The Mortgage Business Public Limited Company

Annual report and Financial Statements

2021

Member of Lloyds Banking Group

Strategic report
For the year ended 31 December 2021

The directors present their Strategic report and audited financial statements of The Mortgage Business Public Limited Company (the "Company") for the year ended 31 December 2021.

Business overview

The Company is a public limited company incorporated and domiciled in the United Kingdom (registered number: 01997277). The registered office for the Company is Trinity Road, Halifax, United Kingdom HX1 2RG. The Directors in office during 2021 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. From 2008 to 19th May 2021 the Company entered into a securitisation arrangement with Deva Financing plc, a special purpose entity created for this purpose. During this time the risks and rewards of the securitised assets were substantially retained by the Company. In May 2021 the Company withdrew from the securitisation arrangement, its sources of funding now being customer repayments and term funding deals arranged by Group Corporate Treasury division of Lloyds Banking Group plc (the "Group").

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 £106,689k (2020: £30,856k). The year on year increase is primarily due to reductions in impairment provisions on the Company's Loans and Advances to Customers driven by an improvement in economic outlook and strong underlying performance.

Interest income in the year was £112,220k which has decreased from £151,717k in 2020, due to net loans to customers reducing to £3,189,237k from £3,694,627k in 2020.

The credit to the Statement of comprehensive income for impairment for 2021 is £46,383k compared to a debit of £41,219k in 2020. In 2021 the provision has decreased by £43,095k (2020 an increase of £29,876k) (note 17.1). The decrease is largely driven by the improved economic outlook in 2021.

The Company's Mortgage book balance is £3,333,360k (2020 £3,881,845k). 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.

Post Balance Sheet events

Since the balance sheet date the Directors have recommended a dividend of £120,000k. The aggregate amount of the proposed dividend is expected to be paid in May 2022 out of retained earnings at the 31st December 2021, and not recognised as a liability at year end.

Further information on post balance sheet events is set out in note 19.

Principal risks and uncertainties

Despite a resilient recovery, 2021 has been another year of significant uncertainty, with COVID-19 accelerating broad structural changes, including ways of working and impacts to global and domestic economies. COVID-19 has continued to have a significant impact on all risk types in 2021. Understanding and managing its impacts dynamically has remained a major area of focus. The Group has responded quickly to the challenges faced, putting in place risk mitigation strategies and refining its investment and strategic plans.

The key risks and uncertainties faced by the Company are managed within the framework established for Lloyds Banking Group plc. The three types of risk associated with the Company are credit risk, liquidity risk and interest rate risk.

Credit risk

Credit risk arises on the individual customer balances, both on the Loans and advances to customers and also any undrawn balances for an existing customer. These loans are continually monitored by Lloyds Banking Group's Internal Risk teams for credit performance and to ensure compliance with current regulations and that customers are being treated fairly. Further information can be found included in note 17.1.

Liquidity risk

Liquidity risk is the risk of the Company being unable to meet its financial obligations. Liquidity risk is subject to independent oversight by Internal Risk teams. The Company's ability to meet its funding obligations is closely monitored by the Group's Corporate Treasury team. Further information can be found in note 17.2.

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis, or are reset at different times. Interest rate risk for the Company includes customer lending and intragroup funding obligations. Further information can be found in note 17.3.

Strategic report (continued)
For the year ended 31 December 2021

Russian invasion of Ukraine

The Russian invasion of Ukraine, beginning in February 2022, has increased tensions between members of the North Atlantic Treaty Organisation (NATO) and Russia and caused sanctions to be imposed. This could have significant adverse economic effects on financial markets and on energy costs, and may also result in increased cyber attacks and an increase in costs associated with such cyber attacks, all of which could have a materially adverse effect on the Company's results of operations, financial conditions or prospects. The Company will continue to monitor the situation and risks to the business.

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 closed decreasing mortgage book and there are no current plans to change this in the future.

Employees

The Company has no employees (2020: nil). It uses the services of its immediate parent undertaking for which a cost transfer charge, included in Other operating expenses, is made.

Section 172(1) statement

In accordance with the Companies Act 2006 ("the Act"), for the year ended 31 December 2021, the directors provide the following statement describing how they have had regard to the matters set out in section 172(1) of the Act, when performing their duty to promote the success of the Company under section 172.

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 by focusing on customer fair value and by treating customers fairly.

The Board meets on a regular basis and directors also regularly review customer behaviour, customer pricing and repayment of customer loans, to understand areas where improvements can be made.

Shareholders

The Company is a wholly owned subsidiary of Bank of Scotland 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 ultimate parent company 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 2021 , 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 Recover by actively managing its current book of mortgages. 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 2021, which does not form part of this report. Additional information on Lloyds Banking Group plc's Helping Britain Recover Plan is available on the Lloyds Banking Group plc website.

Strategic report (continued)

For the year ended 31 December 2021

Section 172(1) statement (continued)

Regulators

The Company has continued to provide quarterly updates on its current status to relevant regulators including disclosures on its loan profile and capital position (see note 17.5) and the assessments of the impact of the COVID-19 pandemic on its liquidity position. During 2021, Lloyds Banking Group plc had extensive engagement with the regulators and Government in the initial response to the COVID-19 crisis, this helped ensure the best support for our customers but also remain in step with Government priorities for supporting the stability of the wider UK economy. The approach of Lloyds Banking Group plc, including that of the Company, to manage regulatory change is detailed further in the Lloyds Banking Group plc Annual Report and Accounts for 2021, 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 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.

During 2021 an area of particular focus for the directors has been to steer through the challenges we have faced into as a result of the global pandemic both from an operational and customer perspective, ensuring alignment with guidance from Lloyds Banking Group plc and regulators.

Emerging risks

The directors consider the following to be risks that have the potential to increase in significance and affect the performance of the Company.

The key risks are financial, derived from both physical risks (climate and weather-related events) and transition risks resulting from the process of adjustment towards a low carbon economy. Climate change extends across multiple risk types e.g. credit, market, conduct and operational. For example physical and transition risks could result in the impairment of asset values, which may impact the creditworthiness of our clients, and the products and services our customers require.

The focus on these risks by key stakeholders including businesses, clients, shareholders, governments and regulators is increasing, aligned to the evolving societal, regulatory and political landscape. There also remains a risk that the level and pace of responses taken by Lloyds Banking Group plc are insufficient to mitigate these risks. This could lead to campaign groups or other bodies seeking to take action against Lloyds Banking Group plc or the financial services industry for funding organisations that they deem to be contributing to climate change.

The Company has taken an exemption from Streamlined Energy and Carbon Reporting (SECR), as it does not have to report on SECR in its own Directors' Report where included in the Group SECR statement of a UK Group report. Further information in respect of SECR is included within the Lloyds Banking Group plc Annual Report and Accounts for 2021, which does not form part of this report, available on the Lloyds Banking Group plc website.

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
25th April 2022

Directors' report

For the year ended 31 December 2021

The directors present their report and the audited financial statements for the Company for the year ended 31 December 2021. The Company is a subsidiary of Lloyds Banking Group plc.

Dividends

A dividend of £49,000k was paid by the Company to the parent company in 2021 (2020: £nil).

Directors

The directors of the Company who were in office during the year and up to the date of signing the financial statements are shown below:

SJ Noakes	appointed 9th December 2019
RW Fletcher	appointed 3rd October 2014
C Gowland	appointed 30th October 2015
J Singh	appointed 28th September 2018
I Santos Perez	appointed 9th December 2019

No changes have taken place between the beginning of the reporting year and the approval of the Annual report and financial statements.

Directors' indemnities

Lloyds Banking Group plc has granted to the directors of the Company a deed of indemnity which constitutes '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 deed for existing directors is available for inspection at the registered office of Lloyds Banking Group plc. In addition, the Group has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

Statement of directors' responsibilities

The directors are responsible for preparing the Directors' and Strategic reports and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the company's financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. 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 these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether the financial statements comply with international accounting standards in conformity with the requirements of the Companies Act 2006, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

Auditor and disclosure of information to auditor

In accordance with Section 418 of the Companies Act 2006, in the case of each director in office at the date the 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
- The director has taken all the steps that they ought to have taken as a director in order to make [himself/herself] aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Going concern

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, with the majority of the loan book with an LTV of < 70%.

