HBOS INVESTMENT FUND MANAGERS LIMITED

ANNUAL REPORT

AND

FINANCIAL STATEMENTS

31 DECEMBER 2017

Member of Lloyds Banking Group plc

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COMPANY INFORMATION

Board of Directors

J M Black
C M Herd
S W Lowther
G M Stewart

Company Secretary

D Clarke

Independent Auditors

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

Registered Office

Trinity Road
Halifax
West Yorkshire
HX1 2RG

Company Registration Number

00941082

STRATEGIC REPORT

The Directors present their strategic report on HBOS Investment Fund Managers Limited ("the Company") for the year ended 31 December 2017.

The Company contributes to the results of the Insurance Division of Lloyds Banking Group ("LBG").

Principal activities

The principal activity of the Company is that of an Authorised Corporate Director of seven Open-Ended Investment Companies ("OEIC") and a manager of an Individual Savings Account ("ISA"). Two of the seven OEICs were terminated in May 2016 and are currently progressing through FCA de-authorisation. The Company is closed to new business but continues to receive increments on existing business.

Result for the year

The result of the Company for the year ended 31 December 2017 is a profit before tax of £67.0m (2016: £57.2m).

The result contains a 4% increase in revenue, which is a consequence of higher funds under management in addition to reduced annual management charge ("AMC") rebates.

There has been a £9.0m decrease in distribution and selling costs in the period, £8.4m of which relates to a one-off adjustment for overpayments of value share in both current and prior periods.

Britain leaving the European Union

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

Key Performance Indicators

The Company is focused on ensuring it maximises capital efficiency and returns for its shareholder and the LBG Insurance Division. To support this, the Company is focused on the following financial key performance indicators. There are no non-financial KPI's to consider.

Funds Under Management

The Company's funds under management are £20.7bn (2016: £20.1bn), the movement reflecting net flows from policy holders and investment return for the year. Revenue from annual management charges was £115.6m (2016: £109.7m).

Capital Resources

The Directors believe that the Company currently has adequate capital resources and will continue to do so in the foreseeable future. Further information on the capital position of the Company is given in note 23.

Liquidity

The Company regularly monitors its liquidity position, to ensure that, even under stressed conditions, the Company has sufficient liquidity to meet its obligations and remain within approved risk appetite.

Other Sources

The Company also forms part of LBG's Insurance Division. The development, performance and position of the Insurance Division are presented within LBG's annual report, which does not form part of this report.

The Directors consider that the above are the key performance indicators which are appropriate to the principal activity of the Company. These, together with other metrics which cover customer, operational measures and capital, are included in the balanced scorecard which is used to measure all aspects of the performance of the business. In addition, the Directors are of the opinion that the information contained in the Company's Financial Conduct Authority ("FCA") returns on capital resources and requirements, in conjunction with the information presented in the financial statements as a whole, provide the management information necessary for the Directors to understand the development, performance and position of the business of the Company.

STRATEGIC REPORT (CONTINUED)

Review of the business

In addition to the progress made against the strategic initiatives summarised earlier there are other areas that are worthy of note and these are described below.

Outsourcing of long-standing customer administration platform

On 26 September 2017, entities within the Insurance Division entered into a long-term strategic partnership with Diligenta, to create an industry-leading policy administration service for our customers with long-standing products. The main benefit to our customers is that this new outsourcing arrangement will provide a service platform with digital capabilities so, over time, our customers with long-standing products can manage their policies in a simpler and more efficient way and we can respond better to their changing needs.

For investment business, the benefits will be realised as they emerge through lower costs payable in relation to the administration costs of these funds.

Outlook

The Directors consider that the Company's principal activities will continue unchanged in the foreseeable future.

Principal risks and uncertainties

During the year, the management of the business and the execution of the Company's strategy were subject to a number of risks. The financial risk management objectives and policies of the Company and the exposure to risks including market, credit, capital, liquidity, operational and conduct risks are set out in note 23.

On behalf of the Board of Directors

S W Lowther
Director
26 January 2018

DIRECTORS' REPORT

The Directors present the audited financial statements of the Company. The Company is a limited liability company, domiciled and incorporated in the United Kingdom.

The Company is a wholly owned subsidiary of Halifax Financial Services (Holdings) Limited. The Company's ultimate parent company and ultimate controlling party is LBG.

Results and dividend

The result of the Company for the year ended 31 December 2017 is a profit before tax of £67.0m (2016: £57.2m).

The result contains a 4% increase in revenue, which is a consequence of higher funds under management in addition to reduced annual management charge ("AMC") rebates. The Directors consider the result for the year to be satisfactory in light of these factors. Further information can be found in the Strategic Report.

An interim dividend of £20.0m was paid during the year (2016: £32.0m in respect of 2016). The Directors recommend no payment of a final dividend in respect of the year ended 31 December 2017 (2016: £nil).

Directors

The names of the current Directors are listed on page 3. Changes in directorships during the year and since the end of the year are as follows:

S W Lowther	(appointed 10 April 2017)
C M Herd	(appointed 06 June 2017)
R F C Taylor	(resigned 31 December 2017)

Particulars of the Directors' emoluments are set out in note 24.

Directors' indemnities

Lloyds Banking Group plc has granted to the Directors of the Company a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements or from the date of appointment in respect of the directors 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 contract of indemnity during that period of service. The indemnity remains in force for the duration of a Director's period of office. The deed indemnifies the Directors to the maximum extent permitted by law.

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

Disclosure of information to auditors

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

Future developments

Details of future developments are provided in the Company Strategic Report.

Financial risk management

Disclosures relating to financial risk management are included in note 23 to the accounts and are therefore incorporated into this report by reference.

