HBOS FINANCIAL SERVICES LIMITED

ANNUAL REPORT

AND

FINANCIAL STATEMENTS

31 DECEMBER 2019

Member of Lloyds Banking Group plc

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COMPANY INFORMATION

Board of Directors

S W Lowther
J Phythian

Company Secretary

K J McKay

Independent Auditors

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

Registered Office

33 Old Broad Street
London
EC2N 1HZ

Company Registration Number

03322151

STRATEGIC REPORT

The Directors present their strategic report on HBOS Financial Services Limited (“the Company”) for the year ended 31 December 2019.

Principal activities

The Company forms part of Lloyds Banking Group plc (“LBG”) Insurance & Wealth Division. The principal activity of the Company is that of a holding company of subsidiaries within Scottish Widows Group Limited (“SWG”).

Result for the year

The result of the Company for the year ended 31 December 2019 is a loss before tax of £86,610k (2018: profit before tax £2,751k), due to an impairment of £84m recognised in respect of the investment in Halifax Financial Services (Holdings). The total net assets of the Company at 31 December 2019 are £348,925k (2018: total net assets £435,833k)

The United Kingdom leaving the European Union

The LBG Insurance and Wealth Division has already considered many of the potential implications following the UK’s vote to leave the European Union (EU) and continues to manage related developments to assess, and if possible mitigate any impact to its customers, colleagues and products − as well as legal, regulatory, tax, finance and capital implications.

There is ongoing uncertainty around the EU exit outcome. With a UK customer base, the Company could be impacted through the impact on the wider economy. As part of the LBG Insurance and Wealth Division, the Company is engaged in mitigating this risk through internal contingency plans, which are regularly reviewed, tracking market conditions and sector reviews including an assessment of EU exit risk and no deal outcomes. The impact of this however on the company is not expected to be significant.

Coronavirus

The rapid pace and scale of measures to contain a major health issue such as the Coronavirus pandemic demonstrate the potentially adverse impact of those measures on the economy. The potential adverse impact on the value and trading of stocks, bond yields, credit spreads and commodities can also be seen in significant market falls, reduced liquidity and rises in volatility. The government and regulators are taking significant action to address the economic impact, which may be temporary, but depending on the severity it could lead to a significant loss of output and recession in the UK. Any sector-specific or wider impact due to this could potentially impact the retail or corporate customers of the Lloyds Banking Group and as a result have a material adverse effect on the Lloyds Banking Group’s results of operations, financial condition or prospects. The impact of this however on the Company is not expected to be significant.

Climate change

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

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

Key performance indicators

The Company’s principal business during the year was the holding of investments in subsidiaries. Its principal income is the receipt of dividends from these subsidiaries. Dividends of £nil were received from subsidiary undertakings in the year (2018: £nil).

The Directors are of the opinion that the above is the key performance indicator which is appropriate to the principal activity of the Company. The development, performance and position of the Insurance & Wealth Division are presented within LBG’s annual report, which does not form part of this report.

Outlook

There are no expected changes in the nature and extent of the Company's operations.

Principal risks and uncertainties

The Company is managed as part of the LBG Insurance & Wealth Division. The management of the business and the execution of the Company’s strategy are subject to a number of risks. In addition, the Company through its investment in subsidiaries is also exposed to financial risk, in particular the risk of reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate

STRATEGIC REPORT (continued)

accounting policies, ineffective controls over financial reporting and financial reporting fraud. The financial and risk management objectives and policies of the Company are also set out in note 16.

Section 172(1) Statement and Statement of Engagement with Employees and Other Stakeholders

In accordance with the Companies Act 2006 (the 'Act') (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), for the year ended 31 December 2019, the Directors provide the following statement describing how they have had regard to the matters set out in section172 (1) of the Act, when performing their duty under section 172. Further details on key actions in this regard are also contained within the Directors' Report on page 7 & 8.

In accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), the following statement also provides details of how the Directors have engaged with and had regard to the interest of key stakeholders. The Company is a subsidiary of LBG, and as such follows many of the processes and practices of LBG, which are further referred to in this statement where relevant.

The Directors acknowledge that one of the primary responsibilities of the Board is to ensure the strategy of the Company, as aligned to that of LBG, achieves long-term success and generates sustainable returns, central to which is ensuring engagement with stakeholders, and considering in all instances the long-term implications of decisions made, acting at all times to maintain the highest possible standards of conduct. This approach has during the course of the year been central to the activities of the Directors, as discussed below.

Shareholders

The Company is a wholly owned subsidiary of LBG. As a wholly owned subsidiary, the Directors ensure that the strategy, priorities, processes and practices of the Company are fully aligned where appropriate to those of LBG, ensuring that the interests of LBG as the Company's sole shareholder are duly acknowledged. Further information in respect of the relationship of LBG with its shareholders is included within the Strategic Report within the LBG Annual Report and Accounts for 2019, available on the LBG website.

