The Mortgage Business Public Limited Company

Annual report and Financial Statements

2022

Member of Lloyds Banking Group

Strategic report
For the year ended 31 December 2022

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 2022.

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 2022 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. Its sources of funding are customer repayments and term funding deals arranged by Group Corporate Treasury division of Lloyds Banking Group (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 £46,238k (2021: £106,689k). The year on year decrease is primarily due to the lower impairment credit in the year of £2,578k (2021: £46,383k). The 2022 credit is largely driven by provision reductions in the first half of the year as a result of improved loss rate assumptions on accounts in long term default, offset by deterioration in the economic outlook in the second half of the year (HPI). This is in contrast to prior year improvements to economic outlook driving provision releases.

Interest income in the year was £118,237k which has increased from £112,220k in 2021, due to the increase in interest rates being partly offset by net loans to customers reducing to £2,552,600k (pre transfer to held for sale referenced below) from £3,189,237k in 2021. Interest expense in the year was £64,450k which has increased from £42,294k in 2021 also due to the increase in interest rates. Average interest rates for funding have increased more than customer interest rates due to the nature of the customer product mix.

Gross loans and advances to customers fell to £39,029k (2021 £3,333,360k), this decrease primarily reflects the £2,647,626k mortgage sale to an unconsolidated structured special purpose entity (SPE) on the 19th January 2023. The loan balances sold have been reclassified to Assets held for sale. It is expected that the remaining 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

On 19th January 2023 the Company sold £2,625,534k of gross loans and advances to customers to an SPE. The gross value of these loans and advances to customers as at 31st December 2022 were £2,647,626k, with an expected credit loss of £126,173k, giving net loans and advances to customers of £2,521,453k.

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

Principal risks and uncertainties

2022 has been a challenging year for many of our customers. Whilst the social and economic consequences of COVID-19 continue to be felt, the Russian invasion of Ukraine in February 2022 added to the economic headwinds from nearly two years of disruption having a large impact on global and UK economies

The Group aim to provide support to customers following the rising rates and offer support in maintaining financial resilience through the cost of living challenges.

Following the sale of the loans and advances to customers on the 19th January 2023 it is believed there will be limited impact on the remaining book in respect of risks and uncertainties.

The key risks and uncertainties faced by the Company are managed within the framework established for the Group. 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 the 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.

Principal risks and uncertainties (continued)

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.

Key performance indicators ("KPIs")

The Company's directors are of the opinion that 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

Following the sale of the majority of the Loans and advances to customers to the SPE on the 19th January 2023 the Company will continue to service these mortgages receiving an arms length service fee from the SPE. On the remaining Loans and advances to customers the Company continues to administer it as per existing practice.

Employees

The Company has no employees (2021: 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 2022, 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 the Group, works toward achieving the Group'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 the Group's Consumer Lending Business Unit. 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 the Group, 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 2022 , which does not form part of this report, available on the Lloyds Banking Group 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 the Group's related initiatives, including Helping Britain Prosper by actively managing its current book of mortgages.

Further information in respect of the Group'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 2022, which does not form part of this report. Additional information on the Group's Helping Britain Prosper Plan is available on the Lloyds Banking Group website.

In October 2022, the Group announced the ambition to achieve a 50 per cent reduction in the carbon emissions we generate through our supply chain by 2030 on the path to net zero by 2050 or sooner.

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 Cost of Living crisis on its liquidity position. During 2022, the Group had extensive engagement with the regulators and Government in the initial response to the Cost of Living 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 the Group, including that of the Company, to manage regulatory change is detailed further in the Lloyds Banking Group plc Annual Report and Accounts for 2022, which does not form part of this report, available on the Lloyds Banking Group 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 the Group), 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 2022 an area of particular focus for the directors has been to steer through the challenges we have faced into as a result of the cost of living crisis both from an operational and customer perspective, ensuring alignment with guidance from the Group 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 the Group are insufficient to mitigate these risks. This could lead to campaign groups or other bodies seeking to take action against the Group 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), in its own Directors' Report as it is included within Lloyds Banking Group plc's SECR report given in the Lloyds Banking Group plc 2022 Annual Report and Accounts, available on the Lloyds Banking Group 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:

AAmbani

Anish Ambani
Director
21 April 2023

Directors' report

For the year ended 31 December 2022

The directors present their report and the audited financial statements for the Company for the year ended 31 December 2022. The Company is a subsidiary of Lloyds Banking Group plc.

Dividends

A dividend of £120,000k was paid by the Company to the parent company in 2022 (2021: £49,000k). see note 8.

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:

RW Fletcher	appointed 3rd October 2014
J Singh	appointed 28th September 2018
Andrew Bickers	appointed 1st January 2023
Andrew Asaam	appointed 27th February 2023
Anish Ambani	appointed 14th March 2023
SJ Noakes	resigned 31st December 2022
I Santos Perez	resigned 24th February 2023
C Gowland	resigned 14th March 2023

Directors' indemnities

The Group 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. 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.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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 sale of £2,521,423k of net loans and advances to customers on the 19th January 2023 leaves the Company with £31,147k remaining. It is expected that the remaining book will continue to run off, earning interest income on its remaining customer loans, enabling it to repay all its future liabilities.
- 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 < 60%.
- There will be limited impact on the Company as a result of the following events, Covid-19, the Cost of living crisis and the Russian invasion of the Ukraine, this will be monitored through the Company's credit risk model.
- 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 2022, 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 the Group, 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 the Group.

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. One Director resigned during the year and two Directors resigned and three were appointed following the year end before the date of signing the financial statements.

Directors' report (continued)
For the year ended 31 December 2022

Approach to Corporate Governance (continued)

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 Group 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 the Group, as part of the Group 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.

