
Annual Report December 31, 2016

Goldman Sachs International Bank (unlimited company)

Company Number: 01122503

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Strategic Report

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). Group Inc., together with its consolidated subsidiaries, form "GS Group" or "the 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 branches in Germany (the Frankfurt branch), which is involved in lending activities, and Korea (the Seoul branch), which was involved in client execution activities, and has representative offices in China (the Beijing rep office) and Turkey (the Istanbul rep office). Following the conclusion of an ongoing review of the group's operations in Korea, the client execution activities conducted by the Seoul branch were transferred to group undertakings during 2016.

As part of the group, the bank seeks to be a leading participant in the global financial markets in which it participates.

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 2016 and 2015 refer to the years ended, or the dates, as the context requires, December 31, 2016 and December 31, 2015, 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 15 of this annual report. The bank's profit for the financial year was \$88 million for 2016, a decrease of 39% compared with 2015.

Net interest income was \$83 million for 2016, compared with \$24 million for 2015. 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 \$124 million for 2016, compared with \$257 million for 2015. This decrease reflects stronger performance in the bank's European government bond market-making business during 2015.

Administrative expenses were \$74 million for 2016, compared with \$93 million for 2015. This decrease reflects decreased management fees charged by group undertakings.

Balance Sheet

The balance sheet is set out on page 16 of this annual report.

As of December 2016, total assets were \$42.35 billion, an increase of \$1.42 billion from December 2015, reflecting increases in collateralised agreements with group undertakings of \$5.07 billion and customer accounts receivable of \$1.28 billion, partially offset by a decrease in financial instruments owned of \$5.37 billion. Collateralised agreements with group undertakings increased primarily to cover the settlement requirements in cash instruments sold, but not purchased. Financial instruments owned decreased primarily due to decreases in cash instruments owned and derivative instruments.

As of December 2016, total liabilities were \$39.43 billion, an increase of \$1.31 billion from December 2015, reflecting an increase in customer accounts payable of \$3.89 billion, partially offset by a decrease in 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 decreased primarily due to lower funding requirements in cash instruments owned.

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Other

Following the transfer of the client execution activities conducted by the Seoul branch to group undertakings during 2016, these activities have been presented as a discontinued operation in the profit and loss account. Additionally, the cumulative translation reserve associated with the Seoul branch has been reclassified to the profit and loss account.

Key Metrics

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

\$ in thousands	As of December	
	2016	2015
Lending activities		
Bank loans included in customer accounts receivable	\$ 1,995,039	\$ 1,866,017
Bank loans included in financial instruments owned	53,913	70,065
Total lending activities	\$ 2,048,952	\$ 1,936,082
Deposit-taking activities		
Customer deposits included in customer accounts payable	\$16,600,215	\$13,492,360
Deposits from group undertakings included in customer accounts payable	1,080,998	1,387,190
Included in deposits by banks	1,162,819	1,955,165
Total deposit-taking activities	\$18,844,032	\$16,834,715

The unfunded portion of bank loans held as principal risk was \$5.15 billion and \$3.96 billion as of December 2016 and December 2015, 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. No significant change in the bank's principal business activities is currently expected.

Business Environment

Global

During 2016, real gross domestic product (GDP) growth appeared to slow in advanced economies and appeared mixed in emerging market economies compared with 2015. In advanced economies, growth was lower in the U.S., the Euro area, the U.K. and Japan. In emerging markets, growth slowed in China, while growth remained stable in India and appeared to contract less in Brazil and Russia than in 2015.

Monetary policy divergence continued in 2016, as the U.S. Federal Reserve increased its target interest rate again, while monetary policy remained accommodative in Europe and Japan. In June, a referendum was passed for the U.K. to exit the European Union (Brexit), and in November, the U.S. held its presidential election. The market reaction to the outcomes of both events was generally more positive than expectations. The price of crude oil (WTI) increased by 45% in 2016 and, in the fourth quarter, OPEC members announced an agreement to reduce oil production. In investment banking, industry-wide mergers and acquisitions activity remained strong for 2016, but declined compared with the level of activity in 2015. Industry-wide volumes in equity underwriting declined compared with a strong 2015, while industry-wide debt underwriting volumes increased compared with the prior year.

Europe

In the Euro area, real GDP increased by 1.7% in 2016, compared with an increase of 1.9% in 2015. Growth in consumer spending declined, while growth in fixed investment and government consumption increased. Measures of inflation remained subdued, prompting the European Central Bank (ECB) to announce multiple easing measures in the first quarter, cutting the deposit rate by 10 basis points to (0.40)% and lowering the main refinancing operations rate by 5 basis points to 0.00%, as well as launching a new series of targeted longer-term refinancing operations, increasing the volume of monthly purchases of bonds, and adding investment grade, non-financial corporate bonds to the list of bonds purchased under its asset purchase programme. In December, the ECB announced an extension of its asset purchase programme through at least the end of 2017, although the pace of purchases will be lower. The Euro depreciated by 3% against the U.S. dollar. In the U.K., real GDP increased by 1.8% in 2016, compared with an increase of 2.2% in 2015. Following the passage of the U.K. referendum, the Bank of England announced a monetary easing package comprised of a 25 basis points cut to the official bank rate, £70 billion of asset purchases, and a Term Funding Scheme. The British pound depreciated by 16% against the U.S. dollar during 2016, reaching its lowest level against the U.S. dollar in over 30 years. Yields on 10-year government bonds in the region generally decreased during the year. In equity markets, the FTSE 100 Index, DAX Index, CAC 40 Index and Euro Stoxx 50 Index increased by 14%, 7%, 5% and 1%, respectively, during 2016.

Strategic Report

Principal Risks and Uncertainties

The bank faces a variety of risks and uncertainties that are substantial and inherent in its businesses including market, liquidity, credit, operational, 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 European Union (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 regulatory and tax authorities 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 regulators or private parties challenging the bank's compliance with laws and regulations, it could be fined, 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 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. 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 has resulted in, and may continue to 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 (BRRD), 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.

Regulatory developments, in particular the Markets in Financial Instruments Regulation and the revision of the Markets in Financial Instruments Directive (collectively, MiFID II), the Basel Committee on Banking Supervision's (Basel Committee) final capital framework for strengthening international capital standards (Basel III) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), have significantly altered the regulatory framework within which the bank operates and may adversely affect the bank's competitive position and profitability.

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 legislation (in the form of the fourth E.U. Capital Requirements Directive and E.U. Capital Requirements Regulation, collectively known as "CRD IV") to implement Basel III requirements for the bank. In addition, the E.U. has finalised MiFID II, which is scheduled to become effective in January 2018.

