

Registered Number 3149607

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**ANNUAL REPORT AND ACCOUNTS**  
**YEAR ENDED 31 December 2011**

SATURDAY



A22 \*A15DOH8P\* 24/03/2012 #66  
COMPANIES HOUSE

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**DIRECTORS AND COMPANY INFORMATION**

**DIRECTORS**

Ian Gordon Stewart  
Tracey Anne Hill

**COMPANY SECRETARY**

Angela Lockwood (resigned 25 11 2011)  
Paul Gittins (appointed 25 11 2011)

**REGISTERED OFFICE**

Trinity Road  
Halifax  
West Yorkshire  
HX1 2RG

**INDEPENDENT AUDITORS**

PricewaterhouseCoopers LLP  
Benson House  
33 Wellington Street  
Leeds  
LS1 4JP

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC  
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011**

The directors present their annual report and the audited financial statements for BOS (Shared Appreciation Mortgages) NO 2 PLC (the "Company") for the year ended 31 December 2011

**PRINCIPAL ACTIVITY**

The principal activity of the Company is to finance mortgage lending. In 1997 the Company issued £105.6m floating rate notes (the "Notes"). Following a business restructure on 28 February 2011 (see business review below), the terms of the Notes were changed and bear a zero rate of interest until August 2027. Thereafter the interest rate applicable to the Notes will be 0.50% fixed until 2072 when the Notes become due. Prior to 28 February 2011, the interest payable on the Notes was set at 60% of the three-month LIBOR rate for Sterling deposits less 0.30% per annum until August 2027. Thereafter, the interest rate applicable to the Notes would have been 60% of the three-month LIBOR rate for Sterling deposits plus 0.10% per annum until the due date in 2072. The Notes are secured on the mortgage portfolio. The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to Note holders and the swap provider.

The activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation").

Movements in the mortgage book are disclosed in the notes to the financial statements.

**Business structure**

The Company is a subsidiary undertaking of Bank of Scotland plc ("BOS") and ultimately Lloyds Banking Group plc ("LBG").

**RESULTS AND DIVIDENDS**

No new mortgages were acquired or generated by the Company in the year and no new Notes were issued.

The profit after taxation for the year amounted to £1,449,431 (2010: £2,037,737 profit). The directors do not recommend payment of a dividend (2010: £2,000,000).

**BUSINESS REVIEW AND FUTURE DEVELOPMENTS**

The Company's business will continue to unwind over the life of the mortgages issued as no further advances will be made. Cash is continuing to be collected.

The principal asset in the Company is a mortgage portfolio which is subject to an annual impairment review. The mortgage portfolio is subject to the economic factors relating to the housing market (see "Credit Risk" below). The Company's results are not impacted by changes in interest rates as the mortgage loans bear a zero rate of interest. No impairment provision was deemed necessary as at 31 December 2011 or 31 December 2010.

The Company was restructured in 2011. On 23 February 2011, at a meeting of Note holders, it was approved that the Guaranteed Investment Contract ("GIC") account should be closed on 28 February 2011 and that the funds from the GIC account be used to repay a proportion of the Notes in issue on the same date. As a result of this agreement, the balance on the GIC account at 28 February 2011 of £35,963,405 was used to pay down an equal amount of the Notes in issue.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC  
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**BUSINESS REVIEW AND FUTURE DEVELOPMENTS (CONTINUED)**

It was also agreed to change the remaining Notes in issue from interest-bearing to zero interest with effect from the same date. The remaining Notes retain the right to receive the shared appreciation on the underlying mortgage loans as per the original agreement.

Under International Financial Reporting Standards ("IFRSs") an effective yield adjustment is made on interest receivable and interest payable, reflecting the discount at which the mortgages and Notes were originally issued, with the net difference passed through the income statement. Following the closure of the GIC account and partial repayment of Notes on 28 February 2011, the discount on the GIC account was fully amortised and the discount on the Notes was amortised in line with the corresponding effective yield adjustment on the Mortgage loans. This resulted in a higher net movement through the income statement of £1,320,762 profit in 2011 (31 December 2010: £82,548 profit).

Standard and Poor's ("S&P"), the Rating Agency rating the Notes, has issued updated criteria for counterparties to a structured finance transaction during 2011 and following an assessment of the Company, the Notes in issue were downgraded from a rating of AAA to A. However, due to the nature of the business the directors do not consider that the change of rating on the Notes will have any significant impact on the Company.

The key performance indicator used by management in assessing the performance of the Company is the monitoring of actual cash flows against planned cash flows on the Notes. The Company's performance is addressed in the quarterly management accounts provided to the directors.

**POLICY AND PRACTICE ON PAYMENT OF CREDITORS**

The Company follows the 'Prompt Payment Code' published by the Department for Business Innovation and Skills (BIS), regarding the making of payments to suppliers. Information about the 'Prompt Payment Code' may be obtained by visiting [www.promptpaymentcode.org.uk](http://www.promptpaymentcode.org.uk)

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performed according to the terms of the contract.

The Company owed no money to trade creditors at 31 December 2011 or at 31 December 2010.

**DIRECTORS**

The directors who served during the year and up to the date of signing the financial statements were as follows:

Ian Gordon Stewart  
Tracey Anne Hill

**THIRD PARTIES INDEMNITIES**

The Company has made qualifying third party indemnity provisions for the benefit of the directors. These indemnity provisions remain in force at the date of this report. A copy of the deed is available for inspection at the registered office of Lloyds Banking Group plc.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**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 a mortgage portfolio, cash and liquid resources, a derivative contract ("swap"), an embedded derivative, loans and borrowings and various other payables that arise directly from its operations. The principal purpose of these financial instruments is to raise finance for the Company's operations.

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments is undertaken.

The principal risk arising from the Company's financial instruments is credit risk. This and other risks which may affect the Company's performance are detailed below. Further analysis of the risks facing the Company on its financial instruments is provided in note 16.

**Credit risk**

Credit risk arises on the individual loans within the mortgage loan portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. However, the maximum loan-to-value of the original advances was 25% and the credit risk is considered to be low.

The extent to which the Company can meet its obligations to repay the Notes will be dependent upon the receipt of funds earned on its bank deposits, the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS (see "Liquidity Risk"). To the extent that this income does not provide sufficient funds to cover the repayment of the Notes, the Note holders have no claim on the assets of BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS will repurchase any mortgages that are found or held not to be valid, binding and enforceable.