- The company is in a net asset position and will continue to be able to repay its liabilities as they fall due through its liquid assets and/or its ability to drawdown on further funding as required from its parent, Bank of Scotland plc.

- That it is the intention of Bank of Scotland plc, to continue to provide adequate access to liquidity for the foreseeable future.

Statement of Engagement with Employees and Other Stakeholders

A statement of engagement with employees and other stakeholders is included in the Strategic report on 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 2021, the Company has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the "Principles"), which are available at frc.org.uk. 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 Company's strategy is set out further in the strategic report on pages 1 to 3.

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 4. 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. There has been no change in the Company's board composition during 2021.

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 through 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. An elected director will chair the board meeting and receive 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, as part of Lloyds Banking Group plc board's role in considering such opportunities relevant to itself and its subsidiaries. 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.

Directors' report (continued)
For the year ended 31 December 2021

Approach to Corporate Governance (continued)

Principle Four – Opportunity and Risk (continued)

Strong risk management is central to the strategy of the Company, which along with a robust risk and 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, and as such are regularly reviewed to ensure they remain fully in line with regulations, law, corporate governance and industry best practice. The Company's principal risks are discussed further within note 17.

Principle Five – Remuneration

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

Principle Six – Stakeholders

The Company, as part of Lloyds Banking Group plc, operates under Lloyds Banking Group's wider Responsible Business approach, as overseen by Lloyds Banking Group plc's Responsible Business Committee. Helping Britain Recover is central to Lloyds Banking Group's responsible business approach and the Company supports this initiative through supporting the needs of its customers and colleagues during these uncertain times.

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 2.

Auditors and disclosure of information to auditors

Deloitte LLP are deemed to be re-appointed as auditor 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

25th April 2022

Financial statements

Statement of comprehensive income

For the year ended 31 December 2021

	Note	**2021** £'000	2020 £'000
Interest income		**112,220**	151,717
Interest expense		**(42,294)**	(69,386)
Net interest income	3	**69,926**	82,331
Fee and commission income		**80**	98
Fee and commission expense		**(1)**	(1)
Net fee and commission income		**79**	97
Credit impairment gains / (losses)	4	**46,383**	(41,219)
Other operating expenses	5	**(9,699)**	(10,353)
Profit before tax	2	**106,689**	30,856
Taxation	7	**(19,658)**	(5,656)
Profit for the year being total comprehensive income		**87,031**	25,200

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

Balance sheet
As at 31 December 2021

	Note	**2021**	2020
		£'000	£'000
ASSETS			
Cash and cash equivalents		**25,780**	397,049
Loans and advances to customers	10	**3,189,237**	3,694,627
Other current assets	9	**59,158**	2,362,082
Deferred tax asset	13	**3,301**	3,081
Total assets		**3,277,476**	6,456,839
LIABILITIES			
Borrowed funds and amounts due to group undertakings	11	**2,895,460**	6,126,552
Other current liabilities		**14**	23
Provision for liabilities and charges	12	**43**	635
Current tax liability		**19,874**	5,575
Total liabilities		**2,915,391**	6,132,785
EQUITY			
Share capital	14	**10,000**	10,000
Retained profit		**352,085**	314,054
Total equity		**362,085**	324,054
Total equity and liabilities		**3,277,476**	6,456,839

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

The financial statements on pages 7 to 34 were approved by the board of directors and were signed on its behalf by:

I Santos Perez
Director

25th April 2022

Statement of changes in equity

For the year ended 31 December 2021

	Share capital £'000	Retained earnings £'000	Total equity £'000
At 1 January 2020	10,000	288,854	298,854
Profit for the year being total comprehensive income	—	25,200	25,200
At 31 December 2020	10,000	314,054	324,054
Profit for the year being total comprehensive income	**—**	**87,031**	**87,031**
Dividend paid to parent	**—**	**(49,000)**	**(49,000)**
At 31 December 2021	**10,000**	**352,085**	**362,085**

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

Cash flow statement

For the year ended 31 December 2021

	2021	2020
	£'000	£'000
Cash flows generated from operating activities		
Profit before tax	**106,689**	30,856
Adjustments for:		
- Interest expense	**42,294**	69,386
- Decrease in Provision for liabilities and charges	**(592)**	(4,990)
Changes in operating assets and liabilities:		
- Net decrease in Loans and advances to customers	**505,390**	500,643
- Net decrease / (increase) in Other receivables	**36**	(244)
- Net decrease in Other current liabilities	**(9)**	(1,896)
Cash generated from operations	**653,808**	593,755
Corporation tax paid	**(5,579)**	(23,501)
Net cash generated from operating activities	**648,229**	570,254
Cash flows used in financing activities		
Repayments received on amounts due from Parent undertakings (see note 16)	**2,187,452**	309,496
Repayments made on amounts due to Parent undertakings (see note 16)	**(3,231,978)**	(413,251)
Repayments received on amounts due from Other related parties (see note 16)	**115,436**	114
Repayments received / (made) on amounts due to Other related parties (see note 16)	**886**	(178)
Interest paid	**(42,294)**	(69,386)
Dividend paid	**(49,000)**	—
Net cash used in financing activities	**(1,019,498)**	(173,205)
Change in Cash and cash equivalents	**(371,269)**	397,049
Cash and cash equivalents at beginning of year	**397,049**	—
Cash and cash equivalents at end of year	**25,780**	397,049

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 2021

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.

The financial statements of the Company comply with international accounting standards in conformity with the requirements of the Companies Act 2006. The financial statements have been prepared in accordance with United Kingdom adopted international accounting standards and International Financial Reporting Standards ("IFRSs") as issued by the International Accounting Standards Board ("IASB"). IFRS comprises accounting standards prefixed IFRS issued by IASB and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the IFRS Interpretations Committee and its predecessor body.

The financial information has been prepared under the historical cost convention. As stated on page 5 the Directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements. In reaching this assessment, the Directors have considered the implications of the short-term impacts of the COVID-19 pandemic and climate change upon the Group's performance and projected funding and capital position. The Directors have also taken into account the impact of further stress scenarios.

Details of those pronouncements which will be relevant to the Company but which were not effective at 31 December 2021 and which have not been applied in preparing these financial statements are given in note 20. No standards have been early adopted.

1.2 Income recognition

(1) Net interest income

Interest income and expense are recognised in the income statement using the effective interest method for all interest bearing financial instruments, except for those classified at fair value through profit or loss. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the 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, other fees, 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

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.

Financial assets and liabilities

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

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

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. Accounting policies (continued)

1.4 Impairment of financial assets

(i) Loans and advances to customers

The impairment charge in the income statement includes the change in expected credit losses and certain fraud write-offs and recoveries. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost 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 is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk, allowance (or provision) is made for expected credit losses resulting from all possible default events over the 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 together with qualitative indicators and other indicators of historical delinquency, credit weakness or financial difficulty. 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. The use of a payment holiday in itself has not been judged to indicate a significant increase in credit risk, with the underlying long-term credit risk deemed to be driven by economic conditions and captured through the use of forward-looking models. These portfolio level models are capturing the anticipated volume of increased defaults and therefore an appropriate assessment of staging and expected credit loss. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since initial recognition, 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. Key differences between Stage 3 balances and non-performing loans relate to the use of 180 days past due for Stage 3 mortgages and to the cure periods applied to forbearance exposures. The use of payment holidays is not considered to be an automatic trigger of regulatory default and therefore does not automatically trigger Stage 3. Days past due will also not accumulate on any accounts that have taken a payment holiday including those already past due.

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). On renegotiation the gross carrying amount of the loan is recalculated as the present value of the renegotiated or modified contractual cash flows, which are discounted at the original effective interest rate. 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 credit impairment losses recorded in the Statement of comprehensive income. 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.

