ANNUAL REPORT AND ACCOUNTS 2009

CREATING THE UK'S BEST FINANCIAL SERVICES PROVIDER

CONTENTS

PRESENTATION OF INFORMATION

In order to provide more meaningful and relevant comparatives, the results of the Group and divisions are presented on a 'combined businesses' basis. The key principles adopted in the preparation of the combined businesses basis of reporting are described below.

In order to reflect the impact of the acquisition, the following adjustments have been made:

- the 2008 results include the results of HBOS as if it had been acquired on 1 January 2008;
- the 2009 results assume HBOS had been owned throughout the year;
- the unwind of acquisition-related fair value adjustments is shown as one line in the 2009 combined businesses income statement and has not been back-dated to 2008; and
- the gain on acquisition of HBOS and amortisation of purchased intangible assets have been excluded.

In order to better present the underlying business performance the following items, not related to the acquisition, have also been excluded:

- the results of BankWest and St. Andrews which were sold in December 2008 and the related loss on disposal;
- insurance and policyholder interests volatility;
- integration costs;
- goodwill impairment; and
- Government Asset Protection Scheme (GAPS) fee.

The combined businesses balance sheet as at 31 December 2008 aggregates the Lloyds TSB Group and the HBOS Group balance sheets as at 31 December 2008, adjusted for the subsequent recapitalisation in January 2009 and reflects the fair value adjustments applied to the HBOS balance sheet at 16 January 2009.

FORWARD LOOKING STATEMENTS

This annual report includes certain forward looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995 with respect to the business, strategy and plans of Lloyds Banking Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds Banking Group's or its directors and/or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future.

Examples of such forward looking statements include, but are not limited to, projections or expectations of the Group's future financial position including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, expenditures or any other financial items or ratios; statements of plans, objectives or goals of Lloyds Banking Group or its management including in respect of the integration of HBOS and the achievement of certain synergy targets; statements about the future business and economic environments in the United Kingdom (UK) and elsewhere including future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments and any impact on the Group; statements about strategic goals, competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements.

Factors that could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by Lloyds Banking Group or on Lloyds Banking Group's behalf include, but are not limited to, general economic conditions in the UK and internationally; inflation, deflation, interest rates, policies of the Bank of England and other G8 central banks, exchange rate, market and monetary fluctuations; changing demographic developments including mortality and changing customer behaviour including consumer spending, saving and borrowing habits, borrower credit quality, technological changes, natural and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, taxation, Government policies or accounting standards or practices and similar contingencies outside Lloyds Banking Group's control; the ability to derive cost savings and other benefits as well as mitigate exposures from the acquisition and integration of HBOS; inadequate or failed internal or external processes, people and systems; exposure to regulatory scrutiny, legal proceedings or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the ability to secure new customers and develop more business from existing customers; the degree of borrower credit quality; the ability to achieve value-creating mergers and/or acquisitions at the appropriate time and prices and the success of Lloyds Banking Group in managing the risks of the foregoing.

Lloyds Banking Group may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds Banking Group annual reviews, half-year announcements, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward looking statements contained in this annual report are made as of the date hereof, and Lloyds Banking Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this annual report to reflect any change in Lloyds Banking Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

OVERVIEW

BUSINESS REVIEW

GOVERNANCE

FINANCIAL STATEMENTS

SHAREHOLDER INFORMATION

VIEW OUR ANNUAL REPORT ONLINE…

A full version of our Annual Report and Accounts and information relating to Lloyds Banking Group is available at **lloydsbankinggroup.com**

GROUP PROFILE

OUR VISION IS TO BE RECOGNISED AS THE BEST FINANCIAL SERVICES COMPANY IN THE UK BY SHAREHOLDERS, CUSTOMERS AND COLLEAGUES

OUR GROUP

Lloyds Banking Group is a leading UK based financial services group providing a wide range of banking and financial services, primarily in the UK, to personal and corporate customers.

Lloyds Banking Group was formed in January 2009 following the acquisition of HBOS and our main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision. The new Group also operates an international banking business with a global footprint in over 30 countries.

The Group is the UK's largest retail bank and has a large and diversified customer base. Services are offered through a number of well recognised brands including Lloyds TSB, Halifax, Bank of Scotland, Scottish Widows, Clerical Medical and Cheltenham & Gloucester, and via a unique distribution capability comprising the largest branch network in the UK and intermediary channels.

Lloyds Banking Group is quoted on both the London Stock Exchange and the New York Stock Exchange and is one of the largest companies within the FTSE 100.

GROUP STRATEGY

A detailed description of the corporate strategy which supports our vision. We aim to understand our customers and meet their needs, while building a high performance, efficient organisation that encourages and develops its staff.

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DIVISIONAL OVERVIEW

Details of our four primary operating divisions, the key product markets in which they participate and their contribution to the Group's total income.

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GROUP PERFORMANCE

2009 at a glance: key highlights of the year together with a summary of group results and key performance indicators.

4-5

OUR CORPORATE STRATEGY

Our corporate strategy supports the Group vision of being recognised as the best financial services company in the UK by customers, colleagues and shareholders. The strategy is focused on being a more conservative, 'through the cycle' relationship based business.

The main focus for the Group remains the financial services markets in the UK and our strategic position was significantly strengthened through the acquisition of HBOS in January 2009. We are a well diversified UK financial services Group and the largest retail financial services provider in the UK. We have leading positions in many of the markets in which we participate, a market leading distribution capability, well recognised brands and a large customer base. The scale of the organisation provides us with the opportunity to further invest in products and services, systems and training that combined will offer unparalleled choice and service to our customers.

Our corporate strategy is focused on:

DEVELOPING STRONG CUSTOMER FRANCHISES THAT ARE BASED ON DEEP CUSTOMER RELATIONSHIPS

All our businesses are focused on extending the reach and depth of our customer relationships, whilst enhancing product capabilities to build competitive advantage. Ensuring we understand and effectively meet the needs of our customers from core banking products to the more specialist services such as insurance, wealth management or corporate banking is at the heart of our business and is fundamental to ensuring we are developing long lasting customer relationships.

BUILDING A HIGH PERFORMANCE ORGANISATION

In delivering a high performance organisation the Group is focused on improving our cost efficiency and utilising our capital more effectively whilst maintaining a prudent approach to risk.

- The Group aspires to have one of the lowest cost to income ratios amongst UK financial institutions and further improving our processing efficiency and effectiveness will remain a priority. The anticipated synergies arising from the acquisition will be key to further improving our efficiency.
- Utilising capital more effectively is increasingly important in the current environment and capital will be rigorously allocated across our portfolio of businesses to support business growth.
- The prudent Lloyds TSB 'through the cycle' approach to risk has been applied to the enlarged Group. Our conservative and prudent approach to risk is core to the business model and the 'through the cycle' approach means we will continue to support our customers throughout the economic cycle. The risk structures and frameworks that have been implemented are the foundation for good business management.

MANAGING OUR MOST VALUABLE RESOURCE, OUR PEOPLE

Executing our strategy effectively will only be possible if we ensure deliverables are effectively aligned with our corporate strategy and we manage our most valuable resource, our people, well. Our people have the skills and capabilities to deliver the strategy but in driving performance it is important to ensure we encourage, manage and develop our staff whilst creating a great place to work.

The effective integration of the two businesses will be a significant challenge over the next few years, but comprehensive plans are in place and excellent progress is already being made.

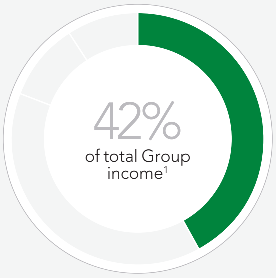
The Group believes that the successful execution of its strategy to focus on core markets, customer and cost leadership, capital efficiency and a prudent risk appetite will enable the Group to achieve its vision of being recognised as the best financial services company in the UK.

DIVISIONAL OVERVIEW

ALL OUR DIVISIONS ASPIRE TO BE RECOGNISED AS THE BEST IN THEIR CHOSEN FINANCIAL MARKETS

OUR DIVISIONS

Since the acquisition of HBOS in January 2009 there have been four primary operating divisions: Retail, Wholesale, Wealth and International, and Insurance. The key product markets in which they participate and relative contribution to the Group's total income are presented below and a more detailed analysis of their strategy, business and performance is outlined within the Business Review.



RETAIL

- Secured lending – mortgages
- Unsecured lending – credit cards, loans and overdrafts
- Internet and telephone banking
- Current accounts
- Savings accounts

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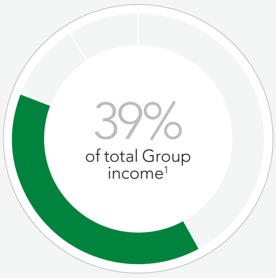

WHOLESALE

- Corporate Markets
- Treasury and Trading
- Asset Finance

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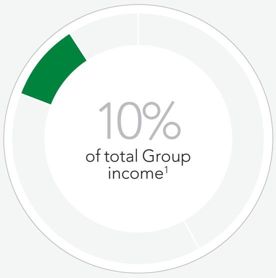

WEALTH AND INTERNATIONAL

- Wealth management
- Asset management
- International Banking

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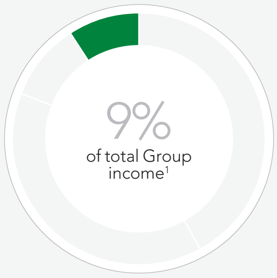


INSURANCE

- Life assurance, pensions and investments
- General Insurance

38

[1]Excludes central group items

A MULTI-BRAND APPROACH

The Group now operates a range of well recognised brands across the four divisions with different brands utilised for different customer segments, geographies and markets. The main four brands operated by the Group are Lloyds TSB, Halifax, Bank of Scotland and Scottish Widows though a number of other brands are used in specialist markets.

Lloyds TSB HALIFAX a little extra help BANK OF SCOTLAND SCOTTISH WIDOWS

GROUP PERFORMANCE

KEY HIGHLIGHTS

Statutory profit before tax of £1,042 million (2008: £760 million) includes an £11,173 million acquisition-related negative goodwill credit.

Combined businesses loss of £6,300 million for the year (2008: £6,713 million loss).

Resilient core businesses performance despite year-on-year margin pressure and weak economy. £35 billion of gross new mortgage lending, approximately 100,000 new commercial accounts.

Total income, net of insurance claims, increased by 12 per cent to £23,964 million due to the absence of £3.4 billion of mark-to-market losses on the Group's treasury asset portfolio and gains of £1.5 billion on capital transactions, which were partly offset by significant year-on-year margin pressures.

Banking net interest margin improved to 1.83 per cent in the second half of the year, compared to 1.72 per cent in the first half.

Integration ahead of schedule and cost synergies target increased to £2 billion run-rate by the end of 2011. Total cost synergies of £534 million have been realised during the year. Annualised run-rate savings totalled £766 million at the year end.

Total impairments significantly higher at £23,988 million for 2009. Second half impairments were 21 per cent lower than in the first half of 2009. We expect to see a similar pace of half-yearly improvement throughout 2010, with further substantial reductions in 2011 and beyond.

Robust capital position and strengthened funding profile. Core tier one capital at 8.1 per cent following the successful capital raising in December 2009. Wholesale funding maturing in more than one year increased from 44 per cent to 50 per cent.

Outlook: economy showing signs of stabilisation, with weak upturn expected in 2010. Significant improvement in the performance of our continuing businesses expected in 2010.

Medium-term goals reflect economic outlook and significant opportunity to leverage relationship-led model across enlarged business base. High single-digit income growth from our continuing businesses targeted within two years. Continued reduction in cost:income ratio. Further run-off of around £140 billion of assets to reduce the balance sheet in the medium term and allow for investment in core relationship businesses.

COMBINED BUSINESSES[1] – RESULTS SUMMARY

	2009 £m	2008 £m
Net interest income	**12,726**	14,903
Other income	**11,875**	6,933
Total income	**24,601**	21,836
Insurance claims	**(637)**	(481)
Total income, net of insurance claims	**23,964**	21,355
Operating expenses	**(11,609)**	(12,236)
Trading surplus	**12,355**	9,119
Impairment	**(23,988)**	(14,880)
Share of results of joint ventures and associates	**(767)**	(952)
Loss before tax and fair value unwind	**(12,400)**	(6,713)
Fair value unwind	**6,100**	–
Loss before tax – combined businesses	**(6,300)**	(6,713)

RECONCILIATION OF COMBINED BUSINESSES LOSS BEFORE TAX TO STATUTORY PROFIT BEFORE TAX

	2009 £m	2008 £m
Loss before tax – combined businesses	**(6,300)**	(6,713)
Integration costs	**(1,096)**	–
Volatility	**478**	(2,349)
GAPS fee	**(2,500)**	–
Negative goodwill credit	**11,173**	–
Amortisation of purchased intangibles and goodwill impairment	**(993)**	(258)
Pre-acquisition results of HBOS plc	**280**	10,825
Insurance grossing adjustment	**–**	10
Results of BankWest and St. Andrews	**–**	90
Loss on disposal of businesses	**–**	(845)
Profit before tax – statutory	**1,042**	760

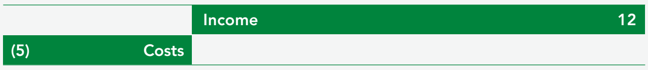
[1] In order to reflect the impact of the acquisition of HBOS, provide more relevant and meaningful comparatives and better present the underlying business performance, the results of the Group and divisions are presented on a combined businesses basis. The key principles adopted in the preparation of the combined businesses basis are described in the contents page. A full reconciliation of the combined businesses basis to the statutory basis is given in note 4 on page 151. Unless otherwise stated, the commentaries on pages 1 to 95 are on a combined businesses basis.

GROUP KEY PERFORMANCE INDICATORS

STATUTORY PROFIT BEFORE TAX
£m

37%

INCOME AND COST GROWTH[1]
%



EARNINGS PER SHARE
pence

12%

PROFIT/LOSS BEFORE TAX[1]
£m

COST:INCOME RATIO[1]
%

CORE TIER 1 CAPITAL RATIO
%

[1] Combined businesses basis.

CHAIRMAN'S STATEMENT

Sir Winfried Bischoff

2009 HAS BEEN **A YEAR OF CHANGE BUT ALSO ONE OF ACHIEVEMENT** AS THE BUSINESS HAS POSITIONED ITSELF TO BENEFIT FROM WHAT WE EXPECT TO BE STRONG EARNINGS MOMENTUM OVER THE NEXT FEW YEARS

OUR YEAR IN BRIEF

CREATION OF LLOYDS BANKING GROUP
Lloyds Banking Group was created in January 2009 and is now the UK's largest retail bank.

GOVERNMENT ASSET PROTECTION SCHEME
In March, in what was clearly a very difficult external market, the Group announced its intention to participate in the Government Asset Protection Scheme. At the time the Scheme provided an opportunity to reduce the risk profile of the balance sheet and significantly strengthen the Group's capital position. A more economically favourable alternative was later pursued.

PLACING AND COMPENSATORY OPEN OFFER
A placing and compensatory open offer was successfully completed in June. The proceeds allowed the Group to repurchase the £4 billion of preference shares held by HM Treasury.

EU STATE AID
In November the Group's restructuring plan was agreed by the European Commission. The board approved the restructuring plan and is confident that this will not have a materially negative impact on the Group.

CAPITAL RAISING
In December we successfully undertook the largest ever capital raising in Europe comprising a £9 billion debt exchange and a £13.5 billion rights issue. This provided a market-based alternative to our intended participation in the Government Asset Protection Scheme and provided superior economic value to our shareholders.

RESILIENT CORE BUSINESS PERFORMANCE
Whilst the capital raising activities took much of the external attention during 2009, the Group has continued to deliver a resilient core business performance in a difficult economic environment. The integration of the two businesses is progressing ahead of schedule and the Group is now very well positioned for future earnings growth.

My first annual statement to you as chairman comes at the end of what has been a momentous and, at times, extraordinary year for Lloyds Banking Group. It has been a year of change but also one of achievement as the business has positioned itself to benefit from what we expect is going to be good earnings momentum over the next few years. The changing economic climate both in the UK and overseas over the past 12 months has presented the banking industry with many difficult challenges. However, as we move into 2010, we believe that we are well positioned to benefit from the encouraging signs of economic recovery, albeit we believe the UK economy will grow at below trend levels over the next few years.

Our commitment to our customers continues to be at the heart of our business and our relationship with them is critical to our success. Only by focusing on the needs of our customers and offering products and services that address those needs can we expect to be successful and deliver benefit to all our stakeholders.

ACHIEVEMENTS

I am encouraged by what Lloyds Banking Group as an organisation has achieved this year. In particular, in November we launched the largest ever capital raising comprising a £9 billion debt exchange and a £13.5 billion rights issue. This capital raising programme could not have been completed so successfully without the strong support of the vast majority of our shareholders, debt holders and of course importantly the UK Government through UK Financial Investments. We remain immensely grateful to them for that support. In providing this market-based alternative to our intended participation in the Government Asset Protection Scheme, we believe we provided superior economic value to our shareholders. Both the rights issue and the liability management exercise are an important step towards meeting our, and the Government's, objective for the Group to operate as a wholly privately owned self-supporting commercial enterprise. HM Treasury's stake in the Group of 43.4 per cent at the year end has reduced to 41.3 per cent following the completion of the capital raising programme in February 2010.

During the last few months of 2009 the Group, together with HM Treasury, concluded negotiations with the European Commission on a restructuring plan required as a result of the state aid received by the Group. We will dispose of a retail banking business with at least 600 branches, a 4.6 per cent market share of the personal current account market in the UK and approximately 19 per cent of the Group's mortgage assets, along with a number of behavioural remedies. The board is confident that the plan will not have a materially negative impact on the Group.

One of the behavioural commitments we entered into as part of the plan is not to make coupon payments or to exercise voluntary call options on certain securities from 31 January 2010 until 31 January 2012. This will also prevent us from paying dividends on our ordinary shares for the same duration. We fully understand the hardship that the lack of dividend and coupon payments has caused many of our shareholders and stakeholders, and we are working diligently to restore the ability to pay dividends and create shareholder value. The board intends to resume dividend payments on ordinary shares as soon as market conditions and the financial performance of the Group permit, subject to the expiry, in 2012, of the restrictions arising from the European Commission's remedies.

Whilst the capital raising activities took much of the external attention during 2009, the Group delivered a resilient core business performance and the integration of the two businesses is progressing ahead of schedule. Further detail on our performance is outlined in the group chief executive's review.

PEOPLE

The past year has been difficult for everyone and we are mindful of the uncertainty our colleagues have faced.

Since joining the Group in September, I have had the pleasure of meeting many of our colleagues and it is clear we have a strong team who have shown an impressive degree of professionalism, enthusiasm, commitment and sheer hard work in these challenging circumstances. Not only have they successfully undertaken the normal day job of serving our customers and realising the potential of the leading franchise in the UK, but they are engaged in implementing one of the most complex integration and corporate restructurings ever undertaken. They have acquitted themselves admirably and I thank them on behalf of all shareholders.

Importantly, our Group is led by a strong management team who I believe have the skills to ensure this organisation delivers value to our customers and shareholders. They have successfully addressed the key strategic and operational challenges facing the organisation and will continue to do so to the benefit of all our stakeholders.

THE BANKING INDUSTRY

It is of course a privilege to have the opportunity to serve our customers. Given our scale, with that privilege comes obligations. That is why we are playing an active part in the UK's economic recovery. I am pleased to note that we extended £70 billion of gross committed lending last year helping many households and businesses in the process. As the country's largest private sector savings institution, we also played a commensurate part in encouraging people to rediscover the savings habit, an essential component of the economic recovery. More broadly we were, and continue to be, involved in all the Government schemes to encourage lending and to assist people or businesses in financial difficulties. Also, our Lloyds Development Capital activities provide vital equity and debt capital to smaller and medium-sized businesses that often are the most vulnerable, but at the same time, most growth orientated parts of the economy.

To the extent that banking institutions, including Lloyds Banking Group, meet their obligations of service and intermediation and are responsible and pro-active conduits of channelling savings into productive enterprises and households, we hope that trust in our institutions may be re-established. It will not happen overnight, but happen it must and it is up to us to ensure by our actions that it does.

