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PERMANENT MASTER ISSUER PLC

Annual report and financial statements
for the year ended 31 December 2019

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DIRECTORS AND COMPANY INFORMATION

Directors

Daniel Marc Richard Jaffe
Intertrust Directors 1 Limited
Intertrust Directors 2 Limited

Company secretary

Intertrust Corporate Services Limited

Registered office

1 Bartholomew Lane
London
EC2N 2AX

Independent auditors

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

Strategic report

For the year ended 31 December 2019

The directors present their Strategic report for Permanent Master Issuer plc ("the Company") for the year ended 31 December 2019.

Principal activities

The principal activity of the Company is the investment of the proceeds of the issue of publicly listed floating and fixed rate asset backed loan notes in the international capital markets which are denominated in a number of currencies (the "Notes"). These proceeds have been invested in loans to Permanent Funding (No.2) Limited (the "Funding company"). No future changes in activity are envisaged.

On receipt of the proceeds, the Funding company invests in the beneficial interests of the assets held by Permanent Mortgages Trustee Limited (the "Trust").These assets comprise mortgage loans secured on residential property originated under the Halifax brand by Bank of Scotland plc ("BOS") or (the "Originator"). The Funding company receives a share of the income from the Trust in proportion to its investment in the mortgage assets of the Trust. The Company receives interest on loans made to the Funding company.

The activities of the Company are conducted primarily by reference to a series of securitisation transaction documents (the "Programme Documentation"). The Permanent securitisation structure as per the Programme Documentation has been established as a means of raising finance for BOS, and subsequently Lloyds Banking Group plc ("LBG"). The Programme Documentation sets out the workings of the transaction and the principal risks to the holders of the Notes. As such, these have not been reproduced in full in the financial statements.

The Company is a wholly owned subsidiary of Permanent Holdings Limited, a company registered in England and Wales. Permanent Holdings Limited holds the entire issued share capital of 50,000 ordinary shares of £1 each (49,998 quarter paid and 2 fully paid ordinary shares of £1 each). The shares of Permanent Holdings Limited are held on a discretionary trust basis by Intertrust Corporate Services Limited ("Intertrust CS") for the benefit of certain charities.

At 31 December 2019 the Permanent Holdings Limited Group (the "Group") comprised Permanent Funding (No.1) Limited, Permanent Funding (No.2) Limited company, Permanent Holdings Limited and the Company.

Business review and Future developments

The loss for the year are set out on page 7. The loss for the financial year amounted to £643,000 (2018: profit of £1,314,000). Total equity at 31 December 2019 was a deficit of £780,000 (2018: £140,000 deficit).

As required under International Financial Reporting Standards ("IFRS"), the loss for the year includes a fair value gain on financial instruments of £6,066,000 (2018: £2,218,000 gain) which reflects the movement in the market value of the derivatives and swap interest payable. The Notes issued were economically hedged using derivative contracts and so gains or losses recognised to date are expected to reverse in the future.

Profits on a cash flow basis are determined under the Programme Documentation; under the terms of the loans to the Funding company, the Company has the right to a fee of 0.01% based on available revenue receipts.

During the year £125m (2018: £250m) of Notes were repaid on their expected payment dates following the receipt of the equivalent amount on the loans to the Funding company. In addition £1,954m of Notes were issued (2018: £2,255m) with the proceeds being invested in loans to the Funding company. As a consequence, the loans to the Funding company increased by a net of £1,836m (2018: £2,016m increase).

The directors' assessment suggests that performance of the mortgage portfolio should continue to be satisfactory. Whilst consensus suggests that interest rates will continue to remain low, as will unemployment rates, inflationary pressures and higher prices caused by sterling weakness may put further pressure on household incomes, which may feed through further increases in mortgage arrears.The situation will be monitored and the Servicer, on behalf of the Company, will continue to adopt appropriate forbearance measures.

Following the UK's exit from the EU, significant negotiation is now required on the terms of the future trade agreement. As a result, the possibility of a limited or no deal at the end of the transition period remains and could manifest in prolonged business uncertainty across the UK, including in the financial services sector. This continued lack of clarity over the UK's relationship with the EU and other foreign countries, and on-going challenges in the Eurozone, including weak growth, raise additional uncertainty for the UK's economic outlook. There also remains the possibility of a further referendum on Scottish independence. The Company is part of the wider Lloyds Banking Group, and, it is at that level that consideration of the many potential implications this may have has been undertaken. Work continues to assess the impact of EU exit at the level of the Lloyds Banking Group, as well as for the Company, upon customers, colleagues and products. This assessment includes all legal, regulatory, tax, finance and capital implications. No impact is expected for the Company.

The derivatives are utilised to economically hedge interest and foreign currency rate risk and thus in the long term are perceived to have no impact.

There has been a global pandemic from the outbreak of Coronavirus which is causing widespread disruption to financial markets and normal patterns of business activity across the world, including the UK. In view of its currently evolving nature, the directors are unable to estimate its financial and other effects.The directors have assessed this to be a non-adjusting post balance sheet event. It is also deemed to have no impact on our going concern assessment.

LBG is managing the process to transition to alternative benchmark rates under its Group-wide IBOR Transition Programme. This programme is working towards ensuring that LBG has the market capability and infrastructure to deal with the reform.

From 25 March 2020 mortgage borrowers impacted financially by Covid-19 can request a payment holiday for up to three months. Where borrowers have made a successful application, they are not considered to be in a payment shortfall and as such will not be reported as delinquent. Payment holidays will reduce the revenue and principal received, however, liquidity remains available through existing structural mechanisms and note principal payments are modest in the next 12 months.

Key performance indicators (KPIs)

The board is responsible for assessing the risk of irregularities, where caused by fraud or error in the financial reporting and ensuring that the processes are in place for the timely identification of internal and external matters with a potential effect on financial reporting.

A defined set of KPIs for the securitisation transaction are set out in the Programme Documentation and published as a monthly Investor Report on the LBG investor returns website (www.lloydsbankinggroup.com). An extract of these is shown in note 11a - credit risk and 11d - prepayment risk of the financial statements.

In order to assist the mitigation of key risks, there is a monthly meeting with the programme managers. This meeting analyses and discusses the KPIs for the month and identifies any issues or required changes. Any such issues are then reported, further discussed and collectively agreed in accordance with the Programme Documentation that governs the transaction.

The KPIs include the excess spread on the Trust assets available as the first line of credit enhancement to the Notes, the losses that have occurred and the level of arrears in the underlying mortgages, the rate of repayment of the loans within the Trust and an analysis of the characteristics of the underlying mortgages in the Trust.

Strategic report (continued)

For the year ended 31 December 2019

Key performance indicators (KPIs) (continued)

A primary key performance indicator used by the directors in assessing the performance of the Company is the monitoring of actual cash flows against planned cash flows. The Company has made all necessary payments on the Notes in accordance with the scheduled repayment dates for the year ended 31 December 2019.

At the time of issue each series and class of Notes is assigned a credit rating which reflects the likelihood of full and timely payment to the holders of the Notes of interest on each interest payment date and the payment of principal by the final maturity date. A rating may be subject to revision, suspension or withdrawal at any time by the rating agencies if the Company's circumstances change.