1.5 Cash and cash equivalents

For the purposes of the Balance sheet and Cash flow statement, Cash and cash equivalents comprise balances with less than three months' maturity.

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 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.

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. In certain cases where forecast profits are not expected to be sufficient to support the recognition of a deferred tax asset on a standalone entity basis, further consideration has been given to the availability of UK group relief with connected companies to support the recognition.

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 Dividends paid

Dividends on ordinary shares are recognised through equity in the period in which they are paid. The Company paid a dividend of £49m to its parent company, Bank of Scotland plc, during 2021.

1.8 Provision for liabilities and charges

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.

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

Securities sold subject to repurchase agreements are 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). In May 2021 the Company withdrew from the securitisation arrangement.

Securities borrowing and lending transactions are typically secured; collateral takes the form of securities or cash advanced or received. Securities lent to counterparties are retained on the Balance Sheet. Securities borrowed are not recognised on the Balance sheet 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. Accounting policies (continued)

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 was a sale transaction from a legal perspective. The directors of the Company concluded that the Company had retained substantially all the risks and rewards of the pool of mortgage loans and as a consequence the Company continued to recognise the mortgage loans on its Statement of financial position.

The initial amount of the deemed loan from Deva Financing plc corresponded to the consideration paid by Deva Financing plc for the mortgage loans less the subordinated loan granted by the Company. Deva Financing plc recognised principal and interest cash flows from the underlying pool of mortgage loans only to the extent that it was entitled to retain such cash flows. Additionally, the directors of the Company considered that the subordinated loan did not meet the definition of a liability as Deva Financing plc would repay the subordinated loan to the Company only if it first received an equivalent amount from the Company.

The deemed loan to the Company from Deva Financing plc was classified within "amounts due to group undertakings". The amount represented 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 was at fair value with subsequent measurement being at amortised cost using the effective interest method. The effective interest on the deemed loan was calculated with reference to the interest earned on the beneficial interest in the mortgage portfolio. In May 2021 the Company withdrew from the securitisation arrangement and the deemed loan was derecognised as a result.

1.11. 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. In preparing the financial statements, the Group has considered the impact of climate-related risks on its financial position and performance. While the effects of climate change represent a source of uncertainty, the Group does not consider there to be a material impact on its judgements and estimates from the physical, transition and other climate-related risks in the short to medium term

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 Credit impairment losses

At 31 December 2021, the Company carried a provision of £144,123k (2020: £187,218k) in respect to future impairment losses on the current loans and advances.

The calculation of the Company’s expected credit loss ("ECL") allowances and provisions against loans and advances to customers under IFRS 9 requires the Company to make a number of judgements, assumptions and estimates. Key judgements include determining an appropriate definition of default against which a probability of default, exposure at default and loss given default parameter can be evaluated, the appropriate life time of an exposure to credit risk for the assessment of lifetime losses, the use of management judgements alongside impairment modelling processes to adjust inputs, parameters and outputs to reflect risks not captured by models; and key estimates include base case and multiple economic scenarios (“MES”) assumptions, including the rate of unemployment and the rate of change of house prices.

The most significant are set out below:

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 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 1.4 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 £26,914k of UK mortgages were classified as Stage 2 rather than Stage 3 at 31 December 2021. The impact on the Company's ECL allowance was not material.

1. Accounting policies (continued)

1.11. Critical accounting estimates and judgements in applying accounting policies (continued)

b) Lifetime of an exposure

The PD of a financial asset is dependent on its expected life. The Company estimates a product's expected life using the full contractual life and taking into account behavioural factors such as early repayments and refinancing. For Loans and advances to customers, 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. Changes to the assumed expected lives of the Company's assets could have a material effect on the ECL allowance recognised by the Company. The assessment of significant increase in credit risk ("SICR") and corresponding lifetime loss, and the PD, of a financial asset designated as Stage 2, or Stage 3, is dependent on its expected life.

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 SICR since initial recognition. Credit-impaired assets are transferred to Stage 3 with a lifetime expected losses allowance.

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. Financial assets are classified as credit-impaired if they are 180 days past due.

A Stage 2 asset that is no longer credit-impaired is transferred back to Stage 2 as no cure period is applied to Stage 3. If an exposure that is classified as Stage 2 no longer meets the SICR criteria, which in some cases capture customer behaviour in previous periods, it is moved back to stage 1. 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) Generation of multiple economic scenarios

The measurement of expected credit losses is required to reflect an unbiased probability-weighted range of possible future outcomes. In addition to a defined base case, as used for planning, the Company's approach relies on model-generated scenarios, reducing scope for bias in the selection of scenarios and their weightings. The assumptions underpinning the base case scenario reflect the Company's best view of future events. The base case is therefore central to the range of future economic scenarios generated by simulation of an economic model, for which the same conditioning assumptions apply as in the base case scenario.

These scenarios are ranked by using estimated relationships with industry-wide historical loss data. With the base case already pre-defined, the other three scenarios are identified as averages of constituent scenarios located around the 15th, 75th and 95th percentiles of the distribution. The full distribution is summarised by a practical number of scenarios to run through ECL models representing four sections: an upside, the base case, and a downside scenario weighted at 30 per cent each, with a severe downside scenario weighted at 10 per cent. The scenario weights therefore represent the distribution of economic scenarios and not a subjective view on likelihood. The inclusion of a severe downside scenario with a smaller weighting ensures that the non-linearity of losses in the tail of the distribution is adequately captured. No material changes were made to the model in 2021.

e) Base case and MES economic assumptions

The Company's base case economic scenario has been revised in light of the continuing impact of the coronavirus pandemic, intensifying global inflation pressures, and a shift towards a more restrictive stance of monetary policy by central banks. The base case scenario reflects three key conditioning assumptions of coronavirus infections not leading to a re-imposition of lockdown restrictions, the rise in energy prices, and the rise in inflation and subsequently reverting to the Bank of England's 2 per cent inflation target.

Based on these assumptions and incorporating the improved economic data in the fourth quarter, the Company's base case outlook is for a modest rise in the unemployment rate alongside a deceleration in property price growth. Risks around this base case economic view lie in both directions and are partly captured by the generation of alternative economic scenarios described above. But uncertainties relating to the key conditioning assumptions, including epidemiological developments and the efficacy of vaccine rollouts, are not specifically captured by the MES scenarios.

1. Accounting policies (continued)

1.11. Critical accounting estimates and judgements in applying accounting policies (continued)

e) Base case and MES economic assumptions (continued)

The key UK economic assumptions made by the Company averaged over a five-year period are shown below. Gross domestic product is presented as an annual change, house price growth and commercial real estate price growth are presented as the growth in the respective indices within the period. UK Bank Rate and unemployment rate are averages for the period.

At 31 December 2021	2021 %	2022 %	2023 %	2024 %	2025 %	Average %
Upside						
Gross domestic product	**7.1**	**4.0**	**1.4**	**1.3**	**1.4**	**3.0**
UK Bank Rate	**0.14**	**1.44**	**1.74**	**1.82**	**2.03**	**1.43**
Unemployment rate	**4.4**	**3.3**	**3.4**	**3.5**	**3.7**	**3.7**
House price growth	**10.1**	**2.6**	**4.9**	**4.7**	**3.6**	**5.1**
Base case						
Gross domestic product	**7.1**	**3.7**	**1.5**	**1.3**	**1.3**	**2.9**
UK Bank Rate	**0.14**	**0.81**	**1.00**	**1.06**	**1.25**	**0.85**
Unemployment rate	**4.5**	**4.3**	**4.4**	**4.4**	**4.5**	**4.4**
House price growth	**9.8**	**0.0**	**0.0**	**0.5**	**0.7**	**2.1**
Downside						
Gross domestic product	**7.1**	**3.4**	**1.3**	**1.1**	**1.2**	**2.8**
UK Bank Rate	**0.14**	**0.45**	**0.52**	**0.55**	**0.69**	**0.47**
Unemployment rate	**4.7**	**5.6**	**5.9**	**5.8**	**5.7**	**5.6**
House price growth	**9.2**	**(4.9)**	**(7.8)**	**(6.6)**	**(4.7)**	**(3.1)**
Severe Downside						
Gross domestic product	**6.8**	**0.9**	**0.4**	**1.0**	**1.4**	**2.1**
UK Bank Rate	**0.14**	**0.04**	**0.06**	**0.08**	**0.09**	**0.08**
Unemployment rate	**4.9**	**7.7**	**8.5**	**8.1**	**7.6**	**7.3**
House price growth	**9.1**	**(7.3)**	**(13.9)**	**(12.5)**	**(8.4)**	**(6.9)**
Probability-weighted						
Gross domestic product	**7.0**	**3.4**	**1.3**	**1.2**	**1.3**	**2.8**
UK Bank Rate	**0.14**	**0.82**	**0.99**	**1.04**	**1.20**	**0.83**
Unemployment rate	**4.6**	**4.7**	**5.0**	**5.0**	**4.9**	**4.8**
House price growth	**9.6**	**(1.4)**	**(2.3)**	**(1.7)**	**(1.0)**	**0.6**