It follows that it is right that there is thoughtful and considered debate on the shape and structure of our industry and not simply knee-jerk reaction by the industry. Accordingly, I believe that the combined efforts of a few of the major global financial institutions, perhaps with two or three of the respected industry bodies, should pro-actively help develop proposals which are acceptable to and can be broadly supported by regulatory authorities and governments. Such proposals could set the industry on the path towards an internationally agreed understanding, removing the uncertainty and scepticism hanging over the industry both of which factors act as a brake on progress, to the detriment of the broader economies.

REMUNERATION

We are conscious of the current public debate about remuneration in the banking sector. We understand that this is a sensitive issue for many people at a time when their personal finances are challenged, and also in the light of the significant support given by taxpayers to our industry. We have thought carefully and responsibly about the design of our remuneration schemes and have been engaged in discussions with, and listened to, the views of a broad group of our shareholders on the remuneration of senior management. We are committed to maintaining the right balance between reward, risk management and performance and will continue to emphasise consultation with our shareholders with a view to achieving the right balance. Specifically, we are active participants in the debate about the appropriate remuneration structures for the banking sector. We believe deferral and clawback are the way forward and have implemented these two factors in our own remuneration structures. They have also become key features of remuneration design in the banking sector more generally and will be refined further, here in the UK and elsewhere.

As we announced on 22 February 2010, our group chief executive, Eric Daniels decided to waive the bonus which the board on the recommendation of the remuneration committee had awarded him. Eric took this decision in the interests of the Group since he felt the public debate about bonuses in the banking industry was in danger of obscuring the very real advances which had been achieved in terms of capital creation, quality of revenues, earnings prospects and write-offs, and integration benefits. We are grateful to Eric for his action. At the same time, I believe it is important for the future that we and our shareholders find a way whereby remuneration models will be allowed to be honoured without the recipient being put in a position to feel he should waive the awards arising from them.

We are, as you know, primarily a retail and commercial bank. This means that the total payout under our Group bonus schemes for 2009 will be a small percentage of overall revenues. All awards in the Group are subject, where appropriate, to deferral and clawback and agreed with UK Financial Investments and the Financial Services Authority (FSA).

DIRECTORS AND GOVERNANCE

Governance structures are increasingly important in the financial services industry. I am committed to ensuring that Lloyds Banking Group is at the forefront of these developments. To that end the board has given additional authority to our nomination committee and renamed it nomination and governance committee, to deal with all governance matters and make recommendations on these to the board.

Since February 2009, there have been eleven changes to the board, five new directors and six departures.

In February 2009 two new non-executive directors were appointed. Anthony Watson CBE brings with him over 40 years experience in the investment management industry. Timothy Ryan is a senior investment banker with a wealth of knowledge and understanding of the financial services industry and significant experience in the governmental sector. Lord Leitch was appointed deputy chairman in May 2009. In March 2010 we will be joined by Glen Moreno and David Roberts. Glen is chairman of Pearson plc and will be senior independent director. He has significant financial and banking industry and public company experience in the UK and abroad. David Roberts' deep understanding at the most senior level of commercial and retail banking in the UK, Europe and internationally is particularly valuable in that core business of our Group. As you know I joined on 15 September 2009. The full particulars and background of all our directors are set out on pages 96 and 97.

We have also seen a number of departures. Ewan Brown, Jan du Plessis, Philip Green, Sir David Manning and Carolyn McCall have all retired from the board. I would like to thank each of them for their contribution to the Group, in some cases for many years, and during a period of great change, and latterly turmoil, in the banking sector. We wish them well for the future. I wish also to pay tribute to my predecessor Sir Victor Blank as chairman of the Group during a tumultuous time. Sir Victor has had a long and distinguished career in financial and professional services and in commerce and industry and he retires with my thanks for his counsel and commitment since his appointment in 2006.

OUTLOOK

The acquisition of HBOS at the beginning of 2009 improved the strategic positioning of Lloyds Banking Group albeit at short-term cost. We now have leading positions in many of the financial markets in which we participate, a market leading distribution capability, well recognised brands and a large customer base. The scale of the organisation provides us with the opportunity to further invest in products and services, systems and training, offering unparalleled choice and service to our customers. This strategic positioning, along with our strong relationship focus and prudent risk appetite, provides the platform for future growth.

The successful execution of our strategy which is to focus on core markets, on customer and cost leadership, on capital efficiency and on a prudent risk and funding profile should enable the Group to deliver earnings growth and shareholder value whilst achieving its aim to be recognised as the best financial services company in the UK.

Sir Winfried Bischoff
Chairman
25 February 2010

GROUP CHIEF EXECUTIVE'S REVIEW

J Eric Daniels

2009 WAS A YEAR OF SIGNIFICANT ACHIEVEMENT IN SHAPING THE GROUP. **WE HAVE ESTABLISHED POSITIVE TRENDS IN MARGIN, COST AND IMPAIRMENTS** AND ARE WELL POSITIONED

ADDRESSING THE KEY ISSUES

CREATING THE PLATFORM FOR FUTURE GROWTH

We now have market-leading positions in many of the financial markets in which we participate, a market-leading distribution capability, well recognised brands and a large customer base. Over the last 12 months we have appointed the management team and implemented the management structures to ensure delivery of our strategy going forward.

INTEGRATION

Excellent progress is being made on the integration of the two businesses. Detailed integration plans have been developed and implemented and we exited the year with a cost synergy run-rate of £766 million. The significant progress being made has led us to raise the expected synergies to a £2 billion annualised run-rate by the end of 2011.

RISK MANAGEMENT

The strong risk management culture and more prudent risk appetite previously prevalent within Lloyds TSB has been applied to the enlarged Group. The new Group has already exited a number of non-core areas in which HBOS previously participated and the more prudent 'through the cycle' approach to risk is being applied to all new business.

EU STATE AID

The uncertainty of the state aid repercussions was addressed in November when our restructuring plan was agreed by the European Commission. The board approved the restructuring plan and is confident that this will not have a materially negative impact on the Group.

CAPITAL

The successful capital raising in December significantly strengthened the Group's capital ratios. The appropriateness of capital levels will continue to be a focus for the regulatory authorities but we will always seek to satisfy capital requirements in a way that protects and maximises value to shareholders.

SUMMARY

2009 was another challenging year for the financial services industry, both in the UK and around the world, reflecting a continuation of many of the issues that arose in 2008. During the year, the UK experienced its sharpest contraction in gross domestic product (GDP) for many decades, with a sharp fall in the value of commercial property alongside rising company failures and higher unemployment levels. Despite the tough market conditions, our core businesses have performed well.

Our significant achievements in 2009 will shape the future of the Lloyds Banking Group. We strengthened our franchise, attracting new customers and building deeper relationships. We have made excellent progress with the integration of HBOS, which we acquired in January 2009. The Group's capital is robust and our funding profile was strengthened considerably during the period.

The management team implemented a number of programmes that have resulted in positive trends in margins, costs and impairments. Given the momentum we have already developed in these areas, and with the stabilising economy, we believe the Group is well positioned to deliver a strong financial performance in the coming years.

We believe we have substantial additional growth opportunities from continuing to develop our business model and applying it across the broader franchise. As we realise the potential, it will enable us to further improve our growth trajectory in the coming years.

Although we are forecasting a slow, below trend, economic recovery, the Group is successfully addressing the near-term challenges and is well positioned to deliver value for our customers and shareholders. As a result, the financial performance of the Group's continuing businesses is expected to improve significantly in 2010 and beyond.

RESULTS OVERVIEW

On a statutory basis, the Group delivered a profit before tax of £1 billion for 2009. This result includes an £11.2 billion negative goodwill gain associated with the purchase of HBOS, given we acquired the business at half book value in anticipation of the likely losses resulting from their troubled asset portfolios.

On a combined businesses basis, the Group reported a £6.3 billion loss for the year, compared to a £6.7 billion loss in 2008. Our total income rose 12 per cent, whilst costs fell 5 per cent. The higher income and lower costs drove a substantial uplift in the trading surplus, which increased by 35 per cent, and our cost:income ratio improved to 48.4 per cent. As guided last August, there was a significant increase in impairments, which rose to £24 billion from £14.9 billion in 2008, principally due to the HBOS portfolios and their high level of exposure to commercial property.

RESILIENT CORE BUSINESS PERFORMANCE

Total income, net of insurance claims, was up 12 per cent on prior year, helped by lower write-downs on treasury assets and the profits from debt swaps. These gains more than offset the year-on-year decline in margins, which suffered from the impact of very low base rates and increased funding costs as we lengthened our maturity profile.

The continued development of our customer franchises has enabled us to offset the impact of the weak economy. In Retail, we opened nearly 2 million current accounts and nearly 5 million new savings accounts, which are important drivers for future profitable growth. We delivered an equally good performance in the Wholesale division. In our Commercial business, we opened approximately 100,000 new accounts and achieved a 23 per cent share of start-up businesses, and in Corporate we saw a 49 per cent improvement in cross-sales income from Lloyds TSB customers. Wealth and International, our new division, made a very encouraging start in 2009 with a strong growth in the number of relationship clients and a 13 per cent growth in the number of UK private banking customers. In Insurance, despite the more difficult market conditions, we made good progress in key product areas such as Open Ended Investment Companies (OEICs) and life assurance protection.

With over 30 million customers we understand the financial hardships that many households and businesses are experiencing as a result of the recent economic decline in the UK. We are committed to helping our customers in these challenging times, which is reflective of our relationship-based approach. In Retail, we maintained strong levels of mortgage lending, with £35 billion of gross new lending, and helped thousands of our customers to buy new homes. In Wholesale we have provided approximately £10 billion of committed gross lending to small and medium-sized enterprises and approximately £25 billion to Corporate customers. We are acutely aware of the importance of supporting households and businesses as we exit the recession, and we will remain just as focused on this in 2010 as we were in 2009.

Our asset margin improved during 2009, although the upturn came earlier than we had expected. We are pricing assets to appropriately reflect risk and our funding costs, and the net interest margin recovered somewhat in the second half. The key drivers influencing our margin in 2010 will be asset pricing, a possible increase in the base rate and the cost of wholesale funding. We expect to be able to achieve a margin of 2 per cent this year, and to be on an upward trajectory after that.

We envisage minimal medium-term impact on our margin from the cost of wholesale funding, as we reduce our absolute wholesale funding requirement. Additionally, whilst we anticipate that a high proportion of our existing government and central bank funding will not have to be re-financed, we believe we can replace the residual portion at a cost that is similar to that which we are paying for these facilities at present.

COST SYNERGY TARGET INCREASED

Costs fell by 5 per cent in the year. We have made great strides on delivering the integration of Lloyds TSB and HBOS, one of the largest financial services mergers ever undertaken. We exited the year with a cost synergy run-rate of £766 million. The key programmes we have put in place are: rationalising our businesses to eliminate areas of duplication; leveraging our procurement skills and re-aligning our property requirements. Given we have now achieved half of our cost run-rate target, we have raised our guidance and are now targeting annual run-rate cost synergies of £2 billion by the end of 2011.

IMPAIRMENTS EXPECTED TO REDUCE SIGNIFICANTLY IN THE COMING YEARS

Impairments in the year were £24 billion, which is reflective of the problem HBOS portfolios, in particular, the over-concentration in commercial real estate. When we released our half-year results, we said that total Group impairments would peak in that half, and the full-year numbers confirm that guidance.

The Lloyds TSB conservative approach to risk management has been implemented across the Group, and is making a difference. All new lending is within the Group's risk appetite and the existing portfolios are being managed to Group standards. Looking forward, we expect to see a similar pace of half-yearly improvement throughout 2010, with further substantial reductions in 2011, and beyond. We expect reductions in all three customer divisions, although we remain cautious on the Irish portfolios, given the uncertain economic outlook.

ROBUST CAPITAL POSITION

Following our recent successful capital raise, the Group's year end core tier one ratio was 8.1 per cent and it rose by a further 30 basis points in February 2010. This reflects a number of successful actions during the year which included the £4 billion ordinary share placing and compensatory open offer in June, and the £22.5 billion equity raising and liability management exercises announced in November.

FUNDING AND LIQUIDITY STRENGTHENED

A number of steps were taken in the year to extend the Group's wholesale funding maturity and to further improve our liquidity profile. The Group's loan to deposit ratio improved and over 50 per cent of the wholesale funding had a maturity of over one year (2008: 44 per cent). We had also established an £88 billion liquidity buffer at the end of 2009. In addition, the Group continued to widen its diverse range of funding sources and had already achieved a significant amount of its expected term funding issuance for 2010 by the end of January.

DELIVERING SUSTAINABLE VALUE THROUGH THE CYCLE

The Group's aim is to be recognised as the UK's best financial services business and to deliver sustainable value through the cycle for our customers and shareholders. The principal element of the Group's strategy remains the focus on building deep, long-lasting customer relationships in all its franchises. We continue to support this with a focus on driving down costs and maintaining effective capital management disciplines, within a strong, conservative, risk management framework.

The Group aims to:

– Deliver high single-digit income growth from our continuing businesses within the next two years.
– Deliver annual reductions in our cost:income ratio of 2 per cent over the next few years.
– Run-off non-relationship assets to reduce the size of our balance sheet, providing the capacity to re-invest in growing our relationship businesses.

STATE AID

During 2009, the Group was required to work with HM Treasury to submit a restructuring plan to the European Commission in the context of a state aid review. During the last few months of 2009, the final terms of the restructuring plan were agreed by the European Commission College of Commissioners. The board approved the restructuring plan and is confident that it will not have a materially negative impact on the Group.

ECONOMIC OUTLOOK

The economic performance last year was worse than most expected, with a 4.8 per cent decline in GDP. Looking forward, we remain cautious but realistic. Our view is that the risk of a severe further downturn in 2010 is lower than a few months ago and we continue to forecast growth in GDP of 1.8 per cent for 2010, with a similar trend in 2011. Against that backdrop, we expect property prices will be broadly flat in 2010 and we remain on the cautious side of the range of market expectations. We anticipate that company failures will peak this year, but do not expect them to reach the heights seen in the last recession due to much lower corporate debt servicing costs. We believe unemployment will also peak in 2010, but at a lower level than seen in the last recession.

Our financial outlook and guidance are based on a range of economic scenarios. Having stressed our portfolios, we are confident of our capital position and the expectation of improving financial performance, albeit the growth would be slower in coming through if there were a second economic downturn, or a weaker than expected economic recovery.

BUSINESS OUTLOOK

2009 was a year of substantial achievement, in which we shaped the Group to enable us to deliver the growth potential of the enlarged franchise. We achieved this whilst maintaining good momentum in the core business, and as a result the Group is now in a strong position.

We have established positive trends in margin, costs and impairments. The management actions we have already taken in these areas, combined with the underlying business momentum, point towards significantly improved financial performance in the coming years.

We also believe there are significant opportunities for additional growth, potentially amounting to hundreds of millions of pounds in revenues. Over the last five years Lloyds TSB has delivered accelerating growth by focusing on acquiring, deepening and broadening customer relationships. We can see significant opportunity from sustaining this trend in the legacy Lloyds TSB franchise, and extending the model across the enlarged Group. As we realise this potential, we will add to our growth trajectory.

OUR PEOPLE

The last 12 months have been very challenging for all of our staff, across the Group. The external environment has been difficult, but our staff have continued to serve and support our customers superbly while delivering one of the largest banking mergers in history. I, along with all the members of the board, am very proud of their achievements this last year, and their performance underpins my confidence in our ability to deliver in the coming years.

J Eric Daniels
Group Chief Executive
25 February 2010

GROUP CHIEF EXECUTIVE'S Q&A

ISSUE: THE GOVERNMENT SHAREHOLDING

As a result of the recapitalisation of the banking sector and the subsequent capital raisings the Government now holds a significant stake in Lloyds Banking Group.

What are the implications of this holding, how does the Government intend to reduce its holding and how does the Government's share ownership impact the Group's business?

As at the date these accounts were approved the Government's shareholding in Lloyds Banking Group was approximately 41.3 per cent, which is managed by UK Financial Investments (UKFI) on behalf of HM Treasury.

We have a very good working relationship with UKFI who act like any value orientated shareholder with regard to the strategic development and financial performance of the Group, providing significant constructive challenge where they see fit. The Government has made it very clear that UK financial institutions in which it holds substantial stakes will continue to be separate economic units with independent powers of decision and will continue to have their own independent boards and management teams, determining their own strategies and commercial policies (including business plans and budgets).

Moreover, the relationship between the Government and the Group falls within the framework document between HM Treasury and UKFI published on 2 March 2009, which states that UKFI will manage investments in the UK financial institutions in which HM Treasury holds an interest on a commercial basis and will not intervene in day-to-day management decisions of the investee companies (including with respect to individual lending or remuneration decisions).

The timing of any share disposal will be at the discretion of UKFI. However, within the publication 'An Introduction: Who We Are, What We Do and the Framework Document Which Governs the Relationship Between UKFI and HM Treasury', it is stated that UKFI is to 'develop and execute an investment strategy for disposing of the investments in the banks in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition'.

Going forward the Group is focused on delivering strategy and subsequently value to all our shareholders. The Government holding does not impact this management focus and we remain committed to operating as a wholly privately owned, self supporting, dividend paying, commercial enterprise over time.

ISSUE: STATE AID

The European Commission required the Group to agree a restructuring plan as a result of the investment in the Group by HM Treasury.

What remedies were agreed with the European Commission and what are the implications of these remedies?

As a result of HM Treasury's investment in the Company in the context of the placing and open offer undertaken by the Company in November 2008 and the Group's participation in the Credit Guarantee Scheme, the Group was required to work with HM Treasury to submit a restructuring plan to the European Commission in the context of a state aid review. This plan was required to contain measures to limit any competition distortions resulting from the state aid received by the Group.

During the last few months of 2009, HM Treasury and the Group were involved in detailed negotiations with the European Commission in relation to the terms of the restructuring plan in order to reach a mutually acceptable solution. The final approval of the UK Government's state aid measures, including the terms of the final restructuring plan, was agreed by the College of Commissioners in November 2009. The plan consists of the following principal elements:

a. the disposal of a retail banking business with at least 600 branches, a 4.6 per cent share of the personal current accounts market in the UK and approximately 19 per cent of the Group's mortgage assets. The business consists of: the TSB brand; the branches, savings accounts and branch based mortgages of Cheltenham & Gloucester; the branches and branch based customers of Lloyds TSB Scotland and a related banking licence; additional Lloyds TSB branches in England and Wales, with branch based customers; and, Intelligent Finance. These disposals need to be made within four years of the date of state aid approval;
b. an asset reduction programme to achieve a £181 billion reduction in a specified pool of end 2008 assets by 31 December 2014; and
c. behavioural commitments, including commitments; not to make certain acquisitions for approximately three to four years; and not to make discretionary payments of coupons or to exercise voluntary call options on hybrid securities from 31 January 2010 until 31 January 2012, which will also prevent the Group from paying dividends on its ordinary shares for the same duration.

The assets and liabilities, and associated income and expenses, of the business to be divested (referred to above) cannot be determined with precision until nearer the date of sale. However, the Company estimated that, as at 31 December 2008 and after aggregating the elements relating to Lloyds TSB and HBOS, the retail business to be divested comprised approximately £70 billion of customer lending and £30 billion of customer deposits. For the year ended 31 December 2008, the board estimated that the retail business to be divested generated income of approximately £1.4 billion and contributed approximately £500 million of profit before tax to the Group.

The board approved the restructuring plan and is confident that this will not have a materially negative impact on the Group.

ISSUE: FUTURE GROWTH

At the time of the acquisition of HBOS the Group indicated that the acquisition was a unique transaction that would position the Group for further growth.

Does the Group still believe that this is the case and how is the Group going to deliver earnings growth over the next few years?

The acquisition of HBOS at the beginning of 2009 has undoubtedly improved the strategic positioning of the Lloyds Banking Group and helped position the Group for future growth. We now have market leading positions in many of the financial markets in which we participate, a market leading distribution capability, well recognised brands and a large customer base. The scale of the organisation provides us with the opportunity to further invest in products and services, systems and training, offering unparalleled choice and service to our customers. This strategic positioning along with our strong relationship focus and prudent risk appetite provides the platform for future growth.