Although in such an event the total value of the outstanding loan will be covered by BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased.

Shared appreciation is subject to the movement in the market value of the property which is dependent upon house price inflation ("HPI"). This may provide a return on the Notes below initial expectations. Any expected increase in value cannot be guaranteed.

**Interest rate risk**

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time.

The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar.

The Company entered into an interest rate derivative at the start of the structure with an external Swap provider to manage the interest rate risk on its operations and sources of finance. The purpose of the interest rate swap was to reduce the interest rate risk on the Company's assets and liabilities by paying over a portion of the capital appreciation on the mortgage loans in return for a fixed interest receipt.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**RISK MANAGEMENT (CONTINUED)**

**Interest rate risk (continued)**

Following the restructure on 28 February 2011, with the closure of the GIC account and partial repayment of the Notes, the Company's exposure to interest rate risk is limited to interest earned on its bank accounts and the interest rate swap, as both the mortgage loans and the remaining Notes pay a zero rate of interest. Therefore, it is not considered to be a significant risk.

**Liquidity risk**

The Company has an unconditional and irrevocable 364-day revolving Letter of Credit provided by BOS. The Letter of Credit is for a maximum aggregate principal amount of £1,165,000 to assist the Company should it not be able to meet its obligations under the Notes. The reliance on this facility is therefore dependent upon the creditworthiness of BOS. The Company has not drawn on the Letter of Credit since inception.

**Operational risk**

In accordance with the Programme Documentation the Company is bound to make payments to meet third party expenses. BOS has been appointed to act as account bank and servicer of the mortgage book on behalf of the Company. The Company also uses the Bank of New York Mellon to provide all corporate services in respect of the Notes in issue.

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

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

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

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements,

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

**Statement of disclosure of information to auditors**

So far as the directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and the directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given, and should be interpreted, in accordance with the provisions of section 418 of the Companies Act 2006.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**EMPLOYEES**

The Company has employed no staff during the year ended 31 December 2011 or the previous year

**INDEPENDENT AUDITORS**

Pursuant to section 487 of the Companies Act 2006, auditors duly appointed by the member of the Company shall, subject to any resolution to the contrary, be deemed to be reappointed for the next financial year and PricewaterhouseCoopers LLP, having expressed their willingness will therefore continue in office

**STATEMENT OF GOING CONCERN**

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 accounts

By Order of the Board



Paul Gittins  
Secretary

Trinity Road  
Halifax  
West Yorkshire  
HX1 2RG

DATE 21 March 2012

**INDEPENDENT AUDITORS' REPORT  
TO THE MEMBER OF BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**

We have audited the financial statements of BOS (Shared Appreciation Mortgages) NO 2 PLC for the year ended 31 December 2011 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

**Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibilities Statement set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's member 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.

**Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Opinion on financial statements**

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2011 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

**Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

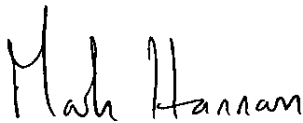


**INDEPENDENT AUDITORS' REPORT  
TO THE MEMBER OF BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC  
(CONTINUED)**

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

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



Mark Hannam (Senior Statutory Auditor)  
For and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Leeds

Date 21 March 2012

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED 31 DECEMBER 2011**

|                                                                           | Notes | 2011<br>£        | 2010<br>£        |
|---------------------------------------------------------------------------|-------|------------------|------------------|
| Interest receivable and similar income                                    | 2     | 6,891,479        | 3,617,230        |
| Interest payable and similar charges                                      | 3     | (5,146,632)      | (1,044,522)      |
| <b>Net interest income</b>                                                |       | <b>1,744,847</b> | <b>2,572,708</b> |
| Net fair value gains and losses on derivatives                            | 4     | 269,162          | 303,841          |
| Other operating income                                                    | 5     | 2,400            | 5,025            |
| Operating expenses                                                        | 6     | (55,873)         | (57,948)         |
| <b>Profit before tax</b>                                                  |       | <b>1,960,536</b> | <b>2,823,626</b> |
| Taxation                                                                  | 7     | (511,105)        | (785,889)        |
| <b>Profit / total comprehensive income attributable to equity holders</b> |       | <b>1,449,431</b> | <b>2,037,737</b> |

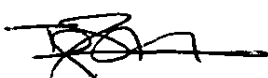
The profit shown above is derived from continuing operations. The Company operates in a single business segment and all of the Company's activities are in the UK.

The accompanying notes on pages 13 to 31 are an integral part of the financial statements.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**BALANCE SHEET AS AT 31 DECEMBER 2011**

|                                       | Notes | 2011<br>£          | 2010<br>£          |
|---------------------------------------|-------|--------------------|--------------------|
| <b>Assets</b>                         |       |                    |                    |
| Cash and cash equivalents             | 8     | 3,982,877          | 34,639,306         |
| Mortgage portfolio                    | 9     | 12,892,692         | 13,362,551         |
| Shared appreciation rights receivable | 10    | 109,298,740        | 113,583,458        |
|                                       |       | <hr/>              | <hr/>              |
| <b>Total assets</b>                   |       | <b>126,174,309</b> | <b>161,585,315</b> |
|                                       |       | <hr/>              | <hr/>              |
| <b>Equity and liabilities</b>         |       |                    |                    |
| Bank overdraft                        | 8     | 74                 | 61                 |
| Loans and borrowings                  | 11    | 12,443,084         | 44,925,276         |
| Shared appreciation rights payable    | 12    | 91,082,293         | 94,024,742         |
| Derivative liability                  |       | 16,792,098         | 18,071,554         |
| Current tax liability                 | 7     | 537,426            | 809,512            |
| Deferred tax liability                | 13    | 101,239            | 127,560            |
| Trade and other payables              | 14    | 634,008            | 491,954            |
|                                       |       | <hr/>              | <hr/>              |
| <b>Total liabilities</b>              |       | <b>121,590,222</b> | <b>158,450,659</b> |
|                                       |       | <hr/>              | <hr/>              |
| Share capital                         | 15    | 50,001             | 50,001             |
| Retained profits                      |       | 4,534,086          | 3,084,655          |
|                                       |       | <hr/>              | <hr/>              |
| <b>Shareholders' equity</b>           |       | <b>4,584,087</b>   | <b>3,134,656</b>   |
|                                       |       | <hr/>              | <hr/>              |
| <b>Total equity and liabilities</b>   |       | <b>126,174,309</b> | <b>161,585,315</b> |
|                                       |       | <hr/>              | <hr/>              |

