors resigning during the year at the date of resignation. No specific allowance for impairments of loans and advances to key management are held (2017: £Nil).

30. Ultimate parent undertaking

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

Until the 30 June 2018, the Company was a wholly owned subsidiary of Lloyds Bank plc. From the 1 July 2018, the Company was a wholly owned subsidiary of Lloyds Bank Corporate Markets plc. The parent undertaking, which is the parent undertaking of the smallest group to consolidate these financial statements is Lloyds Bank plc for the period to 30 June 2018 and Lloyds Bank Corporate Markets plc for the period from 1 July 2018 Copies of the consolidated annual report and accounts of both Lloyds Bank plc and Lloyds Bank Corporate Markets plc may be obtained from Lloyds Bank Corporate Markets plc head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

31. Contingent liabilities and commitments

31.1 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.

Within the usual course of business, there are claims and possible claims against the Company as at 31 December 2018. 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 24.

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.

31. Contingent liabilities and commitments

31.2 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

	2018	2017
	£000	£000
Customer guarantees	**62,403**	98,857

Commitments

	2018	2017
	£000	£000
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Not later than 1 year	**321,464**	124,212
Over 1 year	**913,699**	1,768
	1,235,163	125,980

Commitments in respect of forward foreign exchange contracts are disclosed in note 21.

31.3 Operating lease commitments

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

	2018	2017
	£000	£000
Not later than 1 year	**3,513**	3,625
Later than 1 year and not later than 5 years	**8,284**	9,136
Later than 5 years	**10,142**	11,461
	21,939	24,222

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

	2018	2017
	£000	£000
Not later than 1 year	**113**	104
Later than 1 year and not later than 5 years	**371**	394
Later than 5 years	**110**	190
	594	688

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 premises under an operating lease and given notice of cancellation under the terms of the lease. As disclosed in note 24, the Company has provided for the lease payments to the break date.

32. 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.

Lloyds Bank International Limited

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32. Financial risk management (continued)

32.1 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 £000	Fair value through profit or loss £000	Financial liabilities at amortised cost £000	Total £000
As at 31 December 2018				
Financial assets				
Cash balances	**7,400**	**-**	**-**	**7,400**
Items in the course of collection from banks	**2,437**	**-**	**-**	**2,437**
Derivative financial instruments	**-**	**2,593**	**-**	**2,593**
Loans and receivables:				
Loans and advances to banks	**9,956,321**	**-**	**-**	**9,956,321**
Loans and advances to customers	**3,370,160**	**-**	**-**	**3,370,160**
	13,326,481	**-**	**-**	**13,326,481**
	13,336,318	**2,593**	**-**	**13,338,911**
Financial liabilities				
Deposits from banks	**-**	**-**	**130,035**	**130,035**
Items in the course of collection from banks	**-**	**-**	**3,659**	**3,659**
Customer accounts	**-**	**-**	**12,181,211**	**12,181,211**
Derivative financial instruments	**-**	**2,593**	**-**	**2,593**
Subordinated liabilities	**-**	**-**	**204,279**	**204,279**
	-	**2,593**	**12,519,184**	**12,521,777**
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
Subordinated liabilities	-	-	-	-
	-	4,838	12,617,705	12,622,543

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32. Financial risk management (continued)

32.2 Fair values of financial assets and liabilities

	Carrying value 2018 £000	Carrying value 2017 £000	**Fair value 2018 £000**	Fair value 2017 £000
Financial assets				
Derivative financial instruments	**2,593**	4,838	**2,593**	4,838
Loans and receivables:				
Loans and advances to banks	**9,956,321**	12,401,730	**9,962,857**	12,403,631
Loans and advances to customers	**3,370,160**	1,197,770	**3,383,570**	1,189,230
	13,326,481	13,599,500	**13,346,427**	13,592,861
	13,329,074	13,604,338	**13,349,020**	13,597,699
Financial liabilities				
Deposits from banks	**130,035**	213,425	**143,445**	204,885
Customer accounts	**12,181,211**	12,399,386	**12,148,125**	12,400,419
Derivative financial instruments	**2,593**	4,838	**2,593**	4,838
Subordinated liabilities	**204,279**	-	**204,279**	-
	12,518,118	12,617,649	**12,498,442**	12,610,142

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.

