# Annual Report

## December 31, 2017

Goldman Sachs International Bank (unlimited company)

Company Number: 01122503

# INDEX

## Introduction

Goldman Sachs International Bank (the bank) acts as a primary dealer for European government bonds and is involved in market making in European government bonds, lending and deposit-taking activities, and securities lending.

The bank's primary regulators are the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

The bank's ultimate parent undertaking and controlling entity is The Goldman Sachs Group, Inc. (Group Inc.). Group Inc. is a bank holding company and a financial holding company regulated by the Board of Governors of the Federal Reserve System (Federal Reserve Board or FRB). In relation to the bank, "group undertaking" means Group Inc. or any of its subsidiaries. Group Inc., together with its consolidated subsidiaries, form "GS Group". GS Group is a leading global investment banking, securities and investment management firm that provides a wide range of financial services to a substantial and diversified client base that includes corporations, financial institutions, governments and individuals. GS Group has a presence in Europe, the Middle East and Africa (EMEA) through a number of subsidiaries, including the bank.

The bank's principal office is in the U.K., but the bank also operates a branch in Germany (the Frankfurt branch), which is involved in lending activities, and has a representative office in China (the Beijing rep office). The bank previously operated a branch in Korea (the Seoul branch) and had a representative office in Turkey (the Istanbul rep office). The client execution activities conducted by the Seoul branch were transferred to group undertakings during 2016 and the Seoul branch was subsequently closed in January 2018. The Istanbul rep office was closed in November 2017.

References to "the financial statements" are to the directors' report and audited financial statements as presented in Part II of this annual report. All references to 2017 and 2016 refer to the years ended, or the dates, as the context requires, December 31, 2017 and December 31, 2016, respectively.

All amounts in this annual report are prepared in accordance with United Kingdom Generally Accepted Accounting Practices (U.K. GAAP).

## Executive Overview

### Profit and Loss Account

The profit and loss account is set out on page 18 of this annual report. The bank's profit for the financial year was $119 million for 2017, an increase of 35% compared with 2016.

Net interest income was $145 million for 2017, compared with $83 million for 2016. This increase reflects the bank's continued focus on the expansion of its lending activities and the diversification of funding sources and management of excess liquidity.

Trading profit was $110 million for 2017, compared with $124 million for 2016. This decrease reflects weaker performance in the bank's lending activities, partially offset by stronger performance in the bank's European government bond market-making business.

Administrative expenses were $88 million for 2017, compared with $74 million for 2016. This increase reflects increased management fees charged by group undertakings.

### Balance Sheet

The balance sheet is set out on page 19 of this annual report.

As of December 2017, total assets were $54.45 billion, an increase of $12.10 billion from December 2016, reflecting increases in collateralised agreements with group undertakings of $7.02 billion, cash at bank and in hand of $2.44 billion and financial instruments owned of $1.39 billion. Collateralised agreements with group undertakings increased primarily due to an increase in deposit-taking activities which were reinvested on a secured basis. Cash at bank and in hand increased primarily due to an increase in deposit-taking activities. Financial instruments owned increased primarily due to increases in cash instruments and derivative instruments.

As of December 2017, total liabilities were $51.41 billion, an increase of $11.98 billion from December 2016, reflecting increases in customer accounts payable of $8.41 billion and collateralised financings with group undertakings of $1.84 billion. Customer accounts payable increased primarily due to an increase in deposit-taking activities. Collateralised financings with group undertakings increased primarily due to higher funding requirements in respect of cash instruments owned.

## Key Metrics

The balance sheet included the following amounts related to lending and deposit-taking activities.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| **Lending activities** | | |
| Included in customer accounts receivable: | | |
| – Bank loans | **$ 3,727,884** | $ 1,985,713 |
| – Mortgage-backed loans and securities | **730,929** | 9,326 |
| Included in financial instruments owned: | | |
| – Bank loans | **33,091** | 51,312 |
| – Mortgage-backed loans and securities | **41,215** | 2,601 |
| **Total lending activities** | **$ 4,533,119** | $ 2,048,952 |
| **Deposit-taking activities** | | |
| Customer deposits included in customer accounts payable | **$25,814,493** | $16,600,215 |
| Deposits from group undertakings included in customer accounts payable | **1,192,335** | 1,080,998 |
| Included in deposits by banks | **1,440,949** | 1,162,819 |
| **Total deposit-taking activities** | **$28,447,777** | $18,844,032 |

The unfunded portion of bank loans held as principal risk was $3.89 billion and $5.15 billion as of December 2017 and December 2016, respectively.

In addition to the lending activities detailed above, the bank reinvests funds generated from deposit-taking activities on both a secured and unsecured basis with group undertakings.

## Future Outlook

The directors consider that the year-end financial position of the bank was satisfactory. In March 2018, following the conclusion of an ongoing review of the bank's operations, it was determined that the bank's European government bond market-making activities would be transferred to group undertakings, and the bank would continue to focus on the expansion of its lending and deposit-taking activities while remaining as a primary dealer for European government bonds.

In addition the directors continue to assess the impact on the bank of the U.K.'s decision to leave the European Union (Brexit).

# Business Environment

## Global

During 2017, real gross domestic product (GDP) growth generally increased compared to 2016 in both advanced and emerging market economies. In advanced economies, real GDP growth was higher in the U.S., the Euro area and Japan, but decreased slightly in the U.K. In emerging markets, real GDP growth increased slightly in China, but decreased in India. Real GDP increased in Russia and Brazil compared with contractions in 2016. Broadly, global macroeconomic data remained strong throughout 2017, and volatility in equity, fixed income, currency and commodity markets was low. Major elections were held in France, the U.K., Germany and China, but none of these events resulted in significant volatility across markets. Major central banks continued to gradually tighten their stance on monetary policy, as the U.S. Federal Reserve increased its target interest rate three times and began the process of balance sheet normalisation. In investment banking, industry-wide announced and completed mergers and acquisitions transactions remained solid during 2017, although volumes declined compared with 2016. Industry-wide offerings in equity underwriting increased significantly compared with 2016, and industry-wide debt underwriting offerings remained strong, particularly in leveraged finance activity.

## Europe

In the Euro area, real GDP increased by 2.5% in 2017, compared with an increase of 1.7% in 2016. Net exports improved, while growth in consumer spending and fixed investment slowed slightly. Measures of inflation remained subdued, prompting the European Central Bank (ECB) to announce an extension of its asset purchase programme in the fourth quarter of 2017, although the pace of its monthly asset purchases decreased from €60 billion to €30 billion beginning in January 2018. The ECB maintained its main refinancing operations rate at 0.00% and its deposit rate at (0.40%). The Euro appreciated by 14% against the U.S. dollar. Yields on 10-year government bonds in the Euro area generally increased during the year. In equity markets, the DAX Index, CAC 40 Index and Euro Stoxx 50 Index increased by 13%, 9% and 6%, respectively, during 2017. During 2017, the process of negotiating an arrangement for the withdrawal of the U.K. from the E.U. began, resulting in an agreement on certain issues in December as negotiations shifted to transitional arrangements. In the U.K., real GDP increased by 1.7% in 2017, compared with an increase of 1.9% in 2016. Inflation increased materially in 2017 prompting the Bank of England to raise the official bank rate by 25 basis points in November. The British pound appreciated by 10% against the U.S. dollar during 2017.

Yields on 10-year government bonds in the U.K. decreased slightly during the year and, in equity markets, the FTSE 100 Index increased by 8% during 2017. In investment banking, EMEA industry-wide announced and completed mergers and acquisitions transactions remained solid during 2017, although volumes declined compared with 2016. EMEA industry-wide offerings in equity underwriting increased significantly compared with 2016, and EMEA industry-wide debt underwriting offerings remained strong.

## Principal Risks and Uncertainties

The bank faces a variety of risks that are substantial and inherent in its businesses including market, liquidity, credit, operational, model, legal, regulatory and reputational risks and uncertainties. The following are some of the more important factors that could affect the bank's businesses.

### Economic and Market Conditions

The bank's businesses, by their nature, do not produce predictable earnings and are materially affected by conditions in the global financial markets and economic conditions generally, both directly and through their impact on client activity levels. These conditions can change suddenly and negatively.

### Regulation

As a participant in the financial services industry and a subsidiary of a systemically important financial institution, the bank is subject to extensive regulation, principally in the U.K., and the E.U. more generally, but also in the U.S. as a subsidiary of GS Group and in certain other jurisdictions. The bank faces the risk of significant intervention by law enforcement, regulatory and tax authorities, as well as private litigation, in all jurisdictions in which it conducts its businesses. In many cases, the bank's activities may be subject to overlapping and divergent regulation in different jurisdictions. Among other things, as a result of law enforcement authorities, regulators or private parties challenging the bank's compliance with laws and regulations, the bank or its employees could be fined or criminally sanctioned, prohibited from engaging in certain business activities, subject to limitations or conditions on its business activities including higher capital requirements, or subjected to new or substantially higher taxes or other governmental charges in connection with the conduct of its businesses or with respect to its employees. Such limitations or conditions may limit business activities and negatively impact the bank's profitability.

The bank is subject to E.U. legal and regulatory requirements, based on directly binding regulations of the E.U. and the implementation of E.U. directives by the U.K. The bank currently benefits from non-discriminatory access to E.U. clients and infrastructure based on E.U. treaties and E.U. legislation, including cross-border "passporting" arrangements and specific arrangements for the establishment of E.U. branches. There is considerable uncertainty as to the regulatory regime that will be applicable in the U.K. post-Brexit and the regulatory framework that will govern transactions and business undertaken by the bank in the remaining E.U. countries.

The exit of the U.K. from the E.U. will likely change the arrangements by which U.K. firms are able to provide services into the E.U. which may materially adversely affect the manner in which the bank operates certain of its businesses in Europe and could require the bank to restructure certain of its operations. The outcome of the negotiations between the U.K. and the E.U. in connection with Brexit is highly uncertain. Such uncertainty may result in market volatility and may negatively impact the confidence of investors and clients.

If there are new laws or regulations or changes in the enforcement of existing laws or regulations applicable to the bank's businesses or those of the bank's clients, including capital, liquidity, leverage, long-term debt, loss absorbing capacity and margin requirements, restrictions on other business practices, reporting requirements, requirements relating to the implementation of the E.U. Bank Recovery and Resolution Directive, tax burdens and compensation restrictions, that are imposed on a limited subset of financial institutions (either based on size, activities, geography or other criteria) which may include the bank or Group Inc., compliance with these new laws and regulations, or changes in the enforcement of existing laws or regulations, could adversely affect the bank's ability to compete effectively with other institutions that are not affected in the same way. In addition, regulation imposed on financial institutions or market participants generally, such as taxes on financial transactions, could adversely impact levels of market activity more broadly, and thus impact the bank's businesses.

These developments could impact the bank's profitability in the affected jurisdictions, or even make it uneconomic to continue to conduct all or certain businesses in such jurisdictions, or could result in the bank incurring significant costs associated with changing business practices, restructuring businesses, moving all or certain businesses and employees to other locations or complying with applicable capital requirements, including liquidating assets or raising capital in a manner that adversely increases the bank's funding costs or otherwise adversely affects its shareholder and creditors.

The E.U. and national financial legislators and regulators have proposed or adopted numerous market reforms that have impacted and may continue to impact the bank's businesses. These include stricter capital and liquidity requirements, (including proposed amendments to the E.U. Fourth Capital Requirements Directive (CRD IV) and the E.U. Capital Requirements Regulation (CRR)), authorisations for regulators to impose position limits, Markets in Financial Instruments Regulation and Markets in Financial Instruments Directive (collectively, MiFID II), restrictions on short selling and credit default swaps and market abuse regulations.

The implementation of higher capital requirements, the liquidity coverage ratio, the net stable funding ratio, requirements relating to long-term debt and total loss-absorbing capacity (TLAC) and the prohibition on proprietary trading by the provisions of the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) referred to as the "Volcker Rule" may continue to adversely affect the bank's profitability and competitive position, particularly if these requirements do not apply, or do not apply equally, to the bank's competitors or are not implemented uniformly across jurisdictions.

The bank is also subject to laws and regulations relating to the privacy of the information of clients, employees or others, and any failure to comply with these laws and regulations could expose the bank to liability and/or reputational damage. As new privacy-related laws and regulations, such as General Data Protection Regulation (GDPR), are implemented, the time and resources needed for the bank to comply with such laws and regulations, as well as the bank's potential liability for non-compliance and reporting obligation in the case of data breaches, may significantly increase. In addition, the bank's businesses are increasingly subject to laws and regulations relating to surveillance, encryption and data on-shoring in the jurisdictions in which the bank operates. Compliance with these laws and regulations may require the bank to change its policies, procedures and technology for information security, which could, among other things, make the bank more vulnerable to cyber attacks and misappropriation, corruption or loss of information or technology.

Increasingly, regulators and courts have sought to hold financial institutions liable for the misconduct of their clients where such regulators and courts have determined that the financial institution should have detected that the client was engaged in wrongdoing, even though the financial institution had no direct knowledge of the activities engaged in by its client. Regulators and courts have also increasingly found liability as a "control person" for activities of entities in which financial institutions or funds controlled by financial institutions have an investment, but which they do not actively manage. In addition, regulators and courts continue to seek to establish "fiduciary" obligations to counterparties to which no such duty had been assumed to exist. To the extent that such efforts are successful, the cost of, and liabilities associated with, engaging in brokerage, clearing, market-making, investing and other similar activities could increase significantly. To the extent that the bank has fiduciary obligations in connection with acting as a financial adviser, investment adviser or in other roles for individual, institutional, sovereign or investment fund clients, any breach, or even an alleged breach, of such obligations could have materially negative legal, regulatory and reputational consequences.

### Market Volatility

Certain market-making activities depend on market volatility to provide trading and arbitrage opportunities to clients and decreases in volatility may reduce these opportunities and adversely affect the results of these activities. In contrast, increased volatility, whilst it can increase trading volumes and spreads, also increases risk as measured by Value-at-Risk (VaR) and may expose the bank to increased risks in connection with market-making activities or cause the bank to reduce its market-making inventory to avoid increasing VaR. Limiting the size of such market-making positions can adversely affect the bank's profitability. In periods when volatility is increasing, but asset values are declining significantly, it may not be possible to sell assets at all or it may only be possible to do so at steep discounts. In such circumstances, the bank may be forced to either take on additional risk or to realise losses in order to decrease its VaR. In addition, increases in volatility increase the level of the bank's risk-weighted assets (RWAs), which increases the bank's capital requirements.

The bank has exposure to market interest rate movements as a result of its lending and deposit-taking activities. In addition to the impact on the general economy, changes in interest rates could directly impact the bank in one or more of the following ways:

- The yield on interest-earning assets, primarily on lending activities, and rates paid on interest-bearing liabilities, primarily deposit-taking activities, may change in disproportionate ways;

- The value of certain balance sheet and off-balance sheet financial instruments could decline; or
- The cost of funding from affiliates or third parties may increase and the ability to raise funding could become more difficult.

The bank's profitability depends to an extent on net interest income. Accordingly, the bank's results depend on movements in market interest rates and its ability to manage interest-rate-sensitive assets and liabilities in response to these movements. Factors such as inflation, recession and instability in financial markets, among other factors beyond the bank's control, may affect interest rates.

Any substantial, unexpected, prolonged change in market interest rates could have an adverse effect on the bank's balance sheet, liquidity and profits. Changes in the level of interest rates also may negatively affect the bank's ability to originate loans, the value of assets and the bank's ability to realise gains from the sale of assets, all of which ultimately affect earnings.

### Liquidity

Liquidity is essential to the bank's businesses. The bank's liquidity could be impaired by an inability to access secured and/or unsecured debt markets, an inability to access funds from Group Inc. or other affiliates, an inability to sell assets or redeem investments or unforeseen outflows of cash or collateral. This situation may arise due to circumstances that the bank may be unable to control, such as a general market disruption or an operational problem that affects third parties or the bank or its affiliates or even by the perception amongst market participants that the bank, or other market participants, are experiencing greater liquidity risk.

The bank primarily relies on deposits to be a low cost and stable source of funding for the loans it makes. The bank accepts deposits from institutional and private wealth management clients, issues certificates of deposits and accepts deposits from its affiliates. If the bank experiences significant withdrawals, for any reason, or raises the rates paid on deposits, funding costs may increase and the bank may be required to rely on more expensive sources of funding. If the bank is required to fund its operations at a higher cost, these conditions may require the bank to curtail its activities, which also could reduce the bank's profitability.

Further, the bank's ability to sell assets may be impaired if there is not generally a liquid market for such assets, as well as in circumstances where other market participants are seeking to sell similar assets at the same time, as is likely to occur in a liquidity or other market crisis or in response to changes to rules or regulations. In addition, financial institutions with which the bank interacts may exercise set-off rights or the right to require additional collateral, including in difficult market conditions, which could further impair the bank's liquidity.