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Additional market reforms also include rules on the recovery and resolution of E.U. institutions, rules on the separation of certain trading activities from deposit-taking, rules on the cross-border provision of services from countries outside the European Economic Area. The implementation of these reforms may 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 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 and the prohibition on proprietary trading and the sponsorship of, or investment in, covered funds by the Volcker Rule may 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 regulations could expose the bank to liability and/or reputational damage. 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, prime brokerage, 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.

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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.

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.

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 transactions may also involve the risk that documentation has not been properly executed, that executed agreements may not be enforceable against the counterparty, or that obligations under such agreements may not be able to be netted against other obligations with such counterparty. In addition, counterparties may claim that such transactions were not appropriate or authorised.

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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 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 and other financial institutions have been 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.

As the bank's client base and geographical reach expand and the volume, speed, frequency and complexity of transactions, especially electronic transactions (as well as the requirements to report such transactions on a real-time basis to clients, regulators and exchanges) increase, developing and maintaining operational systems and infrastructure becomes more challenging, and the risk of systems or human error in connection with such transactions increases, as well as the potential consequences of such errors due to the speed and volume of transactions involved and the potential difficulty associated with discovering such errors quickly enough to limit the resulting consequences.

Financial, accounting, data processing or other operating systems and facilities may fail to operate properly or become disabled as a result of events that are wholly or partially beyond the bank's control, such as a spike in transaction volume, adversely affecting the bank's ability to process these transactions or provide these services. The bank must continuously update these systems to support its operations and growth and to respond to changes in regulations and markets, and invest heavily in systemic controls and training to ensure that such transactions do not violate applicable rules and regulations or, due to errors in processing such transactions, adversely affect markets, clients and counterparties or the bank itself.

Systems enhancements and updates, as well as the requisite training, including in connection with the integration of new businesses, entail significant costs and create risks associated with implementing new systems and integrating them with existing ones.

Notwithstanding the proliferation of technology and technology-based risk and control systems, the bank's businesses ultimately rely on people as their greatest resource, and from time-to-time, mistakes are made that are not always caught immediately by technological processes or by other procedures which are intended to prevent and detect such errors. These can include calculation errors, mistakes in addressing emails, errors in software or model development or implementation, or simple errors in judgement. The bank strives to eliminate such human errors through training, supervision, technology and by duplicate or overlapping processes and controls. Human errors, even if promptly discovered and remediated, can result in material losses and liabilities for the bank.

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.

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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 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.

Cyber Security

The bank's operations rely on the secure processing, storage and transmission of confidential and other information in its computer systems and networks. There have been several recent highly publicised cases involving financial services companies, consumer-based companies and other organisations reporting the unauthorised disclosure of client, customer or other confidential information in recent years, as well as cyber attacks involving the dissemination, theft and destruction of corporate information or other assets, as a result of failure to follow procedures by employees or contractors or as a result of actions by third-parties, including actions by foreign governments. There have also been several highly publicised cases where hackers have requested "ransom" payments in exchange for not disclosing customer information.

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. In addition, due to the interconnectivity with third-party vendors, 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.

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. 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 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 litigation 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.

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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.

Unforeseen or Catastrophic Events

The occurrence of unforeseen or catastrophic events, including the emergence of a pandemic, such as the Ebola or Zika viruses, 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 2016		
	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

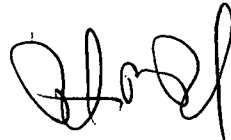
Strategic Report

Leverage Ratio

The bank is required to monitor and disclose its leverage ratio using CRD IV's definition of exposure as amended by the European Commission Leverage Ratio Delegated Act. This leverage ratio compares CRD IV's definition of Tier 1 capital to a measure of leverage exposure, defined as the sum of assets plus certain off-balance-sheet exposures (which include a measure of derivatives exposures, securities financing transactions and commitments), less Tier 1 capital deductions. Any required minimum ratio is expected to become effective for the bank no earlier than January 1, 2018. The bank had a leverage ratio of 15.6% and 12.9% as of December 2016 and December 2015, respectively. This leverage ratio is based on the bank's current interpretation and understanding of this rule and may evolve as its interpretation and application is discussed with the bank's regulators.

Date of Authorisation of Issue

The strategic report was authorised for issue by the Board of Directors on March 28, 2017.



By order of the board
D. W. McDonogh
Director
March 28, 2017

Directors' Report

The directors present their report and the audited financial statements for the year ended December 2016.

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 24 to the financial statements.

Dividends

The directors do not recommend the payment of an ordinary dividend for 2016. No dividends were paid in 2015.

Exchange Rate

The British pound/U.S. dollar exchange rate was £/\$1.2337 and £/\$1.4732 as of December 2016 and December 2015, respectively. The average rate for the year was £/\$1.3439 and £/\$1.5252 for 2016 and 2015, 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**

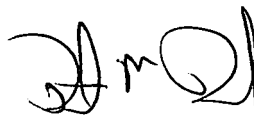
The directors of the bank who served throughout the year and to the date of this report, except where noted, were:

Name	Appointed	Resigned
D.C. M. Bicarregui	December 16, 2016	
E. G. Corrigan		June 17, 2016
Lord Grabiner QC	March 3, 2016	
Lord Griffiths of Fforestfach		
N. Harman	December 16, 2016	
E. H. Leouzon		
D. W. McDonogh		
T. L. Miller OBE		
D. G. J. Paterson		
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 28, 2017.



By order of the board
D. W. McDonogh
Director
March 28, 2017

Independent Auditors' Report to the Members of Goldman Sachs International Bank (unlimited company)

Report on the financial statements

Our opinion

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

- give a true and fair view of the state of the bank's affairs as of December 31, 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements, included within the Annual Report, comprise:

- the Balance Sheet as of December 31, 2016;
- the Profit and Loss Account and the Statements of Comprehensive Income for the year then ended;
- the Statements of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law (United Kingdom Generally Accepted Accounting Practice).

