

Registered Number OC411834

**TSB Covered Bonds LLP**  
**Members' Annual Report and Financial Statements**  
**Year ended 31 December 2018**

TSB Covered Bonds LLP

**Designated members**

TSB Bank Plc

TSB Covered Bonds (LM) Limited

**Management board**

Ralph Coates

Steve Vance

Alison Straszewski

Rangan Ravindran

**Registered office**

35 Great St. Helen's

London

EC3A 6AP

**Registered number**

OC411834

**Independent auditors**

PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

7 More London Riverside

London

SE1 2RT

## TSB Covered Bonds LLP

### Members' Report

The members of TSB Covered Bonds LLP (the "LLP") present their report and audited financial statements for the year ended 31 December 2018.

#### **Incorporation and principal activity**

The LLP, a limited liability partnership, was incorporated in the United Kingdom and registered in England and Wales under the Limited Liabilities Partnerships Act 2000.

The LLP has been created to support TSB Bank plc's ("TSB" or the "Originator") Covered Bond Programme (the "Programme") and the LLP's business is the acquisition, management and sale of mortgage loans and their related security, to enter into other associated financial instruments and guarantee the bonds (the "Covered Bonds") issued by TSB.

No changes in the LLP's activities are envisaged for the foreseeable future.

#### **Business review**

On 1 March 2017, the LLP acquired a £644m beneficial interest in a mortgage loan portfolio originated by TSB in consideration of a capital contribution in kind made by TSB.

The LLP has acquired further beneficial interests in mortgage loan portfolios at subsequent dates. In consideration for the beneficial interest of the mortgage loan portfolio, the LLP is required to give a combination of

- i. a cash payment to TSB from the proceeds of any term loans;
- ii. a record of a capital contribution in kind being made by TSB; and
- iii. deferred consideration which will be paid by the LLP on each LLP payment date in accordance with the relevant priority of payments

In relation to the mortgage portfolio transferred to the LLP, accounting derecognition was considered to be inappropriate for TSB's own financial statements, as TSB retained substantively all of the risks and rewards associated with the transferred assets and the pass-through criteria of International Financial Reporting Standard 9 (IFRS 9) have not been met. The LLP recognises a 'deemed loan' to TSB on its balance sheet to represent its interests in the underlying mortgage portfolio.

The total Covered Bonds Issued by TSB at the end of 2018 were £500m (2017: £500m). The total value of the mortgage portfolio held by TSB was £1,312m (2017: £699m). In November 2018, the LLP increased the balance of the mortgage pool in preparation for the new Covered Bonds issuance in 2019.

Covered Bonds may be issued by TSB in various currencies, with the proceeds being paid across to the LLP on issuance by way of term loans.

The profit for the year is disclosed on page 8. The LLP made a profit of £3k during the year (2017: £3k). No change to the current business activity is expected.

#### **Subsequent events**

On 15th February 2019, TSB issued a Covered Bond in Sterling, totalling £500m, and issued an additional £250m of the same Covered Bond on the 28<sup>th</sup> February 2019. TSB passed the proceeds of both issuances to the LLP by way of term loans with a corresponding reduction in the capital contribution made by TSB. The total term loans as at the end of February were £1,250m. To support the additional issuance the mortgage portfolio was increased, taking the total mortgage portfolio to £1,770m as at the end of February.

#### **Key performance indicators ("KPIs")**

A defined set of KPIs for the Covered Bond Programme are set out within the programme documentation and are published as a monthly Investor Report on the TSB website. The members consider the key performance indicators of the LLP to be:

- the performance of the underlying mortgage loans – specifically the level of arrears and repossessions
- the performance against the triggers set out in the programme documentation

The programme allows a maximum outstanding balance of Covered Bonds, providing that the mortgage loan portfolios held by the LLP, along with other assets available meet the Asset Coverage Test (the 'ACT') which states that the adjusted aggregate amounts of mortgage loan and other assets must be of an amount equal to or greater than the total amounts of Covered Bonds in issue after taking into account other deductions

TSB Covered Bonds LLP  
**Members' Report (continued)**

**Key performance indicators ("KPIs") (continued)**

At the time of issue, the Covered Bonds were assigned credit ratings which reflect the likelihood of full and timely payment of interest to the holders of the Covered Bonds on each Interest Payment Date ('IPD') and the full repayment of principal at the final legal repayment date. A rating may be subject to revision, suspension or withdrawal at any time by the rating agencies if circumstances change.

Any change in the credit rating assigned to a Covered Bond would be used as an indicator as to the performance of the LLP. No changes in credit ratings have been applied to the Covered Bonds in the year under review and subsequently up to the date of approval of these financial statements.