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 the Group, 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 the Group, 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 the Group, operates under the Group's wider Responsible Business approach, as overseen by the Group's Responsible Business Committee. Helping Britain Prosper is central to the 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

The auditor, Deloitte LLP, was the auditor of the Company during the period under review and are to remain in office until the conclusion of the Company's annual general meeting. Having expressed their willingness to continue in office and pursuant to section 489 of the Companies Act 2006, a resolution for the re-appointment of Deloitte LLP will be proposed at the forthcoming annual general meeting.

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

Anish Ambani
Director

21 April 2023

Financial statements

Statement of comprehensive income

For the year ended 31 December 2022

	Note	**2022**	2021
		£'000	£'000
Interest income		**118,237**	112,220
Interest expense		**(64,450)**	(42,294)
Net interest income	3	**53,787**	69,926
Fee and commission income		**96**	80
Fee and commission expense		**(1)**	(1)
Net fee and commission income		**95**	79
Credit impairment gains	4	**2,578**	46,383
Other operating expenses	5	**(10,222)**	(9,699)
Profit before tax	2	**46,238**	106,689
Taxation	7	**(8,785)**	(19,658)
Profit for the year being total comprehensive income		**37,453**	87,031

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 2022

	Note	2022	2021
		£'000	£'000
ASSETS			
Cash and cash equivalents		**66,876**	25,780
Loans and advances to customers	10	**31,147**	3,189,237
Assets held for sale	11	**2,521,453**	—
Other current assets	9	**69,553**	59,158
Deferred tax asset	14	**2,861**	3,301
Total assets		**2,691,890**	3,277,476
LIABILITIES			
Borrowed funds and amounts due to group undertakings	12	**2,403,996**	2,895,460
Other current liabilities		**10**	14
Provision for liabilities and charges	13	**1**	43
Current tax liability		**8,345**	19,874
Total liabilities		**2,412,352**	2,915,391
EQUITY			
Share capital	15	**10,000**	10,000
Retained profit		**269,538**	352,085
Total equity		**279,538**	362,085
Total equity and liabilities		**2,691,890**	3,277,476

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

The presentation requirements for assets (or disposal groups) classified as held for sale at the end of the reporting period do not apply retrospectively. The comparative balance sheet position for any previous periods are therefore not re-presented.

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

A Ambani

Anish Ambani
Director

21 April 2023

Statement of changes in equity
For the year ended 31 December 2022

	Share capital £'000	Retained earnings £'000	Total equity £'000
At 1 January 2021	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
Profit for the year being total comprehensive income	**—**	**37,453**	**37,453**
Dividend paid to parent	**—**	**(120,000)**	**(120,000)**
At 31 December 2022	**10,000**	**269,538**	**279,538**

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

Cash flow statement

For the year ended 31 December 2022

	2022	2021
	£'000	£'000
Cash flows generated from operating activities		
Profit before tax	**46,238**	106,689
Adjustments for:		
- Interest expense	**64,450**	42,294
- Decrease in Provision for liabilities and charges	**(42)**	(592)
Changes in operating assets and liabilities:		
- Net decrease in Loans and advances to customers	**3,158,090**	505,390
- Net (increase) / decrease in Other receivables	**(2,521,195)**	36
- Net decrease in Other current liabilities	**(4)**	(9)
Cash generated from operations	**747,537**	653,808
Corporation tax paid	**(19,874)**	(5,579)
Net cash generated from operating activities	**727,663**	648,229
Cash flows used in financing activities		
Repayments (made) / received on amounts due from Parent undertakings (see note 16)	**(10,653)**	2,187,452
Repayments made on amounts due to Parent undertakings (see note 16)	**(490,706)**	(3,231,978)
Repayments received on amounts due from Other related parties (see note 16)	**—**	115,436
Repayments (made) / received on amounts due to Other related parties (see note 16)	**(758)**	886
Interest paid	**(64,450)**	(42,294)
Dividend paid	**(120,000)**	(49,000)
Net cash used in financing activities	**(686,567)**	(1,019,498)
Change in Cash and cash equivalents	**41,096**	(371,269)
Cash and cash equivalents at beginning of year	**25,780**	397,049
Cash and cash equivalents at end of year	**66,876**	**25,780**

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 2022

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 Covid-19, the Russian invasion of the Ukraine, the Cost of Living crisis 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 2022 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, other financial assets held at amortised cost and certain loan commitments. Expected credit losses are calculated as an unbiased and probability weighted estimate using an appropriate probability of default, adjusted to take into account a range of possible future economic scenarios, and applying this to the estimated exposure of the Company at the point of default after taking into account the value of any collateral held, repayments, or other mitigants of loss and including the impact of discounting using the effective interest rate**.**

At initial recognition, allowance or provision in the case of some loan commitments 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. The use of internal credit ratings and qualitative indicators ensures alignment between the assessment of staging and the Group's management of credit risk which utilises these internal metrics within distinct retail portfolio risk management practices. 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 which the Group now uses for all its products following changes to the definition of default for UK Mortgages on 1 January 2022. In addition, other indicators of mortgage default are added including end-of-term payments on past due interest-only accounts and loans considered non-performing due to recent arrears or forbearance. 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. Accounting policies (continued)

1.5 Assets held for sale

Non-current assets are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell, unless they are financial instruments which continued to be measured in accordance with IFRS 9.

1.6 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.

1.7 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 His 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.

1.8 Dividends paid

Dividends on ordinary shares are recognised through equity in the period in which they are paid. The Company paid a dividend of £120m to its parent company, Bank of Scotland plc, during 2022.