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the bank and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Independent Auditors' Report to the Members of Goldman Sachs International Bank (unlimited company)

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

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 and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the bank's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

Duncan McNab (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT
March 28, 2017

Profit and Loss Account

\$ in thousands	Note	Year Ended December 2016			Year Ended December 2015		
		Continuing operations	Discontinued operations	Total	Continuing operations	Discontinued operations	Total
Interest receivable and similar income	6	\$232,478	\$ 2,167	\$234,645	\$113,729	\$ 851	\$114,580
Interest payable and similar charges	7	(151,145)	(449)	(151,594)	(89,433)	(1,518)	(90,951)
Net interest income/(expense)		81,333	1,718	83,051	24,296	(667)	23,629
Trading profit/(loss)	5	146,038	(21,632)	124,406	227,744	28,984	256,728
Total operating income/(loss)	4	227,371	(19,914)	207,457	252,040	28,317	280,357
Administrative expenses	8	(62,459)	(11,656)	(74,115)	(81,901)	(10,922)	(92,823)
Profit/(loss) on ordinary activities before taxation		164,912	(31,570)	133,342	170,139	17,395	187,534
Tax on profit/(loss) on ordinary activities	12	(48,544)	2,912	(45,632)	(40,517)	(3,609)	(44,126)
Profit/(loss) for the financial year		\$116,368	\$(28,658)	\$ 87,710	\$129,622	\$13,786	\$143,408

Statements of Comprehensive Income

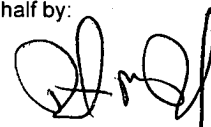
\$ in thousands	Year Ended December	
	2016	2015
Profit for the financial year	\$ 87,710	\$143,408
Other comprehensive income/(loss)		
Items that will not be reclassified subsequently to profit or loss		
Debt valuation adjustment	3,108	–
U.K. deferred tax attributable to components of other comprehensive income/(loss)	(847)	–
Total items that will not be reclassified subsequently to profit or loss	2,261	–
Items that will be reclassified subsequently to profit or loss		
Translation loss	(4,509)	(12,774)
Gain on net investment hedge	2,916	10,467
Reclassification to the profit and loss account	22,906	–
Total items that will be reclassified subsequently to profit or loss	21,313	(2,307)
Other comprehensive income/(loss) for the financial year, net of tax	23,574	(2,307)
Total comprehensive income for the financial year	\$111,284	\$141,101

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

Balance Sheet

\$ in thousands	Note	As of December	
		2016	2015
Assets			
Cash at bank and in hand		\$ 783,184	\$ 289,437
Customer accounts receivable	13	4,027,753	2,748,390
Financial instruments owned (includes \$4,480,088 as of December 2016 and \$7,124,105 as of December 2015, pledged as collateral)	14	6,842,824	12,216,567
Collateralised agreements with group undertakings	15	29,887,562	24,818,466
Tangible fixed assets	16	630	795
Other assets	17	808,194	859,264
Total assets		42,350,147	40,932,919
Liabilities and shareholder's funds			
Customer accounts payable	19	19,410,023	15,515,407
Deposits by banks		1,162,819	1,955,165
Financial instruments sold, but not yet purchased	14	9,116,783	8,822,978
Collateralised financings with group undertakings		7,746,979	9,588,216
Other liabilities	20	1,167,552	1,416,446
Long-term subordinated loans from group undertakings	21	826,000	826,000
Total liabilities		39,430,156	38,124,212
Called up share capital	22	62,558	62,558
Share premium account		2,094,303	2,094,303
Other comprehensive income/(loss)		1,690	(21,884)
Profit and loss account		761,440	673,730
Total shareholder's funds		2,919,991	2,808,707
Total liabilities and shareholder's funds		\$42,350,147	\$40,932,919
Memorandum items			
Financial commitments	23	\$ 6,439,557	\$ 4,846,104
Contingent liabilities	23	\$ 1,384,776	\$ 1,215,544

The financial statements were approved by the Board of Directors on March 28, 2017 and signed on its behalf by:



D. W. McDonogh
Director

Statements of Changes in Equity

<i>\$ in thousands</i>	Year Ended December	
	2016	2015
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
Other comprehensive income/(loss)		
Beginning balance	(21,884)	(19,577)
Other comprehensive income/(loss)	23,574	(2,307)
Ending balance	1,690	(21,884)
Profit and loss account		
Beginning balance	673,730	530,322
Profit for the financial year	87,710	143,408
Share-based payments	(127)	859
Management recharge related to share-based payments	127	(859)
Ending balance	761,440	673,730
Total shareholder's funds	\$2,919,991	\$2,808,707

No dividends were paid in 2016 and 2015.

Notes to the 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.

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, which are required by the E.U. Capital Requirements Regulation. GSG UK's 2016 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, which are required by the Capital Requirements (Country-by-Country Reporting) Regulations 2013. GSG UK's 2016 country-by-country disclosures will be made available by December 31, 2017 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.

Notes to the Financial Statements

Accounting Policies

Revenue Recognition. Total operating income, comprises revenues from market making in European government bonds, client execution activities, 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 charges.

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 on 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 for services rendered to the bank. 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. settles equity awards through the delivery of its ordinary shares. Group Inc. pays cash dividend equivalents on outstanding RSUs. The bank has also entered into a chargeback agreement with Group Inc. under which it is committed to pay to Group Inc. the grant-date fair value as well as subsequent movements in fair value of those awards to Group Inc. at the time of delivery to its employees.

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 on 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. Cash at bank and in hand is highly liquid overnight deposits held in the ordinary course of business.

Notes to the Financial Statements

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.

Net Investment Hedging. Where net investment hedging is employed, all gains and losses on the effective portion of the hedging instrument, together with any gains and losses on the foreign currency translation of the hedge investment, are taken directly to the statements of comprehensive income. Any gains or losses on the ineffective portion are recognised immediately in the profit and loss account. The cumulative gains and losses on the hedging instrument and gains and losses on the translation of the hedged investment are recognised in the profit and loss account only on substantial liquidation of the investment.

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. Financial assets are measured in the balance sheet at fair value and all subsequent gains or losses are recognised in trading profit. 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/(loss), if it does not create or enlarge an accounting mismatch, and the remaining changes in the fair value being recognised in trading profit. See "New Accounting Standards – IFRS 9 'Financial instruments'" below for further information. 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.

Notes to the Financial Statements

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

- Securities purchased under agreements to resell (resale agreements), 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; and
- Certain unsecured debt securities issued, including certain hybrid financial instruments.

Hybrid financial instruments are instruments that contain bifurcable 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 as 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 charges.

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, if trading related, or in administrative expenses if non-trading related.

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 on the balance sheet.

Notes to the Financial Statements

Fair Value Measurement

See Note 25 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 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 on 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 comprises 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/(loss).

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/(loss) 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.

Contingent liabilities and contingent assets are not recognised in the financial statements. However, disclosure is made unless the probability of settlement is remote.

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 November 2016, the E.U. endorsed IFRS 9 'Financial Instruments' (IFRS 9). This standard provides requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items, replacing IAS 39 'Financial Instruments: Recognition and Measurement'. This standard requires that changes in the fair value of financial liabilities attributable to own credit spreads (debt valuation adjustment or DVA) are presented in other comprehensive income/(loss), if it does not create or enlarge an accounting mismatch.