**Designated members**

The designated members during the period and up to the date of signing the financial statements were as follows:

TSB Bank plc  
TSB Covered Bonds (LM) Limited

**Management board**

The members of the LLP management board during the year and up to the date of signing of the financial statements were:

Ralph Coates  
Steve Vance  
Alison Straszewski  
Ian Firth (resigned on 29 August 2018)  
Rangan Ravindran (appointed on 29 August 2018)

**Members' interests**

Under the terms of the Programme, TSB may make cash capital contributions to the LLP or capital contributions in kind, represented by the excess of the current balance of the mortgage loans over the cash payment made by the LLP on that transfer date.

The balance of capital contributions at the 31 December 2018 was £840m (2017: £215m).

**Members' responsibilities statement**

The members are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

The Limited Liability Partnership Act 2000 requires the members to prepare financial statements for each financial year. Under that law the members have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the members 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 limited liability partnership and of the profit or loss of the limited liability partnership for that period. In preparing the financial statements, the members are required to:

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

The members are responsible for keeping adequate accounting records that are sufficient to show and explain the LLP's transactions and disclose with reasonable accuracy at any time the financial position of the LLP and enable them to ensure that the financial statements comply with the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008

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

**Employees**

The LLP had no employees during the year ended 31 December 2018 (2017: no employees).

TSB Covered Bonds LLP  
**Members' Report (continued)**

**Independent auditors**

PricewaterhouseCoopers LLP have been appointed by the members as the auditors of the LLP and are to remain in office until the conclusion of the LLP's members meeting. Having expressed their willingness to continue in office, a resolution for the re-appointment of PricewaterhouseCoopers LLP will be proposed at the forthcoming members' meeting, in accordance with the Companies Act 2006 as applied to the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

In line with the proposed change in auditor of TSB, a resolution to appoint KPMG for the audit of the financial statements for the year ending 31 December 2020 is expected at a future members' meeting.

**Disclosure of information to auditors**

So far as the members are each aware, there is no relevant audit information of which the LLP's auditors are unaware. The members have each taken all the steps that he or she ought to have taken as a member in order to make himself or herself aware of any relevant audit information and to establish that the LLP's auditors are aware of the information.

**Risk management**

The majority of the LLP's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments: Presentation". The LLP's financial instruments comprise a deemed loan to TSB, as the seller of the mortgages, equivalent to the value of its net investment in the mortgages, cash and liquid resources, term loans, derivative contracts and various other receivables and payables.

The principal risks arising from the LLP's financial instruments are credit risk, interest rate risk and liquidity risk. These and other risks which may affect the LLP's performance are detailed below. Further analysis of the risks facing the LLP in relation to its financial instruments and the LLP's financial risk management policies is provided in note 8.

**Credit risk**

Credit risk arises on the individual loans within the mortgage loan portfolio which are in turn secured on UK residential properties. The performance of these loans is therefore influenced by the economic climate and the UK housing market.

**Interest rate risk**

Interest rate risk is the possibility that changes in interest rates will result in higher financing costs and/or reduced income from the LLP's interest bearing financial assets and liabilities.

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

As at 31 December 2018 the interest rate derivative contract provider was TSB. In line with the programme documentation TSB is required to maintain a minimum ratings level of A3(cr) (Moody's). Should TSB not meet the ratings requirements it will be required to post collateral or take other actions.

**Liquidity risk**

The ability of the LLP to meet its obligations to make principal and interest payments on the term loans and to meet its operating and administrative expenses is dependent on the amount and timing of the interest and principal repayments on the mortgage loans which underlie the deemed loan to TSB.

In the event that sufficient funds are not available to redeem the term loans or make the interest payments due, an amount equal to such a shortfall will be deferred until such funds are received. To the extent that the income on the deemed loan to TSB does not provide sufficient funds, the LLP has no other claim on the assets of TSB.

**Operational risk**

The LLP is exposed to operational risks through a number of contracts with third parties who have agreed to provide operational support to the LLP in accordance with the programme documentation. TSB has been appointed servicer and cash manager on behalf of the LLP. Citicorp Trustee Company Limited has been appointed as security trustee. Intertrust Management Limited ("Intertrust") has been appointed to provide corporate services in accordance with a corporate services agreement. HSBC Bank plc has been appointed to act as account bank.

TSB Covered Bonds LLP  
**Members' Report (continued)**

**Business risk**

The principal business risks of the LLP are set out in a number of trigger events in the programme documentation. These trigger events deal with issues such as the solvency of TSB and the performance of underlying mortgage assets. The occurrence of a trigger event may lead to a different priority of payments.