1.9 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. Accounting policies (continued)

1.10 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 Company 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 Company 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 2022, the Company carried a provision of £7,882k (2021: £144,123k) 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. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due which the Company now uses for all its products following changes to the definition of default for UK mortgages on 1 January 2022. In addition, other indicators of mortgage default were added including end-of-term payments on past due interest-only accounts and loans considered non-performing due to recent arrears or forbearance, aligning the definition of Stage 3 credit-impaired for IFRS 9 to the CRD IV prudential regulatory definition of default.

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.

A Stage 3 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.

1. Accounting policies (continued)

1.10 Critical accounting estimates and judgements in applying accounting policies

d) Generation of multiple economic scenarios

The estimate of expected credit losses is required to be based on an unbiased expectation of future economic scenarios. The approach used to generate the range of future economic scenarios depends on the methodology and judgements adopted. The Company's approach is to start from a defined base case scenario, used for planning purposes, and to generate alternative economic scenarios around this base case. The base case scenario is a conditional forecast underpinned by a number of conditioning assumptions that reflect the Company's best view of key future developments. If circumstances appear likely to materially deviate from the conditioning assumptions, then the base case scenario is updated

The base case scenario is central to a 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, three other scenarios are identified as averages of constituent scenarios located around the 15th, 75th and 95th percentiles of the distribution. The full distribution is therefore summarised by a practical number of scenarios to run through ECL models representing an upside, the base case, and a downside scenario weighted at 30 per cent each, together with a severe downside scenario weighted at 10 per cent. The scenario weights represent the distribution of economic scenarios and not subjective views 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 2022.

e) Base case and MES economic assumptions

The Company's base case economic scenario has been revised in light of the ongoing war in Ukraine, reversals in UK fiscal policy, and a continuing global shift towards a more restrictive monetary policy stance against a backdrop of elevated inflation pressures. The Company's updated base case scenario has three conditioning assumptions: first, the war in Ukraine remains 'local', i.e. without overtly involving neighbouring countries, NATO or China; second, the UK labour market participation rate remains below pre-pandemic levels, impeding the economy's supply capacity; and third, the Bank of England accommodates above-target inflation in the medium term, recognising the economic costs that might arise from a rapid return to the two per cent target.

Based on these assumptions and incorporating the economic data published in the fourth quarter, the Company's base case scenario is for a contraction in economic activity and a rise in the unemployment rate alongside declines in residential and commercial property prices, following increases in UK Bank Rate in response to persistent inflationary pressures. Risks around this base case economic view lie in both directions and are largely captured by the generation of alternative economic scenarios.

The Company has accommodated the latest available information at the reporting date in defining its base case scenario and generating alternative economic scenarios. The scenarios include forecasts for key variables in the fourth quarter of 2022, for which actuals may have since emerged prior to publication.

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 and house price growth is presented as the growth in the respective indices within the period. UK Bank Rate and unemployment rate are averages for the period.

Five-year average

The five-year average reflects the average annual growth rate, or level, over the five-year period. It includes movements within the current reporting year, such that the position as of 31 December 2022 covers the five years 2022 to 2026. The inclusion of the reporting year within the five-year period reflects the need to predict variables which remain unpublished at the reporting date and recognises that credit models utilise both level and annual changes. The use of calendar years maintains a comparability between the annual assumptions presented.

Five-year start to peak and trough

The peak or trough for any metric may occur intra year and therefore not be identifiable from the annual assumptions, therefore they are also disclosed. For GDP, house price growth and commercial real estate price growth, the peak, or trough, reflects the highest, or lowest cumulative quarterly position reached relative to the start of the five-year period, which as of 31 December 2022 is 1 January 2022. Given these metrics may exhibit increases followed by greater falls, the start to trough movements quoted may be smaller than the equivalent 'peak to trough' movement (and vice versa for start to peak). Unemployment, UK Bank Rate and CPI Inflation reflect the highest, or lowest, quarterly level reached in the five-year period.

1. Accounting policies (continued)

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

e) Base case and MES economic assumptions (continued)