Our customer franchise and relationship focus will be key drivers of earnings growth going forward and we believe that the Group can deliver high single-digit income growth within the next few years as we meet the needs of our customers more effectively and extend the depth of our customer relationships.

Lloyds TSB has historically been strong in managing the cost base but the unique positioning of the Group also now provides a number of opportunities not available to other providers. The integration of the two businesses provides the opportunity for significant cost synergies. We have already outlined that we are looking to achieve £2 billion of cost synergies per annum by the end of 2011 and are already well on track for this, having delivered £766 million of synergies on an annualised basis in 2009. To date these synergies have primarily arisen from de-duplication of functions and property consolidation but going forward significant opportunities still exist from system integration and procurement. We believe that the Group can deliver a 200 basis points reduction in the cost:income ratio per annum over the next few years.

Impairment losses, particularly from the heritage HBOS business, have also significantly impacted profits over the past two years. We outlined at the half-year that we believed Group impairment losses had peaked in the first half of 2009 and this was borne out in the full year numbers which showed a 21 per cent reduction in impairment in the second half of the year. The Group believes impairment losses will continue to fall going forward and though given the current economic environment such levels are still inflated we believe impairments will return to more normalised levels over the next couple of years. The significant reduction in expected impairments will evidently benefit profits.

Overall the Group believes that the successful execution of its strategy focusing on core markets, customer and cost leadership, capital efficiency and a prudent risk appetite should enable the Group to deliver earnings growth and shareholder value whilst achieving its vision to be recognised as the best financial services company in the UK.

ISSUE: THE GROUP DIVIDEND

The European Commission state aid review prevents the Group from paying dividends on its ordinary shares.

When will you recommence the payment of dividends?

As a result of the UK Government's investment in the Group as part of the initial recapitalisation by the Company in November 2008, the rights issue announced in November 2009 and our participation in the Credit Guarantee Scheme, the Group has been deemed to have accepted state aid and subsequently the European Commission required us to undertake a restructuring plan (see the state aid question for further detail). This, amongst other things, includes a behavioural commitment not to make discretionary payments of coupons or to exercise voluntary call options on hybrid securities from 31 January 2010 until 31 January 2012. This also prevents the Group from paying dividends on its ordinary shares for the same duration.

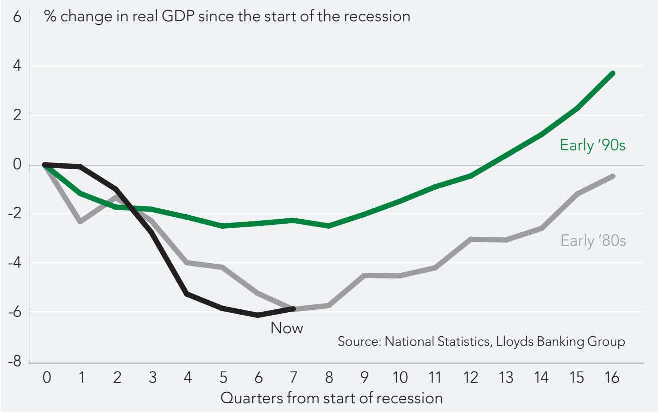
We understand the distress the lack of dividend has caused many of our shareholders and are working hard to restore shareholder value. The capital raising in December 2009 was a significant step towards meeting our objective of operating as a wholly privately owned, self-supporting, dividend paying, commercial enterprise over time. The board intends to resume dividend payments on ordinary shares as soon as market conditions and the financial performance of the Group permit, subject to the expiry of the restrictions arising from the European Commission remedies.

MARKETPLACE TRENDS

THE ECONOMY

2009 has been a mixed year in terms of economic developments. With an estimated fall of 5 per cent, UK GDP growth was towards the bottom end of our, and the market's, range of expectations. The UK experienced the biggest recorded single-year GDP fall since the 1930s, and the peak to trough decline in GDP currently matches the early 1980s recession (see chart 1). The downturn in most other industrialised economies was of similar magnitude. In response, official interest rates have fallen to their lowest level since the Bank of England was founded. Interest rates elsewhere have also fallen to extremely low levels.

CHART 1:
UK GDP IN THE LAST THREE RECESSIONS



Perhaps partly in response to such low interest rates, other economic indicators have not turned out so badly in 2009 as many had feared.

At the beginning of the year, most commentators would have expected such a sharp drop in GDP to result in much worse unemployment numbers than has been the case. In fact, employment has held up quite well given the severity of the decline in GDP (see chart 2). Similarly, the rate of company failures so far in this downturn has been lower than might have been expected given the severity of the GDP decline (see chart 3).

CHART 2:
UK EMPLOYMENT IN THE LAST THREE RECESSIONS

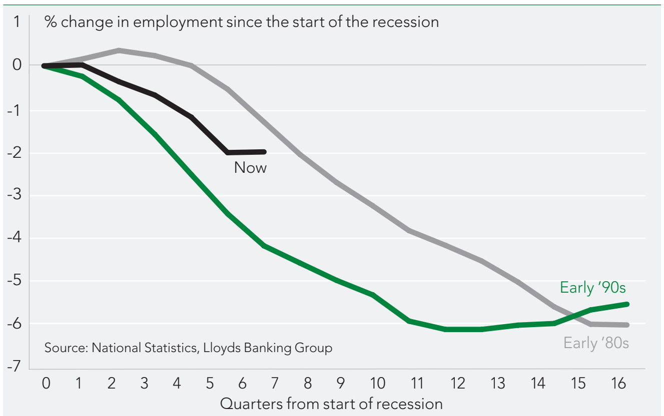
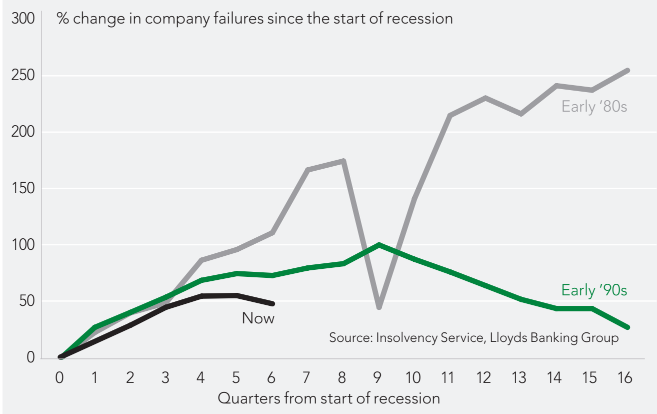


CHART 3:
UK COMPANY FAILURES IN THE LAST THREE RECESSIONS



Companies went into this recession in better shape generally than during the last recession, and seem to have taken early action to cut investment, stocks and working hours. Helped by very low interest rates, the aggregate financial position of the corporate sector has remained strong. This has undoubtedly helped to limit failure rates. And this in turn has probably helped to limit the rise in unemployment – the biggest single cause of job losses in most recessions is business failure.

Meanwhile, property prices have also held up better than many forecasters had expected. At the beginning of the year, the average view was that house prices would fall by around 15 per cent during 2009, and decline further in 2010. In fact, the Halifax house price index ended the year higher than twelve months earlier, and other indices showed a similar picture. House prices fell during the early part of the year, but then started to recover in the second half and finished the year still above long term average levels relative to household incomes, albeit well down on their peak in 2007. The consensus view is now for modest further growth in 2010.

Commercial property prices showed a similar recovery. Having fallen sharply in late 2008 and early 2009, commercial property capital values have stabilised recently, despite continued falls in rental values, and many forecasts for 2009 and 2010 have been revised up. At the end of 2009, the consensus forecast was for modest growth in capital values this year and next, even as rental values decline further.

Looking forward, the most likely immediate economic scenario is one of slow and erratic growth. GDP is estimated to have begun to recover in Q4 2009, and may even have done so earlier once final revisions are made to earlier estimates for Q3. Survey evidence, including purchasing manager indices, were pointing to positive growth in manufacturing and services for most of the second half of 2009. Retail sales growth accelerated in late 2009, although some of this may have been spending brought forward to beat the restoration of VAT to 17.5 per cent. Unemployment appears to have levelled off, at least temporarily, and actually fell in late 2009. Financial market conditions have continued to normalise, in line with the improving economic outlook. The consensus forecast for 2010 has risen gradually, and by the end of 2009 was suggesting

2010 GDP growth of around 1.5 per cent, close to our own central scenario. This slow recovery is consistent with the sort of upturn seen after past financial crises. But even that below-trend growth relies mainly on a recovery in net external trade and an end to company destocking. Domestic demand growth is likely to be minimal in 2010.

Alternative scenarios remain possible. The Bank of England's most likely outcome, as published in the February 2010 Inflation Report, is for a somewhat faster recovery during 2010 than the consensus forecast. However, the risks around that are skewed towards the downside.

It is possible that the economy will dip again if hit by some new shock – and what might start as a temporary setback to recovery could have longer lasting effects if it damages consumer, business or financial market confidence. Furthermore, uncertainties remain about how the economy will respond as and when the Bank of England begins to reverse quantitative easing and restore interest rates to more normal levels, and the Government begins to take action to reduce the large fiscal deficit.

IMPACT ON OUR MARKETS

2009 was a year of weakening growth in most of our markets. On the retail side, net new market mortgage lending (ie new lending minus repayments) was very low throughout 2009, as a result of which growth in outstanding balances slowed to around 1 per cent by year end. Net new market unsecured consumer lending was very weak in the first half of the year, and turned negative in the second half.

Weakening lending growth appears to have been driven by both supply and demand. Some lenders have pulled back from the market, especially from higher risk segments. But at the same time, data on our own retail customers shows that they have reacted to the recession by prioritising reducing debt. This trend is apparent across all our customer groups, whether split by age, income, or indebtedness. This helps to explain why market deposit growth also weakened in 2009, despite a higher national saving ratio. Households have on average chosen to use the cash freed up by reduced spending and lower debt interest payments to pay off debt rather than save more.

Market mortgage arrears rose during the first half of 2009, but then fell back in the second half. Market credit card arrears also fell during the second half. Improving arrears trends may have been helped by households starting to pay down debt. And many mortgage borrowers will have found their debt servicing costs reduced during 2009 as their variable mortgage rates fell or as their fixed rate loans expired and they rolled off onto lower standard variable rates. Quite strong growth in the average household's real disposable income in 2009 will also have helped, aided by better-than-expected employment levels in the second half and falling inflation.

Businesses also appear to have used 2009 to strengthen their financial position where possible. Sharp cutbacks in investment spending, and in stocks, have enabled businesses in aggregate to remain in financial surplus and reduce their reliance on external credit – from banks, trade creditors and others. Large companies have also taken advantage of the recovery in financial markets to increase capital market borrowing thereby further reducing bank credit demand. As a result, the outstanding stock of bank and building society lending to private non-financial businesses declined in 2009, and corporate deposits returned to positive growth despite the weakness of demand in many companies' markets. Strengthened corporate finances were probably a major factor limiting the growth in company failures in 2009. Indeed, as chart 3 shows, the rate of company failures reduced in the second half of 2009.

We expect that the weakness of likely economic recovery will be mirrored in slow growth of major banking markets in 2010 as both households and businesses continue to restructure their finances. However, 2010 may see company failure rates rise again, since it is typically when companies have to restock to meet an upturn in demand that the financial pressures on them are greatest.

SUMMARY OF GROUP RESULTS

During 2009 the Group delivered a resilient trading performance against the backdrop of a marked slowdown in the UK economic environment and continued challenges in financial markets. In addition, the Group has made excellent progress in the integration of HBOS following its acquisition on 16 January 2009. Statutory profit before tax in 2009 was £1,042 million, compared to £760 million in 2008, largely reflecting the impact of an £11,173 million credit to the income statement from the gain arising on the HBOS acquisition (negative goodwill) which offset the significant increase in impairments during the year. Profit attributable to equity shareholders was £2,827 million and earnings per share (EPS) totalled 7.5p.

To enable meaningful comparisons to be made with 2008, the income statement and balance sheet commentaries are on a combined businesses basis. Certain commentaries also exclude the unwind of fair value adjustments.

On a combined businesses basis, the Group reported a loss before tax in 2009 of £6,300 million, compared to a loss before tax of £6,713 million in 2008. Whilst the Group delivered resilient revenues, lower costs and a strong trading surplus performance, up 35 per cent to £12,355 million, profits were adversely impacted by significantly higher impairment losses which increased by £9,108 million to £23,988 million.

A RESILIENT REVENUE PERFORMANCE

The Group delivered a resilient revenue performance in 2009 given significant year-on-year margin pressures. Total income, net of insurance claims, was 12 per cent higher at £23,964 million, supported by a good performance in Wholesale largely as a result of the absence of last year's £3.4 billion impact of market dislocation, more favourable interest and currency rate environments, good transaction volumes in capital markets and strong flows of client driven derivative transactions at improved spreads. Income also includes £1.5 billion gains on a number of liability management transactions.

In Retail, lower levels of income from payment protection insurance, reflecting the impact of the decision in January 2009 to move to a monthly premium product, and lower loan volumes, the impact of falling interest rates on deposit margins and higher overall funding costs from wholesale money markets have led to retail banking revenues being 13 per cent lower than in 2008. Whilst lending markets have remained generally subdued throughout the industry, the Group has maintained a 24 per cent share of gross mortgage lending. Unsecured lending balances were slightly lower, reflecting lower customer demand and tightened credit criteria. During the year, we have continued to build our current account and savings customer franchises in what remains a competitive market for customer deposits.

New business sales in our life assurance and pensions businesses were 26 per cent lower than last year, reflecting the extremely challenging market conditions which led to a general market-wide slowdown in the sale of life, pensions and investments products. Sales of OEICs and life assurance protection products remain good.

In Wealth and International, income was 6 per cent lower reflecting the impact of deposit margin pressure and falls in global stock markets in the first half of 2009.

Total assets decreased by 9 per cent to £1,027 billion, with a 7 per cent decrease in loans and advances to customers reflecting the impact of reductions in non-relationship lending portfolios. Customer deposits decreased by 1 per cent to £407 billion, as growth in Retail was offset by the planned reduction in higher interest paying term deposits elsewhere.

Year-on-year Group net interest income decreased by £2,177 million, or 15 per cent, to £12,726 million. The net interest margin from our banking businesses was 24 basis points lower at 1.77 per cent, as higher asset pricing was more than offset by the impact of lower deposit margins, reflecting the impact of falling base rates, and higher funding costs, which included the impact of the Group extending its wholesale funding maturity profile. During the second half of 2009 however, the impact of asset pricing more than offset the impact of lower base rates and higher funding costs and the margin increased to 1.83 per cent, compared to 1.72 per cent in the first half of the year. The net interest margin is expected to increase in 2010 to approximately 2 per cent, with further improvements expected in the margin in subsequent years reflecting the impact of continued improvements in asset pricing, moderate base rate rises and greater stability in wholesale funding markets. This margin outlook reflects our core economic assumptions for the medium term and includes the impact of the Group's asset reduction programme and the assumed costs of refinancing as wholesale funding matures. Other income, net of insurance claims, increased by £4,786 million, or 74 per cent, to £11,238 million, largely reflecting the absence of last year's investment write-downs, and the gains on liability management transactions.

STRONG COST MANAGEMENT DELIVERING BENEFITS

The Group has an excellent track record in managing its cost base, and has continued to deliver a strong cost performance. During 2009, operating expenses decreased by 5 per cent to £11,609 million, as integration related savings have started to be captured and lower operating lease depreciation offset inflation linked growth and investment in our continuing businesses. Over the last twelve months, the total number of roles has reduced by over 11,500 as the Group has started to achieve its targeted cost synergy savings.

In addition, we have already made significant progress in capturing savings from areas such as procurement and, overall, £534 million of cost synergy savings have already been realised, which represent annual run-rate savings of over £760 million. As a result of the integration programme being ahead of schedule the Group has increased its commitment to deliver cost synergies and other operating efficiencies to achieve run-rate savings of £2 billion per annum by the end of 2011. One-off integration costs over this period are expected to total approximately 1.55 times the revised targeted cost synergies. The Group also expects to continue to improve its cost:income ratio by in excess of 2 percentage points per annum during this period, with further improvements thereafter as we seek to optimise the ratio over the medium term.

IMPAIRMENT LEVELS HIGHER BUT EXPECTED TO HAVE PEAKED

During 2009 we have experienced a significant rise in impairment levels in the Group's lending portfolios. This largely represents falls in the value of commercial real estate and the impact of the economic deterioration during the year, including the effects of rising unemployment and reduced corporate cash flows, although the effects of some of these issues started to reduce in the second half of the year. This increase in impairment levels was however partially offset by the accelerated unwind of credit related fair value adjustments taken at the time of the HBOS acquisition totalling over £7 billion. The impairment charge in the second half of 2009 was 21 per cent lower than in the first half of the year, reflecting the peak of overall impairments in the first half.

In Retail, impairment losses increased by £532 million, or 14 per cent, to £4,227 million, particularly reflecting increases in UK unemployment during 2009 on the unsecured charge, which was partly offset by a lower secured impairment charge as house prices stabilised. Compared to 2009, we expect to see a reduction in the Retail impairment charge in 2010 with further improvements thereafter as the UK economic environment improves and house prices continue to stabilise.

The Wholesale charge for impairment losses increased significantly by £5,289 million to £15,683 million, reflecting, in particular, the year-on-year decline in commercial property valuations and reduced levels of corporate cash flows. In particular, the real estate related lending exposures in the legacy HBOS portfolios were more sensitive to the downturn in the economic environment.

We continue to believe that the overall Wholesale impairment charge peaked in the first half of 2009 and we have seen significant reduction in the Wholesale impairment charge in the second half of 2009. Further significant reductions are expected in 2010 and beyond, assuming current economic expectations. We have spent a significant amount of time analysing and addressing the issues in the legacy HBOS portfolios, with the greatest attention paid to the over concentration in real estate related lending and those portfolios that fall outside the Lloyds TSB risk appetite. As a result of our portfolio review, which applied prudent assumptions to real estate asset expectations, and with the deterioration in the economy translating into lower commercial property valuations, we took prudent and material impairment charges especially in the first half of the year.

In our Wealth and International business the impairment charge rose by £3,347 million to £4,078 million, reflecting significant provisions against our Irish (£1,793 million) and Australian (£508 million) commercial real estate portfolios. We continue to have ongoing concerns with regard to the outlook for the Irish economy although we expect 2009 to have been the peak for the International impairment charge.

Overall, impairment losses increased by £9,108 million to £23,988 million. Impairment losses on loans and advances to customers expressed as a percentage of average lending was 3.25 per cent, compared to 1.81 per cent in 2008. Impaired loans and advances increased by £27,529 million to £58,833 million and now represent 8.9 per cent of total loans and advances to customers, up from 4.4 per cent at 31 December 2008.

At the Group level, we are confident that the overall impairment charge peaked during 2009. Although we would normally expect that impairments would peak one to two years after the low point of a recession, given the significant Wholesale charge during the year, predominantly driven by the HBOS property and property related portfolios and HBOS (UK and US) corporate portfolios, we believe that the charge in 2010 will be significantly lower than the 2009 charge. The impairment charge in the second half of 2009 was 21 per cent lower than that in the first half of the year. Given our current economic outlook, we expect to see a similar pace of half-yearly improvement throughout 2010, with further substantial reductions in 2011 and beyond.

ACQUISITION RELATED BALANCE SHEET ADJUSTMENTS

Fair value adjustments reflected in the calculation of the net assets acquired totalled £1,241 million. Negative adjustments in respect of tangible net assets totalled £2,107 million principally reflecting the write-down of HBOS's retail and corporate lending portfolios offset by gains on the valuation of HBOS's own debt. Intangible assets totalling £4,650 million have been recognised, largely reflecting the value of HBOS's relationship with its retail customer base and the value of its brands. Other acquisition related balance sheet adjustments include the elimination of HBOS's available-for-sale and cash flow hedging reserves which totalled £6,439 million.

As a result of these adjustments, the Group expects some £3.3 billion, net, to unwind positively through the Group's income statement over the medium to long term. During 2009, the Group's income statement reflected gains of £6.1 billion. In 2010, we currently expect a further benefit of some £2.5 billion. Thereafter, over the medium term, smaller benefits are expected to accrue.