### Concentration of Risk

Concentration of risk increases the potential for significant losses in market-making, underwriting, and investing activities. The number and size of such transactions may affect the bank's results of operations in a given period. Moreover, because of concentration of risk, the bank may suffer losses even when economic and market conditions are generally favourable for competitors. Disruptions in the credit markets can make it difficult to hedge these credit exposures effectively or economically.

### Credit Quality

The bank is exposed to the risk that third parties who owe money, securities or other assets will not perform their obligations. These parties may default on their obligations to the bank due to bankruptcy, lack of liquidity, operational failure or other reasons. A failure of a significant market participant, or even concerns about a default by such an institution, could lead to significant liquidity problems, losses or defaults by other institutions, which in turn could adversely affect the bank.

The bank is also subject to the risk that its rights against third parties may not be enforceable in all circumstances. In addition, deterioration in the credit quality of third parties whose securities or obligations are held by the bank, including a deterioration in the value of collateral posted by third parties to secure their obligations to the bank under derivatives contracts and loan agreements, could result in losses and/or adversely affect the bank's ability to rehypothecate or otherwise use those securities or obligations for liquidity purposes.

A significant downgrade in the credit ratings of the bank's counterparties could also have a negative impact on the bank's results. While in many cases the bank is permitted to require additional collateral from counterparties that experience financial difficulty, disputes may arise as to the amount of collateral the bank is entitled to receive and the value of pledged assets. The termination of contracts and the foreclosure on collateral may subject the bank to claims for the improper exercise of its rights. Default rates, downgrades and disputes with counterparties as to the valuation of collateral increase significantly in times of market stress and illiquidity.

The bank might underestimate the credit losses inherent in its loan portfolio and have credit losses in excess of the amount reserved. While management uses the best information available to determine this estimate, there could be future adjustments to the allowance for impairment of bank loans held at amortised cost based on, among other things, changes in the economic environment or variances between actual results and the original assumptions used.

### Derivative Transactions

The bank is party to a number of derivative transactions, including credit derivatives. Many of these derivative instruments are individually negotiated and non-standardised, which can make exiting, transferring or settling positions difficult. Many credit derivatives require that the bank deliver to the counterparty the underlying security, loan or other obligation in order to receive payment. In a number of cases, the bank does not hold the underlying security, loan or other obligation and may not be able to obtain the underlying security, loan or other obligation. This could cause the bank to forfeit the payments due under these contracts or result in settlement delays with the attendant credit and operational risk as well as increased costs to the bank.

Derivative contracts and other transactions entered into with third parties are not always confirmed by the counterparties or settled on a timely basis. While the transaction remains unconfirmed or during any delay in settlement, the bank is subject to heightened credit and operational risk and in the event of a default may find it more difficult to enforce its rights.

In addition, as new complex derivative products are created, covering a wider array of underlying credit and other instruments, disputes about the terms of the underlying contracts could arise, which could impair the bank’s ability to effectively manage its risk exposures from these products and subject it to increased costs. The provisions of legislation requiring central clearing of credit derivatives and other over-the-counter (OTC) derivatives, or a market shift toward standardised derivatives, could reduce the risk associated with such transactions, but under certain circumstances could also limit the bank’s ability to develop derivatives that best suit the needs of clients and to hedge its own risks, and could adversely affect the bank’s profitability and increase credit exposure to such a platform.

### Operational Infrastructure

The bank’s businesses are highly dependent on its ability to process and monitor, on a daily basis, a very large number of transactions, many of which are highly complex, and occur at high volumes and frequencies, across numerous and diverse markets in many currencies. These transactions, as well as information technology services provided to clients, often must adhere to client-specific guidelines, as well as legal and regulatory standards.

Many rules and regulations worldwide govern the bank’s obligations to report transactions and other information to regulators, exchanges and investors. Compliance with these legal and reporting requirements can be challenging, and the group has been, and may in the future be, subject to regulatory fines and penalties for failing to report timely, accurate and complete information. As reporting requirements expand, compliance with these rules and regulations has become more challenging.

The use of computing devices and phones is critical to the work done by the bank’s employees and the operation of the bank’s systems and businesses and those of its clients and third-party service providers and vendors. It has been reported that there are some fundamental security flaws in computer chips found in many types of computing devices and phones. Addressing this issue could be costly and affect the performance of these businesses and systems, and operational risks may be incurred in applying fixes and there may still be residual security risks.

Additionally, although the prevalence and scope of applications of distributed ledger technology and similar technologies is growing, the technology is also nascent and may be vulnerable to cyber attacks or have other inherent weaknesses. The bank may be, or may become, exposed to risks related to distributed ledger technology through the bank’s facilitation of clients’ activities involving financial products linked to distributed ledger technology, such as blockchain or cryptocurrencies, and the use of distributed ledger technology by third-party vendors, clients, counterparties, clearing houses and other financial intermediaries.

In addition, the bank faces the risk of operational failure, termination or capacity constraints of any of the clearing agents, exchanges, clearing houses or other financial intermediaries that it uses to facilitate securities and derivatives transactions, and as interconnectivity with clients grows, the bank will increasingly face the risk of operational failure with respect to clients’ systems.

Despite the resiliency plans and facilities that are in place, the bank's ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports its businesses and the communities in which the bank is located. This may include a disruption involving electrical, satellite, undersea cable or other communications, internet, transportation or other services facilities used by the bank, its employees or third parties with which the bank conducts business, including cloud service providers. These disruptions may occur as a result of events that affect only the bank's buildings or systems or those of such third parties, or as a result of events with a broader impact globally, regionally or in the cities where those buildings or systems are located, including, but not limited to, natural disasters, war, civil unrest, terrorism, economic or political developments, pandemics and weather events.

In addition, although the bank seeks to diversify its third-party vendors to increase its resiliency, the bank is also exposed to the risk that a disruption or other information technology event at a common service provider to the bank's vendors could impede their ability to provide products or services to the bank. The bank may not be able to effectively monitor or mitigate operational risks relating to its vendors' use of common service providers.

Furthermore, the bank relies upon certain group undertakings for various support services, including, but not limited to, trade execution, relationship management, loan origination, settlement and clearing, loan servicing, risk management and other administrative services. Such services are provided to the bank pursuant to a Master Services Agreement, which is generally terminable upon mutual agreement of Group Inc. and its subsidiaries, subject to certain exceptions, including material breach of the agreement. If group undertakings were to cease to provide such services, the bank would be required to seek alternative sources, which could be difficult to obtain on the same terms or could result in increased costs.

### Cyber Security

The bank is regularly the target of attempted cyber attacks, including denial-of-service attacks, and must continuously monitor and develop its systems to protect its technology infrastructure and data from misappropriation or corruption. The increasing migration of the bank's communication and other platforms from company provided devices to employee-owned devices presents additional risks of cyber attacks. In addition, due to the interconnectivity with third-party vendors (and their respective service providers), central agents, exchanges, clearing houses and other financial institutions, the bank could be adversely impacted if any of them is subject to a successful cyber attack or other information security event. These effects could include the loss of access to information or services from the third party subject to the cyber attack or other information security event, which could, in turn, interrupt certain of the bank's businesses.

Despite the bank's efforts to ensure the integrity of its systems and information, it may not be able to anticipate, detect or implement effective preventive measures against all cyber threats, especially because the techniques used are increasingly sophisticated, change frequently and are often not recognised until launched. Cyber attacks can originate from a variety of sources, including third parties who are affiliated with foreign governments or are involved with organised crime or terrorist organisations. Third parties may also attempt to place individuals within the bank or induce employees, clients or other users of the bank's systems to disclose sensitive information or provide access to the bank's data or that of its clients, and these types of risks may be difficult to detect or prevent.

Although the bank takes protective measures and endeavours to modify them as circumstances warrant, its computer systems, software and networks may be vulnerable to unauthorised access, misuse, computer viruses or other malicious code and other events that could have a security impact. Due to the complexity and interconnectedness of the company's systems, the process of enhancing protective measures can itself create a risk of systems disruptions and security issues. If one or more of such events occur, this potentially could jeopardise the bank or its clients' or counterparties' confidential and other information processed and stored in, and transmitted through, the bank's computer systems and networks, or otherwise cause interruptions or malfunctions in the bank's, its clients', its counterparties' or third parties' operations, which could impact their ability to transact with the bank or otherwise result in legal or regulatory action, significant losses or reputational damage.

The increased use of mobile and cloud technologies can heighten these and other operational risks. The bank expects to expend significant additional resources on an ongoing basis to modify protective measures and to investigate and remediate vulnerabilities or other exposures, but these measures may be ineffective and the bank may be subject to legal or regulatory action, and financial losses that are either not insured against or not fully covered through any insurance it maintains. Certain aspects of the security of such technologies are unpredictable or beyond the bank's control, and the failure by mobile technology and cloud service providers to adequately safeguard their systems and prevent cyber attacks could disrupt the bank's operations and result in misappropriation, corruption or loss of confidential and other information. In addition, there is a risk that encryption and other protective measures, despite their sophistication, may be defeated, particularly to the extent that new computing technologies vastly increase the speed and computing power available.

The bank routinely transmits and receives personal, confidential and proprietary information by email and other electronic means. The bank has discussed and worked with clients, vendors, service providers, counterparties and other third parties to develop secure transmission capabilities and protect against cyber attacks, but does not have, and may be unable to put in place, secure capabilities with all of its clients, vendors, service providers, counterparties and other third parties and it may not be able to ensure that these third parties have appropriate controls in place to protect the confidentiality of the information. An interception, misuse or mishandling of personal, confidential or proprietary information being sent to or received from a client, vendor, service provider, counterparty or other third party could result in legal liability, regulatory action and reputational harm.

### Risk Management

The bank seeks to monitor and control its risk exposure through a risk and control framework encompassing a variety of separate, but complementary financial, credit, operational, compliance and legal reporting systems, internal controls, management review processes and other mechanisms. The bank's risk management process seeks to balance its ability to profit from market-making positions and underwriting activities with its exposure to potential losses. Whilst the bank employs a broad and diversified set of risk monitoring and risk mitigation techniques, those techniques and the judgements that accompany their application cannot anticipate every economic and financial outcome or the specifics and timing of such outcomes. Thus, the bank may, in the course of its activities, incur losses. Market conditions in recent years have involved unprecedented dislocations and highlight the limitations inherent in using historical data to manage risk.

### New Business Initiatives

The bank faces enhanced risks as new business initiatives lead it to transact with a broader array of clients and counterparties and expose it to new asset classes and new markets. A number of the bank's recent and planned business initiatives and expansions of existing businesses may bring it into contact, directly or indirectly, with individuals and entities that are not within the bank's traditional client and counterparty base and expose it to new asset classes and new markets.

New business initiatives expose the bank to new and enhanced risks, including risks associated with dealing with governmental entities, reputational concerns arising from dealing with less sophisticated clients, counterparties and investors, greater regulatory scrutiny of these activities, increased credit-related, market, sovereign and operational risks, risks arising from accidents or acts of terrorism, and reputational concerns with the manner in which these assets are being operated or held or in which the bank interacts with these counterparties.

### Conflicts of Interest

A failure to appropriately identify and address potential conflicts of interest could adversely affect the bank's businesses. Due to the broad scope of GS Group's businesses and client base, the bank regularly addresses potential conflicts of interest, including situations where services to a particular client or GS Group's own investments or other interests conflict, or are perceived to conflict, with the interests of another client, as well as situations where one or more of its businesses have access to material non-public information that may not be shared with other businesses within GS Group and situations where it may be a creditor of an entity with which GS Group also has an advisory or other relationship.

Extensive procedures and controls are in place that are designed to identify and address conflicts of interest, including those designed to prevent the improper sharing of information among businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and the bank's reputation, which is one of its most important assets, could be damaged and the willingness of clients to enter into transactions with the bank may be affected if it fails, or appears to fail, to identify, disclose and deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or regulatory enforcement actions.

### Changes in Underliers

Certain of the bank's businesses and its funding may be adversely affected by changes in the reference rates, currencies, indexes, baskets or other financial metrics (the underlier) to which the products offered by the bank or funding raised by the bank are linked. All of the bank's floating rate funding pays interest by reference to a rate, such as the London Interbank Offered Rate (LIBOR) or Federal Funds. In addition, many of the products that the bank owns or that it offers, pay interest or determine the principal amount to be paid at maturity or in the event of default by reference to similar rates or by reference to the underlier. In the event that the composition of the underlier is significantly changed, by reference to rules governing such underlier or otherwise, or the underlier ceases to exist (for example, in the event that LIBOR is discontinued, a country withdraws from the Euro or links its currency to or delinks its currency from another currency or benchmark, or an index materially alters the composition of an index), there may be uncertainty as to the calculation of the amounts to be paid to the lender, investor or counterparty, depending on the terms of the governing instrument.

Such changes in an underlier or underliers could result in the bank's hedges being ineffective or otherwise result in losses on a product or having to pay more or receive less on securities that the bank owns or has issued. In addition, such uncertainty could result in lengthy and costly litigation.

### Unforeseen or Catastrophic Events

The occurrence of unforeseen or catastrophic events, including the emergence of a pandemic, or other widespread health emergency (or concerns over the possibility of such an emergency), terrorist attacks, extreme terrestrial or solar weather events or other natural disasters, could create economic and financial disruptions, and could lead to operational difficulties (including travel limitations) that could impair the bank's ability to manage its businesses and result in losses.

## Credit Ratings

The table below presents the unsecured credit ratings and outlook of the bank by Fitch, Inc. (Fitch), Moody's Investors Service (Moody's) and Standard & Poor's Ratings Services (S&P).

| | As of December 2017 | | |
|---|---|---|---|
| | **Fitch** | **Moody's** | **S&P** |
| Short-term bank deposit | **F1** | **P-1** | **N/A** |
| Short-term debt | **F1** | **P-1** | **A-1** |
| Long-term bank deposit | **A** | **A1** | **N/A** |
| Long-term debt | **A** | **A1** | **A+** |
| Ratings outlook | **Stable** | **Stable** | **Stable** |

On March 7, 2018, Moody's changed the bank's ratings outlook from stable to negative.

## Date of Authorisation of Issue

The strategic report was authorised for issue by the Board of Directors on March 29, 2018.

**By order of the board**
**D. M. Bicarregui**
**Director**
**March 29, 2018**

# Directors' Report

The directors present their report and the audited financial statements for the year ended December 2017.

### Introduction

In accordance with section 414A of the Companies Act 2006, the directors have prepared a strategic report, which is included in Part I of this annual report and which contains a review of the bank's businesses and a description of the principal risks and uncertainties facing the bank. The directors have chosen to make reference to the future outlook of the bank in the strategic report in accordance with section 414C(11) of the Companies Act 2006. The bank's risk management objectives and policies, including exposures to market risk, credit risk and liquidity risk, are described in Note 25 to the financial statements.

### Dividends

The directors do not recommend the payment of an ordinary dividend for 2017. No dividends were paid in 2016.

### Exchange Rate

The British pound/U.S. dollar exchange rate was £/$1.3524 and £/$1.2337 as of December 2017 and December 2016, respectively. The average rate for the year was £/$1.3020 and £/$1.3439 for 2017 and 2016, respectively.

### Employment of Disabled Persons

Applications for employment by disabled persons are fully and fairly considered with regard to the aptitudes and abilities of each applicant. Efforts are made to enable any employees who become disabled during employment to continue their careers within GS Group. Training, career development and promotion of disabled persons are, to the extent possible, identical to that of other employees who are not disabled.

### Employee Involvement

It is GS Group policy that there should be effective communication with all employees who, subject to practical and commercial considerations, should be consulted on and involved in decisions that affect their current jobs or future prospects. Employees share in performance-based incentive schemes.

### Disclosure of Information to Auditors

In the case of each of the persons who are directors of the bank at the date when this report was approved:

- So far as each of the directors is aware, there is no relevant audit information of which the bank's auditors are unaware; and
- Each of the directors has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the bank's auditors are aware of that information.

### Independent Auditors

Prior to 1 October 2007, the bank passed an elective resolution under section 386 of the Companies Act 1985 to dispense with the annual reappointment of auditors. PricewaterhouseCoopers LLP will, accordingly, continue in office as auditors of the bank pursuant to section 487(2) of the Companies Act 2006 and paragraph 44 of Schedule 3 to the Companies Act 2006 (Commencement No. 3 Consequential Amendment, Transitional Provisions and Savings) Order 2007.

### Statement of Directors' Responsibilities

The directors are responsible for preparing the strategic report, the directors' report and the financial statements in accordance with applicable law and regulations. Company law requires the directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the bank as at the end of the financial period and of the profit or loss of the bank for that period. In preparing those accounts, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed subject to any material departures disclosed and explained in the financial statements; and
- Prepare the accounts on the going concern basis unless it is inappropriate to presume that the bank will continue in business.