DIRECTORS' REPORT (CONTINUED)

Statement of Directors' Responsibilities

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

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

The Directors 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 and, as regards the Financial Statements, Article 4 of the IAS Regulation. 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 Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors whose names are listed on page 3 confirms that, to the best of their knowledge:

- the Company financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and
- the Strategic Report on pages 4 to 5, and the Directors' Report on pages 6 to 7, includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

On behalf of the Board of Directors

S W Lowther
Director
26 January 2018

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF HBOS INVESTMENT FUND MANAGERS LIMITED

Report on the audit of the financial statements

Opinion

In our opinion, HBOS Investment Fund Managers Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2017; the statement of comprehensive income for the year ended 31 December 2017; the statement of cash flows for the year ended 31 December 2017; the statement of changes in equity for the year ended 31 December 2017; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

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

Independence

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

Conclusions relating to going concern

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

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

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

Reporting on other information

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

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

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

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

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF HBOS INVESTMENT FUND MANAGERS LIMITED (CONTINUED)

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 7, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the financial statements

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

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Claire Turner

Claire Turner (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol
26 January 2018

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 £000	2016 £000
Revenue	3	123,749	119,415
Distribution and selling costs	4	4,670	(4,345)
Gross profit		128,419	115,070
Investment income	5	640	932
Net losses on financial instruments at fair value through profit or loss	6	(508)	(873)
Administrative expenses	7	(61,529)	(57,851)
Finance costs	9	(57)	(78)
Profit before tax		66,965	57,200
Taxation charge	10	(12,892)	(11,440)
Profit and total comprehensive income for the year		54,073	45,760

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

The notes set out on pages 14 to 33 are an integral part of these financial statements.

BALANCE SHEET AS AT 31 DECEMBER 2017

	Notes	31 December 2017 £000	31 December 2016 £000
ASSETS			
Deferred origination costs	11	2,421	2,959
Financial assets:			
Financial assets at fair value through profit or loss	12	3,101	5,546
Trade and other receivables	13	61,252	56,351
Cash and cash equivalents	14	174,462	147,667
Total assets		241,236	212,523
EQUITY AND LIABILITIES			
Equity attributable to Company's equity shareholder			
Share capital	15	8,000	8,000
Retained profits		163,676	129,603
Total equity		171,676	137,603
Liabilities			
Current income tax liability	16	12,892	11,440
Provisions	17	390	7,871
Financial liabilities:			
Trade and other payables	18	56,202	45,516
Derivative financial instruments	19	76	126
Bank borrowings	20	-	9,967
Total liabilities		69,560	74,920
Total liabilities and equity		241,236	212,523

The notes set out on pages 14 to 33 are an integral part of these financial statements.

The financial statements on pages 10 to 33 were approved by the Board on 26 January 2018 and signed on its behalf.

S W Lowther
Director

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 £000	2016 £000
Cash flows from operating activities			
Profit before tax		66,965	57,200
Adjusted for:			
Decrease in deferred origination costs	11	538	538
Net movement in operating assets and liabilities	21	699	5,363
Taxation paid		(11,440)	(12,550)
Net cash flows from operating activities		56,762	50,551
Cash flows from financing activities			
Dividends paid	22	(20,000)	(32,000)
Net cash flows used in financing activities		(20,000)	(32,000)
Net increase in cash and cash equivalents		36,762	18,551
Cash and cash equivalents at the beginning of the year		137,700	119,149
Net cash and cash equivalents at the end of the year	14	174,462	137,700

The notes set out on pages 14 to 33 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2017

	Share *capital* **£000**	**Retained** *profits* **£000**	**Total attributable to owner of** *the parent* **£000**
Balance as at 1 January 2016	8,000	115,843	123,843
Total comprehensive income/Profit for the year	-	45,760	45,760
Dividend paid	-	(32,000)	(32,000)
Balance as at 31 December 2016	8,000	129,603	137,603
Total comprehensive income/Profit for the year	-	54,073	54,073
Dividend paid	-	(20,000)	(20,000)
Balance as at 31 December 2017	8,000	163,676	171,676

Not all of the above amounts can be distributed to the equity holder since the Company is required to meet regulatory capital requirements. Further details are given in note 23 c) 4).

The notes set out on pages 14 to 33 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

1. Accounting policies

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

(a) Basis of preparation

The financial statements of the Company have been prepared:

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

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

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

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

In accordance with IAS 1 "Presentation of Financial Statements", assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity. Analysis of the assets and liabilities of the Company into amounts expected to be received or settled within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in the notes.

Standards and interpretations effective in 2017

The Company has not adopted any new standards, amendments to standards and interpretations of published standards which became effective financial years beginning on or after 1 January 2017, which have had a material impact on the Company.

Details of standards and interpretations in issue but which have not been adopted early are set out at note 26.

(b) Revenue recognition

Revenue

Revenue, which arose wholly in the United Kingdom, represents the following:

- Net fee income from the sale of shares in OEIC sub funds and other similar fees
- Net fee remuneration from the management of shares in OEIC sub funds
- Other income, which includes registration fees and other similar fees

The fees are recognised as revenue in the statement of comprehensive income in the year as the services are being provided. If the fees are for services to be provided in future years, these are deferred and recognised in the statement of comprehensive income as revenue as the service is provided.

Net gains and losses on assets and liabilities at fair value through profit or loss

Net gains and losses on assets and liabilities at fair value through profit or loss includes both realised and unrealised gains and losses. Movements are recognised in the statement of comprehensive income in the period in which they arise.