GAIN ON ACQUISITION OF HBOS

Following the acquisition of HBOS in January 2009, the Group has recognised a gain of £11,173 million in respect of negative goodwill. This arises because the consideration paid to acquire HBOS, in January 2009, was considerably less than the fair value of the net assets acquired, reflecting the unique circumstances surrounding the transaction.

VOLATILITY

A large proportion of the investments held by the Group's insurance businesses is invested in assets which are expected to be held on a long-term basis and which are inherently subject to short-term investment market fluctuations. Whilst it is expected that these investments will provide enhanced returns over the longer term, the short-term impact of investment market volatility can be significant. In 2009, higher equity market returns compared to our long-term assumption have contributed to positive insurance and policyholder volatility totalling £478 million.

TAXATION

The Group's 2009 income statement includes a tax credit of £1,911 million. This primarily reflects a tax credit relating to the Group's reported loss and a policyholder interests related tax charge offsetting in full the credit for policyholder interests included in the Group's profit before tax.

The UK Government has published draft legislation which, when enacted, will introduce a bank payroll tax of 50 per cent applicable to discretionary bonuses and other amounts over £25,000 awarded to bank employees in the period 9 December 2009 to 5 April 2010. The legislation has yet to be finalised and there remain significant uncertainties over aspects of its detailed application and the Group continues to asses its ultimate liability in respect of all of its schemes. However, in accordance with the requirements of International Accounting Standard (IAS) 19 'Employee Benefits' the Group has provided in full for the estimated cost of the bank payroll tax; the amount is not significant.

ROBUST CAPITAL RATIOS

At the end of December 2009, the Group's capital ratios, following the Group's successful capital raising in December 2009, increased significantly with a total capital ratio on a Basel II basis of 12.4 per cent, a tier 1 ratio of 9.6 per cent and a core tier 1 ratio of 8.1 per cent. These capital ratios were further enhanced by the issuance on 18 February 2010 of £1.5 billion equity, as part of the capital raising programme announced in November 2009, which further increased the core tier 1 capital ratio by 30 basis points to an adjusted 8.4 per cent. During 2009, risk-weighted assets decreased by 1 per cent to £493.3 billion, as the reduction in balance sheet assets was partly offset by the procyclical impact of the weaker economic environment. Over the next few years we expect to see further reductions in risk-weighted assets as a result of both balance sheet asset reductions and a positive procyclical impact from the expected improvement in the UK economic environment.

Following the introduction of a prescribed stress test by the Financial Services Authority in January 2009 the Group undertook a significant exercise which stress tested the Group's capital base to withstand the impact of a significant economic deterioration in the UK, resulting in a requirement to increase the Group's capital position. As a result of this increased capital requirement, in March 2009, in what was clearly a difficult external market, the Group announced its intention to participate in the Government Asset Protection Scheme. This would have enabled the Group to substantially strengthen its capital position to meet the newly increased regulatory capital requirements, and reduce the risk profile of the enlarged Group's balance sheet.

In June 2009, the Group successfully completed a £4 billion placing and compensatory open offer with the proceeds being used to redeem the £4 billion of preference shares held by HM Treasury. The redemption of the HM Treasury preference shares removed the annual cost of the preference share dividends of £480 million and improves the Group's cash flow generation.

On 3 November 2009 the Group announced further proposals to meet its current and long-term capital requirements by way of a £13.5 billion rights issue and the generation of at least £7.5 billion (subsequently increased to £9 billion) core tier 1 and/or contingent core tier 1 capital through a number of debt exchange offers. In doing so the Group announced that it would not participate in GAPS. This reflected the more positive economic environment than the conditions prevailing in March 2009 when the Group announced its intention to participate in GAPS. As a result of the highly successful conclusion of this transaction, reflecting the strong support received from shareholders and investors, the Group is now in a robust capital position. We note the various recently issued regulatory capital consultation papers and impact studies and will continue to work with our regulators to ensure this robust capital position is maintained as the ongoing capital requirements for banks continue to change.

In addition, during 2009, the Group completed a number of balance sheet liability management transactions that have generated significant core tier 1 capital by redeeming certain securities at a discount to their balance sheet carrying value. A substantial number of note holders have accepted the various offers made and, as a result, the Group has generated a pre-tax profit from these transactions of approximately £1.5 billion.

RIGHTSIZING THE BALANCE SHEET

In the Group's Interim Results announcement in August 2009, we set out our strategy to reduce assets associated with non-relationship lending and investments, including business which is outside our current risk appetite, by some £200 billion by the end of 2014. It is our intention to manage these assets for value and, given the current economic climate, our primary focus will be on running these assets down over time. During 2009, the Group's total balance sheet assets reduced by £100 billion of which £60 billion related to the portfolios of assets in run-off (£15 billion customer assets; £30 billion treasury assets; £15 billion impairment). We expect to achieve a further reduction in such assets of approximately £140 billion over the next few years. The impact of running down these portfolios is not expected to have a significant impact on the Group's financial performance over the medium term.

The balance sheet reduction over time will provide the Group with increased optionality and flexibility from the resultant releases in both funding and capital. These benefits have been incorporated into the Group's overall business plans, which include actions to increase retail and corporate deposits over time. Together these actions will reduce the proportion of the Group's funding that is derived from wholesale markets and eliminate our use of government and central bank sponsored funding facilities, whilst providing capacity for core relationship business growth.

A STRONG LIQUIDITY AND FUNDING POSITION

The recent extended turbulence in global capital markets has been a severe examination of the banking system's capacity to absorb sudden significant changes in the funding and liquidity environment, and individual institutions have faced varying, but significant, degrees of stress. The Group has a strong liquidity position which is supported by our robust and stable customer deposit base. The Group continues to benefit from a diversity of funding sources, which have recently been enhanced by the establishment of a US Medium Term Note programme, and a second regulated covered bond programme. The Group's wholesale funding base has proved to be resilient, supporting the Group's balance sheet with a reduced dependence on short-term funding. During the year the Group has also significantly increased its holdings of liquid assets from £104.5 billion to £150.8 billion. In addition, the Group has improved the quality of its liquid asset portfolio by increasing its cash at central banks and Government debt securities, and reducing its holdings of eligible bank debt securities.

During 2009, the Group has extended the maturity profile of wholesale funding, such that, at 31 December 2009, 50 per cent of wholesale funding had a maturity date greater than one year (31 December 2008: 44 per cent). Over time, and as we see improvements in the capacity of wholesale funding markets, we expect to maintain the amount of the Group's wholesale borrowings with a maturity date greater than one year in excess of 40 per cent which we consider to be an appropriate and sustainable long-term proportion. However, in this regard we note recent regulatory consultation papers relating to liquidity requirements which, if put into practice, could require banks to manage their liquidity risk differently. Increases in customer deposits and the reduction in assets set out above, mean that we expect to see a slow but steady improvement in the Group's loan to deposit ratio. The Group does not set a target for this ratio, which we believe does not reflect either the quality of lending or the term of deposits held but would expect to see it return to legacy Lloyds TSB levels of approximately 140 per cent over the next few years. During 2009 the ratio excluding repos, improved to 169 per cent.

Relative to the size of its balance sheet, the Group does not have significant senior funding issuance requirements. Over the next three years the Group expects its public capital and senior funding issuance to total in the range of £20 billion to £25 billion per annum. We have made good progress on our 2010 term funding issuance plans following the issuance in December 2009 of US$2 billion tier 1 securities and in January 2010 the Group issued US$5 billion senior unsecured debt, and executed a £2.5 billion Residential Mortgage-Backed Securities (RMBS) transaction which included the first public US$ tranche of RMBS by a UK issuer since 2008.

At 31 December 2009, the Group's overall funding support from governmental and central bank sources totalled £157 billion, with a significant proportion (predominantly Special Liquidity Scheme (SLS) and Credit Guarantee Scheme (CGS) funding) maturing over the course of the next two years. The Group's balance sheet reduction plans will avoid the necessity to refinance much of this funding. The current cost to the Group of participating in these schemes is currently approximately 50 basis points over LIBOR for the SLS and approximately 130 basis points over LIBOR for CGS. Overall, based on expected spreads and balance sheet mix, we believe the increased cost of wholesale funding over the next few years is expected to negatively impact the Groups net interest margin by less than 10 basis points, and this cost is expected to be more than offset by the impact of improved product pricing.

SUMMARY

The deterioration in the UK economic environment, particularly in the first half of 2009, created an extremely challenging operating background against which to integrate two large banking organisations. As expected, against this backdrop, the significant increase in corporate impairments has led the Group to report a loss before the credit for negative goodwill arising on the acquisition of HBOS. The Group has a strong risk management culture and is well-placed to manage through the near-term challenges and benefit from what we expect to be a slow but steady UK economic recovery during 2010 and beyond.

Our revenue performance has been resilient and we are already beginning to deliver improving interest margins, which we expect to improve further over the next few years. We have an excellent track record in cost management, with a unique opportunity to capture significant acquisition related synergies over the next few years. We believe the Group's overall impairment charge has now peaked, with a significant reduction expected in 2010. We have a robust capital and funding position. Overall, therefore, based on our current economic outlook, we expect to deliver a significantly improving combined businesses financial performance in 2010, with strong medium-term prospects thereafter.

Tim J W Tookey
Group Finance Director
25 February 2010

COMBINED BUSINESSES SEGMENTAL ANALYSIS

2009	Retail £m	Wholesale £m	Wealth and International £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	7,970	4,710	1,217	(287)	(884)	12,726
Other income	1,804	4,199	1,128	2,944	1,800	11,875
Total income	9,774	8,909	2,345	2,657	916	24,601
Insurance claims	–	–	–	(637)	–	(637)
Total income, net of insurance claims	9,774	8,909	2,345	2,020	916	23,964
Operating expenses	(4,566)	(4,106)	(1,544)	(974)	(419)	(11,609)
Trading surplus	5,208	4,803	801	1,046	497	12,355
Impairment	(4,227)	(15,683)	(4,078)	–	–	(23,988)
Share of results of joint ventures and associates	(6)	(720)	(21)	(22)	2	(767)
Profit (loss) before tax and fair value unwind	975	(11,600)	(3,298)	1,024	499	(12,400)
Fair value unwind[1]	407	6,897	942	(49)	(2,097)	6,100
Profit (loss) before tax	1,382	(4,703)	(2,356)	975	(1,598)	(6,300)
Banking net interest margin[2]	1.97%	1.52%	1.71%			1.77%
Cost:income ratio	46.7%	46.1%	65.8%	48.2%		48.4%
Impairment as a percentage of average advances[3]	1.11%	5.92%	6.04%			3.25%
Key balance sheet and other items 31 December 2009	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers	371.1	191.8	63.5		0.6	627.0
Customer deposits	224.1	153.4	29.0		0.2	406.7
Risk-weighted assets	128.6	286.0	63.2	1.1	14.4	493.3

COMBINED BUSINESSES SEGMENTAL ANALYSIS continued

2008	Retail £m	Wholesale £m	Wealth and International £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	8,454	5,752	1,314	(345)	(272)	14,903
Other income	2,739	(302)	1,191	3,493	(188)	6,933
Total income	11,193	5,450	2,505	3,148	(460)	21,836
Insurance claims	–	–	–	(481)	–	(481)
Total income, net of insurance claims	11,193	5,450	2,505	2,667	(460)	21,355
Operating expenses	(4,963)	(4,591)	(1,476)	(1,129)	(77)	(12,236)
Trading surplus	6,230	859	1,029	1,538	(537)	9,119
Impairment	(3,695)	(10,394)	(731)	–	(60)	(14,880)
Share of results of joint ventures and associates	7	(944)	(21)	2	4	(952)
Profit (loss) before tax	2,542	(10,479)	277	1,540	(593)	(6,713)
Banking net interest margin[2]	2.15%	1.85%	2.06%			2.01%
Cost:income ratio	44.3%	84.2%	58.9%	42.3%		57.3%
Impairment as a percentage of average advances[3]	0.97%	3.32%	1.05%			1.81%
Key balance sheet and other items 31 December 2008	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers	377.1	234.6	64.6	–	0.9	677.2
Customer deposits	216.3	157.9	34.1	–	0.9	409.2
Risk-weighted assets	118.9	311.0	61.2	0.7	6.7	498.5

[1] Fair value unwind represents the impact on the consolidated and divisional income statements of the acquisition related balance sheet adjustments. These adjustments principally reflect the application of market based credit spreads to HBOS's lending portfolios and own debt. The net fair value unwind in 2009 is mainly attributable to a reduction in the impairment charge of £6,859 million, as losses reflected in the opening balance sheet valuation of the lending portfolios have been incurred, offset by a charge to net interest income of £2,166 million as the value of HBOS's own debt accretes to par.

[2] The Group's net interest income includes certain amounts attributable to policyholders, in addition to the interest earnings on shareholders' funds held in the Group's insurance businesses. In addition, the Group's net interest income is significantly affected by the accounting treatment of a number of products predominately in Wholesale division where either the funding costs or the related revenues are recognised within other income. In order to enhance comparability in the Group's banking net interest margin, these items have been excluded in determining net interest income and average interest earning assets.

[3] Impairment on loans and advances to customers divided by average loans and advances to customers, excluding reverse repo transactions, gross of allowance for impairment losses.

DIVISIONAL RESULTS
RETAIL

BY MAKING ITS **CUSTOMERS CENTRAL TO ITS STRATEGY** RETAIL CONTINUES TO MAKE SUBSTANTIAL STRATEGIC PROGRESS

OVERVIEW

Retail is the largest retail bank in the UK and the leading provider of current accounts, savings, personal loans, credit cards and mortgages. With its strong stable of brands including Lloyds TSB, Halifax, Bank of Scotland and Cheltenham & Gloucester, it serves over 30 million customers through one of the largest branch and fee free ATM networks in the UK.

Retail has approximately 22 million current account customers and provides social banking to over 4 million people through basic banking or social banking accounts. It is also the largest provider of personal loans in the UK, as well as being the UK's leading credit card issuer. Retail provides one in four residential mortgages making it the leading UK mortgage lender as well as being a major provider of home finance for the first time buyer. Retail is the largest private sector savings provider in the UK, with over 21 million savers. It is also a major general insurance and bancassurance distributor, selling a wide range of long-term savings, investment and general insurance products.

KEY OPERATING BRANDS

Lloyds TSB

HALIFAX
a little extra help

BANK OF SCOTLAND

C&G Cheltenham & Gloucester

BM BIRMINGHAM MIDSHIRES

INTELLIGENT FINANCE

KEY HIGHLIGHTS

Profit before tax and fair value unwind amounted to £975 million, a decrease of £1,567 million on 2008 primarily due to lower income and higher levels of impairment, partly offset by a decrease in operating expenses.

Net interest income has decreased by 6 per cent to £7,970 million. The banking net interest margin decline of 18 basis points reflected higher wholesale funding costs and lower deposit margins in the low base rate environment, partly offset by higher asset pricing, the benefits from which improved the margin in the second half of the year.

Other operating income has decreased by 34 per cent to £1,804 million, primarily due to lower payment protection income and non-recurring one-off income in 2008.

Strong cost management delivering benefits. Operating expenses decreased by 8 per cent primarily due to tight cost control, cost savings achieved from the integration programme and lower Financial Services Compensation Scheme charges.

Impairment losses have increased by 14 per cent to £4,227 million, reflecting the effect of increased UK unemployment during 2009 on the unsecured charge, partly offset by a lower secured impairment charge as house prices stabilised.

Continued good new lending quality, reflecting continued strong credit criteria with the average loan-to-value ratio on new mortgage lending at 59 per cent, compared to 63 per cent for 2008.

Good progress was made in integrating the Lloyds TSB and HBOS retail businesses. New management structures have been implemented across Retail and continuing good progress has been made in streamlining, simplifying and integrating back office processes. Retail's integration synergies of £124 million for 2009 were ahead of expectations.

Loans and advances to customers have decreased by 2 per cent, reflecting the impact of customers reducing their personal indebtedness and not taking on new financial commitments.

Customer deposits have increased by 4 per cent, despite the high level of term deposits maturing in the period. The growth in deposits accelerated in the second half of 2009, increasing by £5.6 billion, or 3 per cent.

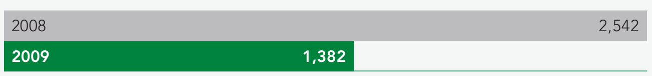
Good momentum in the business into the second half, with a positive trend in income growth in 2009, tight cost control, good progress being made on integration, and impairment losses peaking.

PERFORMANCE SUMMARY

	2009 £m	2008 £m	Change %
Net interest income	**7,970**	8,454	(6)
Other income	**1,804**	2,739	(34)
Total income	**9,774**	11,193	(13)
Operating expenses	**(4,566)**	(4,963)	8
Trading surplus	**5,208**	6,230	(16)
Impairment	**(4,227)**	(3,695)	(14)
Share of results of joint ventures and associates	**(6)**	7	
Profit before tax and fair value unwind	**975**	2,542	(62)
Fair value unwind	**407**	–	
Profit before tax	**1,382**	2,542	(46)
Banking net interest margin	**1.97%**	2.15%	
Cost:income ratio	**46.7%**	44.3%	
Impairment losses as a % of average advances	**1.11%**	0.97%	
As at 31 December	**2009 £bn**	2008 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**371.1**	377.1	(2)
Customer deposits:			
Savings	**185.6**	182.7	2
Current accounts	**38.5**	33.6	15
	224.1	216.3	4
Risk-weighted assets	**128.6**	118.9	8

PERFORMANCE INDICATORS

PROFIT BEFORE TAX £m
(46%)



INCOME AND COST GROWTH 2009 %

CUSTOMER DEPOSITS £bn
4%

LOANS AND ADVANCES TO CUSTOMERS £bn
(2%)

DIVISIONAL RESULTS

RETAIL

STRATEGIC VISION

Retail's strategic goal is to be recognised by its customers as the UK's best and most recommended bank. It will achieve this by building deep and enduring customer relationships which deliver real value to customers. Supporting this strategy are a strong stable of brands which provide unparalleled customer reach and choice; deep customer insight based on the strength of the customer franchise; and highly efficient and effective low cost processes as a result of business scale. Real customer understanding and lower cost processes will enable further investment in the products and services that Retail customers want. Last, but not least, investment in effective tools and processes will allow Retail colleagues to focus on meeting customer needs. This strategy will be delivered within clearly defined and prudent risk parameters.

PROGRESS AGAINST STRATEGIC INITIATIVES

INTEGRATION

The immediate priority of the business has been to plan and successfully deliver the integration of the retail activities of Lloyds TSB and HBOS. Good progress has been made in 2009. Organisational structures have been aligned to establish a single management team across Retail. The management of the sales force is now consistent across both heritages. The different mortgage operating models have been integrated and simplified and the number of mortgage operational sites reduced. In Direct Channels the multi-skilling of advisors has commenced enabling advisors to answer both banking and savings calls. Retail has sold Halifax Estate Agencies as part of ongoing initiatives to focus on its core business. Retail is on track to deliver its annualised cost savings target of £378 million for 2011.

DEEP AND ENDURING CUSTOMER RELATIONSHIPS

A key goal of Retail is to build deeper and enduring relationships with customers and, in particular to help its customers build a more secure financial future. Retail has continued to maintain momentum in its key businesses and is making good progress in implementing its relationship strategy. In 2009 the number of customers with their main current account with Retail (those paying in more than £1,000 a month) increased by 4 per cent. In addition, almost 5 million new savings accounts and almost 2 million new current accounts were opened.

New accounts opened in Lloyds TSB in 2009 were broadly in line with 2008 despite the difficult market, with lower mortgage sales being offset by a particularly strong performance in savings. Sales in the Halifax and Bank of Scotland networks have shown an improving trend in the second half of the year. The pilot of the Lloyds TSB leads system in Halifax and Bank of Scotland in the second half resulted in a significant sales uplift. This will be rolled out to the whole network in 2010.