Colleagues

The Company's approach in respect of employees, including their engagement, is part of that of LBG, where colleagues take pride in working for an inclusive and diverse bank which continues to work towards building a culture in which everyone feels included, empowered and inspired to do the right thing for customers. In 2019, the LBG Board agreed how LBG, including the Company, would engage with the workforce following the Financial Reporting Council's guidelines. The definition of 'workforce', as agreed by the Board is permanent employees, contingent workers and third-party suppliers that work on LBG premises delivering services to customers and supporting key business operations. In addition the LBG Remuneration Committee receives regular updates on colleague matters. The LBG CEO and the Chair of the LBG Remuneration Committee meet with recognised unions on at least an annual basis.

In June 2019, the LBG Group People and Productivity director, Jen Tippin, presented to the LBG Board on 'People & Transforming Ways of Working', providing them with an update on the LBG people strategy, including that of the Company, which along with the wider LBG approach to organisational culture is discussed further on pages 72 to 74 of the LBG annual report and accounts for 2019. As well as its own engagement survey, of which the Company is part, LBG takes part in the Banking Standards Board assessment on a yearly basis, which provides member firms with the evidence, support and challenge to help them achieve and maintain high standards of behaviour and competence both individually and collectively. There are five parts to the assessment; an online employee survey, a set of Board questions, interviews with executive and non-executive directors and employee focus groups.

Communities and the Environment

The Directors acknowledge that the Company, as part of one of the largest retail and commercial banks in the UK, has responsibilities to invest in the communities in which it operates, to help them prosper economically, build social cohesion and tackle disadvantage. The Company therefore participates in all related LBG initiatives, with the Directors' ensuring the Company plays an appropriate role in LBG's related Helping Britain Prosper Plan. Further information in respect of the LBG approach to engaging with and contributing to the communities in which it operates is included within the Strategic Report within the LBG Annual Report and Accounts for 2019. Additional information on LBG's Helping Britain Prosper Plan is available on the LBG website.

The Responsible Business Committee of the Board of LBG is responsible for overseeing LBG's approach, including that of the Company, to responding to environmental and sustainability issues, including measurement and reporting. Priorities during the year have included supporting the ongoing transition to a low carbon economy, and the development of related targets for LBG and its subsidiaries. LBG is working closely with the Government to support their Clean Growth Strategy, as well as supporting customers with a range of initiatives to help them with being more sustainable, including support in accessing 'green' finance. LBG's Sustainability team provides further coordination in the delivery and reporting of LBG's sustainability strategy, including mechanisms for keeping management and directors of LBG subsidiaries, including those of the Company, updated on environmental and sustainability issues impacting LBG. Further information in respect of the work of LBG's Responsible Business Committee is included within the Corporate Governance Report within the LBG Annual Report and Accounts for 2019, available on the LBG website.

STRATEGIC REPORT (continued)

Suppliers

The Company's approach to supplier management is part of that of LBG, which works with around 3,100 active suppliers of varying sizes, most in professional services sectors such as IT, cyber, operations, management consultancy, legal, HR, marketing and communication. The supply chain is crucial to the way the Company and LBG serves its customers, and through it the reach is considerable.

In 2019 LBG's supplier expenditure was £5.9 billion, with 95.5 per cent of third party supplier spend being incorporated in the UK. Great importance is placed on having the right supplier framework to operate responsibly. LBG's Sourcing & Supply Chain Management Policy applies to all businesses, divisions, and subsidiaries of LBG, including the Company, with the Directors assuming ultimate responsibility for its application as relevant to the Company. This Policy has been designed to assist in managing the risk that may occur as a result of outsourcing services, as well as the risks inherent in dealing with third party suppliers. Suppliers are required to adhere to relevant LBG policies and comply with LBG's Code of Supplier Responsibility. This defines expectations for responsible business behaviour, underpinning the efforts of the Company and LBG to share and extend good practice. All material contracts are subject to rigorous cost management governance with regular review of key supplier risks.

On behalf of the Board of Directors

S W Lowther
Director

14th August 2020

DIRECTORS' REPORT

The Directors present the audited financial statements of HBOS Financial Services Limited (the "Company"), a limited company domiciled and incorporated in the United Kingdom whose principal activity is that of a holding company. The Company is a wholly owned subsidiary of Scottish Widows Financial Services Holdings. The Company's ultimate parent company and ultimate controlling party is Lloyds Banking Group plc.

Results and dividend

The result of the Company for the year ended 31 December 2019 is a loss before tax of £86,610k (2018: profit before tax £2,751k) and this has been transferred to reserves. The total net assets of the Company at 31 December 2019 are £348,925k (2018: total net assets £435,833k).

Dividends of £nil were paid on the ordinary shares during the year in respect of 2019 (2018: £20,000k).

Directors

The names of the current Directors are listed on page 3. Changes in directorship during the year are as follows:

G M Norton	(resigned 29 March 2019)
I H Price	(resigned 9 July 2019)
J Phythian	(appointed 9 July 2019)

Particulars of the Directors' emoluments are set out in note 17.