At 31 December 2020	2021 %	2022 %	2023 %	2024 %	2025 %	Average %
Upside						
Gross domestic product	(10.5)	3.7	5.7	1.7	1.5	0.3
UK Bank Rate	0.10	1.14	1.27	1.20	1.21	0.98
Unemployment rate	4.3	5.4	5.4	5.0	4.5	5.0
House price growth	6.3	(1.4)	5.2	6.0	5.0	4.2
Base case						
Gross domestic product	(10.5)	3.0	6.0	1.7	1.4	0.1
UK Bank Rate	0.10	0.10	0.10	0.21	0.25	0.15
Unemployment rate	4.5	6.8	6.8	6.1	5.5	5.9
House price growth	5.9	(3.8)	0.5	1.5	1.5	1.1
Downside						
Gross domestic product	(10.6)	1.7	5.1	1.4	1.4	(0.4)
UK Bank Rate	0.10	0.06	0.02	0.02	0.03	0.05
Unemployment rate	4.6	7.9	8.4	7.8	7.0	7.1
House price growth	5.6	(8.4)	(6.5)	(4.7)	(3.0)	(3.5)
Severe Downside						
Gross domestic product	(10.8)	0.3	4.8	1.3	1.2	(0.8)
UK Bank Rate	0.10	0.00	0.00	0.01	0.01	0.02
Unemployment rate	4.8	9.9	10.7	9.8	8.7	8.8
House price growth	5.3	(11.1)	(12.5)	(10.7)	(7.6)	(7.5)
Probability-weighted						
Gross domestic product	(10.6)	2.6	5.5	1.6	1.4	(0.1)
UK Bank Rate	0.10	0.39	0.42	0.43	0.45	0.36
Unemployment rate	4.5	7.0	7.3	6.7	6.0	6.3
House price growth	5.9	(5.2)	(1.5)	(0.2)	0.3	(0.2)

1. Accounting policies (continued)

1.11. Critical accounting estimates and judgements in applying accounting policies (continued)

f) ECL sensitivity to economic assumptions

The table below shows the Company's ECL for the upside, base case, downside and severe downside scenarios. The stage allocation for an asset is based on the overall scenario probability-weighted PD and, hence, the staging of assets is constant across all the scenarios. In each economic scenario the ECL for individual assessments and post-model adjustments is constant reflecting the basis on which they are evaluated. Judgements applied through changes to inputs are reflected in the scenario sensitivities. The probability-weighted view shows the extent to which a higher ECL allowance has been recognised to take account of multiple economic scenarios relative to the base case.

	At 31 December 2021					At 31 December 2020				
	Probability -weighted	**Upside**	**Base**	**Downside**	**Severe Downside**	Probability -weighted	Upside	Base	Downside	Severe Downside
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	£'000	£'000	£'000	£'000	£'000
ECL allowance	**144,164**	**126,295**	**134,647**	**155,794**	**191,426**	187,399	149,268	167,435	207,130	302,491

The impact of changes in the UK unemployment rate and House Price Index (HPI) have also been assessed. Although such changes would not be observed in isolation, as economic indicators tend to be correlated in a coherent scenario, this gives insight into the sensitivity of the Company's ECL to gradual changes in these two critical economic factors.

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). The increase / decrease is presented based on the adjustment phased evenly over the first ten quarters of the base case scenario.

	31 December 2021		31 December 2020	
HPI	**10pp Increase**	**10pp Decrease**	10pp Increase	10pp Decrease
ECL impact, £'000	**(6,741)**	**9,714**	(28,000)	38,000

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. The increase / decrease is presented based on the adjustment phased evenly over the first ten quarters of the base case scenario.

	31 December 2021		31 December 2020	
UK unemployment	**1pp Increase**	**1pp Decrease**	1pp Increase	1pp Decrease
ECL impact, £'000	**1,619**	**(1,275)**	3,000	(3,000)

g) Application of judgement in adjustments to modelled ECL

Impairment models fall within the Group's model risk framework with model monitoring, periodic validation and back testing performed on model components (i.e. probability of default, exposure at default and loss given default). Limitations in the Group and TMB's impairment models or data inputs may be identified through the ongoing assessment and validation of the output of the models. In these circumstances, management make appropriate adjustments to the Group and TMB's allowance for impairment losses to ensure that the overall provision adequately reflects all material risks. These adjustments are determined by considering the particular attributes of exposures which have not been adequately captured by the impairment models and range from changes to model inputs and parameters, at account level, through to more qualitative post-model adjustments.

Judgements are not typically assessed under each distinct economic scenario used to generate ECL, but instead are applied on the basis of final modelled ECL which reflects the probability-weighted view of all scenarios. All Group adjustments are reviewed quarterly and are subject to internal review and challenge, including by the Audit Committee, to ensure that amounts are appropriately calculated and that there are specific release criteria identified.

1. Accounting policies (continued)

1.11. Critical accounting estimates and judgements in applying accounting policies (continued)

g) Application of judgement in adjustments to modelled ECL (continued)

These adjustments principally comprise:

*Increase in time to repossession: £7,767k (2020: £4,915k***)**

This reflects an adjustment made to allow for an increase in the time assumed between default and repossession as a result of the Group temporarily suspending the repossession of properties to support customers during the pandemic.

Adjustment to modelled forecast parameters: £7,917k (2020: £35,300k)

Adjustments to the estimated defaults used within the ECL calculation for UK mortgages were introduced in 2020 following the adoption of new default forecast models. Work has progressed through the year to embed the new model, including updates to model design choices through the implementation of formal model changes or through in-model adjustments, which are considered judgemental pending final evaluation and model governance. These remaining in-model adjustments now target a combination of specific enhancements which will continue to be progressed through to model changes. The reduction in the adjustment is also partly due to the improved economic outlook which reduces the impact of adopting the new forecast model.

End-of-term interest-only: £27,056k (2020: £29,279k)

The current definition of default used in the UK mortgages impairment model excludes past term interest-only accounts that continue to make interest payments but have missed their capital payment upon maturity of the loan. This adjustment therefore mitigates the risk that the model understates the credit losses associated with interest-only accounts which have missed, or will potentially miss, their final capital payment. For those accounts that have reached end of term this adjustment manually overwrites PDs to 70 per cent or 100 per cent, thereby moving them into Stage 2, or Stage 3, depending on whether they are considered performing or non-performing respectively. For interest-only accounts with six years or less to maturity an appropriate incremental PD uplift is made to PDs based on the probability of missing a future capital payment, assessed through segmentation of behaviour score, debt-to-value and worst ever arrears status.

Long-term defaults: £18,570k (2020: £19,085k)

The Group suspended mortgage litigation activity between late 2014 and mid 2018 as changes were implemented to the treatment of amounts in arrears, interrupting the natural flow of accounts to possession. An adjustment is made to ensure adequate provision coverage considering the resulting build-up of accounts in long-term default. Coverage is uplifted to the equivalent levels of those accounts already in repossession on an estimated shortfall of balances expected to flow to possession. A further adjustment is made to mitigate for the risk that credit model provision understates the probability of possession for accounts which have been in default for more than 24 months, with an arrears balance increase in the last 6 months. These accounts have their probability of possession set to 95 per cent based on observed historical losses incurred on accounts that were of an equivalent status.