The Directors approved the financial statements on 21 March 2012

  
 Ian Gordon Stewart  
 Director

The accompanying notes on pages 13 to 31 are an integral part of the financial statements

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31 DECEMBER 2011**

|                                                  | <b>Share<br/>Capital<br/>£</b> | <b>Retained<br/>Profits<br/>£</b> | <b>Total<br/>£</b> |
|--------------------------------------------------|--------------------------------|-----------------------------------|--------------------|
| Balance at 1 Jan 2011                            | 50,001                         | 3,084,655                         | 3,134,656          |
| Profit / total comprehensive income for the year | -                              | 1,449,431                         | 1,449,431          |
| Balance at 31 Dec 2011                           | 50,001                         | 4,534,086                         | 4,584,087          |

|                                                  | <b>Share<br/>Capital<br/>£</b> | <b>Retained<br/>Profits<br/>£</b> | <b>Total<br/>£</b> |
|--------------------------------------------------|--------------------------------|-----------------------------------|--------------------|
| Balance at 1 Jan 2010                            | 50,001                         | 3,046,918                         | 3,096,919          |
| Profit / total comprehensive income for the year | -                              | 2,037,737                         | 2,037,737          |
| Dividends paid in the year                       | -                              | (2,000,000)                       | (2,000,000)        |
| Balance at 31 Dec 2010                           | 50,001                         | 3,084,655                         | 3,134,656          |

The accompanying notes on pages 13 to 31 are an integral part of the financial statements

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2011**

|                                                 | Notes | 2011<br>£           | 2010<br>£           |
|-------------------------------------------------|-------|---------------------|---------------------|
| <b>Operating Activities</b>                     |       |                     |                     |
| Inter-company fees paid                         |       | (42,239)            | (44,187)            |
| External audit fees paid                        |       | (6,444)             | (3,290)             |
| Administration expenses paid                    |       | (8,344)             | (5,552)             |
| Tax paid                                        |       | (809,512)           | (551,357)           |
| <b>Net cash flows from operating activities</b> |       | <u>(866,539)</u>    | <u>(604,386)</u>    |
| <b>Investing Activities</b>                     |       |                     |                     |
| Repayments on mortgage portfolio                |       | 1,156,837           | 1,450,125           |
| Shared appreciation rights received             |       | 4,991,575           | 7,143,455           |
| <b>Net cash flows from investing activities</b> |       | <u>6,148,412</u>    | <u>8,593,580</u>    |
| <b>Financing Activities</b>                     |       |                     |                     |
| Bank interest received                          |       | 464,318             | 2,578,529           |
| Bank interest paid                              |       | (195)               | -                   |
| Swap interest received                          |       | 331,975             | 351,896             |
| Repayment of borrowings                         |       | (37,521,661)        | (3,702,906)         |
| Interest paid on borrowings                     |       | (21,427)            | (65,313)            |
| Restructuring costs paid                        |       | (61,917)            | -                   |
| Shared appreciation rights paid                 |       | (4,877,099)         | (7,257,082)         |
| Dividends paid                                  |       | -                   | (2,000,000)         |
| <b>Net cash flows from financing activities</b> |       | <u>(41,686,006)</u> | <u>(10,094,876)</u> |
| Net decrease in cash and cash equivalents       |       | (36,404,133)        | (2,105,682)         |
| Cash and cash equivalents at start of year      |       | <u>40,386,936</u>   | <u>42,492,618</u>   |
| <b>Cash and cash equivalents at end of year</b> | 8     | <u>3,982,803</u>    | <u>40,386,936</u>   |

The cash flow statement is presented using the direct method of preparation

The accompanying notes on pages 13 to 31 are an integral part of the financial statements

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011**

**1 SIGNIFICANT ACCOUNTING POLICIES**

BOS (Shared Appreciation Mortgages) NO 2 PLC is a company domiciled in the United Kingdom

**(a) Statement of compliance**

The financial statements for the year ended 31 December 2011 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union. 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. The financial statements comply with IFRSs.

The Company has adopted the following new and relevant IFRS pronouncements which became effective for financial years beginning on or after 1 January 2011. None of these standards or amendments has had a material impact on these company financial statements.

- Improvements to IFRSs (issued May 2010) Amends IFRS 7 Financial Instruments Disclosure to require further disclosures in respect of collateral held by the Company as security for financial assets and sets out minor amendments to other IFRS standards as part of the annual improvements process,
- IAS 24 Related Party Disclosures (Revised) Simplifies the definition of a related party and provides a partial exemption from the requirement to disclose transactions and outstanding balances with the government and government-related entities.

The financial statements also comply with the relevant provisions of Part XV of the Companies Act 2006.

The Company is a subsidiary undertaking of BOS and ultimately LBG. The directors of the Company are satisfied that it is the current intention of LBG to ensure that its subsidiaries, including the Company, shall have at all times in the foreseeable future (being the period until at least 31 December 2013) access to adequate capital and liquidity resources to continue as a going concern. Accordingly, the financial statements have been prepared on a going concern basis.

The Company has opted to align the presentation of the financial statements with those of LBG to improve comparability across all companies within the group. This has not resulted in any material changes to the financial statements, with only the split between current and non-current being removed from the face of the balance sheet. However, the analysis is unchanged in the notes to the financial statements.

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 fair value).

**(b) Revenue recognition**

Interest receivable and similar income 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.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(c) Taxation**

Income tax recognised in the income statement comprises both current and deferred tax. Current income tax, which is payable on taxable profits, is recognised as an expense in the period in which the profits arise.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

The Company's tax charge is calculated on an IFRS basis and disclosed in accordance with IAS 12.

**(d) Financial instruments**

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, a derivative contract ("swap"), an embedded derivative, loans and borrowings and various other payables that arise directly from its operations.

The main purpose of these financial instruments is to raise finance for the Company's operations. These financial instruments are classified in accordance with the principles of IAS 39 as described below.