The directors are responsible for keeping adequate accounting records which disclose with reasonable accuracy at any time the financial position of the bank and to enable them to ensure that the accounts comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the bank and, hence, for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the bank's financial statements on the Goldman Sachs website. Legislation in the U.K. governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Directors' Report

## Directors

The directors of the bank who served throughout the year and to the date of this report were:

| Name |
|---|
| D. M. Bicarregui |
| Lord Grabiner QC |
| Lord Griffiths of Fforestfach (resigned on December 31, 2017) |
| N. Harman |
| E. H. Leouzon |
| D. W. McDonogh, Chief executive officer |
| T. L. Miller OBE |
| D. G. J. Paterson (resigned on May 10, 2017) |
| E. E. Stecher, Chair |
| D. D. Wildermuth |

No director had, at the year end, any interest requiring note herein.

## Date of Authorisation of Issue

The financial statements were authorised for issue by the Board of Directors on March 29, 2018.

**By order of the board**
**D. M. Bicarregui**
**Director**
**March 29, 2018**

# Independent auditors' report to the members of Goldman Sachs International Bank (unlimited company)

## Report on the audit of the financial statements

### Opinion

In our opinion, Goldman Sachs International Bank's ("the bank") financial statements:

- give a true and fair view of the state of the bank's affairs as at December 31, 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report, which comprise: the Balance Sheet as at December 31, 2017; the Profit and Loss Account, the Statements of Comprehensive Income, the Statements of Changes in Equity for the year then ended; and the Notes to the Financial Statements, which include a description of the significant accounting policies and other explanatory information.

Our opinion is consistent with our reporting to the Audit Committee.

### 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 bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in the U.K., which includes the Financial Reporting Council's ("FRC") Ethical Standard as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

In accordance with the partner rotation rules of the FRC, a new Senior Statutory Auditor took responsibility for the 2017 audit.

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

Other than those disclosed in Note 8 'Administrative Expenses' to the financial statements, we have provided no other non-audit services to the bank in the period from January 1, 2017 to December 31, 2017.

### Our audit approach

#### *Overview*

| | |
|---|---|
| *Materiality* | • Overall materiality: \$18.4 million (2016: \$16.7 million).<br>• Based on: 0.5% of total regulatory capital resources. |
| *Audit scope* | • The bank prepares individual bank financial statements. The bank operates branches and a representative office to provide financial services to clients in those regions. These branches and representative office are not material and are excluded from our audit scope.<br>• We consider that the bank is a single audit component. |
| *Key audit matter* | • Provision for impairment of loans held at amortised cost. |

### *The scope of our audit*

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

We gained an understanding of the legal and regulatory framework applicable to the bank and the industry in which it operates, and considered the risk of acts by the bank which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the bank's financial statements, including but not limited to, the Companies Act 2006, the Financial Conduct Authority's Client Asset Sourcebook, and the Prudential Regulation Authority's regulations. Our tests included, but were not limited to, a review of the financial statement disclosures to underlying supporting documentation, review of correspondence with the regulators, review of correspondence with legal advisors, enquiries of management and review of internal audit reports in so far as they related to the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

### *Key audit matters*

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

| Key audit matter | How our audit addressed the key audit matter |
|---|---|

***Provision for impairment of loans held at amortised cost***

The bank makes loans to clients which are held at amortised cost less any provision for impairment.

As set out in Note 3 'Critical Accounting Estimates and Judgements' on page 26, management make judgements over both the timing of recognition of potential impairment provisions and the estimation of the size of any such provisions.

Management estimate specific impairment provisions on individually significant balances. A collective model based provision is then estimated for all other exposures.

We focused our audit effort on the following areas:

- The timely identification of impairment trigger events; and
- The key assumptions used and judgements made by management that underlie the estimation of the specific and collective provisions.

We tested the design and operating effectiveness of the controls over data and calculations used in the provisioning process. These controls included those over:

- the assignment and review of internal credit ratings and Loss Given Defaults ("LGD") for each borrower;
- the independent review of assigned internal credit ratings;
- the ongoing monitoring of the credit quality and performance of the loans by an independent function;
- the reconciliation of model output to the general ledger;
- the governance over the impairment process, including the approval of impairment models, and management's review of the provision for impairment; and
- the calculation of the impairment provisions.

We determined that these controls were designed and operated effectively and therefore we determined that we could place reliance on them for the purposes of our audit.

In addition we performed the following substantive procedures:

**Specific impairment**

We examined a sample of loans which had not been identified by management as potentially impaired and formed our own judgement as to whether that was appropriate through reviewing information such as the counterparty's payment history and performance of the business during the year. In performing this work, we considered the guidance on impairment triggers in IAS 39.

Based on the evidence obtained, we did not identify any impairment triggers and we concurred with management's conclusion to not record any specific provision for impairment.

**Modelled impairment**

We tested the reconciliation between the model output and the general ledger. We also critically assessed and tested the key underlying assumptions used by management.

Based on the evidence obtained we found the impairment model assumptions to be reasonable.

### How we tailored the audit scope

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

The bank acts as a primary dealer for European government bonds and is involved in market making in European government bonds, lending and deposit-taking activities, and securities lending. The bank operates branches and a representative office to provide financial services to clients in those regions. These branches and representative office are not material and are excluded from our audit scope. We consider that the bank is a single audit component.

Traders based in overseas locations enter into transactions on behalf of the bank. In these circumstances, certain internal controls relevant to financial reporting operate in those locations. In addition, there are a number of centralised functions operated by the ultimate parent company, The Goldman Sachs Group, Inc., in the U.S. or in group shared service centres in other locations which are relevant to the audit of the bank. We determined the scope of the work required in each of these locations and we issued instructions to PwC network firms. We interacted regularly with the firms responsible for the work throughout the course of the audit. This included reviewing key working papers and discussing the results of work in higher risk areas of the audit. We concluded that the procedures performed on our behalf were sufficient for the purposes of issuing our opinion.

### Materiality

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

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

| | |
|---|---|
| *Overall materiality* | $18.4 million (2016: $16.7 million). |
| *How we determined it* | 0.5% of total regulatory capital resources (2016: 0.5%). |
| *Rationale for benchmark applied* | The immediate and ultimate parent companies, management, and the bank's regulators are the primary users of the financial statements. The level of total regulatory capital resources is a key focus of these users. |

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above $0.9 million (2016: $0.8 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

## Conclusions relating to going concern

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

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

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

## Reporting on other information

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

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

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

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

### *Strategic Report and Directors' Report*

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

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

## Responsibilities for the financial statements and the audit

### *Responsibilities of the directors for the financial statements*

As explained more fully in the Statement of Directors' Responsibilities set out on page 11, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal controls as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

### *Auditors' responsibilities for the audit of the financial statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

### *Use of this report*

This report, including the opinions, has been prepared for and only for the bank'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.

## Other required reporting

### Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

### Appointment

We were appointed by the directors on August 10, 1982 to audit the financial statements for the period ended November 25, 1983 and subsequent financial periods. The period of total uninterrupted engagement is 35 years, covering the periods ended November 25, 1983 to December 31, 2017.

Nick Morrison (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
**March 29, 2018**

# Profit and Loss Account

| | | Year Ended December 2017 | Year Ended December 2016 | | |
|---|---|---|---|---|---|
| | | | Continuing | Discontinued | |
| *$ in thousands* | **Note** | Total | operations | operations | Total |
| Interest receivable and similar income | 5 | **$ 389,518** | $ 232,478 | $ 2,167 | $ 234,645 |
| Interest payable and similar expenses | 6 | **(244,270)** | (151,145) | (449) | (151,594) |
| **Net interest income** | | **145,248** | 81,333 | 1,718 | 83,051 |
| Trading profit/(loss) | 7 | **110,072** | 146,038 | (21,632) | 124,406 |
| **Total operating income/(loss)** | 4 | **255,320** | 227,371 | (19,914) | 207,457 |
| Administrative expenses | 8 | **(87,954)** | (62,459) | (11,656) | (74,115) |
| **Profit/(loss) before taxation** | | **167,366** | 164,912 | (31,570) | 133,342 |
| Tax on profit/(loss) | 12 | **(48,635)** | (48,544) | 2,912 | (45,632) |
| **Profit/(loss) for the financial year** | | **$ 118,731** | $ 116,368 | $(28,658) | $ 87,710 |

# Statements of Comprehensive Income

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Profit for the financial year | **$118,731** | $ 87,710 |
| **Other comprehensive income** | | |
| **Items that will not be reclassified subsequently to profit or loss** | | |
| Debt valuation adjustment | **(7,885)** | 3,108 |
| U.K. deferred tax attributable to components of other comprehensive income | **2,137** | (847) |
| **Total items that will not be reclassified subsequently to profit or loss** | **(5,748)** | 2,261 |
| **Items that will be reclassified subsequently to profit or loss** | | |
| Translation gain/(loss) | **724** | (4,509) |
| Gain on net investment hedge | **–** | 2,916 |
| Reclassification to the profit and loss account | **–** | 22,906 |
| **Total items that will be reclassified subsequently to profit or loss** | **724** | 21,313 |
| **Other comprehensive income/(loss) for the financial year, net of tax** | **(5,024)** | 23,574 |
| **Total comprehensive income for the financial year** | **$113,707** | $ 111,284 |

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

# Balance Sheet

| | | As of December | |
|---|---|---|---|
| *$ in thousands* | **Note** | **2017** | 2016 |
| **Assets** | | | |
| Cash at bank and in hand | | **$ 3,227,390** | $ 783,184 |
| Customer accounts receivable | 13 | **5,261,302** | 4,027,753 |
| Financial instruments owned (includes **$5,355,680** and $4,480,088 pledged as collateral) | 14 | **8,231,812** | 6,842,824 |
| Collateralised agreements with group undertakings | 15 | **36,909,581** | 29,887,562 |
| Tangible fixed assets | 16 | **–** | 630 |
| Other assets | 17 | **816,746** | 808,194 |
| **Total assets** | | **$54,446,831** | $42,350,147 |
| | | | |
| **Liabilities and shareholder's funds** | | | |
| Customer accounts payable | 19 | **$27,818,016** | $19,410,023 |
| Deposits by banks | | **1,440,949** | 1,162,819 |
| Financial instruments sold, but not yet purchased | 14 | **10,020,454** | 9,116,783 |
| Collateralised financings with group undertakings | 20 | **9,586,952** | 7,746,979 |
| Other liabilities | 21 | **1,720,762** | 1,167,552 |
| Long-term subordinated loans from group undertakings | 22 | **826,000** | 826,000 |
| **Total liabilities** | | **$51,413,133** | $39,430,156 |
| | | | |
| Called up share capital | 23 | **62,558** | 62,558 |
| Share premium account | | **2,094,303** | 2,094,303 |
| Accumulated other comprehensive income | | **(3,334)** | 1,690 |
| Profit and loss account | | **880,171** | 761,440 |
| **Total shareholder's funds** | | **3,033,698** | 2,919,991 |
| **Total liabilities and shareholder's funds** | | **$54,446,831** | $42,350,147 |
| | | | |
| **Memorandum items** | | | |
| **Financial commitments** | 24 | **$ 5,633,208** | $ 6,439,557 |
| **Contingent liabilities** | 24 | **$ 1,954,234** | $ 1,384,776 |

The financial statements were approved by the Board of Directors on March 29, 2018 and signed on its behalf by:

**D. M. Bicarregui**
**Director**

The accompanying notes are an integral part of these financial statements.
Company number: 01122503

# Statements of Changes in Equity

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| **Called up share capital** | | |
| Beginning balance | **$ 62,558** | $ 62,558 |
| Ending balance | **62,558** | 62,558 |
| | | |
| **Share premium account** | | |
| Beginning balance | **2,094,303** | 2,094,303 |
| Ending balance | **2,094,303** | 2,094,303 |
| | | |
| **Accumulated other comprehensive income** | | |
| Beginning balance | **1,690** | (21,884) |
| Other comprehensive income/(loss) | **(5,024)** | 23,574 |
| Ending balance | **(3,334)** | 1,690 |
| | | |
| **Profit and loss account** | | |
| Beginning balance | **761,440** | 673,730 |
| Profit for the financial year | **118,731** | 87,710 |
| Share-based payments | **52** | (127) |
| Management recharge related to share-based payments | **(52)** | 127 |
| Ending balance | **880,171** | 761,440 |
| **Total shareholder's funds** | **$3,033,698** | $2,919,991 |

No dividends were paid in 2017 and 2016.

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

**Note 1.**

## General Information

The bank is a private unlimited company and is incorporated and domiciled in England and Wales. The address of its registered office is Peterborough Court, 133 Fleet Street, London, EC4A 2BB, United Kingdom.

The bank's immediate parent undertaking is Goldman Sachs Group UK Limited (GSG UK), a company incorporated and domiciled in England and Wales. GSG UK together with its consolidated subsidiaries form "GSG UK Group".

The ultimate controlling undertaking and the parent company of the smallest and largest group for which consolidated financial statements are prepared is The Goldman Sachs Group, Inc., a company incorporated in the United States of America. Copies of its consolidated financial statements, as well as certain regulatory filings, for example Quarterly Reports on Form 10-Q and the Annual Report on Form 10-K, that provide additional information about GS Group and its business activities, can be obtained from Investor Relations, 200 West Street, New York, NY 10282, United States of America, GS Group's principal place of business, or at www.goldmansachs.com/shareholders/.

### Basel III Pillar 3 Disclosures

The bank is included in the consolidated Pillar 3 disclosures of GSG UK, as required by the CRR. GSG UK's 2017 Pillar 3 disclosures will be made available in conjunction with the publication of its consolidated financial information at www.goldmansachs.com/disclosures/.

### Country-by-Country Reporting

The bank is included in the consolidated country-by-country reporting disclosures of GSG UK, as required by the Capital Requirements (Country-by-Country Reporting) Regulations 2013. GSG UK's 2017 country-by-country disclosures will be made available by December 31, 2018 at www.goldmansachs.com/disclosures/.

**Note 2.**

## Summary of Significant Accounting Policies

### Basis of Preparation

The bank prepares financial statements under U.K. GAAP. These financial statements have been prepared in accordance with FRS 101 'Reduced Disclosure Framework' (FRS 101).

These financial statements have been prepared on the going concern basis, under the historical cost convention (modified as explained in "Financial Assets and Financial Liabilities" below), and in accordance with the Companies Act 2006.

The following exemptions from the disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the E.U. have been applied in the preparation of these financial statements in accordance with FRS 101:

- IFRS 2 'Share-based Payment' paragraph 45(b) and 46 to 52. These disclosures are provided in the consolidated financial statements of Group Inc.
- IAS 1 'Presentation of Financial Statements' paragraph 38 to present comparative information in respect of:
  - IAS 1 'Presentation of Financial Statements' paragraph 79(a)(iv); and
  - IAS 16 'Property, Plant and Equipment' paragraph 73(e).
- IAS 1 'Presentation of Financial Statements' paragraphs 10(f), 16, and 40A-D;
- IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' paragraph 33(c);
- IAS 7 'Statement of Cash Flows';
- IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' paragraphs 30 and 31;
- IAS 24 'Related Party Disclosures' paragraph 17; and
- IAS 24 'Related Party Disclosures' requirements to disclose transactions with companies also wholly owned within GS Group.

## Accounting Policies

**Revenue Recognition.** Total operating income, consists of revenues from market making in European government bonds, lending and deposit-taking activities, and securities lending.

Financial assets and financial liabilities held for trading or designated at fair value through profit or loss are recognised at fair value with realised and unrealised gains and losses as well as associated interest and expenses included in total operating income. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs.

Non-derivative financial instruments owned and financial instruments sold, but not yet purchased (i.e., cash instruments) are recognised using settlement date accounting. See "Financial Assets and Financial Liabilities – Recognition and Derecognition" below for further details. Unrealised gains and losses related to the change in the fair value of these instruments between trade date and settlement date are recognised within trading profit.

Loans and receivables, and financial liabilities measured at amortised cost are initially recognised at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest method. Finance revenue is recorded in interest receivable and similar income. Finance costs, including discounts allowed on issue, are recorded in interest payable and similar expenses.

Commission revenues from securities lending are recognised on the day the trade is executed.

**Operating Leases.** The bank has entered into operating lease arrangements as the lessee. Leased assets are not recognised in the balance sheet. Costs in respect of operating leases, adjusted for any incentives granted by the lessor, are charged on a straight-line basis over the lease term and included within administrative expenses in the profit and loss account.

**Short-Term Employee Benefits.** Short-term employee benefits, such as wages and salaries, are measured on an undiscounted basis and accrued as an expense over the period in which the employee renders the service to the bank. Provision is made for discretionary year-end compensation whether to be paid in cash or share-based awards where, as a result of company policy and past practice, a constructive obligation exists at the balance sheet date.

**Share-Based Payments.** Group Inc. issues awards in the form of restricted stock units (RSUs) and stock options to the bank's employees in exchange for employee services. Awards are classified as equity settled and hence the cost of share-based transactions with employees is measured based on the grant-date fair value of the award. Share-based awards that do not require future service (i.e., vested awards, including awards granted to retirement eligible employees) are expensed immediately. Share-based awards that require future service are amortised over the relevant service period. Expected forfeitures are included in determining share-based employee compensation expense.