Any change in the credit rating assigned to a Note would be used as an indicator as to the performance of the Company. No downgrade in credit ratings has been applied to the Company's Notes in the year under review and subsequently up to the date of approval of these financial statements.

In relation to the Company's principal outflows (interest and principal payments on the Notes) the Company has hedged the risk of exchange rate fluctuations using a series of derivative contracts, providing certainty over the amounts due.

Taxation

The Company's tax charge is based on the permanent tax regime for securitisation companies. All fair value adjustments on derivative contracts are ignored for taxation purposes as tax is assessed on the cash retained as profit in the Company.

Risk management

The majority of the Company's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments: Presentation". The Company's financial instruments comprise loans to the Funding company, Notes issued in the capital markets, derivatives (swaps), various other receivables and payables and cash and liquid resources.

The principal risks and uncertainties for the Company arise from the Company's financial instruments. These are credit risk, liquidity risk, interest rate risk and currency risk. These and other risks which may affect the Company's performance are detailed below. Further analysis of the risks facing the Company in relation to its financial instruments and the Company's financial risk management policies is provided in note 11 of the financial statements.

Credit risk

The loans to the Funding company are ultimately secured against a beneficial interest in a mortgage portfolio held in trust. The performance of the mortgage loans, secured on UK residential properties, is influenced by the economic environment and the UK housing market. LBG has an option to offer to repurchase loans in arrears of greater than three months.

There is excess spread within the Funding company after all interest is paid on the loans from the Company and third party expenses have been settled.

There is also a fully funded general reserve balance available to the Funding company that provides a level of credit enhancement to the Notes of the Company. However, the primary function of this reserve fund is to provide liquidity to the bullet and scheduled redemption of the Notes.

Liquidity risk

The ability of the Company to meet its obligations to make principal and interest payments on the Notes is dependent on funds being received under the loans held with the Funding company. The Funding company is only obliged to pay interest and principal to the Company to the extent that it has such amounts available to it. The Company has recourse to the other assets of the Funding company for any shortfall in receipts due under the agreement for loans to Group companies.

The Company received all necessary payments on the intercompany loans with Funding, in accordance with the expected repayment dates for the year ended 31 December 2019 and the year ended 31 December 2018.

An optional redemption in full is available to the Company should it wish to repay any of the Notes earlier than the expected maturity date. The first call option date was 18 August 2017 and the final call option date is 18 August 2022. Noteholders must be informed by giving not more than 20 nor less than 10 days' notice. During the year £nil Notes (2018: £nil) repaid earlier than the expected maturity date .

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at different times. The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of the intercompany loans and the Notes (its principal assets and liabilities) are similar; where this is not possible the Company uses derivative contracts to mitigate any residual interest rate risk.

Currency risk

The Company has issued certain Notes denominated in US Dollars and Euros ("Currency Notes"). All the Company's assets and its other liabilities are denominated in Sterling. The Company's policy is to eliminate all exposures arising from movements in exchange rates by the use of currency and interest rate related contracts to hedge payments of interest and principal on the Currency Notes. Currency and interest rate related contract providers are BOS, ING Bank NV and National Australia Bank Limited. These financial institutions were rated A+ (long term) or above by Standard & Poor's as at 31 December 2019 (2018: A (long term) or above).

Operational risks

The Company is also exposed to operational risks through a number of contracts with third parties who have agreed to provide operational support to the Company in accordance with the Programme Documentation. Intertrust Management Limited ("Intertrust Management") has been appointed to provide corporate services in accordance with a corporate services agreement. Other third parties that provide services with respect to the Notes include Citibank N.A. London Branch as the paying agents, and BOS as issuing entity swap providers. BOS has been appointed to act as account bank and cash manager on behalf of the Company.

Business risks

The principal business risks of the Company are set out in a number of asset and non-asset trigger events in the Programme Documentation. There are additional triggers including some which relate to the underlying performance of the mortgage pool. The occurrence of trigger events may lead to a different priority of payments of the Notes in accordance with established priorities. There have been no such trigger events since inception of the Programme.

Strategic report (continued)
For the year ended 31 December 2019

Section 172(1) of the Companies Act 2006

The Company is a special purpose vehicle and as such performs a very limited range of activities. As a special purpose vehicle, the governance structure of the Company is such that the key policies have been predetermined at the time of its incorporation. The directors have had regards to the matters set out in section 172(1) of the Companies Act 2006 as follows:

- the documents governing the financing and other principal transactions to which the Company is party (together, the "programme documentation") have been formulated with the aim of achieving the Company's purpose and business objectives, safeguarding the assets of the Company and promoting the success of the Company;

- in accordance with relevant securitisation legislation the Company is only permitted to retain minimal profit;

- the Company has no employees;

- the Company has appointed various third parties to perform certain roles strictly governed by the programme documentation, fee arrangements agreed in

- as a special purpose vehicle, the Company has no physical presence or operations and accordingly has minimal impact on the community and the environment;

- the Company has a sole member with the issued shares all held on a discretionary trust basis for charitable purposes.

Further, in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the directors also confirm that they have both engaged with and had regard to the interest of key stakeholders, in their duties as directors of the Company.

In accordance with s. 426B of the Companies Act 2006 the above statement is available at the following website address https://www.intertrustgroup.com/our-services/capital-markets-services/public-transactions.

As approved by the board of Directors and signed on its behalf by:

Helena Whitaker
Per pro Intertrust Corporate Services Limited
As Company Secretary

Registered office
1 Bartholomew Lane
London
EC2N 2AX

28th April 2020

Directors' report

For the year ended 31 December 2019

The directors present their annual report and the audited financial statements for the Company for the year ended 31 December 2019.

Directors and directors' interests

The directors of the Company during the year, and up to the date of signing the financial statements were:

Daniel Marc Richard Jaffe
Intertrust Directors 1 Limited
Intertrust Directors 2 Limited

None of the directors has any beneficial interest in the ordinary share capital of the Company. None of the directors had any interest in any material contract or arrangement with the Company either during or at the end of the year.

Company secretary

The company secretary during the year, and subsequently, was Intertrust Corporate Services Limited.

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 regulation.

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

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

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

The directors are also 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.

Disclosure of information to auditors

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 themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' indemnities

Qualifying third party indemnity provisions for the benefit of the directors were in force during the year under review and remain in force as at the date of approval of the annual report and financial statements.

Future developments

The Company will continue to issue Notes and invest the proceeds as loans to the Funding company.

The directors' assessment suggests that performance of the mortgage portfolio should continue to be satisfactory. Whilst consensus suggests that interest rates will continue to remain low, as will unemployment rates, inflationary pressures and higher prices caused by sterling weakness may put further pressure on household incomes, which may feed through further increases in mortgage arrears. The situation will be monitored and the Servicer, on behalf of the Company, will continue to adopt appropriate forbearance measures.

However, the derivatives are utilised to economically hedge interest and foreign exchange rate risk and thus in the long term are perceived to have no impact.