Investment income

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

(c) Expense recognition

Distribution and selling costs

Distribution and selling costs consist of commission and value share paid to acquire new business and existing business. Where certain criteria are met, commission and other acquisition costs may be deferred. The circumstances under which such costs are deferred are set out at policy (d).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

1. Accounting policies (continued)

(c) Expense recognition (continued)

Administrative expenses

These consist of recharges from group companies and fund management fees that are recognised in the statement of comprehensive income as they accrue.

Finance costs

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

(d) Deferred origination costs

The costs of commission paid to acquire new business incurred during a financial year but which relate to subsequent financial years are deferred to the extent that they are recoverable out of future revenue margins. This asset is subsequently amortised over the remaining contractual lifetime of each holding on a straight-line basis unless there is evidence to support an alternative recognition basis. Where an alternative recognition basis is applied, this is calculated by reference to experience information in respect of the period over which income from contracts is earned. The amortisation charge for the year is recognised through the statement of comprehensive income, within distribution and selling costs. The carrying value of the asset is tested for impairment at each reporting date. Deferred origination costs are split between current and non-current. Current deferred costs run off within the next year and non-current in more than the next year. The deferred origination costs have a finite life and run off over varying periods based on the expectation of various products. Further information on the Company's impairment policy is set out at policy (i).

(e) Financial assets and financial liabilities

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

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Company has transferred substantially all of the risks and rewards of ownership. Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

All financial assets and financial liabilities are designated at fair value through profit or loss, with the exception of certain trade and other receivables, borrowings and trade and other payables, which are stated at amortised cost (as described in policies (g), (p) and (l)). The classification depends on the purpose for which the financial assets and financial liabilities were acquired.

No assets are classified as held-to-maturity or available-for-sale. Derivative assets (other than a derivative which is a designated and effective hedging instrument) are classified as held for trading. With the exception of derivative liabilities, no liabilities are classified as held for trading.

Transaction costs incidental to the acquisition of a financial asset are expensed through the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss.

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

(f) Fair value methodology

All assets and liabilities carried at fair value, or for which a fair value measurement is disclosed are categorised into a "fair value hierarchy" as follows:

(i) Level 1

Valued using quoted prices (unadjusted) in active markets for identical assets and liabilities to those being valued. An active market is one in which arm's length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an ongoing basis. Examples include listed equities, listed debt securities, OEICs and unit trusts traded in active markets and exchange traded derivatives such as futures.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

1. Accounting policies (continued)

(f) Fair value methodology (continued)

(ii) Level 2

Valued using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices). If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- Quoted prices for similar (but not identical) instruments in active markets;
- Quoted prices for identical or similar instruments in markets that are not active, where prices are not current, or price quotations vary substantially either over time or among market makers;
- Inputs other than quoted prices that are observable for the instrument (for example, interest rates and yield curves observable at commonly quoted intervals and default rates);
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means.

Examples of these are securities measured using discounted cash flow models based on market observable swap yields, and listed debt or equity securities in a market that is inactive.

(iii) Level 3

Valued using inputs for the asset or liability that include significant unobservable inputs (inputs not based on observable market data). Unobservable inputs may have been used to measure fair value where observable inputs are not available. This approach allows for situations in which there is little, if any, market activity for the asset or liability at the measurement date (or market information for the inputs to any valuation models). Unobservable inputs reflect the assumptions the Company considers that market participants would use in pricing the asset or liability, for example certain private equity investments held by the Company.

Where estimates are used, these are based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible.

Further analysis of the Company's instruments held at fair value is set out at note 23.

(g) Trade and other receivables

Trade and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, and that are not designated as fair value through profit or loss at initial recognition.

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

A charge for impairment in respect of trade and other receivables would be made in the statement of comprehensive income where there is objective evidence that the Company will not be able to collect all amounts due according to their original terms. The impairment charge would be recognised in that part of the statement of comprehensive income in which the original transaction was reported. Further information on the Company's impairment policy is set out in policy (i).

(h) Cash and cash equivalents

Cash and cash equivalents comprises cash at bank, short term highly liquid investments with original maturities of three months or less (excluding such investments as otherwise meet this definition but which are held for investment purposes rather than for the purposes of meeting short-term cash commitments) and bank overdrafts where a legal right of set off exists.

(i) Impairment

Financial assets

The carrying value of all financial assets held at amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The identification of impairment and the determination of recoverable amounts is an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, observable fair prices and expected net selling prices. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

1. Accounting policies (continued)

(i) Impairment (continued)

Non-financial assets

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

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

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

Impairment process

Objective evidence that an asset or group of assets is impaired includes observable data that comes to the attention of the Company about the following events:

(i) significant financial difficulty of the issuer or debtor;
(ii) a breach of contract;
(iii) the disappearance of an active market for that asset because of financial difficulties; or
(iv) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of assets since the initial recognition of those assets, even where the decrease cannot yet be identified with the individual assets of the Company, including:

- adverse changes in the payment status of issuers or receivables; or
- national or local economic conditions that correlate with defaults on the assets in the Company.

The Company first assesses whether objective evidence of impairment exists individually for assets that are individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

(j) Taxation, including deferred income taxes

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement 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 income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

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

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

(k) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

Dividends payable

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

1. Accounting policies (continued)

(l) Trade and other payables

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

(m) Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, when it is probable that the obligation will result in an outflow of resources to settle the obligation and when a reliable estimate of the amount of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability.

The Company recognises a provision for onerous contracts when the expected benefits to be derived from contracts are less than the unavoidable costs of meeting the obligations under the contracts.

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 the likelihood of possible obligations arising is remote.

(n) Derivative financial instruments

All derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value.

Changes in the fair value of derivatives are recognised in the statement of comprehensive income, through net gains and losses on assets and liabilities at fair value through profit or loss.