Group Inc. generally issues new shares of common stock upon delivery of share-based awards. Cash dividend equivalents, unless prohibited by regulation, are generally paid on outstanding RSUs. The bank has also entered into a chargeback agreement with Group Inc. under which it is committed to pay the grant-date fair value as well as subsequent movements in the fair value of those awards to Group Inc. at the time of delivery to its employees. As a result, the share-based payment transaction and recharge arrangement creates a total charge to the profit and loss account based on the grant-date fair value of the awards adjusted for subsequent movements in the fair value of those awards prior to delivery.

**Dividends.** Final equity dividends are recognised as a liability and deducted from equity in the period in which the dividends are approved by the bank's shareholder. Interim equity dividends are recognised and deducted from equity when paid.

**Pension Arrangements.** The bank is a sponsor of a defined contribution pension plan. The contributions payable for the year are charged to administrative expenses. Differences between contributions payable for the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

**Tangible Fixed Assets.** Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment. Fixtures, fittings and equipment are depreciated on a straight-line basis over their estimated useful lives, which is between 3 to 7 years. Depreciation is included in administrative expenses.

Leasehold improvements are depreciated over the shorter of the useful economic life of the asset or the remaining life of the lease when the asset is brought into use. Depreciation policies are reviewed on an annual basis.

**Cash at Bank and In Hand.** This includes cash at bank and in hand and highly liquid overnight deposits held in the ordinary course of business.

**Foreign Currencies.** The bank's financial statements are presented in U.S. dollars, which is also the bank's functional currency.

Transactions denominated in foreign currencies are translated into U.S. dollars at rates of exchange ruling on the date the transaction occurred. Monetary assets and liabilities, and non-monetary assets and liabilities measured at fair value, denominated in foreign currencies are translated into U.S. dollars at rates of exchange ruling at the balance sheet date. Foreign exchange gains and losses are recognised in trading profit.

The results of branches and representative offices with non-U.S. dollar functional currencies are translated at the average rates of exchange during the period and their balance sheets at the rates ruling at the balance sheet date. Exchange differences arising from the retranslation of their balance sheet and results are reported in the statements of comprehensive income.

**Financial Assets and Financial Liabilities.**

***Recognition and Derecognition***

Non-derivative financial instruments owned and financial instruments sold, but not yet purchased (i.e., cash instruments) purchased or sold in regular way transactions are recognised and derecognised using settlement date accounting.

Other financial assets and financial liabilities are recognised when the bank becomes party to the contractual provisions of the instrument. They are de-recognised when the contractual rights to the cash flows from the financial asset expire or if the bank transfers the financial asset and substantially all the risk and rewards of ownership of that financial asset. A financial liability is derecognised only when it is extinguished (i.e., when the obligation specified in the contract is discharged or cancelled or expires).

***Classification and Measurement***

The bank classifies its financial assets and financial liabilities into the below categories. The classification, which is determined at initial recognition, depends on the purpose for which they were acquired or originated.

- **Financial assets and financial liabilities classified as held for trading.** Financial assets and financial liabilities classified as held for trading include financial instruments owned and financial instruments sold, but not yet purchased. Financial instruments owned and financial instruments sold, but not yet purchased include cash instruments and derivative instruments. Both are initially recognised at fair value with transaction costs expensed in profit or loss. Such financial instruments are carried in the balance sheet at fair value and all subsequent gains or losses are recognised in trading profit.

  The directors are of the opinion that it would not be appropriate to classify them as current asset investments or to provide an analysis of such securities between those listed and unlisted.

- **Financial assets and financial liabilities designated at fair value through profit or loss.** The bank designates certain of its other financial assets and financial liabilities at fair value through profit or loss. Financial assets and financial liabilities designated at fair value through profit or loss are initially recognised at fair value with transaction costs expensed in profit or loss. Such financial assets are measured in the balance sheet at fair value and all subsequent gains or losses are recognised in trading profit. Such financial liabilities are measured in the balance sheet at fair value, with changes in fair value attributable to own credit spreads (debt valuation adjustment or DVA) being recognised in other comprehensive income, if it does not create or enlarge an accounting mismatch, and the remaining changes in the fair value being recognised in trading profit. The primary reasons for designating such financial assets and financial liabilities at fair value through profit or loss are:

  - The group of financial assets, financial liabilities or both is managed and its performance evaluated on a fair value basis; and
  - To eliminate or significantly reduce a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

  Financial assets and financial liabilities designated at fair value through profit or loss include:

  - Securities purchased under agreements to resell (resale agreements), securities borrowed, other secured lending arrangements and securities sold under agreements to repurchase (repurchase agreements);
  - Certain balances related to lending activities included in customer accounts receivable;
  - Certain balances related to deposit-taking activities included in customer accounts payable and deposits by banks;
  - Certain intercompany unsecured borrowings included in other liabilities;
  - Certain financial guarantee contracts written; and
  - Certain unsecured debt securities issued, including certain hybrid financial instruments.

Hybrid financial instruments are instruments that contain bifurcatable embedded derivatives. If the bank elects to bifurcate the embedded derivative from the associated debt, the derivative is accounted for at fair value and the host contract is accounted for at amortised cost, adjusted for the effective portion of any fair value hedges. If the bank does not elect to bifurcate, the entire hybrid financial instrument is designated at fair value through profit or loss.

These financial assets and financial liabilities at fair value are generally valued based on discounted cash flow techniques, which incorporate inputs with reasonable levels of price transparency, and are generally classified in level 2 because the inputs are observable. Valuation adjustments may be made for liquidity and for counterparty and GS Group's credit quality.

- **Loans and receivables; and financial liabilities measured at amortised cost.** Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They include all cash at bank and in hand, certain customer accounts receivable and substantially all other assets. Such financial assets are initially recognised at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest method (see below). Finance revenue is recorded in interest receivable and similar income.

  Financial liabilities measured at amortised cost include certain customer accounts payable, certain other liabilities and all long-term subordinated loans from group undertakings. Such financial liabilities are initially recognised at fair value plus transactions costs and subsequently measured at amortised cost using the effective interest method (see below). Finance costs, including discounts allowed on issue, are recorded in interest payable and similar expenses.

  The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability 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 bank estimates cash flows considering all contractual terms of the financial asset or financial liability but does not consider future credit losses. The calculation includes all fees and points paid or received that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

  The bank assesses its loans and receivables at each balance sheet date for any objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the financial asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The amount of the loss is included within trading profit.

### *Classification of Financial Liabilities and Equity*

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements. A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset to another entity; or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity. An equity investment is any contract that evidences a residual interest in the assets of the entity after deducting all liabilities. Instruments are evaluated to determine if they contain both liability and equity components. The initial carrying amount of a compound financial instrument is allocated first to the liability component, measured at fair value, and the equity is assigned the residual amount.

### *Offsetting Financial Assets and Financial Liabilities*

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet where there is:

- Currently a legally enforceable right to set-off the recognised amounts; and
- Intent to settle on a net basis or to realise the asset and settle the liability simultaneously.

Where these conditions are not met, financial assets and financial liabilities are presented on a gross basis in the balance sheet.

### *Fair Value Measurement*

See Note 26 for details about the fair value measurement of the bank's financial assets and financial liabilities.

### *Fair Value Hedges*

The bank applies fair value hedge accounting for certain interest rate swaps used to manage the interest rate exposure of certain fixed-rate customer deposits. To qualify for hedge accounting, the derivative hedge must be highly effective at reducing the risk from the exposure being hedged. Additionally, the bank must formally document the hedging relationship at inception and test the hedging relationship to ensure the derivative hedge continues to be highly effective over the life of the hedging relationship.

**Collateralised Agreements and Collateralised Financings.** Collateralised agreements include resale agreements, securities borrowed and other secured lending arrangements. Collateralised financings include repurchase agreements. See “Classification and Measurement” above for details on the classification and measurement of these instruments. Collateral received or posted can be in the form of cash or securities. Cash collateral is recognised/derecognised when received/paid. Collateral posted by the bank in the form of securities is not derecognised from the balance sheet, whilst collateral received in the form of securities is not recognised in the balance sheet. If collateral received is subsequently sold, the obligation to return the collateral and the cash received are recognised on balance sheet.

**Current and Deferred Taxation.** The tax expense for the period consists of current and deferred taxation. Tax is recognised in the profit and loss account, except to the extent it relates to items recognised in other comprehensive income.

Current tax is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the bank operates and generates taxable income. Deferred tax is recognised in respect of all temporary differences that have originated, but not reversed at the balance sheet date, where transactions or events have occurred at that date that will result in an obligation to pay more tax or a right to pay less tax in the future with the following exceptions:

- Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.
- Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which temporary differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Deferred tax is recognised in the profit and loss account or directly in other comprehensive income according to where the associated gain or loss, to which the deferred tax is attributable, is recognised.

**Provisions, Contingent Liabilities and Contingent Assets.** Provisions are recognised in the financial statements when it is probable that an outflow of economic benefits will be required to settle a present (legal or constructive) obligation, which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation. Legal obligations that may arise as a result of proposed new laws are recognised as obligations only when the legislation is virtually certain to be enacted as drafted.

A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the bank or a present obligation that arises from past events but is not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the bank.

**Discontinued Operations.** A discontinued operation is a component of the entity that has been disposed of or which ceases to be used and that represents a separate major line of business or geographical area of operations. The results of discontinued operations are presented separately in the profit and loss account.

**New Accounting Standards.**

***IFRS 9 ‘Financial Instruments’***

In July 2014, the International Accounting Standards Board (IASB) issued IFRS 9 ‘Financial Instruments’ (IFRS 9), which replaces IAS 39 ‘Financial Instruments: Recognition and Measurement’ (IAS 39) for annual periods beginning on or after January 1, 2018. In November 2016, the E.U. endorsed IFRS 9.

Key changes as a result of the new standard include:

**Classification and Measurement.** IFRS 9 introduces a principles-based approach to the classification of financial assets, resulting in the following categories: fair value through profit or loss; fair value through other comprehensive income; and amortised cost.

IFRS 9 requires debt assets to be classified based on a combination of the bank’s business models and the nature of the assets’ cash flows. No significant changes are expected in the classification of the bank’s financial assets as a result of the new model.

Accounting for financial liabilities remains largely unchanged from IAS 39, except for the requirements related to changes in the fair value of financial liabilities attributable to own credit spreads (debt valuation adjustment or DVA). The bank early adopted the DVA requirements, effective from January 2016.

**Impairment.** IFRS 9 changes the impairment methodology for applicable financial assets, replacing the incurred loss model of IAS 39 with a forward-looking expected credit loss (ECL) approach.

The bank is required to assess expected losses based on the probability of default in the next twelve months, unless there has been a significant increase in credit risk since origination, in which case, the expected loss is based on the probability of default over the life of the asset

The bank has developed and tested an impairment model that complies with the key requirements of IFRS 9, including staging requirements and multiple forward-looking economic scenarios. Based on expected credit losses generated from the model as of December 2017, shareholder's funds at January 1, 2018 will increase by $9 million.

**Hedge Accounting.** IFRS 9 allows entities to continue with the hedge accounting requirements under IAS 39 even when other elements of IFRS 9 became mandatory on January 1, 2018. Based on the bank's analysis, the impact from adopting hedge accounting under IFRS 9 would be insignificant and it has decided to continue to apply hedge accounting under IAS 39.

### *IFRS 15 'Revenue from Contracts with Customers'*

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers'. This standard, as amended, provides comprehensive guidance on the recognition of revenue from customers arising from the transfer of goods and services, guidance on accounting for certain contract costs, and new disclosures.

The standard became effective for the bank in January 2018. The implementation of the standard did not have an impact on the bank's balance sheet or its statements of comprehensive income on the date of adoption. As a result of adopting this standard, the bank will prospectively change the presentation of certain costs from a net basis within trading profit to a gross basis. Whilst this presentation change will not change the bank's operating profit, it is expected to increase the bank's trading profit and administrative expenses, in comparison to the bank's current presentation.

**Note 3.**

## Critical Accounting Estimates and Judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the amounts recognised in these financial statements. The nature of estimation means that actual outcomes could differ from those estimates. The following judgements have had the most significant effect on amounts recognised in the financial statements:

### Deferred Tax

The bank has recognised a deferred tax asset (see Note 18) which requires judgement for determining the extent of its recoverability at each reporting date. The bank assesses recoverability with reference to forecasts of future taxable profits. These forecasts require the use of assumptions and estimates. Where the temporary differences are related to losses, relevant tax law is considered to determine the availability of the losses to offset against the future taxable profits.

### Fair Value Measurement

Certain of the bank's financial assets and financial liabilities include significant unobservable inputs (i.e., level 3). See Note 26 for information about the carrying value, valuation techniques and significant inputs of these instruments.

### Allowance for Impairment of Bank Loans Held at Amortised Cost

The allowance for impairment of bank loans held at amortised cost (see Notes 13 and 21) is determined using various inputs, including industry default and loss data, current macroeconomic indicators, borrower's capacity to meet its financial obligations, borrower's country of risk, loan seniority, and collateral type. Management's estimate of losses entails judgements about loan collectability based on information at the reporting dates, and there are uncertainties inherent in those judgements.

### Note 4.

## Segment Reporting

The table below presents the bank's total operating income into business segments.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Investment Banking | **$ 22,136** | $ 16,448 |
| Institutional Client Services | **228,294** | 164,422 |
| Investing & Lending | **(19,360)** | 21,679 |
| Investment Management | **24,250** | 4,908 |
| **Total operating income** | **$255,320** | $207,457 |

In the table above, Institutional Client Services included a loss of $20 million for the year ended December 2016, relating to discontinued operations following the transfer of the client execution activities conducted by the Seoul branch to group undertakings.

The bank reports its business segments in line with that of GS Group:

### Investment Banking

Consists of underwriting and origination of debt instruments including European government bonds and bank loans.

### Institutional Client Services

Consists of client execution activities related to making markets in European government bonds, secondary dealing in bank loans and securities lending.

### Investing & Lending

Consists of lending activities which are typically longer-term in nature and included impairments and losses on bank loans.

### Investment Management

Consists of deposit-taking and lending activities with high-net-worth individuals.

The bank's administrative expenses and assets are primarily attributable to Institutional Client Services.

For the year ended December 2017, the bank's operating income was all attributable to EMEA. For the year ended December 2016, the bank had operating income of $227 million attributable to EMEA and an operating loss of $20 million attributable to Asia.

The Frankfurt branch had total assets of $8 million (€6 million) and $94 million (€89 million) as of December 2017 and December 2016, respectively.

### Note 5.

## Interest Receivable and Similar Income

The table below presents the bank's interest receivable and similar income.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Interest on loans to banks and customers | **$ 64,126** | $ 55,776 |
| Interest on collateralised agreements with group undertakings | **243,964** | 138,344 |
| Interest on loans to group undertakings | **81,428** | 40,525 |
| **Total interest receivable and similar income** | **$389,518** | $234,645 |

### Note 6.

## Interest Payable and Similar Expenses

The table below presents the bank's interest payable and similar expenses.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Interest on loans from banks and customers | **$177,226** | $ 98,726 |
| Interest on long-term subordinated loans from group undertakings (see Note 22) | **36,824** | 31,840 |
| Interest on loans from group undertakings | **20,331** | 12,544 |
| Negative interest on collateralised agreements with group undertakings | **9,889** | 8,484 |
| **Total interest payable and similar expenses** | **$244,270** | $151,594 |

In the table above, interest on loans from banks and customers included interest on customer deposits and deposits by banks.

### Note 7.

## Trading Profit

Trading profit included trading interest income of $212 million and $133 million for 2017 and 2016, respectively, and trading interest expense of $249 million and $123 million for 2017 and 2016, respectively.

Trading interest income and expense represents coupon interest arising on European government bonds, interest on bank loans classified as held for trading, and interest on collateralised agreements and collateralised financings associated with the bank's European government bond market-making business.

Trading profit included impairments on loans and receivables of $15 million and $2 million for 2017 and 2016, respectively and losses on loans and receivables of $23 million and $nil for 2017 and 2016, respectively.

**Note 8.**

## Administrative Expenses

The table below presents the bank's administrative expenses.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Management fees charged by group undertakings | **$69,648** | $53,543 |
| Direct costs of employment | **1,892** | 9,631 |
| Brokerage, clearing and exchange fees | **5,763** | 5,398 |
| Market development | **586** | 92 |
| Communications and technology | **122** | 481 |
| Depreciation | **79** | 178 |
| Occupancy | **690** | 919 |
| Professional fees | **2,155** | 1,158 |
| Other expenses | **7,019** | 2,715 |
| **Total administrative expenses** | **$87,954** | $74,115 |

In the table above:

- Management fees charged by group undertakings relate to operational and administrative support, and management services received from group undertakings.
- Direct costs of employment are in relation to the Seoul branch and representative offices.