Adjustment for specific segments: £8,270k (2020: £6,288k)

The Group monitors risks across specific segments of its portfolios which may not be fully captured through wider collective models. Along with continued judgmental increases to probability of default on forborne accounts, £5,197k (2020: £6,288k), TMB has taken an additional £3,073k (2020: £nil) judgement for fire safety and cladding uncertainty. This captures risks within the assessment of affordability and asset valuations, not captured by underlying models. Though experience remains limited the risk is now considered sufficiently material to address through judgement, given that more cases have been assessed as having defective cladding, or other fire safety issues, together with emerging evidence of higher arrears and weaker sales values relative to the wider portfolio.

Inflation and interest rate risk: £5,072k (2020: £nil)

The Group's approach to MES modelling incorporates a range of interest rate scenarios, however it is recognised that given current inflationary pressures the risk of a very rapid increase in interest rates may not be fully captured in the range of economic assumptions used to assess credit losses. Therefore an additional management judgement for the mortgage portfolio, for which default rates are most sensitive to interest rates, has been taken to reflect this heightened risk. The quantification of this risk adopts an alternative severe downside scenario which leverages the Group's internal stress testing exercise. The increase in ECL therefore reflects the incremental losses from adopting a severe downside scenario with interest rates increasing to 4 per cent, with peak unemployment and house price falls broadly consistent with the Lloyds Banking Group's and TMB's stated severe downside scenario. Lloyds Banking Group plc will continue to reassess inflationary risks and whether this additional judgement is required.

Deferred tax

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.

2. Profit before tax

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

	2021	2020
	£'000	£'000
Income		
Fees receivable	**79**	97
Expenses		
Interest payable to related undertakings (see note 16)	**42,294**	69,386
Management fees (see note 16)	**9,060**	8,877
Profit before tax	**106,689**	30,856

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 £58k (2020: £55k) was borne by the parent company, no non-audit services were provided to the Company by the auditors. In 2021 the Company sold debt that had previously been fully impaired for £2.2m. This was offset against impairment losses during the year.

3. Net interest income

	2021	2020
	£'000	£'000
Interest income		
From other loans and advances	**108,052**	132,117
Interest income from parent (see note 16)	**4,168**	19,600
	112,220	151,717
Interest expense		
Interest expense (see note 16)	**(42,294)**	(69,386)
Net interest income	**69,926**	82,331

4. Credit impairment losses

	Stage 1	**Stage 2**	**Stage 3**	**Total**
31 December 2021	**£'000**	**£'000**	**£'000**	**£'000**
Transfers between stages	**(358)**	**4,098**	**(1,184)**	**2,556**
Other changes in credit quality	**2,775**	**5,411**	**16,880**	**25,066**
Repayments	**427**	**8,677**	**9,657**	**18,761**
Other items charged to the income statement	**3,202**	**14,088**	**26,537**	**43,827**
Total impairment credit	**2,844**	**18,186**	**25,353**	**46,383**
In respect of:				
Loans and advances to customer (see note 17)	**2,795**	**18,100**	**25,355**	**46,250**
Undrawn loan commitments	**49**	**86**	**(2)**	**133**

4. Credit impairment losses (continued)

31 December 2020	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Transfers between stages	292	(10,131)	(16,405)	(26,244)
Other changes in credit quality	(3,734)	(7,006)	(11,187)	(21,927)
Repayments	99	3,937	2,916	6,952
Other items charged to the income statement	(3,635)	(3,069)	(8,271)	(14,975)
Total Impairment charge	(3,343)	(13,200)	(24,676)	(41,219)
In respect of:				
Loans and advances (see note 17)	(3,296)	(13,112)	(24,680)	(41,088)
Undrawn loan commitments	(47)	(88)	4	(131)

The impairment credit of £46m for 2021 is driven by an improvement in economic outlook and strong underlying performance. The Company's impairment charge comprises the following items:

Additions and repayments
Expected loss allowances are recognised on origination of new loans or further drawdowns of existing facilities. Repayments relate to the reduction of loss allowances resulting from the repayments of outstanding balances that have been provided against.

Other changes in credit quality
Changes in loss allowance as a result of movements in risk parameters that reflect changes in customer quality, but which have not resulted in a transfer to a different stage. This also contains the impact on the impairment charge as a result of write-offs and recoveries, where the related loss allowances are reassessed to reflect ultimate realisable or recoverable value.

5. Other operating expenses

	2021 £'000	2020 £'000
Management fees (see note 16)	**9,060**	8,877
Conduct provisions (see note 12)	**317**	1,265
Other operating expenses	**322**	211
	9,699	10,353

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.

The Company has no employees (2020: nil). It uses the services of its immediate parent undertaking for which a cost transfer charge, included in Other operating expenses, is made.

6. Directors' emoluments

No director received any fees or emoluments from the Company during the year (2020: £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.

7. Taxation

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

	2021	2020
	£'000	£'000
UK corporation tax:		
- Current tax on taxable profit/(loss) for the year	**19,830**	5,575
- Adjustments in respect of prior years	**48**	—
Current tax charge/(credit)	**19,878**	5,575
UK deferred tax:		
- Origination and reversal of timing differences	**440**	440
- Due to change in UK corporation tax rate	**(660)**	(359)
Deferred tax charge (see note 13)	**(220)**	81
Tax charge/(credit)	**19,658**	5,656

Corporation tax is calculated at a rate of 19.00% (2020: 19.00%) of the taxable profit for the year.

b) Factors affecting the tax charge/(credit) 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:

	2021	2020
	£'000	£'000
Profit/(loss) before tax	**106,689**	30,856
Tax charge/(credit) thereon at UK corporation tax rate of 19.00% (2020: 19.00%)	**20,270**	5,863
Factors affecting charge/(credit):		
- Due to change in UK corporation tax rate	**(660)**	(359)
- Disallowed and non-taxable items	**—**	152
- Adjustments in respect of prior years	**48**	—
Tax charge/(credit) on profit/(loss) on ordinary activities	**19,658**	5,656
Effective rate	18.43%	18.33%

The Finance Act 2016 reduced the main rate of corporation tax to 17% with effect from 1 April 2020. This reduction was superseded by The Finance Act 2020 which was enacted on 22 July 2020, and maintained the main rate of corporation tax at 19% with effect from 1 April 2020. The Finance Act 2021, which received Royal Assent on 10 June 2021, increases the rate of corporation tax from 19% to 25% with effect from 1 April 2023.

8. Dividends paid

	2021	2020
	£'000	£'000
Equity Ordinary shares - Final paid: £4.90 (2020: nil) per £1 share	**49,000**	—

9. Other current assets

	2021	2020
	£'000	£'000
Current		
Amounts due from group undertakings (see note 16)	**58,772**	2,361,660
Other debtors	**386**	422
	59,158	2,362,082

All amounts are receivable within 1 year.