LBG is managing the process to transition to alternative benchmark rates under its Group-wide IBOR Transition Programme. This programme is working towards ensuring that LBG has the market capability and infrastructure to deal with the reform. The directors have addressed LIBOR related exposures within the transaction which go beyond 1 January 2022.

Further information on future developments is included in the Business review and future developments section of the strategic report.

Directors' report (continued)

For the year ended 31 December 2019

Corporate governance

The directors have been charged with governance in accordance with the Programme Documentation detailing the structure and operation of the transaction. The governance structure of the Company is such that the key policies have been predetermined at the time of issuance and the operational roles have been assigned to third parties with their roles strictly governed by the Programme Documentation.

The Programme Documentation provides for procedures that have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for the reliability and usefulness of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives whilst enabling them to comply with the regulatory obligations.

Due to the nature of the securities which have been issued, the Company is largely exempt from the requirements of the Financial Conduct Authority Disclosure and Transparency Rules (DTR) and detailed in DTR 7.1 audit committees and 7.2 corporate governance statements (save for the rule DTR 7.2.5 requiring descriptions of the features of the internal control and risk management systems), which would otherwise require the Company respectively, to have an audit committee in place and include a corporate governance statement in the report of the directors. The directors are therefore satisfied that there is no requirement for an audit committee or a supervisory body entrusted to carry out the functions of an audit committee or to publish a corporate governance statement.

From the perspective of the Company, the daily operational internal controls and risk management systems are integrated with those of LBG, the Company's ultimate controlling party. Therefore additional information may be found in section "Internal Control" of the 2019 Annual Report of LBG, which does not form part of this report. Details of where to get access to the 2019 Annual Report of LBG can be found in note 15.

Dividends

The directors did not recommend the payment of a dividend for the year ended 31 December 2019 (2018: £nil).

Risk Management

Further details on the risks facing the Company and how these risks are managed are detailed in the Strategic report.

Employees

The Company had no staff during the year ended 31 December 2019 or the previous year.

None of the directors received any emoluments from the Company in the current or previous year in respect of qualifying services provided to the Company (2018: nil).

Independent auditors

PricewaterhouseCoopers LLP have indicated their willingness to continue in office until the next annual general meeting. Pursuant to section 489 of the Companies Act 2006, a resolution for the re-appointment of PricewaterhouseCoopers LLP as auditors of the Company will be proposed at the forthcoming annual general meeting.

Statement of going concern

The Company has continued to perform in line with the Programme Documentation. There are certain rating and non-rating triggers included in the Programme Documentation as referred to in the accounts in Key Performance Indicators (Strategic Report) and exampled in the note on Management of Risk (note 11). In the course of their regular monitoring of these Key Performance Indicators and review of risk, the directors are confident that these triggers remain un-breached and will remain so for the foreseeable future,despite the current adverse environment.

The directors are satisfied that the Company has adequate resources to continue to operate for the foreseeable future and is financially sound.For this reason, they continue to adopt the going concern basis in preparing the financial statements.

As approved by the board of directors and signed on its behalf by:

Helena Whitaker
Per pro Intertrust Corporate Services Limited
As Company Secretary

Registered Office
1 Bartholomew Lane
London
EC2N 2AX

28th April 2020

Statement of comprehensive income

For the year ended 31 December 2019

	Note	2019 £'000	2018 £'000
Interest receivable and similar income	2	**121,312**	94,915
Interest payable and similar charges	3	**(128,030)**	(95,825)
Net interest expense		**(6,718)**	(910)
Fair value gains	4	**6,066**	2,218
Income from Group undertaking	5	**11**	8
(Loss)/profit before tax		**(641)**	1,316
Taxation	6	**(2)**	(2)
(Loss)/profit for the financial year and total comprehensive (expense)/ income		**(643)**	1,314

The (loss) / profit shown above is derived from continuing operations. The Company operates in a single business segment and all of the Company's activities are in the UK.

There was no income or expense recognised directly in equity in the current year or preceding year.

The accompanying notes on pages 11 to 21 are an integral part of the financial statements.

Balance sheet

As at 31 December 2019

	Note	2019 £'000	2018 £'000
Assets			
Cash and cash equivalents		**316**	304
Loans to Group Company	7	**8,995,517**	7,159,988
Derivative financial assets	8	**41,576**	106,945
Total assets		**9,037,409**	7,267,237
Liabilities			
Debt securities in issue	9	**9,038,190**	7,267,375
Current tax liability	6	**2**	2
Total liabilities		**9,038,192**	7,267,377
Equity			
Share capital	10	**13**	13
Accumulated losses		**(796)**	(153)
Total equity		**(783)**	(140)
Total equity and liabilities		**9,037,409**	7,267,237

The financial statements on pages 7 to 21 were approved by the board of Directors on 28th April 2020 and were signed on its behalf by:

Helena Whitaker
Per pro Intertrust Directors 1 Limited
As Director

The accompanying notes on pages 11 to 21 are an integral part of the financial statements.

Statement of changes in equity

For the year ended 31 December 2019

	Share capital £'000	Accumulated losses £'000	Total Equity £'000
At 1 January 2019	**13**	**(153)**	**(140)**
Loss for the financial year being total comprehensive expense	-	**(643)**	**(643)**
At 31 December 2019	**13**	**(796)**	**(783)**
At 1 January 2018	13	(1,467)	(1,454)
Profit for the financial year being total comprehensive income	-	1,314	1,314
At 31 December 2018	13	(153)	(140)

The accompanying notes on pages 11 to 21 are an integral part of the financial statements.

Cash flow statement
For the year ended 31 December 2019

	2019 £'000	2018 £'000
Operating activities		
Income received from Group undertaking	2	2
Tax paid	(2)	(1)
Net cash generated from operating activities	-	1
Investing activities		
Principal (issued) / receipts from loan to Group Company	(1,828,950)	(2,005,401)
Interest received on loan to Funding company	114,735	84,472
Net cash flows used in investing activities	(1,714,215)	(1,920,929)
Financing activities		
New debt securities issued	1,953,950	2,255,401
Principal repayment of debt securities	(125,000)	(250,000)
Interest paid on debt securities	(121,942)	(83,019)
Net interest received/(paid) on derivatives	7,219	(1,445)
Net cash flows generated from financing activities	1,714,227	1,920,937
Change in cash and cash equivalents	12	9
Cash and cash equivalents at beginning of year	304	295
Cash and cash equivalents at end of year	316	304

The Cash flow statement is presented using the direct method.

The accompanying notes on pages 11 to 21 are an integral part of the financial statements.

Notes to the financial statements

For the year ended 31 December 2019

1. Significant accounting policies

The Company is a public limited liability company domiciled in England and Wales and incorporated in the United Kingdom under the Companies Act 2006. The registered office address of the Company is 1 Bartholomew Lane London EC2N 2AX.

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.

(a) Basis of preparation

The financial statements for the year ended 31 December 2019 have been prepared in accordance with EU adopted International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee (IFRS IC). The standards applied by the Company are those endorsed by the European Union and effective at the date the financial statements are approved by the board. All the accounting policies have been consistently applied in the financial statements.