Directors' indemnities

LBG has granted to the Directors of the Company a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements or from the date of appointment in respect of directors who join the board of the Company during the financial year. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service. The indemnity remains in force for the duration of the Director's period of office. The deed indemnifies the Directors to the maximum extent permitted by law.

The deed for existing Directors is available for inspection at the registered office of LBG. In addition, LBG has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

Political contributions

During the year the Company made no political contributions (2018: £nil).

Disclosure of information to auditors

Each person who is a Director at the date of approval of this report confirms that, so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware and each Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given, and should be interpreted in accordance with, the provisions of the Companies Act 2006.

Going concern

The going concern of the Company is dependent on successfully maintaining adequate levels of capital and liquidity. In order to satisfy themselves that the Company has adequate resources to continue to operate for the foreseeable future, the Directors have considered a number of key dependencies which are set out in the risk management section under principal risks and uncertainties. These include the liquidity and capital position in addition to considering projections for the Company's capital and liquidity position. Having consulted on these, the Directors conclude that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

Independent auditors

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

DIRECTORS' REPORT (continued)

Statement of Directors' responsibilities in respect of the financial statements

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

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

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

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

On behalf of the Board of Directors

S W Lowther
Director

14th August 2020

Independent auditors' report to the members of HBOS Financial Services Limited

Report on the audit of the financial statements

Opinion

In our opinion, HBOS Financial Services Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2019 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2019; the statement of comprehensive income, the statement of cash flows and the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

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

Independence

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

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you where:

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

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

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

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

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

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

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2019 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities in respect of the financial statements set out on page 8, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the financial statements

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

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

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Neil Riches

Neil Riches (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol
14 August 2020

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2019

	Note(s)	2019 £000	2018 £000
Income			
Revenue		-	52
Investment income	2	212	157
Other operating income	3	-	2,645
Total income		212	2,854
Operating expenses	4	(2,623)	(103)
Impairment of a subsidiary undertaking	6	(84,199)	-
(Loss) / Profit before tax		(86,610)	2,751
Taxation charge	5	(298)	(717)
(Loss) / Profit and total comprehensive (expense) / income for the year		(86,908)	2,034

There are no items of comprehensive income which have not already been presented in arriving at the profit for the financial year. Accordingly, the profit for the year is the same as the total comprehensive income for the year.

The notes set out on pages 15 to 30 are an integral part of these financial statements.

BALANCE SHEET AS AT 31 DECEMBER 2019

	Note(s)	2019 £000	2018 £000
ASSETS			
Non-current assets			
Deferred tax asset	8	2,929	3,842
Investments in subsidiaries	6	314,034	398,233
Current assets			
Current tax receivable	8	681	400
Amounts due from LBG undertakings	9	4,038	8,210
Cash and cash equivalents	10	28,925	27,493
Total assets		350,607	438,178
EQUITY AND LIABILITIES			
Capital and reserves attributable to Company's equity shareholders			
Share capital	11	100,000	100,000
Retained earnings		248,925	335,833
Total equity		348,925	435,833
LIABILITIES			
Current liabilities			
Other financial liabilities	12	1,401	1,470
Amounts due to LBG undertakings	13	281	875
Total liabilities		1,682	2,345
Total liabilities and equity		350,607	438,178

The notes set out on pages 15 to 30 are an integral part of these financial statements.

The financial statements on pages 11 to 30 were approved by the Board of Directors on 14th August 2020 and signed on its behalf by:

S W Lowther
Director

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 £000	2018 £000
Cash flows from operating activities			
(Loss) / Profit before tax		(86,610)	2,751
Adjusted for:			
Depreciation of property, plant and equipment		-	103
Investment Income	2	(212)	(157)
Tax credit received		334	608
Net movement in operating assets and liabilities	14	3,509	5,988
Impairment of subsidiaries	6	84,199	-
Net cash flows (used in) / generated from operating activities		1,220	9,293
Cash flows from investing activities			
Investment Income	2	212	157
Proceeds from sale of property, plant and equipment		-	1,941
Net cash flows generated from investing activities		212	2,098
Cash flows from financing activities			
Dividend paid	15	-	(20,000)
Net cash flows used in financing activities		-	(20,000)
Net increase / (decrease) in cash and cash equivalents		1,432	(8,609)
Cash and cash equivalents at the beginning of the year		27,493	36,102
Cash and cash equivalents at the end of the year	10	28,925	27,493

The notes set out on pages 15 to 30 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	Share capital £000	Retained earnings £000	Total equity £000
Balance as at 1 January 2018		100,000	353,799	453,799
Profit for the year and total comprehensive income		-	2,034	2,034
Dividends paid	15	-	(20,000)	(20,000)
Balance as at 31 December 2018 and 1 January 2019		100,000	335,833	435,833
(Loss) for the year and total comprehensive expense		-	(86,908)	(86,908)
Balance as at 31 December 2019		100,000	248,925	348,925

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

The notes set out on pages 15 to 30 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

1. Accounting policies

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

a) Basis of preparation

The financial statements of the Company have been prepared:

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

(2) in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS; and

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

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

In accordance with IAS 1 "Presentation of Financial Statements", assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity.