Notes to the Financial Statements

This standard is effective for the bank in January 2018, with early application being permitted either in its entirety or only in relation to the presentation of DVA. The bank has early adopted only the requirements related to the presentation of DVA effective from January 2016.

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 25 for information about the carrying value, valuation techniques and significant inputs of these instruments.

Provision for Impairment of Bank Loans Held at Amortised Cost

The provision for impairment of bank loans held at amortised cost (see Note 20) 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.

\$ in thousands	Year Ended December	
	2016	2015
Investment Banking	\$ 16,448	\$ 7,712
Institutional Client Services	164,422	259,770
Investing & Lending	21,679	6,122
Investment Management	4,908	6,753
Total operating income	\$207,457	\$280,357

In the table above, Institutional Client Services includes a loss of \$20 million and an income of \$28 million for 2016 and 2015, respectively, relating to discontinued operations.

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

Investment Banking

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

Institutional Client Services

Comprises client execution activities related to making markets in European government bonds, interest rate products and currencies, secondary dealing in bank loans and securities lending.

Investing & Lending

Comprises lending activities which are typically longer-term in nature.

Investment Management

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

Substantially all of the bank's administrative expenses and assets are attributable to Institutional Client Services.

Notes to the Financial Statements

The bank operates in two geographically distinct regions, EMEA, the location of the head office, the Frankfurt branch and the Istanbul rep office; and Asia, the location of the Seoul branch and the Beijing rep office. The table below categorises the bank's total operating income into geographic segments. Geographic results have been allocated between EMEA and Asia based on the location of the business.

\$ in thousands	Year Ended December	
	2016	2015
Europe, Middle East and Africa	\$227,390	\$252,043
Asia	(19,933)	28,314
Total operating income	\$207,457	\$280,357

The Seoul branch had total assets of \$406 million (₩489.27 billion) and \$3.52 billion (₩4,130.29 billion) as of December 2016 and December 2015, respectively.

The Frankfurt branch had total assets of \$94 million (€89 million) and \$100 million (€92 million) as of December 2016 and December 2015, respectively.

Note 5.

Trading Profit

Trading profit includes trading interest income of \$133 million and \$171 million for 2016 and 2015, respectively, and trading interest expense of \$123 million and \$146 million for 2016 and 2015, 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.

Note 6.

Interest Receivable and Similar Income

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

\$ in thousands	Year Ended December	
	2016	2015
Interest on loans to banks and customers	\$ 55,776	\$ 23,101
Interest on collateralised agreements with group undertakings	138,344	73,321
Interest on loans to group undertakings	40,525	18,158
Total interest receivable and similar income	\$234,645	\$114,580

Note 7.

Interest Payable and Similar Charges

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

\$ in thousands	Year Ended December	
	2016	2015
Interest on loans from banks and customers	\$ 98,726	\$50,142
Interest on long-term subordinated loans from group undertakings (see Note 21)	31,840	26,211
Interest on loans from group undertakings	12,544	14,598
Negative interest on collateralised agreements with group undertakings	8,484	—
Total interest payable and similar charges	\$151,594	\$90,951

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

Notes to the Financial Statements**Note 8.****Administrative Expenses**

The table below presents the bank's administrative expenses.

\$ in thousands	Year Ended December	
	2016	2015
Management fees charged by group undertakings	\$53,543	\$70,978
Direct costs of employment	9,631	8,635
Brokerage, clearing and exchange fees	5,398	6,945
Market development	92	301
Communications and technology	481	498
Depreciation of tangible fixed assets	178	165
Occupancy	919	963
Professional fees	1,158	1,706
Other expenses	2,715	2,632
Total administrative expenses	\$74,115	\$92,823

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.
- Professional fees include fees payable to the bank's auditors for the audit of the bank's annual financial statements of \$282,000 and \$369,000 for 2016 and 2015, respectively.

Note 9.**Directors' Emoluments**

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

\$ in thousands	Year Ended December	
	2016	2015
Aggregate emoluments	\$968	\$772
Company pension contributions to money purchase schemes	2	2
Total directors' emoluments	\$970	\$774

The table below presents emoluments for the highest paid director.

\$ in thousands	Year Ended December	
	2016	2015
Aggregate emoluments	\$263	\$372
Company pension contributions to money purchase schemes	2	1
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, six directors were members of a defined contribution scheme and five directors were members of a defined benefit scheme; six 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; and two directors have exercised options during the year.

Notes to the Financial Statements**Note 10.****Staff Costs**

All persons involved in the bank's operations, other than the Seoul branch and representative offices, 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.

Number	Average for the Year Ended December	
	2016	2015
Employees		
Investment Banking	1	2
Institutional Client Services	6	6
Support Functions	18	23
Total average number of staff	25	31

Total headcount was 16 and 31 as of December 2016 and December 2015, respectively.

Additionally, 31 persons, who were employed by group undertakings were assigned or seconded to the bank through employee arrangements as of both December 2016 and December 2015.

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.

\$ in thousands	Year Ended December	
	2016	2015
Aggregate gross wages and salaries	\$9,214	\$7,740
Employer's National Insurance Contributions	14	394
Pension costs, employer contributions to defined contribution plan	403	501
Total direct costs of employment	\$9,631	\$8,635

In the table above, total direct costs of employment include a charge of \$11,000 and \$155,000 for 2016 and 2015, 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 and incentive stock options.

The Seoul branch and representative offices recorded share-based compensation in respect of the amortisation of granted equity awards, net of forfeitures, of \$127,000 (credit) and \$859,000 (charge) for 2016 and 2015, respectively. The corresponding credit 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 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 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 as outlined in the applicable RSU agreements. Employee RSU 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.

Notes to the Financial Statements**Note 12.****Tax on Profit on Ordinary Activities**

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

\$ in thousands	Year Ended December	
	2016	2015
Current tax		
U.K. corporation tax	\$35,231	\$33,953
Adjustments in respect of prior periods	(528)	944
Overseas taxation	4,967	176
Total current tax	39,670	35,073
Deferred tax		
Origination and reversal of temporary differences	4,009	4,462
Effect of decreased U.K. corporate tax rates	1,953	4,591
Total deferred tax	5,962	9,053
Total tax on profit on ordinary activities	\$45,632	\$44,126

In September 2016, a budget was enacted that will reduce the U.K. corporate tax rate by 1 percentage point effective April 1, 2020. This resulted in the bank recognising a \$2 million expense relating to the revaluation of its deferred tax asset.