There are no accounting pronouncements that will be relevant to the Company, but which were not effective at 31 December 2019.

The financial statements have been prepared in accordance with the Companies Act 2006 as applicable to companies using IFRS and comply with the relevant provisions of Part 15 of the Companies Act 2006.

The financial statements have been prepared using the going concern basis. On behalf of the directors the programme managers have reviewed the expected future cash flows and believe they are adequate to meet the anticipated payments due in accordance with the Programme Documentation. The directors believe that the Company has additional safeguards in place to cover any unexpected issues which may arise including access to a general cash reserve and the ability to defer payment in certain circumstances.

The financial statements are presented in Sterling which is the Company's functional and presentation currency and have been prepared on the historical cost basis (except that derivative financial instruments are stated at their fair value).

(b) Interest income and payable

Interest receivable and similar income and interest payable and similar charges have been calculated using the effective interest method. 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 or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument but not future credit losses.

(c) Accrued interest

Accrued interest has been incorporated within the loans to the Funding company and within the outstanding balance of debt securities in issue on the Balance sheet. An analysis of principal and accrued interest can be found in note 7 and note 9 respectively.

(d) Taxation

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

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

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

The Company's taxable profits are charged under the Taxation of Securitisation Companies Regulations 2006 (SI 2006/3296).

(e) Financial instruments

The Company's financial instruments comprise loans to the Funding company, Notes issued in the capital markets, derivatives contracts (swaps), various other receivables and payables, Cash and cash equivalents and other liquid resources. The main purpose of these financial instruments is to raise and manage finance for BOS and LBG. These financial instruments are classified in accordance with the principles of IFRS 9 as described below.

(e)(i) Loans to the Funding company

In accordance with IFRS 9, the loans to the Funding company are treated as "loans and receivables" and are stated at amortised cost.

(e)(ii) Derivative financial instruments

Derivative financial instruments comprise foreign currency swaps held with external counterparties. All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the Balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

The fair value of derivative contracts is the estimated amount that the Company would receive or pay to terminate the swap at the Balance sheet date, taking into account current exchange rates.

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

1. Significant accounting policies (continued)

(e) Financial instruments (continued)

(e)(iii) Cash & cash equivalents

For the purposes of the Cash flow statement, cash and cash equivalents comprise cash and amounts due from banks with a maturity of less than three months. As the cash can only be used to meet certain specific liabilities and is not available to be used with discretion, it is viewed as restricted cash. This bank account is classified within "loans and receivables" in accordance with IFRS 9 and income is being recorded using the effective interest method.

(e)(iv) Impairment of financial assets

At initial recognition, an impairment allowance is required for expected credit losses ("ECL") resulting from default events expected within the next 12 months (12-month ECL).

At each balance sheet date an assessment is made as to whether, as a result of one or more events occurring after initial recognition, there is objective evidence that the deemed loan has had a significant increase in credit risk.

In the event of a significant increase in credit risk, allowance is required for ECL resulting from default events expected over the estimated life of the financial instrument ("lifetime ECL"). IFRS 9 requires the financial asset to be allocated to one of three 'stages' as follows:

· Stage 1 - Financial assets which have not experienced a significant increase in credit risk since they were originated. Recognition of a 12-month ECL is required. Interest income on stage 1 financial assets is calculated on the gross carrying amount of the financial asset;

· Stage 2 – Financial assets which have experienced a significant increase in credit risk. For financial assets in stage 2, recognition of a lifetime ECL impairment allowance is required. Interest income on stage 2 financial assets is calculated on the gross carrying amount of the financial asset; and

· Stage 3 - Financial assets which have experienced one of more events that have had a detrimental impact on the estimated future cash flows and are considered to be credit impaired. Like stage 2, recognition of a lifetime expected ECL impairment allowance is required. However, interest income on stage 3 loans is calculated on the financial asset balance net of the impairment allowance.

In assessing the deemed loan for impairment, the directors consider both impairments on the underlying mortgage assets and the overcollateralisation required in the transaction which provides credit enhancement in excess of the ECL of the underlying mortgage assets.

Taking into account these factors, the directors conclude that there is no significant increase in credit risk of the deemed loan since inception and therefore record it as Stage 1.

(e)(v) Debt securities in issue

Debt securities in issue are recognised initially at fair value less directly related incremental transaction costs. Subsequent to initial recognition, debt securities in issue are stated at amortised cost with any difference between cost and redemption value being recognised in the Statement of comprehensive Income over the period of the borrowings on an effective interest basis.

(e)(vi) Foreign currency translation

Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Statement of comprehensive Income.

(f) Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments.

The directors of the Company consider that the entity has only one geographical and one business segment and therefore is not required to produce additional segmental disclosure.

(g) Critical accounting estimates and judgements

The preparation of the financial statements necessarily requires the exercise of judgement both in the application of accounting policies and in the selection of assumptions used in the calculation of accounting estimates. These judgements are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. The most significantly affected components of the financial statements and associated critical judgements are as follows:

(g)(i) Effective interest rate method

In calculating the effective interest rate of financial instruments the Company takes into account interest received or paid, fees and commissions paid or received, expected early redemptions and related penalties and premiums and discounts on acquisition or issue that are integral to the yield as well as incremental transaction costs.

For the purpose of the effective yield calculation, it has been assumed that the average expected life of the debt securities in issue by the Company will end at the date of the first step-up or step-down in interest rates (unless specified earlier in the Programme Documentation when the earlier date will be used), based on the payment experience to date. This may not be the case in practice.

(h) Dividends

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

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

1. Significant accounting policies (continued)

(i) Capital management

The Company is not subject to externally imposed capital requirements in the current and prior year. The Company manages its ordinary share capital in order that there is sufficient capital, in the opinion of the directors, to support the transactions and level of business undertaken by the Company.

(j) Income from Group undertaking

Under the terms of the agreement for the loan with the Funding company, the Company has the right to receive a fee for the provision of such loans. This fee includes an amount equal to 0.01% of the interest receivable on the loans to the Funding company, together with an amount equivalent to payments made to certain third party suppliers for ongoing expenses.

2. Interest receivable and similar income

	2019 £'000	2018 £'000
Interest receivable from loans to the Funding company	121,310	94,913
Bank interest receivable	2	2
	121,312	94,915

3. Interest payable and similar charges

	2019 £'000	2018 £'000
Interest payable on debt securities in issue	128,030	95,825
	128,030	95,825

4. Fair value gains

	2019 £'000	2018 £'000
Profit / (loss) on retranslation of Euro loan notes to sterling	23,457	(4,866)
Gain / (loss) on retranslation of US$ loan notes to sterling	40,759	(27,810)
Net foreign exchange gain / (loss)	64,216	(32,676)
Fair value (loss) / gain on Euro currency swap	(29,626)	582
Fair value (loss) / gain on US$ currency swap	(28,524)	34,312
Net fair value on currency swap derivatives	(58,150)	34,894
Fair value gains	6,066	2,218

Fair value movements reflect the market value of the derivatives and swap interest payable. The notes issued were economically hedged using derivative contracts and so gains or losses recognised to date are expected to reverse in the future.