As the Company is a wholly owned subsidiary undertaking of LBG, registered in the United Kingdom, the Company has taken advantage of the exemption under section 400 of the Companies Act 2006 and has not produced consolidated financial statements.

b) Financial assets and financial liabilities

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

1. Accounting policies (continued)

c) Revenue recognition

Revenue, which arose wholly in the United Kingdom, consists of the management charges levied to other LBG companies. Revenue is recognised in the period in which it accrues.

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

Dividend income is recognised when received. All dividends received are recognised through the Statement of Comprehensive Income, in investment income.

d) Investment in subsidiaries

The Company owns a number of subsidiaries, as set out in note 6. These subsidiaries trade with a view to making a profit, and the risks and rewards of owning these subsidiaries primarily rest with the shareholder of the Company. These subsidiaries are held initially at cost, being the fair value of the consideration given to acquire the holding, then subsequently at cost subject to impairment. Further information on the Company's impairment policy is set out at policy (h).

e) Expense recognition

Operating expenses are recognised in the statement of comprehensive income in the period in which they accrue. Expenses incurred on behalf of other LBG companies are then recharged.

f) Amounts due from LBG undertakings

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

Amounts due from LBG undertakings are initially recognised at fair value less directly attributable transactions costs and subsequently measured at amortised cost, subject to impairment. Further information on the Company’s impairment policy is set out at policy (h).

g) Cash and cash equivalents

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

Holdings in liquidity funds are measured at fair value through profit or loss, with income received recognised in investment income. The fair value of holdings in liquidity funds is determined as the last published price applicable to the vehicle at the reporting date.

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

h) Impairment

Financial assets

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

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses. In determining

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

1. Accounting policies (continued)

whether there has been a significant increase in credit risk, the Company uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings and other indicators of historic delinquency. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since origination, the asset is transferred back to Stage 1.

For financial instruments that are considered to have low credit risk, the credit risk is assumed to not have increased significantly since initial recognition. Financial instruments are considered to have low credit risk when the borrower is considered to have a low risk of default from a market perspective, such as external bank accounts.

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

Non-financial assets

Assets that have an indefinite useful life, for example investments in subsidiaries, are not subject to depreciation or amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

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

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

i) Taxes

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

Current tax

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

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

Deferred tax

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

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

1. Accounting policies (continued)

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

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

j) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets.

k) Dividends payable

Dividends payable on ordinary shares are recognised in equity in the period in which they are approved.

l) Other financial liabilities

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

m) Critical accounting estimates and judgments in applying accounting policies

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

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

The recoverable amount of investments in subsidiaries involves critical accounting estimates with regard to future cash flows and the applied growth and discount rates. In determining these estimates, key judgements are applied concerning the future operations and estimation uncertainty at the reporting date in particular when calculating the value in use for subsidiaries still trading. Further information on these estimates is given in note 6.

2. Investment income

	2019 **£000**	**2018** **£000**
Interest receivable on investments in a liquidity fund	212	157
Total	212	157

3. Other operating income

	2019 **£000**	**2018** **£000**
Sundry income	-	2,645
Total	-	2,645

Sundry income represents prior year administration charges reimbursed to the Company during the year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

4. Operating expenses

	2019 £000	2018 £000
Depreciation of tangible fixed assets	-	103
Recharges from other LBG Companies	17	-
Write off of irrecoverable debt	2,606	
Total	2,623	103

(a) Audit fees for 2019 and 2018 were borne by another Company within LBG and were not recharged to the Company.
(b) The Company had no direct employees during the year (2018: nil).

5. Taxation charge

(a) Analysis of charge for the year

	2019 £000	2018 £000
UK corporation tax:		
Current tax on taxable profit for the year	681	400
Adjustments in respect of prior years	(66)	-
Current tax credit	615	400
UK deferred tax:		
Origination and reversal of timing differences	(718)	(941)
Adjustments in respect of prior years	(271)	-
Impact of deferred tax rate change	76	(176)
Deferred tax charge	(913)	(1,117)
Total tax charge	(298)	(717)

Corporation tax is calculated at a rate of 19.00% (2018: 19.00%) of the taxable profit for the year.