As TSB's short term Counterparty Risk Assessment rating is P-2(cr) TSB is required to fund the Reserve Fund to the Reserve Fund Required Amount, as defined by the programme documentation. As at 31 December 2018 the Reserve Fund balance was £1,089,815 (2017: £1,012,980).

**Statement of going concern**

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

Signed for and on behalf of the members of TSB Covered Bonds LLP



Helena Whitaker  
Per pro Intertrust Directors 1 Limited  
As director of TSB Covered Bonds (LM) Limited  
35 Great St. Helen's  
London EC3A 6AP



Alison Straszewski  
On behalf of  
TSB Bank plc  
Henry Duncan House, 120 George Street  
Edinburgh EH2 4LH

29 April 2019

## Independent auditors' report to the members of TSB Covered Bonds LLP

for the year ended 31 December 2018

### Report on the audit of the financial statements

#### Opinion

In our opinion, TSB Covered Bonds LLP's financial statements:

- give a true and fair view of the state of the limited liability partnership's affairs as at 31 December 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

We have audited the financial statements, included within the Members' Annual Report and Financial Statements (the "Annual Report"), which comprise: the Balance Sheet as at 31 December 2018; the Statement of comprehensive income, the Cash flow statement, Statement of changes in members' other interests for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

#### Basis for opinion

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

#### Independence

We remained independent of the limited liability partnership 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

ISAs (UK) require us to report to you when:

- the members' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the members have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the limited liability partnership'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.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the limited liability partnership's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the limited liability partnership's trade, customers, suppliers and the wider economy.

#### 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 members 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 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.

TSB Covered Bonds LLP

**Independent auditors' report to the members of TSB Covered Bonds LLP  
(continued)**

for the year ended 31 December 2018

**Responsibilities for the financial statements and the audit**

**Responsibilities of the members for the financial statements**

As explained more fully in the Members' responsibilities statement set out on page 3, the members 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 members 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 members are responsible for assessing the limited liability partnership'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 members either intend to liquidate the limited liability partnership 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](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditors' report.

**Use of this report**

This report, including the opinion, has been prepared for and only for the members of the partnership as a body in accordance with the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 and for no other purpose. We do not, in giving this opinion, 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 as applicable to limited liability partnerships 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 limited liability partnership, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.



Laura Needham (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London

30 April 2019



TSB Covered Bonds LLP  
**Statement of comprehensive income**  
for the year ended 31 December 2018

	Note	2018 £'000	2017 £'000
Interest receivable and similar income	2	4,601	320
Interest payable and similar charges	3	(4,531)	(261)
<b>Net interest income</b>		<u>70</u>	<u>59</u>
Operating expenses	4	(67)	(56)
<b>Profit for the year and total comprehensive income available for division among members</b>		<u>3</u>	<u>3</u>

There were no gains or losses other than those in the statement of comprehensive income. Accordingly, no statement of total recognised gains or losses is presented.

The accompanying notes on pages 12 to 22 are an integral part of the financial statements.

TSB Covered Bonds LLP

**Balance sheet**

as at 31 December 2018

	Note	31 Dec 2018 £000	31 Dec 2017 £000
<b>Assets</b>			
Cash and cash equivalents		28,273	16,165
Deemed loan to TSB	5	472,173	484,124
Other assets		0	5
<b>Total assets</b>		<b>500,446</b>	<b>500,294</b>
<b>Members' other interests and liabilities</b>			
Loans and borrowings	6	500,393	500,261
Other payables		47	30
<b>Total liabilities</b>		<b>500,440</b>	<b>500,291</b>
Reserves	7	6	3
<b>Total members' other interests</b>		<b>6</b>	<b>3</b>
<b>Total members' other interests and liabilities</b>		<b>500,446</b>	<b>500,294</b>
<b>Total members' interests</b>			
Reserves	7	(6)	(3)
Deemed loan to TSB	5	472,173	484,124
Loans and borrowings	6	(500,393)	(500,261)
		<b>(28,226)</b>	<b>(16,140)</b>

The accompanying notes on pages 12 to 22 are an integral part of the financial statements.

The financial statements on pages 8 to 22 were approved by the members on 29 April 2019 and signed on their behalf by:



Helena Whitaker  
Per pro Intertrust Directors 1 Limited  
As director of TSB Covered Bonds (LM) Limited



Alison Straszewski  
On behalf of  
TSB Bank plc

29 April 2019

TSB Covered Bonds LLP

**Statement of changes in members' other interests**

for the year ended 31 December 2018

	2018 £000	2017 £000
Balance at start of the year	3	-
Profit for the year	3	3
	<hr/>	<hr/>
Balance at 31 December	<b>6</b>	<b>3</b>
	<hr/>	<hr/>

The accompanying notes on pages 12 to 22 are an integral part of the financial statements.

TSB Covered Bonds LLP  
**Cash flow statement**  
for the year ended 31 December 2018

	2018 £'000	2017 £'000
<b>Operating activities</b>		
Operating expenses paid	(45)	(11)
	<hr/>	<hr/>
<b>Net cash flows used in operating activities</b>	<b>(45)</b>	<b>(11)</b>
<b>Investing activities</b>		
Principal receipts from deemed loan to TSB	182,193	124,721
Revenue receipts from deemed loan to TSB	19,942	13,490
Increase in deemed loan to TSB	(185,625)	(622,040)
Bank interest received	42	5
	<hr/>	<hr/>
<b>Net cash flows used in investing activities</b>	<b>16,552</b>	<b>(483,824)</b>
<b>Financing activities</b>		
Proceeds from term loans	-	500,000
Interest on term loans	(4,399)	-
	<hr/>	<hr/>
<b>Net cash flows from financing activities</b>	<b>(4,399)</b>	<b>500,000</b>
	<hr/>	<hr/>
<b>Change in cash and cash equivalents</b>	<b>12,108</b>	<b>16,165</b>
Cash and cash equivalents at start of the year	16,165	-
	<hr/>	<hr/>
<b>Cash and cash equivalents at end of the year</b>	<b>28,273</b>	<b>16,165</b>
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The accompanying notes on pages 12 to 22 are an integral part of the financial statements.

TSB Covered Bonds LLP  
**Notes to the financial statements**

for the year ended 31 December 2018

**1. Significant accounting policies**

The LLP is a limited liability partnership incorporated in the United Kingdom and registered in England and Wales under the Limited Liabilities Partnerships Act 2000.

**(a) Basis of preparation**

The financial statements of the LLP for the year ended 31 December 2018 have been prepared in accordance with the Companies Act 2006, as applied to limited liability partnerships, and with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). IFRS comprises accounting standards prefixed IFRS, issued by the International Accounting Standards Board (IASB) and those prefixed IAS, issued by the IASB's predecessor body, as well as interpretations issued by the IFRS Interpretations Committee (IFRS IC) and its predecessor body.

The principal accounting policies applied in the preparation of these financial statements are set out below and have been consistently applied in the financial statements.

The financial statements are presented in Sterling which is the LLP's functional and presentation currency and have been prepared on the historical cost basis.

The members consider that there are no critical accounting estimates and judgments.

**Changes to accounting policies**

IFRS 9 replaced IAS 39 'Financial Instruments: Recognition and Measurement' and was effective for these financial statements from 1st January 2018. This new accounting standard includes requirements in three areas: classification and measurement of financial instruments; impairment of financial instruments; and hedge accounting.

As permitted by the transitional provisions of IFRS 9, the LLP has elected not to restate comparative figures for 2017. Consequently, for note disclosures, the consequential amendments to IFRS 7 'Financial Instruments: Disclosures' have only been applied to the current year. There has been no impact resulting from the adoption of IFRS 9.

**(b) Interest receivable and interest payable**

Interest receivable and similar income and interest payable and similar charges have been calculated using the effective interest rate ("EIR") method. The EIR 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 EIR 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 EIR, 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 deemed loan to TSB Bank plc ("TSB") and within the term loans on the balance sheet.

**(d) Financial instruments**

Financial instruments comprise a deemed loan to TSB, cash and liquid resources, term loans, derivative contracts, and other receivables and payables that arise directly from its operations. The main purpose of these financial instruments is to raise finance for TSB. These financial instruments are classified in accordance with the principles of International Financial Reporting Standard 9 (IFRS 9) as described below.

**(e)(i) Deemed loan to TSB**

Financial assets are de-recognised when a transferor meets the pass-through requirements combined with the transfer of sufficient risk and rewards test.

Where a transferor retains substantially all the risks and rewards associated with transferred assets, the transfer is accounted for as a financing transaction, notwithstanding that it is a sale transaction from a legal perspective. In such a case the transferee would not recognise the assets on its balance sheet but rather a deemed loan to the originator, where recourse to the originator is limited to the cash flows from the mortgage loans and any additional credit enhancement provided.

## Notes to the financial statements (continued)

for the year ended 31 December 2018

### 1. Significant accounting policies (continued)

#### (e)(i) Deemed loan to TSB (continued)

This is the treatment which has been adopted on the transfer of the mortgage loans from TSB to the LLP. The LLP has determined that the transfer of the contractual rights to cash flows is not affected by TSB retaining the cash manager and servicer roles and the revolving nature of the asset pool underlying the programme introduces a material delay between the original cash collection and its final remittance to TSB under the term loans. As a result of this, the pass-through arrangement is failed and TSB continues to recognise the mortgage assets on its balance sheet.

Had the pass-through arrangement conditions been met, the mortgages would still not be eligible for de-recognition because TSB bears the risk of default on the loans through the requirement to add additional collateral to pass the Asset Coverage Test, and also receives excess income generated from the loans, exposing it to the variability of rewards of the underlying mortgage portfolio.

#### Impact of IFRS9 on the measurement of the deemed loan to TSB

On initial recognition, financial assets are classified into one of three measurement categories, amortised cost, fair value through other comprehensive income, or fair value through profit or loss depending on the LLP's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest.

The LLP assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how performance of the portfolio is measured and reported, how management are compensated, and the frequency and the reasons for asset sales from the portfolio.

In applying the business model test, the members consider the business model for the deemed loan to TSB is to hold the assets to collect the contractual cashflow in order to service the LLP's liabilities. The members consider the cashflows to represent solely payments of principal and interest and therefore have classified the deemed loan to TSB at amortised cost. As such, there has been no change in the measurement of the deemed loan to TSB as a result of the adoption of IFRS 9.

#### (e)(ii) Impairment of deemed loan to TSB

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 to TSB 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 to TSB for impairment, the members first consider the impaired value of the underlying mortgage loans, using the above 3 stage approach. Following this review, they consider the ECL of the deemed loan to TSB, taking into account the expected cash flows arising from the mortgage loans and the interest rate swap. Key to this assessment is the level of expected excess

TSB Covered Bonds LLP

**Notes to the financial statements (continued)**

for the year ended 31 December 2018

**1. Significant accounting policies (continued)**

**(e)(ii) Impairment of deemed loan to TSB (continued)**

spread in the structure, which provides protection to the LLP against principal losses via the priority of payments, and the incorporation of the subordinated loan balance within the deemed loan to TSB. As a result of this review, the members have concluded that the application of IFRS 9 is not expected to result in impairment due to the credit enhancement embedded in the deemed loan exceeding the impairment provisions of the underlying mortgage assets.

**(e)(iii) Cash and 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 at the LLP's discretion, it is viewed as restricted cash.

**(e)(iv) Derivative financial instruments**

The interest rate derivative contracts used to manage the interest rate risk are not recognised separately on the balance sheet as financial instruments as the amounts payable under the derivative contracts reflect interest flows from the mortgage loans which are not recognised by the LLP for accounting purposes. Instead, the deemed loan to TSB is recognised with an EIR which reflects the amount received or paid under the derivative contracts.

**(f) 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:

**(f)(i) Effective interest rate method**

In calculating the EIR of financial instruments, the LLP takes into account interest received or paid, fees and commissions paid or received and premiums and discounts on acquisition or issue that are integral to the yield as well as incremental transaction costs.

**(f)(ii) Fair value calculations**

Fair value is the price that would be paid to transfer a liability (or sell an asset) in an orderly transaction between market participants at the measurement date. Fair value 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. Other factors are also considered, such as counterparty credit quality and liquidity.

**(f)(iii) Impairment of deemed loan to TSB**

The LLP's accounting policy for losses arising on the deemed loan classified as loans and receivables is described in note 1(e)(ii). The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date.

At 31 December 2018, impairment allowances against the deemed loan totalled £nil (2017: £nil).

**2. Interest receivable and similar income**

	2018 £'000	2017 £'000
Interest receivable on deemed loan	4,559	315
Bank interest receivable	42	5
<b>Total</b>	<b>4,601</b>	<b>320</b>

The LLP accounts for the interest due on the deemed loan by capping it at a level which covers its liabilities, including the retention of a notional profit, effectively netting down deferred consideration within the interest income of the LLP.

TSB Covered Bonds LLP  
**Notes to the financial statements (continued)**  
for the year ended 31 December 2018

**3. Interest payable and similar charges**

	2018 £'000	2017 £'000
Interest payable on term loans	4,531	261

**4. Operating expenses**

	2018 £'000	2017 £'000
Administration charges	37	26
Audit fees	30	30
<b>Total</b>	<b>67</b>	<b>56</b>

The LLP had no employees during the year (2017: nil).

The audit fees for the LLP relate to the statutory audit. The fee for the LLP for the current year is £18,000 (2017: £18,000) and paid by the LLP. The LLP also pays the audit fees for TSB Covered Bonds Holdings Limited and TSB Covered Bonds (LM) Limited, the combined fees for both entities for the current year is £12,000 (2017: £12,000).

**5. Deemed loan to TSB**

The members of the LLP have concluded that TSB has retained substantially all the risks and rewards of the pool of mortgage loans underlying the deemed loan and as a consequence, the LLP does not recognise the mortgage loans on its balance sheet but rather a deemed loan to TSB, where recourse is limited to the cash flows from the mortgage loans and any additional credit enhancement provided by TSB.

The LLP recognises principal and interest cash flows from the underlying pool of mortgage loans only to the extent that it is entitled to retain such cash flows. Cash flows attributable to TSB are not recognised by the LLP. The mortgage loans are secured on residential property in England, Wales and Scotland. Mortgages in the pool must fulfil certain criteria. If they fail to do so they are removed from the pool and the pool may be replenished.

	31 Dec 2018 £'000	31 Dec 2017 £'000
<b>Non current</b>		
Principal	467,614	483,809
<b>Current</b>		
Interest	4,559	315
<b>Deemed loan to TSB</b>	<b>472,173</b>	<b>484,124</b>

The loan is expected to be repaid on the final maturity date of the term loans.



TSB Covered Bonds LLP

**Notes to the financial statements (continued)**

for the year ended 31 December 2018

**6. Loans and borrowings**

Loans and borrowings comprise a series of term loans from TSB, equivalent to the Covered Bonds issued by TSB.

TSB will not be relying on repayment of any term loan by the LLP nor the interest thereon to meet its repayment or interest obligations under the Covered Bonds. The term loans will not be repaid by the LLP until amounts payable under the corresponding series of Covered Bonds have been repaid. Amounts owed by the LLP will be paid in accordance with the priority of payments detailed in the programme documentation.

The Covered Bonds issued by TSB are unconditionally guaranteed by the LLP. Under the terms of the programme documentation, the LLP has provided a guarantee as to payments of interest and principal under the Covered Bonds. The obligations of the LLP under its guarantee constitute direct obligations of the LLP secured against the assets of the LLP and recourse against the LLP is limited to such assets. The principal asset is the beneficial interest in the mortgage loans acquired from TSB.

	31 Dec 2018 £'000	31 Dec 2017 £'000
<b>Non-current</b>		
Term loans with TSB	500,000	500,000
<b>Current</b>		
Interest due on term loans	393	261
GBP – priced against 3 month Libor Weighted average margin 0.24% (2017: 0.24%)		
<b>Total</b>	<u>500,393</u>	<u>500,261</u>

**7. Reserves**

	Members' Capital £000	Reserves £000	Total £000	Loan due to members £000	Total £000
Members' Interest as at 1 January 2018	-	3	3	500,000	500,003
Profit for the year available for division among members	-	3	3	-	3
Loans introduced by members	-	-	-	-	-
Repaid to members	-	-	-	-	-
	<u>-</u>	<u>6</u>	<u>6</u>	<u>500,000</u>	<u>500,006</u>
Members' Interest as at 31 December 2018					

TSB Covered Bonds LLP

**Notes to the financial statements (continued)**

for the year ended 31 December 2018

**8. Management of risk**

The principal risks arising from the LLP's financial instruments are credit risk, interest rate risk and liquidity risk. However, the LLP directs TSB to expend considerable resource to maintaining effective controls to manage, measure and mitigate each of these risks in its role as servicer. Further detailed analysis of the risks facing the LLP in relation to its financial instruments is provided below.

The LLP exposure to risk on its financial instruments and the management of such risk is largely determined at the inception of the Programme. The LLP's activities and the role of each party to the Programme are clearly defined and documented. Cash flow modelling, including multiple stress scenarios, is carried out as part of the structuring of the Programme. For this reason, sensitivity to risk is minimal.

**8(a) Credit risk**

Credit risk is the risk of financial loss if a counterparty to a financial instrument fails to meet its contractual obligations.

The ability of the LLP to meet its obligations to make principal and interest payments on the term loans and to meet its operating and administrative expenses is dependent on funds being received on the deemed loan. The primary credit risk of the LLP therefore relates to the credit risk associated with the underlying pool of mortgages originated by TSB.

The underlying mortgage assets are all secured on residential properties in England, Wales and Scotland. The nature of the residential mortgage portfolio means there is no significant individual counterparty credit risk in relation to the underlying mortgage pool.

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 of the customer and the product type. Significant changes in the economy, or in the health of a particular geographical area that represents a concentration in the mortgage assets, could also affect the cash flows from the mortgage pool.

The LLP has engaged TSB as servicer of the mortgage loans in the portfolio to help reduce the risk of loss. The servicer is required to monitor repayments of the mortgage loans in accordance with its normal credit policies. The servicer is also responsible for ensuring mortgage loans meet the eligibility criteria set out in the programme documentation.

The income on the mortgage pool is expected to exceed the LLP's expenses and the interest payable on the term loans. Any excess income that is not required to meet expenses of interest payments is returned to TSB as deferred consideration.

Credit risk for the LLP is mitigated by the amount of over collateralisation of the beneficial interest in mortgages which is provided by TSB. The over collateralisation is available in full for the benefit of the LLP. The programme documentation provides for an Asset Coverage Test ("ACT"), under which the LLP must ensure that the adjusted aggregate loan amount of the mortgage pool asset and cash is at least equal to the aggregate amount outstanding on the Covered Bonds on each calculation date after taking into account other deductions.

In the event that there is a breach of the ACT, TSB is required to take steps to make good the deficit by providing the necessary capital contributions in order that the ACT breach is cured before the next calculation date. If there is a deficit on the following calculation date, this will constitute a TSB Event of Default, which would entitle the Trustee to serve an Issuer Acceleration Notice on TSB. Upon service of such notice, the Bond Trustee will serve a notice to pay on the LLP under the Covered Bond guarantee. This would require the LLP to repay all amounts outstanding on the Covered Bonds, including principal and accrued interest.

The total mortgage pool made available to the LLP as at 31 December 2018 amounted to £1,312m (2017: £699m). As noted in the accounting policies section, the LLP does not recognise the mortgage pool but rather a deemed loan to TSB.

The LLP 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 rating scale of the credit rating agencies that rate the Covered Bonds, the programme documentation contains various rating triggers linked to each counterparty, which require certain actions to be taken if triggers are breached.

TSB Covered Bonds LLP

**Notes to the financial statements (continued)**

for the year ended 31 December 2018

**8. Management of risk (continued)**

**8(a) Credit risk (continued)**

Counterparty	Rating	Required Rating (Moody's)	Rating as at 31 Dec 2018 (Moody's)	Rating as at date of approval of the financial statements (Moody's)
HSBC Bank plc (in capacity as account bank)	Short Term Long Term	P-1 A2	P-1 Aa3	P-1 Aa3
TSB Bank plc (in capacity as swap provider)	Long Term	A3(cr)	A3(cr)	A3(cr)

In the event that a swap counterparty is downgraded by a rating agency below the ratings 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 the required rating, procuring another entity with the required rating to become co-obligor to its obligations, or taking such other action as it may agree with the relevant rating agency.

**Financial assets subject to credit risk**

The maximum exposure to credit risk arising on the LLP's financial assets at the reporting date is disclosed in the table below and equates to carrying value.

	31 Dec 2018 £'000	31 Dec 2017 £'000
<b>Assets held at amortised cost:</b>		
Deemed loan to TSB	472,173	484,124
Cash and cash equivalents	28,273	16,165
Other assets	0	5
	<b>500,446</b>	<b>500,294</b>

At the balance sheet date, no financial assets subject to credit risk were past due or impaired.

**Mortgage assets**

For the purposes of the LLP'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. TSB 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.

**Notes to the financial statements (continued)**

for the year ended 31 December 2018

**8. Management of risk (continued)****8(a) Credit risk (continued)**

2018	Mortgage Balance £'000	Number of Accounts
Stage 1	1,240,103	11,001
Stage 2	67,075	689
Stage 3	4,331	39
<b>Total</b>	<b>1,311,509</b>	<b>11,729</b>

**8(b) Interest rate risk**

Interest rate risk arises where assets and liabilities have interest rates set under a different basis or which reset at different times. The mortgage assets, the term loans and the cash and cash equivalents are exposed to these risks. The LLP minimises its exposure to such risk by ensuring that the interest rate characteristics of assets and liabilities are similar and where this is not possible, the LLP uses derivative financial instruments to mitigate these risks.

The underlying mortgage pool comprises mortgage loans which are subject to variable rates of interest set by TSB based on general interest rates and competitive considerations, mortgage loans which track the Bank of England base rate and mortgage loans which are subject to fixed rates of interest. To mitigate the changes in interest rates that may result in the interest cash flows from the mortgage pool being insufficient to meet the payments under the term loans, the LLP has entered into basis swaps with TSB which substantially eliminate the sensitivity to movements in interest rates.

**8(c) Liquidity risk**

Liquidity risk is the risk that the LLP is not able to meet its financial obligations as they fall due.

The LLP's ability to meet payments on the term loans as they fall due is dependent on the receipt of funds from the deemed loan to TSB which will vary due to the level of repayments on the underlying mortgage portfolio.

Principal repayments are made on the term loans with TSB in accordance with the LLP's principal priority of payments and reflect the amount of principal collections from the underlying mortgage loans. In the event that the LLP does not have sufficient cash to repay the term loans as and when they fall due, the members may be required to make cash capital contributions, extend the repayment of the term loans, or sell mortgages from the mortgage pool, in accordance with the terms of the programme documentation. Recourse against the LLP under its guarantee is limited to the mortgage pool and any other assets held by the LLP.

TSB Covered Bonds LLP

**Notes to the financial statements (continued)**

for the year ended 31 December 2018

**8. Management of risk (continued)**

**8(c) Liquidity risk (continued)**

The tables below reflect the undiscounted cash payments which will fall due at the contractual maturity dates of the term loans. It is anticipated that the interest and principal repayments on the deemed loan to TSB will be sufficient to allow repayment of the term loans.

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
<b>Principal</b>							
Term loans with TSB	500,000	500,000	-	-	-	500,000	-
<b>Other Payables</b>							
Interest payable on Term loans with TSB	393	22,930	-	1,414	4,350	17,166	-
	<u>500,393</u>	<u>522,930</u>	<u>-</u>	<u>1,414</u>	<u>4,350</u>	<u>517,166</u>	<u>-</u>

2017	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
<b>Principal</b>							
Term loans with TSB	500,000	500,000	-	-	-	500,000	-
<b>Other Payables</b>							
Interest payable on Term loans with TSB	261	19,054	-	940	2,871	15,243	-
	<u>500,261</u>	<u>519,054</u>	<u>-</u>	<u>940</u>	<u>2,871</u>	<u>515,243</u>	<u>-</u>

TSB Covered Bonds LLP

**Notes to the financial statements (continued)**

for the year ended 31 December 2018

**9. Related party transactions**

The LLP is a special purpose entity controlled by TSB, one of the two designated members. The second designated member is TSB Covered Bonds (LM) Limited.

The LLP has provided a deemed loan to TSB on which the LLP receives income. In addition, the LLP paid servicer and cash manager Fees to TSB in connection with the provision of services defined under the programme documentation. TSB is the counterparty of the interest rate swap agreements. The swap payments and management fees are included in the income from the deemed loan.

Intertrust Corporate Services Limited (Intertrust) is the immediate parent company of TSB Covered Bond (Holdings) Limited who is the majority shareholder of TSB Covered Bonds (LM) Limited. Intertrust is a wholly owned subsidiary of Intertrust Management Limited. TSB pays corporate services fees to Intertrust in connection with its provision of corporate management services to the LLP and related companies. In 2018 this amounted to £19,224 (2017: £12,871).

The LLP has entered into related party transactions with Intertrust Management Limited ("Intertrust") and TSB Bank plc ("TSB").

During the year, the LLP undertook the transactions set out below with TSB.

	2018 £'000	2017 £'000
<b>Interest receivable and similar income</b>		
Income from deemed loan to TSB	4,601	320
Cash manager and servicing fees	837	475
<b>Interest payable and similar charges</b>		
Interest payable to TSB on term loans	(4,531)	(261)
	<b>31 Dec 2018 £'000</b>	<b>31 Dec 2017 £'000</b>
<b>Assets</b>		
Deemed loan to TSB	472,173	484,124
<b>Liabilities</b>		
Term loans from TSB	(500,393)	(500,261)

TSB Covered Bonds LLP

**Notes to the financial statements (continued)**

for the year ended 31 December 2018

**10. Future accounting pronouncements**

The following pronouncements may be relevant to the LLP but are not applicable for the year ended 31 December 2018.

<b>Pronouncement</b>	<b>Nature of Change</b>	<b>IASB effective date</b>
IFRS 16 <i>Leases</i>	Replaces IAS 17 <i>Leases</i> and brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. IFRS 16 requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged. The impact of IFRS 16 on the LLP is not expected to be material.	Annual periods beginning on or after 1 January 2019

**11. Parent undertaking and controlling party**

The designated members of the LLP are TSB Bank plc and TSB Covered Bonds (LM) Limited (as Liquidation Member).

For accounting purposes, at 31 December 2018 the LLP's ultimate controlling party was Banco de Sabadell S.A., which is the parent undertaking of the largest group to consolidate these financial statements. Copies of the consolidated annual report and accounts of Banco Sabadell S.A. are available from [www.grupbancsabadell.com/en/](http://www.grupbancsabadell.com/en/). TSB Bank plc is the parent undertaking of the smallest group to consolidate these financial statements. Copies of the consolidated financial statements of TSB Bank plc may be obtained from 20 Gresham Street, London, EC2V 7JE or downloaded via [www.tsb.co.uk](http://www.tsb.co.uk).