(o) Financial assets at fair value through profit or loss

Classification

Financial asset investment balances comprise the stock of shares held in the manager's box and investments held through liquidity funds.

Recognition

Purchases and sales of financial assets are recognised on the trade date, i.e. the date the Company commits to purchase the asset from, or deliver the asset to, the counterparty. Investments are initially recognised at fair value through profit or loss, being the fair value of the consideration given, and are subsequently re-measured at fair value.

Measurement

The fair values of investments are based on a combination of current bid, mid or offer prices. If the market for a financial asset is not active, and also for unlisted securities, fair value is established by using valuation techniques. These include the use of similar arm's length transactions and reference to other instruments that are substantially the same, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

For equity investments that are quoted and actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the final pricing point on the reporting date. Prices are provided by vendors such as Reuters or Bloomberg or by direct reference to the Stock Exchange.

The fair value of holdings in collective investment vehicles (including OEICs and unit trusts) is determined as the last published price applicable to the vehicle at the reporting date.

(p) Borrowings

Borrowings are recognised initially at fair value, being the issue proceeds net of transaction costs incurred. In practice, due to the nature of these balances, being bank overdrafts, the carrying value equates to the fair value of these liabilities as the borrowings are repayable on demand.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

2. Critical accounting estimates and judgments in applying accounting policies

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

Critical accounting estimates

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period are discussed below.

(a) Deferred origination costs

Origination costs in respect of the contracts managed by the Company, which are incurred during the financial period but which relate to subsequent financial periods, are deferred to the extent that they are recoverable out of future revenue margins. The calculation of the deferred origination cost asset and its pattern of amortisation requires estimation of both the expected pattern of receipt of future revenue margins and the period of time that the business is expected to remain in force. Estimation is required of the period that the business is expected to remain in force and prudent assumptions are required for contracts which do not have a fixed maturity date. Further information on this asset is given in notes 1(d) and 11.

3. Revenue

	2017 £000	2016 £000
Annual management charges	115,575	109,656
Exit fees	5,659	6,940
Unit dealing income	745	895
Other income	1,770	1,924
Total	**123,749**	**119,415**

Included in annual management charges is an amount of (£900k), (2016: (£2,794k)) in respect of customer remediation which has been provided during the year.

4. Distribution and selling costs

	2017 £000	2016 £000
Commissions payable and other selling costs	5,213	(3,807)
Change in deferred origination costs	(538)	(538)
Stamp duty	(5)	-
Total	**4,670**	**(4,345)**

There has been a £9.0m decrease in distribution and selling costs in the period, £8.4m of which relates to a one-off corrective adjustment recognised in 2017 for overpayments of internal commission in relation to both current and prior periods.

5. Investment income

	2017 £000	2016 £000
Interest and dividend income on financial assets at fair value through profit or loss	640	932
Total	**640**	**932**

6. Net losses on financial instruments at fair value through profit or loss

	2017 £000	2016 £000
Net losses on financial instruments at fair value through profit or loss	(508)	(873)
Total	**(508)**	**(873)**

Included in the net losses on financial assets at fair value through profit or loss are movements as a result of holding prefunded OEIC shares to facilitate transactions.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

7. Administrative expenses

	2017 £000	2016 £000
Recharges from other group companies	(36,585)	(30,984)
Investment expenses	(22,561)	(24,665)
Custodian fees	(521)	(513)
Trustee fees	(863)	(759)
Other (including provision in respect of customer remediation)	(999)	(930)
Total	(61,529)	(57,851)

Administrative expenses relate to the costs incurred in the administration and investment management of ISAs and OEIC shares.

Administration of the recharges is primarily undertaken by Scottish Widows Services Limited with respect to those costs incurred on behalf of the Company.

The Company had no direct employees during the year (2016: nil). The employee costs, including pension costs, are included in the recharge from other group companies noted above.

8. Auditors' remuneration

	2017 £000	2016 £000
Fees payable to the Company's auditor for the audit of the Company's annual financial statements	(19)	(20)
Fees payable to the Company's auditor and its associates for other services:		
Audit-related assurance services	(95)	(114)
Total	(114)	(134)

Audit fees for 2016 and 2017 were borne by Scottish Widows Services Limited and recharged to the Company.

9. Finance costs

	2017 £000	2016 £000
Interest on borrowings	(57)	(78)
Total	(57)	(78)

10. Taxation charge

(a) Current year tax charge

	2017 £000	2016 £000
Current tax:		
UK corporation tax	(12,892)	(11,440)
Total income tax charge	(12,892)	(11,440)

10. Taxation charge (continued)

(b) Reconciliation of tax charge

	2017 £000	2016 £000
Profit before tax	66,965	57,200
Tax at 19.25% (2016: 20%)	(12,892)	(11,440)
Effects of:		
Change in tax rate	-	-
Total	(12,892)	(11,440)

The Finance (No. 2) Act 2015 reduced the main rate of corporation tax to 19% with effect from 1 April 2017.

Finance Act 2016 further reduced the main rate of corporation tax to 17% with effect from 1 April 2020.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

11. Deferred origination costs

	2017 £000	2016 £000
At 1 January	2,959	3,497
Amortisation during the year	(538)	(538)
At 31 December	**2,421**	**2,959**

Of the above total, £1,883k (2016: £2,421k) is expected to be recovered more than one year after the reporting date.

12. Financial assets at fair value through profit or loss

	2017 £000	2016 £000
Other OEIC holdings	3,101	5,546
Total	**3,101**	**5,546**

Other OEIC holdings comprise shares held in the OEIC funds that are managed by the Company which are classified at fair value through profit or loss as part of the manager's daily box holdings. Purchases and sales are recognised on the trade date, i.e. the date the Company commits to purchase the asset from, or deliver the asset to, the counterpart.