The table below presents the fees payable to the bank's auditors, which are included within professional fees.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Fees for the bank's audit | **$ 721** | $180 |
| Audit related assurance services | **341** | 147 |
| Taxation compliance services | **–** | 59 |
| Total fees for non-audit services | **341** | 206 |
| **Total** | **$1,062** | $386 |

**Note 9.**

## Directors' Emoluments

The table below presents the bank's directors' emoluments.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Aggregate emoluments | **$1,463** | $968 |
| Company pension contributions to money purchase schemes | **7** | 2 |
| **Total directors' emoluments** | **$1,470** | $970 |

The table below presents emoluments for the highest paid director.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Aggregate emoluments | **$309** | $263 |
| Company pension contributions to money purchase schemes | **$ 2** | $ 2 |
| Accrued annual pension at end of year | **$ –** | $ 1 |

In accordance with the Companies Act 2006, directors' emoluments above represent the proportion of total emoluments paid or payable in respect of qualifying services only. This total only includes the value of cash and benefits in kind, and does not include the value of equity awards in accordance with the provisions of Schedule 5 of SI 2008/410. Directors also receive emoluments for non-qualifying services which are not required to be disclosed.

For persons who were directors for some or all of the year, three directors were members of a defined contribution scheme. Three directors, including the highest paid director, have received or are due to receive Group Inc. shares in respect of long-term incentive schemes during the year. No directors have exercised stock options during the year.

Note 10.

## Staff Costs

All persons involved in the bank's operations, other than the representative office, are employed by group undertakings. The charges made by these group undertakings, including share-based payments, for all the services provided (personnel and other) to the bank are included in the management fees charged by group undertakings (see Note 8).

The table below presents the Seoul branch and representative offices' average monthly number of staff.

| | Average for the Year Ended December | |
|---|---|---|
| *Number* | **2017** | 2016 |
| **Employees** | | |
| Investment Banking | **1** | 1 |
| Institutional Client Services | **–** | 6 |
| Support Functions | **5** | 18 |
| **Total average number of staff** | **6** | 25 |

Total headcount was 2 and 16 as of December 2017 and December 2016, respectively. The decrease reflects the closure of both the Seoul branch and Istanbul rep office.

Additionally, 59 and 31 persons, who were employed by group undertakings were assigned or seconded to the bank through employee arrangements as of December 2017 and December 2016, respectively.

Services are also provided to the bank by employees of other group undertakings under a Master Services Agreement supplemented by Service Level Agreements.

The table below presents employment costs incurred by the bank.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Aggregate gross wages and salaries | **$1,720** | $9,214 |
| Employer's National Insurance Contributions | **56** | 14 |
| Pension costs, employer contributions to defined contribution plan | **116** | 403 |
| **Total direct costs of employment** | **$1,892** | $9,631 |

In the table above, total direct costs of employment included a charge of $23,000 and $11,000 for 2017 and 2016, respectively, relating to the mark-to-market of share-based compensation.

Note 11.

## Share-Based Payments

### Stock Incentive Plan

Group Inc. sponsors a stock incentive plan, The Goldman Sachs Amended and Restated Stock Incentive Plan (2015) (2015 SIP), which provides for, amongst others, grants of RSUs, restricted stock, dividend equivalent rights and incentive stock options.

The bank recorded share-based compensation in respect of the amortisation of granted equity awards, net of forfeitures, of $52,000 (charge) and $127,000 (credit) for 2017 and 2016, respectively. The corresponding credit/charge to equity has been transferred to liabilities as a result of the terms of the chargeback agreement with Group Inc. under which the bank is committed to pay to Group Inc. the grant-date fair value as well as subsequent movements in the fair value of those awards to Group Inc. at the time of delivery to its employees.

### Restricted Stock Units

Group Inc. grants RSUs to the Seoul branch and representative offices' employees under the 2015 SIP, which are generally valued based on the closing price of the underlying shares on the date of grant after taking into account a liquidity discount for any applicable post-vesting and delivery transfer restrictions. RSUs generally vest and underlying shares of common stock deliver (net of required holding tax) as outlined in the applicable award agreements. Employee award agreements generally provide that vesting is accelerated in certain circumstances, such as on retirement, death, disability and conflicted employment. Delivery of the underlying shares of common stock is conditioned on the grantees satisfying certain vesting and other requirements outlined in the award agreements.

Note 12.

## Tax on Profit

The table below presents the bank's analysis of tax on profit.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| **Current tax** | | |
| U.K. corporation tax | **$42,171** | $35,231 |
| Adjustments in respect of prior periods | **2,029** | (528) |
| Overseas taxation | **2,446** | 4,967 |
| **Total current tax** | **46,646** | 39,670 |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | **1,989** | 4,009 |
| Effect of decreased U.K. corporate tax rates | **–** | 1,953 |
| **Total deferred tax** | **1,989** | 5,962 |
| **Total tax on profit** | **$48,635** | $45,632 |

The table below presents a reconciliation between tax on profit and the amount calculated by applying the weighted average rate of U.K. corporation tax applicable to the bank for the year of 27.25% (2016: 28.0%) to the profit before taxation.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Profit before taxation | **$167,366** | $133,342 |
| Profit multiplied by U.K. corporate tax rate of 27.25% (2016: 28.0%) | **45,607** | 37,336 |
| Changes in recognition and measurement of deferred tax assets | **525** | 63 |
| Permanent differences | **5** | 6,457 |
| Exchange differences and other | **469** | 351 |
| Adjustments in respect of prior periods | **2,029** | (528) |
| Effect of decreased U.K. corporate tax rates | **–** | 1,953 |
| **Total tax on profit** | **$ 48,635** | $ 45,632 |

Note 13.

## Customer Accounts Receivable

The table below presents the bank's customer accounts receivable balances.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Bank loans | **$3,727,884** | $1,985,713 |
| Mortgage-backed loans and securities | **730,929** | 9,326 |
| Amounts due from customers | **299,900** | 97,325 |
| Amounts due from group undertakings | **502,589** | 1,935,389 |
| **Total customer accounts receivable** | **$5,261,302** | $4,027,753 |

In the table above, bank loans and mortgage-backed loans and securities included an allowance for impairment of $21 million and $6 million as of December 2017 and December 2016, respectively.

The table below presents the maturity of the bank's customer accounts receivable balances.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Less than three months | **$2,617,009** | $2,032,719 |
| Between three months and one year | **465,272** | 235,826 |
| Between one and five years | **1,344,382** | 427,262 |
| Over five years | **834,639** | 1,331,946 |
| **Total customer accounts receivable** | **$5,261,302** | $4,027,753 |

### Note 14.

## Financial Instruments Owned and Financial Instruments Sold, But Not Yet Purchased

Financial instruments owned and financial instruments sold, but not yet purchased consist of financial instruments and investments within the operating activities of the bank. Financial instruments owned includes financial instruments owned pledged as collateral. See Note 26 for further information.

The table below presents the bank's financial instruments owned.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| **Cash instruments** | | |
| Government bonds | **$ 5,743,797** | $4,933,711 |
| Bank loans | **33,091** | 51,312 |
| Mortgage-backed loans and securities | **41,215** | 2,601 |
| **Total cash instruments** | **5,818,103** | 4,987,624 |
| **Derivative instruments** | | |
| Interest rates | **1,636,661** | 1,739,000 |
| Currencies | **562,228** | 75,753 |
| Equities | **193,446** | 37,497 |
| Commodities | **7,940** | 2,149 |
| Credit | **13,434** | 801 |
| **Total derivative instruments** | **2,413,709** | 1,855,200 |
| **Total financial instruments owned** | **$ 8,231,812** | $6,842,824 |

The table below presents the bank's financial instruments sold, but not yet purchased.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| **Cash instruments** | | |
| Government bonds | **$ 7,918,536** | $7,284,063 |
| Bank loans | **51** | 1,534 |
| **Total cash instruments** | **7,918,587** | 7,285,597 |
| **Derivative instruments** | | |
| Interest rates | **1,600,341** | 1,701,377 |
| Currencies | **204,485** | 67,662 |
| Equities | **8,680** | 37,497 |
| Commodities | **7,940** | 2,149 |
| Credit | **113,725** | 22,501 |
| **Total derivative instruments** | **1,935,171** | 1,831,186 |
| **Financial guarantee contracts** | **166,696** | – |
| **Total financial instruments sold, but not yet purchased** | **$10,020,454** | $9,116,783 |

### Note 15.

## Collateralised Agreements With Group Undertakings

The table below presents the bank's collateralised agreements with group undertakings.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Resale agreements | **$35,349,084** | $29,887,562 |
| Securities borrowed | **1,560,497** | – |
| **Total collateralised agreements with group undertakings** | **$36,909,581** | $29,887,562 |

In the table above, total collateralised agreements with group undertakings included balances due in more than one year of $2.51 billion and $322 million as of December 2017 and December 2016, respectively.

### Note 16.

## Tangible Fixed Assets

The table below presents the movements in tangible fixed assets during the year.

| *$ in thousands* | Leasehold improvements | Fixtures, fittings and equipment | Total |
|---|---|---|---|
| **Cost** | | | |
| As of January 1 | $ 1,612 | $ 1,465 | $ 3,077 |
| Disposals | **(1,734)** | **(1,556)** | **(3,290)** |
| Translation gain | **122** | **91** | **213** |
| As of December 31 | **–** | **–** | **–** |
| **Accumulated depreciation** | | | |
| As of January 1 | 1,055 | 1,392 | 2,447 |
| Charge for the year (see Note 8) | **41** | **38** | **79** |
| Disposals | **(1,179)** | **(1,511)** | **(2,690)** |
| Translation loss | **83** | **81** | **164** |
| As of December 31 | **–** | **–** | **–** |
| **Net book value** | | | |
| As of December 2017 | **$ –** | **$ –** | **$ –** |
| As of December 2016 | $ 557 | $ 73 | $ 630 |

Note 17.

## Other Assets

The table below presents the bank's other assets. All other assets are due within one year of the balance sheet date, unless noted below.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Other amounts due from group undertakings | **$750,808** | $745,066 |
| Deferred tax (see Note 18) | **49,597** | 49,442 |
| Other assets | **16,341** | 13,686 |
| **Total other assets** | **$816,746** | $808,194 |

In the table above:

- Other amounts due from group undertakings included balances due in more than one year of $657 million and $304 million as of December 2017 and December 2016, respectively.
- Total other assets included financial assets of $766 million and $755 million as of December 2017 and December 2016, respectively, and non-financial assets of $51 million and $53 million as of December 2017 and December 2016, respectively.

Note 18.

## Deferred Tax

The table below presents the components of the bank's deferred tax asset.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Unused tax losses | **$48,239** | $50,155 |
| Debt valuation adjustment | **1,290** | (847) |
| Other temporary differences | **68** | 134 |
| **Total deferred tax** | **$49,597** | $49,442 |

The table below presents changes in each component of the bank's deferred tax asset.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| **Unused tax losses** | | |
| As of January 1 | $50,155 | $55,977 |
| Transfer to the profit and loss account | **(1,916)** | (5,822) |
| As of December 31 | **$48,239** | $50,155 |
| **Debt valuation adjustment** | | |
| As of January 1 | $ (847) | $ – |
| Transfer to other comprehensive income | **2,137** | (847) |
| As of December 31 | **$ 1,290** | $ (847) |
| **Other temporary differences** | | |
| As of January 1 | $ 134 | $ 294 |
| Transfer to the profit and loss account | **(73)** | (140) |
| Translation gain/(loss) | **7** | (20) |
| As of December 31 | **$ 68** | $ 134 |
| **Total** | | |
| As of January 1 | $49,442 | $56,271 |
| Transfer to the profit and loss account (see Note 12) | **(1,989)** | (5,962) |
| Transfer to other comprehensive income | **2,137** | (847) |
| Translation gain/(loss) | **7** | (20) |
| **As of December 31** | **$49,597** | $49,442 |

The deferred tax asset is recognised on the basis of estimated future taxable profits over the bank's planning horizon. Having considered the expected performance of the business, the directors are of the opinion that these projections support the recognition of the deferred tax asset.

**Note 19.**

## Customer Accounts Payable

The table below presents the bank's customer accounts payable balances.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Customer deposits | **$25,814,493** | $16,600,215 |
| Amounts due to customers | **320,122** | 224,807 |
| Deposits from group undertakings | **1,192,335** | 1,080,998 |
| Amounts due to group undertakings | **491,066** | 1,504,003 |
| **Total customer accounts payable** | **$27,818,016** | $19,410,023 |

### Debt Valuation Adjustment

The bank calculates the fair value of customer deposits that are designated at fair value through profit or loss by discounting future cash flows at a rate which incorporates GS Group's credit spreads. The net DVA on such financial liabilities is a pre-tax loss of $8 million for 2017 and gain of $3 million for 2016 and has been included in "Debt valuation adjustment" in the statements of comprehensive income.

**Note 20.**

## Collateralised Financings With Group Undertakings

Collateralised financings with group undertakings of $9.59 billion and $7.75 billion as of December 2017 and December 2016, respectively, consists of repurchase agreements.

**Note 21.**

## Other Liabilities

The table below presents the bank's other liabilities.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Accruals and deferred income | **$ 2,049** | $ 13,278 |
| Other amounts due to group undertakings | **1,690,540** | 1,119,299 |
| Corporation tax payable | **18,795** | 23,347 |
| Other liabilities | **9,378** | 11,628 |
| **Total other liabilities** | **$1,720,762** | $1,167,552 |

In the table above:

- Other liabilities included an allowance for impairment in respect of unfunded bank loans held at amortised cost of $9 million and $8 million as of December 2017 and December 2016, respectively.
- Total other liabilities included financial liabilities of $1.70 billion and $1.14 billion as of December 2017 and December 2016, respectively, and non-financial liabilities of $19 million and $30 million as of December 2017 and December 2016, respectively.

**Note 22.**

## Long-Term Subordinated Loans From Group Undertakings

Long-term subordinated loans from group undertakings are unsecured and carry interest at a margin over the U.S. Federal Reserve's Federal Funds rate and constitute regulatory capital as approved by the PRA. Long-term subordinated loans from group undertakings are repayable on September 8, 2025. Any repayment prior to this maturity date requires PRA approval.

**Note 23.**

## Share Capital

The table below presents the bank's share capital.

| **Allotted, called up and fully paid** | **Ordinary shares of £1 each** | ***$ in thousands*** |
|---|---|---|
| As of January 1, 2017 | **40,169,994** | **$62,558** |
| **As of December 31, 2017** | **40,169,994** | **$62,558** |

**Note 24.**

## Financial Commitments and Contingencies

### Financial Commitments

The table below presents the bank's financial commitments.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Principal risk | **$3,893,724** | $5,154,200 |
| Sub-participated | **1,696,024** | 1,248,775 |
| Unfunded bank loans | **5,589,748** | 6,402,975 |
| Forward starting resale agreements | **27,049** | 26,506 |
| Leases | **45** | 156 |
| Other | **16,366** | 9,920 |
| **Total financial commitments** | **$5,633,208** | $6,439,557 |

The bank originates a number of bank loans which are held as principal risk. The bank also holds bank loans which are sub-participated to group undertakings and third party institutions. The unfunded portion of these agreements, where cash has not been deposited with the bank to collateralise the undrawn commitment is presented above.

The bank enters into resale agreements that settle at a future date, generally within three business days. The bank's funding of these commitments depends on the satisfaction of all contractual conditions to the resale agreement and these commitments can expire unused.

Other commitments relate to collateral commitments.

### Leases

The bank leases certain buildings under long-term non-cancellable lease agreements. Under these lease agreements, which are subject to renegotiation at various intervals specified in the leases, the bank pays all insurance, maintenance and repairs of these properties. The table below presents total future minimum rental payments under non-cancellable operating leases for each of the following periods.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Less than one year | **$45** | $121 |
| Between one and five years | **–** | 35 |
| Over five years | **–** | – |
| **Total leases** | **$45** | $156 |

### Contingent Liabilities

The bank, in its capacity as an agent in securities lending, indemnifies most of its securities lending customers against losses incurred in the event that borrowers do not return securities. The maximum exposure to loss under guarantees was $1.95 billion and $1.38 billion as of December 2017 and December 2016, respectively. The market value of the collateral held to cover the loss was $2.15 billion and $1.52 billion as of December 2017 and December 2016, respectively.

**Note 25.**

## Financial Risk Management and Capital Management

### Capital Management

#### Overview

The bank determines the appropriate level and composition of its equity capital by considering multiple factors including the bank's current and future regulatory capital requirements, the results of the bank's capital planning and stress testing process, resolution capital models and other factors such as rating agency guidelines, the business environment and conditions in the financial market.