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 £000 £000	**Level 2 £000** £000	**Level 3 £000 £000**	**Total £000** £000
As at 31 December 2018				
Financial assets				
Derivative financial instruments	**-**	**2,593**	**-**	**2,593**
	-	**2,593**	**-**	**2,593**
Financial liabilities				
Derivative financial instruments	**-**	**2,593**	**-**	**2,593**
	-	**2,593**	**-**	**2,593**
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
Subordinated liabilities	-	-	-	-
	-	4,838	-	4,838

32. Financial risk management (continued)

32.2 Fair values of financial assets and liabilities (continued)

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.

Derivative financial instruments
Derivative financial instruments comprise forward foreign exchange contracts and equity linked options disclosed in note 21. 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.

Subordinated liabilities
The fair value approximates to their carrying value due to their short term nature of the market rates used.

32.3 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).

32. Financial risk management (continued)

32.3 Credit Risk (continued)

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 21 to the financial statements shows the total notional principal amount of interest rate, exchange rate, equity and other contracts outstanding at 31 December 2018. 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').

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.

32. Financial risk management (continued)

32.3 Credit Risk (continued)

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.

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.

	2018	2017
	£000	£000
Less than 70 per cent	**396,128**	372,140
70 per cent to 80 per cent	**117,586**	105,310
80 per cent to 90 per cent	**173,383**	150,000
90 per cent to 100 per cent	**17,021**	17,470
Greater than 100 per cent	**1,525**	2,797
Total	**705,643**	647,717

Non-mortgage lending
At 31 December 2018, the net non-mortgage lending amounted to £2,664,425,000 (2017: £554,289,000). 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 £14,197,000 (2017: £41,003,000) and unsecured commercial loans of £2,188,444,000 (2017: £42,935,000).

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 31; and
- Forward foreign exchange contracts detailed in note 21.

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

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32. Financial risk management (continued)

32.3 Credit Risk (continued)

Gross carrying amounts	Loans and advances to banks	Loans and advances to customers		
		Retail	Commercial	Total
	£000	£000	£000	£000
As at 31 December 2018				
Stage 1				
Good quality	**9,958,706**	**725,384**	**2,620,392**	**13,304,482**
Stage 2				
Special mention	**-**	**463**	**8,411**	**8,874**
Lower quality	**-**	**253**	**832**	**1,085**
	-	**716**	**9,243**	**9,959**
Stage 3				
Credit impaired	**-**	**2,347**	**21,634**	**23,981**
Total	**9,958,706**	**728,447**	**2,651,269**	**13,338,422**
As at 1 January 2018 (see note 34)				
Stage 1				
Good quality	12,401,730	670,266	440,878	13,512,874
Stage 2				
Special mention	-	1,078	286	1,364
Lower quality	-	174	57,129	57,303
	-	1,252	57,415	58,667
Stage 3				
Credit impaired	-	4,282	41,812	46,094
Total	12,401,730	675,800	540,105	13,617,635

Loan commitments and financial guarantees	Retail	Commercial	Total
	£000	£000	£000
As at 31 December 2018			
Stage 1			
Good quality	**84,750**	**1,212,816**	**1,297,566**
	84,750	**1,212,816**	**1,297,566**
As at 1 January 2018 (see note 34)			
Stage 1			
Good quality	60,156	164,681	224,837
	60,156	164,681	224,837

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.

All loan commitments and financial guarantees are assessed as Stage 1.