Interests in unconsolidated structured entities

These are included within investments at fair value through profit or loss £3.1m (2016: £5.5m) in note 12 and cash and cash equivalents £165.4m (2016: £144.8m) in note 14. These are investments in unconsolidated structured entities of £168.5m (2016: £150.3m) arising from investments in collective investment vehicles.

The investments are carried at fair value and the Company's maximum exposure to loss is equal to the carrying value of the investment. At 31 December 2017, the total net assets of unconsolidated collective investment vehicles in which the Company held a beneficial interest was £35.5bn (2016: £34.3bn). During the year the Company has not provided any non-contractual financial or other support to these unconsolidated collective investment vehicles.

The Company sponsors a range of collective investment vehicles where it acts as the decision maker over the investment activities and markets the funds under one of LBG's brands. The Company earns fees from managing the investments of these funds. The investment management fees that the Company earned from these sponsored unconsolidated collective investment vehicles, including those in which the Company held no interest at 31 December 2017, was £115.6m (2016: £109.7m).

13. Trade and other receivables

	2017 £000	2016 £000
Trade and other receivables		
Trade receivables	52,363	53,638
Amounts due from group undertakings (see note 24)	8,258	2,120
Non-trade receivables	631	593
Total	**61,252**	**56,351**

None of the above balances are interest-bearing (2016: none).

Further information in respect of credit risk in relation to trade and other receivables is given in note 23.

Of the above total, £nil (2016: £nil) is expected to be settled more than one year after the reporting date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

14. Cash and cash equivalents

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

	2017 £000	2016 £000
Cash at bank	9,066	2,833
Investments held through liquidity funds	165,396	144,834
	174,462	**147,667**
Less: Bank borrowings (see note 20)	-	(9,967)
Total	**174,462**	**137,700**

Cash and cash equivalents does not include client monies held on deposit of £16,091k (2016: £17,735k). These amounts are similarly excluded from current liabilities.

Investments held through (OEIC) liquidity funds are used to optimise returns on excess funds held by the Company. Further information in respect of credit risk in relation to cash and cash equivalents is given in note 23.

15. Share capital

	2017 £000	2016 £000
Authorised, allotted, called up and fully paid share capital:		
8,000,000 (2016: 8,000,000) ordinary "A" shares of £1 each	8,000	8,000
	8,000	**8,000**

There were no changes in share capital during the year. All shares rank equally with regard to the Company's residual assets.

16. Tax liabilities

	2017 £000	2016 £000
Current tax liability	12,892	11,440
Total tax liabilities	**12,892**	**11,440**

17. Provisions

	2017 £000	2016 £000
At 1 January	7,871	15,300
Amounts provided for during the year	900	3,150
Amounts utilised during the year	(8,381)	(10,579)
At 31 December	**390**	**7,871**

A provision of £7.9m was held as at 31 December 2016 under Project Bramble; the project undertook a review of annual management charges and decided to reduce charges on certain funds and to backdate their effect. The residual balance at the end of the reporting period is £0.4m.

Of the above total, £nil (2016: £nil) is expected to be settled more than one year after the reporting date.

18. Trade and other payables

	2017 £000	2016 £000
Trade payables	41,987	30,039
Amounts due to group undertakings (see note 24)	13,072	13,640
Other payables	1,143	1,837
Total	**56,202**	**45,516**

None of the above balances are interest-bearing or secured (2016: none). Further information in respect of liquidity risk in relation to trade and other payables is given in note 23.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

19. Derivative financial instruments

The Company's derivative financial instruments are recognised at fair value. Futures are bought to offset the risk of unforeseen losses in operating the other OEIC holdings (see note 12).

	2017 £000	2016 £000
Derivative liability	76	126
Total	**76**	**126**

The contract amount of the derivatives is £2,291k (2016: £5,091k). The carrying amount disclosed reflects the fair values at the year end, and relates to derivative contracts maturing within the next 12 months.

20. Bank borrowings

	2017 £000	2016 £000
Bank borrowings	-	9,967
Total	**-**	**9,967**

Further information in respect of liquidity risk in relation to trade and other payables is given in note 23.

21. Increase in operating assets and liabilities

	2017 £000	2016 £000
Net (increase)/decrease in operating assets:		
Financial assets at fair value through profit or loss	2,445	5,437
Trade and other receivables	(4,901)	26,570
Net (increase)/decrease in operating assets	**(2,456)**	**32,007**
Net increase/(decrease) in operating liabilities:		
Trade and other payables and provisions	3,205	(26,392)
Derivative financial instruments	(50)	(252)
Net increase/(decrease) in operating liabilities	**3,155**	**(26,644)**
Net increase in operating assets and liabilities	**699**	**5,363**

22. Dividends paid

	2017 £000	2016 £000
Total dividends paid on equity shares	20,000	32,000
Total	**20,000**	**32,000**

During the year interim dividends of £20.0m were paid in respect of 2017 (2016: £32.0m paid in respect of 2016).

The dividend paid in the year amounted to £2.50 per share (2016: £4.00 per share)

No final dividend is proposed in respect of the year ended 31 December 2017 (2016: £nil).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

23. Risk Management

The principal activity of the Company is that of an Authorised Corporate Director of seven OEICs and a manager of an ISA. Two of the seven OEICs were terminated in May 2016 and are currently progressing through FCA de-authorisation. The Company is closed to new business but continues to receive increments on existing business.

This note summarises the risks associated with the Company's business and the way in which the Company managed them during the year.

(a) Governance framework

The Company is part of LBG, which has established a risk management function with responsibility for implementing the LBG risk management framework within the Company.