31 December 2022	2022 %	2023 %	2024 %	2025 %	2026 %	Average %	Start to peak (1) %	Start to trough (1) %
Upside								
Gross domestic product	**4.1**	**0.1**	**1.1**	**1.7**	**2.1**	**1.8**	**6.5**	**0.4**
UK Bank Rate	**1.94**	**4.95**	**4.98**	**4.63**	**4.58**	**4.22**	**5.39**	**0.75**
Unemployment rate	**3.5**	**2.8**	**3.0**	**3.3**	**3.4**	**3.2**	**3.8**	**2.8**
House price growth	**2.4**	**(2.8)**	**6.5**	**9.0**	**8.0**	**4.5**	**24.8**	**(1.1)**
Base case								
Gross domestic product	**4.0**	**(1.2)**	**0.5**	**1.6**	**2.1**	**1.4**	**4.3**	**(1.1)**
UK Bank Rate	**1.94**	**4.00**	**3.38**	**3.00**	**3.00**	**3.06**	**4.00**	**0.75**
Unemployment rate	**3.7**	**4.5**	**5.1**	**5.3**	**5.1**	**4.8**	**5.3**	**3.6**
House price growth	**2.0**	**(6.9)**	**1.2**	**2.9**	**4.4**	**0.2**	**6.4**	**(6.3)**
Downside								
Gross domestic product	**3.9**	**(3.0)**	**(0.5)**	**1.4**	**2.1**	**0.8**	**1.2**	**(3.6)**
UK Bank Rate	**1.94**	**2.93**	**1.39**	**0.98**	**1.04**	**1.65**	**3.62**	**0.75**
Unemployment rate	**3.8**	**6.3**	**7.5**	**7.6**	**7.2**	**6.5**	**7.7**	**3.6**
House price growth	**1.6**	**(11.1)**	**(9.8)**	**(5.6)**	**(1.5)**	**(5.4)**	**6.4**	**(24.3)**
Severe Downside								
Gross domestic product	**3.7**	**(5.2)**	**(1.0)**	**1.3**	**2.1**	**0.1**	**0.7**	**(6.4)**
UK Bank Rate - modelled	**1.94**	**1.41**	**0.20**	**0.13**	**0.14**	**0.76**	**3.50**	**0.12**
UK Bank Rate - adjusted (2)	**2.44**	**7.00**	**4.88**	**3.31**	**3.25**	**4.18**	**7.00**	**0.75**
Unemployment rate	**4.1**	**9.0**	**10.7**	**10.4**	**9.7**	**8.8**	**10.7**	**3.6**
House price growth	**1.1**	**(14.8)**	**(18.0)**	**(11.5)**	**(4.2)**	**(9.8)**	**6.4**	**(40.1)**
Probability-weighted								
Gross domestic product	**4.0**	**(1.8)**	**0.2**	**1.5**	**2.1**	**1.2**	**3.4**	**(1.8)**
UK Bank Rate - modelled	**1.94**	**3.70**	**2.94**	**2.59**	**2.60**	**2.76**	**3.89**	**0.75**
UK Bank Rate - adjusted (2)	**1.99**	**4.26**	**3.41**	**2.91**	**2.91**	**3.10**	**4.31**	**0.75**
Unemployment rate	**3.7**	**5.0**	**5.8**	**5.9**	**5.7**	**5.2**	**5.9**	**3.6**
House price growth	**1.9**	**(7.7)**	**(3.2)**	**0.7**	**2.9**	**(1.2)**	**6.4**	**(9.5)**

1. Since the level of property prices peaked during 2022, peak to trough declines for house price growth and commercial real estate price growth are larger than the start to trough declines over the period shown.
2. The adjustment to UK Bank Rate and CPI inflation in the severe downside is considered to better reflect the risks around the Group's base case view in an economic environment where supply shocks are the principal concern.

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	0.5	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

1. Accounting policies (continued)

1.10 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.

	31 December, 2022					31 December, 2021				
ECL allowance £'000	**Probability -weighted**	**Upside**	**Base**	**Downside**	**Severe Downside**	Probability -weighted	Upside	Base	Downside	Severe Downside
Loans & Advances to customers	**7,882**	**5,165**	**6,515**	**9,275**	**15,955**	144,164	126,295	134,647	155,794	191,426
Assets held for sale	**126,173**	**82,416**	**103,936**	**148,322**	**257,712**	—	—	—	—	—

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.

HPI	**31 December 2022**		31 December 2021	
ECL impact, £'000	**10pp Increase**	**10pp Decrease**	10pp Increase	10pp Decrease
Loans & Advances to customers	**(1,322)**	**2,174**	(6,741)	9,714
Assets held for sale	**(21,033)**	**34,609**	—	—

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.

UK unemployment	**31 December 2022**		31 December 2021	
ECL impact, £'000	**1pp Increase**	**1pp Decrease**	1pp Increase	1pp Decrease
Loans & Advances to customers	**159**	**(127)**	1,619	(1,275)
Assets held for sale	**2,535**	**(1,999)**	—	—

g) Application of judgement in adjustments to modelled ECL

Impairment models fall within the Company'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 Company'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 Company'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 Company 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)

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

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

These adjustments principally comprise:

Inflationary and interest rate pressures:	*Loans and advance to customers*	*£185k*	*(2021: £5,072k)*
	Assets held for sale	*£4,567k*	

There has been only modest evidence of credit deterioration in the UK mortgages portfolio through 2022 despite the high levels of inflation and the rising interest rate environment. Mortgage ECL models use bank base rate as a driver of predicted defaults and that has contributed to the elevated levels of ECL at 31 December 2022. However, there remains a potential risk to affordability from continued inflationary pressures combined with higher interest rates, and that this may not be fully captured by the Company''s ECL models. This risk is to customers maturing from low fixed rate deals, the building impact on variable rate holders and lower levels of real household income. The level of risk is somewhat mitigated from stressed affordability assessments applied at loan origination which means most customers are anticipated to be able to absorb payment shocks. A judgemental uplift in ECL has therefore been taken in specific segments of the mortgages portfolio, either where inflation is expected to present a more material risk, or where segments within the model do not use bank base rate as a material driver of predicted defaults.

At 31 December 2021 additional judgemental ECL was taken in UK mortgages to recognise the heightened risk of interest rates increasing rapidly compared to the base case outlook. This judgement quantified incremental losses from adopting an alternative severe downside scenario with a 4 per cent interest rate peak. This judgement is no longer required given the Company's base case outlook, and modelled ECL, now captures an equivalent interest rate view within the base case alongside an adjusted severe scenario with a 7 per cent interest rate peak.

Increase in time to repossession:	*Loans and advance to customers*	*£518k*	*(2021: £18,570k)*
	Assets held for sale	*£15,390k*	

Due to the Company suspending mortgage litigation activity between late-2014 and mid-2018 due to policy changes for the treatment of arrears, and as collections strategy normalises post COVID-19 pandemic, the Company's experience of possessions data on which our models rely on is limited. This reflects an adjustment made to allow for an increase in the time assumed between default and repossession.

Provision 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 accounts which have been in default for more than 24 months, with an arrears balance increase in the last six months. These accounts have their probability of possession set to 70 per cent based on observed historical losses incurred on accounts that were of an equivalent status. The increase in the judgement reflects a lower modelled coverage that requires a larger adjustment to reach the required levels.