32. Financial risk management (continued)

32.3 Credit Risk (continued)

Lending concentration

As at 31 December 2018	Gross loans £000	Expected Loss Allowance £000	Loans and advances to customers £000
Stage 1			
Retail - House purchase	704,629	(50)	704,579
Retail - Other advances	20,755	(323)	20,432
	725,384	(373)	725,011
Commercial – Property Companies	83,725	(100)	83,625
Commercial – Construction	177,581	(215)	177,366
Commercial – Other	2,359,086	(918)	2,358,168
	2,620,392	(1,233)	2,619,159
	3,345,776	(1,606)	3,344,170
Stage 2			
Retail - House purchase	662	(2)	660
Retail - Other advances	54	(16)	38
	716	(18)	698
Commercial – Property Companies	-	-	-
Commercial – Construction	9,243	(1,417)	7,826
Commercial – Other	-	-	-
	9,243	(1,417)	7,826
	9,959	(1,435)	8,524
Stage 3			
Retail - House purchase	1,869	(599)	1,270
Retail - Other advances	478	(425)	53
	2,347	(1,024)	1,323
Commercial – Property Companies	290	(210)	80
Commercial – Construction	20,310	(4,673)	15,637
Commercial – Other	1,034	(608)	426
	21,634	(5,491)	16,143
	23,981	(6,515)	17,466
Total loans and advances to customers	3,379,716	(9,556)	3,370,160

32. Financial risk management (continued)

32.3 Credit Risk (continued)

Lending concentration (continued)

As at 1 January 2018 (see note 34)	Gross loans £000	Expected Loss Allowance £000	Loans and advances to customers £000
Stage 1			
Retail - House purchase	643,862	(75)	643,787
Retail - Other advances	26,404	(318)	26,086
	670,266	(393)	669,873
Commercial – Property Companies	365,060	(718)	364,342
Commercial – Construction	616	(48)	568
Commercial – Other	75,202	(527)	74,675
	440,878	(1,293)	439,585
	1,111,144	(1,686)	1,109,458
Stage 2			
Retail - House purchase	1,182	(5)	1,177
Retail - Other advances	70	(37)	33
	1,252	(42)	1,210
Commercial – Property Companies	26,410	(2)	26,408
Commercial – Construction	27,301	(3)	27,298
Commercial – Other	3,704	-	3,704
	57,415	(5)	57,410
	58,667	(47)	58,620
Stage 3			
Retail - House purchase	840	(120)	720
Retail - Other advances	3,442	(1,793)	1,649
	4,282	(1,913)	2,369
Commercial – Property Companies	669	(322)	347
Commercial – Construction	30,017	(13,190)	16,827
Commercial – Other	11,126	(1,271)	9,855
	41,812	(14,783)	27,029
	46,094	(16,696)	29,398
Total loans and advances to customers	1,215,905	(18,429)	1,197,476

32.4 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.

32.4.1 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.

32. Financial risk management (continued)

32.4 Market risk (continued)

32.4.1 Interest rate risk (continued)

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.

	2018	2017
	£000	£000
OYE	**3,520**	5,232
OYE limit	**30,000**	30,000

Interest rate sensitivity gap analysis

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

	Less than 3 months	**3-12 months**	**1-4 years**	**Over 4 years**	**Non interest bearing**	**Total**
As at 31 December 2018	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Assets						
Loans and advances to banks	**9,660,272**	**234,099**	**61,950**	**-**	**-**	**9,956,321**
Loans and advances to customers	**2,662,717**	**316,548**	**265,018**	**125,877**	**-**	**3,370,160**
Other assets	**5**	**2,589**	**-**	**-**	**31,488**	**34,082**
	12,322,994	**553,236**	**326,968**	**125,877**	**31,488**	**13,360,563**
Liabilities						
Deposits from banks and customers	**10,918,718**	**919,064**	**339,769**	**133,695**	**-**	**12,311,246**
Subordinated liabilities	**204,279**	**-**	**-**	**-**	**-**	**204,279**
Other liabilities	**5**	**2,589**	**-**	**-**	**33,287**	**35,881**
	11,123,002	**921,653**	**339,769**	**133,695**	**33,287**	**12,551,406**
Interest rate re-pricing gap	**1,199,992**	**(368,417)**	**(12,801)**	**(7,818)**	**(1,799)**	**809,157**
As at 31 December 2017						
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
Liabilities						
Deposits from banks and customers	11,503,025	513,332	507,208	89,246	-	12,612,811
Subordinated liabilities	-	-	-	-	-	-
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

32. Financial risk management (continued)

32.4 Market risk (continued)

32.4.2 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 2018 the Company's aggregate net OEP limit, either long or short, was £1,000,000 (2017: £1,000,000). The table below indicates maximum net positions, either long or short, for individual currencies.