**(d)(i) Mortgage portfolio**

The Company's mortgage portfolio comprises mortgage loans with no fixed maturity date. The individual mortgage loans terminate on the earlier of the date of sale of the property or the death of the mortgage account holder.

Under IAS 39, the mortgage portfolio is classified within "loans and receivables". The initial measurement is at fair value (excluding amounts for the shared appreciation referred to in (d)(iv) below). Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method. The discount arising on initial recognition is being amortised over the expected life of the mortgages.

At each reporting period end, the Company assesses whether there is any objective evidence that mortgage loans within the portfolio are impaired. The directors do not consider that a provision for impaired assets is currently required.

**(d)(ii) Cash and cash equivalents**

The Company holds bank accounts with BOS, its parent undertaking. These accounts are held in the Company's name and meet the definition of cash and cash equivalents. The use of certain accounts is restricted by a detailed priority of payments set out in the Programme Documentation. 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.

These bank accounts are classified within "loans and receivables" in accordance with IAS 39 and income is being recognised using the effective interest method.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(d) Financial instruments (continued)**

**(d)(iii) Loans and borrowings**

The Company's loans and borrowings comprise mortgage-backed Notes that have been issued in the capital market

Loans and borrowings are recognised initially at fair value less directly related incremental transaction costs. Subsequent to initial recognition, loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis

**(d)(iv) Embedded derivatives**

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host instrument, and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument with changes in fair value of the embedded derivative recognised in the income statement. Depending on the classification of the host instrument, the host is then measured in accordance with IAS 39

The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to the Note holders and the swap provider

The economic characteristics and risks of the shared appreciation rights receivable and payable are not viewed as being closely related to those arising on the mortgages and Notes, respectively. The shared appreciation rights receivable and payable have therefore been valued separately from the mortgages and Notes using current HPI. There is uncertainty regarding the timing of any future shared appreciation receipts and the directors do not consider that it is practical to include an estimate of future HPI in these valuations

The resulting fair value movements of these embedded derivatives are recorded in net fair value gains and losses on derivatives in the income statement and the embedded derivatives are shown separately on the face of the balance sheet. The host instruments are valued at amortised cost, as noted above in (d)(i) and (d)(iii)

**(d)(v) Derivatives**

IAS 39 requires all derivative financial instruments to be recognised initially at fair value on the balance sheet and to be re-measured to fair value at subsequent reporting dates. Where the value of the derivative is positive, it is carried as a derivative asset and where negative, as a derivative liability. The gain or loss on re-measurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged



**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(d) Financial instruments (continued)**

**(d)(v) Derivatives (continued)**

The Company uses a derivative financial instrument to hedge its exposure to interest rate risk arising from operational, financing and investment activities. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

The gain or loss on re-measurement of the interest rate swap to fair value has been recognised immediately in net fair value gains and losses on derivatives in the income statement.

The fair value of interest rate swaps is the estimated amount that the Company would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

**(e) 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 are 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.

**(f) Critical accounting judgements and estimates**

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 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:

**Effective interest rate method**

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument. The calculation includes all amounts expected to be paid or received by the Company including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**(f) Critical accounting judgements and estimates (continued)**

**Effective interest rate method (continued)**

For the purpose of the effective yield calculation on the Notes, an average expected life has been calculated based on prepayment expectations for the mortgages. This is revised on a regular basis in light of actual redemption experience.

**Fair value calculations**

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty.

The value of the embedded derivative has been calculated separately from the host contract using current HPI, with the value of the interest rate swap calculated by discounting future cash flows at an appropriate market rate. All inputs into the valuation models are obtained from observable market data. No assumption for future HPI has been included as this is not considered to be practical.

**(g) Fees and commissions**

Fees and commissions receivable for the continuing service of loans and advances are recognised on the basis of work done. Other fees are recognised when receivable.

**(h) Dividends**

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

**(i) Trade and other payables**

Trade and other payables are stated at cost or at amortised cost if deemed to be a financial liability.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**2 INTEREST RECEIVABLE AND SIMILAR INCOME**

|                                           | <b>2011</b><br><b>£</b> | <b>2010</b><br><b>£</b> |
|-------------------------------------------|-------------------------|-------------------------|
| Interest receivable on mortgage portfolio | 6,427,161               | 679,470                 |
| Bank interest receivable                  | 464,318                 | 2,937,760               |
|                                           | <hr/>                   | <hr/>                   |
|                                           | 6,891,479               | 3,617,230               |
|                                           | <hr/>                   | <hr/>                   |

**3 INTEREST PAYABLE AND SIMILAR CHARGES**

|                                     | <b>2011</b><br><b>£</b> | <b>2010</b><br><b>£</b> |
|-------------------------------------|-------------------------|-------------------------|
| Interest payable on Notes           | 5,120,790               | 1,022,134               |
| Amortisation of issue costs         | 22,388                  | 22,388                  |
| Amortisation of restructuring costs | 3,259                   | -                       |
| Bank interest payable               | 195                     | -                       |
|                                     | <hr/>                   | <hr/>                   |
|                                     | 5,146,632               | 1,044,522               |
|                                     | <hr/>                   | <hr/>                   |

**4 NET FAIR VALUE GAINS AND LOSSES ON DERIVATIVES**

|                                                              | <b>2011</b><br><b>£</b> | <b>2010</b><br><b>£</b> |
|--------------------------------------------------------------|-------------------------|-------------------------|
| Fair value movement on shared appreciation rights receivable | (4,284,718)             | 1,472,951               |
| Fair value movement on shared appreciation rights payable    | 2,942,449               | (1,431,745)             |
| Fair value movement on interest rate derivative              | 1,280,760               | (87,423)                |
|                                                              | <hr/>                   | <hr/>                   |
|                                                              | (61,509)                | (46,217)                |
|                                                              | <hr/>                   | <hr/>                   |
| Income receivable on interest rate derivative                | 330,671                 | 350,058                 |
|                                                              | <hr/>                   | <hr/>                   |
|                                                              | 269,162                 | 303,841                 |
|                                                              | <hr/>                   | <hr/>                   |

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**5 OTHER OPERATING INCOME**

|                                 | <b>2011</b>  | <b>2010</b>  |
|---------------------------------|--------------|--------------|
|                                 | <b>£</b>     | <b>£</b>     |
| Fees and commissions receivable | 2,400        | 5,025        |
| Shared appreciation receivable  | 4,991,575    | 7,143,455    |
| Shared appreciation payable     | (4,991,575)  | (7,143,455)  |
|                                 | <u>2,400</u> | <u>5,025</u> |

**6 OPERATING EXPENSES**

|                     | <b>2011</b>   | <b>2010</b>   |
|---------------------|---------------|---------------|
|                     | <b>£</b>      | <b>£</b>      |
| Inter-company fees  | 42,110        | 43,928        |
| Administration fees | 10,763        | 10,545        |
| Audit fees          | 3,000         | 3,475         |
|                     | <u>55,873</u> | <u>57,948</u> |

The Company has no employees (2010 nil) and none of the directors received any emoluments from the Company in the current or previous year

Audit fees relate to the statutory audit. There are no fees payable to the auditors and their associates for services other than the statutory audit.

The audit fee for the current year, net of VAT, was £2,500 (2010 £2,870)

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**7 TAXATION**

|                                                                                                                 | <b>2011</b> | <b>2010</b> |
|-----------------------------------------------------------------------------------------------------------------|-------------|-------------|
|                                                                                                                 | <b>£</b>    | <b>£</b>    |
| <b>Current Tax</b>                                                                                              |             |             |
| Corporation tax charge for the year at a rate of 26.5% (2010: 28%)                                              | 537,426     | 809,512     |
|                                                                                                                 | <hr/>       | <hr/>       |
| <b>Deferred Tax</b>                                                                                             |             |             |
| Deferred tax change in tax rate – credit                                                                        | (8,436)     | (4,725)     |
| Deferred tax credit for the year at a rate of 26.5% (2010: 28%)                                                 | (17,885)    | (18,898)    |
|                                                                                                                 | <hr/>       | <hr/>       |
| <b>Total tax charge</b>                                                                                         | 511,105     | 785,889     |
|                                                                                                                 | <hr/>       | <hr/>       |
| <b>Reconciliation of effective tax rate</b>                                                                     | <b>2011</b> | <b>2010</b> |
|                                                                                                                 | <b>£</b>    | <b>£</b>    |
| The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 26.5% (2010: 28%) |             |             |
| Profit before tax                                                                                               | 1,960,536   | 2,823,626   |
|                                                                                                                 | <hr/>       | <hr/>       |
| Profit before tax multiplied by the standard rate of corporation tax in the UK of 26.5% (2010: 28%)             | 519,541     | 790,614     |
| Effects of                                                                                                      |             |             |
| Deferred tax change in tax rate – credit                                                                        | (8,436)     | (4,725)     |
|                                                                                                                 | <hr/>       | <hr/>       |
| <b>Total tax charge</b>                                                                                         | 511,105     | 785,889     |
|                                                                                                                 | <hr/>       | <hr/>       |

The current tax liability of £537,426 (2010: £809,512 liability) represents the net amount of income tax payable in respect of the current year.

The standard rate of Corporation Tax in the UK changed from 28% to 26% with effect from 1 April 2011. Accordingly, the Company's profits for this accounting period are taxed at an effective rate of 26.5%.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**8 CASH AND CASH EQUIVALENTS**

|                                                       | <b>2011</b><br><b>£</b> | <b>2010</b><br><b>£</b> |
|-------------------------------------------------------|-------------------------|-------------------------|
| Bank accounts                                         | 3,982,877               | 40,386,997              |
| Unamortised discount                                  | -                       | (5,747,691)             |
|                                                       | <hr/>                   | <hr/>                   |
| Bank overdraft                                        | 3,982,877<br>(74)       | 34,639,306<br>(61)      |
|                                                       | <hr/>                   | <hr/>                   |
|                                                       | 3,982,803               | 34,639,245              |
| Unamortised discount                                  | -                       | 5,747,691               |
|                                                       | <hr/>                   | <hr/>                   |
| Cash and cash equivalents per the cash flow statement | 3,982,803               | 40,386,936              |
|                                                       | <hr/>                   | <hr/>                   |

The Company holds bank accounts with BOS. The use of the accounts is restricted by a detailed priority of payments set out in the Programme Documentation. 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. The accounts are held in the Company's name and meet the definition of cash and cash equivalents.

**9 MORTGAGE PORTFOLIO**

|                                  | <b>2011</b><br><b>£</b> | <b>2010</b><br><b>£</b> |
|----------------------------------|-------------------------|-------------------------|
| At 1 January                     | 13,362,551              | 14,129,109              |
| Mortgage redemptions in the year | (1,149,329)             | (1,446,028)             |
| Amortisation of discount         | 679,470                 | 679,470                 |
|                                  | <hr/>                   | <hr/>                   |
| At 31 December                   | 12,892,692              | 13,362,551              |
|                                  | <hr/>                   | <hr/>                   |

The mortgage loans advanced by the Company have no fixed maturity date but would terminate on the earlier of, the date of sale of the property, or the death of the mortgage account holder.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**10 SHARED APPRECIATION RIGHTS RECEIVABLE**

The right for the Company to receive a share of the capital appreciation arising on the individual mortgages, as set out in the original loan agreements, is classified as an embedded derivative, in accordance with the principles of IAS 39. The embedded derivative has been valued separately from the host contract using current HPI. No estimate has been made of the effect of future HPI as the directors consider that this is impractical.

The Company is contractually obliged to pay to the Note holders or the swap provider any amounts received from mortgage customers for the shared appreciation. A corresponding derivative liability has therefore been recognised in the balance sheet.