10. Loans and advances to customers

10.1 Loans and advances to customers - maturity

	2021 £'000	2020 £'000
Gross loans and advances to customers	**3,333,360**	3,881,845
Less: allowances for losses on loans and advances	**(144,123)**	(187,218)
Net loans and advances to customers	**3,189,237**	3,694,627
of which:		
Due within one year	**385,397**	365,900
Due after one year	**2,803,840**	3,328,727
	3,189,237	3,694,627

Included within the "due within one year" maturity bucket there is £213.0m (2020: £223.5m) 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

	Stage 1 £'000	**Stage 2** £'000	**Stage 3** £'000	**Total** £'000
Balance at 1 January 2021	**2,156,159**	**1,351,362**	**374,324**	**3,881,845**
Transfers to Stage 1	**295,431**	**(295,431)**	**—**	**—**
Transfers to Stage 2	**(210,569)**	**283,957**	**(73,388)**	**—**
Transfers to Stage 3	**(6,525)**	**(87,993)**	**94,518**	**—**
Net increase/(decrease) in loans and advances to customers	**(296,527)**	**(200,109)**	**(52,275)**	**(548,911)**
Financial assets that have been written off during the year	**—**	**—**	**(2,630)**	**(2,630)**
Recoveries of prior advances written off	**—**	**—**	**3,056**	**3,056**
Gross loans and advances to customers at 31 December 2021	**1,937,969**	**1,051,786**	**343,605**	**3,333,360**
Less: allowances for losses on loans and advances	**(1,682)**	**(61,152)**	**(81,289)**	**(144,123)**
Net loans and advances to customers at 31 December 2021	**1,936,287**	**990,634**	**262,316**	**3,189,237**

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Balance at 1 January 2020	2,862,221	1,110,557	379,834	4,352,612
Transfers to Stage 1	81,225	(81,012)	(213)	—
Transfers to Stage 2	(480,276)	543,595	(63,319)	—
Transfers to Stage 3	(11,151)	(120,010)	131,161	—
Net increase/(decrease) in loans and advances to customers	(295,860)	(101,768)	(58,847)	(456,475)
Financial assets that have been written off during the year	—	—	(14,871)	(14,871)
Recoveries of prior advances written off	—	—	579	579
Gross loans and advances to customers at 31 December 2020	2,156,159	1,351,362	374,324	3,881,845
Less: allowances for losses on loans and advances	(4,478)	(79,251)	(103,489)	(187,218)
Net loans and advances to customers at 31 December 2020	2,151,681	1,272,111	270,835	3,694,627

10. Loans and advances to customers (continued)

10.3 Securitisation transactions

During 2021 the Company ended its securitised transactions, therefore at year end no assets were subject to repurchase agreements (2020: £2,189,212k). There are no securitised assets and related liabilities as at December 2021. In 2020 Loans and advances to customers included residential mortgage balances that had been been securitised but not derecognised, the carrying value of which are set out below together with any related liabilities. These mortgages loans were not derecognised in 2020 because the Company retained substantially all the risk of any default in respect of them.

		Loans and advances securitised	**Notes in issue**	Loans and advances securitised	Notes in issue
		2021	**2021**	2020	2020
Securitisation	**Type of loan**	**£'000**	**£'000**	£'000	£'000
Deva Financing plc	UK Residential Mortgages	—	—	2,164,554	2,189,212

11. Borrowed funds and amounts due to group undertakings

	2021	2020
	£'000	£'000
Amounts due to group undertakings (see note 16)	**2,895,460**	6,126,552

There are no contracts with an IBOR benchmark attached at 31 December 2021.

Amounts due to group undertakings includes £1.5m in respect of cost allocations recharged from The Group.

12. Provision for liabilities and charges

	Conduct	**Commitments**	**Total**
	£'000	**£'000**	**£'000**
At 1 January 2020	5,582	43	5,625
Charge for the year	1,265	131	1,396
Utilised during the year	(6,386)	—	(6,386)
At 31 December 2020	461	174	635
Charge / (credit) for the year	317	(133)	184
Utilised during the year	(776)	—	(776)
At 31 December 2021	**2**	**41**	**43**

As at 31 December 2021, one conduct provision for £2k (2020: one provision £461k) is held, in respect of repayments of fees applicable to mortgage accounts. During the year, the utilisation of £776k is in respect of customer redress. The charge for the year of £317k relates to an increase in the provision to cover redress.

A provision for commitments of £41k (2020 : £174k) is held in cases where the Company is contractually obligated to advance additional funds.

13. Deferred tax asset

The movement in the Deferred tax asset is as follows:

	2021	2020
	£'000	£'000
Brought at 1 January	**3,081**	3,162
Charge for the year	**(440)**	(440)
Effect of change in tax rate and related impacts	**660**	359
Balance at 31 December	**3,301**	3,081

The deferred tax charge in the Statement of comprehensive income comprises the following temporary differences:

	2021	2020
	£'000	£'000
Other temporary differences	**220**	(81)

Deferred tax asset comprises:

	2021	2020
	£'000	£'000
Other temporary differences	**3,301**	**3,081**

14. Share capital

	2021	2020
	£'000	£'000
Allotted, issued and fully paid		
10,000,000 (2020: 10,000,000) ordinary shares of £1 each	**10,000**	10,000

Ordinary shares carry one vote each. The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern, provide an adequate return to its shareholder through pricing products and services commensurately with the level of risk and, indirectly, to support the Group's regulatory capital requirements.

The Company's parent manages the Company's capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company's parent may adjust the amount of dividends to be paid to the shareholder, return capital to the shareholder, issue new shares, or enter into debt financing. The Company's parent can also request the Company to pay dividends or make a capital contribution in order to maintain or adjust the Group's capital structure. The Company's capital comprises all components of equity, movements in which appear in the Statement of changes in equity.

15. Transfer of financial assets

As set out within note 10.3, during 2021 the Company closed its securitisation programmes with Lloyds Banking Group plc. The table below sets out the details of the repurchase agreements in place in 2021. For securitisation programmes, the associated liabilities represented the external notes in issue.

		Carrying value of transferred assets	Carrying value of associated liabilities
		£'000	**£'000**
Loan notes subject to repurchase	At 31 December 2021	—	—
Loan notes subject to repurchase	At 31 December 2020	2,189,212	2,189,212

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 Lloyds Banking Group plc responsibilities. No director entered into transactions with the Company in the year (2020: 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 £58k (2020: £55k) 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.

Cash and cash equivalents of £25,780k (2020: £397,049k) comprises a bank account held with its parent undertaking Bank of Scotland plc.

Included in the "Amounts due from group undertakings" in 2020 is £2,189,212k relating to the Deva securitisation programme which nets off against liabilities within the Company's balance sheet. These interest bearing assets were charged at a fixed rate plus 3 month libor and repayable on demand.

In addition to the above there is £58,770k (2020: £56,846k) due from the Company's parent in relation to customer loan repayments.

Amounts due from group undertakings are unsecured. Balances are included within Stage 1 for IFRS 9 purposes and any expected credit losses are considered to be immaterial.

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

	2021	2020
	£'000	£'000
Amounts due from group undertakings		
Amounts due from parent	**58,770**	2,246,222
Amounts due from other related parties	**2**	115,438
Total amounts due from group undertakings	**58,772**	2,361,661
Amounts due to group undertakings		
Amounts due to parent	**2,893,916**	6,125,894
Amounts due to other related parties	**1,544**	658
Total amounts due to group undertakings	**2,895,460**	6,126,552

Net repayment of borrowings with parent undertaking £1,044,526k (£103,755k).

The Deva securitisation programme ended in May 2021. Prior to this the effective interest on the deemed loan was calculated with reference to the interest earned on the beneficial interest in the mortgage portfolio. No interest was charged on amounts owed to Deva Financing plc although a notional interest was payable representing fees and charges.

Interest on term funding balances owed to Bank of Scotland plc is charged at SONIA 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 Bank Base Rate (BBR) plus 10 basis points.

All related party transactions are at arms length, apart from the intercompany balances which are settled on a monthly basis with short term timing differences.

The decrease in Amounts due from and to parents is due to the closure of Deva securitisation balances during 2021.

16. Related party transactions (continued)

	2021	2020
	£'000	£'000
Interest income		
Interest income from parent	**4,168**	19,600
Total Interest income (see note 3)	**4,168**	19,600
Interest expense		
Interest expense with parent	**42,294**	69,386
Total Interest expense (see note 3)	**42,294**	69,386
Management fees		
Management recharge from Lloyds Banking Group plc	**9,060**	8,877
Total Management fees (see note 5)	**9,060**	8,877

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 and liquidity risk faced by the Company is in substance managed and borne by other Lloyds Banking Group plc 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

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The credit risk associated with Loans and advances to customers is managed through the application of strict underwriting criteria, determined by the Retail Division's credit committee and credit functions. Significant credit exposures are measured and reported on a regular basis. Impairment provisions are provided for all losses expected to be incurred at the Balance sheet date, using the basis of assessment discussed in notes 1.4 and 1.11.