	2018	2017
	£000	£000
OEP expressed in GBP equivalent		
USD	**176**	305
EUR	**(48)**	86
Other Currencies	**1**	(350)
Total	**129**	41

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.

32.4.3 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.

32.5 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.

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.

32. Financial risk management (continued)

32.5 Liquidity risk (continued)

The table below analyses the 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.

	Up to 1 month £000	**1-3 months £000**	**3-12 months £000**	**1-5 years £000**	**Over 5 years £000**	**Total £000**
As at 31 December 2018						
Liabilities						
Deposits from banks and customers	**9,539,195**	**906,830**	**1,792,712**	**72,509**	**-**	**12,311,246**
Derivative financial instruments	**-**	**5**	**992**	**1,596**	**-**	**2,593**
Subordinated liabilities	**-**	**-**	**-**	**-**	**204,279**	**204,279**
Other liabilities	**33,288**	**-**	**-**	**-**	**-**	**33,288**
Total Liabilities	**9,572,483**	**906,835**	**1,793,704**	**74,105**	**204,279**	**12,551,406**
As at 31 December 2017						
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
Subordinated liabilities	-	-	-	-	-	-
Other liabilities	28,923	-	-	-	-	28,923
Total liabilities	10,699,074	382,500	1,313,129	251,869		12,646,572

The maturity analysis of the contractual amounts of the Company's commitments to extend credit to customers and other facilities are disclosed in note 31.

Geographical analysis of deposits from banks and customers

	2018 £000	2017 £000
Jersey, Guernsey, and Isle of Man	**6,808,276**	6,467,450
United Kingdom	**2,330,281**	2,281,972
Other EU	**568,556**	523,600
European non-EU	**166,989**	265,434
Middle East	**434,487**	689,060
Far East	**427,628**	337,310
North America	**480,145**	1,062,941
Other	**1,094,884**	985,044
Total	**12,311,246**	12,612,811

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.

32. Financial risk management (continued)

32.6 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 ("JFSC"). The JFSC require the Company to maintain a minimum Basel II Ratio of 11%. As at 31 December 2018 this ratio was 18.79% (2017: 18.2%). Refer to note 35.

The Company's objectives when managing capital are to safeguard the Company'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.

Mitigation

The Company is able to accumulate additional capital through the retention of profits over time, by raising new equity and by raising additional tier 1 or tier 2 capital through issuing tier 1 instruments or subordinated liabilities.

32.7 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.

33. Notes to the statement of cash flows

Reconciliation of profit to net cash flows from operating activities

	Note	2018 £000	2017 £000
Profit before tax		**76,955**	82,050
Adjustments for non cash items included in profit			
Loss on disposal of fixed assets	14	**2,571**	-
Depreciation of fixed assets	14	**4,221**	4,974
Interest expense on subordinated liabilities	25	**3,889**	-
Adjustments for net cash movements in balance sheet			
Movement in loans and advances to banks		**539,776**	1,757,709
Movement in loans and advances to customers		**(2,172,390)**	119,010
Movement in derivative assets		**2,245**	5,318
Movement in other assets		**(6,577)**	4,968
Movement in deposits from banks		**(84,625)**	(12,487)
Movement in customer accounts		**(218,175)**	(1,260,541)
Movement in derivative liabilities		**(2,245)**	(5,318)
Movement in other liabilities		**7,972**	(14,688)
Movement in subordinated liabilities		**4,038**	-
Movement in retirement benefit obligations		**1,700**	15,200
Other non cash movements		**(1,973)**	(10,200)
Income tax paid		**(11,400)**	(2)
Pension transfer proceeds	22	**16,700**	-
Pension debt payment	22	**(15,000)**	-
Pension deficit clearance payments	22	**(6,400)**	(21,700)
		(1,935,673)	582,243
Net cash (used in)/generated by operating activities		**(1,858,718)**	664,293

The 'Other non cash movements' includes the IFRS 9 transition balances of £3,272,000 (2017: £Nil).