To support Retail customers, who are encountering financial difficulties, a cross-channel support programme has been launched. Lloyds TSB branches and telephone units have at least one trained Financial Health Specialist providing customers with budgeting and money management advice. In the Halifax and Bank of Scotland businesses, customers have a dedicated telephone support line with trained specialists able to guide them through financial difficulties. Support is also available for all customers online and through a specially developed brochure. For those customers requiring more intensive help, assistance is provided through dedicated support units where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies where they have multiple credit facilities that require restructuring.

CREATING PRODUCTS AND SERVICES THAT CUSTOMERS VALUE

The introduction of the new Reward current account by Halifax and Bank of Scotland was well received by customers. Halifax and Bank of Scotland have taken the lead in the market and moved the majority of their customers to a new and simpler overdraft charging structure. In addition, they have also launched the new Visa contactless debit card. Another innovative product launched in 2009 was the Lloyds TSB 'Lend a Hand' mortgage. This allows first time buyers access to interest rates usually available to those with a 25 per cent deposit by linking the product to funds in a savings account provided by family or friends. As well as providing a return for savers, this product supports growth in the important first time buyers market. In addition, Lloyds TSB launched its new monthly saver with an interest rate of 5 per cent for 12 months.

In Lloyds TSB the role of the bank manager is being re-defined, backed by a marketing campaign, with the focus on traditional customer service and advice, building relationships with the customer within a modern banking environment. Retail also continues to lead the market in the provision of mobile banking services which assist customers in monitoring their bank accounts by providing access through their mobile phone.

IMPROVING PRODUCTIVITY AND CONTINUALLY IMPROVING CUSTOMER SERVICE

Productivity in both branch networks has increased during 2009. The Lloyds TSB network has continued to realise the benefits of the investments made in 2008 in developing branch staff as well as increasing the number of branches opening on a Saturday. Consequently in 2009, sales of personal core banking products by personal bankers increased by 20 per cent. Productivity in the Halifax branch network has grown steadily, with the introduction of the Lloyds TSB leads system to support the more effective cross-selling of products. The sharing of best practice with the Halifax financial advisors has seen their number of monthly sales of protection products increase by over 200 per cent during 2009.

Following a period of strong growth in the use of internet banking, a significant percentage of Retail's customer enquiries and transactions now occur online. There are 6.8 million active users of Retail internet services logging on 52 million times a month. There has been an 18 per cent growth in online account transfers and online payments to third parties. In addition, customers are making increasing use of electronic statements, with more than 6 million accounts now having statements delivered electronically rather than in paper format.

FINANCIAL PERFORMANCE

Profit before tax and fair value unwind decreased by £1,567 million to £975 million. This decrease was driven by higher impairment losses and lower income, partly offset by a reduction in operating expenses.

Retail's banking net interest margin decreased by 18 basis points to 1.97 per cent reflecting higher wholesale funding costs and reduced margins on savings products due to the low base rate environment, partly offset by higher asset pricing which led to a stronger margin in the second half of 2009.

Total income has decreased by £1,419 million, or 13 per cent, to £9,774 million, reflecting the impact on margins referred to above, lower payment protection income and non-recurring one-off income in 2008. Total income is analysed as follows:

	2009 £m	2008 £m	Change %
Mortgages and Savings	**3,667**	5,009	(27)
Consumer Banking	**6,107**	6,184	(1)
Total income	**9,774**	11,193	(13)

Total income in Mortgages and Savings has decreased by 27 per cent. The reduction in Mortgage income reflected increased wholesale money market funding costs, which was partly offset by higher asset pricing. Lower income in Savings was the result of margin pressures arising from lower base rates and the competitive environment, the impact of which was partly offset by higher customer deposits.

Consumer Banking (current accounts and unsecured lending) income was broadly unchanged in 2009 compared to 2008. As previously reported, on 1 January 2009 Retail introduced a monthly premium payment protection product and ceased selling single premium products. This new product offers customers the benefit of monthly payments whilst retaining the product's valuable benefits and has been well received by both customers and the market. Income from this product is recognised over the life of the loan rather than all being recognised in the first year. This reduction in income, together with the effect of lower loan volumes, was broadly offset by a strong performance across the rest of Consumer Banking, including benefits from asset re-pricing.

Lending to customers in 2009 has fallen by 2 per cent reflecting the impact of customers reducing their personal indebtedness and not taking on new financial commitments in the current difficult economic environment. Risk-weighted assets increased by 8 per cent reflecting the impact of the weak economic environment on credit quality.

Retail continued to make good progress in building its mortgage business in a contracting market by focusing on the prime mortgage market, particularly through its network rather than intermediaries, whilst maintaining a prudent approach to risk. Gross new mortgage lending totalled £35 billion during 2009, representing a market share of 24 per cent. Retail has maintained its strong commitment to the housing market and first time buyers, with more than 60 per cent of new lending in 2009 being for house purchase rather than for re-mortgage. In March 2009, the Group committed to increase its planned gross lending to homebuyers by £3 billion in the following 12 months – Retail is on track to deliver this commitment. The average loan-to-value ratio at the end of 2009 was 54.8 per cent compared with 54.9 per cent at the end of 2008, whilst the average loan-to-value ratio on new residential lending in 2009 was 59.3 per cent compared with 63.1 per cent in 2008. Retail continued to be an industry leader in its support for shared equity and share ownership schemes. Specialist lending balances (self-certified and sub-prime) decreased slowly following the decision, at the start of the year, to withdraw from this market. New buy to let lending remained broadly flat at 13 per cent of total mortgage lending; however, redemptions in this book were low. Buy to let mortgage balances have increased by £2.9 billion in the year. Retail continued to carefully assess the risks of such lending and as a result the average loan-to-value on new lending in the buy to let portfolio has fallen to 65.6 per cent at the end of 2009 compared to 73.1 per cent at the end of 2008.

Customer deposits have increased by 4 per cent over the last 12 months despite the high level of term deposits maturing during the period, as a result of Halifax and Bank of Scotland deposit gathering activities in the first half of 2008. Deposit growth accelerated through 2009 reversing the trend of declining deposit balances in the second half of 2008. Deposit growth in the second half of 2009 was particularly strong at £5.6 billion, or 3 per cent. Current account balances have increased by 15 per cent in the year resulting from growth in the number of current accounts and the low interest rate environment.

Operating expenses decreased by £397 million, or 8 per cent, to £4,566 million driven primarily by strong cost control, cost savings resulting from integrating the two businesses and the benefit of a lower Financial Services Compensation Scheme levy. The reduction in operating expenses resulting from integrating the Lloyds TSB and HBOS retail businesses was delivered through streamlining management structures, consolidating the number of mortgage operational sites, integrating and simplifying the mortgage operating model, procurement savings from the rationalisation of suppliers and property savings through the consolidation of sites.

Impairment losses on loans and advances have increased by £532 million, or 14 per cent, to £4,227 million in 2009. Impairment losses as a percentage of average advances were 1.11 per cent in 2009 compared to 0.97 per cent in 2008. Higher unemployment and the weak economy drove a significant increase in unsecured impairments which was partly offset by a lower secured impairment charge as house prices stabilised. Unsecured impairment losses are sensitive to economic conditions, particularly unemployment levels; consequently the 2009 impairment charge increased by £1,038 million to £3,438 million. The stabilisation of the housing market, in combination with lower interest rates and prudent risk management, has resulted in the secured impairment charge decreasing in 2009 by £506 million to £789 million. Total impaired loans, as a percentage of closing advances to customers, decreased during the second half of the year to 2.9 per cent compared to 3.0 per cent at 30 June 2009 and 2.6 per cent at 31 December 2008.

Arrears levels in the secured portfolios were higher than 2008 but improved in the second half of 2009, and remained below the industry average. The percentage of mortgage cases more than three months in arrears increased to 2.3 per cent at 31 December 2009 compared to 1.8 per cent as at 31 December 2008. The stock of repossessed properties reduced by 32 per cent to 2,720 properties compared to 4,011 properties at the end of 2008 and, as a proportion of total accounts, remains lower than the industry average. Currently, average proceeds from the sale of repossessed properties are in excess of average valuations assumed in Retail's provisioning models.

The level of impaired loans in the unsecured lending portfolio, as at 31 December 2009, totalled £3.8 billion, or 11.9 per cent of closing advances (after writing off £2.1 billion of loans provided against in earlier years). This compared with £5.4 billion, or 14.7 per cent of closing advances at 31 December 2008; however, on an equivalent basis (adjusting for the £2.1 billion write-off in 2009) impaired loans at 31 December 2008 totalled £3.3 billion, or 8.9 per cent of advances. The underlying increase in impaired loans which occurred in the first half of 2009 reflected the weak economy, particularly rising unemployment. During 2009 a number of actions have been taken which improved delinquency rates on new business.

Compared to 2009, Retail expects to see a reduction in its impairment charge in 2010 as house prices continue to stabilise, with further improvements thereafter as the UK economic environment improves.

DIVISIONAL RESULTS
WHOLESALE

THE **'THROUGH THE CYCLE' RELATIONSHIP FOCUSED STRATEGY** MEANS WHOLESALE WILL SUPPORT CUSTOMERS THROUGHOUT THE ECONOMIC CYCLE

OVERVIEW

The Wholesale division serves in excess of a million businesses, ranging from start-ups and small enterprises to global corporations, with a range of propositions fully segmented according to customer need. The division comprises Corporate Markets, Treasury and Trading, and Asset Finance.

Corporate Markets comprises Corporate, Commercial, Corporate Real Estate, Specialist Finance and Wholesale Markets. Corporate, Commercial and Corporate Real Estate provide relationship-based banking, risk management and advisory services to corporate and commercial customers principally in the UK. Specialist Finance includes the acquisition finance and private equity businesses. Wholesale Markets provides risk management solutions, specialised lending, capital markets advisory and multi-product financing solutions to its customers, whilst managing the Group's own portfolio of structured credit investments and treasury assets.

Treasury and Trading's role is to provide access to financial markets in order to meet the Group's balance sheet management requirements, and provides trading infrastructure to support execution of customer-driven risk management transactions, whilst operating within a well controlled and conservative risk appetite.

Asset Finance consists of a number of leasing and speciality lending businesses including Contract Hire (Lex, Autolease and Hill Hire), Specialist Assets and Consumer Finance (Black Horse Motor and Personal Finance).

KEY OPERATING BRANDS

Lloyds TSB

BANK OF SCOTLAND

blackhorse

Lex Autolease

KEY HIGHLIGHTS

Loss before tax and fair value unwind amounted to £11,600 million, an increase of £1,121 million on 2008 due to higher levels of impairment, partly offset by an increase in other operating income and a decrease in operating expenses.

Total income has increased by 63 per cent to £8,909 million, particularly reflecting the lower impact of market dislocation and continued strength in sales and trading activity.

Net interest income has decreased by 18 per cent to £4,710 million. The banking net interest margin decline of 33 basis points since prior year reflected higher wholesale funding costs partly offset by higher asset pricing. Margins fell in the first half of the year but have stabilised in the second half of 2009.

Strong cost management delivering benefits, excluding the cost of settlement of certain historic US dollar payments practices incurred in 2008, total operating expenses decreased by 7 per cent, reflecting reduced levels of operating lease business and cost savings achieved from the integration programme, partly offset by increased investment in Wholesale's customer focused business support functions.

Impairment losses amounted to £15,683 million, compared to £10,394 million in 2008, reflecting the continued weak economic climate and the application of Lloyds Banking Group prudent impairment assumptions, primarily in HBOS Corporate Real Estate and HBOS (UK and US) Corporate businesses. Total impairment losses are expected to have peaked in the first half of 2009, with a significant reduction in the impairment charge delivered in the second half of 2009 of 39 per cent.

Cross-selling from deepening relationships has increased by 26 per cent reflecting increased product competencies and opportunities through a single sales force on the combined customer base.

Balance sheet reductions, reflect active de-risking of the balance sheet by either selling down or reducing holdings in debt securities and available-for-sale positions, deleveraging by customers in Wholesale's strategic segments and the impact of impairments and foreign exchange movements.

Good progress was made in integrating the Lloyds TSB and HBOS wholesale businesses. Wholesale's integration synergies for 2009 were ahead of expectations.

PERFORMANCE SUMMARY

	2009 £m	2008 £m	Change %
Net interest income	**4,710**	5,752	(18)
Other income	**4,199**	(302)	
Total income	**8,909**	5,450	63
Operating expenses	**(4,106)**	(4,591)	11
Trading surplus	**4,803**	859	
Impairment	**(15,683)**	(10,394)	(51)
Share of results of joint ventures and associates	**(720)**	(944)	24
Loss before tax and fair value unwind	**(11,600)**	(10,479)	(11)
Fair value unwind	**6,897**	–	
Loss before tax	**(4,703)**	(10,479)	55
Loss before tax and fair value unwind by business unit			
Corporate Markets	**(11,736)**	(10,509)	(12)
Treasury and Trading	**595**	273	
Asset Finance	**(459)**	(243)	(89)
Loss before tax and fair value unwind	**(11,600)**	(10,479)	(11)
Banking net interest margin	**1.52%**	1.85%	
Cost:income ratio	**46.1%**	84.2%	
Impairment losses as a % of average advances	**5.92%**	3.32%	

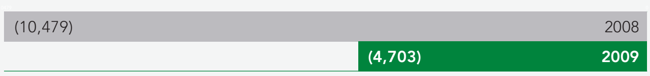
As at 31 December	2009 £bn	2008 £bn	Change %
Key balance sheet and other items			
Loans and receivables:			
Loans and advances to customers	**191.8**	234.6	(18)
Loans and advances to banks	**18.9**	37.0	(49)
Debt securities	**31.7**	40.5	(22)
Available-for-sale financial assets	**36.9**	74.1	(50)
Customer deposits[1]	**153.4**	157.9	(3)
Risk-weighed assets	**286.0**	311.0	(8)

[1] Of which repos represents £35.5 billion (2008: £18.1 billion).

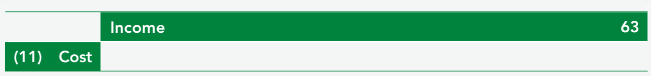
PERFORMANCE INDICATORS

LOSS BEFORE TAX £m

55%



INCOME AND COST GROWTH 2009 %



GROWTH IN CROSS-SELLING INCOME %

COMMITTED GROSS LENDING £bn

[2] No equivalent data in 2008 (pre-acquisition).

DIVISIONAL RESULTS

WHOLESALE

STRATEGIC VISION

Wholesale's strategic goal is to be recognised as the UK's leading, 'through-the-cycle', relationship-focused wholesale bank. The mission is to deepen and retain recurring, multi-product customer relationships building on deep insight into customer needs to provide a broad range of banking, risk management and capital market products.

PROGRESS AGAINST STRATEGIC INITIATIVES

SUPPORTING CUSTOMERS THROUGH THE CYCLE

Wholesale has provided approximately £35 billion of committed gross lending to the Corporate and Small and Medium Enterprises (SME) sector during 2009 and recruited approximately 100,000 new commercial accounts. Additionally, Wholesale has expanded its product capability in Wholesale Markets to allow customers to diversify their funding by accessing wider sources of capital markets liquidity, and to manage their interest rate and currency risks in an uncertain operating environment.

For customers who have been adversely impacted by the recession, Wholesale has continued to expand its dedicated Business Support Units across its Corporate, Commercial, Corporate Real Estate and Specialist Finance business areas. Business Support Units offer solutions to customers including providing finance to maintain cash flow and capital restructuring where appropriate. By focusing on effective customer turnaround during turbulent times, Wholesale is deepening relationships and retaining loyal customers.

Wholesale's 'through-the-cycle' commitment to businesses is also supported by other key initiatives such as the SME Business Charter that expects by 2012 to help a further 300,000 people start in business and to stage at least 200 customer seminars a year to help them develop their businesses and to provide additional finance for growth. The Charter ensures that customer interest rates are transparent and reflect the cost of funds and risk in lending to Wholesale's small business customers. In the fourth quarter of 2009, Commercial held a series of regional customer events aimed at helping customers plan for the upturn by providing practical guidance and maximising networking opportunities through bringing local business communities together.

INTEGRATING THE BUSINESSES

The Corporate and Commercial businesses have made substantial progress in building on the strengths of both heritages to provide a single relationship face to its strategic customer segments. Risk management processes within all the former HBOS businesses have been brought into line with the more conservative appetite of the Group. The balance sheet capacity of Wholesale Markets has been better aligned with the needs of customers by reducing exposure to assets not specifically required to support its strategic customer segments. The treasury activities of both heritages have been brought under one Treasury and Trading business so that Wholesale is able to provide a single, consistent face to the market. Consolidation and rationalisation of Asset Finance businesses continues, bringing together consumer finance businesses under the Black Horse brand and further centralisation of its sales channel and merging the market-leading Lex and Autolease contract hire businesses.

Wholesale's integration programme is making good progress and synergies for the year are ahead of expectations. The initial planning and organisational design stage has been completed, and the Wholesale Operating Model has been defined. All major systems platform decisions have been made and the first product migrations have been completed. The focus for 2010 is on planning and execution of additional product migrations and strengthening risk systems. Wholesale is on track to deliver its annualised cost savings target by 2011.

PRIORITISING BUSINESSES

Wholesale is investing in product and service capability in businesses where it believes it can grow in a capital and liquidity efficient manner, build competitive customer propositions drawing on its existing strengths, and thereby increase the breadth and depth of trusted customer relationships. Wholesale is building this capability within a prudent risk framework.

In order to build capacity for this investment, Wholesale has systematically reviewed its assets, portfolios and businesses to identify those that are not consistent with its relationship-focused strategic vision. Wholesale aims to maximise near-term returns in these businesses, whilst exploring options for divestment during the next three to five years. These comprise approximately £160 billion of Wholesale's total assets and form part of its commitment under the state aid restructuring plan.

FINANCIAL PERFORMANCE

Loss before tax and fair value unwind increased by £1,121 million to £11,600 million. This increase was driven by increased impairment losses reflecting the continued weak economic climate and the application of prudent Lloyds Banking Group impairment assumptions, primarily in HBOS Corporate Real Estate and HBOS (UK and US) Corporate businesses, partly offset by an increase in other operating income and a decrease in operating expenses.

Total income increased by £3,459 million, or 63 per cent, to £8,909 million driven by a large increase in other income. Prior year income was significantly lower due to the effect of the market dislocation which resulted in investment valuation write-downs in Wholesale Markets, which were not repeated in the current year. Excluding these amounts total income decreased by 4 per cent as strong performances in Wholesale Markets and Treasury and Trading due to a more favourable interest rate environment, good transaction volumes in capital markets and strong flows of client-driven derivative transactions at improved spreads were more than offset by higher funding costs.

Operating expenses decreased by £485 million, or 11 per cent, to £4,106 million. Excluding the cost of settlement of certain historic US dollar payments practices, expenses decreased by 7 per cent primarily as a result of reduced levels of operating lease business in Asset Finance and a continued focus on cost management including cost savings attributable to the integration programme.

Impairment losses have increased by £5,289 million to £15,683 million in 2009. Impairment losses for loans and advances as a percentage of average loans and advances to customers were 5.92 per cent in 2009 compared to 3.32 per cent in 2008. Higher levels of failures, and application of prudent Lloyds Banking Group provisioning policy, notably in HBOS Corporate Real Estate and HBOS Corporate (UK and US) transactions, drove a significant increase in impairments in these portfolios. However, total impairment losses are expected to have peaked in the first half of 2009, amounting to £9,738 million, compared to £5,945 million in the second half, a reduction of 39 per cent.

Following detailed in depth reviews of all higher risk portfolios, especially HBOS, Wholesale has applied appropriate assumptions, particularly on HBOS Corporate Real Estate lending which resulted in prudent and significant impairment charges in 2009. As a result, Wholesale is expecting total impairments in 2010 to be significantly lower than 2009 in line with the Group's base economic assumptions. Wholesale expects the volume of underlying impairments from traditional trading and manufacturing businesses to increase in 2010, as the full impact of economic conditions filters into business insolvencies and asset values. This is a factor of a typical lag effect as the economy passes through the recession, and reflects guidance provided in the first half of the year. However, the effects of this are expected to be significantly less than the benefit of lower absolute impairments from the HBOS Corporate Real Estate and HBOS (UK and US) Corporate portfolios.