5. Income from group undertaking

	2019 £'000	2018 £'000
Fee from the funding company	11	8

This fee is not included in determining the effective interest rate arising on the loans to the funding company that are held at amortised cost.

The Company has no employees (2018: nil).The corporate services provider fees are paid and borne by Permanent Funding (No.2) Limited.

There are no fees payable to the auditors for services other than the statutory audit. The audit fees for the Company are paid for by Permanent Funding (No.2) Limited. The fee for the current year was £15,000 net of VAT (2018: £15,000).

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

6. Taxation

	2019 £'000	2018 £'000
Current Tax		
Corporation tax charge for the year at a rate of 19.00% (2018: 19.00%)	2	2
Total tax charge	2	2

Reconciliation of effective tax rate	2019 £'000	2018 £'000
The tax assessed for the year is higher than the standard average rate of corporation tax in the UK of 19.00% (2018: 19.00%)		
(Loss)/profit before tax	(641)	1,316
(Loss)/profit before tax multiplied by the standard average rate of corporation tax in the UK of 19.00% (2018: 19.00%)	(122)	250
Effects of:		
Items not allowable/(taxable) under permanent tax regime for securitisation companies	124	(248)
Total tax expense in the Statement of comprehensive Income	2	2

7. Loans to group company

	2019 £'000	2018 £'000
Intercompany loans to the Funding company		
Non-current		
Principal	7,713,950	7,010,751
Current		
Principal	1,250,751	125,000
Interest	30,816	24,237
Total	8,995,517	7,159,988

The loans to the Funding company are all denominated in Sterling and are at variable rates of interest, based on either the London Interbank Offered Rate (LIBOR) for three-month Sterling deposits or Sterling Overnight Interbank Average (SONIA). Such loans have ultimately been secured against a beneficial interest in a mortgage portfolio held in trust on behalf of the Group.

The Funding company's ability to pay amounts due on the intercompany loans will depend mainly upon it receiving sufficient revenue and principal receipts from the mortgage portfolio; receiving the required funds from the Funding company's swap provider. In the case of a shortfall, holders of the Notes may, subject to what other sources of funds are available to the Company, receive less than the full interest and/or principal than would otherwise be due on the Notes. The repayment of loans to the Group company will coincide with the repayment of the Notes.

8. Derivative financial assets

The principal derivatives used by the Company are exchange rate and interest rate contracts.

- An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts.

- Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies.

The principal amount of the contract does not represent the Company's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Company should the counterparty default. To reduce credit risk the Company only deals with highly rated counterparties and uses credit enhancement techniques such as collateralisation, where security is provided against the exposure in the event that one of the currency swap counterparties has their ratings downgraded. At the Balance sheet date there were no credit enhancements, including collateralisation, in place for any of the currency swap counterparties (2018: none). Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate.

Notes to the financial statements (continued)

For the year ended 31 December 2019

8. Derivative financial assets (continued)

The notional principal amount and fair value of instruments entered into was:

	2019 £'000	2018 £'000
Exchange and / or interest rate contracts:		
Currency swaps	1,329,701	1,125,751
Fair value		
Assets	41,576	106,945
Liabilities	-	-
	41,576	106,945

9. Debt securities in Issue

	2019 £'000	2018 £'000
Non-Current		
Principal -		
GBP - priced against 3 month GBP LIBOR /fixed GBP /SONIA	7,510,000	5,885,000
USD - priced against 3 month USD LIBOR	189,280	783,210
EUR - priced against 3 month EURIBOR	-	448,484
	7,699,280	7,116,694
Current		
Principal -		
GBP - priced against 3 month GBP LIBOR /fixed GBP /SONIA	125,000	125,000
USD - priced against 3 month USD LIBOR	757,120	-
EUR - priced against 3 month EURIBOR	425,025	-
	1,307,145	125,000
Interest		
Interest payable on debt securities	31,765	25,681
	9,038,190	7,267,375

Debt securities in issue at 31 December 2019 comprise of floating rate and fixed rate Notes with scheduled maturity dates between January 2020 and October 2025 issued by the Company in connection with the securitisation of mortgages originated within BOS and are shown net of retranslation adjustments. For more information about the Company's exposure to risk, see note 11.

There have been no defaults in the payment of principal and interest or other breaches with respect to liabilities in the year or the previous year.

10. Share capital

	2019 £'000	2018 £'000
Allotted		
2 (2018: 2) ordinary shares of £1	-	-
49,998 (2018: 49,998) quarter paid ordinary shares of £1 each	13	13
	13	13

11. Management of risk

The Company's exposure to risk on its financial instruments and the management of such risk is largely determined at the inception of the securitisation transaction. The Company's activities and the role of each party to the transaction are clearly defined and documented. Cash flow modelling, including multiple stress scenarios, is carried out as part of the structuring of the transaction, and as such is required by the rating agencies. In addition, derivative contracts are entered into as part of the securitisation transaction to hedge all currency risk arising in the transaction including the obligations under the Notes.There is minimal sensitivity to risk.

The derivative counterparties are selected as highly rated, regulated financial institutions and this reduces the risk of default and loss for the Company. Additional credit protection is afforded by the requirement for the derivative counterparties to post collateral in the event of a downgrade to a counterparty's credit rating.

Notes to the financial statements (continued)

For the year ended 31 December 2019

11. Management of risk (continued)

11a. Credit risk

Credit risk arises where there is a possibility that a counterparty may default on its financial obligations resulting in a loss to the Company.

The ability of the Company to meet its obligations to make principal and interest payments on the Notes is dependent on funds being received under the loans held with the Funding company. The primary credit risk of the Company therefore relates to the default on the share of the mortgage assets of the Trust held by the Funding company. The primary credit risk of the Funding company relates to the credit risk associated with the securitised pool of mortgages originated by BOS.

The likelihood of defaults in the mortgage pool and the amounts that may be recovered in the event of default are related to a number of factors and may vary according to characteristics and product type. Significant changes in the economy, or in the performance of a particular geographical region that represents a concentration in the securitised assets, could also affect the cash flows from the mortgage pool.

To mitigate this risk, credit enhancement is provided to the transaction within the Funding company in the form of excess spread, a reserve fund and a Z loan. The Funding company's share of the income on the mortgage pool is expected to exceed the interest payable on the loan from Permanent Master Issuer plc. This excess spread is available to make good any reduction in the principal balance of the mortgage pool as a result of defaults by customers. For December 2019, tle Funding company's post interest rate swap yield was 1.885% (2018: 1.982%)).

In addition, the Originator has provided start up loans and Z loans to the Funding company to provide credit enhancement which can be used in certain circumstances to meet any deficit in revenue or to repay amounts of principal. Therefore, delinquencies and defaults on the underlying securitised assets will not result in a default on the loan as long as they do not exceed the credit enhancement provided. The Funding company's share of losses in the mortgage pool covered by excess spread in the year to 31 December 2019 was £27,000 (2018: £39,000).