(b) Factors affecting the tax charge for the year

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

	2019 £000	2018 £000
(Loss) / Profit before tax	(86,610)	2,751
Tax at 19.00% (2018: 19.00%)	16,456	(523)
Effects of:		
Disallowed items	(16,493)	(18)
Non-taxable items	-	-
Adjustments in respect of prior years	(337)	-
Effect of reduction in tax rate and related impacts	76	(176)
Total	(298)	(717)

The Finance Act 2016 reduced the main rate of corporation tax to 17% with effect from 1 April 2020. Within the March 2020 budget, the UK government stated its intention to maintain the corporation tax rate at 19 per cent with effect from 1 April 2020. This intention to maintain the corporation tax rate was enacted under the Provisional Collection of Taxes Act 1968 on 17 March 2020. The effect of this proposed rate change on the Company's deferred tax balances has been assessed and is not significant.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

6. Investments in subsidiaries

Investments in subsidiary undertakings are as follows:

	2019 £000	2018 £000
At 1 January	398,233	398,233
Impairment of subsidiary undertakings	(84,199)	-
At 31 December	314,034	398,233

An impairment of £84m has been recognised during 2019 in respect of the investment in Halifax Financial Services (Holdings) Limited ("HFS(H)L"), leaving a carrying value of £313.8m (2018: £398.0m).

Significant Estimate: Key assumptions used for value-in-use calculations
A review of the carrying value of the subsidiary investments to assess indications of impairment is performed on an annual basis. The recoverable amount for 2018 and 2019 have both been calculated on a value in use basis. A discount factor has been applied to underlying profit and dividend payments over the expected life of the subsidiary in order to establish a net present value. The applicable discount factor used for 2019 is 8.64% (2018: 8.64%).

Significant Estimate: Impairment Charge
The impairment arose following an impairment of the carrying value in Halifax Financial Services (Holdings) Limited ("HFS(H)L") of the investment in its subsidiary, HBOS Investment Fund Managers Limited ("HIFML"). This occurred as a result of changes to a cost sharing agreement between HIFML and Scottish Widows Limited resulting in a reduction in the HIFML value in use. HBOS FS is the parent of HFS(H)L.

Significant Estimate: Impact of possible changes in key assumptions
If the discount rate applied to the cash flow projections had been 1% higher (9.64% instead of 8.64%), the impairment charge would have been £100.2m, an increase of £16.0m. If the discount rate had been 1% lower (7.64% instead of 8.64%), the impairment charge would have been £68.2m, a decrease of £16m. In the prior year, there were no reasonable potential changes in any of the key assumptions that would have resulted in an impairment.

The following are particulars of the Company's subsidiaries:

Name	Class of stock	2019 % held	2018 % held	Country of incorporation	Registered Address	Nature of business
Clerical Medical Finance plc (1)	Ordinary	100	100	England & Wales	33 Old Broad Street, London, EC2N 1HZ	Finance Company
Halifax Financial Services (Holdings) Limited	Ordinary	100	100	England & Wales	Trinity Road, Halifax, West Yorkshire, HX1 2RG	Intermediate Holding Company

The following are particulars of the Company's indirect subsidiaries:

HBOS Investment Fund Managers Limited (1)

Halifax Financial Brokers Limited (*) (1)

Clerical Medical Investment Fund Managers (*) (1)

Legacy Renewal Company Limited (*) (2)

Halifax Financial Services Limited (1)

Halifax Investment Services Limited (*) (1)

Halifax Equitable Limited (^) (1)

(*) To be liquidated.
(^) Dissolved 04/09/2019

(1) Subsidiaries incorporated in England & Wales and have the registered office address: Trinity Road, Halifax, West Yorkshire, HX1 2RG.
(2) Subsidiaries incorporated in Scotland and have the registered office address: Bank Of Scotland, The Mound, Edinburgh, EH1 1YZ

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

7. Auditors' remuneration

The fees payable in respect of the audit of the financial statements of the Company are £34k (2018: £34k). The company received no non-audit services during the year (2018: none).

8. Tax assets and liabilities

	2019 £000	2018 £000
Deferred tax asset at 1 January	3,842	4,960
Charge to statement of comprehensive income	(913)	(1,118)
Total deferred tax asset at 31 December	2,929	3,842
Current tax (payable) / receivable	681	400
Total current tax (liability) / asset	681	400

Deferred tax asset of £2,929k (2018: £3,842k) is expected to be recovered more than one year after the reporting date and relates primarily to accelerated capital allowances. The deferred tax charge in the year comprises a temporary difference of £913k (2018: £1,118k) relating to accelerated capital allowances.

9. Amounts due from LBG undertakings

	2019 £000	2018 £000
Amounts due from LBG undertakings	4,038	8,210
Total	4,038	8,210

Further information in respect of credit risk is given in note 16.

10. Cash and cash equivalents

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

	2019 £000	2018 £000
Investments in a liquidity fund	28,925	27,493
Total	28,925	27,493

11. Share capital

	2019 £000	2018 £000
Allotted, called up and fully paid share capital		
100,000,000 shares of £1 each (2018:100,000,000 shares of £1 each)	100,000	100,000

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

12. Other financial liabilities

	2019 £000	2018 £000
Trade and other payables	1,401	1,470
Total	1,401	1,470

None of the above balances are interest-bearing. All trade payables are expected to be settled less than one year after the reporting date.

13. Amounts due to LBG undertakings

	2019 £000	2018 £000
Amounts due to LBG undertakings	281	875
Total	281	875

Further information in respect of liquidity risk is given in note 16.