The table below presents a reconciliation between tax on profit on ordinary activities and the amount calculated by applying the weighted average rate of U.K. corporation tax applicable to the bank for the year of 28.0% (2015: 20.25%) to the profit on ordinary activities before tax.

\$ in thousands	Year Ended December	
	2016	2015
Profit on ordinary activities before taxation	\$133,342	\$187,534
Profit on ordinary activities multiplied by U.K. corporate tax rate of 28.0% (2015: 20.25%)	37,336	37,976
Changes in recognition and measurement of deferred tax assets	63	440
Permanent differences	6,457	35
Exchange differences and other	351	140
Adjustments in respect of prior periods	(528)	944
Effect of decreased U.K. corporate tax rates	1,953	4,591
Total tax on profit on ordinary activities	\$ 45,632	\$ 44,126

Note 13.**Customer Accounts Receivable**

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

\$ in thousands	As of December	
	2016	2015
Bank loans	\$1,995,039	\$1,866,017
Amounts due from customers	97,325	317,269
Amounts due from group undertakings	1,935,389	565,104
Total customer accounts receivable	\$4,027,753	\$2,748,390

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

\$ in thousands	As of December	
	2016	2015
Less than three months	\$2,032,719	\$ 882,373
Between three months and one year	235,826	557,946
Between one and five years	427,262	266,648
Over five years	1,331,946	1,041,423
Total customer accounts receivable	\$4,027,753	\$2,748,390

Notes to the Financial Statements**Note 14.****Financial Instruments Owned and Financial Instruments Sold, But Not Yet Purchased**

Financial instruments owned and financial instruments sold, but not yet purchased comprise financial instruments and investments within the operating activities of the bank. Financial instruments owned includes financial instruments owned pledged as collateral. See Note 25 for further information.

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

\$ in thousands	As of December	
	2016	2015
Cash Instruments		
Government bonds	\$4,933,711	\$ 7,664,493
Bank loans	53,913	70,065
Total cash instruments	4,987,624	7,734,558
Derivative Instruments		
Interest rates	1,739,000	3,821,704
Currencies	75,753	639,287
Equities	37,497	18,840
Commodities	2,149	—
Credit	801	2,178
Total derivative instruments	1,855,200	4,482,009
Total financial instruments owned	\$6,842,824	\$12,216,567

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

\$ in thousands	As of December	
	2016	2015
Cash Instruments		
Government bonds	\$7,284,063	\$4,437,463
Bank loans	1,534	2,031
Total cash instruments	7,285,597	4,439,494
Derivative Instruments		
Interest rates	1,701,377	3,684,514
Currencies	67,662	672,655
Equities	37,497	18,840
Commodities	2,149	—
Credit	22,501	7,475
Total derivative instruments	1,831,186	4,383,484
Total financial instruments sold, but not yet purchased	\$9,116,783	\$8,822,978

Note 15.**Collateralised Agreements With Group Undertakings**

The table below presents the bank's collateralised agreements with group undertakings. All collateralised agreements with group undertakings are due within one year of the balance sheet date, unless noted below.

\$ in thousands	As of December	
	2016	2015
Resale agreements	\$29,887,562	\$24,818,466
Total collateralised agreements with group undertakings	\$29,887,562	\$24,818,466

In the table above, resale agreements includes balances due in more than one year of \$322 million and \$118 million as of December 2016 and December 2015, 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	\$1,627	\$2,199	\$3,826
Additions	27	3	30
Disposals	(3)	(689)	(692)
Translation loss	(39)	(48)	(87)
As of December 31	1,612	1,465	3,077
Accumulated depreciation			
As of January 1	978	2,053	3,031
Charge for the year (see Note 8)	104	74	178
Disposals	—	(689)	(689)
Translation gain	(27)	(46)	(73)
As of December 31	1,055	1,392	2,447
Net book value			
As of December 2016	\$ 557	\$ 73	\$ 630
As of December 2015	\$ 649	\$ 146	\$ 795

Notes to the Financial Statements**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.

\$ in thousands	As of December	
	2016	2015
Other amounts due from group undertakings	\$745,066	\$789,261
Deferred tax (see Note 18)	49,442	56,271
Other assets	13,686	13,732
Total other assets	\$808,194	\$859,264

In the table above:

- Other amounts due from group undertakings includes balances due in more than one year of \$304 million and \$nil as of December 2016 and December 2015, respectively.
- Total other assets includes financial assets of \$755 million and \$798 million as of December 2016 and December 2015, respectively, and non-financial assets of \$54 million and \$61 million as of December 2016 and December 2015, respectively.

Note 18.**Deferred Tax**

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

\$ in thousands	As of December	
	2016	2015
Unused tax losses	\$50,155	\$55,977
Debt valuation adjustment	(847)	–
Other temporary differences	134	294
Total deferred tax	\$49,442	\$56,271

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

\$ in thousands	As of December	
	2016	2015
Unused tax losses		
As of January 1	\$55,977	\$64,775
Transfer to the profit and loss account	(5,822)	(8,798)
As of December 31	\$50,155	\$55,977

Debt valuation adjustment		
As of January 1	\$ –	\$ –
Transfer to other comprehensive income/ (loss)	(847)	–
As of December 31	\$ (847)	\$ –

Other temporary differences		
As of January 1	\$ 294	\$ 507
Transfer to the profit and loss account	(140)	(255)
Translation (loss)/gain	(20)	42
As of December 31	\$ 134	\$ 294

Total		
As of January 1	\$56,271	\$65,282
Transfer to the profit and loss account (see Note 12)	(5,962)	(9,053)
Transfer to other comprehensive income/ (loss)	(847)	–
Translation (loss)/gain	(20)	42
As of December 31	\$49,442	\$56,271

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.

Notes to the Financial Statements**Note 19.****Customer Accounts Payable**

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

<i>\$ in thousands</i>	As of December	
	2016	2015
Customer deposits	\$16,600,215	\$13,492,360
Amounts due to customers	224,807	322,026
Deposits from group undertakings	1,080,998	1,387,190
Amounts due to group undertakings	1,504,003	313,831
Total customer accounts payable	\$19,410,023	\$15,515,407

Debt Valuation Adjustment

The fair value of customer deposits that are designated at fair value through profit or loss are calculated 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 gain of \$3 million for 2016 and has been included in "Debt valuation adjustment" in the statements of comprehensive income.

Note 20.**Other Liabilities**

The table below presents the bank's other liabilities.