The Company has a concentration of risk to the Originator. The underlying mortgage assets of the securitisation are all in the UK market. The nature of the residential mortgage portfolio means there is no significant counterparty credit risk in relation to the underlying mortgage pool.

The Company assesses its counterparties for credit risk before contracting with them. Credit rating is the main method used to measure credit risk. In accordance with the criteria of the rating agencies that rate the Notes, the Programme Documentation contains various rating triggers linked to each counterparty, which require certain actions to be taken if triggers are breached.

In the event that a swap counterparty is downgraded by a rating agency below the rating(s) specified in the relevant swap agreement, the relevant swap provider will be required to take certain remedial measures as defined in that agreement which may include providing collateral for its obligations under the relevant swap, arranging for its obligations to be transferred to an entity with sufficient rating, or taking such other action as it may agree with the relevant rating agency.

	Counterparty	**Rating as at date 31 December 2019**	**Rating as at date of approval of financial statements**
		S&P	**S&P**
Account bank and currency swap provider	BOS	Long term: A+ Short term: A-1	Long term: A+ Short term: A-1
Currency swap provider	ING Bank NV	Long term: A+ Short term: A-1	Long term: A+ Short term: A-1
	National Australia Bank Limited	Long term: AA- Short term: A-1+	Long term: AA- Short term: A-1+

An additional Guarantee Investment Account ("GIC") account for the Funding company benefits from collateral provided by LBG and secured in favour of the Funding company with such collateral to be posted to a custody account held with Bank of New York Mellon, London Branch and marked to market on a daily basis. The cash held in the collateralised GIC at 31 December 2019 was £432m (2018: £149m).

Financial assets subject to credit risk

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date is disclosed in the table below and equates to carrying value. At the Balance sheet date all financial assets subject to credit risk were neither past due, nor impaired.

	2019 **£'000**	2018 £'000
Assets held at amortised cost		
Loans to related company	**8,995,517**	7,159,988
Cash and cash equivalents	**316**	304
Assets held at fair value		
Derivative assets	**41,576**	106,945
	9,037,409	7,267,237

Notes to the financial statements (continued)

For the year ended 31 December 2019

11. Management of risk (continued)

11a. Credit risk (continued)

The Company meets its obligation on the Notes issued from the cash flows it receives from the Funding company. These represent the only recourse for the Company. As a consequence, the credit quality of the mortgage loans indicates the capacity of the Company to service its payments, although the mortgages remain on the balance sheet of Lloyds and the structure of the securitisation provides for other credit enhancements.

Securitised mortgage assets

Securitised mortgage loans are analysed according to the rating systems used by the Company and Originator when assessing customers and counterparties. The total mortgage portfolio balance against which the deemed loan to Originator is ultimately secured has been analysed below.

For the purposes of the Company's disclosures regarding credit quality, securitised mortgage loans subject to credit risk have been analysed as follows:

Stage 1 - Financial assets which have not experienced a significant increase in credit risk since they were originated.

Stage 2 – Financial assets which have experienced a significant increase in credit risk

Stage 3 - Financial assets which have experienced one or more events that have had a detrimental impact on the estimated future cash flows and are considered to be credit impaired. Financial assets are considered to be credit impaired and included in stage 3 when there is objective evidence of credit impairment. BOS assesses a loan as stage 3 when contractual payments of either principal or interest are past due for more than 90 days, the debtor is assessed as unlikely to pay, or the loan is otherwise considered to be in default.

2019	**Mortgage balance £'000**	**Number of accounts**
Mortgage balance by impairment stage		
Stage 1	**11,549,743**	137,352
Stage 2	**119,942**	1,442
Stage 3	**13,826**	172
	11,683,511	138,966

Collateral held against retail mortgage lending comprises of residential properties.

2018	Mortgage balance £'000	Number of accounts
Mortgage balance by impairment stage		
Stage 1	8,369,300	130,578
Stage 2	114,546	1,385
Stage 3	1	1
	8,483,847	131,964

Notes to the financial statements (continued)

For the year ended 31 December 2019

11. Management of risk (continued)

11b. Foreign currency rate risk

The Company's assets are denominated in sterling. However, during the year, the Company had Notes denominated in Sterling and also US Dollars and Euros on a fixed and floating rate basis. It is therefore exposed to currency risk as the value of the Notes will fluctuate due to changes in foreign currency exchange rates and in US and Euro interest rates.

The Company's policy is to eliminate all exposures arising from movements in exchange rates by the use of currency swaps to hedge payments of interest and principal on the Currency Notes.

The effect of currency movements has no bearing on the results of the Company due to the use of the currency swaps. However, the Company is exposed to a small amount of volatility on the margin on the currency swap which is shown below. This arises on the different yield curves used to value Sterling LIBOR and the respective foreign currency interest rates. It is a fair value adjustment which will reverse over the life of the swap to nil. All interest received on the loans to Group company is paid to the paying agent and the swap provider covers any movement on exchange rates to the Note holders. The volatility is recorded within net fair value gains and losses in the Statement of comprehensive income.

The Company's elimination of foreign currency rate risk is as follows:

2019	**US Dollar floating £'000**	**EURO floating £'000**	**Sterling floating £'000**	**Total £'000**
Debt securities in issue	**(951,352)**	**(425,027)**	**(7,661,813)**	**(9,038,192)**
Derivatives				
- Derivatives notional balance	**964,303**	**370,352**	**-**	**1,334,655**
- Net fair value of derivative contracts	**(13,427)**	**54,053**	**-**	**40,626**
Valuation difference	**(476)**	**(622)**	**(7,661,813)**	**(7,662,911)**

2018	US Dollar floating £'000	EURO floating £'000	Sterling floating £'000	Total £'000
Debt securities in issue	(787,989)	(448,582)	(6,030,804)	(7,267,375)
Derivatives				
- Derivatives notional balance	760,180	370,449	-	1,130,629
- Net fair value of derivative contracts	27,894	77,599	-	105,493
Valuation difference	85	(534)	(6,030,804)	(6,031,253)
Mark to market volatility	(561)	(88)	(1,631,009)	(1,631,658)

Notes to the financial statements (continued)

For the year ended 31 December 2019

11. Management of risk (continued)

11c. Liquidity risk

The Company's ability to meet payments on the Notes as they fall due is dependent on the timely receipt of funds under the loan agreements which may be delayed due to the level of repayment on the underlying mortgage portfolio (see 11d. prepayment risk below). If insufficient funds are received by the Funding company to repay the loans, then the Notes may not be paid in full and a part of the Notes may be deferred to subsequent years. Such deferred amounts will be due but not payable until funds are available in accordance with the relevant priority of payments as set out in the Programme Documentation. Variations in the rate of repayment of principal on the mortgage loans may affect each series and class of Notes differently.

The liquidity tables reflect the undiscounted cash payments which will fall due if the structure continues until the step-up or step-down date as defined in the Programme Documentation (unless it is known that a Note will be repaid prior to this date when the earlier date will be used). The step-up or step-down date is the earliest date on which the Company could be required to repay the liability and commercially the most likely.