The share of losses from joint ventures and associates reduced by £224 million to a loss of £720 million. There were fewer write-offs in 2009 as the majority of the book is now valued at nil, with a remaining portfolio conservative carrying value of approximately £190 million.

Balance sheet reductions reflect active de-risking of the balance sheet by either selling down or reducing holdings in debt securities and available-for-sale positions, deleveraging by customers in Wholesale's strategic segments and the impact of impairments and foreign exchange movements. Credit markets rallied in the second half of 2009 which brought back some strategic buyers for asset-backed securities (ABS) and allowed Wholesale to sell £3.5 billion notional of non-core ABS positions.

FINANCIAL PERFORMANCE BY BUSINESS UNITS

Corporate Markets

	2009 £m	2008 £m	Change %
Net interest income	**3,756**	4,693	(20)
Other income	**2,541**	(1,780)	
Total income	**6,297**	2,913	
Operating expenses	**(2,461)**	(2,583)	5
Trading surplus	**3,836**	330	
Impairment	**(14,855)**	(9,896)	(50)
Share of results of joint ventures and associates	**(717)**	(943)	24
Loss before tax and fair value unwind	**(11,736)**	(10,509)	(12)
Cost:income ratio	**39.1%**	88.7%	
Impairment losses as a % of average advances	**6.09%**	3.78%	

As at 31 December	2009 £bn	2008 £bn	Change %
Key balance sheet and other items			
Loans and receivables:			
Loans and advances to customers	**177.7**	216.4	(18)
Loans and advances to banks	**4.5**	9.3	(52)
Debt securities	**31.7**	40.5	(22)
Available-for-sale financial assets	**32.1**	38.3	(16)
Customer deposits[1]	**89.7**	96.6	(7)
Risk-weighted assets	**263.8**	284.7	(7)

[1] Of which repos represents £35.5 billion (2008: £18.1 billion).

Loss before tax and fair value unwind increased by £1,227 million to £11,736 million, due to an increase in impairment losses, partly offset by an increase in other income.

Total income increased by £3,384 million to £6,297 million as a result of the significantly reduced impact from market dislocation and the absence of investment write downs in 2009. Performance in key income drivers across Commercial Banking, Corporate Banking, Wholesale Markets and Corporate Real Estate are further discussed below.

Commercial Banking net interest income decreased due to the lower base rate environment which impacted margins on some current account and savings products, and other operating income decreased slightly, primarily reflecting lower customer transactions and activity in their businesses, as a consequence of the depressed economic environment.

Corporate Banking net interest income increased marginally as re-pricing reflected changing risk profiles and higher liquidity costs; however, this was mostly offset by higher funding costs. Average transaction volumes were maintained year-on-year; however lending showed a decline through 2009 as customers actively deleveraged their balance sheets, aligned with a suppressed appetite for new borrowing in the current economic environment. Other operating income increased by approximately 18 per cent reflecting improved upfront fees, exit fees and commitment commissions.

Wholesale Markets net interest income was approximately 34 per cent lower primarily reflecting the higher cost of funding. Other operating income increased by £4,472 million, primarily due to the absence of prior year investment write downs associated with the dislocated markets and some valuation recoveries in 2009.

Corporate Real Estate net interest income decreased overall due to the increased funding costs and falling levels of income from impaired assets, partly offset by increased margins from asset re-pricing.

Operating expenses decreased by £122 million, or 5 per cent to £2,461 million, as a result of continued focused cost management. After excluding the cost incurred in 2008 on settlement of certain historic US dollar payments practices, operating expenses increased by 2 per cent, with integration savings offset by increased investment in Wholesale's customer focused business support functions, which now employ approximately 1,000 people.

Impairment losses increased by £4,959 million to £14,855 million, due to increased levels of impairments across all areas of Corporate Markets, notably in the HBOS Corporate Real Estate and the HBOS (UK and US) Corporate portfolio. The significant increase in impairments in 2009 was against the backdrop of weaker economic conditions; application of Lloyds Banking Group prudent valuation assumptions; portfolio concentration in property lending; material single name exposures; poorly structured lending agreements; and aggressive loan-to-value positions at origination in the legacy HBOS portfolios. However, impairment losses of £9,334 million in the first half of 2009 fell significantly in the second half to £5,521 million, a reduction of 41 per cent.

DIVISIONAL RESULTS

WHOLESALE

In 2009, Wholesale has spent a significant amount of time continuing to analyse and address the issues in the legacy HBOS portfolios, with the greatest attention paid to over concentrations in real estate, individual entrepreneurial cases and those other portfolios that fall outside the legacy Lloyds TSB credit risk appetite. As a result, and in particular, Wholesale has applied appropriate assumptions about real estate asset expectations and with the deterioration in the economic conditions translating into lower commercial property valuations, has taken prudent and significant impairment charges. Whilst a recent improvement in property valuations has been noted, this has had a limited impact on the property development portfolio.

The share of losses from joint ventures and associates of £717 million, reduced by £226 million. There were fewer write-offs in 2009 as the majority of the book is now valued at nil with a remaining portfolio conservative carrying value of approximately £180 million.

Loans and advances to customers decreased by £38.7 billion to £177.7 billion as an estimated £20 billion of total lending drawdowns in the year was more than offset by scheduled amortisations and repayments and the impact of customers deleveraging their balance sheets by using alternative forms of funding. The decrease was also driven by the transfer of a £7 billion European loan portfolio to Wealth and International, significant impairment losses in 2009 and foreign exchange movements, partially offset by the unwind of fair value adjustments booked on acquisition of HBOS.

Debt securities and available-for-sale financial assets balances reduced by £15 billion as Corporate Markets de-risked the balance sheet by either selling down or not replenishing total holdings after amortisations or maturities.

Treasury and Trading

	2009 £m	2008 £m	Change %
Net interest income	**544**	746	(27)
Other income	**238**	(193)	
Total income	**782**	553	41
Operating expenses	**(187)**	(188)	1
Trading surplus	**595**	365	63
Impairment	**–**	(92)	
Profit before tax and fair value unwind	**595**	273	
Cost:income ratio	**23.9%**	34.0%	

As at 31 December	2009 £bn	2008 £bn	Change %
Key balance sheet and other items			
Loans and receivables:			
Loans and advances to customers	**2.5**	4.8	(48)
Loans and advances to banks	**14.4**	27.7	(48)
Available-for-sale financial assets	**4.8**	35.8	(87)
Customer deposits	**63.7**	61.3	4
Risk-weighted assets	**8.4**	11.6	(28)

Income performance benefited from strong customer demand for interest rate and foreign exchange products, market volatility and both internal and external demand for Treasury's pricing and risk management service, albeit at more moderate levels in the second half of 2009. Trading flows are managed with the overriding aim of providing a service to customers, whilst maintaining Treasury and Trading's conservative risk appetite.

Operating expenses reduced by £1 million to £187 million reflecting a continued focus on cost management and cost savings achieved through integration.

Impairment losses of £92 million in 2008 reflected the impact of a number of high profile financial services company failures in the second half of 2008.

The reduction in available-for-sale financial assets is a result of the decision to sell the majority of these assets, which were held for liquidity purposes, and increase deposits with the Bank of England, thereby improving the quality of the liquid asset portfolio.

Asset Finance

	2009 £m	2008 £m	Change %
Net interest income	**410**	313	31
Other income	**1,420**	1,671	(15)
Total income	**1,830**	1,984	(8)
Operating expenses	**(1,458)**	(1,820)	20
Trading surplus	**372**	164	
Impairment	**(828)**	(406)	
Share of results of joint ventures and associates	**(3)**	(1)	
Loss before tax and fair value unwind	**(459)**	(243)	(89)
Cost:income ratio	**79.7%**	91.7%	
Impairment losses as a % of average advances	**5.86%**	2.53%	
As at 31 December	**2009 £bn**	2008 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**11.6**	13.4	(13)
Operating lease assets	**3.4**	3.9	(13)
Risk-weighted assets	**13.8**	14.7	(6)

Loss before tax and fair value unwind increased by £216 million to £459 million due to higher impairment losses, partially offset by a decrease in operating expenses.

Total income decreased by £154 million, or 8 per cent, to £1,830 million from lower business volumes on assets held under operating leases, lower insurance income in the Personal Finance business due to the move to a monthly premium product, as well as reduced new business volumes. This was offset in part by margin improvement across the consumer finance businesses.

Operating expenses decreased by £362 million, or 20 per cent, to £1,458 million, reflecting the impact of lower business volumes reducing depreciation charges on assets held under operating lease, year-on-year improvement in used car values and cost savings achieved from integration.

Impairment losses increased by £422 million to £828 million, reflecting increases in impairment in both the retail and non-retail consumer finance businesses. In retail consumer finance, impairment increases reflected both the increase in the number of customers going into arrears and changes in the expected recovery rates on the defaulted second lien portfolio resulting from house price deflation, which has now stabilised. The business has also seen a significant increase in the number of corporate failures within its non-retail books which have also caused an increase in the impairment charge.

DIVISIONAL RESULTS
WEALTH AND INTERNATIONAL

INCREASING THE PENETRATION OF THE WEALTH OFFERING INTO THE GROUP'S EXISTING CUSTOMER BASE PROVIDES A **SIGNIFICANT GROWTH OPPORTUNITY**

OVERVIEW

Wealth and International is a new division formed in 2009 to give increased focus and momentum to the private banking and asset management businesses and to closely co-ordinate the management of our international businesses. The division operates in more than 30 countries around the world.

The Wealth business comprises private banking, wealth and asset management businesses in the UK and overseas. The key operations are UK and International Private Banking, which operate under the Lloyds TSB and Bank of Scotland brands, the Channel Islands and Isle of Man offshore businesses, the expatriates business and the Asset Management business which, following the completion of the sale of Insight Investment, is now consolidated within Scottish Widows Investment Partnership (SWIP). SWIP is one of the largest asset managers in the UK, managing £142 billion worth of assets on behalf of a wide range of institutions. In addition the Group holds a 60 per cent stake in St James's Place plc and a 55 per cent stake in Invista Real Estate, respectively the UK's largest independent listed wealth manager and real estate fund management Group.

The International business comprises the Groups other international banking businesses outside of the UK, with the exception of the corporate business in North America which is managed through the Group's Wholesale division. These largely comprise corporate, commercial and asset finance businesses in Australia, Ireland and Continental Europe and retail businesses in Ireland, Germany and the Netherlands.

KEY OPERATING BRANDS

Private Banking Lloyds TSB

LOOK AT THINGS DIFFERENTLY
BANK OF SCOTLAND

International Private Banking Lloyds TSB

SCOTTISH WIDOWS INVESTMENT PARTNERSHIP

Lloyds TSB | International

KEY HIGHLIGHTS

Loss before tax and fair value unwind amounted to £3,298 million, compared to a profit of £277 million in 2008 due to higher levels of impairment.

Total income has decreased by 6 per cent to £2,345 million, reflecting lower net interest margins, and the impact of lower global stock markets particularly in the first half of the year, partly offset by favourable foreign exchange movements.

Net interest income has decreased by 7 per cent to £1,217 million, the banking net interest margin decline of 35 basis points reflects higher wholesale funding costs and lower deposit margins in the low base rate environment, partly offset by the impact of strong portfolio management in International, leading to an underlying gross asset reduction of 7 per cent, and higher asset pricing leading to higher margins.

Targeted cost management has delivered benefits, excluding the impact of foreign exchange movements and additional costs associated with transitional services in the Australian business, underlying costs were slightly lower than 2008 due to cost savings achieved from integration partly offset by investments into higher growth areas and business support functions.

Impairment losses amounted to £4,078 million, compared to £731 million in 2008, reflecting the significant deterioration in the credit risk environment in Ireland and Australia. The impairment charge for Wealth and International is expected to have peaked in 2009, although the economic conditions in Ireland continue to be monitored closely.

Good progress was made in integrating the Lloyds TSB and HBOS Wealth and International businesses. Wealth and International's integration synergies for 2009 were ahead of expectations.

Loans and advances to customers have decreased by 2 per cent to £63.5 billion, primarily due to net repayments and increased impairment provisions in the International businesses offset by the transfer of a £7 billion European loan portfolio from Wholesale division.

Customer deposits have decreased by 15 per cent to £29 billion, primarily due to outflows in Ireland reflecting aggressive pricing from competitors who have also benefited from the Irish Government deposit guarantee.

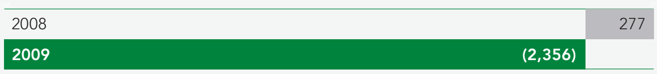
PERFORMANCE SUMMARY

	2009 £m	2008 £m	Change %
Net interest income	**1,217**	1,314	(7)
Other income	**1,128**	1,191	(5)
Total income	**2,345**	2,505	(6)
Operating expenses	**(1,544)**	(1,476)	(5)
Trading surplus	**801**	1,029	(22)
Impairment	**(4,078)**	(731)	
Share of results of joint ventures and associates	**(21)**	(21)	
Profit (loss) before tax and fair value unwind	**(3,298)**	277	
Fair value unwind	**942**	–	
Profit (loss) before tax	**(2,356)**	277	
Profit (loss) before tax and fair value unwind by business unit			
Wealth	**198**	369	
International	**(3,496)**	(92)	
Profit (loss) before tax and fair value unwind	**(3,298)**	277	
Banking net interest margin	**1.71%**	2.06%	
Cost:income ratio	**65.8%**	58.9%	
Impairment losses as a % of average advances	**6.04%**	1.05%	

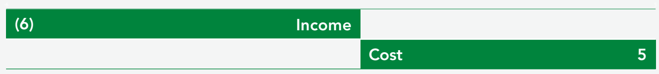
As at 31 December	2009 £bn	2008 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**63.5**	64.6	(2)
Customer deposits	**29.0**	34.1	(15)
Risk-weighted assets	**63.2**	61.2	3

PERFORMANCE INDICATORS

PROFIT/LOSS BEFORE TAX £m



INCOME AND COST GROWTH 2009 %



CUSTOMER DEPOSITS £bn

(15%)

WEALTH RELATIONSHIP CLIENTS

7%

DIVISIONAL RESULTS

WEALTH AND INTERNATIONAL

STRATEGIC VISION

Wealth represents a key growth opportunity for the Group and, through deepening the relationships with existing Group clients alongside targeted external customer acquisition, Wealth's goal is to be recognised as the trusted advisor to expatriate and private banking clients both in the UK and selected international markets. Wealth's initial focus in the UK will be to increase the penetration of its offering into the Group's existing customer base by referring wealthier customers to its private banking businesses where their wider financial needs can be more effectively met. Outside the UK, Wealth will be building on the strengths of its brand portfolio and existing expatriate, offshore and international private banking propositions.

Wealth also represents an opportunity to diversify income growth to less capital intensive businesses and, following an initial outflow of price sensitive deposits in 2009, contribute valuable relationship based customer deposits to improve the Group's funding profile.

In the International businesses, the priority is to maximise value in the short to medium term. International's immediate focus is close management of the lending portfolio, particularly in the Irish business, embedding the Group's risk management policies and procedures and repricing assets where appropriate. At the same time International will be delivering operational efficiencies, reshaping the business models and rightsizing the balance sheet to reflect the ongoing environment.

PROGRESS AGAINST STRATEGIC INITIATIVES

DEEP AND ENDURING CUSTOMER RELATIONSHIPS

In Wealth, the focus has been on driving additional income growth from the Group's affluent and high net worth client base through more effective use of the opportunities afforded by the Retail and Wholesale franchises to cross-sell Wealth products to these customers. The total number of Wealth relationship clients increased by 8 per cent to approximately 300,000 at the end of 2009, including a 13 per cent increase within UK Wealth. Net new inflows of funds under management in the year were £7 billion.

MAXIMISING VALUE IN THE SHORT TO MEDIUM TERM

In International, the focus is on managing the impaired asset portfolio with redeployment of resource from front line activity and the wider Group to manage arrears and collections. The business is responding to the challenging environment through strong portfolio management and repricing assets as opportunities arise.

INTEGRATION

Wealth and International is making good progress with the integration of its Wealth operations, including private banking and in particular its asset management businesses. The internal funds management business of Insight Investment has now been transferred to Scottish Widows Investment Partnership (SWIP) pushing it into the top five largest UK active asset managers, with funds under management of £142 billion. Wealth and International is on track to deliver its annualised cost savings target by 2011.

On 9 February 2010 the Group announced its intention to reshape the Irish business to reflect the continuing difficult economic environment and secure a viable future. The Group intends to close both the Halifax retail business in the Republic of Ireland and the Bank of Scotland (Ireland) intermediary business and refocus the Irish business on its established strengths and long standing ICC Bank heritage of corporate and commercial banking. The resulting closure of 44 Halifax retail branches and the majority of the associated job losses are planned to take place by the end of July 2010.

FINANCIAL PERFORMANCE BY BUSINESS UNIT

Wealth

	2009 £m	2008 £m	Change %
Net interest income	**383**	445	(14)
Other income	**1,003**	1,096	(8)
Total income	**1,386**	1,541	(10)
Operating expenses	**(1,119)**	(1,130)	1
Trading surplus	**267**	411	(35)
Impairment	**(71)**	(23)	
Share of results of joint ventures and associates	**2**	(19)	
Profit before tax and fair value unwind	**198**	369	(46)
Cost:income ratio	**80.7%**	73.3%	
Impairment losses as a % of average advances	**0.70%**	0.22%	
As at 31 December	**2009 £bn**	2008 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**9.2**	10.4	(12)
Customer deposits	**23.2**	26.7	(13)
Risk-weighted assets	**10.0**	11.6	(14)

Profit before tax and fair value unwind decreased by 46 per cent to £198 million primarily due to lower income.

Total income decreased by £155 million, or 10 per cent, to £1,386 million. Net interest income decreased by £62 million, or 14 per cent, to £383 million reflecting margin compression driven by reducing base rates and a very competitive deposit market which led to an outflow in deposits of £3.5 billion. Other income decreased by £93 million, or 8 per cent, to £1,003 million driven by falls in global stock markets particularly in the first half of 2009, impacting sales volumes and fee income across all Wealth businesses.

Operating expenses decreased by £11 million to £1,119 million driven by cost savings from integration, particularly in the asset management business, offset by investments to increase distribution capacity in Private Banking to support future growth plans and the negative impact of foreign exchange movements, principally arising from the stronger Euro.

Impairment losses have increased by £48 million to £71 million, reflecting the impact of the economic environment on the UK Private Banking and Expatriate lending portfolios.

The Wealth results include total income of £66 million and operating expenses of approximately £65 million relating to the external fund management business of Insight Investment which was sold in November 2009. No material gain or loss arose on the disposal.

	2009 £bn	2008 £bn
Funds under management		
SWIP and Insight:		
Internal	**111.7**	95.0
External	**30.0**	107.2
	141.7	202.2
Other Wealth:		
St. James's Place	**21.4**	16.3
Invista	**5.4**	6.3
Other (including Private Banking)	**15.6**	20.1
Closing funds under management	**184.1**	244.9

	2009 £bn	2008 £bn
Opening funds under management	**244.9**	253.0
Inflows – SWIP and Insight:		
internal	**7.1**	8.4
external	**33.1**	31.3
Other	**4.1**	5.5
	44.3	45.2
Outflows – SWIP and Insight:		
internal	**(6.8)**	(11.9)
external	**(26.4)**	(15.9)
Other	**(4.0)**	(3.2)
	(37.2)	(31.0)
Investment return, expenses and commission	**16.4**	(22.3)
Net operating increase (decrease) in funds[1]	**23.5**	(8.1)
Sale of Insight	**(84.3)**	–
Closing funds under management	**184.1**	244.9

[1] The movement in funds under management includes movements in respect of Insight's external fund management business up to disposal on 2 November 2009. All funds which will continue to be managed by SWIP post-transition are included within closing funds under management.

Excluding the impact of the sale of Insight Investment's external fund management business, funds under management are £23.5 billion higher than December 2008 due to strong inflows and a broad recovery in equity values in the second half of 2009.