14. Decrease/(increase) in operating assets and liabilities

	2019 £000	2018 £000
Decrease in operating assets:		
Financial assets:		
Amounts due from LBG undertakings	4,172	14,094
Decrease in operating assets	4,172	14,094
Decrease in operating liabilities:		
Financial liabilities:		
Amounts due to LBG undertakings	(594)	(8,059)
Other financial liabilities	(69)	(47)
Decrease in operating liabilities	(663)	(8,106)
Net decrease/(increase) in operating assets and liabilities	3,509	5,988

15. Dividends paid

	2019 £000	2018 £000
Total dividends paid on equity shares	-	20,000

The dividends paid in 2019 amounted to £nil pence per share (2018: 20 pence per share).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

16. Risk management

The principal activity of the Company is to act as a holding company. This note summarises the risks associated with the activities of the Company and the way in which the Company manages them.

The Company is managed as part of the Insurance Division; as such risk is managed across all of the entities within the Insurance Division and not at the individual company level. The Company's activities expose it to a variety of risks. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

(a) Governance framework

The Company is part of LBG, which has established a risk management function with responsibility for implementing the LBG risk management framework (with appropriate Insurance focus) within the Group.

This enterprise-wide risk management framework for the identification, assessment, measurement and management of risk covers the full spectrum of risks that the Company are exposed to, with risks categorised according to an approved LBG risk language. This covers the principal risks faced by the Company, including the exposures to market, insurance underwriting, model risk, credit, capital, liquidity, regulatory & legal, conduct, people, governance and operational risks. The performance of the Company, its continuing ability to write business and the strategic management of the business depend on its ability to manage these risks.

Responsibility for setting and managing risk appetite and risk policy resides with the Board. Risks are managed in line with LBG and Insurance risk policies. The Board has delegated certain risk matters to the Insurance Risk Oversight Committee ("ROC") with operational implementation assigned to the Insurance and Wealth Risk Committee ("IWRC").

The risk management approach aims to ensure effective independent checking or "oversight" of key decisions by operating a "three lines of defence" model. The first line of defence is line management, who have direct accountability for risk decisions. The Risk function provides oversight and challenge and is the second line of defence. Internal Audit, the third line of defence, provide independent assurance to the Insurance Audit Committee and the Board that risks are recognised, monitored and managed within acceptable parameters.

Policy owners, identified from appropriate areas of the LBG and Insurance business, are responsible for drafting risk policies, for ensuring that they remain up-to-date and for facilitating any changes. Policies are subject to at least an annual review. Limits are prescribed within which those responsible for the day to day management of each company can take decisions. Line management are required to follow prescribed reporting procedures to the bodies responsible for monitoring compliance with policy and controlling the risks.

(b) Risk appetite

Risk appetite is the amount and type of risk that the Board prefers, accepts or wishes to avoid and is aligned to the LBG strategy. The Insurance Board has defined a framework for the management of risk and approved a set of risk appetite statements that cover financial risks (capital, insurance underwriting, credit, market and liquidity), operational risks, people, conduct risks, regulatory & legal risks, model risk and governance risks. The risk appetite statements set limits for exposures to the key risks faced by the business. Risk appetite is reviewed at least annually by the Insurance Board. Executive owned Tier 2 and Tier 3 limits sit beneath Board owned risk appetite (Tier 1) and are managed and governed within the Insurance business.

Experience against Risk Appetite is reported (by exception) to each meeting of IWRC and ROC. Copies are also supplied regularly to the Company's regulators as part of the close and continuous relationship. Reporting focuses on ensuring, and demonstrating to the Board, and their delegate ROC that the Company is run in line with approved risk appetite. Any breaches of risk appetite require clear plans and timescales for resolution.

(c) Financial risks

The Company is exposed to a range of financial risks through its financial assets and financial liabilities. The most important components of financial risk are credit, liquidity and market risk.

The Company manages these risks in a numbers of ways, including risk appetite assessment and monitoring of capital resource requirements.

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

The sensitivity analyses given throughout this note are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur as changes in some of the assumptions may be correlated, for example changes in

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

16. Risk management (continued)

(c) Financial risks (continued)

interest rates and changes in market values. The sensitivity analysis presented also represents management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions.

(1) Credit risk

The risk that counterparties with whom we have contracted, fail to meet their financial obligations (both on and off balance sheet).