It is anticipated that the interest and principal received on the loans to Group company will be sufficient to allow repayment of the Notes by the step-up or step-down date and thereby avoid the increase in the interest rate margin payable on the Notes.

2019	**Carrying Value**	**Contractual repayment value**	**<1 month**	**1-3 months**	**3 months - 1 year**	**1-5 years**	**>5 years**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Principal							
Debt securities in issue	**9,006,425**	**8,964,701**	**125,000**	**-**	**936,901**	**5,262,800**	**2,640,000**
Interest payable							
Interest payable on Debt securities in issue	**31,765**	**492,288**	**37,466**	**-**	**103,598**	**314,842**	**36,382**
	9,038,190	**9,456,989**	**162,466**	**-**	**1,040,499**	**5,577,642**	**2,676,382**

2018	Carrying Value	Contractual repayment value	<1 month	1-3 months	3 months - 1 year	1-5 years	>5 years
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Principal							
Debt securities in issue	7,241,694	7,135,751	-	-	125,000	4,370,751	2,640,000
Interest payable							
Interest payable on Debt securities in issue	25,681	547,307	32,425	-	95,836	327,883	91,163
	7,267,375	7,683,058	32,425	-	220,836	4,698,634	2,731,163

11d. Prepayment risk

In the normal course of business, a proportion of borrowers repay their loan in advance of their contractual maturity date. As a result the weighted average life of the loans to Group Company and of the Notes is likely to be significantly less than that implied by the contractual maturity dates of the mortgage pool.

The terms of the Notes specify that payments on the Notes will only be made to the extent that sufficient cash flows have been received from the Company's assets. The terms of the currency swaps also specify that the principal amounts of the swaps will amortise to match the outstanding amount of the currency denominated Notes to which they relate.

The rate of prepayment of loans is influenced by a wide variety of economic, social and other factors, including prevailing mortgage market interest rates, the availability of alternative financing programmes, local and regional economic conditions and homeowner mobility. In the event that prepayment rates on the mortgage pool reduce, principal repayments on the loan to Group company and on the Notes may be spread over a longer period.

The Principal Prepayment Rate ("PPR") for the underlying mortgage pool is as follows:

	Monthly PPR %	**1 month annualised %**	**3 month annualised %**	**12 month annualised %**
31 December 2019	**1.19**	**13.33**	**15.54**	**20.88**
31 December 2018	1.71	18.73	19.01	22.01

Notes to the financial statements (continued)

For the year ended 31 December 2019

11. Management of risk (continued)

11e. Fair values

The fair values of the Company's main financial instruments are detailed below:

Financial assets and liabilities carried at fair value

The financial instruments below are analysed by valuation method. The different levels are defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

Derivative assets and liabilities

Fair value of derivative assets and liabilities is based, where available, on quoted market prices and upon cash flow models which use, wherever possible, independently sourced market parameters such as interest rate yield curves and currency rates. Other factors are also considered, such as counterparty credit quality and liquidity. The valuation method is consistent with commonly used market techniques. For this reason, in accordance with "IFRS 7 Financial Instruments: Disclosures", the fair value measurement is considered to be Level 2 in the fair value hierarchy.

Financial assets and liabilities carried at amortised cost

Loans to the Group company

The carrying value of the variable rate loans is assumed to be their fair value. The loans to Group company are all denominated in Sterling and are at variable rates of interest (LIBOR or SONIA), therefore these loans are considered to be a close approximation to fair value.

Trade and other payables

Trade and other payables are recognised on an amortised cost basis. The fair value of these liabilities is considered to be a close approximation to amortised cost due to the short term nature of these liabilities.

Debt securities in issue

The book value as at 31 December 2019 was £9,038,190k (2018: £7,267,375k) and the fair value as at 31 December 2019 was £9,016,375k (2018: £7,405,748k). The Notes have been valued where possible based on quoted market prices in active markets, including recent market transactions. However, notes held within LBG cannot be valued in this way using observable inputs. For this reason, in accordance with "IFRS 7 Financial Instruments: Disclosures" and "IFRS 13 Fair Value Measurement", the debt securities in issue are considered to be Level 3 in the fair value hierarchy.

12. Related party transactions

A number of transactions are entered into with related parties as part of the Company's normal business.

The related parties are Bank of Scotland plc ('BOS'), Lloyds Banking Group plc ('LBG') and Intertrust Management Limited ("Intertrust Management") by virtue of their various roles and inputs into securitisation arrangements to which the Company is a party.

BOS provides cash management services defined under the Programme Documentation. Fees for these services are paid on behalf of the Company by the Funding company, a company which is part of the Permanent Holdings Limited Group. These fees amounted to £1,776,061 in the year (2018: £1,411,859). Audit fees of £18,000 are also payable to PricewaterhouseCoopers LLP on behalf of the Company by the Funding company (2018: £18,000).

Intertrust Management provides corporate administration services pursuant to a corporate services agreement with the Company. Fees paid to Intertrust Management during the year amounted to £68,732 (2018: £51,567). These fees are paid on behalf of the Company by other companies within the Permanent structure.

Notes to the financial statements (continued)

For the year ended 31 December 2019

12. Related party transactions (continued)

During the year, the Company undertook the following transactions with companies within the LBG group:

At 31 December	Parent 2019 £'000	Other related parties 2019 £'000	Parent 2018 £'000	Other related parties 2018 £'000
Interest receivable and similar income				
Interest receivable from loans to Group company	-	121,310	-	94,913
Bank interest	2	-	2	-
Interest payable and similar charges				
Interest payable on debt securities in issue held by LBG and subsidiary undertakings	93,838	-	76,590	-
Income from Group undertaking	-	11	-	8
Assets				
Loans to Group company	-	8,964,701	-	7,135,760
Interest receivable on loans to Group company	-	30,816	-	24,228
Derivative assets with BOS	-	-	-	-
Cash and cash equivalents	2	-	2	-
Liabilities				
Debt securities held by LBG and subsidiary undertakings	6,260,000	-	5,260,000	-
Interest payable on Debt securities held by LBG and subsidiary undertakings	23,182	-	18,880	-

13. Post balance sheet event

Since the balance sheet date there has been a global pandemic from the outbreak of Coronavirus which is causing widespread disruption to financial markets and normal patterns of business activity across the world, including the UK. The directors assess this event to be a non-adjusting post balance sheet event. In view of its currently evolving nature, the directors are unable to estimate its financial and other effects.

From 25 March 2020 mortgage borrowers impacted financially by Covid-19 can request a payment holiday for up to three months. Where borrowers have made a successful application, they are not considered to be in a payment shortfall and as such will not be reported as delinquent. Payment holidays will reduce the revenue and principal received, however, liquidity remains available through existing structural mechanisms and note principal payments are modest in the next 12 months.

14. Future accounting pronouncements

The following pronouncement is not applicable for the year ended 31 December 2019 and has not been applied in preparing these financial statements. The impact of this accounting change is still being assessed by the Company and reliable estimates cannot be made at this stage. At the date of signing these financial statements, this pronouncement had been endorsed by the EU.