33.1 Analysis of cash as shown in the balance sheet

	Note	2018 £000	2017 £000
Cash balances		**7,400**	7,296
Items in the course of collection from banks		**2,437**	4,630
Loans and advances to banks included within cash and cash equivalents	11.1	**6,108,807**	8,014,440
Total cash and cash equivalents		**6,118,644**	8,026,366

34. Transition to IFRS 9

34.1 Impact of transition

The following table summarises the adjustments arising on the adoption of IFRS 9 to the Company's balance sheet as at 1 January 2018.

	As at 31 December 2017 £000	IFRS 9 : Impairment £000	**Adjusted as at 1 January 2018 £000**
Assets			
Cash	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	(2,978)	**12,398,752**
Loans and advances to customers	1,197,770	(294)	**1,197,476**
	13,599,500	(3,272)	**13,596,228**
Property and equipment	15,546	-	**15,546**
Deferred tax assets	-	-	**-**
Current tax assets	375	-	**375**
Other assets	3,474	-	**3,474**
Total assets	13,635,659	(3,272)	**13,632,387**
Liabilities			
Deposits from banks	213,425	-	**213,425**
Items in course of transmission to banks	4,894	-	**4,894**
Customer deposits	12,399,386	-	**12,399,386**
Derivative financial instruments	4,838	-	**4,838**
Retirement benefit obligations	3,000	-	**3,000**
Current tax liabilities	10,048	-	**10,048**
Other liabilities	10,682	-	**10,682**
Provisions	3,298	-	**3,298**
Subordinated liabilities	-	-	**-**
Total liabilities	12,649,571	-	**12,649,571**
Equity			
Share capital	536,852	-	**536,852**
Share premium account	14,985	-	**14,985**
Retained profits	434,251	(3,272)	**430,979**
Total shareholder's equity	986,088	(3,272)	**982,816**
Total equity and liabilities	13,635,659	(3,272)	**13,632,387**

There have been no classification or measurement adjustments of the financial assets and liabilities as a result of the adoption of IFRS 9.

Notes to the financial statements
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34. Transition to IFRS 9 (continued)

34.2 Impairment

The Company adopted IFRS 9 from 1 January 2018. In accordance with the transition requirements of IFRS 9, comparative information for 2017 has not been restated and transitional adjustments have been accounted through retained earnings as at 1 January 2018, the date of the initial application; and as a result shareholders' equity reduced by £3,272,000, driven by the effects of the additional impairment provisions following the implementation of the expected credit loss methodology. It is not practical to quantify the impact of adoption of IFRS 9 on the results for the current period.

The following table summarises the impact of the transitional adjustment on the Company's loss allowance at 1 January 2018.

	IAS 39 allowance at 31 December 2017 £000	Transitional adjustment to loss allowance £000	**IFRS 9 loss allowance at 1 January 2018 £000**
Loans and advances to banks	-	2,978	**2,978**
Loans and advances to customers	18,135	294	**18,429**
	18,135	3,272	**21,407**
Provisions for undrawn commitments and financial guarantees	-	-	**-**
Total loss allowance	18,135	3,272	**21,407**

35. Post balance sheet events

The Jersey Financial Services Commission introduced new requirements for the treatment of Regulatory Tier 2 Capital which came into effect on 1 January 2019. This sets out that the Tier 2 capital must be immediately callable at the discretion of the Resolution Board.

As a result, the Subordinated liabilities held at the reporting date will no longer qualify as Regulatory Tier 2 Capital from 1 January 2019. Had this been in effect at 31 December 2018, the Basel II Ratio as disclosed in Note 32.6 would have been 14.73%.

36. Future accounting developments

The following pronouncements are not applicable for the year ended 31 December 2018 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.

Pronouncement	Nature of change	IASB effective date
IFRS 16 'Leases' [1,2]	Replaces IAS 17 Leases and 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.	Annual periods beginning on or after 1 January 2019.
Amendments to other accounting standards [1,2] standards	The IASB has issued amendments to IAS 12 Income Taxes and IFRIC 23 Uncertainty over Income Tax Treatments.	Annual periods beginning on or after 1 January 2019.

[1] At the date of this report, these pronouncements were awaiting EU endorsement.

[2] The full impact of these pronouncements is being assessed by the Company. However, the initial view is that they are not expected to cause any material adjustments to the reported numbers in the financial statements.