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

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

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

	2019 £000	2018 £000
Amounts due from LBG undertakings	4,038	8,210
Cash and cash equivalents	28,925	27,493
Total assets bearing credit risk	32,963	35,703

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

As at 31 December 2019

	Total £000	AAA £000	AA £000	A £000	BBB or lower £000	Not rated £000
Stage 1 assets						
Amounts due from LBG undertakings	4,038	-	-	4,038	-	-
Loss allowance	-	-	-	-	-	-
Exposure to credit risk	4,038	-	-	4,038	-	-
Assets at fair value through profit or loss						
Cash and cash equivalents	28,925	28,925	-	-	-	-
Total	**32,963**	**28,925**	**-**	**4,038**	**-**	**-**

As at 31 December 2018

	Total £000	AAA £000	AA £000	A £000	BBB or lower £000	Not rated £000
Amounts due from LBG undertakings	8,210	-	-	8,210	-	-
Cash and cash equivalents	27,493	-	-	27,493	-	-
Total	**35,703**	**-**	**-**	**35,703**	**-**	**-**

(2) Credit concentration risk

Exposure to credit risk is concentrated across counterparties as follows:

	2019 £000
Amounts due from LBG undertakings	4,038
Cash and cash equivalents (amounts due from financial institutions)	28,925
Total	**32,963**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

16. Risk management (continued)

(c) Financial risks (continued)

(3) Liquidity risk

Liquidity risk is the risk that the Company does not have sufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values, or from the inability to generate cash inflows as anticipated.

Liquidity risk is managed in line with the Insurance Liquidity Risk Policy and the wider LBG Funding and Liquidity Risk Policy.

Liquidity risk has been analysed as arising from the settlement of balances owed to other LBG undertakings of £281k (2018: £875k) and other financial liabilities of £1,401k (2018: £1,470k). These amounts are all contractually due within one month from the reporting date.

(4) Capital risk

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

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

The Company manages the capital structure and makes adjustments to reflect changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to the shareholder, return capital to the shareholder, issue new shares or sell assets.

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

(5) Market risk

Market risk is the risk that our capital or earnings profile is affected by adverse market rates, in particular equity and credit spreads in Insurance business. Investments in collective investment schemes are categorised as level 1 in the fair value hierarchy.

(6) Interest rate risk

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

If interest rates were to increase or decrease by 25 basis points, the impact on profit or loss after tax would be an increase or decrease respectively of £72k (2018: increase or decrease respectively of £69k) in respect of interest-bearing financial assets and financial liabilities.

The Company is not exposed to equity or property risk through its financial assets and financial liabilities.

(7) Risk associated with investment in subsidiaries

The Company owns two direct subsidiary undertakings, the carrying values of which are assessed for reasonableness at least once in each financial year. Any impairment in the value of these investments could result in a significant financial exposure of the Company. The underlying activity in the subsidiary undertakings is regularly monitored and any implications on the financial position of the Company assessed. All subsidiaries of the Company are managed in accordance with LBG risk policies to mitigate against any unforeseen circumstances.

(d) Non-financial risks

The Group faces a variety of non-financial risks through its operations and service provision. The Group manages these risks by following the embedded Risk Management Framework, which uses methodologies and systems consistent with those implemented across the Group. The various stages of the framework are:

Identification

- Risks identified in products, processes, channels, customers and people
- Emerging risks
- Changes to the risk profile through ongoing tracking, pricing reviews and monitoring of external factors
- Change Management at project, programme or portfolio level

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

16. Risk management (continued)

(d) Non-financial risks

- Implement Risk and Control Framework and standards, including loss estimation and provisioning

Measurement

- Evaluate risk exposure vs appetite
- Modelling and stress testing, including Internal Model outputs
- Actual vs expected losses
- Scenario analysis

Management

- Identify and operate controls
- Perform day-to-day control activities
- Ensure appropriate segregation of duties
- Control assessment and estimation of residual risk
- Controls testing activities
- Effectiveness reviews

Monitoring

- Performance vs risk appetite
- Internal Model performance monitoring
- Risk metrics on for example products, processes, customer experience, service, retention
- Change portfolio
- Regulatory and external environment
- Quality checking
- Action management

Reporting

- Monthly Executive Risk Reporting presented through the corporate governance structure leads to top down review and challenge evidenced via the Insurance Consolidated Risk Report
- Material Events escalation, including related actions
- ORSA reporting

The primary non-financial risk categories are:

Conduct risk
Conduct risk is defined as the risk of customer detriment across the customer lifecycle including: failures in product management, distribution and servicing activities; from other risks materialising, or other activities which could undermine the integrity of the market or distort competition, leading to unfair customer outcomes, regulatory censure, reputational damage or financial loss.

Governance risk
Governance risk is defined as the risk that the Group's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively.

Model risk
The risk of financial loss, regulatory censure, reputational damage or customer detriment, as a result of deficiencies in the development, application and ongoing operation of Models and Ratings systems.

Operational risk
Operational risk is defined as the risk of loss from inadequate or failed internal processes, people and systems or from external events. As operational risk covers such a range of elements, there are secondary risk types within this area, including:

Change risk
Change risk is defined as the risk that, in delivering its change agenda, the Group fails to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operate within the Group's risk appetite.

Cyber and information security
The risk of financial loss, disruption or damage to the reputation of Lloyds banking Group from a malicious attack that impacts the confidentiality and/or integrity of electronic data or the availability of systems. The risk also to the security of information and data.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019
16. Risk management (continued)

(d) Non-financial risks

Data management
The risk that the Group fails to effectively govern, manage and protect its data (or the data shared with Third Party Suppliers) impacting the Group's agility, accuracy, access and availability of data, ultimately leading to poor customer outcomes, loss of value to the Group and mistrust from regulators.

External service provision
Failure in the provision of the formally agreed services (i.e. within the scope for the Group Service Provision Policy / supporting Procedures) which are required so Business Units meet their agreed deliverables.

Financial crime
Financial crime is the risk of acts intended to bribe, corrupt, launder money, fund terrorist activity or circumvent sanctions intended for personal gain or to cause loss to another party, by customers/clients, suppliers, third parties or colleagues.

Financial reporting risk
Financial reporting risk is defined as the risk that the Group suffers reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over business or finance processes impacting financial, prudential regulatory, and tax reporting, failure to manage the associated risks of changes in taxation rates, law, corporate ownership or structure and the failure to disclose timely and appropriate information in accordance with regulatory requirements.

Fraud
The risk of acts of deception or omission intended for personal gain or to cause loss to another party, by customers/clients, third parties or colleagues,

Internal service provision
The risk associated with the management of internal service arrangements.

IT systems
The risk of failure in technology governance and the development, delivery and maintenance of effective IT solutions.

Operational resilience risk
Operational resilience risk covers the risk that the Group fails to design resilience into business operations, underlying infrastructure and controls (people, process, technical) so that it is able to withstand external or internal events which could impact the continuation of operations, and fails to respond in a way which meets stakeholder expectations and needs when the continuity of operations is compromised.

Physical security risk
The risk to the security of people and property (including damage (malicious or non-malicious) to LBG branches and buildings managed through Group Property).

Sourcing
Sourcing risk covers the risk associated with the activity related to the agreement and management of services provided by third parties including outsourcing (excludes internal service arrangements).

People risk
People risk is defined as the risk that the Group fails to provide an appropriate colleague and customer centric culture, supported by robust regard and wellbeing policies and processes; effective leadership to manage colleague resources; effective talent and succession management; and robust control to ensure all colleague-related requirements are met.

Regulatory and legal risk
The risk of financial penalties, regulatory censure, criminal or civil enforcement action or customer detriment as a result of failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements.

(e) UK political uncertainties including EU exit

Following the UK's exit from the EU, significant negotiation is now required on the terms of the future trade agreement. As a result, the possibility of a limited or no deal at the end of the transition period remains and could manifest in prolonged business uncertainty across the UK, including the financial services sector. The continued lack of clarity over the UK's eventual relationship with the EU and other foreign countries, and ongoing challenges in the Eurozone, including weak growth raises additional uncertainty for the UK economic outlook. The Group's response to these risks and uncertainty is as follows:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

16. Risk management (continued)

(e) UK political uncertainties including EU exit (continued)

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

(f) Economic Risk

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

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

The rapid pace and scale of measures to contain a major health issue such as the Coronavirus pandemic demonstrate the potentially adverse impact of those measures on the economy. The government and regulators are taking significant action to address the economic impact, which may be temporary, but depending on the severity it could lead to a significant loss of output and recession in the UK.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

17. Related party transactions

a) Ultimate parent and shareholding

The Company's immediate parent undertaking is Scottish Widows Financial Services Holdings, a company registered in the United Kingdom. Scottish Widows Financial Services Holdings has taken advantage of the provisions of the Companies Act 2006 and has not produced consolidated financial statements.

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

b) Transactions and balances with related parties

Transactions between the Company and other LBG companies

The Company has entered into transactions with related parties in the normal course of business during the year.

		2019		
	Income during year £000	**Dividends paid during year £000**	**Payable at year end £000**	**Receivable at year end £000**
Relationship				
Parent	-	-	-	-
Subsidiary	-	-	-	-
Other related parties	-	-	281	4,038

		2018		
	Income during year £000	**Dividends paid during year £000**	**Payable at year end £000**	**Receivable at year end £000**
Relationship				
Parent	-	20,000	-	-
Subsidiary	-	-	-	-
Other related parties	52	-	875	8,210

All amounts payable and receivable from LBG undertakings are non-interest bearing, and are expected to be settled or recovered less than one year after reporting date.

Transactions between the Company and key management

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, which is determined to be the Company's Directors.

Key management compensation

The Directors consider that they receive no remuneration for their services to the Company (2018: nil). Key management personnel provide services to other companies within LBG and consider their services to the Company to be incidental to their other activities within LBG.

18. Contingent liabilities

The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law which might lead to additional tax. The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Group that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities for the company of approximately £1,716k (including interest). The Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

19. Future accounting development

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

20. Events after the reporting date

Since the balance sheet date there has been a global pandemic from the outbreak of Coronavirus which is causing widespread disruption to financial markets and normal patterns of business activity across the world including the UK. In view of its currently evolving nature, the Directors are unable to estimate its financial effect, although no significant impact is expected.