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

15. Parent undertaking and controlling party

The immediate parent undertaking is Permanent Holdings Limited, a company registered in England and Wales. The shares of Permanent Holdings Limited are held on a discretionary trust basis by Intertrust Corporate Services Limited for the benefit of certain charities.

The Company meets the definition of a special purpose entity under IFRS. In accordance with IFRS 10 Consolidated Financial Statements, the Company's financial statements are consolidated within the group financial statements of Lloyds Banking Group plc for the year ended 31 December 2019.

At 31 December 2019, the Permanent Holdings Limited Group (the Group) comprised Permanent Funding (No.1) Limited, Permanent Funding (No.2) Limited, Permanent Holdings Limited and the Company.

The parent undertaking, which is the parent undertaking of the smallest group to consolidate these financial statements is BOS. Copies of the consolidated annual report and financial statements of BOS may be obtained from LBG Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

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

Independent auditors' report to the members of Permanent Master Issuer plc

Report on the audit of the financial statements

Opinion

In our opinion, Permanent Master Issuer plc's financial statements:

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

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

Our opinion is consistent with our reporting to the directors.

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

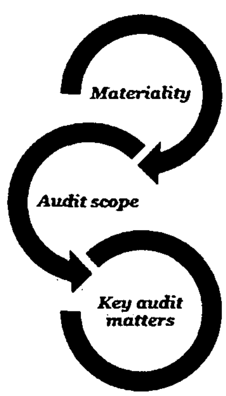
We remained independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities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

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company.

We have provided no non-audit services to the Company in the period from 1 January 2019 to 31 December 2019.

Our audit approach

Overview



- Overall materiality: £90.4 million (2018: £72.7 million), based on 1% of total assets.

- The Company is a special purpose vehicle that forms part of a securitisation structure, established primarily as a means of raising wholesale funding for Bank of Scotland plc ("BOS") and subsequently Lloyds Banking Group plc ("LBG") the ultimate parent undertaking. LBG manages the securitisation transaction in its role as administrator, servicer of the underlying mortgage loans and cash manager.
- We tailored the scope of our audit to ensure that we performed sufficient work to enable us to opine on the annual report and financial statements, ensuring audit procedures were performed in respect of every material financial statements line item.
- In establishing the overall approach to the audit, we determined the type of work that needed to be performed by us taking into account the accounting processes and controls in place at LBG as administrator and servicer, and the industry in which the Company operates.
- We obtained an understanding of the control environment in place at the administrator and adopted a controls and substantive testing approach.

The area of focus for our audit which involved the greatest allocation of our resources' effort was:

- The impact of Covid-19

- The risk of errors in the priority of payments ("the Waterfalls") due to a lack of understanding of the transaction.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Company and industry, we identified that the principal risks of non-compliance with laws and regulations related to the underlying legal documents and agreements governing this securitisation transaction, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. Audit procedures performed by the engagement team included:

- Management inquiries;
- Review of board meeting minutes; and
- Review and testing where applicable of the transaction documents.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	***How our audit addressed the key audit matter***
Impact of Covid-19 Since the balance sheet date there has been a global pandemic from the outbreak of coronavirus (Covid-19). During finalisation of the financial statements, the potential financial and social impact of coronavirus became significant and is causing widespread disruption to financial markets and normal patterns of business activity across the world, including the UK. In response, the UK government, and the Bank of England, have announced measures designed to ameliorate resulting adverse impacts on the economy. Whilst it is too early to accurately estimate the financial and business impact of Covid-19, management has considered the potential implications of these events on the Annual Report, including its going concern assessment and post-balance sheet events disclosures. The directors have concluded that the matter is a non-adjusting post balance sheet event, the financial effect cannot be reliably estimated at this stage. Refer to note 13 for further information.	We critically assessed management's conclusion that the matter be treated as a non-adjusting post balance sheet event and that the directors consider that the impact cannot be reliably estimated at this stage. We considered: • the timing of the development of the outbreak across the world and in the UK; and • how the financial statements and structure of the Company might be impacted by the disruption. In forming our conclusions over going concern, we evaluated whether management's going concern assessment considered impacts arising from Covid-19. Our procedures in respect of going concern included: • Enquiries of management to understand the current impact of Covid-19 on the Company's recent financial performance and business operations; • inspection of transaction documents to confirm that loan notes are limited recourse; • inspection of post period end investor reports for pertinent changes in cash flows;

Key audit matter	*How our audit addressed the key audit matter*
	• confirmation of period end cash reserve balances; and • checking the consistency of relevant "other information" with the financial statements, our knowledge based on the audit, and our procedures above.
Errors in the priority of payments (the "Waterfalls") due to a lack of understanding of the transaction Due to the complexity of the securitisation structure contractual terms and the special purpose nature of the entity, the Waterfalls present a pervasive risk to the overall accounting for the entity. If the Waterfalls are incorrectly processed, there is a risk that interest expense and principal balances payable to investors are not appropriately calculated and settled, and the cash flows returned to the seller as excess spread are incorrect. Due to the complexity and pervasive nature of the Waterfalls, this was an area of focus in our audit.	We understood the design of the securitisation structure through discussions with management and review of primary contractual documentation. We reviewed all investor reports and minutes of board meetings for the period to identify and investigate any unusual trends or incidents that would indicate a misstatement in the preparation and calculation of the Waterfalls. We tested the design and operating effectiveness of management's Waterfalls calculation through: • Discussion with management and by review of Waterfalls working papers for consistency with the base prospectus; and • Inspection of supporting documentation and recalculation of relevant data points for a sample of Waterfalls in the period. We performed substantive testing over this sample of Waterfalls to ensure no errors were made in Waterfalls preparation, including agreeing cash balances and transactions to cash account records, and agreeing cash collection balances to system reports. We additionally tested key system reports to validate that pool assets were completely and accurately identified in source systems to support the cash collections as presented in the Waterfalls working papers.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Company, the accounting processes and controls, and the industry in which it operates.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	£90,374,090 (2018: £76,070,743).
How we determined it	1% of total assets.
Rationale for benchmark applied	The entity is a not-for-profit whose main priority is to remit the cash received in respect of its assets so as to repay its liabilities. As such total assets is considered an appropriate benchmark. Where total assets is used, if the company is a public interest entity, a rule of thumb of up to 1% can be applied. We have deemed this to be a public interest entity due to the fact the entity has listed debt and have therefore applied 1%.

We agreed with the directors that we would report to them misstatements identified during our audit above £4,518,705 (2018: £3,663,619) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

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

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

Reporting on other information

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

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

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

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

Strategic Report and Directors' Report

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

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities set out on page 5, 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.

Appointment

We were appointed by the directors on 15 May 2009 to audit the financial statements for the year ended 31 December 2009 and subsequent financial periods. The period of total uninterrupted engagement is 11 years, covering the years ended 31 December 2009 to 31 December 2019.

The audit of Lloyds Banking Group and its subsidiaries was tendered in 2014 and we were re-appointed with effect from 1 January 2016. There will be a mandatory rotation of Lloyds Banking Group for the 2021 audit.

Daniel Pearce

Daniel Pearce (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol
28 April 2020