International

	2009 £m	2008 £m	Change %
Net interest income	**834**	869	(4)
Other income	**125**	95	32
Total income	**959**	964	(1)
Operating expenses	**(425)**	(346)	(23)
Trading surplus	**534**	618	(14)
Impairment	**(4,007)**	(708)	
Share of results of joint ventures and associates	**(23)**	(2)	
Loss before tax and fair value unwind	**(3,496)**	(92)	
Cost:income ratio	**44.3%**	35.9%	
Impairment losses as a % of average advances	**6.99%**	1.18%	

As at 31 December	2009 £bn	2008 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**54.3**	54.2	–
Customer deposits	**5.8**	7.4	(22)
Risk-weighted assets	**53.2**	49.6	7

Loss before tax and fair value unwind increased by £3,404 million to £3,496 million due to an increase in impairment losses, reflecting the significant deterioration in the credit risk environment, particularly in relation to commercial real estate lending in Ireland and Australia, and concentrations in sectors most impacted by the downturn in Australia such as printing, media and transport.

Excluding favourable foreign exchange movements of approximately £120 million, total income fell by 13 per cent to £959 million reflecting higher wholesale funding costs, the impact on net interest income of the increase in impaired assets and a very competitive deposit market, partly offset by improved customer lending margins.

Excluding adverse foreign exchange movements of approximately £40 million, operating expenses increased by 10 per cent to £425 million driven by additional costs associated with the transitional services following the disposal by HBOS of BankWest and St. Andrews Australia in December 2008, the development of International's deposit taking operation in Germany and increased risk management resources to manage impaired asset portfolios in Ireland and Australia.

Impairment losses and loans and advances to customers are summarised by key geography in the following table.

	Impairment losses		Loans and advances	
	2009 £m	2008 £m	As at 31 December 2009 £bn	As at 31 December 2008 £bn
Ireland	**2,949**	526	**24.9**	29.6
Australia	**849**	164	**13.0**	12.3
Wholesale Europe	**129**	9	**8.6**	3.5
Latin America/Middle East	**69**	2	**0.6**	1.0
Netherlands	**11**	7	**7.2**	7.8
	4,007	708	**54.3**	54.2

Impairment losses have increased by £3,299 million to £4,007 million. Of the total impairment losses £2,949 million arose in Ireland which experienced a significant deterioration in asset values driven by the collapse in liquidity and severe decline in the property sector which saw commercial real estate values fall by over 50 per cent and house prices by over 25 per cent from their peak. A further £849 million of the total impairment losses arose in Australia driven by concentrations in property and in other sectors such as media, printing and transport which have been hardest hit by the downturn. Business Support Units have been established in both Ireland and Australia, supplemented by a divisional sanctioning process, to provide independent divisional oversight and control of the portfolios.

Loans and advances to customers include the transfer of a £7 billion European loan portfolio from Wholesale division in the second half of the year. The impact of this is offset by net repayments across all businesses and higher impairment provisions.

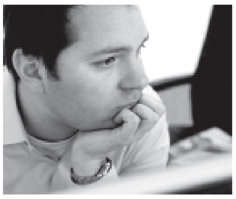
Customer deposits fell by 22 per cent to £5.8 billion, principally in Ireland reflecting aggressive pricing from competitors who have also benefited from the Irish Government deposit guarantee. This was partly offset by a strong performance in Bank of Scotland Germany, which raised over €1 billion of deposits since its launch in January 2009.

DIVISIONAL RESULTS
INSURANCE

DEVELOPING STRONG AND ENDURING CUSTOMER RELATIONSHIPS AND DELIVERING SUSTAINABLE PROFITABLE GROWTH REMAIN KEY AREAS OF FOCUS







OVERVIEW

The Insurance division offers life assurance, pensions, investment products and general insurance and operates through three main businesses: Life, Pensions and Investments UK; Life, Pensions and Investments Europe; and General Insurance.

The UK Life, Pensions and Investment business is the leading bancassurance provider in the UK and has one of the largest intermediary sales forces in the industry. The business includes Scottish Widows which, for a number of years, has been a subsidiary of the Lloyds TSB Group and the provider of long term savings and investment products distributed through all Lloyds TSB channels. Following the acquisition of HBOS, our Life, Pensions and Investments business also includes business written through the intermediary and bancassurance channels under the Clerical Medical and Halifax brands respectively.

The European Life, Pensions and Investments business distributes products primarily in the German market under the Heidelberger Leben and Clerical Medical brands.

The combined General Insurance business is a leading distributor of home and payment protection insurance in the UK, with products distributed through the branch network, direct channels and strategic corporate partners. The business is one of the largest underwriters of personal insurance business in the UK and also operates significant brokerage operations for personal and commercial insurances. It operates primarily under the Lloyds TSB, Halifax and Bank of Scotland brands.

KEY OPERATING BRANDS

SCOTTISH WIDOWS

1824 clerical medical

Lloyds TSB

HALIFAX
a little extra help

BANK OF SCOTLAND

KEY HIGHLIGHTS

Profit before tax and fair value unwind amounted to £1,024 million, a decrease of £516 million on 2008, resulting from a reduction in income and an increase in claims, due to factors including demanding market conditions, partly offset by a decrease in operating expenses.

Total income net of insurance claims has decreased by £647 million to £2,020 million, due to the non-recurrence of £334 million of HBOS legacy one-off benefits, a £156 million increase in insurance claims and the impact of challenging economic conditions driving lower sales and returns, partially offset by significantly lower charges for policyholder lapses.

Life, Pensions and Investments UK sales of £12,973 million (PVNBP) reduced by 26 per cent. In addition to the general contraction in the market, sales were significantly impacted as the intermediary sales forces were integrated and a number of HBOS legacy products with poor returns were withdrawn. These factors led to sales through the intermediary channel reducing by 35 per cent. Bancassurance sales, excluding payment protection, were resilient given the challenging market conditions with a reduction of 11 per cent from 2008. Sales of OEIC products delivered strong growth of 12 per cent.

Life, Pensions and Investments european embedded value (EEV) new business margins for the year was 2.5 per cent. The margin for the second half of 2009 increased to 2.6 per cent from 2.4 per cent in the first half, reflecting strong cost control and increased focus on the profitability of the combined product range.

General Insurance profits have decreased by 32 per cent to £367 million, due to a £156 million increase in claims, primarily unemployment related, lower investment returns and the market wide move to monthly premium payment protection business.

Strong cost management delivering benefits. Operating expenses have decreased by £155 million to £974 million mainly due to continued focus on cost management and delivering integration synergies. Underlying operating expenses reduced by 8 per cent allowing for certain reclassifications and non-recurring items.

Good progress was made in integrating the legacy Lloyds TSB and HBOS Insurance businesses. Insurance division integration synergies of £55 million for 2009 were ahead of expectations.

The capital position of the two life insurance groups within the division remains robust with increases in Insurance Group Directive (IGD) capital surpluses.

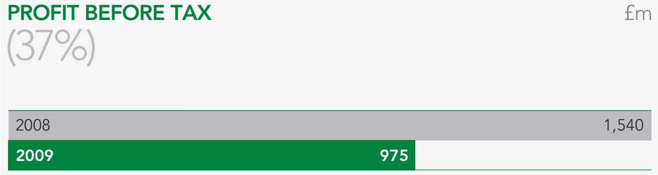
PERFORMANCE SUMMARY

	2009 £m	2008 £m	Change %
Net interest income	**(287)**	(345)	17
Other income	**2,944**	3,493	(16)
Total income	**2,657**	3,148	(16)
Insurance claims	**(637)**	(481)	(32)
Total income, net of insurance claims	**2,020**	2,667	(24)
Operating expenses	**(974)**	(1,129)	14
Share of results of joint ventures and associates	**(22)**	2	
Profit before tax and fair value unwind	**1,024**	1,540	(34)
Fair value unwind	**(49)**	–	
Profit before tax	**975**	1,540	(37)
Profit before tax and fair value unwind by business unit			
Life, pensions and investments:			
UK business	**617**	826	(25)
European business	**75**	149	(50)
General insurance	**367**	537	(32)
Other[1]	**(35)**	28	
Profit before tax and fair value unwind	**1,024**	1,540	(34)
EEV new business margin	**2.5%**	3.1%	

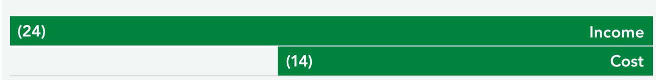
[1]Includes certain divisional costs and income not allocated to business units, as well as the division's share of results of joint ventures and associates.

PERFORMANCE INDICATORS

PROFIT BEFORE TAX £m



INCOME AND COST GROWTH 2009[2] %



NEW BUSINESS MARGIN (EEV) LP&I %

LIFE BANCASSURANCE SALES[2] £m

[2]Excluding payment protection.

DIVISIONAL RESULTS

INSURANCE

STRATEGIC VISION

The Insurance division's strategic vision is to be recognised as the best insurance business in the UK by its customers, staff and shareholders. The division has set itself four strategic objectives to achieve its vision of being the best insurance business in the UK:

- complete the integration of its market leading businesses,
- continue to strengthen its leading brands and grow sales profitably in its targeted markets,
- enhance the capital and operational efficiency of existing and future business, and
- leverage Lloyds Banking Group strengths in distribution and asset management.

PROGRESS AGAINST STRATEGIC INITIATIVES

INTEGRATING THE BUSINESSES

The integration of the legacy Life, Pensions and Investments businesses and the legacy General Insurance businesses have progressed well with the 2009 synergy benefits of £55 million significantly exceeding initial expectations. This has been achieved by aligning management structures, moving to a consistent operating model in each business, reducing the number of servicing sites in Life, Pensions and Investments and removing duplicated support functions across both legacies. The full year impact of integration activities already completed and the benefit of planned synergies is expected to lead to further cost reductions in future.

SUSTAINABLE PROFITABLE GROWTH

Delivering profitable new business growth remains a key area of focus for the division. The intermediary sales forces of Scottish Widows and Clerical Medical were combined under the Scottish Widows brand on 1 July 2009 and work is well progressed in developing an integrated bancassurance proposition, planned to be launched mid 2010. The combined business will seek to build on the strengths inherent in each of the legacies and will use the financial return and capital disciplines employed by Scottish Widows. During the year certain legacy HBOS products were withdrawn and replaced by higher returning Scottish Widows products. This change in product offering, in keeping with the division's strategic objectives, enhances the customer proposition, improves capital efficiency and increases shareholder return.

In General Insurance, growth in home insurance sales continued along with a resilient underwriting performance in 2009. Despite adverse weather claims in the year, the underwriting performance of the home book remained strong with a claims ratio of 36 per cent.

OPERATIONAL AND CAPITAL EFFICIENCY

The Insurance division continues to focus on cost reduction, with underlying costs decreasing by 8 per cent after allowing for the allocation of Lloyds TSB Insurance claims handling expenses to claims rather than expenses in 2009 and the non-recurrence of certain 2008 HBOS marketing costs. Another major factor has been a reduction in staff numbers. The synergy savings and additional operational efficiencies have been achieved without compromising the quality of customer service with customer satisfaction scores remaining robust across the businesses.

Improving capital efficiency remained a key priority throughout 2009. At a product level, initiatives focused on improving return on capital for example by continuing to move away from products with initial commission and changes in product design which allow for capital to be recovered more quickly. Capital efficiency was further enhanced through the repurchase of £0.6 billion of Clerical Medical's subordinated capital. In 2009, dividends totalling £0.5 billion were paid by companies in the Insurance division to the Group and a number of hedging initiatives were completed with the aim of managing capital and profit volatility.

Leveraging distribution and asset management

For Life, Pensions and Investments work is well progressed in developing an integrated bancassurance proposition, planned to be launched mid 2010. In conjunction with Scottish Widows Investment Partnership, during 2009 Life, Pensions and Investments UK also made good progress in further developing its OEIC proposition, leading to strong sales of its new capital protected fund OEIC.

In General Insurance, Home insurance total gross written premiums through the bancassurance network increased by 5 per cent. Home retention rates for both brands in the retail business improved in the second half of the year as a result of a combination of an improving market and a customer loyalty programme.

LIFE, PENSIONS AND INVESTMENTS

UK BUSINESS

	2009 £m	2008 £m	Change %
Net interest income	**(273)**	(282)	3
Other income	**1,474**	1,758	(16)
Total income	**1,201**	1,476	(19)
Operating expenses	**(584)**	(650)	10
Profit before tax and fair value unwind	**617**	826	(25)
Profit before tax analysis			
New business profit:			
Insurance business[1]	**328**	465	(29)
Investment business[1]	**(196)**	(247)	21
Total new business profit	**132**	218	(39)
Existing business profit	**483**	534	(10)
Expected return on shareholders' net assets	**2**	74	(97)
Profit before tax and fair value unwind	**617**	826	(25)
EEV new business margin (UK)	**2.6%**	3.0%	

[1] As required under International Financial Reporting Standards (IFRS), products are split between insurance and investment contracts depending on the level of insurance risk contained. For insurance contracts, the new business profit includes the net present value of profits expected to emerge over the lifetime of the contract, including profits anticipated in periods after the year of sale; for investment contracts the figure reflects the profit in the year of sale only, after allowing for the deferral of initial income and expenses. Consequently the recognition of profit for investment contracts is deferred relative to insurance contracts.

Profit before tax and fair value unwind decreased by £209 million. New business profit was significantly impacted by the general contraction in the life, savings and investments market but the reduction also reflects the integration of the intermediary sales forces and the withdrawal of a number of legacy HBOS products with poor returns. The EEV new business margin (UK) fell to 2.6 per cent in 2009 largely due to the transitional basis of commission payable on legacy HBOS products through the bancassurance channel. However, the UK margin increased to 2.7 per cent in the second half of 2009 from 2.5 per cent in the first reflecting strong cost control and increased focus on the profitability of the combined product range. The margin in respect of Scottish Widows products increased to 3.5 per cent in 2009 from 3.2 per cent in 2008.

Existing business profit has reduced by 10 per cent. The figure includes a reduction in expected return, reflecting lower asset values resulting from adverse investment markets in 2008, a lower assumed rate of return and the non-recurrence of one-off benefits in HBOS of £211 million relating to a more market consistent basis of embedded value and enhancements to the bond proposition. Those impacts have been partly offset by a significant reduction in charges for policyholder lapses in 2009. The customer loyalty programmes have proved to be increasingly successful during 2009 but given the potential volatility of behaviour caused by turbulent markets an appropriately prudent approach has been taken in the assessment of future trends.

Expected returns on shareholders net assets were impacted both by a lower assumed rate of return and reduced asset values as a result of severe market falls in 2008.

The capital positions of the UK life insurance companies within the Insurance division remain robust. As at 31 December 2009, the estimated Insurance Groups Directive (IGD) capital surplus for the Scottish Widows Insurance group was £1.3 billion, with additional surplus within the Long Term Fund of an estimated £1.1 billion, and the estimated IGD capital surplus for the HBOS Insurance group was £1.6 billion. The IGD capital surpluses include £0.5 billion and £0.1 billion respectively of assets in the Long Term Fund, as allowed by the FSA in December 2009, not previously recognised in the calculation of IGD capital.

EUROPEAN BUSINESS

Profit before tax decreased by 50 per cent to £75 million. New business profits reduced by £32 million driven by lower sales, reflecting economic and market conditions. Existing business profits decreased, primarily due to lower expected returns. In 2008, as a result of moving to a more market consistent basis of embedded value in HBOS, a one-off benefit of £123 million arose. The impact of this was largely offset by a significant reduction in charges for policyholder lapses in 2009.

NEW BUSINESS

An analysis of the present value of new business premiums for business written by the Insurance division, split between the UK and European Life, Pensions and Investments businesses is given below:

	2009			2008			
	UK £m	Europe £m	Total £m	UK £m	Europe £m	Total £m	Change %
Protection	**519**	**49**	**568**	492	51	543	5
Payment protection	**153**	**–**	**153**	679	–	679	(77)
Savings and investments	**2,689**	**312**	**3,001**	4,149	372	4,521	(34)
Individual pensions	**2,275**	**185**	**2,460**	4,216	306	4,522	(46)
Corporate and other pensions	**2,600**	**–**	**2,600**	2,940	–	2,940	(12)
Retirement income	**887**	**–**	**887**	1,451	–	1,451	(39)
Managed fund business	**146**	**–**	**146**	216	–	216	(32)
Life and pensions	**9,269**	**546**	**9,815**	14,143	729	14,872	(34)
OEICs	**3,704**	**–**	**3,704**	3,303	–	3,303	12
	12,973	**546**	**13,519**	17,446	729	18,175	(26)
Analysis by channel							
Bancassurance excluding payment protection	**6,844**	**–**	**6,844**	7,677	–	7,677	(11)
Payment protection	**153**	**–**	**153**	679	–	679	(77)
Bancassurance	**6,997**	**–**	**6,997**	8,356	–	8,356	(16)
Intermediary	**5,639**	**546**	**6,185**	8,704	729	9,433	(34)
Direct	**337**	**–**	**337**	386	–	386	(13)
	12,973	**546**	**13,519**	17,446	729	18,175	(26)

The present value of new business premiums reduced by 26 per cent, reflecting both a general contraction in the UK and European markets as well as the re-positioning of the UK intermediary product range. Sales through the intermediary channel were significantly impacted as the UK intermediary sales forces were integrated and a number of legacy HBOS products with poor returns were withdrawn. As a result, sales in the intermediary channel reduced by 34 per cent. Sales through the bancassurance channel, excluding payment protection, continued to perform relatively robustly with a reduction of 11 per cent. This includes Scottish Widows sales through the bancassurance network which showed good growth of 18 per cent. Sales of OEIC products were strong with an increase of 12 per cent in 2009.

DIVISIONAL RESULTS

INSURANCE

RESULTS ON A EUROPEAN EMBEDDED VALUE BASIS

In addition to reporting under IFRS, the Insurance division provides supplementary financial reporting for its Life, Pensions and Investments business on an EEV basis. For the purpose of EEV reporting, covered business is defined as all life, pensions and investments business written in the Insurance division. This definition therefore excludes the results of St. James's Place and the results of the business sold through the Wealth and International division which is not manufactured by the Insurance division.

	2009 £m	2008[1] £m	Change %
New business profit	**341**	563	(39)
Expected return on existing business	**268**	403	(33)
Expected return on shareholders' net assets	**219**	292	(25)
Profit before tax, before experience variances and assumption changes	**828**	1,258	(34)
Experience variances	**139**	(301)	
Assumption changes	**(1)**	(222)	
Profit before tax	**966**	735	31
Volatility	**228**	(1,675)	
Other items[2]	**53**	56	(5)
Profit (loss) before tax	**1,247**	(884)	
Taxation	**(349)**	396	
Profit (loss) after tax	**898**	(488)	
EEV new business margin	**2.5%**	3.1%	

[1] The 2008 comparative results include the results of the HBOS Life, Pensions and Investments business as if it had been acquired on 1 January 2008. The 2008 results for the HBOS Life, Pensions and Investments business have been restated from those previously published including use of the market consistent economic assumptions as adopted by Scottish Widows, but excluding the impact of any acquisition-related fair value adjustments. From 1 January 2009 the results reflect additional alignment with Scottish Widows in respect of accounting practices and non-economic assumptions.

[2] Other items represent amounts not considered attributable to the underlying performance of the business.

Total profit before tax, before volatility and other items, increased by £231 million, or 31 per cent, to £966 million. Excluding the impact of experience variances and assumption changes, the profit before tax decreased by £430 million or 34 per cent to £828 million.

New business profit has decreased by 39 per cent to £341 million, reflecting a reduction in sales volumes driven by adverse economic conditions and the reduction in new business from the withdrawal of legacy HBOS products with poor returns. The new business margin for Life, Pensions and Investments UK has increased in the second half of 2009 to 2.7 per cent from 2.5 per cent in the first half, reflecting strong cost control and increased focus on the profitability of the combined product range. The margin in respect of the heritage Scottish Widows products increased to 3.5 per cent in 2009 from 3.2 per cent in 2008.

Expected return on existing business has decreased by 33 per cent to £268 million, reflecting a reduction in the value of the opening balance sheet, driven by lower asset values from adverse investment markets in 2008, and a reduction in the assumed rate of return. The expected return on shareholders' net assets has reduced by 25 per cent to £219 million for the same reasons.