Asset recovery values:	*Loans and advance to customers*	*£486k*	*(2021: £4,007k)*
	Assets held for sale	*£7,777k*	

Due to low repossession volumes, sales data informing the estimated level of discount in the event of repossessions has been limited, impacting the ability to update model parameters. Despite these low volumes, since 2020 the observed asset recovery sale values have remained broadly the same on the limited volumes seen, however the indexed valuation within the model has shown an increasing trend due to HPI increases, therefore management consider it appropriate to uplift ECL to reflect expected recovery values.

Adjustment for specific segments:	*Loans and advance to customers*	*£121k*	*(2021: £8,270k)*
	Assets held for sale	*£1,201k*	

The Company monitors risks across specific segments of its portfolios which may not be fully captured through wider collective models. Judgemental increases applied to probability of default on forborne accounts (31 December 2021: £5,197k) have been removed as models now include forborne accounts in Stage 3 assets. The judgement for fire safety and cladding uncertainty has reduced to £1,322k (31 December 2021: £3,073k). Though experience remains limited the risk is considered sufficiently material to address through judgement, given that there is evidence of assessed cases having defective cladding, or other fire safety issues, but this risk has reduced throughout the year.

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

	2022	2021
	£'000	£'000
Income		
Fees receivable	**95**	79
Expenses		
Interest payable to related undertakings (see note 16)	**64,450**	42,294
Management fees (see note 16)	**9,728**	9,060
Profit before tax	**46,238**	106,689

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 £61k (2021: £58k) 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 £2,249k (2022: nil). This was offset against impairment losses during 2021.

3. Net interest income

	2022	2021
	£'000	£'000
Interest income		
From other loans and advances	**118,237**	108,052
Interest income from parent	**—**	4,168
	118,237	112,220
Interest expense		
Interest expense (see note 16)	**(64,450)**	(42,294)
Net interest income	**53,787**	69,926

4. Credit impairment gains

31 December 2022	**Stage 1 £'000**	**Stage 2 £'000**	**Stage 3 £'000**	**Total £'000**
Transfers between stages	**655**	**7,521**	**(23,868)**	**(15,692)**
Other changes in credit quality	**(894)**	**4,929**	**(13,923)**	**(9,888)**
Repayments	**396**	**11,866**	**15,896**	**28,158**
Other items charged to the income statement	**(498)**	**16,795**	**1,973**	**18,270**
Total impairment credit	**157**	**24,316**	**(21,895)**	**2,578**
In respect of:				
Loans and advances to customer (see note 17)	**150**	**24,311**	**(21,894)**	**2,567**
Undrawn loan commitments	**7**	**5**	**(1)**	**11**

4. Credit impairment gains (continued)

31 December 2021	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'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 charge	2,844	18,186	25,353	46,383
In respect of:				
Loans and advances (see note 17)	2,795	18,100	25,355	46,250
Undrawn loan commitments	49	86	(2)	133

The impairment credit of £2,578k for 2022 is driven by significant adverse impacts from economic updates throughout the year, with worsening HPI and unemployment forecasts along with additional provisions taken in relation to inflation/interest rate risk, being offset by a reduction in provision relating to customer repayments driving the small credit for the year. 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

	2022 £'000	2021 £'000
Management fees (see note 16)	**9,728**	9,060
Conduct provisions (see note 13)	**—**	317
Other operating expenses	**494**	322
	10,222	9,699

Management fees relate to recharges made by the Group in relation to our Group service centres. See note 13 for details in the movement of provisions during the year.

The Company has no employees (2021: nil). It uses the services of its immediate parent undertaking for which a cost transfer charge, included in Management fees, is made.

6. Directors' emoluments

No director received any fees or emoluments from the Company during the year (2021: £nil). The directors are employed by other companies within the Group and consider that their services to the Company are incidental to their other responsibilities.

7. Taxation

a) Analysis of charge for the year

	2022	2021
	£'000	£'000
UK corporation tax:		
- Current tax on taxable profit for the year	**8,345**	19,830
- Adjustments in respect of prior years	**—**	48
Current tax charge	**8,345**	19,878
UK deferred tax:		
- Origination and reversal of timing differences	**440**	440
- Impact of deferred tax rate change	**—**	(660)
Deferred tax charge / (credit) (see note 14)	**440**	(220)
Tax charge	**8,785**	19,658

Corporation tax is calculated at a rate of 19.00% (2021: 19.00%) of the taxable profit for the year.

b) Factors affecting the tax charge for the year

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

	2022	2021
	£'000	£'000
Profit before tax	**46,238**	106,689
Tax charge thereon at UK corporation tax rate of 19.00% (2021: 19.00%)	**8,785**	20,270
Factors affecting charge:		
- Effect of change in tax rate and related impacts	**—**	(660)
- Adjustments in respect of prior years	**—**	48
Tax charge on profit on ordinary activities	**8,785**	19,658
Effective rate	**19.00%**	18.43%

8. Dividends paid

	2022	2021
	£'000	£'000
Equity ordinary shares - Final paid: £12.00 (2021: £4.90) per £1 share	**120,000**	49,000

9. Other current assets

	2022	2021
	£'000	£'000
Current		
Amounts due from group undertakings (see note 16)	**69,425**	58,772
Other debtors	**128**	386
	69,553	59,158

All amounts are receivable within 1 year.