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

Responsibility for the management of risk resides with the Board of the Company. The Board manages risks in line with LBG and Insurance risk policies. The Board has delegated certain risk matters to the Insurance Risk Oversight Committee ("IROC") with the operational implementation of these being assigned to the Insurance and Wealth Risk Committee ("IWRC").

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

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

(b) Risk appetite

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

Experience against Risk Appetite is reported monthly (by exception) and quarterly (in full) to the IWRC, quarterly (by exception) to the IROC and bi-annually (in full) to the Insurance Board. Copies are also supplied regularly to the regulators as part of the close and continuous relationship. Reporting focuses on ensuring, and demonstrating to the Insurance Board, and their delegate the IROC that the Insurance Division is run in line with approved risk appetite. Any breaches of risk appetite require clear plans and timescales for resolution.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

23. Risk Management (continued)

(c) Financial risks

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

The market risks that the Company primarily faces due to the nature of its financial assets and financial liabilities are interest rate and equity risk.

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

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

The sensitivity analyses given throughout this note are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur as changes in some of the assumptions may be correlated, for example changes in interest rates and changes in market values. The sensitivity analysis presented also represents management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions.

1) Market risk

Market risk is defined as the risk that unfavourable market movements (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and/or value.

Investment holdings within the Company have been diversified across markets and, within markets, across sectors. Holdings of individual assets are diversified to minimise specific risk and large individual exposures are monitored closely. Diversification is achieved by investing in a diversified portfolio of assets, which are managed according to their respective investment strategy.

In addition to market risk on directly held assets and liabilities the Company has an exposure to indirect market risk. This arises from the fact that the annual management charges collected and associated costs for the management of the funds fluctuate with the market movements impacting the value of policyholder funds. For example if the underlying market value of policyholder funds fell by 10%, AMC is estimated to fall by £7.9m (2016: £7.5m) based on year end values. These are classified as indirect market risks.

Below is an analysis of financial assets and financial liabilities at fair value through profit or loss for which a fair value is required to be disclosed, according to their fair value hierarchy (as defined in note 1 (f)):

As at 31 December 2017

		Fair value hierarchy		
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Financial assets at fair value through profit or loss	3,101	-	-	3,101
Total assets	**3,101**	**-**	**-**	**3,101**
Derivative financial liabilities	76	-	-	76
Total liabilities	**76**	**-**	**-**	**76**

As at 31 December 2016

		Fair value hierarchy		
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Financial assets at fair value through profit or loss	5,546	-	-	5,546
Total assets	**5,546**	**-**	**-**	**5,546**
Derivative financial liabilities	126	-	-	126
Total liabilities	**126**	**-**	**-**	**126**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

23. Risk Management (continued)

(c) Financial risks (continued)

1) Market risk (continued)

(i) Equity risk

The Company's exposure to equity risk relates to income which will fluctuate as a result of changes in market prices other than from interest and foreign exchange fluctuations. This is due to both Investment Management fee income and Registration fee income being linked to the value of underlying Funds under Management. Accordingly, the Company monitors exposure limits both to any one counterparty and any one market. In addition, there is a small amount of equity held in the other OEIC holdings. The risk on the small amount of equity held in the other OEIC holdings is mitigated by futures. As such equity risk is not considered material.

(ii) Interest rate risk

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates and the shape of the yield curve. The sensitivity analysis below illustrates how the fair value of future cash flows in respect of interest-bearing financial assets, net of offsetting movements in insurance and investment contract liabilities, will fluctuate because of changes in market interest rates at the reporting date.

	Impact on profit after tax and equity for the year	
	2017	2016
	£000	£000
25 basis points (2016: 25 basis points) increase in yield curves	598	453
25 basis points (2016: 25 basis points) decrease in yield curves	598	453

2) Credit risk

The risk that counterparties with whom we have contracted, fail to meet their financial obligations, resulting in loss to the Company.

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

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

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

	2017	2016
	£000	£000
Trade and other receivables	61,252	56,351
Cash and cash equivalents	174,462	147,667
Total assets bearing credit risk	**235,714**	**204,018**

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

As at 31 December 2017

	Total	AAA	AA	A	BBB or lower	Not rated
	£000	£000	£000	£000	£000	£000
Trade and other receivables	61,252	-	16,620	511	-	44,121
Cash and cash equivalents	174,462	170,625	-	3,837	-	-
Total	**235,714**	**170,625**	**16,620**	**4,348**	**-**	**44,121**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

23. Risk Management (continued)

(c) Financial risks (continued)

2) Credit risk (continued)

As at 31 December 2016

	Total £000	AAA £000	AA £000	A £000	BBB or lower £000	Not rated £000
Trade and other receivables	56,351	-	13,585	865	-	41,901
Cash and cash equivalents	147,667	144,834	-	2,833	-	-
Total	**204,018**	**144,834**	**13,585**	**3,698**	**-**	**41,901**

Amounts classified as "not rated" in the above tables are not rated by Standard and Poor or an equivalent rating agency.

3) Liquidity risk

Liquidity risk is defined as the risk that the Company has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values or from the inability to generate cash inflows as anticipated.

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

The following tables indicate the timing of the contractual cash flows arising from the Company's financial liabilities, as required by IFRS 7.