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 31 December 2021		As at 31 December 2020	
	Maximum Exposure	**Net Exposure**	Maximum Exposure	Net Exposure
	£'000	**£'000**	£'000	£'000
Loans and advances to customers, net[1]	**3,189,237**	**3,189,237**	3,694,627	3,694,627
Off balance sheet items:				
Commitments to lend	**112,845**	**112,845**	122,868	122,868
	3,302,082	**3,302,082**	3,817,495	3,817,495

The gross fair value of collateral held is £3,315m (2020: £3,852m) representing 99% of gross loans and advances to customers.

17. Financial risk management (continued)

17.1 Credit risk (continued)

Credit risk management (continued)

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.

		Gross loans and advances to customers - Loan Quality			
At 31 December 2021		**Stage 1**	**Stage 2**	**Stage 3**	**Total**
	PD Range	**£'000**	**£'000**	**£'000**	**£'000**
Retail					
RMS 1-6	0.00-4.50%	**1,933,095**	**761,009**	**—**	**2,694,104**
RMS 7-9	4.51-14.00%	**4,874**	**171,859**	**—**	**176,733**
RMS 10	14.01-20.00%	**—**	**32,753**	**—**	**32,753**
RMS 11-13	20.01-99.99%	**—**	**86,165**	**—**	**86,165**
RMS 14	100%	**—**	**—**	**343,605**	**343,605**
Total		**1,937,969**	**1,051,786**	**343,605**	**3,333,360**

		Gross loans and advances to customers - Loan Quality			
At 31 December 2020		**Stage 1**	**Stage 2**	**Stage 3**	**Total**
	PD Range	**£'000**	**£'000**	**£'000**	**£'000**
Retail					
RMS 1-6	0.00-4.50%	2,141,130	618,146	—	2,759,276
RMS 7-9	4.51-14.00%	14,984	337,622	—	352,606
RMS 10	14.01-20.00%	45	105,866	—	105,911
RMS 11-13	20.01-99.99%	—	289,728	—	289,728
RMS 14	100%	—	—	374,324	374,324
Total		2,156,159	1,351,362	374,324	3,881,845

	Stage 1	Stage 2	Stage 3	Total
Loan Commitments	**£'000**	**£'000**	**£'000**	**£'000**
At 31 December 2021	**89,714**	**21,570**	**1,561**	**112,845**
At 31 December 2020	98,402	23,825	641	122,868

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 1.4. All Loans and advances to customers are assessed for impairment. No amounts due from Lloyds Banking Group plc undertakings are impaired (2020: £nil).

17. Financial risk management (continued)

17.1 Credit risk (continued)

Credit risk management (continued)

Analysis of movement in the allowance for impairment losses by stage

In respect of drawn balances	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 January 2021	4,478	79,251	103,489	187,218
Exchange and other adjustments	(1)	1	(1)	(1)
Transfers to Stage 1	8,744	(8,744)	—	—
Transfers to Stage 2	(532)	11,888	(11,356)	—
Transfers to Stage 3	(24)	(6,558)	6,582	—
Impact of transfers between stages	(7,828)	(643)	5,954	(2,517)
	360	(4,057)	1,180	(2,517)
Other items credited to the income statement	(3,155)	(14,043)	(26,535)	(43,733)
Credit for the year (including recoveries) (see note 4)	(2,795)	(18,100)	(25,355)	(46,250)
Advances written off	—	—	(2,630)	(2,630)
Recoveries of prior advances written off	—	—	3,056	3,056
Discount unwind	—	—	2,730	2,730
At 31 December 2021	1,682	61,152	81,289	144,123

In respect of undrawn balances	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 January 2021	62	112	—	174
Transfers to Stage 1	39	(39)	—	—
Transfers to Stage 2	(3)	4	(1)	—
Transfers to Stage 3	—	(6)	6	—
Impact of transfers between stages	(38)	—	(1)	(39)
	(2)	(41)	4	(39)
Other items credited to income statement	(47)	(45)	(2)	(94)
Charge / (release) to the income statement (see note 4)	(49)	(86)	2	(133)
At 31 December 2021	13	26	2	41

17. Financial risk management (continued)

17.1 Credit risk (continued)

Credit risk management (continued)

Analysis of movement in the allowance for impairment losses by stage

In respect of drawn balances	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 January 2020	1,182	66,139	90,020	157,341
Transfers to Stage 1	1,877	(1,830)	(47)	—
Transfers to Stage 2	(660)	6,768	(6,108)	—
Transfers to Stage 3	(8)	(9,419)	9,427	—
Impact of transfers between stages	(1,498)	14,545	13,134	26,181
	(289)	10,064	16,406	26,181
Other items charged to the income statement	3,585	3,048	8,274	14,907
Charge for the year (including recoveries) (see note 4)	3,296	13,112	24,680	41,088
Advances written off	—	—	(14,871)	(14,871)
Recoveries of prior advances written off	—	—	579	579
Discount unwind	—	—	3,081	3,081
At 31 December 2020	4,478	79,251	103,489	187,218

In respect of undrawn balances	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 January 2020	15	24	4	43
Transfers to Stage 1	1	(1)	—	—
Transfers to Stage 2	(4)	6	(2)	—
Transfers to Stage 3	—	—	—	—
Impact of transfers between stages	—	62	1	63
	(3)	67	(1)	63
Other items charged / (credited) to income statement	50	21	(3)	68
Charge / (release) to the income statement (see note 4)	47	88	(4)	131
At 31 December 2020	62	112	—	174

Loans and advances to customers are held at amortised cost.

17. Financial risk management (continued)

17.1 Credit risk (continued)

Credit risk management (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	**Stage 2**	**Stage 3**	**Total**
	£'000	**£'000**	**£'000**	**£'000**
Less than 60%	**1,470,066**	**741,259**	**169,675**	**2,381,000**
60% to 70%	**334,685**	**184,111**	**54,874**	**573,670**
70% to 80%	**68,912**	**53,378**	**38,961**	**161,251**
80% to 90%	**23,249**	**23,667**	**21,480**	**68,396**
90% to 100%	**15,300**	**16,032**	**13,834**	**45,166**
Greater than 100%	**25,757**	**33,339**	**44,781**	**103,877**
At 31 December 2021	**1,937,969**	**1,051,786**	**343,605**	**3,333,360**

	Stage 1	Stage 2	Stage 3	Total
	£'000	£'000	£'000	£'000
Less than 70%	1,836,101	1,030,851	220,572	3,087,524
70% to 80%	232,823	172,571	45,254	450,648
80% to 90%	44,929	53,900	32,896	131,725
90% to 100%	18,417	22,520	17,972	58,909
Greater than 100%	23,889	71,520	57,630	153,039
At 31 December 2020	2,156,159	1,351,362	374,324	3,881,845

Repossessed collateral

During 2021 the Company obtained assets with a carrying value of £13,609k (2020: £20,352k) 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

Liquidity risk is the risk that the Company is unable to meet its obligations as they fall due. To manage this risk extensive borrowing facilities are available from within Lloyds Banking Group plc.

Liquidity risk is managed as part of Lloyds Banking Group plc by an intermediate parent company, Lloyds Bank plc, in consultation with the board of directors. Monthly reviews of funding positions are undertaken to anticipate any shortfalls.

The liquidity table below is a contractual maturity analysis for Amounts due to group undertakings, based on the earliest date the entity could be expected to repay the amounts owed.

17. Financial risk management (continued)

17.2 Liquidity risk (continued)

As at 31 December 2021	**Up to 1 month £'000**	**1-12 months £'000**	**1-5 years £'000**	**Total £'000**
Borrowed funds (see note 10)	**545,460**	**1,800,000**	**550,000**	**2,895,460**
Contractual interest payments	**83**	**32,719**	**3,006**	**35,808**

As at 31 December 2020	Up to 1 month £'000	1-12 months £'000	1-5 years £'000	Total £'000
Borrowed funds (see note 10)	3,126,552	400,000	2,600,000	6,126,552
Contractual interest payments	22	1,623	66,130	67,775

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

Borrowed funds are classed as stage 1 for IFRS 9 purposes.

Cash and cash equivalents and other current assets 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.

Amounts due from group undertakings include amounts that are interest bearing at fixed rates for funding of long term loans and advances and variable rates for other borrowings.

Amounts due to group undertakings include amounts that are interest bearing at fixed rates for funding of long term loans and advances and variable rates for other borrowings.

Interest rate risk - sensitivity analysis

The sensitivity analysis is based on the Company's interest-bearing Amounts due to group undertakings and takes account of movement in SONIA (2020: LIBOR), which is the basis for the interest charged on such balances. A 0.5% (2020: 0.5%) increase or decrease is used to assess the possible change in Interest expense. This rate is appropriate as it is the amount by which the SONIA (2020: LIBOR) increased in the year.

	-50 bps £'000	**Profit before taxation £'000**	**+50 bps £'000**
2021	**88,651**	**106,689**	**124,727**
2020	10,270	30,856	51,422

	-50 bps £'000	**Equity £'000**	**+50 bps £'000**
2021	**344,071**	**362,085**	**380,099**
2020	303,468	324,054	344,640

17. Financial risk management (continued)

17.3 Interest rate risk (continued)

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

2021	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	**385,397**	**200,840**	**489,672**	**2,113,328**	**3,189,237**
Interest bearing loans and borrowings	**2,345,460**	**400,000**	**150,000**	**—**	**2,895,460**

2020	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	365,900	204,410	550,873	2,573,444	3,694,627
Interest bearing loans and borrowings	3,526,552	2,200,000	400,000	—	6,126,552

17.4 Fair values of financial assets and 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.

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

Level 1 portfolios

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

Level 2 portfolios

Level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3 portfolios

Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments are valued using various valuation techniques that require significant management judgment in determining appropriate assumptions, including earnings multiples and estimated future cash flows.

Financial assets and liabilities carried at amortised cost

Cash and cash equivalents, Loans and advances to customers, Bank borrowings and Amounts due to group undertakings are all held at amortised cost.

As at 31 December 2021, the carrying amount of loans and advances to customers is £3,189,237k (2020: £3,694,627k) and a fair value £3,245,053k (2020: £3,760,706k). The fair value is classified as level 3 due to significant unobservable inputs used in the valuation models.

The carrying value of all other financial assets and liabilities is considered an approximation of fair value, due to their short term nature.

17. Financial risk management (continued)

17.5. Capital disclosures

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

The Company's parent manages the Company's capital structure and advises the board of directors to consider making adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the board of directors may adjust the amount of dividends to be paid to shareholders, return capital to shareholders, issue new shares, or sell assets.

The managed capital of the Company constitutes Total equity. This consists entirely of issued Share capital and retained profits. As at 31 December 2021, total managed capital was £362,085k (2020: £324,054k).

The Company is authorised and regulated by the Financial Conduct Authority ('FCA') and is subject to 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 2021.

18. Contingent liabilities and capital commitments

Contingent tax liability

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 its interpretation of the UK rules means that the group relief is not available. In 2020, HMRC concluded their enquiry into the matter and issued a closure notice. The Group's interpretation of the rules has not changed and hence it has appealed to the First Tier Tax Tribunal, with a hearing expected in 2022. If the final determination of the matter by the judicial process is that HMRC's position is correct, management estimate that this would result in an increase in current tax liabilities for the company of approximately £28,762k (including interest). The Group, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

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.

19. Post balance sheet events

Dividends

Since the balance sheet date the Directors have recommended a dividend of £120,000k. The aggregate amount of the proposed dividend is expected to be paid in May 2022 out of retained earnings at the 31st December 2021, and not recognised as a liability at year end.

Russian invasion of Ukraine

The Russian invasion of Ukraine, beginning in February 2022, has increased tensions between members of the North Atlantic Treaty Organisation (NATO) and Russia and caused sanctions to be imposed. This could have significant adverse economic effects on financial markets and on energy costs, and may also result in increased cyber attacks and an increase in costs associated with such cyber attacks, all of which could have a materially adverse effect on the Company's results of operations, financial conditions or prospects. The Company will continue to monitor the situation and risks to the business.

There are no other post balance sheet events requiring disclosure in these financial statements.

20. Future developments

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2022 and in later years (including IFRS 9 Financial Instruments and IAS 37 Provisions, Contingent Liabilities and Contingent Assets). These amendments are not applicable for the year ended 31 December 2021 and have not been applied in preparing these financial statements. They are not expected to have a significant impact on the Group.

21. Ultimate parent undertaking and controlling party

The immediate parent company is Bank of Scotland plc (incorporated in Scotland). The company regarded by the directors as the ultimate parent company and controlling party is Lloyds Banking Group plc (incorporated in Scotland), which is also the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the Company is a member. Bank of Scotland plc is the parent undertaking of the smallest such group of undertakings. Copies of the financial statements of both companies may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN. The Lloyds Banking Group plc financial statements may be downloaded via www.lloydsbankinggroup.com.

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

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of The Mortgage Business Public Limited Company (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 December 2021 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom adopted international accounting standards and International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity;
- the cash flow statement; and
- the related notes 1 to 21.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom adopted international accounting standards and IFRSs as issued by the IASB.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Report on the audit of the financial statements

Other information
The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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 course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. 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 in this regard.

Responsibilities of directors
As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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

Extent to which the audit was considered capable of detecting irregularities, including fraud
Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

We considered the nature of the company's industry and its control environment, and reviewed the company's documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management about their own identification and assessment of the risks of irregularities.

Report on the audit of the financial statements

We obtained an understanding of the legal and regulatory framework that the company operates in, and identified the key laws and regulations that:

- had a direct effect on the determination of material amounts and disclosures in the financial statements. These included the Companies Act 2006 and UK tax legislation; and
- do not have a direct effect on the financial statements but compliance with which may be fundamental to the company’s ability to operate or to avoid a material penalty. These included Financial Conduct Authority (“FCA”) regulations.

We discussed among the audit engagement team including relevant internal specialists such as IT specialists, regarding the opportunities and incentives that may exist within the organisation for fraud and how and where fraud might occur in the financial statements.

As a result of performing the above, we identified the greatest potential for fraud in the following area, and our specific procedures performed to address them are described below:

- The valuation of expected credit loss (ECL) is not appropriate due to limitations in macroeconomic scenarios and associated probability weightings not being appropriately addressed by manual adjustments or overlays - we tested the controls over the generation of the multiple economic scenarios including those over the governance processes to determine the base case, different scenarios and the weightings applied to each scenario; we challenged and evaluated economic forecasts in the base scenario such as the unemployment rate, house price index and gross domestic product through comparison to an independent economic outlook, external analysts and market data; we challenged and evaluated the appropriateness of the methodology applied to generate alternative macroeconomic scenarios, including associated weightings, and assumptions within; we tested whether the methodology has been appropriately reflected in the model code by producing an independent version of the model generating alternative macroeconomic scenarios and reconciling its outputs to the company’s model; we tested the completeness and accuracy of the data used by the model; we performed a stand back assessment of the appropriateness of the weightings applied to each of the scenarios based on publicly available data; and we evaluated the adequacy of disclosures in respect of significant judgements and sources of estimation uncertainty including macroeconomic scenarios.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, we tested the appropriateness of journal entries and other adjustments; assessed whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluated the business rationale of any significant transactions that are unusual or outside the normal course of business.

In addition to the above, our procedures to respond to the risks identified included the following:

- reviewing financial statement disclosures by testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- enquiring of management and in-house legal counsel concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and
- reading minutes of meetings of those charged with governance.

Report on the audit of the financial statements

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

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

- the information given in the strategic report and the directors’ report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors’ report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors’ report.

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

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

We have nothing to report in respect of these matters.

Use of our report

This report is made solely to the company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company’s members those matters we are required to state to them in an auditor’s report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company’s members as a body, for our audit work, for this report, or for the opinions we have formed.

Stephen Williams ACA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Edinburgh, United Kingdom
25 April 2022