10. Loans and advances to customers

10.1 Loans and advances to customers - maturity

	2022	2021
	£'000	£'000
Gross loans and advances to customers	**39,029**	3,333,360
Less: allowances for losses on loans and advances	**(7,882)**	(144,123)
Net loans and advances to customers	**31,147**	3,189,237
of which:		
Due within one year	**4,721**	385,397
Due after one year	**26,426**	2,803,840
	31,147	3,189,237

Included within the “due within one year” maturity bucket there is £3,632k (2021: £213,015k) in relation to past term customers. On average these customers have a loan to value of <60%. 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	**Stage 2**	**Stage 3**	**Total**
	£'000	**£'000**	**£'000**	**£'000**
Balance at 1 January 2022	**1,937,969**	**1,051,786**	**343,605**	**3,333,360**
Transfers to Stage 1	**118,718**	**(118,432)**	**(286)**	**—**
Transfers to Stage 2	**(372,750)**	**382,998**	**(10,248)**	**—**
Transfers to Stage 3	**(9,702)**	**(209,970)**	**219,672**	**—**
Net decrease in loans and advances to customers	**(352,780)**	**(211,288)**	**(71,420)**	**(635,488)**
Financial assets that have been written off during the year	**—**	**—**	**(11,701)**	**(11,701)**
Gross assets transferred to assets to held for sale	**(1,312,659)**	**(888,134)**	**(446,833)**	**(2,647,626)**
Recoveries of prior advances written off	**—**	**—**	**484**	**484**
Gross loans and advances to customers at 31 December 2022	**8,796**	**6,960**	**23,273**	**39,029**
Less: allowances for losses on loans and advances	**(126)**	**(1,983)**	**(5,773)**	**(7,882)**
Net loans and advances to customers at 31 December 2022	**8,670**	**4,977**	**17,500**	**31,147**

	Stage 1	Stage 2	Stage 3	Total
	£'000	£'000	£'000	£'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 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

11. Assets held for sale

	2022	2021
	£'000	£'000
Assets held for sale	**2,521,453**	—

On 19th January 2023 the Company sold net loans and advances of £2,521,453k to an SPE (See note 19). The equivalent gross loans and advances to customers were £2,647,626k (note 10.2) with an impairment allowance of £126,173k (£126,144k drawn, £29k undrawn, note 17.1).

These mortgages are a group of assets which were actively marketed for sale in a single transaction and available for immediate sale. This sale was a highly probable event at the balance sheet date and as such considered a material disposal group under IFRS 15. The disposal group shall be presented separately from other assets on the face of the balance sheet as an asset held for sale. As the disposal group only comprises mortgages, under IFRS 5 there is no requirement to remeasure the assets, the financial assets continue to be measured under IFRS 9.

The mortgages transferred by the Company to the SPE by way of equitable assignment will be derecognised. This is due to a qualifying transfer of the contractual cashflows taking place, and substantially all risks and rewards having been transferred. The Company will derecognise the mortgages in full, recognising any difference between carrying value and sale price in Other Operating Income (gain of £26m) and through the impairment charge in relation to any Stage 3 impaired loans (gain of £4m).

The Company will continue to service the mortgages receiving an arms length service fee from the SPE.

Comparative amounts for disposal groups held for sale in the statements of financial position for prior periods are not reclassified or re-presented to reflect the classification in the statement of financial position for the latest period presented.

12. Borrowed funds and amounts due to group undertakings

	2022	2021
	£'000	£'000
Amounts due to group undertakings (see note 16)	**2,403,996**	2,895,460

Amounts due to group undertakings includes £0.8m in respect of cost allocations recharged from the Group.

13. Provision for liabilities and charges

	Conduct	**Commitments**	**Total**
	£'000	**£'000**	**£'000**
At 1 January 2021	461	174	635
Charge for the year	317	(133)	184
Utilised during the year	(776)	—	(776)
At 31 December 2021	**2**	**41**	**43**
Charge / (credit) for the year (see note 4)	**—**	**(11)**	**(11)**
Transfer to assets held for sale (see note 17.1)	**—**	**(29)**	**(29)**
Utilised during the year	**(2)**	**—**	**(2)**
At 31 December 2022	**—**	**1**	**1**

As at 31 December 2022, no conduct provisions are held (2021: one provision £2k in respect of repayments of fees applicable to mortgage accounts). During the year, the utilisation of £2k is in respect of customer redress.

A provision for commitments of £1k (2021: £41k) is held in cases where the Company is contractually obligated to advance additional funds.

14. Deferred tax asset

The movement in the Deferred tax asset is as follows:

	2022	2021
	£'000	£'000
Brought forward at 1 January	**3,301**	3,081
Charge for the year	**(440)**	(440)
Effect of change in tax rate and related impacts	**—**	660
Balance at 31 December	**2,861**	3,301

The deferred tax (charge) / credit in the Statement of comprehensive income comprises the following temporary differences:

	2022	2021
	£'000	£'000
Other temporary differences	**(440)**	220

Deferred tax asset comprises:

	2022	2021
	£'000	£'000
Other temporary differences	**2,861**	3,301

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.

15. Share capital

	2022	2021
	£'000	£'000
Allotted, issued and fully paid		
10,000,000 (2021: 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.

16. Related party transactions

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity. The Company's key management personnel are its directors, who consider that their duties in respect of the Company are incidental to their Group responsibilities. No director entered into transactions with the Company in the year (2021: 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 £61k (2021: £58k) was borne by the parent company.

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

Cash and cash equivalents of £66,876k (2021: £25,780k) comprises a bank account held with its parent undertaking Bank of Scotland plc.

Included in the "Amounts due from group undertakings" there is £69,423k (2021: £58,770k) 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.

	2022	2021
	£'000	£'000
Amounts due from group undertakings		
Amounts due from parent	**69,423**	58,770
Amounts due from other related parties	**2**	2
Total amounts due from group undertakings	**69,425**	58,772
Amounts due to group undertakings		
Amounts due to parent	**2,403,210**	2,893,916
Amounts due to other related parties	**786**	1,544
Total amounts due to group undertakings	**2,403,996**	2,895,460

Net repayment of borrowings with parent undertaking £501,359k (2021: £1,044,526k).