The table below presents the bank's capital components under CRD IV.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Called up share capital | **$ 62,558** | $ 62,558 |
| Share premium account | **2,094,303** | 2,094,303 |
| Retained earnings | **876,837** | 763,130 |
| Total shareholder's funds | **3,033,698** | 2,919,991 |
| Deductions | **(185,680)** | (238,674) |
| **Common Equity Tier 1 and Tier 1 capital** | **$2,848,018** | $2,681,317 |
| **Tier 2 and Total capital** | | |
| Long-term subordinated loans from group undertakings | **$ 826,000** | $ 826,000 |
| Deductions | **–** | (115,000) |
| Tier 2 capital | **826,000** | 711,000 |
| **Total capital** | **$3,674,018** | $3,392,317 |

During 2017 and 2016, the bank was in compliance with the capital requirements set by the PRA.

### Liquidity Risk Management

#### Overview

Liquidity risk is the risk that the bank will be unable to fund itself or meet its liquidity needs in the event of bank-specific, broader industry, or market liquidity stress events. Liquidity is of critical importance to the bank, as most of the failures of financial institutions have occurred in large part due to insufficient liquidity. Accordingly, the bank has in place a comprehensive and conservative set of liquidity and funding policies. The principal objective is to be able to fund the bank and to enable the core businesses to continue to serve clients and generate revenues, even under adverse circumstances.

Treasury has the primary responsibility for assessing, monitoring and managing liquidity and funding strategy. Treasury is independent of the revenue-producing units and reports to GS Group's chief financial officer.

GS Group's Liquidity Risk Management and Analysis (Liquidity Risk Management) function is an independent risk management function responsible for control and oversight of GS Group's liquidity risk management framework, including stress testing and limit governance. Liquidity Risk Management is independent of the revenue-producing units and Treasury, and reports to GS Group's chief risk officer.

#### Liquidity Risk Management Principles

The bank manages liquidity risk according to three principles (i) hold sufficient excess liquidity in the form of Global Core Liquid Assets (GCLA) to cover outflows during a stressed period, (ii) maintain appropriate Asset-Liability Management and (iii) maintain a viable Contingency Funding Plan.

**Global Core Liquid Assets.** GCLA is liquidity that the bank maintains to meet a broad range of potential cash outflows and collateral needs in a stressed environment.

**Asset-Liability Management.** The bank's liquidity risk management policies are designed to ensure it has a sufficient amount of financing, even when funding markets experience persistent stress. The bank manages maturities and diversity of funding across markets, products and counterparties, and seeks to maintain a diversified external funding profile with an appropriate tenor, taking into consideration the characteristics and liquidity profile of its assets.

**Contingency Funding Plan.** GS Group maintains a contingency funding plan, which has a specific Goldman Sachs International Bank addendum, to provide a framework for analysing and responding to a liquidity crisis situation or periods of market stress. The contingency funding plan outlines a list of potential risk factors, key reports and metrics that are reviewed on an ongoing basis to assist in assessing the severity of, and managing through, a liquidity crisis and/or market dislocation. The contingency funding plan also describes the bank's potential responses if assessments indicate that the bank has entered a liquidity crisis, which includes pre-funding for what the bank estimates will be its potential cash and collateral needs as well as utilising secondary sources of liquidity. Mitigants and action items to address specific risks which may arise are also described and assigned to individuals responsible for execution.

## Market Risk Management

### Overview

Market risk is the risk of loss in the value of the bank's inventory, as well as certain other financial assets and financial liabilities, due to changes in market conditions. The bank employs a variety of risk measures, each described in the respective sections below, to monitor market risk. Categories of market risk include the following:

- Interest rate risk: results from exposures to changes in the level, slope and curvature of yield curves, the volatilities of interest rates, prepayment speeds and credit spreads;
- Equity price risk: results from exposures to changes in prices and volatilities of individual equities, baskets of equities and equity indices;
- Currency rate risk: results from exposures to changes in spot prices, forward prices and volatilities of currency rates; and
- Commodity price risk: results from exposures to changes in spot prices, forward prices and volatilities of commodities, such as crude oil and metals.

Market Risk Management and Analysis (Market Risk Management), which is independent of the revenue-producing units and reports to the GS Group chief risk officer, has primary responsibility for assessing, monitoring and managing market risk. Risks are monitored and controlled through strong oversight and independent control and support functions across the global businesses.

Managers in revenue-producing units and Market Risk Management discuss market information, positions and estimated risk and loss scenarios on an ongoing basis. Managers in revenue-producing units are accountable for managing risk within prescribed limits, both at the GS Group and bank level. These managers have in-depth knowledge of their positions, markets and the instruments available to hedge their exposures.

### Market Risk Management Process

The bank manages market risk by diversifying exposures, controlling position sizes and establishing economic hedges in related securities or derivatives. This process includes:

- Accurate and timely exposure information incorporating multiple risk metrics;
- A dynamic limit setting framework; and
- Constant communication among revenue-producing units, risk managers and senior management.

The bank's framework for managing market risk is consistent with, and part of, the GS Group framework, and results are analysed by business and in aggregate, at both the GS Group and bank level.

**Value-at-Risk.** VaR is the potential loss in value due to adverse market movements over a defined time horizon with a specified confidence level. A one-day time horizon with a 95% confidence level is typically employed. The VaR model is a single model that captures risks including interest rates, equity prices, currency rates and commodity prices. As such, VaR facilitates comparison across portfolios of different risk characteristics. VaR also captures the diversification of aggregated risk across the bank.

### Metrics

The table below presents average daily VaR, period-end VaR, and high and low VaR.

| | As of or for the year ended December | |
|---|---|---|
| *$ in millions* | **2017** | 2016 |
| Average daily VaR | **$2.3** | $3.0 |
| Period-end VaR | **$2.5** | $2.9 |
| High VaR | **$9.7** | $7.2 |
| Low VaR | **$1.3** | $1.5 |

## Credit Risk Management

### Overview

Credit risk represents the potential for loss due to the default or deterioration in credit quality of a counterparty (e.g., an OTC derivatives counterparty or a borrower) or an issuer of securities or other instruments the bank holds. The bank's exposure to credit risk comes mostly from lending activities and client transactions in OTC derivatives. Credit risk also comes from cash placed with banks, securities financing transactions (i.e., resale and repurchase agreements) and customer accounts receivable.

Credit Risk Management and Advisory (Credit Risk Management), which is independent of the revenue-producing units and reports to GS Group's chief risk officer, has primary responsibility for assessing, monitoring and managing credit risk. The bank's framework for managing credit risk is consistent with the framework of GS Group. GS Group's Credit Policy Committee and Firmwide Risk Committee establish and review credit policies and parameters for GS Group as a whole. In addition, the bank holds other positions that give rise to credit risk (e.g., bonds held in inventory) – these credit risks are captured as a component of market risk measures, which are monitored and managed by Market Risk Management, consistent with other inventory positions. The bank also enters into derivatives to manage market risk exposures. Such derivatives also give rise to credit risk which is monitored and managed by Credit Risk Management.

### Credit Risk Management Process

Effective management of credit risk requires accurate and timely information, a high level of communication and knowledge of customers, countries, industries and products. The process for managing credit risk includes:

- Approving transactions and setting and communicating credit exposure limits;
- Monitoring compliance with established credit exposure limits;
- Assessing the likelihood that a counterparty will default on its payment obligations;
- Measuring the bank's current and potential credit exposure and losses resulting from counterparty default;
- Reporting of credit exposures to senior management, the bank's board of directors and regulators;
- Using credit risk mitigants, including collateral and hedging; and
- Communicating and collaborating with other independent control and support functions such as operations, legal and compliance.

As part of the risk assessment process, Credit Risk Management performs credit reviews, which include initial and ongoing analyses of the bank's counterparties. For substantially all of the bank's credit exposures, the core of the process is an annual counterparty credit review. A credit review is an independent analysis of the capacity and willingness of a counterparty to meet its financial obligations, resulting in an internal credit rating. The determination of internal credit ratings also incorporates assumptions with respect to the nature of and outlook for the counterparty's industry, and the economic environment. Senior personnel within Credit Risk Management, with expertise in specific industries, inspect and approve credit reviews and internal credit ratings.

The global credit risk management systems capture credit exposure to individual counterparties and on an aggregate basis to counterparties and their subsidiaries (economic groups). These systems also provide management with comprehensive information on aggregate credit risk by product, internal credit rating, industry, country and region.

### Credit Exposures

The bank's credit exposures are described further below.

**Cash at Bank and in Hand.** Cash at bank and in hand include both interest-bearing and non-interest-bearing deposits. To mitigate the risk of credit loss, the bank places substantially all of its deposits with highly-rated banks and central banks.

**Customer Accounts Receivable.** The bank is exposed to credit risk from its customer accounts receivable through its amounts due from customers, bank loans, mortgage-backed loans and securities and amounts due from group undertakings. The bank manages its lending activities using the process described above, including participation agreements with affiliates.

**Financial Instruments Owned.** Financial instruments owned includes cash instruments and derivatives. The bank's credit exposure on derivatives arises primarily from market-making activities. As a market maker, the bank enters into derivative transactions to provide liquidity to clients and to facilitate the transfer and hedging of their risks. The bank also enters into derivatives to manage market risk exposures. In the table below cash instruments are included in the gross exposure; however, to the extent that they have been captured by market risk they are removed to arrive at net credit exposure. Derivatives are reported at fair value on a gross by counterparty basis in the bank's financial statements unless it has current legal right of set-off and also intends to settle on a net basis. OTC derivatives are risk managed using the risk processes, measures and limits described above.

**Collateralised Agreements With Group Undertakings.** The bank bears credit risk related to collateralised agreements only to the extent that cash advanced to the counterparty exceeds the value of the collateral received. The bank's credit exposure on these transactions is therefore significantly lower than the amounts recorded in the balance sheet, which represent fair values or contractual value before consideration of collateral received. The bank also has credit exposure on collateralised financings, which are liabilities on its balance sheet, to the extent that the value of collateral pledged to the counterparty for these transactions exceeds the amount of cash or collateral received.

The tables below present the bank's gross credit exposure to financial assets and net credit exposure after taking account of assets captured by market risk in the bank's risk management process, counterparty netting (i.e., the netting of financial assets and financial liabilities for a given counterparty when a legal right of set-off exists under an enforceable netting agreement), and cash and security collateral received and cash collateral posted under credit support agreements, which management considers when determining credit risk. This is presented by financial asset class and by credit rating equivalent (internally determined public rating agency equivalents).

In the tables below, cash collateral is slightly higher than the amounts disclosed in Note 27 to the financial statements as the below disclosure includes additional cash collateral that management considers when determining credit risk.

| *$ in thousands* | Gross exposure | Assets captured by market risk | Counterparty netting | Cash collateral | Security Collateral received | Net credit exposure |
|---|---|---|---|---|---|---|
| **Financial Asset Class** | | | | | | |
| **As of December 2017** | | | | | | |
| Cash at bank and in hand | **$ 3,227,390** | **$ –** | **$ –** | **$ –** | **$ –** | **$3,227,390** |
| Customer accounts receivable | **5,261,302** | **–** | **–** | **(100,202)** | **(2,501,138)** | **2,659,962** |
| Financial instruments owned | **8,231,812** | **(5,743,797)** | **(1,804,856)** | **(389,505)** | **(103,579)** | **190,075** |
| Collateralised agreements with group undertakings | **36,909,581** | **–** | **(9,586,952)** | **–** | **(27,183,080)** | **139,549** |
| Other assets | **766,258** | **–** | **–** | **–** | **–** | **766,258** |
| **Total** | **$54,396,343** | **$(5,743,797)** | **$(11,391,808)** | **$(489,707)** | **$(29,787,797)** | **$6,983,234** |
| As of December 2016 | | | | | | |
| Cash at bank and in hand | $ 783,184 | $ – | $ – | $ – | $ – | $ 783,184 |
| Customer accounts receivable | 4,027,753 | – | – | (195,742) | (1,442,189) | 2,389,822 |
| Financial instruments owned | 6,842,824 | (4,933,711) | (1,664,490) | (181,225) | – | 63,398 |
| Collateralised agreements with group undertakings | 29,887,562 | – | (7,746,979) | – | (22,140,583) | – |
| Other assets | 754,614 | – | – | – | – | 754,614 |
| Total | $42,295,937 | $(4,933,711) | $ (9,411,469) | $(376,967) | $(23,582,772) | $3,991,018 |

| *$ in thousands* | Gross exposure | Assets captured by market risk | Counterparty netting | Cash collateral | Security Collateral received | Net credit exposure |
|---|---|---|---|---|---|---|
| **Credit Rating Equivalent** | | | | | | |
| **As of December 2017** | | | | | | |
| AAA/Aaa | **$ 2,712,560** | **$ –** | **$ –** | **$ –** | **$ –** | **$2,712,560** |
| AA/Aa2 | **576,791** | **–** | **(137)** | **(5,121)** | **–** | **571,533** |
| A/A2 | **40,533,504** | **–** | **(11,357,060)** | **(419,939)** | **(27,234,370)** | **1,522,135** |
| BBB/Baa2 | **2,161,583** | **–** | **(32,692)** | **(60,556)** | **(1,810,159)** | **258,176** |
| BB/Ba2 or lower | **2,589,403** | **–** | **(1,919)** | **(4,091)** | **(743,268)** | **1,840,125** |
| Unrated | **5,822,502** | **(5,743,797)** | **–** | **–** | **–** | **78,705** |
| **Total** | **$54,396,343** | **$(5,743,797)** | **$(11,391,808)** | **$(489,707)** | **$(29,787,797)** | **$6,983,234** |
| As of December 2016 | | | | | | |
| AAA/Aaa | $ 75,437 | $ – | $ – | $ – | $ – | $ 75,437 |
| AA/Aa2 | 220,915 | – | (66) | (222) | – | 220,627 |
| A/A2 | 34,978,525 | – | (9,410,724) | (366,055) | (22,140,583) | 3,061,163 |
| BBB/Baa2 | 1,294,294 | – | (170) | (7,706) | (1,119,996) | 166,422 |
| BB/Ba2 or lower | 769,795 | – | (509) | (2,984) | (322,193) | 444,109 |
| Unrated | 4,956,971 | (4,933,711) | – | – | – | 23,260 |
| Total | $42,295,937 | $(4,933,711) | $ (9,411,469) | $(376,967) | $(23,582,772) | $3,991,018 |

The unrated net credit exposure of $79 million and $23 million as of December 2017 and December 2016, respectively, relates to financial assets for which the bank has not assigned an internally determined public rating agency equivalent.

As of December 2017 and December 2016, financial assets past due were not material. The bank has recognised an allowance for impairment of $30 million and $14 million as of December 2017 and December 2016, respectively (see Notes 13 and 21).

In addition to credit risk on financial assets, the bank also has credit exposure in respect of contingent and forward starting resale agreements and financial guarantee contracts written. The bank's gross credit exposure related to contingent and forward starting resale agreements was $27 million as of both December 2017 and December 2016. However, this is fully mitigated by collateral if these commitments are fulfilled. As a result, the bank did not have net credit exposure to these commitments. The bank's gross credit exposure related to a financial guarantee contract written was $962 million and $nil as of December 2017 and December 2016, respectively. However, this is fully mitigated by a derivative instrument with an affiliated GS Group undertaking.

**Note 26.**

## Financial Assets and Financial Liabilities

### Financial Assets and Financial Liabilities by Category

The tables below present the carrying value of the bank's financial assets and financial liabilities by category.

| | Financial Assets | | | |
|---|---|---|---|---|
| *$ in thousands* | Held for trading | Designated at fair value | Loans and receivables | Total |
| **As of December 2017** | | | | |
| Cash at bank and in hand | **$ –** | **$ –** | **$ 3,227,390** | **$ 3,227,390** |
| Customer accounts receivable | **–** | **324,119** | **4,937,183** | **5,261,302** |
| Financial instruments owned | **8,231,812** | **–** | **–** | **8,231,812** |
| Collateralised agreements with group undertakings | **–** | **36,909,581** | **–** | **36,909,581** |
| Other assets | **–** | **–** | **766,258** | **766,258** |
| **Total financial assets** | **$8,231,812** | **$37,233,700** | **$ 8,930,831** | **$54,396,343** |
| As of December 2016 | | | | |
| Cash at bank and in hand | $ – | $ – | $ 783,184 | $ 783,184 |
| Customer accounts receivable | – | 159,024 | 3,868,729 | 4,027,753 |
| Financial instruments owned | 6,842,824 | – | – | 6,842,824 |
| Collateralised agreements with group undertakings | – | 29,887,562 | – | 29,887,562 |
| Other assets | – | – | 754,614 | 754,614 |
| Total financial assets | $6,842,824 | $30,046,586 | $ 5,406,527 | $42,295,937 |

| | Financial Liabilities | | | |
|---|---|---|---|---|
| *$ in thousands* | Held for trading | Designated at fair value | Amortised cost | Total |
| **As of December 2017** | | | | |
| Customer accounts payable | **$ –** | **$17,040,215** | **$10,777,801** | **$27,818,016** |
| Deposits by banks | **–** | **1,440,949** | **–** | **1,440,949** |
| Financial instruments sold, but not yet purchased | **9,853,758** | **166,696** | **–** | **10,020,454** |
| Collateralised financings with group undertakings | **–** | **9,586,952** | **–** | **9,586,952** |
| Other liabilities | **–** | **939,404** | **762,913** | **1,702,317** |
| Long-term subordinated loans from group undertakings | **–** | **–** | **826,000** | **826,000** |
| **Total financial liabilities** | **$9,853,758** | **$29,174,216** | **$12,366,714** | **$51,394,688** |
| As of December 2016 | | | | |
| Customer accounts payable | $ – | $ 7,643,739 | $11,766,284 | $19,410,023 |
| Deposits by banks | – | 1,162,819 | – | 1,162,819 |
| Financial instruments sold, but not yet purchased | 9,116,783 | – | – | 9,116,783 |
| Collateralised financings with group undertakings | – | 7,746,979 | – | 7,746,979 |
| Other liabilities | – | 439,926 | 697,128 | 1,137,054 |
| Long-term subordinated loans from group undertakings | – | – | 826,000 | 826,000 |
| Total financial liabilities | $9,116,783 | $16,993,463 | $13,289,412 | $39,399,658 |

In the table above, financial instruments owned held for trading included $6 million and $5 million as of December 2017 and December 2016, respectively, and financial instruments sold, but not yet purchased held for trading included $2 million and $1 million as of December 2017 and December 2016 respectively, of derivative instruments designated as hedges.