**11 LOANS AND BORROWINGS**

This note provides information about the contractual terms of the Company's loans and borrowings. For more information about the Company's exposure to interest rate risk and the fair value of its financial instruments, see note 16.

|                                          | 2011<br>£        | 2010<br>£        |
|------------------------------------------|------------------|------------------|
| <b>Non-current liabilities</b>           |                  |                  |
| Notes                                    | 12,837,566       | 45,276,452       |
| Deferred issue costs                     | (319,033)        | (335,824)        |
| Deferred restructuring costs             | (55,725)         | -                |
|                                          | <hr/> 12,462,808 | <hr/> 44,940,628 |
| <b>Current liabilities</b>               |                  |                  |
| Accrued interest payable to Note holders | -                | 7,036            |
| Deferred issue costs                     | (16,791)         | (22,388)         |
| Deferred restructuring costs             | (2,933)          | -                |
|                                          | <hr/> (19,724)   | <hr/> (15,352)   |
| <b>At 31 December</b>                    | <hr/> 12,443,084 | <hr/> 44,925,276 |

The mortgage-backed Notes are due in 2072. The interest rate applicable on the Notes up to and including the interest period ending 28 February 2011 was 60% of the three-month LIBOR rate for Sterling deposits less 0.30% per annum. Thereafter, the interest rate applicable to the Notes was changed as part of the restructure (referred to in the Directors' Report) and the Notes now bear a zero rate of interest until August 2027. Thereafter the interest rate applicable to the Notes will increase to 0.50% fixed until 2072 when the Notes become due. At the end of the year the Notes, as rated by S&P, had a rating of A (2010 rating of AAA).

The Notes carry, in addition to interest, rights to receive certain amounts calculated by reference to the value of shared appreciation proceeds received from redeemed mortgages. The Notes are subject to mandatory part redemption from time to time based on the level of redeemed mortgages and can be redeemed in full, in certain circumstances, at the option of the Company. The Notes are secured on the mortgage portfolio, the bank accounts and certain other assets of the Company.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**12 SHARED APPRECIATION RIGHTS PAYABLE**

The Company is contractually obliged to pay to the Note holders and swap provider any amounts received from mortgage customers for the shared appreciation arising on the sale of the property. A derivative liability has therefore been recognised in the balance sheet for the same value as the embedded derivative asset (note 10)

**13 DEFERRED TAX LIABILITY**

|                             | <b>2011</b><br><b>£</b> | <b>2010</b><br><b>£</b> |
|-----------------------------|-------------------------|-------------------------|
| At 1 January                | 127,560                 | 151,183                 |
| Credit for year             | (17,885)                | (18,898)                |
| Change in Tax Rate – credit | (8,436)                 | (4,725)                 |
|                             | <hr/>                   | <hr/>                   |
| At 31 December              | 101,239                 | 127,560                 |
|                             | <hr/>                   | <hr/>                   |

The deferred tax liability was recognised for the fair value adjustments that arose on transition to IFRS and is being released to the income statement over a period of ten years from adoption

Legislation to reduce the main rate of corporation tax from 26% to 25% with effect from 1 April 2012 was substantively enacted on 5 July 2011. This has resulted in a decrease in the Company's provision for deferred tax at 31 December 2011 of £8,436

**14 TRADE AND OTHER PAYABLES**

|                              | <b>2011</b><br><b>£</b> | <b>2010</b><br><b>£</b> |
|------------------------------|-------------------------|-------------------------|
| Shared appreciation payable  | 448,232                 | 333,756                 |
| Note redemptions payable     | 107,125                 | 83,501                  |
| Accruals and deferred income | 75,112                  | 71,029                  |
| Amounts owed to BOS          | 3,539                   | 3,668                   |
|                              | <hr/>                   | <hr/>                   |
|                              | 634,008                 | 491,954                 |
|                              | <hr/>                   | <hr/>                   |



**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**15. SHARE CAPITAL**

|                                           | 2011   | 2010   |
|-------------------------------------------|--------|--------|
|                                           | £      | £      |
| <b>Authorised</b>                         |        |        |
| 50,000 ordinary shares of £ 1 each        | 50,000 | 50,000 |
|                                           | <hr/>  | <hr/>  |
| 1 deferred share of £ 1                   | 1      | 1      |
|                                           | <hr/>  | <hr/>  |
| <b>Allotted, called up and fully paid</b> |        |        |
| 50,000 ordinary shares of £1 each         | 50,000 | 50,000 |
|                                           | <hr/>  | <hr/>  |
| 1 deferred share of £1                    | 1      | 1      |
|                                           | <hr/>  | <hr/>  |

The Company is a directly held subsidiary undertaking of BOS

The £1 deferred share is held by Deutsche Trustee Company Limited (formerly Bankers Trustee Company Limited)

The holder of the ordinary shares is entitled to receive dividends as declared from time to time

The deferred share carries no entitlement to any dividend or to any share in any surplus assets of the Company on a winding-up, other than the right to be repaid the amount of any paid-up share capital thereon. The right to be repaid any paid-up share capital in the deferred share shall be deferred until after all paid-up share capital has been first repaid on all other classes of issued share capital in the Company

The deferred share carries the right to receive notice of all general meetings of the Company but does not carry the right to attend, speak or vote at a general meeting unless a resolution is to be proposed abrogating, varying or modifying any of the rights or privileges of the holder of the deferred share, or for the winding up or administration of the Company under the Insolvency Act 1986, or for the entry by the Company with any other party into a merger, reconstruction, scheme of arrangement or amalgamation of or affecting the Company, in any of which cases such holder shall have the right to attend such general meeting and shall be entitled to speak and vote. Whenever the holder of the deferred share is entitled to vote at a general meeting, such holder shall have one vote and on a poll such number of votes as is equal to 34% of the number of votes attached to all other issued shares of the Company

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**16 MANAGEMENT OF RISK**

The principal risk arising from the Company's financial instruments is credit risk. However, considerable resource is given to maintaining effective controls to manage, measure and mitigate this risk. Further detailed analysis of this risk and other risks facing the Company in relation to its financial instruments is provided below.

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 is clearly defined and documented.

**16(a) Credit risk**

Credit risk is the risk of financial loss arising from a customer's failure to settle financial obligations as they fall due.

Credit risk arises on the individual loans within the mortgage portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. Mortgage loans are no longer offered by the Company but the maximum loan-to-value of the original advances was 25% and the credit risk is considered to be low.

The ability of the Company to meet its obligations to repay the Notes is dependent upon the receipt of funds earned on the bank deposits, the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS (see "Liquidity Risk"). To the extent that this income does not provide sufficient funds to cover the repayment of the Notes, the Note holders have no claim on the assets of BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS will repurchase any mortgages that are found or held not to be valid, binding and enforceable.

Although in such an event the total value of the outstanding loan will be covered by BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased. In terms of the shared appreciation, in accordance with the Programme Documentation, amounts received by the Company from the borrower are required to be paid over to the Note holders and swap provider.

Credit risk also exists on the derivative contract with an external provider that the Company has entered into to manage the interest rate risk arising on its operations and sources of finance (see 16(b) below). The swap counterparty, UBS, is a regulated financial institution with a long term rating from Standard and Poor's (S&P) of A (2010 S&P long-term rating A+).

All loans in the mortgage portfolio pay a zero rate of interest. As a result, there are no arrears of interest, properties in possession or bad debts within the Company and therefore no impairment provision is considered to be necessary at 31 December 2011 or 31 December 2010.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**16. MANAGEMENT OF RISK (CONTINUED)**

**16(a) Credit risk (continued)**

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date is disclosed in the table below

|                                       | Note | Carrying<br>Amount<br>2011<br>£ | Maximum<br>Exposure<br>2011<br>£ | Carrying<br>Amount<br>2010<br>£<br>Restated | Maximum<br>Exposure<br>2010<br>£<br>Restated |
|---------------------------------------|------|---------------------------------|----------------------------------|---------------------------------------------|----------------------------------------------|
| <b>Assets held at amortised cost</b>  |      |                                 |                                  |                                             |                                              |
| Cash and cash equivalents             | 8    | 3,982,877                       | 3,982,877                        | 34,639,306                                  | 40,386,936                                   |
| Mortgage portfolio                    | 9    | 12,892,692                      | 23,084,744                       | 13,362,551                                  | 24,234,073                                   |
| <b>Assets held at fair value</b>      |      |                                 |                                  |                                             |                                              |
| Shared appreciation rights receivable | 10   | 109,298,740                     | 109,298,740                      | 113,583,458                                 | 113,583,458                                  |
| <b>Total Assets</b>                   |      | <b>126,174,309</b>              | <b>136,366,361</b>               | <b>161,585,315</b>                          | <b>178,204,467</b>                           |

**16(b) Interest rate risk**

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time

The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar; where this is not possible the Company uses a derivative financial instrument to mitigate interest rate risk

Prior to 28 February 2011, the Notes were exposed to cash flow interest rate risk as the Notes carried a floating interest rate that was reset as market rates changed. The Company entered into an interest rate swap with an external swap provider, UBS, to manage the interest rate risk on its operations and sources of finance. The purpose of the interest rate swap was to reduce the interest rate risk on the Company's assets and liabilities by paying over a portion of capital appreciation on the mortgage loans in return for a fixed interest receipt and this remained in place following the restructure to enable the Company's operations to continue.

Following the restructure on 28 February 2011, with the closure of the GIC account and partial repayment of the Notes, the Company's exposure to interest rate risk is limited to interest earned on its bank accounts and the interest rate swap, as both the mortgage loans and the remaining Notes pay a zero rate of interest. Therefore, it is not considered to be a significant risk.

The main impact on profit is from the movements on the derivative. However prior to the restructure in February 2011, the profit was also impacted by the interest earned on the GIC balance and the variable rate movements on the Notes.

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**16 MANAGEMENT OF RISK (CONTINUED)**

**16(c) Liquidity risk**

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due or can do so only at an unacceptably high cost

The extent to which the Company can meet its obligations to repay the Notes will be dependent upon the receipt of funds earned on the bank deposits, the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS

The Company has an unconditional and irrevocable 364-day revolving Letter of Credit provided by BOS. The Letter of Credit is for a maximum aggregate principal amount of £1,165,000 to assist the Company should it not be able to meet its obligations under the Notes. The reliance on this facility is therefore dependent upon the creditworthiness of BOS, which currently has a long term rating from Standard and Poor's (S&P) of A (2010 S&P long-term rating A+)

The Company has not drawn on the Letter of Credit since inception

The liquidity tables reflect the undiscounted cash payments which will fall due if the structure continues until the earliest contractual maturity date as set out in the Programme Documentation. The Note repayment profile mirrors the repayment of the mortgages, and based on current modelling assumptions, it is not anticipated that any mortgages will still be outstanding beyond the step-up date of August 2027.

| 2011                        | Carrying<br>amount | Contractual<br>repayment<br>value | Not later<br>than one<br>month | Later than<br>one month<br>but not<br>later than<br>three<br>months | Later than<br>three<br>months but<br>not later<br>than one<br>year | Later than<br>one year<br>and not<br>later than<br>five years | Later than<br>five years |
|-----------------------------|--------------------|-----------------------------------|--------------------------------|---------------------------------------------------------------------|--------------------------------------------------------------------|---------------------------------------------------------------|--------------------------|
|                             | £                  | £                                 | £                              | £                                                                   | £                                                                  | £                                                             | £                        |
| <b>Principal</b>            |                    |                                   |                                |                                                                     |                                                                    |                                                               |                          |
| Notes                       | 12,837,566         | 23,029,618                        | -                              | -                                                                   | -                                                                  | -                                                             | 23,029,618               |
| Derivative liability (swap) | 16,792,098         | 13,125,994                        | -                              | (80,520)                                                            | (243,330)                                                          | (1,292,746)                                                   | 14,742,590               |
| Shared appreciation payable | 91,082,293         | 91,082,293                        | -                              | -                                                                   | -                                                                  | -                                                             | 91,082,293               |
| Trade and other payables    | 634,008            | 634,008                           | -                              | 634,008                                                             | -                                                                  | -                                                             | -                        |
|                             | <u>121,345,965</u> | <u>127,871,913</u>                | <u>-</u>                       | <u>553,488</u>                                                      | <u>(243,330)</u>                                                   | <u>(1,292,746)</u>                                            | <u>128,854,501</u>       |

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**16 MANAGEMENT OF RISK (CONTINUED)**

**16(c) Liquidity risk (continued)**

| 2010                        | Carrying amount    | Contractual repayment value | Not later than one month | Later than one month but not later than three months | Later than three months but not later than one year | Later than one year and not later than five years | Later than five years |
|-----------------------------|--------------------|-----------------------------|--------------------------|------------------------------------------------------|-----------------------------------------------------|---------------------------------------------------|-----------------------|
|                             | £                  | £                           | £                        | £                                                    | £                                                   | £                                                 | £                     |
| <b>Principal</b>            |                    |                             |                          |                                                      |                                                     |                                                   |                       |
| Notes                       | 45,276,452         | 60,658,404                  | -                        | -                                                    | -                                                   | -                                                 | 60,658,404            |
| Derivative liability (swap) | 18,071,554         | 13,875,768                  | -                        | (83,600)                                             | (255,445)                                           | (1,357,108)                                       | 15,571,921            |
| Shared appreciation payable | 94,024,742         | 97,793,578                  | -                        | -                                                    | -                                                   | -                                                 | 97,793,578            |
| Trade and other payables    | 491,954            | 491,954                     | -                        | 488,510                                              | 3,444                                               | -                                                 | -                     |
| <b>Interest payable</b>     |                    |                             |                          |                                                      |                                                     |                                                   |                       |
| Interest payable on Notes   | 7,036              | 1,455,475                   | -                        | 21,411                                               | 65,423                                              | 347,573                                           | 1,021,068             |
|                             | <u>157,871,738</u> | <u>174,275,179</u>          | <u>-</u>                 | <u>426,321</u>                                       | <u>(186,578)</u>                                    | <u>(1,009,535)</u>                                | <u>175,044,971</u>    |

**16(d) Fair values**

The fair values of the Company's principal financial instruments, together with the carrying amounts shown in the balance sheet are as follows

|                                                | Note | Carrying amount 2011<br>£ | Fair value 2011<br>£ | Carrying amount 2010<br>£ | Fair value 2010<br>£ |
|------------------------------------------------|------|---------------------------|----------------------|---------------------------|----------------------|
| <b>Loans and Receivables at amortised cost</b> |      |                           |                      |                           |                      |
| Mortgage portfolio                             | 9    | 12,892,692                | 20,843,498           | 13,362,551                | 3,206,456            |
| <b>Financial liabilities at amortised cost</b> |      |                           |                      |                           |                      |
| Loans and borrowings                           | 12   | (12,443,084)              | (20,793,718)         | (44,925,276)              | (44,434,186)         |

The embedded derivatives for shared appreciation receivable and payable are recognised in the balance sheet at fair value

The following comments summarise the main methods and assumptions used in estimating the fair value of financial instruments

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**16 MANAGEMENT OF RISK (CONTINUED)**

**16(d) Fair values (continued)**

The fair value of the mortgage portfolio, loans and borrowings and the derivative swap have been calculated by discounting future cash flows at an appropriate market rate. The fair value of the shared appreciation rights receivable and shared appreciation rights payable have been calculated using current HPI. The valuation method is consistent with commonly used market techniques. All significant inputs into the valuation models are obtained from observable market data.

For this reason, in accordance with "IFRS 7 Financial Instruments Disclosures", the fair value measurement for the shared appreciation is deemed to be Level 2 in the Fair Value Hierarchy. The change in fair value that has been calculated using this valuation technique has been recognised in the income statement for the year ended 31 December 2011.

The cash and cash equivalents and other payables are recognised on an amortised cost basis that is considered to be a close approximation to fair value.

**17 RELATED PARTIES**

The Company is a subsidiary undertaking of BOS and ultimately LBG.

The Company receives bank interest from BOS on its bank deposits. BOS administers the mortgage portfolio on behalf of the Company, for which quarterly service fees are paid. During the year no dividend was paid to BOS (2010: £2,000,000).

During the year the Company undertook the following transactions with companies in the LBG Group:

|                                          | <b>LBG and<br/>subsidiary<br/>undertakings</b> | <b>LBG and<br/>subsidiary<br/>undertakings</b> |
|------------------------------------------|------------------------------------------------|------------------------------------------------|
|                                          | <b>2011<br/>£</b>                              | <b>2010<br/>£</b>                              |
| <b>Statement of Comprehensive Income</b> |                                                |                                                |
| Interest receivable and similar income   | 464,318                                        | 2,937,760                                      |
| Interest payable and similar expense     | (195)                                          | -                                              |
| Operating expenses                       | (42,110)                                       | (43,928)                                       |
| <br><b>Balance Sheet</b>                 |                                                |                                                |
| <b>Assets</b>                            |                                                |                                                |
| Cash and cash equivalents                | 3,982,877                                      | 40,386,997                                     |
| <b>Liabilities</b>                       |                                                |                                                |
| Bank overdraft                           | (74)                                           | (61)                                           |
| Other payables                           | (3,539)                                        | (3,668)                                        |
| <b>Equity</b>                            |                                                |                                                |
| Dividends paid                           | -                                              | (2,000,000)                                    |

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**18 FUTURE ACCOUNTING PRONOUNCEMENTS**

The following pronouncements will be relevant to the Company but are not applicable for the year ending 31 December 2011 and have not been applied in preparing these financial statements. The full impact of these accounting changes is currently being assessed by the Company.

| <b>Pronouncement</b>                              | <b>Nature of change</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | <b>IASB effective date</b>                          |
|---------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------|
| IFRS 9 Financial Instruments <sup>(1)</sup>       | Replaces those parts of IAS 39 Financial Instruments Recognition and Measurement relating to the classification, measurement and derecognition of financial assets and liabilities. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument. The available-for-sale financial asset and held-to-maturity investment categories in existing IAS 39 will be eliminated. The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39. | Annual periods beginning on or after 1 January 2015 |
| IFRS 10 Consolidated Financial Statements         | Supersedes IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purpose Entities and establishes principles for the preparation of consolidated financial statements when an entity controls one or more entities.                                                                                                                                                                                                                                                                                                                                                                                                                                   | Annual periods beginning on or after 1 January 2013 |
| IFRS 12 Disclosure of Interests in Other Entities | Requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.                                                                                                                                                                                                                                                                                                                                                                                                          | Annual periods beginning on or after 1 January 2013 |

**BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

**18 FUTURE ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

| <b>Pronouncement</b>           | <b>Nature of change</b>                                                                                                                                                                                                                                 | <b>IASB effective date</b>                          |
|--------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------|
| IFRS 13 Fair Value Measurement | The standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. It applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements. | Annual periods beginning on or after 1 January 2013 |

<sup>(1)</sup> IFRS 9 is the initial stage of the project to replace IAS 39. Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39.

At the date of this report, these pronouncements are awaiting EU endorsement.

**19 PARENT UNDERTAKING AND CONTROLLING PARTY**

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