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.

16. Related party transactions (continued)

	2022	2021
	£'000	£'000
Interest income		
Interest income from parent	—	4,168
Total Interest income (see note 3)	—	4,168
Interest expense		
Interest expense with parent	**64,450**	42,294
Total Interest expense (see note 3)	**64,450**	42,294
Management fees		
Management recharge from the Group	**9,728**	9,060
Total Management fees (see note 5)	**9,728**	9,060

17. Financial risk management

The Company's operations expose it to credit risk, liquidity risk and interest rate risk; it is not exposed to any significant foreign exchange, business or market 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 Group undertakings which fund the Company and credit risk is carefully monitored by Retail Finance's credit committee and credit functions. Business risk is managed through regular reporting and oversight.

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

17.1 Credit risk

Credit risk management

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 1.10. Credit risk disclosures for assets held for sale have not been presented on the basis the assets were sold post year end

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 2022		As at 31 December 2021	
	Maximum Exposure	**Net Exposure**	Maximum Exposure	Net Exposure
	£'000	**£'000**	£'000	£'000
Loans and advances to customers (net)	**31,147**	**31,147**	3,189,237	3,189,237
Off balance sheet items:				
Commitments to lend	**3,222**	**3,222**	112,845	112,845
	34,369	**34,369**	3,302,082	3,302,082

The gross fair value of collateral held is £37,848k (2021: £3,315,081k) representing 97% 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 2022		**Stage 1**	**Stage 2**	**Stage 3**	**Total**
	PD Range	**£'000**	**£'000**	**£'000**	**£'000**
Retail					
RMS 1-6	0.00-4.50%	**8,750**	**3,095**	**—**	**11,845**
RMS 7-9	4.51-14.00%	**46**	**1,146**	**—**	**1,192**
RMS 10	14.01-20.00%	**—**	**334**	**—**	**334**
RMS 11-13	20.01-99.99%	**—**	**2,385**	**—**	**2,385**
RMS 14	100%	**—**	**—**	**23,273**	**23,273**
Total		**8,796**	**6,960**	**23,273**	**39,029**

		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

	Stage 1	**Stage 2**	**Stage 3**	**Total**
Loan Commitments	**£'000**	**£'000**	**£'000**	**£'000**
At 31 December 2022	**1,409**	**1,759**	**54**	**3,222**
At 31 December 2021	89,714	21,570	1,561	112,845

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 Group undertakings are impaired (2021: £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 2022	1,682	61,152	81,289	144,123
Transfers to Stage 1	3,111	(3,095)	(16)	—
Transfers to Stage 2	(922)	2,350	(1,428)	—
Transfers to Stage 3	(24)	(15,464)	15,488	—
Impact of transfers between stages	(2,817)	8,688	9,821	15,692
	(652)	(7,521)	23,865	15,692
Other items credited to the income statement	502	(16,790)	(1,971)	(18,259)
Credit for the year (including recoveries) (see note 4)	(150)	(24,311)	21,894	(2,567)
Advances written off	—	—	(11,701)	(11,701)
Recoveries of prior advances written off	—	—	484	484
Discount unwind	—	—	3,687	3,687
Transferred to assets held for sale	(1,406)	(34,858)	(89,880)	(126,144)
At 31 December 2022	126	1,983	5,773	7,882

In respect of undrawn balances	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
1 January 2022	13	26	2	41
Transfers to Stage 1	1	(1)	—	—
Transfers to Stage 2	(3)	3	—	—
Transfers to Stage 3	—	(3)	3	—
Impact of transfers between stages	(1)	1	(1)	(1)
	(3)	—	2	(1)
Other items credited to income statement	(4)	(5)	(1)	(10)
Charge / (release) to the income statement (see note 4)	(7)	(5)	1	(11)
Transfer to assets held for sale	(5)	(21)	(3)	(29)
At 31 December 2022	1	—	—	1

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
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 charged to the income statement	(3,155)	(14,043)	(26,535)	(43,733)
Charge 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 charged / (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

Loans and advances to customers are held at amortised cost.

17. Financial risk management (continued)

17.1 Credit risk (continued)

Credit risk management (continued)

Analysis of loan to value

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%	**7,645**	**5,638**	**14,807**	**28,090**
60% to 70%	**918**	**761**	**1,666**	**3,345**
70% to 80%	**142**	**218**	**483**	**843**
80% to 90%	**57**	**72**	**1,101**	**1,230**
90% to 100%	**34**	**142**	**835**	**1,011**
Greater than 100%	**—**	**129**	**4,381**	**4,510**
At 31 December 2022	**8,796**	**6,960**	**23,273**	**39,029**

	Stage 1	Stage 2	Stage 3	Total
	£'000	£'000	£'000	£'000
Less than 60%	1,470,066	741,259	169,674	2,380,999
60% to 70%	334,685	184,111	54,875	573,671
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

Repossessed collateral

During 2022 the Company obtained assets with a carrying value of £14,086k (2021: £13,609k) 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 the Group.

Liquidity risk is managed as part of the Group 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 2022	**Up to 1 month**	**1-12 months**	**1-5 years**	**Total**
	£'000	**£'000**	**£'000**	**£'000**
Borrowed funds (see note 12)	**1,853,982**	**400,014**	**150,000**	**2,403,996**
Contractual interest payments	**—**	**7,339**	**5,730**	**13,069**

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

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, which is the basis for the interest charged on such balances. A 0.5% (2021: 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 SONIA increased in the year. 2022 excludes amounts in respect of the disposal group (see note 11).