### Fair Value Hierarchy

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. The bank measures certain financial assets and financial liabilities as a portfolio (i.e., based on its net exposure to market and/or credit risks).

U.K. GAAP has a three-level hierarchy for disclosure of fair value measurements. The fair value hierarchy prioritises inputs to the valuation techniques used to measure fair value, giving the highest priority to level 1 inputs and the lowest priority to level 3 inputs. A financial asset or financial liability's level in the fair value hierarchy is based on the lowest level of input that is significant to its fair value measurement.

The hierarchy is as follows:

**Level 1.** Inputs are unadjusted quoted prices in active markets to which the bank had access at the measurement date for identical, unrestricted assets or liabilities.

**Level 2.** Inputs to valuation techniques are observable, either directly or indirectly.

**Level 3.** One or more inputs to valuation techniques are significant and unobservable.

The fair values for substantially all of the bank's financial assets and financial liabilities that are fair valued on a recurring basis are based on observable prices and inputs and are classified in levels 1 and 2 of the fair value hierarchy. Certain level 2 and level 3 financial assets and financial liabilities may require appropriate valuation adjustments that a market participant would require to arrive at fair value for factors such as counterparty and the bank's and GS Group's credit quality, funding risk, transfer restrictions, liquidity and bid/offer spreads. Valuation adjustments are generally based on market evidence.

## Valuation Techniques and Significant Inputs

**Cash Instruments.** Cash instruments include government bonds, bank loans and mortgage-backed loans and securities. Valuation techniques and significant inputs for each level of the fair value hierarchy include:

### *Level 1 Cash Instruments*

Level 1 cash instruments are valued using quoted prices for identical unrestricted instruments in active markets. The bank defines active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity.

### *Level 2 Cash Instruments*

Level 2 cash instruments can be verified to quoted prices, recent trading activity for identical or similar instruments, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g., indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources.

Valuation adjustments are typically made to level 2 cash instruments (i) if the cash instrument is subject to transfer restrictions and/or (ii) for other premiums and liquidity discounts that a market participant would require to arrive at fair value. Valuation adjustments are generally based on market evidence.

### *Level 3 Cash Instruments*

Level 3 cash instruments have one or more significant valuation inputs that are not observable. Absent evidence to the contrary, level 3 cash instruments are initially valued at transaction price, which is considered to be the best initial estimate of fair value. Subsequently, the bank uses other methodologies to determine fair value, which vary based on the type of instrument. Valuation inputs and assumptions are changed when corroborated by substantive observable evidence, including values realised on sales of financial assets.

Valuation techniques of level 3 cash instruments vary by instrument, but are generally based on discounted cash flow techniques. The valuation techniques and the nature of significant inputs used to determine the fair values of each type of level 3 cash instrument are described below.

**Bank Loans and Mortgage-Backed Loans and Securities (Bank Loans and Mortgages).** Significant inputs are generally determined based on relative value analyses and include:

- Market yields implied by transactions of similar or related assets;
- Current levels and changes in market indices such as the iTraxx and CDX, and LCDX (indices that track the performance of corporate credit and loans, respectively);
- Current performance of the borrower or loan collateral and recovery assumptions if a default occurs; and
- Timing of expected future cash flows (duration) which, in certain cases, may incorporate the impact of other unobservable inputs (e.g., prepayment speeds).

**Derivative Instruments.** Derivatives may be traded on an exchange (exchange-traded) or they may be privately negotiated contracts, which are usually referred to as OTC derivatives. Certain of the bank’s OTC derivatives are cleared and settled through central clearing counterparties (OTC-cleared), while others are bilateral contracts between two counterparties (bilateral OTC).

The bank’s level 2 and level 3 derivatives are valued using derivative pricing models (e.g., discounted cash flow models, correlation models, and models that incorporate option pricing methodologies, such as Monte Carlo simulations). Price transparency of derivatives can generally be characterised by product type, as described below.

- **Interest Rate.** In general, the key inputs used to value interest rate derivatives are transparent, even for most long-dated contracts. Interest rate swaps and options denominated in the currencies of leading industrialised nations are characterised by high trading volumes and tight bid/offer spreads. Interest rate derivatives that reference indices, such as an inflation index, or the shape of the yield curve (e.g., 10-year swap rate vs. 2-year swap rate) are more complex, but the key inputs are generally observable.

- **Credit.** Price transparency for credit default swaps, including both single names and baskets of credits, varies by market and underlying reference entity or obligation. Credit default swaps that reference indices, large corporates and major sovereigns generally exhibit the most price transparency. For credit default swaps with other underliers, price transparency varies based on credit rating, the cost of borrowing the underlying reference obligations, and the availability of the underlying reference obligations for delivery upon the default of the issuer. Credit default swaps that reference loans, asset-backed securities and emerging market debt instruments tend to have less price transparency than those that reference corporate bonds. In addition, more complex credit derivatives, such as those sensitive to the correlation between two or more underlying reference obligations generally have less price transparency.

- **Currency.** Prices for currency derivatives based on the exchange rates of leading industrialised nations, including those with longer tenors, are generally transparent. The primary difference between the price transparency of developed and emerging market currency derivatives is that emerging markets tend to be observable for contracts with shorter tenors.

- **Equity.** Price transparency for equity derivatives varies by market and underlier. Options on indices and the common stock of corporates included in major equity indices exhibit the most price transparency. Equity derivatives generally have observable market prices, except for contracts with long tenors or reference prices that differ significantly from current market prices. More complex equity derivatives, such as those sensitive to the correlation between two or more individual stocks, generally have less price transparency.

Liquidity is essential to observability of all product types. If transaction volumes decline, previously transparent prices and other inputs may become unobservable. Conversely, even highly structured products may at times have trading volumes large enough to provide observability of prices and other inputs.

### *Level 1 Derivatives*

Level 1 derivatives include short-term contracts for future delivery of securities when the underlying security is a level 1 instrument, and exchange-traded derivatives if they are actively traded and are valued at their quoted market price.

### *Level 2 Derivatives*

Level 2 derivatives include OTC derivatives for which all significant valuation inputs are corroborated by market evidence and exchange-traded derivatives that are not actively traded and/or that are valued using models that calibrate to market-clearing levels of OTC derivatives. In evaluating the significance of a valuation input, the bank considers, among other factors, a portfolio's net risk exposure to that input.

The selection of a particular model to value a derivative depends on the contractual terms of and specific risks inherent in the instrument, as well as the availability of pricing information in the market. For derivatives that trade in liquid markets, model selection does not involve significant management judgement because outputs of models can be calibrated to market-clearing levels.

Valuation models require a variety of inputs, such as contractual terms, market prices, yield curves, discount rates (including those derived from interest rates on collateral received and posted as specified in credit support agreements for collateralised derivatives), credit curves, measures of volatility and correlations of such inputs. Significant inputs to the valuations of level 2 derivatives can be verified to market transactions, broker or dealer quotations or other alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g., indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources.

### *Level 3 Derivatives*

Level 3 derivatives are valued using models which utilise observable level 1 and/or level 2 inputs, as well as unobservable level 3 inputs. Unobservable inputs include certain correlations as well as credit spreads and equity volatility inputs.

Subsequent to the initial valuation of a level 3 derivative, the bank updates the level 1 and level 2 inputs to reflect observable market changes and any resulting gains and losses are recorded in level 3. Level 3 inputs are changed when corroborated by evidence such as similar market transactions, third-party pricing services and/or broker or dealer quotations or other empirical market data. In circumstances where the bank cannot verify the model value by reference to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value.

### *Valuation Adjustments*

Valuation adjustments are integral to determining the fair value of derivative portfolios and are used to adjust the mid-market valuations produced by derivative pricing models to the appropriate exit price valuation. These adjustments incorporate bid/offer spreads, the cost of liquidity, credit valuation adjustments and funding valuation adjustments, which account for the credit and funding risk inherent in the uncollateralised portion of derivative portfolios. The bank also makes funding valuation adjustments to collateralised derivatives where the terms of the agreement do not permit the bank to deliver or repledge collateral received. Market-based inputs are generally used when calibrating valuation adjustments to market-clearing levels.

In addition, for derivatives that include significant unobservable inputs, the bank makes model or exit price adjustments to account for the valuation uncertainty present in the transaction.

### Other Financial Assets and Financial Liabilities

Valuation techniques and significant inputs of other financial assets and financial liabilities include:

- **Customer Accounts Receivable.** Customer accounts receivable measured at fair value consists of certain bank loans and mortgages. The significant inputs to the valuation of bank loans and mortgages are consistent with those described above as part of cash instruments.

- **Collateralised Agreements With Group Undertakings and Collateralised Financings With Group Undertakings.** The significant inputs to the valuation of resale and repurchase agreements and securities borrowed are funding spreads, the amount and timing of expected future cash flows and interest rates.

- **Customer Accounts Payable and Deposits by Banks.** Customer accounts payable and deposits by banks measured at fair value consists of certain balances related to deposit-taking activities. The significant inputs to the valuation of these balances are interest rates and the amount and timing of future cash flows.

- **Financial guarantee contracts.** The significant inputs to the valuation of financial guarantee contracts designated at fair value is consistent with those described above in relation to level 2 derivative instruments.

### Fair Value of Financial Assets and Financial Liabilities by Level

The tables below present, by level within the fair value hierarchy, financial assets and financial liabilities measured at fair value on a recurring basis.

| | Financial Assets and Financial Liabilities at Fair Value as of December 2017 | | | |
|---|---|---|---|---|
| *$ in thousands* | **Level 1** | **Level 2** | **Level 3** | **Total** |
| **Financial Assets** | | | | |
| Customer accounts receivable | **$ –** | **$ 275,640** | **$48,479** | **$ 324,119** |
| Cash instruments | **5,647,840** | **129,048** | **41,215** | **5,818,103** |
| Derivative instruments | **1,770** | **2,411,054** | **885** | **2,413,709** |
| Financial instruments owned | **5,649,610** | **2,540,102** | **42,100** | **8,231,812** |
| Collateralised agreements with group undertakings | **–** | **36,909,581** | **–** | **36,909,581** |
| **Total financial assets** | **$5,649,610** | **$39,725,323** | **$90,579** | **$45,465,512** |
| **Financial Liabilities** | | | | |
| Customer accounts payable | **$ –** | **$17,040,215** | **$ –** | **$17,040,215** |
| Deposits by banks | **–** | **1,440,949** | **–** | **1,440,949** |
| Cash instruments | **7,883,246** | **35,341** | **–** | **7,918,587** |
| Derivative instruments | **1,882** | **2,098,738** | **1,247** | **2,101,867** |
| Financial instruments sold, but not yet purchased | **7,885,128** | **2,134,079** | **1,247** | **10,020,454** |
| Collateralised financings with group undertakings | **–** | **9,586,952** | **–** | **9,586,952** |
| Other liabilities | **–** | **939,404** | **–** | **939,404** |
| **Total financial liabilities** | **$7,885,128** | **$31,141,599** | **$ 1,247** | **$39,027,974** |
| **Net derivative instruments** | **$ (112)** | **$ 312,316** | **$ (362)** | **$ 311,842** |

| | Financial Assets and Financial Liabilities at Fair Value as of December 2016 | | | |
|---|---|---|---|---|
| *$ in thousands* | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets | | | | |
| Customer accounts receivable | $ – | $ 805 | $158,219 | $ 159,024 |
| Cash instruments | 4,769,733 | 208,553 | 9,338 | 4,987,624 |
| Derivative instruments | 3,495 | 1,851,705 | – | 1,855,200 |
| Financial instruments owned | 4,773,228 | 2,060,258 | 9,338 | 6,842,824 |
| Collateralised agreements with group undertakings | – | 29,887,562 | – | 29,887,562 |
| Total financial assets | $4,773,228 | $31,948,625 | $167,557 | $36,889,410 |
| Financial Liabilities | | | | |
| Customer accounts payable | $ – | $ 7,643,739 | $ – | $ 7,643,739 |
| Deposits by banks | – | 1,162,819 | – | 1,162,819 |
| Cash instruments | 7,168,618 | 115,451 | 1,528 | 7,285,597 |
| Derivative instruments | 3,280 | 1,827,906 | – | 1,831,186 |
| Financial instruments sold, but not yet purchased | 7,171,898 | 1,943,357 | 1,528 | 9,116,783 |
| Collateralised financings with group undertakings | – | 7,746,979 | – | 7,746,979 |
| Other liabilities | – | 439,926 | – | 439,926 |
| Total financial liabilities | $7,171,898 | $18,936,820 | $ 1,528 | $26,110,246 |
| Net derivative instruments | $ 215 | $ 23,799 | $ – | $ 24,014 |

### Significant Unobservable Inputs Used in Level 3 Fair Value Measurements

As of December 2017 and December 2016, the bank had level 3 bank loans and mortgage assets of $90 million (comprising customer accounts receivable of $48 million and cash instruments of $41 million) and $168 million (comprising customer accounts receivable of $158 million and cash instruments of $9 million), respectively. Level 3 derivative instruments were not material.

The table below presents the amount of level 3 bank loans and mortgage assets, and ranges and weighted averages of significant unobservable inputs used to value the bank's level 3 bank loans and mortgage assets.

| | Level 3 Bank Loans and Mortgage Assets and Range of Significant Unobservable Inputs (Weighted Average) as of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| **Bank loans and mortgages** | **$89,694** | $167,557 |
| Yield | **2.4% to 9.5% (3.3%)** | 1.3% to 11.0% (4.5%) |
| Recovery rate | **20.0% to 20.0% (20.0%)** | 40.0% to 85.0% (50.5%) |
| Duration (years) | **3.0 to 3.5 (3.1)** | 1.0 to 4.8 (2.5) |

In the table above:

- Ranges represent the significant unobservable inputs that were used in the valuation.
- Weighted averages are calculated by weighting each input by the relative fair value of the bank loans and mortgages.
- The ranges and weighted averages of these inputs are not representative of the appropriate inputs to use when calculating the fair value of any one bank loan and mortgage. For example, the highest yield for bank loans and mortgages is appropriate for valuing a specific bank loan or mortgage but may not be appropriate for valuing any other bank loan or mortgage. Accordingly, the ranges of inputs do not represent uncertainty in, or possible ranges of, fair value measurements of the bank's level 3 bank loans and mortgages.
- Increases in yield or duration used in the valuation of the bank's level 3 bank loans and mortgages would result in a lower fair value measurement, while increases in recovery rate would result in a higher fair value measurement.
- Bank loans and mortgages are valued using discounted cash flows.
- The fair value of any one instrument may be determined using multiple valuation techniques. For example, market comparables and discounted cash flows may be used together to determine fair value. Therefore, the level 3 balance encompasses both of these techniques.

### Transfers Between Level 1 and Level 2 of the Fair Value Hierarchy

During 2017 and 2016, there were no significant transfers between level 1 and level 2 financial assets and financial liabilities measured at fair value on a recurring basis.