Net positive experience variances and assumption changes are predominantly driven by favourable tax experience and other non-recurring items. The corresponding figure for 2008 includes a number of adverse impacts within the HBOS legacy business, including significant charges from policyholder lapses and other modelling changes.

COMPOSITION OF EEV BALANCE SHEET

	2009 £m	2008[1] £m
Value of in-force business (certainty equivalent)	**5,623**	4,647
Value of financial options and guarantees	**(176)**	(208)
Cost of capital	**(150)**	(152)
Non-market risk	**(132)**	(132)
Total value of in-force business	**5,165**	4,155
Shareholders' net assets	**3,840**	3,948
Total EEV of covered business	**9,005**	8,103

[1] See above note on restatement.

RECONCILIATION OF OPENING EEV BALANCE SHEET TO CLOSING EEV BALANCE SHEET ON COVERED BUSINESS

	Shareholders' net assets £m	Value of in-force business £m	Total £m
As at 31 December 2007[1]	3,812	5,675	9,487
Total profit (loss) after tax	275	(763)	(488)
Other capital movements	390	–	390
Dividends received from Group companies	40	–	40
Dividends paid to Group companies	(815)	–	(815)
As at 31 December 2008[1]	3,702	4,912	8,614
Fair value adjustments	246	(757)	(511)
As at 31 December 2008 – restated[1]	3,948	4,155	8,103
Total profit (loss) after tax	**(112)**	**1,010**	**898**
Other capital movements	**191**	**–**	**191**
Dividends paid to Group companies	**(187)**	**–**	**(187)**
As at 31 December 2009	**3,840**	**5,165**	**9,005**

[1] See above note on restatement.

ANALYSIS OF SHAREHOLDERS' NET ASSETS ON AN EEV BASIS ON COVERED BUSINESS

	Required capital £m	Free surplus £m	Shareholders' net assets £m
As at 31 December 2007[1]	2,464	1,348	3,812
Total profit (loss) after tax	(1,063)	1,338	275
Other capital movements	–	390	390
Dividends received from Group companies	–	40	40
Dividends paid to Group companies	–	(815)	(815)
As at 31 December 2008[1]	1,401	2,301	3,702
Fair value adjustments	–	246	246
As at 31 December 2008 – restated[1]	1,401	2,547	3,948
Total profit (loss) after tax	**1**	**(113)**	**(112)**
Other capital movements	**106**	**85**	**191**
Dividends paid to Group companies	**–**	**(187)**	**(187)**
As at 31 December 2009[1]	**1,508**	**2,332**	**3,840**

[1] See above note on restatement.

ECONOMIC ASSUMPTIONS

A bottom-up approach is used to determine the economic assumptions for valuing the business in order to determine a market consistent valuation. The results for the HBOS Life, Pensions and Investments business have been restated from those previously published and have been produced using the market consistent economic assumptions adopted by Scottish Widows.

The liabilities in respect of the Group's UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds. In accordance with the approach adopted in December 2008, the value of the in-force business asset for annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of these corporate bond holdings.

For December 2008 onwards, the risk-free rate assumed in valuing the non-annuity in-force business is the 15 year government bond yield for the appropriate territory. The risk-free rate assumed in valuing the in-force asset for the UK annuity business is presented as a single risk-free rate to allow a better comparison to the rate used for other business. That single risk-free rate has been derived to give the equivalent value to the UK annuity book, had that book been valued using the UK gilt yield curve increased to reflect the illiquidity premium described above. The risk-free rate used in valuing financial options and guarantees in the Scottish Widows With Profit Fund is defined as the spot yield derived from the UK gilt yield curve. A similar approach is taken to valuing the financial options and guarantees in the HBOS Life, Pensions and Investments business. The table below shows the range of resulting yields and other key assumptions.

United Kingdom (Sterling)	2009 %	2008 %
Risk-free rate (value of in-force non-annuity business)	**4.45**	3.74
Risk-free rate (value of in-force annuity business)	**5.05**	5.22
Risk-free rate (financial options and guarantees)	**0.87 to 4.76**	1.11 to 4.24
Retail price inflation	**3.64**	2.75
Expense inflation	**4.42**	3.50

NON-ECONOMIC ASSUMPTIONS

Future mortality, morbidity, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. These assumptions are intended to represent a best estimate of future experience.

NON-MARKET RISK

An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the With Profit Fund these can be asymmetric in the range of potential outcomes for which an explicit allowance is made.

DIVISIONAL RESULTS
INSURANCE

SENSITIVITY ANALYSIS

The table below shows the sensitivity of the EEV and the new business profit before tax to movements in some of the key assumptions. The impact of a change in the assumption has only been shown in one direction as the impact can be assumed to be reasonably symmetrical.

2009 EEV/NEW BUSINESS PROFIT BEFORE TAX

	Impact on EEV £m	Impact on new business profit before tax £m
100 basis points reduction in risk-free rate[1]	224	13
10 per cent reduction in market values of equity assets[2]	(276)	n/a
10 per cent reduction in market values of property assets[3]	(17)	n/a
10 per cent reduction in expenses[4]	229	51
10 per cent reduction in lapses[5]	205	48
5 per cent reduction in annuitant mortality[6]	(87)	(3)
5 per cent reduction in mortality and morbidity (excluding annuitants)[7]	57	11
100 basis points increase in equity and property returns[8]	nil	nil
25 basis points increase in corporate bond spreads[9]	(107)	(6)
10 basis points increase in illiquidity premium[10]	56	n/a

[1] In this sensitivity the impact takes into account the change in the value of in-force business, financial options and guarantee costs, statutory reserves and asset values.

[2] The reduction in market values is assumed to have no corresponding impact on dividend yields.

[3] The reduction in market values is assumed to have no corresponding impact on rental yields.

[4] This sensitivity shows the impact of reducing new business, maintenance expenses and investment expenses to 90 per cent of the expected rate.

[5] This sensitivity shows the impact of reducing lapse and surrender rates to 90 per cent of the expected rate.

[6] This sensitivity shows the impact on the Group's annuity and deferred annuity business of reducing mortality rates to 95 per cent of the expected rate.

[7] This sensitivity shows the impact of reducing mortality rates on non-annuity business to 95 per cent of the expected rate.

[8] Under a market consistent valuation, changes in assumed equity and property returns have no impact on the EEV.

[9] This sensitivity shows the impact of a 25 basis point increase in corporate bond yields and the corresponding reduction in market values. Government bond yields, the risk-free rate and illiquidity premia are all assumed to be unchanged.

[10] This sensitivity shows the impact of a 10 basis point increase in the allowance for illiquidity premium. It assumes that the overall corporate bond spreads are unchanged and hence market values are unchanged. Government bond yields and the non-annuity risk-free rate are both assumed to be unchanged. The increased illiquidity premium increases the annuity risk-free rate.

In sensitivities (4) to (7) and (9) assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and statutory reserving bases. A change in risk discount rates is not relevant as the risk discount rate is not an input to a market consistent valuation.

GENERAL INSURANCE

	2009 £m	2008 £m	Change %
Home insurance			
Underwriting income (net of reinsurance)	897	885	1
Commission receivable	71	50	42
Commission payable	(94)	(70)	(34)
	874	865	1
Payment protection insurance			
Underwriting income (net of reinsurance)	731	860	(15)
Commission receivable	13	428	(97)
Commission payable	(395)	(923)	57
	349	365	(4)
Other			
Underwriting income (net of reinsurance)	8	20	(60)
Commission receivable	69	71	(3)
Commission payable	(28)	(36)	22
Other (including investment income)	(6)	93	
	43	148	(71)
Net operating income	1,266	1,378	(8)
Claims paid on insurance contracts (net of reinsurance)	(637)	(481)	(32)
Operating income, net of claims	629	897	(30)
Operating expenses	(262)	(360)	27
Profit before tax	367	537	(32)
Claims ratio	35%	25%	
Combined ratio	83%	76%	

Profit before tax and fair value unwind from General Insurance decreased by £170 million to £367 million.

Claims were £156 million higher than 2008, primarily due to higher payment protection insurance claims related to unemployment. This also reflects the reclassification of Lloyds TSB Insurance Claims Handling expenses into claims paid in 2009. Whilst property claims were impacted by flooding and freeze claims in the final quarter of the year, benefits from ongoing investments in claims processes continue to be realised.

Against the background of a particularly competitive market in which the General Insurance business has a leading position, home insurance income generated modest growth of 1 per cent to £874 million. Payment protection insurance income decreased by £16 million, or 4 per cent, to £349 million as a result of the market wide move to monthly premiums on payment protection, partly offset by lower distribution commission payable to the Retail division.

Other income has reduced, primarily reflecting lower interest rates and the allocation of certain charges.

Operating expenses decreased by £98 million, or 27 per cent, to £262 million. Adjusting for the reclassification of claims handling expenses into claims paid and non-recurring marketing spend in 2008, costs improved by 10 per cent year-on-year, reflecting continued focus on cost management and cost savings achieved through the integration.

DIVISIONAL RESULTS
GROUP OPERATIONS

OVERVIEW

Group Operations manages the Group's technology platforms, property estate, operations, procurement services and security. Through these areas Group Operations drives efficiencies and supports income growth across multiple brands and channels using scalable platforms, common processes and leveraging the Group's purchasing power.

The division operates through four primary business functions; Information Technology; Operations; Procurement and Property. The Information Technology area provides technological expertise to each area of the Group whilst Operations includes Banking Operations, Collections and Recoveries and Payments and Business Services. The role of Procurement is to ensure that the Group gets the best value from its external expenditure and strategic suppliers and Property manages and maintains the Group's estates portfolio.

STRATEGY

Group Operations aims to be recognised as a world class operations business by colleagues, customers, stakeholders and peers whilst ensuring value through cost and process efficiency. This will be achieved by providing excellent technology and effective process to support the businesses; driving simplification, automation and continuous improvement; developing world class operations, leadership and capability; and maintaining strong controls to protect the Group.

In addition to this the Integration programme will develop and deliver plans to produce synergy benefits. The focus throughout 2010 will be to combine systems and process legacies onto a single platform. This will primarily be achieved by delivering the IT consolidation, a single and centralised operating model, along with excellent disciplined procurement and rationalisation of the property portfolio.

KEY HIGHLIGHTS

Group Operations' direct costs decreased by 3 per cent or £90 million in the year to £3,066 million due to the impact of integration synergies and a continued focus on cost management.

Analysed by business function, IT costs decreased by £82 million, or 6 per cent, to £1,265 million, driven by the early realisation of synergy savings due to the consolidation of IT operations across the Group in addition to lower investment spend as project activity was rationalised and replaced by integration activity. Within Operations, costs were broadly flat, increasing by only £13 million to £555 million. Activity during 2009 has focused on centralising and then rationalising the Group's operational activities.

A great deal of centralisation activity occurred in the second half of the year which resulted in increased spend within the division compared to the first half of the year but in doing so significant efficiencies have been realised which will become evident in the 2010 run-rate. In addition increased recruitment in the Collections and Recoveries business meant that the Group was able to offer pro-active assistance to customers in financial difficulty thereby helping to minimise the impact of impairment losses on the Retail, Wholesale and Wealth and International divisions.

Property costs have decreased by £40 million, or 4 per cent, to £979 million primarily due to the realisation of synergy savings as a result of the integration and the consolidation of premises, which has been achieved at a faster rate than originally anticipated. Procurement costs have increased by £7 million, or 4 per cent, to £166 million due to an £11 million charge in respect of joint ventures.

Group Operations' support function costs have increased by £12 million, or 13 per cent, to £101 million, primarily driven by costs of £15 million relating to investments to further improve payments filtering and ensuring that the demands of increased regulation are met. Underlying support function costs have remained flat compared to 2008.

PERFORMANCE SUMMARY

	2009 £m	2008[1] £m	Change %
Net interest income	**(69)**	(59)	(17)
Other income	**20**	35	(43)
Total income	**(49)**	(24)	
Direct costs:			
Information technology	**(1,265)**	(1,347)	6
Operations	**(555)**	(542)	(2)
Property	**(979)**	(1,019)	4
Procurement	**(166)**	(159)	(4)
Support functions	**(101)**	(89)	(13)
	(3,066)	(3,156)	3
Result before recharges to divisions	**(3,115)**	(3,180)	2
Total net recharges to divisions	**2,941**	3,100	(5)
Share of results of joint ventures and associates	**3**	4	(25)
Loss before tax and fair value unwind	**(171)**	(76)	
Fair value unwind	**22**	–	
Loss before tax	**(149)**	(76)	(96)

[1] 2008 comparative figures have been amended to reflect the impact of centralising operations across the Group as part of the integration programme. To ensure a fair comparison of 2009 performance, 2008 direct costs have been increased with an equivalent offsetting increase in recharges to divisions.

CENTRAL ITEMS

	2009 £m	2008 £m
Net interest income	**(815)**	(213)
Other income	**1,780**	(223)
Total income	**965**	(436)
Operating expenses	**(294)**	(21)
Trading surplus (deficit)	**671**	(457)
Impairment	**–**	(60)
Share of results of joint ventures and associates	**(1)**	–
Profit (loss) before tax and fair value unwind	**670**	(517)
Fair value unwind	**(2,119)**	–
Loss before tax	**(1,449)**	(517)

Central items includes certain income and expenditure not recharged to the divisions including the costs of certain central and head office functions and hedge ineffectiveness.

Central items profit before tax and fair value unwind amounted to £670 million, compared to a loss of £517 million in 2008. Total income increased by £1,401 million to £965 million primarily as a result of gains arising when the Group exchanged certain existing subordinated debt securities for new securities. These exchanges resulted in a gain on extinguishment of the existing liability of £1,498 million (of which £1,468 million is reflected in central items), being the difference between the carrying amount of the security extinguished and the fair value of the new security together with related fees and costs.

Operating expenses increased by £273 million to £294 million due to higher professional fees and other costs associated with a number of group wide projects including GAPS and an increase in the amount of pension costs held centrally.

VOLATILITY

The Group's statutory profit before tax is significantly affected by two items that impact the underlying financial performance of the Group, namely insurance volatility, caused by movements in financial markets, and policyholder interests volatility, which primarily reflects the gross up of policyholder tax included in the Group tax charge.

During 2009, the Group's statutory profit before tax included positive insurance and policyholder interests volatility of £478 million compared to negative volatility of £2,349 million in 2008 primarily reflecting the more favourable financial markets in 2009.

Volatility comprises the following:

	2009 £m	2008 £m
Insurance volatility	237	(1,425)
Policyholder interests volatility	298	(924)
Total volatility	535	(2,349)
Group hedge costs	(57)	–
	478	(2,349)

INSURANCE VOLATILITY

The Group's insurance businesses have liability products that are supported by substantial holdings of investments, including equities, property and fixed interest investments, all of which are subject to variations in their value. The value of the liabilities does not move exactly in line with changes in the value of the investments, yet IFRS requires that the changes in both the value of the liabilities and investments be reflected within the income statement. As these investments are substantial and movements in their value can have a significant impact on the profitability of the Group, management believes that it is appropriate to disclose the division's results on the basis of an expected return in addition to results based on the actual return.

The expected sterling investment returns used to determine the normalised profit of the business, which are based on prevailing market rates and published research into historical investment return differentials, are set out below:

United Kingdom (Sterling)	2010 %	2009 %	2008 %
Gilt yields (gross)	4.45	3.74	4.55
Equity returns (gross)	7.45	6.74	7.55
Dividend yield	3.00	3.00	3.00
Property return (gross)	7.45	6.74	7.55
Corporate bonds in unit linked and with Profit Funds (gross)	5.05	4.34	5.15
Fixed interest investments backing annuity liabilities (gross)	5.30	5.72	5.52

The impact on the results due to the actual return on these investments differing from the expected return (based upon economic assumptions made at the beginning of the year) is included within insurance volatility. Changes in market variables also affect the realistic valuation of the guarantees and options embedded within the With Profits Funds, the value of the in-force business and the value of shareholders' funds.

The liabilities in respect of the Group's annuity business are matched by a portfolio of fixed interest securities, which includes a large proportion of corporate bonds. In accordance with the approach adopted in 2008, the value of in-force business for the annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of these corporate bond holdings. The illiquidity premium is estimated to have reduced to 75 basis points as at 31 December 2009 (31 December 2008: 154 basis points) which has offset the gains on assets backing the annuity liabilities reducing the volatility of the results. Overall, the positive volatility in 2009 in the Insurance division of £237 million, reflected a partial recovery in financial markets. During 2009, equities have recovered by 22 per cent and corporate bond spreads have narrowed, offset by a reduction in gilts reflecting an increase in yields and a reduction in property values of 6.6 per cent. This contrasts with 2008 where a 33 per cent reduction in equities was the main driver of the £1,425 million negative volatility in 2008.

HEDGE COSTS

To protect against further deterioration in equity market conditions, and the consequent negative impact on the value of business in-force on the Group balance sheet, the Group purchased put option contracts. The charge booked for 2009 was £57 million. These options expired on 15 January 2010.

POLICYHOLDER INTERESTS VOLATILITY

The application of accounting standards results in the introduction of other sources of significant volatility into the pre-tax profits of the life and pensions business. In order to provide a clearer representation of the performance of the business, and consistent with the way in which it is managed, equalisation adjustments are made to remove this volatility from underlying profits. The effect of these adjustments is separately disclosed as policyholder interests volatility; there is no impact upon profit attributable to equity shareholders over the long term.

The most significant of these additional sources of volatility is policyholder tax. Accounting standards require that tax on policyholder investment returns should be included in the Group's tax charge rather than being offset against the related income. The impact is, therefore, to either increase or decrease profit before tax with a corresponding change in the tax charge. Over the longer term the charges levied to policyholders to cover policyholder tax on investment returns and the related tax provisions are expected to offset. In practice, timing and measurement differences exist between provisions for tax and charges made to policyholders. Consistent with the normalised approach taken in respect of insurance volatility, differences in the expected levels of the policyholder tax provision and policyholder charges are adjusted through policyholder interests volatility. Other sources of volatility include the minorities' share of the profits earned by investment vehicles which are not wholly owned by the long-term assurance funds.

During the year ended 31 December 2009, the statutory profit before tax in both the Insurance and Wealth and International divisions included credits to other income which relate to the policyholder interests volatility charge of £298 million (2008: £924 million). The market recovery in 2009 increased policyholder tax liabilities and led to a policyholder tax charge of £346 million during the year in the Group's tax charge. This was partly offset by a credit of £48 million relating to differences in the expected levels of policyholder tax provisions and charges. This compares to 2008 when substantial policyholder tax losses were generated as a result of the fall in property, bond and equity values.

INTEGRATION

Annualised cost savings from synergies and other operating efficiencies of £2 billion are now targeted by the end of 2011, an increase from the previously forecast cost savings in excess of £1.5 billion. The increase arises in the main from further efficiency gains leading to role reductions and, to a lesser extent, property and procurement benefits which are now more certain following the application of the Lloyds TSB approach to HBOS.

Total cost reductions from synergies of £534 million are ahead of the target £450 million. They are analysed by division in the table below and included in the Group's combined businesses basis loss before tax for the year to 31 December 2009. These benefits relate primarily to reductions in staff numbers and procurement savings.

One-off integration costs of £1,096 million were incurred in the year which have been excluded from the combined businesses basis loss before tax. The integration costs relate to severance, IT and business costs of implementation. The severance provisions are for over 15,000 role reductions announced in the year, of which more than 11,500 relate to 2009, the balance being delivered in 2010. The overwhelming majority of role reductions in 2009 were achieved through redeployment, natural turnover and voluntary redundancy.

The Group's policy is to use natural turnover and to redeploy people wherever possible to retain their expertise and knowledge within the Group. Where it is necessary for colleagues to leave the Company, this is achieved by offering voluntary severance and by making less use of contractors and agency colleagues. Compulsory redundancies are a last resort.

Savings realised year to 31 December 2009	£m
By division	
Retail	**124**
Wholesale	**86**
Wealth and International	**28**
Insurance	**55**
Group Operations	**221**
Central items	**20**
	534
By expenditure type	
People	**263**
Procurement[1]	**126**
IT	**57**
Property	**11**
Other	**77**
	534

[1] