The Mortgage Business Public Limited Company

Annual Report and Accounts

2019

Member of Lloyds Banking Group

Strategic Report

For the year ended 31 December 2019

The directors present their strategic report and the audited financial statements of The Mortgage Business Public Limited Company (the "Company") for the year ended 31 December 2019.

Business Overview

The Company is a public limited company incorporated and domiciled in England and Wales (registered number: 01997277). The registered office for the Company is Trinity Road, Halifax, United Kingdom HX1 2RG. The Directors in office during 2019 are listed in the Directors report and the Company Secretary is Mr P Gittins.

The Company's principal objective is the administration of residential mortgages. In 2008 the Company withdrew from the secured mortgage market and no longer offers new mortgages, other than further drawdowns on existing loans. Also in 2008 the Company entered into a securitisation arrangement with Deva Financing plc, a special purpose entity created for this purpose. The risks and rewards of the securitised assets are substantially retained by the Company and continue to be recognised in the Statement of Financial Position.

The Company is funded entirely by its parent company Bank of Scotland plc which is a subsidiary of Lloyds Banking Group plc.

Review of the business

The results for the year are set out in the Statement of comprehensive income. The Company’s profit before tax for the financial year was £122,904k (2018: £94,972k). The year on year increase is primarily due to release of impairment provisions on the Company's Loans and Advances to Customers due to updated management estimates.

Interest receivable in the year was £205,723k which has decreased from £224,544k in 2018, due to gross loans to customers reducing to £4,352,612k in the year (2018: £4,997,765k) as the mortgage book continues to run off.

The credit to the Statement of comprehensive income for impairment for 2019 is £35,798k compared to £2,796k in 2018. In 2019 the provision has decreased by £47,212k (2018: reduction of £11,888k).

The Company's Mortgage book balance is £4,352,612k (2018: £4,997,765k). It is expected that the book will continue to run off, earning interest income on its remaining customer loans, enabling it to repay all its future liabilities.

Principal risks and uncertainties

The key risks and uncertainties faced by the Company are managed within the framework established for Lloyds Banking Group plc. The main principle of credit risk for the Company is in relation to customer loans. Internal Risk teams continually monitor the loans ensuring compliance and that customers are being treated fairly. Liquidity Risk and Interest rate risk is managed and monitored by Internal Risk teams. The key risks surrounding credit quality, liquidity, markets and operations are set out in note 17.

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. Any sector-specific or wider impact due to this could potentially impact the retail customers of the Lloyds Banking Group plc and as a result have a material adverse effect on the Lloyds Banking Group plc's results of operations, financial condition or prospects.

As a result of the global health issues, the potential for operational risks materialising increases, notably in the areas of cyber, fraud, people, technology, operational resilience and where there is reliance on third-party suppliers. In addition to the key operational risks, new risks are likely to arise as the business will need to change its ways of working whilst managing any site contamination to ensure continuity and support to colleagues and customers.

Key Performance Indicators (KPIs)

The Company’s directors are of the opinion that KPI's are not required and results based on interest receivable and impaired loans relative to the amount of gross loans and advances to customers are sufficient for an understanding of the development, performance and position of the Company. Included in the Strategic report is information as to how the Company’s directors engage with its relevant stakeholders.

Future developments

The Company continues to administer a decreasing mortgage book and there are no current plans to change this in the future.

Employees

The Company has no employees (2018: nil). It uses the services of its immediate parent undertaking for which a management fee, included in administrative expenses, is made.

Section 172(1) Statement

In accordance with the Companies Act 2006 (the 'Act'), 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 to promote the success of the Company under section 172.

Strategic Report (continued)

For the year ended 31 December 2019

Statement of Engagement with Employees and Other Stakeholders

In accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the following statement also provides details on how the Directors have engaged with, and had regard to, the interest of key stakeholders only as the Company has no direct employees. The Company is a subsidiary of Lloyds Banking Group plc, and as such follows many of the processes and practices of Lloyds Banking Group plc, which are further referred to in this statement where relevant.

Customers

The Directors' ensure the Company, as part of Lloyds Banking Group plc, works toward achieving Lloyds Banking Group plc's customer ambitions and focusing on treating customers fairly. The Directors have also worked to agree customer plans, regularly reviewing customer behaviour, customer pricing and repayment of customer loans, to understand areas where improvements can be made. Lloyds Banking Group plc regularly benchmarks amongst its customers the performance of itself and its subsidiaries, and uses this insight along with a range of internal and external research to ensure ongoing improvement in customer experience.

Shareholders

The Company is a wholly owned subsidiary of Lloyds Banking Group plc, forming part of Lloyds Banking Group plc's retail division. As a wholly owned subsidiary, the Directors ensure that the strategy, priorities, processes and practices of the Company are fully aligned where required to those of Lloyds Banking Group plc, ensuring that the interests of Lloyds Banking Group plc as the Company's sole shareholder are duly acknowledged. Further information in respect of the relationship of Lloyds Banking Group plc with its shareholders is included within the Strategic Report within the Lloyds Banking Group plc Annual Report and Accounts for 2019, which does not form part of this report, available on the Lloyds Banking Group plc website.

Communities and the Environment

Due to its limited physical presence, the Company has a minimal direct impact on the community and the environment, it does however continue to support Lloyds Banking Group plc's related initiatives, including Helping Britain Prosper by actively managing its current mortgage book. Further information in respect of Lloyds Banking Group plc's overall approach to engaging with and contributing to the communities in which it operates is included within the Strategic Report within the Lloyds Banking Group plc's Annual Report and Accounts for 2019, which does not form part of this report. Additional information on Lloyds Banking Group plc's Helping Britain Prosper Plan is available on the Lloyds Banking Group plc website.

Regulators

The Company provides quarterly updates on its current status to relevant regulators including disclosures on its loan profile and capital position (see note 17.6). During 2019 the Company's directors had meetings with the regulators, representing the interests of Lloyds Banking Group plc and its subsidiaries as required. The status of regulatory relationships continue to be closely monitored, enhancing proactive engagement across key regulatory changes and areas of focus. The approach of Lloyds Banking Group plc, including that of the Company, to managing regulatory change is detailed further on page 11 of the Lloyds Banking Group plc Annual Report and Accounts for 2019, which does not form part of this report, available on the Lloyds Banking Group plc website.

How stakeholder interest has influenced decision making

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 Lloyds Banking Group plc, is to effectively manage its remaining customer base to generate 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.

On this basis, during 2019, the TMB Board made a number of changes, firstly in its directors, to enable better reflection on stakeholder feedback, due to their wider backgrounds and experience in the group and secondly, the implementation of the SMCR 3 regime to increase financial control and more transparent reporting.

Emerging Risks

Transition from IBOR to Alternative Risk Free Reference rates: Widely used benchmark rates such as the London Interbank Offered Rate (LIBOR) have been subject to increasing regulatory scrutiny, with regulators signalling the need to use alternative benchmark rates. As a result, existing benchmark rates may be discontinued or the basis on which they are calculated may change. The Company currently has libor linked loans. The alternative method will change the way that the loans are priced but any changes are not thought to be material.

General

The directors do not consider there to be any further material issues which need to be included in the strategic report.

Approved by the board of directors and signed on its behalf by:

I Santos Perez
Director

29 May 2020

Directors' report

For the year ended 31 December 2019

The directors present their report and the audited financial statements for the Company for the year ended 31 December 2019. The Company is a subsidiary of Lloyds Banking Group plc.

Dividends

No dividend was paid by the Company in 2019 (2018 £100m).

Directors

The directors of the Company who were in office during the year are shown below:

RW Fletcher
C Gowland
SJ Noakes (Chairman)
J Singh
I Santos Perez
JRC Von Schmidt Auf Altenstadt

The following changes have taken place between the beginning of the reporting year and the approval of the Annual report and financial statements:

SJ Noakes (Chairman)	(appointed 9 December 2019)
I Santos Perez	(appointed 9 December 2019)
JRC Von Schmidt Auf Altenstadt	(resigned 22 November 2019)

Directors' indemnities

Lloyds Banking Group plc 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 the director who joined the board of the Company during the financial year. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this deed of indemnity during that period of service. The indemnity remains in force for the duration of a 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 Lloyds Banking Group plc. In addition, Lloyds Banking Group plc has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

Statement of directors' responsibilities

The directors are responsible for preparing the 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.

Directors' confirmations

In the case of each director in office at the date the Directors' Report is approved:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Directors' report (continued)

For the year ended 31 December 2019

Statement on going concern

In context of the Covid-19 pandemic and the potential adverse impact on the Company. The Directors are satisfied that the financial statements have been prepared on a going concern basis taking into account the following;

- The current LTV profile of its customer loans provides significant mitigation against the effects of an adverse credit environment.
- There is no expectation that its parent, Bank of Scotland plc, will request a repayment in advance of the Company's ability to pay.
- Lloyds Banking Group plc will honour the current letter of support to its subsidiaries (including the Company) dated 19th February 2020.

Statement of Engagement with Employees and Other Stakeholders

A statement of Engagement with Employees and other Stakeholders is included in the Strategic report page 2.

Approach to Corporate Governance

In accordance with the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018) (the ‘Regulations’), for the year ended 31 December 2019, the Company has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the ‘Principles’). The following section explains the Company’s approach to corporate governance, and its application of the Principles.

Principle One – Purpose and Leadership

The Board is collectively responsible for the management of the Company. It achieves this by managing its remaining customer loans within the wider strategy of Lloyds Banking Group plc, and overseeing delivery against it. The Companies strategy is set out further in the strategic report on pages 1 to 2.

Consideration of the needs of its customers is fundamental to the way the Company operates, as is maintaining the highest standards of business conduct. The Company’s approach is further influenced by the need to maintain a culture in which everyone feels included, empowered and inspired to do the right thing for customers. To this end, the Board plays a role in establishing, promoting and monitoring the company’s corporate culture and values, aligning to the culture and values of Lloyds Banking Group plc.

Principle Two – Board Composition

The Company is led by a Board comprising a Chairman and Executive Directors, further details of the directors can be found on page 3. The Board considers its composition regularly, and is committed to ensuring it has the right balance of skills and experience. The Board considers that its current size and composition is appropriate to the Company's circumstances. New appointments are made on merit, taking account of the specific skills, experience and knowledge needed to ensure a rounded Board and the benefits each candidate can bring to the Board overall.

Principle Three – Director Responsibilities

The Directors assume ultimate responsibility for the affairs of the Company, and along with senior management are committed to maintaining a robust control framework as the foundation for the delivery of good governance, including the effective management of delegation though related Lloyds Banking Group plc processes. Policies are also in place in relation to potential conflicts of interest which may arise.

The Board does not operate any committees. The Chairman of the Board assumes responsibility with support from the Company Secretary for the provision to each meeting of accurate and timely information.

Principle Four – Opportunity and Risk

Strategic opportunities which may arise are considered in the first instance by the board of Lloyds Banking Group plc. Any opportunity which is specifically relevant to the Company is subsequently considered by the Board.

The Board is responsible for generating sustainable returns for the Company, generating value for its shareholder.

Strong risk management culture is central to the strategy of the Company, which along with a robust risk control framework acts as the foundation for the delivery of effective risk management. The Board agrees the Company’s risk appetite, within the wider risk appetite of Lloyds Banking Group plc, and ensures the Company manages risk effectively through delegation within the management hierarchy. Board level engagement, coupled with the direct involvement of management in risk issues ensures that escalated issues are promptly addressed and remediation plans are initiated where required. The Company’s risk appetite, principles, policies, procedures, controls and reporting are managed in conjunction with those of Lloyds Banking Group plc. The Company's principle risks are detailed further on page 22.

Principle Five – Remuneration

The Company has no direct employees. Therefore principle 5 is not applicable to the Company.

Directors' report (continued)

For the year ended 31 December 2019

Approach to Corporate Governance (continued)

Principle Six – Stakeholders

The Company, as part of Lloyds Banking Group plc, operates under Lloyds Banking Group plc's wider Responsible Business approach. Helping Britain Prosper is central to Lloyds Banking Group plc's responsible business approach and the Company supports this initiative through managing the needs of its customers.

Financial risk management

The key risks surrounding credit, liquidity, markets and operations are set out in note 17.

Future Developments

Future developments are set out in the strategic report on page 1.

Independent Auditors

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

Approved by the board of directors and signed on its behalf by:

I Santos Perez
Director

29 May 2020

Statement of comprehensive income

For the year ended 31 December 2019

	Note	**2019** **£'000**	2018 £'000
Interest income		**205,723**	224,544
Interest expense		**(111,107)**	(122,509)
Net interest income	2	**94,616**	102,035
Fees and commission income		**88**	110
Impairment	4	**35,798**	2,796
Administrative expenses	3	**(7,598)**	(9,969)
Profit before tax	5	**122,904**	94,972
Taxation	7	**(23,928)**	(18,045)
Profit for the year being total comprehensive income		**98,976**	76,927

All profit for the year being total comprehensive income is attributable to continuing operations.

The accompanying notes to the financial statements are an integral part of these financial statements.

Statement of financial position

As at 31 December 2019

	Note	**2019**	2018
		£'000	£'000
ASSETS			
Cash and cash equivalents		**-**	723
Other current assets	9	**2,671,448**	3,151,141
Loans and advances to customers	10	**4,195,270**	4,793,211
Deferred tax asset	13	**3,162**	3,591
Total assets		**6,869,880**	7,948,666
LIABILITIES			
Borrowed funds	11	**6,539,981**	7,720,441
Other current liabilities		**1,919**	1,686
Provision for liabilities and charges	12	**5,625**	9,055
Current tax liability		**23,501**	17,606
Total liabilities		**6,571,026**	7,748,788
EQUITY			
Share capital	14	**10,000**	10,000
Retained profits		**288,854**	189,878
Total equity		**298,854**	199,878
Total equity and liabilities		**6,869,880**	7,948,666

The accompanying notes to the financial statements are an integral part of these financial statements.

The financial statements on pages 6 to 9 were approved by the Board of Directors and signed on its behalf by:

I Santos Perez
Director

29 May 2020

Statement of changes in equity
For the year ended 31 December 2019

	Share capital £'000	Retained profits £'000	Total equity £'000
At 1 January 2018	10,000	212,951	222,951
Profit for the year being total comprehensive income attributable to:			
- Owners of the parent	-	76,927	76,927
Dividend paid to equity holders of the Company	-	(100,000)	(100,000)
At 31 December 2018	**10,000**	**189,878**	**199,878**
At 1 January 2019	**10,000**	**189,878**	**199,878**
Profit for the year being total comprehensive income attributable to:			
- Owners of the parent	-	98,976	98,976
At 31 December 2019	**10,000**	**288,854**	**298,854**

The accompanying notes to the financial statements are an integral part of these financial statements.

Cash flow statement

For the year ended 31 December 2019

	2019 £'000	2018 £'000
Cash flows generated from operating activities		
Profit before tax	**122,904**	94,972
Adjustments for:		
- Interest expense	**111,107**	122,509
- Decrease in Provision for liabilities and charges	**(3,430)**	(12,384)
Changes in operating assets and liabilities:		
- Net decrease in Loans and advances to customers	**597,941**	726,261
- Net increase in Loans and advances to customers - adjustment on adoption of IFRS 9	**-**	(23,092)
- Net (increase) / decrease in Other receivables	**(178)**	1,116
- Net increase / (decrease) in Other current liabilities	**233**	(551)
- Net decrease in Other current liabilities - initial application of IFRS 9	**-**	(72)
Cash generated from operations	**828,577**	908,759
Corporation tax paid	(17,604)	(24,193)
Net cash generated from operating activities	**810,973**	884,566
Cash flows used in financing activities		
Net Repayment of borrowings with Parent undertakings (see note 16)	**(714,723)**	(692,618)
Net Proceeds from borrowings with Other related parties (see note 16)	**14,134**	31,284
Interest expense	**(111,107)**	(122,509)
Dividend paid	**-**	(100,000)
Net cash used in financing activities	**(811,696)**	**(883,843)**
Change in Cash and cash equivalents	**(723)**	723
Cash and cash equivalents at beginning of year	**723**	-
Cash and cash equivalents at end of year	**-**	723

The accompanying notes to the financial statements are an integral part of these financial statements.

Notes to the financial statements

For the year ended 31 December 2019

1. Accounting policies

1.1 Basis of preparation

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied in both years presented, unless otherwise stated.

These financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). IFRS comprise 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 IFRS Interpretations Committee (IFRS IC) and its predecessor body.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, financial assets measured at fair value through other comprehensive income, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts. As stated on page 4, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statement.

Details of IFRS pronouncements which will be relevant to the Company but which were not effective at 31 December 2019 and which have not been applied in preparing these financial statements are given in note 20. No standards have been early adopted.

1.2 Revenue recognition

(1) Net interest income
Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the effective interest method, except for those classified at fair value through profit or loss. The effective interest method is used to calculate the interest income or interest expense recognised over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument to the gross carrying amount of the financial asset (before adjusting for expected credit losses) or to the amortised cost of the financial liability, including early redemption fees, and related penalties, and premiums and discounts that are an integral part of the overall return.

Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account. Interest income from non-credit impaired financial assets is recognised by applying the effective interest rate to the gross carrying amount of the asset; for credit impaired financial assets, the effective interest rate is applied to the net carrying amount after deducting the allowance for expected credit losses.

(2) Fee and commission income and expense
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 obligations. 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 as an adjustment to the effective interest rate for loans expected to be drawn. Incremental costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

1.3 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 the risks and rewards, but has transferred control.

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

Loans and advances to customers at amortised cost

Financial assets include loans and advances to customers. Financial assets 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 method less provision for impairment.

The Company has entered into securitisation and similar transactions to finance certain loans and advances to customers. In cases where the securitisation vehicles are funded by the issue of debt, on terms whereby substantially all the risks and rewards of the portfolio of securitised lending are retained by the Company, these loans and advances continue to be recognised by the Company, together with a corresponding liability for the funding.

Notes to the financial statements (continued)

For the year ended 31 December 2019

1. Accounting policies (continued)

1.3 Financial assets and liabilities (continued)

Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest rate method.

1.4 Dividends paid

Dividends on ordinary shares are recognised through equity in the period in which they are paid.

1.5 Impairment of Financial Assets

The impairment charge in the income statement includes the change in expected credit losses and certain fraud costs. 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 certain loan commitments and financial guarantee contracts. Expected credit losses are calculated as an unbiased and probability-weighted estimate 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, repayments or other mitigants 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 since origination, allowance (or provision) is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3.

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

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. Default is considered to have occurred when there is evidence that the customer is experiencing financial difficulty which is likely to affect significantly the ability to repay the amount due. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. For UK mortgages, the Company uses a backstop of 180 days past due as mortgage exposures more than 90 days past due, but less than 180 days, typically show high cure rates and this aligns with Lloyds Banking Group plc’s risk management practices.

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 credit impaired (for a return to Stage 2). Renegotiation may also lead to the loan and associated allowance being derecognised 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 has been completed, or the status of the account reaches a point where policy dictates that continuing concessions are no longer appropriate.

Notes to the financial statements (continued)
For the year ended 31 December 2019

1. Accounting policies (continued)

1.6 Taxation, including deferred income taxes

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

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

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or 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 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 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.

1.7 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 unless they are remote.

Provision is made for irrevocable undrawn loan commitments if it is probable that the facility will be drawn and result in the recognition of an asset at an amount less than the amount advanced.

1.8 Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements requires management to make judgements, estimates and assumptions 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 upon amounts which differ from those estimates. Estimates, judgements 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. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The significant estimates 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 results and financial position, are as follows:

- Allowance for impairment losses on financial assets (note 1.5); and
- Provisions for customer redress (note 12).

Allowance for impairment losses

At 31 December 2019, the Company carried a provision of £157,342k (2018: £204,554k) in respect to future impairment losses on the current loans and advances.

Determining the amount of provision requires judgement around the probability of default, expected recovery amount and wider long term economic trends. Consequently the continued appropriateness of the underlying assumptions are reviewed on a regular basis against actual experience and adjustments are made to the provisions where appropriate.

Notes to the financial statements (continued)
For the year ended 31 December 2019

1. Accounting policies (continued)

1.8 Critical accounting estimates and judgements in applying accounting policies (continued)

a) 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 expected credit losses (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 1.5 Impairment of financial assets. The Company has rebutted the presumption in IFRS 9 that default occurs no later than when a payment is 90 days past due for UK mortgages. As a result, approximately £86m of UK mortgages were classified as Stage 2 rather than Stage 3 at 31 December 2019. The impact on the Company's ECL allowance was not material.

b) Lifetime of an exposure

The PD of a financial asset is dependent on its 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 significant losses to be observed and for a material proportion of the assets to fully resolve through either closure or write-off.

c) Significant increase in credit risk

Performing assets are classified as either Stage 1 or Stage 2. An ECL allowance equivalent to 12 months expected losses is established against assets in Stage 1; 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 whether there has been a SICR for an asset. A deterioration in the Retail Master Scale (default model that segments customer loans into a number of rating grades, each representing a defined range of default probabilities) of three grades for personal mortgages, 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 risk indicators requires judgement. The use of different trigger points may have a material impact upon the size of the ECL allowance. The Company monitors the effectiveness of SICR criteria on an ongoing basis.

d) Origination PDs

The assessment of whether there has been a significant increase in credit risk is a relative measure, dependent on an 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 used 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 the risk of bias. The use of proxies and simplifications is not considered to materially impact the ECL allowance on transition.

e) Post-model adjustments

Limitations in the Company's impairment models may be identified through its on-going assessment of the models. In these circumstances, judgement is used to make appropriate adjustments to the Company's allowance for impairment losses. These adjustments are generally modelled taking into account the particular attributes of the exposure which have not been adequately captured by the primary impairment model. Expert judgements are made on behalf of the Company by Lloyds Banking Group plc.

At 31 December 2019, significant post-model adjustments included within the allowance for expected credit losses amounted to £52m (2018 £81m). The most significant post model adjustment relates to interest only mortgage accounts, where the impairment model does not fully capture all the relevant aspects of the related credit risk.

Notes to the financial statements (continued)
For the year ended 31 December 2019

1. Accounting policies (continued)

1.8 Critical accounting estimates and judgements in applying accounting policies (continued)

f) Forward looking information

The measurement of expected credit losses is required to reflect an unbiased probability-weighted range of possible future outcomes. In order to do this, Lloyds Banking Group plc has developed an economic model to project a wide range of key impairment drivers using information derived mainly from external sources. These drivers include factors such as the unemployment rate, the house price index, commercial property prices and corporate credit spreads.

The model generated economic scenarios for the six years beyond 2019 are mapped to industry-wide historical loss data by portfolio. Combined losses across portfolios are used to rank the scenarios by severity of loss. Alongside a defined central scenario three further scenarios are generated by averaging a group of individual scenarios around specified points along the loss distribution to reflect the range of outcomes. The central scenario reflects Lloyds Banking Group plc's base case assumptions used for medium-term planning purposes, an upside and a downside scenario are also produced together with a severe downside scenario.

Rare occurrences of adverse economic events can lead to relatively large credit losses which means that typically the most likely outcome is less than the probability-weighted outcome of the range of possible future events. To allow for this a relatively unlikely severe downside scenario is therefore included. At 31 December 2018 and 2019, the base case, upside and downside scenarios each carry a 30 per cent weighting; the severe downside scenario is weighted at 10 per cent.

The choice of alternative scenarios and scenario weights is a combination of quantitative analysis and judgemental assessment to ensure that the full range of possible outcomes and material non linearity of losses are captured. A committee under the chairmanship of the Chief Economist meets quarterly, to review and, if appropriate, recommend changes to the economic scenarios to the Chief Financial Officer and Chief Risk Officer. Findings dealing with all aspects of the expected credit loss calculation are presented to the Group Audit Committee.

The tables below shows the impact on the Company's ECL resulting from a decrease / increase in Loss Given Default for a 10 percentage point (pp) increase / decrease in the UK House Price Index (HPI).

	31 December 2019		31 December 2018	
HPI	10pp Increase	10pp Decrease	10pp Increase	10pp Decrease
ECL impact, £m	(11)	13	(11)	14

The table below shows the impact on the Company's ECL resulting from a decrease / increase for a 1 percentage point (pp) increase / decrease in the UK Unemployment rate.

	31 December 2019		31 December 2018	
UK Unemployment	1pp Increase	1pp Decrease	1pp Increase	1pp Decrease
ECL impact, £m	3	(3)	4	(3)

Redress

At 31 December 2019, the Company carried an overall provision of £5,582k (2018: £8,988k) in respect to customer redress payments in relation to the fees charged on Mortgage accounts and post contract documentation which has been judged non–compliant with the consumer credit act (note 12).

Determining the amount of provision requires judgement on the number of accounts and average cost of redress. Consequently the continued appropriateness of the underlying assumptions are reviewed on a regular basis against actual experience and adjustments are made to the provisions where appropriate.

Notes to the financial statements (continued)

For the year ended 31 December 2019

1.9 Sale and repurchase agreements (including securities lending and borrowing)

Securities sold subject to repurchase agreements continue to be recognised where substantially all of the risks and rewards are retained. Funds received under these arrangements are included in amounts due from parent and amounts due to parent (note 16).

Securities borrowing and lending transactions are typically secured; collateral take the form of securities or cash advanced or received. Securities lent to counter parties are retained on the Statement of financial position. Securities borrowed are not recognised on the Statement of financial position unless they are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability. Cash collateral given or received is treated as a loan or receivable or a customer deposit.

1.10 Deemed loan from Deva Financing plc

Under IFRS, if a transferor retains substantially all the risks and rewards associated with the transferred assets, the transaction is accounted for as a financing transaction, notwithstanding that it is a sale transaction from a legal perspective. The directors of the Company have concluded that the Company has retained substantially all the risks and rewards of the pool of mortgage loans and as a consequence the Company continues to recognise the mortgage loans on its Statement of financial position.

The initial amount of the deemed loan from Deva Financing plc corresponds to the consideration paid by Deva Financing plc for the mortgage loans less the subordinated loan granted by the Company. Deva Financing plc recognises principal and interest cash flows from the underlying pool of mortgage loans only to the extent that it is entitled to retain such cash flows. Additionally, the directors of the Company consider that the subordinated loan does not meet the definition of a liability as Deva Financing plc will repay the subordinated loan to the Company only if it first receives an equivalent amount from the Company.

The deemed loan to the Company from Deva Financing plc is classified within "amounts due to group undertakings". Amount represents the net position of the deemed loan and asset as per IFRS9 which permits the elimination of both the deemed loan and the asset within the Company as a self retained transaction. The initial measurement is at fair value with subsequent measurement being at amortised cost using the effective interest method. The effective interest on the deemed loan is calculated with reference to the interest earned on the beneficial interest in the mortgage portfolio.

1.11 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash held with central banks with a maturity of less than three months.

2. Net interest income

	2019	2018
	£'000	£'000
Interest income		
Interest income from parent (see note 16)	**32,903**	32,350
From loans and advances to customers	**172,820**	192,194
	205,723	224,544
Interest expense		
Interest expense (see note 16)	**(111,107)**	(122,509)
Net interest income	**94,616**	102,035

3. Administrative expenses

	2019	2018
	£'000	£'000
Management fees (see note 16)	**7,929**	6,632
Conduct provisions	**(690)**	3,000
Other operating expenses	**359**	337
	7,598	9,969

Management fees relate to recharges made by Lloyds Banking Group plc in relation to our Group service centres.

See note 12 for details in the movement of provisions during the year.

Notes to the financial statements (continued)
For the year ended 31 December 2019

4. Impairment

31 December 2019

	Stage 1	**Stage 2**	**Stage 3**	**Total**
	£'000	£'000	£'000	**£'000**
Impact of transfers between stages	973	(1,321)	(4,386)	**(4,734)**
Other changes in credit quality	(371)	10,861	8,418	**18,908**
Repayments	631	8,379	12,614	**21,624**
Other items released to income statement	260	19,240	21,032	**40,532**
	1,233	17,919	16,646	**35,798**
In respect of:				
Loans and advances to customers	1,230	17,895	16,649	**35,774**
Loan commitments	3	24	(3)	**24**

31 December 2018

	Stage 1	Stage 2	Stage 3	Total
	£'000	£'000	£'000	£'000
Impact of transfers between stages	(858)	5,461	(20,582)	(15,979)
Other changes in credit quality	23	2,550	3,704	6,277
Repayments	850	8,045	3,603	12,498
Other items released to income statement	873	10,595	7,307	18,775
	15	16,056	(13,275)	2,796
In respect of:				
Loans and advances to customers	21	16,045	(13,275)	2,791
Loan commitments	(6)	11	-	5

5. Profit before tax

The following items have been included in arriving at Profit before tax

	2019	2018
	£'000	£'000
Income		
Fees receivable	**88**	110
Expenses		
Interest payable to related undertakings (see note 16)	**111,107**	122,509
Management fees (see note 16)	**7,929**	6,632
Profit before tax	**122,904**	94,972

Accounting and administration services are provided by a related undertaking and are recharged to the Company as part of Management fees. The auditors remuneration of £50k (2018: £50k) was borne by the parent company, no non-audit services were provided to the Company by the auditors.

6. Directors' emoluments

No director received any fees or emoluments from the Company during the year (2018: £nil). The directors are employed by other companies within Lloyds Banking Group plc and consider that their services to the Company are incidental to their other responsibilities.

Notes to the financial statements (continued)
For the year ended 31 December 2019

7. Taxation

a) Analysis of charge for the year	2019 £'000	2018 £'000
UK corporation tax:		
- Current tax on taxable profit before tax	**23,501**	17,606
- Adjustments in respect of prior years	**(2)**	-
Current tax charge	**23,499**	17,606
UK deferred tax:		
- Origination and reversal of timing differences	**440**	438
- Adjustments in respect of prior years	**(11)**	-
Deferred tax charge	**429**	438
Tax charge	**23,928**	18,045

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

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
Profit before tax	**122,904**	94,972
Tax charge thereon at UK corporation tax rate of 19.00% (2018: 19.00%)	**23,352**	18,045
- Disallowable items	**589**	-
- Adjustments in respect of prior years	**(13)**	-
Tax charge on profit before tax	**23,928**	18,045
Effective rate	19.5%	19.0%

Within the March 2020 budget, the UK government stated its intention to maintain the corporation tax rate at 19 per cent on 1 April 2020. The effect of this proposed rate change on the Company's deferred tax balances has been assessed and is not significant.

8. Dividends

	2019 £'000	2018 £'000
Equity - ordinary		
Interim paid: nil (2018: £10.00) per £1 share	-	100,000
	-	100,000

9. Other current assets

	2019 £'000	2018 £'000
Amounts due from group undertakings (see note 16)	**2,671,270**	3,151,141
Other debtors	**178**	-
	2,671,448	3,151,141

Notes to the financial statements (continued)

For the year ended 31 December 2019

10. Loans and advances to customers

10.1 Loans and advances to customers maturity

	2019 £'000	2018 £'000
Gross loans and advances to customers	**4,352,612**	4,997,765
Less: Impairment provision	**(157,342)**	(204,554)
Net loans and advances to customers	**4,195,270**	4,793,211
of which:		
Due within one year	**357,269**	394,613
Due after one year	**3,838,001**	4,398,598
	4,195,270	4,793,211

Included within the "due within one year" maturity bucket there is £212.1m in relation to past term customers. On average these customers have a loan to value of <70%. The accounts are actively managed and controlled within an agreed framework by the divisional risk teams.

10.2 Loans and advances to customers movement over time

	Loans and advances to customers			
	Stage 1 £'000	**Stage 2** £'000	**Stage 3** £'000	**Total £'000**
Balance at 1 January 2019	**3,279,201**	**1,241,987**	**476,577**	**4,997,765**
Transfers to Stage 1	208,194	(207,750)	(444)	-
Transfers to Stage 2	(219,612)	305,069	(85,457)	-
Transfers to Stage 3	(20,273)	(95,728)	116,001	-
Decrease in loans and advances to customers	(385,289)	(133,021)	(111,407)	(629,717)
Recoveries	-	-	1,741	1,741
Financial assets that have been written off during the year	-	-	(17,177)	(17,177)
As at 31 December 2019	**2,862,221**	**1,110,557**	**379,834**	**4,352,612**
Allowance for impairment losses	**(1,183)**	**(66,139)**	**(90,020)**	**(157,342)**
Total loans and advances to customers	**2,861,038**	**1,044,418**	**289,814**	**4,195,270**

	Loans and advances to customers			
	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Balance at 1 January 2018	3,648,310	1,563,429	501,083	5,712,822
Transfers to Stage 1	309,133	(308,994)	(139)	-
Transfers to Stage 2	(209,788)	299,495	(89,707)	-
Transfers to Stage 3	(19,575)	(129,780)	149,355	-
(Decrease) in loans and advances to customers	(448,879)	(182,163)	(67,968)	(699,010)
Financial assets that have been written off during the year	-	-	(16,047)	(16,047)
As at 31 December 2018	3,279,201	1,241,987	476,577	4,997,765
Allowance for impairment losses	(2,411)	(84,034)	(118,109)	(204,554)
Total loans and advances to customers	3,276,790	1,157,953	358,468	4,793,211

Notes to the financial statements (continued)
For the year ended 31 December 2019

10.3 Securitisation transactions

Loans and advances to customers include residential mortgage balances that have been securitised but not derecognised, the carrying values of which are set out below together with any related liabilities. These mortgage loans are not derecognised because the Company has retained substantially all of the risk of any default in respect of them.

At the year end £2,492,209k of assets were subject to repurchase agreements (2018: £2,895,656k).

Securitisation	Type of Loan	**Gross assets securitised 2019 £'000**	**Notes in issue 2019 £'000**	Gross assets securitised 2018 £'000	Notes in issue 2018 £'000
Deva Financing plc	UK Residential Mortgages	**2,457,193**	**2,492,209**	2,841,019	2,895,656

In keeping with normal market practice, the Company enters into securities lending transactions and repurchase agreements, whereby cash and securities are temporarily received or transferred as collateral. Where the securities sold subject to repurchase or pledged as collateral are retained on the Statement of financial position the funds received under these arrangements are recognised as liabilities.

11. Borrowed funds

	2019 £'000	2018 £'000
Amounts due to group undertakings (see note 16)	**6,539,981**	7,720,441

12. Provision for liabilities and charges

	Conduct £'000	**Commitments £'000**	**Total £'000**
At 1 January 2018	21,439	72	21,511
Charge for the year	3,000	-	3,000
Utilised during the year	(15,451)	(5)	(15,456)
At 31 December 2018	8,988	67	9,055
Release for the year	(690)	-	(690)
Utilised during the year	(2,716)	(24)	(2,740)
At 31 December 2019	**5,582**	**43**	**5,625**

As at 31 December 2019, two main conduct provisions are being held totalling £5,582k (2018: £8,988k). One provision of £5,566k (2018: £7,142k) is being held in respect of repayments of fees applicable to mortgage accounts. The second provision of £16k (2018: £790k) relates to a small number of other conduct and redress matters which are individually immaterial. The provision held in 2018 (£1,056k) relating to the issuance of post contract documentation that had been judged not compliant with the Consumer Credit Act has now closed and all redress amounts have been settled. The combined provision represents an estimate of the likely future outflows to settle claims against the Company and the costs associated with processing these claims.

A provision for commitments of £43k (2018: £67k) is held in cases where the Company is contractually obligated to advance additional funds.

Notes to the financial statements (continued)

For the year ended 31 December 2019

13. Deferred tax asset

The movement in the Deferred tax asset is as follows:	**2019 £'000**	2018 £'000
Balance at 1 January	3,591	4,029
Charge for the year	(440)	(438)
- Adjustments in respect of prior years	11	-
Balance at 31 December	**3,162**	3,591

Deferred tax charge	**2019** £'000	2018 £'000
Other temporary differences	(429)	(438)
	(429)	**(438)**

Deferred tax assets comprises:	**2019 £'000**	2018 £'000
Other temporary differences	3,162	3,591
	3,162	3,591

14. Share capital

	2019 £'000	2018 £'000
Allotted, issued and fully paid		
10,000,000 (2018: 10,000,000) ordinary shares of £1 each	**10,000**	10,000

Ordinary shares carry one vote each.

15. Transfer of Financial Assets

The Company enters into repurchase and securities lending transactions in the normal course of business that do not result in derecognition of the financial assets concerned. In all cases the transferee has the right to sell or repledge the assets concerned to the transferor.

As set out within note 10, included within loans and advances to customers are loans securitised under Lloyds Banking Group plc's securitisation programmes. The Company retains substantially all of the risks and rewards associated with these loans and they are retained on the Company's Statement of financial position. Assets transferred into the securitisation programmes are not available to be used by the Company during the term of those arrangements.

The table below sets out the details of the repurchase agreements in place. For securitisation programmes, the associated liabilities represent the external notes in issue.

		Carrying value of transferred assets £'000	Carrying value of associated liabilities £'000
Loans notes subject to repurchase	At 31 December 2019	2,492,209	2,492,209
Loans notes subject to repurchase	At 31 December 2018	2,895,656	2,895,656

Notes to the financial statements (continued)

For the year ended 31 December 2019

16. Related party transactions

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity. The Company's key management personnel are its directors, who consider that their duties in respect of the Company are incidental to their Group responsibilities. No director entered into transactions with the Company in the year (2018: none).

As disclosed below, a management recharge is made by the immediate parent company to cover the costs of administration and other services provided to the Company. The auditors' remuneration of £50k (2018: £50k) was borne by the parent company.

Banking transactions are entered into by the Company with Lloyds Banking Group plc and its subsidiaries in the normal course of business and on normal commercial terms.

Included in the "Amounts due from group undertakings" is £2,492,209k relating to the DEVA securitisation programme which nets off against liabilities within the Company's balance sheet.

In addition to the above there is £58,847k held with the Company's parent in relation to customer loan repayments. This balance is settled on a monthly basis.

No intercompany balances are secured and no provision for doubtful debt is provided in the accounts for 2019.

A summary of the outstanding balances at the year end and the related income and expense for the year is set out below.

	2019	2018
	£'000	£'000
Amounts due from group undertakings		
Amounts due from parent	**2,555,718**	3,022,291
Amounts due from other related parties	**115,552**	128,850
Total Amounts due from group undertakings (see note 9)	**2,671,270**	3,151,141
Amounts due to group undertakings		
Amounts due to parent	**6,539,145**	7,720,441
Amounts due to other related parties	**836**	-
Total Amounts due to group undertakings	**6,539,981**	7,720,441

Net repayment of borrowings with parent undertaking £714,723k (2018: £692,618k).

Interest on the deposit and the repurchase liability with Bank of Scotland plc is charged at 3 month Libor plus fixed margin.

For amounts owed by Deva Financing plc, the effective interest on this deemed loan is calculated with reference to the interest earned on the beneficial interest in the mortgage portfolio. No interest is charged on amounts owed to Deva Financing plc although a notional interest is payable representing fees and charges.

Interest on term funding balances owed to Bank of Scotland plc is charged at 3 month rolling average Libor plus an internal liquidity transfer pricing rate and is repayable on demand.

Interest payable in relation to the call account owed to Bank of Scotland is charged at BBR (2019 0.75%) plus 10 basis points.

Notes to the financial statements (continued)

For the year ended 31 December 2019

16. Related party transactions (continued)

	2019 £'000	2018 £'000
Interest income		
Interest income from parent	**32,903**	32,350
Total Interest income (see note 2)	**32,903**	32,350
Interest expense		
Interest expense with parent	**111,107**	122,509
Total Interest expense (see note 2)	**111,107**	122,509

	2019 £'000	2018 £'000
Management fees		
Management recharge from Lloyds Banking Group plc	**7,929**	6,632
Total Management fees (see note 3)	**7,929**	6,632

17. Financial risk management

The Company's operations expose it to credit risk, liquidity risk, interest rate risk, market risk, and business risk; it is not exposed to any significant foreign exchange risk. Responsibility for the control of overall risk lies with the board of directors, operating within a management framework established by the immediate parent company, Bank of Scotland plc, and the ultimate parent, Lloyds Banking Group plc. Interest rate hedges are used to mitigate interest rate risk relating to a proportion of the Company's intercompany borrowings. The remaining interest rate and liquidity risk faced by the Company is in substance managed and borne by other group undertakings which fund the Company and credit risk is carefully monitored by Retail Finance's credit committee and credit functions. Business risk is managed through regular reporting and oversight.

A description of the Company's financial assets/liabilities and associated accounting is provided in note 1.

17.1 Credit risk

Credit risk management

The Company's credit risk exposure arises in the UK.

The maximum credit risk exposure of the Company in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the Statement of financial position carrying amount for loans and advances to customers and commitments.

	As at 31st December 2019		As at 31st December 2018	
	Maximum Exposure £'000	Net Exposure £'000	Maximum Exposure £'000	Net Exposure £'000
Loans & advances to customers, net (1)	**4,195,270**	**4,195,270**	**4,793,211**	**4,793,211**
Off balance sheet items				
Irrevocable commitments and guarantees	**128,552**	**128,552**	**135,757**	**135,757**
	4,323,822	**4,323,822**	**4,928,968**	**4,928,968**

(1) Amounts shown net of impairment balances

Classifications of lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models. Good quality lending includes the lower assessed default probabilities and all loans with low expected losses in the event of default, with other categories reflecting progressively higher risks and lower expected recoveries.

Notes to the financial statements (continued)

For the year ended 31 December 2019

17. Financial risk management (continued)

17.1 Credit risk (continued)

At 31 December 2019		Gross loans and advances to customers - Loan Quality			
		Stage 1	**Stage 2**	**Stage 3**	**Total**
		£'000	£'000	£'000	**£'000**
RMS 1-6	0.00-4.50%	2,856,020	768,144	-	**3,624,164**
RMS 7-9	4.51-14.00%	6,201	193,155	-	**199,356**
RMS 10	14.01-20.00%	-	52,712	-	**52,712**
RMS 11-13	20.01-99.99%	-	96,546	-	**96,546**
RMS 14	100%	-	-	379,834	**379,834**
Total		2,862,221	1,110,557	379,834	**4,352,612**

At 31 December 2018		Gross loans and advances to customers - Loan Quality			
		Stage 1	**Stage 2**	**Stage 3**	**Total**
		£'000	£'000	£'000	**£'000**
RMS 1-6	0.00-4.50%	3,257,527	884,726	-	**4,142,253**
RMS 7-9	4.51-14.00%	21,540	190,383	-	**211,923**
RMS 10	14.01-20.00%	134	41,190	-	**41,324**
RMS 11-13	20.01-99.99%	-	125,688	-	**125,688**
RMS 14	100%	-	-	476,577	**476,577**
Total		3,279,201	1,241,987	476,577	**4,997,765**

Loan Commitments	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
	£'000	£'000	£'000	**£'000**
At 31 December 2019	116,032	11,271	1,249	**128,552**
At 31 December 2018	121,443	12,722	1,592	**135,757**

The principle sources of credit risk for the Company arise from Loan and Advances to customers. Credit risk arises both from amounts advanced and commitments to extend credit to a customer.

The risk division sets out the credit principles, credit risk policies and credit risk appetite statements. These are subject to regular review and governance, with any changes subject to an approval process. Risk teams monitor credit performance trends, review and challenge exceptions, and test the adequacy and adherence to credit risk policies and processes.

The criteria used to determine that there is objective evidence of an impairment is disclosed in note 1.5. All Loans and advances to customers are assessed for impairment. No amounts due to group undertakings are impaired (2018: £nil).

Notes to the financial statements (continued)
For the year ended 31 December 2019

17. Financial risk management (continued)

17.1 Credit risk (continued)

Allowance for impairment losses by Stage

In respect of drawn balances at 31 December 2019	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 January 2019	2,411	84,034	118,109	**204,554**
Transfers to Stage 1	5,403	(5,380)	(23)	**-**
Transfers to Stage 2	(956)	15,566	(14,610)	**-**
Transfers to Stage 3	(462)	(12,986)	13,448	**-**
Impact of transfers between stages	(4,958)	4,132	5,567	**4,741**
	(973)	1,332	4,382	**4,741**
Other items credited to income statement	(257)	(19,227)	(21,031)	**(40,515)**
Credit to the income statement (note 4)	(1,230)	(17,895)	(16,649)	**(35,774)**
Advances written off			(17,177)	**(17,177)**
Recoveries			1,741	**1,741**
Discount unwind			3,998	**3,998**
At 31 December 2019	**1,181**	**66,139**	**90,022**	**157,342**

In respect of undrawn balances at 31 December 2019	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 January 2019	18	48	1	**67**
Transfers to Stage 1	15	(15)	-	**-**
Transfers to Stage 2	(1)	1	-	**-**
Transfers to Stage 3	(1)	(2)	3	**-**
Impact of transfers between stages	(13)	5	1	**(7)**
	-	(11)	4	**(7)**
Other items charged to income statement	(3)	(13)	(1)	**(17)**
Release to the income statement (note 4)	(3)	(24)	3	**(24)**
At 31 December 2019	**15**	**24**	**4**	**43**

Notes to the financial statements (continued)

For the year ended 31 December 2019

17. Financial risk management (continued)

17.1 Credit risk (continued)

Allowance for impairment losses by Stage

In respect of drawn balances at 31 December 2018

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Balance at 1 January 2018	2,432	100,079	113,931	**216,442**
Transfers to Stage 1	6,371	(6,348)	(23)	**-**
Transfers to Stage 2	(423)	12,684	(12,261)	**-**
Transfers to Stage 3	(332)	(17,178)	17,510	**-**
Impact of transfers between stages	(4,762)	5,388	15,355	**15,981**
	854	(5,454)	20,581	**15,981**
Other items credited to income statement	(875)	(10,591)	(7,306)	**(18,772)**
Credit to the income statement (note 4)	(21)	(16,045)	13,275	**(2,791)**
Advances written off			(16,047)	**(16,047)**
Recoveries			2,894	**2,894**
Discount unwind			3,933	**3,933**
Other			123	**123**
At 31 December 2018	**2,411**	**84,034**	**118,109**	**204,554**

In respect of undrawn balances at 31 December 2018

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Balance at 1 January 2018	12	59	1	72
Transfers to Stage 1	9	(9)	-	-
Transfers to Stage 2	-	2	(2)	-
Transfers to Stage 3	-	(4)	4	-
Impact of transfers between stages	(5)	4	(1)	(2)
	4	(7)	1	(2)
Other items charged to income statement	2	(4)	(1)	(3)
Release to the income statement (note 4)	6	(11)	-	(5)
At 31 December 2018	18	48	1	67

17. Financial risk management (continued)

17.1 Credit risk (continued)

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, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations.

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	**Total £'000**
Less than 70%	2,144,425	745,740	181,631	**3,071,796**
70% to 80%	500,462	197,870	64,623	**762,955**
80% to 90%	122,986	78,160	42,282	**243,428**
90% to 100%	33,167	22,602	26,948	**82,717**
Greater than 100%	61,181	66,185	64,350	**191,716**
At 31 December 2019	2,862,221	1,110,557	379,834	**4,352,612**

	Total £'000
Less than 70%	3,370,716
70% to 80%	842,281
80% to 90%	436,466
90% to 100%	127,497
Greater than 100%	220,805
At 31 December 2018	4,997,765

Repossessed collateral

During 2019, the Company obtained assets with a carrying value of £43,909k (2018: £28,728k) as a result of the enforcement of collateral held as security. The Company does not take physical possession of any collateral; instead it uses agents to realise the collateral's value as soon as practicable, usually at auction, to settle indebtedness. Any surplus funds are then returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

17.2 Liquidity risk

The Company is deemed to have low exposure to the risk of being unable to meet its financial obligations as they fall due or only being able to do so at an unacceptably high cost. This is because the Company is funded by companies within Lloyds Banking Group plc and, as a result, liquidity risk is managed within the Group.