As at 31 December 2017

Liabilities		Contractual cash flows (undiscounted)					
	Carrying amount £000	No stated maturity £000	Less than 1 month £000	1-3 Months £000	3-12 months £000	1-5 years £000	More than 5 years £000
Bank borrowings	-	-	-	-	-	-	-
Derivative financial instruments	76	-	-	76	-	-	-
Trade and other payables	56,202	-	56,202	-	-	-	-
Total	**56,278**	**-**	**56,202**	**76**	**-**	**-**	**-**

As at 31 December 2016

Liabilities		Contractual cash flows (undiscounted)					
	Carrying amount £000	No stated maturity £000	Less than 1 month £000	1-3 Months £000	3-12 months £000	1-5 years £000	More than 5 years £000
Bank borrowings	9,967	-	9,967	-	-	-	-
Derivative financial instruments	126	-	-	126	-	-	-
Trade and other payables	45,516	-	45,516	-	-	-	-
Total	**55,609**	**-**	**55,483**	**126**	**-**	**-**	**-**

The contractual cash flow analysis set out above has been based on the earliest possible contractual date, regardless of the surrender penalties that might apply and has not been adjusted to take account of such penalties.

4) Capital risk

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

- the Company has insufficient capital to meet its regulatory capital requirements;
- the Company has insufficient capital to provide a stable resource to absorb all losses up to a confidence level defined in the risk appetite;
- the Company loses reputational status by having capital that is regarded as inappropriate, either in quantity, type or distribution; and/or
- the capital structure is inefficient.

The business of the Company is regulated by the FCA. The FCA specifies the minimum amount of capital that must be held by the Company in addition to its liabilities.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

23. Risk Management (continued)

(c) Financial risks (continued)

4) Capital risk (continued)

Within the Insurance Division, capital risk is actively monitored by the Insurance and Wealth Asset and Liability Committee ("IWALCO").

The minimum required capital must be maintained at all times throughout the year. These capital requirements and the capital available to meet them are regularly estimated in order to ensure that capital maintenance requirements are being met.

The Company's objectives when managing capital are:

- to have sufficient further capital to safeguard the Company's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders;
- to comply with the regulatory capital requirements set out by the FCA in the UK; and
- when capital is needed, to require an adequate return to the shareholder by pricing contracts according to the level of risk associated with the business written.

The Company's capital comprises all components of equity, movements in which are set out in the statement of changes in equity.

The table below sets out the regulatory capital and the required capital held at 31 December in each year. The current year information is, in general, an estimate that will be updated once the FCA returns for the year are finalised.

	2017 £000	2016 £000
Regulatory capital held	169,255	134,644
Regulatory capital required	18,799	7,915

All minimum regulatory requirements were met during the year.

(d) Operational risks

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. There are a number of secondary categories of operational risk including the undernoted:

Financial crime and fraud risk

Financial crime concerns activity related to money laundering, sanctions, terrorist financing and bribery. Fraud covers acts intended to defraud, misappropriate property or circumvent the law. These activities could give rise to risk of reduction in earnings and/or value, through financial or reputational loss. Losses may include censure, fines or the cost of litigation.

Information security and physical security risk

Information security risk relates to the risk of reductions in earnings and/or value, through financial or reputational loss, resulting from theft of or damage to the security of the Insurance Division's information and data. Physical security risk relates to the risk to the security of people and property.

Operational resilience risk

Operational resilience risk covers the risk or instances of interruptions to business operations (including critical buildings, critical and core infrastructure and IT systems, suppliers and colleagues), as a consequence of external or internal events due to insufficient resilience, inadequate recovery strategies and/or continuity systems and controls.

Change risk

Change risk is related to the management of change - designing and implementing key projects or programme. Potential loss could arise from failure requirements, budget or timescale; failure to implement change effectively; or failure to realise desired benefits.

Sourcing and service provision risk

Sourcing risk covers the risk of reductions in earnings and/or value through financial or reputational loss from risks associated with activity related to the agreement and management of services provided by third parties including outsourcing.

Service provision risk covers the risks associated with provision of services to a third party and with the management of internal intra-group service arrangements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

23. Risk Management (continued)

(d) Operational risks (continued)

IT systems and cyber risk

The risk of reductions in earnings and/or value through financial or reputational loss resulting from the failure to develop, deliver or maintain a resilient IT solution or protect against cyber-attack and other system disruption. A risk framework has been embedded and this is monitored to ensure its effective operation across the Insurance Division.

(e) Regulatory and legal risks

Regulatory and legal risk is defined as the risk that the Company is exposed to fines, censure, legal or enforcement action, civil or criminal proceedings in the courts (or equivalent) and risk that the Company is unable to enforce its rights as anticipated.

Regulators aim to protect the rights of customers, ensuring firms satisfactorily manage their affairs for the benefit of customers and that they retain sufficient capital and liquidity. The Insurance Division has embedded a risk framework to closely monitor and manage its legal and regulatory risks, and maintains regular interaction with its regulators.

(f) Conduct risk

Conduct risk is defined as the risk of customer detriment or regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment or business conduct.

The Insurance Division is focused on delivering fair customer outcomes, and has embedded a risk framework to effectively monitor and manage its conduct risks.

(g) Financial reporting risk

Financial reporting risk is defined as the risk that the Company suffers reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial and regulatory reporting, failure to manage the associated risks of changes in taxation rates, law, ownership or corporate structure and the failure to disclose accurate and timely information.

(h) Governance risk

The risk that the Company's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions have been implemented effectively.

24. Related party transactions

a) Ultimate parent and shareholding

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

The parent undertaking which is the parent undertaking of the smallest group to consolidate these financial statements is Lloyds Bank plc. Copies of the consolidated annual report and accounts of Lloyds Bank plc may be obtained from Group Secretariat, 25 Gresham Street, London EC2V 7HN.