<i>\$ in thousands</i>	As of December	
	2016	2015
Accruals and deferred income	\$ 36,625	\$ 21,857
Other amounts due to group undertakings	1,119,299	1,380,087
Other liabilities	11,628	14,502
Total other liabilities	\$1,167,552	\$1,416,446

In the table above:

- Other amounts due to group undertakings includes group relief payable of \$306,000 and \$5 million as of December 2016 and December 2015, respectively.
- Other liabilities includes a provision for impairment in respect of unfunded bank loans held at amortised cost of \$8 million and \$6 million as of December 2016 and December 2015, respectively.
- Total other liabilities includes financial liabilities of \$1.14 billion and \$1.40 billion as of December 2016 and December 2015, respectively, and non-financial assets of \$30 million and \$16 million as of December 2016 and December 2015, respectively.

Note 21.**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 22.**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, 2016	40,169,994	\$62,558
As of December 31, 2016	40,169,994	\$62,558

Notes to the Financial Statements**Note 23.****Financial Commitments and Contingencies****Financial Commitments**

The table below presents the bank's financial commitments.

\$ in thousands	As of December	
	2016	2015
Principal risk	\$5,154,200	\$3,957,873
Sub-participated	1,248,775	822,157
Unfunded bank loans	6,402,975	4,780,030
Forward starting resale agreements	26,506	65,000
Leases	156	1,074
Other	9,920	—
Total financial commitments	\$6,439,557	\$4,846,104

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 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.

\$ in thousands	As of December	
	2016	2015
Less than one year	\$121	\$ 524
Between one and five years	35	550
Over five years	—	—
Total leases	\$156	\$1,074

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 \$1.38 billion and \$1.22 billion as of December 2016 and December 2015, respectively. The market value of the collateral held to cover the loss was \$1.52 billion and \$1.36 billion as of December 2016 and December 2015, respectively. These guarantees are covered by back-to-back guarantees with the bank's ultimate parent company, Group Inc.

Notes to the Financial Statements**Note 24.****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 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.

\$ in thousands	As of December	
	2016	2015
Called up share capital	\$ 62,558	\$ 62,558
Share premium account	2,094,303	2,094,303
Retained earnings	763,130	651,846
Total shareholder's funds	2,919,991	2,808,707
Deductions	(238,674)	(154,771)
Common Equity Tier 1 and Tier 1 capital	\$2,681,317	\$2,653,936
Tier 2 and Total capital		
Long-term subordinated loans from group undertakings	\$ 826,000	\$ 826,000
Deductions	(115,000)	(150,000)
Tier 2 capital	711,000	676,000
Total capital	\$3,392,317	\$3,329,936

During 2016 and 2015, 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 long-dated and diversified external funding profile, 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.

Notes to the Financial Statements

Liquidity Coverage Ratio

The liquidity coverage ratio (LCR) is designed to ensure that the entity maintains an adequate level of unencumbered high-quality liquid assets based on expected net cash outflows under an acute short-term liquidity stress scenario. The LCR rule issued by the European Commission became effective on October 1, 2015. The PRA set out a phase-in period whereby certain financial institutions, including the bank, must have an 80% minimum ratio initially, increasing to 90% on January 1, 2017 and 100% on January 1, 2018.

Market Risk Management

Overview

Market risk is the risk of loss in the value of the bank's financial instruments owned and financial instruments sold, but not yet purchased (i.e., 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. The bank holds inventory primarily for market-making for clients. The bank's inventory therefore changes based on client demands. The bank's inventory is accounted for at fair value and therefore fluctuates on a daily basis, with the related gains and losses included in trading profit. 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, mortgage 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 and currency rates. 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.

\$ in millions	December	
	2016	2015
Average daily VaR for the year ended	\$3.0	\$3.2
Period-end VaR as of	2.9	2.2
High VaR for the year ended	7.2	13.5
Low VaR for the year ended	1.5	1.2

Notes to the Financial Statements

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 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.

Notes to the Financial Statements

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 on 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 26 to the financial statements as the below disclosure includes additional cash collateral that management considers when determining credit risk.

Notes to the Financial Statements

<i>\$ in thousands</i>	Gross exposure	Assets captured by market risk	Counterparty netting	Cash collateral	Security Collateral received	Net credit exposure
Financial Asset Class						
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

As of December 2015						
Cash at bank and in hand	\$ 289,437	\$ –	\$ –	\$ –	\$ –	\$ 289,437
Customer accounts receivable	2,748,390	–	–	(419,672)	(1,136,352)	1,192,366
Financial instruments owned	12,216,567	(7,664,493)	(3,930,312)	(406,813)	(34,031)	180,918
Collateralised agreements with group undertakings	24,818,466	–	(9,588,216)	–	(15,230,250)	–
Other assets	798,079	–	–	–	–	798,079
Total	\$40,870,939	\$(7,664,493)	\$(13,518,528)	\$(826,485)	\$(16,400,633)	\$2,460,800

<i>\$ in thousands</i>	Gross exposure	Assets captured by market risk	Counterparty netting	Cash collateral	Security Collateral received	Net credit exposure
Credit Rating Equivalent						
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

As of December 2015						
AAA/Aaa	\$ 135,935	\$ –	\$ –	\$ –	\$ –	\$ 135,935
AA/Aa2	321,370	–	(74,169)	(15,120)	–	232,081
A/A2	30,632,042	–	(13,376,487)	(787,869)	(15,230,250)	1,237,436
BBB/Baa2	1,028,614	–	(64,168)	(21,287)	(718,005)	225,154
BB/Ba2 or lower	1,057,693	–	(3,704)	(2,209)	(451,306)	600,474
Unrated	7,695,285	(7,664,493)	–	–	(1,072)	29,720
Total	\$40,870,939	\$(7,664,493)	\$(13,518,528)	\$(826,485)	\$(16,400,633)	\$2,460,800

The unrated net credit exposure of \$23 million and \$30 million as of December 2016 and December 2015, respectively, relates to financial assets for which the bank has not assigned an internally determined public rating agency equivalent.

In addition to credit risk on financial assets, the bank also has credit exposure in respect of contingent and forward starting resale agreements. The bank's gross credit exposure related to these activities is \$27 million and \$65 million as of December 2016 and December 2015, respectively. However, this will be fully mitigated by collateral if these commitments are fulfilled. As a result, the bank did not have net credit exposure to these commitments.

As of December 2016 and December 2015, financial assets past due or impaired were not material.

Notes to the Financial Statements

Note 25.

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.

\$ in thousands	Financial Assets			
	Held for trading	Designated at fair value	Loans and receivables	Total
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

As of December 2015				
Cash at bank and in hand	\$ –	\$ –	\$ 289,437	\$ 289,437
Customer accounts receivable	–	273,835	2,474,555	2,748,390
Financial instruments owned	12,216,567	–	–	12,216,567
Collateralised agreements with group undertakings	–	24,818,466	–	24,818,466
Other assets	–	–	798,079	798,079
Total financial assets	\$12,216,567	\$25,092,301	\$3,562,071	\$40,870,939

\$ in thousands	Financial Liabilities			
	Held for trading	Designated at fair value	Amortised cost	Total
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

As of December 2015				
Customer accounts payable	\$ –	\$ 6,862,234	\$ 8,653,173	\$15,515,407
Deposits by banks	–	1,955,165	–	1,955,165
Financial instruments sold, but not yet purchased	8,822,978	–	–	8,822,978
Collateralised financings with group undertakings	–	9,588,216	–	9,588,216
Other liabilities	–	839,983	559,981	1,399,964
Long-term subordinated loans from group undertakings	–	–	826,000	826,000
Total financial liabilities	\$8,822,978	\$19,245,598	\$10,039,154	\$38,107,730

In the table above, certain of the bank's intercompany unsecured borrowings that have been designated at fair value were previously disclosed as measured at amortised cost. As of December 2015, \$784 million of other liabilities have been moved from amortised cost to designated at fair value to more appropriately present these balances. These financial instruments have been presented in level 2 in the fair value hierarchy. See "Fair Value of Financial Assets and Financial Liabilities by Level" below.

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 fair value 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 fair value 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 GS Group's credit quality, funding risk, transfer restrictions, liquidity and bid/offer spreads. Valuation adjustments are generally based on market evidence.

Notes to the Financial Statements

Valuation Techniques and Significant Inputs

Cash Instruments. Cash instruments include government bonds and bank loans. 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.** 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, 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.

Notes to the Financial Statements

- **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.

Notes to the Financial Statements

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 comprises certain bank loans. The significant inputs to the valuation of bank loans 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 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 comprise 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.

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 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

Financial Assets and Financial Liabilities at Fair Value as of December 2015				
\$ in thousands	Level 1	Level 2	Level 3	Total
Financial Assets				
Customer accounts receivable	\$ –	\$ 113,377	\$160,458	\$ 273,835
Cash instruments	7,482,228	240,150	12,180	7,734,558
Derivative instruments	400	4,472,546	9,063	4,482,009
Financial instruments owned	7,482,628	4,712,696	21,243	12,216,567
Collateralised agreements with group undertakings	–	24,818,466	–	24,818,466
Total financial assets	\$7,482,628	\$29,644,539	\$181,701	\$37,308,868
Financial Liabilities				
Customer accounts payable	\$ –	\$ 6,862,234	\$ –	\$ 6,862,234
Deposits by banks	–	1,955,165	–	1,955,165
Cash instruments	4,327,931	109,661	1,902	4,439,494
Derivative instruments	402	4,373,910	9,172	4,383,484
Financial instruments sold, but not yet purchased	4,328,333	4,483,571	11,074	8,822,978
Collateralised financings with group undertakings	–	9,588,216	–	9,588,216
Other liabilities	–	839,983	–	839,983
Total financial liabilities	\$4,328,333	\$23,729,169	\$ 11,074	\$28,068,576
Net derivative instruments	\$ (2)	\$ 98,636	\$ (109)	\$ 98,525

In the table above, as of December 2015, level 2 other liabilities have been increased by \$784 million. See “Financial Assets and Financial Liabilities by Category” above for further details.

Notes to the Financial Statements

Significant Unobservable Inputs Used in Level 3 Fair Value Measurements

As of December 2016 and December 2015, the bank had level 3 bank loan assets of \$168 million (comprising customer accounts receivable of \$158 million and cash instruments of \$9 million) and \$173 million (comprising customer accounts receivable of \$160 million and cash instruments of \$12 million), respectively. Level 3 cash instrument liabilities and derivatives were not material. The table below presents the amount of level 3 bank loan assets, and ranges and weighted averages of significant unobservable inputs used to value the bank's level 3 bank loan assets.

\$ in thousands	Level 3 Bank Loan Assets and Range of Significant Unobservable Inputs (Weighted Average) as of	
	December 2016	December 2015
Bank loans	\$167,557	\$172,638
Yield	1.3% to 11.0% (4.5%)	1.4% to 7.8% (5.2%)
Recovery rate	40.0% to 85.0% (50.5%)	20.0% to 85.0% (50.6%)
Duration (years)	1.0 to 4.8 (2.5)	0.9 to 4.9 (3.4)

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.
- 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. For example, the highest yield for bank loans is appropriate for valuing a specific loan but may not be appropriate for valuing any other loan. 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.
- Increases in yield or duration used in the valuation of the bank's level 3 bank loans would result in a lower fair value measurement, while increases in recovery rate would result in a higher fair value measurement.
- 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 2016 and 2015, there were no significant transfers between level 1 and level 2 financial assets and financial liabilities measured at fair value on a recurring basis.

Notes to the Financial Statements

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 in the table below 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 below 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							
	Balance, beginning of year	Gains/ (losses)	Purchases	Sales	Settlements	Transfers into level 3	Transfers out of level 3	Balance, end of year
\$ in thousands								
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)
Year Ended December 2015								
Customer accounts receivable	\$ –	\$(4,513)	\$162,453	\$ –	\$ (557)	\$ 3,075	\$ –	\$160,458
Financial instruments owned	99,973	8,666	3,140	(19,198)	(85,962)	20,677	(6,053)	21,243
Total level 3 financial assets	\$ 99,973	\$ 4,153	\$165,593	\$(19,198)	\$(86,519)	\$23,752	\$(6,053)	\$181,701
Financial instruments sold, but not yet purchased	\$(20,124)	\$(5,806)	\$ 3,749	\$ (187)	\$ 11,289	\$ –	\$ 5	\$(11,074)
Total level 3 financial liabilities	\$(20,124)	\$(5,806)	\$ 3,749	\$ (187)	\$ 11,289	\$ –	\$ 5	\$(11,074)

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

During 2016 and 2015, 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 2016 and December 2015.

Notes to the Financial Statements

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

As of December 2016 and December 2015, the bank had \$5.41 billion and \$3.56 billion, respectively, of financial assets and \$13.29 billion and \$10.04 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 with the exception of a liability which would be recognised in respect of unfunded bank loans held at amortised cost of \$98 million and \$105 million as of December 2016 and December 2015, respectively. 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						
	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
<i>\$ in thousands</i>							
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
As of December 2015							
Customer accounts payable	\$ 6,513,419	\$ 2,797,736	\$ 2,077,719	\$3,886,832	\$ 132,909	\$ 118,755	\$15,527,370
Deposits by banks	–	416,787	923,790	614,588	–	–	1,955,165
Financial instruments sold, but not yet purchased	8,822,978	–	–	–	–	–	8,822,978
Collateralised financings with group undertakings	–	9,915	9,578,301	–	–	–	9,588,216
Other liabilities	–	559,981	–	–	839,983	–	1,399,964
Long-term subordinated loans from group undertakings	–	–	4,860	–	116,631	987,047	1,108,538
Total – on-balance-sheet	15,336,397	3,784,419	12,584,670	4,501,420	1,089,523	1,105,802	38,402,231
Total – off-balance-sheet	–	4,845,030	–	524	550	–	4,846,104
Total financial liabilities	\$15,336,397	\$ 8,629,449	\$12,584,670	\$4,501,944	\$1,090,073	\$1,105,802	\$43,248,335

Following further review of the contractual terms associated with balances in the table above, long-term subordinated loans from group undertakings due in more than one year but less than five years have decreased by \$841 million as of December 2015 and long-term subordinated loans from group undertakings due in greater than five years have increased by \$987 million as of December 2015 to more appropriately present these balances.

Notes to the Financial Statements

Collateral Received and Pledged

The bank receives financial instruments (e.g., government and agency obligations, corporate debt securities, equities and convertible debentures) as collateral, primarily in connection with resale agreements 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 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 financial instruments received as collateral that were available to be delivered, or repledged and were delivered or repledged by the bank.

\$ in thousands	As of December	
	2016	2015
Collateral available to be delivered or repledged	\$28,350,373	\$23,817,889
Collateral that was delivered or repledged	8,951,995	6,332,290

The table below presents information about assets pledged.

\$ in thousands	As of December	
	2016	2015
Financial instruments owned pledged to counterparties that:		
Had the right to deliver or repledge	\$4,480,088	\$7,124,105
Did not have the right to deliver or repledge	–	–

The bank has received cash collateral in respect of financial instruments owned of \$206 million and \$410 million as of December 2016 and December 2015, respectively, and posted cash collateral in respect of financial instruments sold, but not yet purchased of \$201 million and \$431 million as of December 2016 and December 2015, respectively.

Hedge Accounting

Fair Value Hedges. The bank designates certain interest rate swaps as fair value hedges. These interest rate swaps hedge changes in fair value attributable to the relevant benchmark interest rate (e.g., London Interbank Offered Rate (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 total operating income. 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.

\$ in thousands	Year Ended December	
	2016	2015
Interest rate hedges	\$ 1,715	\$ 22
Hedge customer deposits	(1,728)	(35)
Hedge ineffectiveness	\$ (13)	\$(13)

The table below presents the fair value of asset and liability derivative instruments designated as hedges.

\$ in thousands	As of December 2016		As of December 2015	
	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
Total	\$4,886	\$765	\$1,916	\$56

Notes to the Financial Statements

Net Investment Hedging. The bank seeks to reduce the impact of fluctuations in foreign exchange rates on its foreign operations through the use of foreign currency forward contracts. For foreign currency forward contracts designated as hedges, the effectiveness of the hedge is assessed based on the overall changes in the fair value of the forward contracts (i.e., based on changes in forward rates).

For qualifying net investment hedges, the gains or losses on the hedging instruments, to the extent effective, are included in the statements of comprehensive income.

The table below presents the fair value of asset and liability derivative instruments designated as hedges.

\$ in thousands	As of December 2016		As of December 2015	
	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
Total	\$ –	\$ –	\$7,940	\$148

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 ‘Financial Instruments: Recognition and Measurement’, and as a result of which the bank continues to recognise these assets in full on 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”.

The table below presents financial assets which have been transferred but which remain on balance sheet for accounting purposes. The carrying amount of the associated financial liabilities generally approximate the carrying amount of the assets transferred.

\$ in thousands	As of December	
	2016	2015
Government bonds	\$4,480,088	\$7,124,105
Total	\$4,480,088	\$7,124,105

Notes to the Financial Statements

Note 26.

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:

- Gross amounts exclude the effects of both counterparty netting and collateral, and therefore are not representative of the bank's economic exposure.
- 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 include derivative assets and derivative liabilities of \$1 million and \$9 million, respectively, as of December 2016, and derivative assets and derivative liabilities of \$80 million and \$32 million, respectively, as of December 2015, 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 2016 and December 2015.

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

Notes to the Financial Statements

As of December 2015

As of December 2018							
				Amounts not offset in the balance sheet			
	Gross amounts	Amounts offset in the balance sheet	Net amount presented in the balance sheet	Counterparty netting	Cash collateral	Security collateral	Net amount
\$ in thousands							
Financial Assets							
Customer accounts receivable	\$ 1,561,986	\$ –	\$ 1,561,986	\$ –	\$(363,955)	\$(1,136,352)	\$ 61,679
Financial instruments owned	4,482,009	–	4,482,009	(3,930,312)	(362,601)	(34,031)	155,065
Collateralised agreements with group undertakings	24,841,429	(22,963)	24,818,466	(9,588,216)	–	(15,230,250)	–
Financial assets subject to enforceable netting agreements	30,885,424	(22,963)	30,862,461	(13,518,528)	(726,556)	(16,400,633)	216,744
Financial assets not subject to enforceable netting agreements	10,008,478	–	10,008,478	–	–	–	10,008,478
Total financial assets	\$40,893,902	\$(22,963)	\$40,870,939	\$(13,518,528)	\$(726,556)	\$(16,400,633)	\$10,225,222
Financial Liabilities							
Customer accounts payable	\$ 394,782	\$ –	\$ 394,782	\$ –	\$(362,601)	\$ –	\$ 32,181
Financial instruments sold, but not yet purchased	4,383,484	–	4,383,484	(3,930,312)	(363,955)	–	89,217
Collateralised financings with group undertakings	9,611,179	(22,963)	9,588,216	(9,588,216)	–	–	–
Other liabilities	55,659	–	55,659	–	–	–	55,659
Financial liabilities subject to enforceable netting agreements	14,445,104	(22,963)	14,422,141	(13,518,528)	(726,556)	–	177,057
Financial liabilities not subject to enforceable netting agreements	23,685,589	–	23,685,589	–	–	–	23,685,589
Total financial liabilities	\$38,130,693	\$(22,963)	\$38,107,730	\$(13,518,528)	\$(726,556)	\$ –	\$23,862,646