	-50 bps	**Profit before taxation**	**+50 bps**
	£'000	**£'000**	**£'000**
2022	**447**	**662**	**878**
2021	88,651	106,689	124,727

	-50 bps	**Equity**	**+50 bps**
	£'000	**£'000**	**£'000**
2022	**3,787**	**4,003**	**4,218**
2021	344,071	362,085	380,099

17. Financial risk management (continued)

17.3 Interest rate risk (continued)

Interest rate risk - maturity

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

2022	**Less than 1 year**	**Between 1-2 years**	**Between 2-5 years**	**5 years or more**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Loans and advances to customers	**4,721**	**1,075**	**8,146**	**17,205**	**31,147**
Interest bearing loans and borrowings	**2,253,996**	**150,000**	**—**	**—**	**2,403,996**

2021	Less than 1 year	Between 1-2 years	Between 2-5 years	5 years or more	Total
	£'000	£'000	£'000	£'000	£'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

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, Assets held for sale, Bank borrowings and Amounts due to group undertakings are all held at amortised cost.

As at 31 December 2022, the carrying amount of loans and advances to customers is £31,147k (2021: £3,189,237k) and a fair value £34,555k (2021: £3,245,053k). The fair value is classified as level 3 due to significant unobservable inputs used in the valuation models.

Assets held for sale with a gross value of £2,647,626k (net £2,521,453k) at 31 December 2022 were valued at £2,625,534k on the 19th January 2023 and sold for £2,656,324k.

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 the Group's 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 2022, total managed capital was £279,538k (2021: £362,085k).

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 2022.

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 2023. 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 £30,013k (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

Sale of Loans and Advances to Special Purpose Entity

On 19th January 2023 the Company sold £2,625,534k (2022 value: £2,647,626k) of gross loans and advances to customers to an unconsolidated structured special purpose entity (SPE) for proceeds of £2,656,324k, incurring a gain of £30,790k. The Company will continue to service the mortgages receiving an arms length service fee from the SPE.

Under IAS 10, the transaction is classified as a non-adjusting event, being defined as an event after the reporting period that is indicative of conditions that arose after the reporting period. Non-adjusting events do not give rise to a need for changes in the amounts recognised in the financial statements, but should be disclosed if they are material, such that non-disclosure could reasonably be expected to influence decisions that the primary users make on the basis of general purpose financial statements.

This disposal group has been classified within Assets held for sale on the Balance Sheet with further details in Note 11.

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 2023 (including IAS 1 Presentation of financial statements and IAS 8 Accounting policies, changes in accounting estimates and errors). These amendments are not applicable for the year ended 31 December 2022, have not been applied in preparing these financial statements and 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, 25 Gresham Street, London, EC2V 7HN. The Group's 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 2022 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.

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.

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 areas of the expected credit loss ("ECL") calculation, and our specific procedures performed to address them are described below:

The ECL provision (including that related to assets held for sale) is determined on a collective basis using impairment models to calculate a probability weighted estimate by applying a probability of default, exposure at default and a loss given default, taking account of collateral held or other loss mitigants, discounted using the effective interest rate.
The key judgements and estimates in determining the ECL for the Retail division include:

- Modelling approach, modelling simplifications and judgements, and selection of modelling data;
- Behavioural lives; and
- The appropriate allocation of assets into the correct IFRS 9 stage through the assessment of significant deterioration in credit risk since origination.

Adjustments are made to models to address known model and data limitations, and emerging or non-modelled risks. The current economic environment continues to be uncertain and differs from recent experience which is characterised by elevated inflation and increasing cost, increased cost of living and increasing costs of financing, which affects the debt servicing capability for borrowers. As a result, the judgements around if and when the company have recognised adjustments in the model to account for the impacts of the current economic environment and potential model weaknesses in coping with the current economic outlook are highly judgemental and inherently uncertain. These adjustments require specialist auditor judgement when evaluating the completeness of adjustments, and the methodology, models and inputs to the adjustments.

In response to the risk identified we:

- Tested controls across the process to determine the ECL provisions including:
  - Model governance including model validation and monitoring;
  - Model assumptions;
  - The allocation of assets into stages; and
  - Data accuracy and completeness.

Working with our internal modelling specialists, our audit procedures over the key areas of estimation covered the following:

- Model estimations, where we:
  - evaluated the appropriateness of the modelling approach and assumptions used;

    - independently replicated the models for all material portfolios and compared the outputs of our independent models to the company's outputs;
    - assessed model performance by evaluating variations between observed data and model predictions;
    - developed an understanding and assessed model limitations and remedial actions; and
    - tested the completeness and accuracy of the data used in model execution and calibration.
- Allocation of assets into stages, where we:
    - evaluated the appropriateness of quantitative and qualitative criteria used for allocation into IFRS 9 stages;
    - tested the appropriateness of the stage allocation for a sample of exposures; and
    - tested the data used by models in assigning IFRS 9 stages and evaluated the appropriateness of the model logic used.

In respect of the adjustment to models, we performed the following procedures in conjunction with our specialists:

- Tested the controls over the adjustments to the models;
- Evaluated the methodology, approach and assumptions in developing the adjustments, and evaluated the company's selection of approach;
- Tested the completeness and accuracy of the data used;
- Performed a recalculation of the adjustments;
- Evaluated the completeness of adjustments based on our understanding of model and data limitations, including those related to cost of living pressures; and
- Evaluated whether duplication exists between different model adjustments and between model adjustments and core models.

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 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

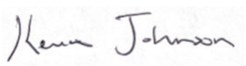
Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- 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.



Kevin Johnson ACA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Edinburgh, United Kingdom
21 April 2023