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

24. Related party transactions (continued)

b) Transactions and balances with related parties

The Company acts as an Authorised Corporate Director for 19 authorised OEIC sub-funds (2016: 40). Transactions and balances in respect of these funds are as follows:

	2017 £000	2016 £000
OEIC sub funds		
Aggregate total transactions for the year:		
Creations	898,881	887,358
Cancellations	2,258,488	3,860,504
Aggregate amounts due to trustees and depositary:		
Accrued at year end	37	26
Amounts received by the Company:		
Gross annual investment management fees	115,575	109,656
Amounts receivable at year end:		
Investment management fees	8,326	8,165
Managers' box		
Managers' box held at year end:	3,101	5,546

Transactions between the Company and other LBG companies

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

2017	Income during period £000	Expenses during period £000	Payable at period end £000	Receivable at period end £000
Relationship				
Parent	-	20,000	-	-
Other related parties	7,206	38,579	13,032	8,258

2016	Income during period £000	Expenses during period £000	Payable at period end £000	Receivable at period end £000
Relationship				
Parent	-	32,000	-	-
Other related parties	25,146	34,824	13,640	2,120

Transactions between the Company and key management

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company which, for the Company, are the Executive Directors.

The Directors consider that they receive no remuneration for their services to the Company.

25. Contingent liabilities and capital commitments

Outsourcing of long-standing customer administration platform

The outsourcing contract signed with Diligenta on 25 September 2017 provides for certain future payments which are contingent on contractual milestones being achieved. £5.1m relating to the share of these future payments may be expensed to the Company as incurred in future periods.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

26. Future accounting developments

The following pronouncements will be relevant to the Company but were not effective at 31 December 2017 and have not been applied in preparing these financial statements.

Pronouncement	Nature of change	IASB effective date
IFRS 9 "Financial Instruments"	Replaces IAS 39 "Financial Instruments: Recognition and Measurement." *Classification and Measurement* IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income or amortised cost. Financial assets will be measured at amortised cost if they are held within a business model the objective of which is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent solely payments of principal and interest. Financial assets will be measured at fair value through other comprehensive income if they are held within a business model the objective of which is achieved by both collecting contractual cash flows and selling financial assets and their contractual cash flows represent solely payments of principal and interest. Financial assets not meeting either of these two business models; and all equity instruments (unless designated at inception to fair value through other comprehensive income); and all derivatives are measured at fair value through profit and loss. An entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch. The Insurance Division has undertaken an assessment of the classification and measurement of financial assets. The majority of assets retain the existing measurement category as under IAS 39. There are no financial assets in the Company which require reclassification from amortised cost to fair value through profit or loss as at 1 January 2018.	Annual periods beginning on or after 1 January 2018

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

26. Future accounting developments (continued)

Pronouncement	Nature of change	IASB effective date
IFRS 9 "Financial Instruments" (continued)	IFRS 9 retains most of the existing requirements for financial liabilities. However, for financial liabilities designated at fair value through profit or loss, gains or losses attributable to changes in own credit risk may be presented in other comprehensive income. *Impairment* The IFRS 9 impairment model will be applicable to all financial assets at amortised cost, debt instruments measured at fair value through other comprehensive income, lease receivables, loan commitments and financial guarantees not measured at fair value through profit or loss. IFRS 9 replaces the existing 'incurred loss' impairment approach with an Expected Credit Loss ('ECL') model, resulting in earlier recognition of credit losses compared with IAS 39. Expected credit losses are the unbiased probability weighted average credit losses determined by evaluating a range of possible outcomes and future economic conditions. The ECL model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk since initial recognition (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39. The requirement to recognise lifetime ECL for loans which have experienced a significant increase in credit risk since origination, but which are not credit impaired, does not exist under IAS 39. The assessment of whether an asset is in stage 1 or 2 considers the relative change in the probability of default occurring over the expected life of the instrument, not the change in the amount of expected credit losses. This will involve setting quantitative tests combined with supplementary indicators such as credit risk classification. Reasonable and supportable forward looking information will also be used in determining the stage allocation. Any asset more than 30 days past due, but not credit impaired, will be classed as stage 2. The new impairment requirements will result in an increase in the Company's balance sheet provisions for credit losses and may have a negative impact on the Company's regulatory capital position. The initial impact at 1 January 2018 is expected to be a reduction to retained profits of approximately £0.9m. The ongoing impact on the financial results will only become clearer after running the IFRS 9 impairment models over a period of time and under different economic environments, however, it could result in impairment charges being more volatile when compared to the current IAS 39 impairment model, due to the forward looking nature of expected credit losses. *Hedge Accounting* The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. The standard does not address macro hedge accounting, which is being considered in a separate project. There is an option to maintain the existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. The Company currently expects to continue applying IAS 39 hedge accounting in accordance with this accounting policy choice.	Annual periods beginning on or after 1 January 2018

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017 (CONTINUED)

26. *Future accounting developments (continued)*

Pronouncement	Nature of change	IASB effective date
IFRS 15 "Revenue from Contracts with Customers"	Replaces IAS 18 "Revenue" and IAS 11 "Construction Contracts". IFRS 15 establishes principles for reporting useful information about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised at an amount that reflects the consideration to which the entity expects to be entitled in exchange for goods and services. All of the Company's revenue streams are within the scope of IFRS 15, however application of the new standard is not expected to have a significant impact on the financial results or position of the Company.	Annual periods beginning on or after 1 January 2018
Minor amendments to other accounting standards [1]	The IASB has issued a number of minor amendments to IFRSs effective 1 January 2018 (including IFRS 2 Share-based Payment and IAS 40 Investment Property) and IFRIC 23 Uncertainty over Income Tax Treatments effective 1 January 2019. These revised requirements are not expected to have a significant impact on the Company.	Annual periods beginning on or after 1 January 2018 or 2019

[1] At the date of this report, these pronouncements are awaiting European Union endorsement.

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

27. Events after the reporting date

There are no events after the reporting date.