Lloyds Banking Group plc manages and monitors liquidity risks and ensures that liquidity risk management systems and arrangements are adequate with regards to the internal risk appetite, strategy and regulatory requirements. Liquidity policies and procedures are subject to independent internal oversight by Risk. The Company ensures it is compliant with these requirements, policies and procedures.

The liquidity table on the following page is a contractual maturity analysis for all financial liabilities, based on the earliest date the entity could be expected to repay the amounts owed.

Notes to the financial statements (continued)

For the year ended 31 December 2019

17. Financial risk management (continued)

17.2 Liquidity risk (continued)

As at 31 December 2019

	Less than 1 month £'000	1-12 months £'000	1-5 years £'000	>5 years £'000	**Total £'000**
Borrowed funds	4,339,981	200,000	2,000,000	-	**6,539,981**
Contractual interest payments	-	2,371	130,809	-	**133,180**

As at 31 December 2018

	Less than 1 month £'000	1-12 months £'000	1-5 years £'000	>5 years £'000	**Total £'000**
Borrowed funds	4,520,441	800,000	2,400,000	-	7,720,441
Contractual interest payments	12,400	4,740	200,666	-	217,806

All other funding is repayable on demand, although there is no expectation that such a demand would be made. All other financial liabilities are repayable on demand.

17.3 Interest rate risk

Interest rate risk is the risk of financial loss as a result of adverse movements in interest rates, and arises largely because of timing differences between the repricing of financial assets and liabilities. Interest rate risk is managed at a divisional level, however the Company is exposed to interest rate fluctuations due to factors outside the Company, and as a result a sensitivity analysis has been prepared to illustrate the impact of a change in the rates.

A sensitivity analysis has been performed as at 31 December 2019 to assess the impact on interest margins being 50 basis points higher or lower with all other variables held constant. The Company has taken a prudent approach to this analysis by assuming that any basis point movement would be completely reflected in all variable products. The net effect on the Company's Statement of comprehensive income would be as shown in the following table:

	-50bps £'000	Profit before taxation £'000	+50 bps £'000
2019	99,528	122,904	146,280
2018	68,196	94,972	121,748

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates the years in which they contractually mature:

2019	Less than 1 year £'000	Between 1-2 years £'000	Between 2-5 years £'000	5 years or more £'000	**Total £'000**
Loans and advances to customers	357,269	171,497	657,779	3,008,725	**4,195,270**
Interest-bearing loans and borrowings	4,539,981	400,000	1,600,000	-	**6,539,981**

2018	Less than 1 year £'000	Between 1-2 years £'000	Between 2-5 years £'000	5 years or more £'000	**Total £'000**
Loans and advances to customers	394,613	142,440	737,726	3,518,432	**4,793,211**
Interest-bearing loans and borrowings	5,320,441	400,000	2,000,000	-	**7,720,441**

Notes to the financial statements (continued)

For the year ended 31 December 2019

17. Financial risk management (continued)

17.4 Fair values of financial assets and liabilities

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

The Company has provided loans and advances to customers on fixed, tracker and variable rate bases. The carrying value of the variable rate loans is assumed to be their fair value. For fixed and tracker rate lending, fair value is estimated by discounting anticipated cash-flows (based on contractual interest rates / capital repayments and current experienced level of prepayments) at a market rate (current quarter pricing of buy to let products) offered by the Company.

As at 31 December 2019, the carrying amount of loans and advances to customers is £4,195,270k (2018: £4,793,211k) and a fair value £4,276,138k (2018: £4,824,967k). The fair value is classified as level 3 due to significant unobservable inputs used in the valuation models.

The fair value of all other financial assets and liabilities, which comprise amounts due to and due from related party undertakings, are equal to their carrying value and classified as level 2 in the fair value hierarchy.

17.5 Financial assets and liabilities available for offsetting

Within the loans and advances and amounts owed to group companies in note 16, all current asset and current liability amounts are shown gross. Amounts available for offsetting in accordance with IAS32 are offset within these financial statements.

17.6 Capital disclosures

The managed capital of the Company constitutes total equity. This consists entirely of issued ordinary share capital and retained profits. As at 31 December 2019, total managed capital was £298,854k (2018: £199,878k).

The Company is authorised and regulated by the Financial Conduct Authority (‘FCA’) and is subject to the FCA’s capital resource requirements as set out by the FCA. Capital is actively managed at an appropriate level of frequency and regulatory capital levels are a key factor in the Company’s budgeting and planning processes.

All FCA capital requirements imposed on the Company during the year were met.

On a quarterly basis it is assessed whether:

- Equity is in excess of capital requirements stated under MIPRU regulations;
- Equity has exceeded capital requirements throughout 2019; and
- Lloyds Banking Group plc will continue to support the Company in the event of a loss.

18. Contingent liabilities

18.1 Contingent tax liability

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 £27,518k (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.

18.2 Contingent liabilities

During the ordinary course of business the Company is subject to complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the United Kingdom and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Company incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management’s best estimate of the amount required at the relevant Statement of financial position date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed to properly assess the situation, and no provisions are held in relation to such matters.

Notes to the financial statements (continued)

For the year ended 31 December 2019

19. Events since the balance sheet 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. The Directors assess this event to be a non-adjusting post balance sheet event. In view of its currently evolving nature, the Directors continue to monitor the environment closely and based on emerging signals known at the time, the impairment provision for the Company was increased by £12m in March 2020.

20. Future Accounting Developments

The following pronouncements are not applicable for the year ending 31 December 2019 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.

With the exception of certain minor amendments, as at date 29 May 2020 these pronouncement have been endorsed by the European Union.

Pronouncement	Nature of change
Minor amendments to accounting standard	The IASB has issued a number of minor amendments to IFRSs effective 1 January 2020 (including IFRS 3 Business Combinations and IAS 1 Presentation of Financial Statements). These amendments are not expected to have a significant impact on the Group.

21. Ultimate parent undertaking

The immediate parent company is Bank of Scotland plc.

The parent undertaking, which is the parent undertaking of the smallest group to consolidate these financial statements is Bank of Scotland plc. This company is incorporated in Scotland. Copies of the consolidated annual report and accounts of Bank of Scotland plc may be obtained from Lloyds Banking Group plc's head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

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

Independent auditors' report to the members of The Mortgage Business Public Limited Company

Report on the audit of the financial statements

Opinion

In our opinion, The Mortgage Business Public Limited Company'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 profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Accounts (the "Annual Report"), which comprise: the Statement of financial position as at 31 December 2019; the Statement of comprehensive income, the Cash flow statement, 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 set out on page 3, 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.

Ian Godsmark (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
29 May 2020