### Level 3 Rollforward

The table below presents a summary of the changes in fair value for all level 3 financial assets and financial liabilities measured at fair value on a recurring basis. Gains and losses arising on level 3 assets are recognised within trading profit in the profit and loss account. In the table below:

- If a financial asset or financial liability was transferred to level 3 during a reporting period, its entire gain or loss for the period is included in level 3. For level 3 financial assets, increases are shown as positive amounts, while decreases are shown as negative amounts. For level 3 financial liabilities, increases are shown as negative amounts, while decreases are shown as positive amounts.
- Transfers between levels are recognised at the beginning of the reporting period in which they occur. Accordingly, the tables do not include gains or losses for level 3 financial assets and financial liabilities that were transferred out of level 3 prior to the end of the period.
- Level 3 financial assets and financial liabilities are frequently economically hedged with level 1 and level 2 financial assets and financial liabilities. Accordingly, level 3 gains or losses that are reported for a particular class of financial asset or financial liability can be partially offset by gains or losses attributable to level 1 or level 2 in the same class of financial asset or financial liability or gains or losses attributable to level 1, level 2 or level 3 in a different class of financial asset or financial liability. As a result, gains or losses included in the level 3 rollforward do not necessarily represent the overall impact on the bank's results of operations, liquidity or capital resources.

| | Level 3 Financial Assets and Financial Liabilities at Fair Value | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| *$ in thousands* | Balance, beginning of year | Gains/ (losses) | Purchases | Sales | Settlements | Transfers into level 3 | Transfers out of level 3 | Balance, end of year |
| **Year Ended December 2017** | | | | | | | | |
| Customer accounts receivable | **$158,219** | **$ 4,779** | **$ 47,725** | **$ (47,988)** | **$(114,256)** | **$ –** | **$ –** | **$ 48,479** |
| Financial instruments owned | **9,338** | **43,879** | **5,934** | **–** | **(19,061)** | **2,010** | **–** | **42,100** |
| **Total level 3 financial assets** | **$167,557** | **$48,658** | **$ 53,659** | **$ (47,988)** | **$(133,317)** | **$2,010** | **$ –** | **$ 90,579** |
| Financial instruments sold, but not yet purchased | **$ (1,528)** | **$(1,287)** | **$ 1,568** | **$ –** | **$ –** | **$ –** | **$ –** | **$ (1,247)** |
| **Total level 3 financial liabilities** | **$ (1,528)** | **$(1,287)** | **$ 1,568** | **$ –** | **$ –** | **$ –** | **$ –** | **$ (1,247)** |
| Year Ended December 2016 | | | | | | | | |
| Customer accounts receivable | $160,458 | $ 4,872 | $129,069 | $(134,562) | $ (1,618) | $ – | $ – | $158,219 |
| Financial instruments owned | 21,243 | (123) | 991 | (242) | (12,531) | – | – | 9,338 |
| Total level 3 financial assets | $181,701 | $ 4,749 | $130,060 | $(134,804) | $ (14,149) | $ – | $ – | $167,557 |
| Financial instruments sold, but not yet purchased | $(11,074) | $ 160 | $ 423 | $ (125) | $ 9,088 | $ – | $ – | $ (1,528) |
| Total level 3 financial liabilities | $(11,074) | $ 160 | $ 423 | $ (125) | $ 9,088 | $ – | $ – | $ (1,528) |

### Transfers Between Level 2 and Level 3 of the Fair Value Hierarchy

During 2017 and 2016, there were no significant transfers between level 2 and level 3 financial assets and financial liabilities measured at fair value on a recurring basis.

### Fair Value Financial Assets and Financial Liabilities Valued Using Techniques That Incorporate Unobservable Inputs

The fair value of financial assets and financial liabilities may be determined in whole or part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same instrument or based on available observable market data and changing these assumptions will change the resultant estimate of fair value. The potential impact of using reasonable possible alternative assumptions for the valuations, including significant unobservable inputs was not material as of December 2017 and December 2016.

## Fair Value of Financial Assets and Financial Liabilities Not Measured at Fair Value

As of December 2017 and December 2016, the bank had $8.93 billion and $5.41 billion, respectively, of financial assets and $12.37 billion and $13.29 billion, respectively, of financial liabilities that are not measured at fair value. Given the short-term nature of these instruments, their carrying amounts in the balance sheet are a reasonable approximation of fair value. The interest rate associated with long term subordinated loans from group undertakings is variable in nature and approximates prevailing market interest rates for instruments with similar terms and characteristics. As such, the carrying amount in the balance sheet is a reasonable approximation of fair value.

## Maturity of Financial Liabilities

The table below presents the cash flows of the bank's financial liabilities by contractual maturity including interest that will accrue, except for financial instruments sold, but not yet purchased. Financial instruments sold, but not yet purchased are classified as trading/on demand. Financial liabilities, with the exception of those that are held for trading or designated at fair value through profit and loss, are disclosed at their undiscounted cash flows.

The fair values of financial liabilities held for trading and financial liabilities designated at fair value through profit and loss have been disclosed as this is consistent with the values used in the liquidity risk management of these instruments. Liquidity risk on derivatives is mitigated through master netting agreements and cash collateral arrangements.

| | Financial Liabilities | | | | | | |
|---|---|---|---|---|---|---|---|
| *$ in thousands* | Trading/ on demand | Less than one month | More than one month but less than three months | More than three months but less than one year | More than one year but less than five years | Greater than five years | Total |
| **As of December 2017** | | | | | | | |
| Customer accounts payable | **$ 8,360,443** | **$ 2,468,670** | **$2,689,238** | **$10,445,774** | **$3,348,103** | **$ 563,672** | **$27,875,900** |
| Deposits by banks | **–** | **–** | **678,167** | **762,782** | **–** | **–** | **1,440,949** |
| Financial instruments sold, but not yet purchased | **10,020,454** | **–** | **–** | **–** | **–** | **–** | **10,020,454** |
| Collateralised financings with group undertakings | **9,568,067** | **18,885** | **–** | **–** | **–** | **–** | **9,586,952** |
| Other liabilities | **–** | **46,213** | **30,000** | **–** | **1,626,104** | **–** | **1,702,317** |
| Long-term subordinated loans from group undertakings | **–** | **–** | **9,613** | **–** | **155,949** | **960,159** | **1,125,721** |
| **Total – on-balance-sheet** | **27,948,964** | **2,533,768** | **3,407,018** | **11,208,556** | **5,130,156** | **1,523,831** | **51,752,293** |
| **Total – off-balance-sheet** | **–** | **5,633,163** | **–** | **45** | **–** | **–** | **5,633,208** |
| **Total financial liabilities** | **$27,948,964** | **$ 8,166,931** | **$3,407,018** | **$11,208,601** | **$5,130,156** | **$1,523,831** | **$57,385,501** |
| As of December 2016 | | | | | | | |
| Customer accounts payable | $ 8,704,244 | $ 3,272,822 | $2,303,459 | $ 4,338,939 | $ 593,015 | $ 221,568 | $19,434,047 |
| Deposits by banks | – | 252,830 | 200,417 | 709,572 | – | – | 1,162,819 |
| Financial instruments sold, but not yet purchased | 9,116,783 | – | – | – | – | – | 9,116,783 |
| Collateralised financings with group undertakings | 5,700,849 | 2,046,130 | – | – | – | – | 7,746,979 |
| Other liabilities | – | 118,919 | 20,000 | 558,209 | 439,926 | – | 1,137,054 |
| Long-term subordinated loans from group undertakings | – | – | 7,943 | – | 128,856 | 969,065 | 1,105,864 |
| Total – on-balance-sheet | 23,521,876 | 5,690,701 | 2,531,819 | 5,606,720 | 1,161,797 | 1,190,633 | 39,703,546 |
| Total – off-balance-sheet | – | 6,439,401 | – | 121 | 35 | | 6,439,557 |
| Total financial liabilities | $23,521,876 | $12,130,102 | $2,531,819 | $ 5,606,841 | $1,161,832 | $1,190,633 | $46,143,103 |

### Collateral Received and Pledged

The bank receives cash and securities (e.g., government and agency obligations, corporate debt securities, equity securities) as collateral, primarily in connection with resale agreements, securities borrowed and derivative transactions. The bank obtains cash and securities as collateral on an upfront or contingent basis for derivative instruments and collateralised agreements to reduce its credit exposure to individual counterparties.

In many cases, the bank is permitted to deliver or repledge financial instruments received as collateral in connection with collateralising derivative transactions and meeting bank settlement requirements.

The table below presents financial instruments received as collateral that were available to be delivered, or repledged and were delivered or repledged by the bank.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Collateral available to be delivered or repledged | **$36,879,430** | $28,350,373 |
| Collateral that was delivered or repledged | **$12,508,756** | $ 8,951,995 |

The bank also pledges certain financial instruments owned in connection with repurchase agreements to counterparties who may or may not have the right to deliver or repledge.

The table below presents information about assets pledged.

| | As of December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Financial instruments owned pledged to counterparties that: | | |
| Had the right to deliver or repledge | **$5,355,680** | $4,480,088 |
| Did not have the right to deliver or repledge | **$ 4,612** | $ – |

The bank has received cash collateral in respect of financial instruments owned of $431 million and $206 million as of December 2017 and December 2016, respectively, and posted cash collateral in respect of financial instruments sold, but not yet purchased of $101 million and $201 million as of December 2017 and December 2016, respectively.

### Hedge Accounting

**Fair Value Hedges.** The bank designates certain interest rate swaps as fair value hedges of certain customer deposits. These interest rate swaps hedge changes in fair value attributable to the relevant benchmark interest rate (e.g., LIBOR), effectively converting fixed rate obligations into floating rate obligations.

The bank applies a statistical method that utilises regression analysis when assessing the effectiveness of its fair value hedging relationships in achieving offsetting changes in the fair values of the hedging instrument and the risk being hedged (i.e., interest rate risk). An interest rate swap is considered highly effective in offsetting changes in fair value attributable to changes in the hedged risk when the regression analysis results in a coefficient of determination of 80% or greater and a slope between 80% and 125%.

For qualifying fair value hedges, gains or losses on derivatives and the change in fair value of the hedged item attributable to the hedged risk are included in trading profit. When a derivative is no longer designated as a hedge, any remaining difference between the carrying value and par value of the hedged item is amortised over the remaining life of the hedged item using the effective interest method.

The table below presents the gains/(losses) from interest rate derivatives accounted for as hedges, the related hedged customer deposits and the hedge ineffectiveness on these derivatives.

| | Year Ended December | |
|---|---|---|
| *$ in thousands* | **2017** | 2016 |
| Interest rate hedges | **$(1,662)** | $ 1,715 |
| Hedged customer deposits | **1,571** | (1,728) |
| **Hedge ineffectiveness** | **$ (91)** | $ (13) |

The fair value of derivative instruments designated as hedges for derivate assets was $6 million and $5 million as of December 2017 and December 2016, respectively, and for derivate liabilities was $2 million and $1 million as of December 2017 and December 2016, respectively.

### Transferred Assets

**Assets Continued to be Recognised in Full.** During the year, the bank transferred certain financial assets where the transfers failed to meet the derecognition criteria, as contained in IAS 39, and as a result of which the bank continues to recognise these assets in full in the balance sheet.

The bank transfers assets owned to counterparties in the ordinary course of business to collateralise repurchase agreements. In these transactions the transferred assets continue to be recognised by the bank for accounting purposes because the transactions require the financial instruments to be repurchased at maturity of the agreement and the bank remains exposed to the price, credit and interest rate risk of these instruments. When the bank receives cash proceeds from the transfer of the asset, a financial liability is recognised in respect of the consideration received and recorded within "Collateralised financings with group undertakings". When the bank receives non cash collateral (in the form of securities) no liability is initially recognised. If collateral received is subsequently sold, the obligation to return the collateral is recognised as a liability within "Financial instruments sold, but not yet purchased".

Other financial assets transferred that continue to be recognised on balance sheet for accounting purposes relate to pledges of securities as collateral, primarily for derivative transactions. The obligations under such derivatives are recorded in "Financial instruments sold, but not yet purchased".

Financial assets which have been transferred but which remain on balance sheet for accounting purposes of $5.36 billion and $4.48 billion as of December 2017 and December 2016, respectively, consist of government bonds. The carrying amount of the associated financial liabilities generally approximate the carrying amount of the assets transferred.

**Note 27.**

## Offsetting of Financial Assets and Financial Liabilities

The tables below present the bank's financial assets and financial liabilities that are subject to enforceable netting agreements and offsetting. Amounts are only offset in the balance sheet when the bank currently has a legally enforceable right to set-off the recognised amounts and an intention either to settle on a net basis, or to realise the asset and settle the liability simultaneously. In the tables below:

- Amounts not offset in the balance sheet include counterparty netting (i.e., the netting of financial assets and financial liabilities for a given counterparty when a legal right of setoff exists under an enforceable netting agreement), and cash and security collateral received and posted under enforceable credit support agreements, that do not meet the criteria for offsetting under U.K. GAAP.
- Where the bank has received or posted collateral under credit support agreements, but has not yet determined whether such agreements are enforceable, the related collateral has not been included in the amounts not offset in the balance sheet.
- Gross amounts included derivative assets and derivative liabilities of $119 million and $180 million, respectively, as of December 2017, and derivative assets and derivative liabilities of $1 million and $9 million, respectively, as of December 2016, which are not subject to an enforceable netting agreement or are subject to a netting agreement that the bank has not yet determined to be enforceable.
- All collateralised agreements and collateralised financings are subject to enforceable netting agreements as of December 2017 and December 2016.

| | As of December 2017 | | | | |
|---|---|---|---|---|---|
| | | Amounts not offset in the balance sheet | | | |
| *$ in thousands* | Gross amount and net amount presented in the balance sheet | Counterparty netting | Cash collateral | Security collateral | Net amount |
| **Financial Assets** | | | | | |
| Customer accounts receivable | $ 2,602,043 | $ – | $(100,202) | $ (2,501,138) | $ 703 |
| Financial instruments owned | 2,413,709 | (1,804,856) | (386,685) | (103,579) | 118,589 |
| Collateralised agreements with group undertakings | 36,909,581 | (9,586,952) | – | (27,183,080) | 139,549 |
| Financial assets subject to enforceable netting agreements | 41,925,333 | (11,391,808) | (486,887) | (29,787,797) | 258,841 |
| Financial assets not subject to enforceable netting agreements | 12,471,010 | – | – | – | 12,471,010 |
| **Total financial assets** | $54,396,343 | $(11,391,808) | $(486,887) | $(29,787,797) | $12,729,851 |
| **Financial Liabilities** | | | | | |
| Customer accounts payable | $ 420,760 | $ – | $(386,685) | $ – | $ 34,075 |
| Financial instruments sold, but not yet purchased | 2,101,867 | (1,804,856) | (100,202) | – | 196,809 |
| Collateralised financings with group undertakings | 9,586,952 | (9,586,952) | – | – | – |
| Other liabilities | 33,009 | – | – | – | 33,009 |
| Financial liabilities subject to enforceable netting agreements | 12,142,588 | (11,391,808) | (486,887) | – | 263,893 |
| Financial liabilities not subject to enforceable netting agreements | 39,252,100 | – | – | – | 39,252,100 |
| **Total financial liabilities** | $51,394,688 | $(11,391,808) | $(486,887) | $ – | $39,515,993 |

| | As of December 2016 | | | | |
|---|---|---|---|---|---|
| | | Amounts not offset in the balance sheet | | | |
| *$ in thousands* | Gross amount and net amount presented in the balance sheet | Counterparty netting | Cash collateral | Security collateral | Net amount |
| Financial Assets | | | | | |
| Customer accounts receivable | $ 1,633,326 | $ – | $(151,482) | $ (1,442,189) | $ 39,655 |
| Financial instruments owned | 1,855,200 | (1,664,490) | (180,547) | – | 10,163 |
| Collateralised agreements with group undertakings | 29,887,562 | (7,746,979) | – | (22,140,583) | – |
| Financial assets subject to enforceable netting agreements | 33,376,088 | (9,411,469) | (332,029) | (23,582,772) | 49,818 |
| Financial assets not subject to enforceable netting agreements | 8,919,849 | – | – | – | 8,919,849 |
| Total financial assets | $42,295,937 | $(9,411,469) | $(332,029) | $(23,582,772) | $ 8,969,667 |
| Financial Liabilities | | | | | |
| Customer accounts payable | $ 196,566 | $ – | $(180,547) | $ – | $ 16,019 |
| Financial instruments sold, but not yet purchased | 1,831,186 | (1,664,490) | (151,482) | – | 15,214 |
| Collateralised financings with group undertakings | 7,746,979 | (7,746,979) | – | – | – |
| Other liabilities | 41,931 | – | – | – | 41,931 |
| Financial liabilities subject to enforceable netting agreements | 9,816,662 | (9,411,469) | (332,029) | – | 73,164 |
| Financial liabilities not subject to enforceable netting agreements | 29,582,996 | – | – | – | 29,582,996 |
| Total financial liabilities | $39,399,658 | $(9,411,469) | $(332,029) | $ – | $29,656,160 |

**Note 28.**

## Post Balance Sheet Events

In March 2018, following the conclusion of an ongoing review of the bank's operations, it was determined that the bank's European government bond market-making activities would be transferred to group undertakings, and the bank would continue to focus on the expansion of its lending and deposit-taking activities while remaining as a primary dealer for European government bonds. In 2017 the European government bond market-making business contributed $106 million to the bank's profit before taxation.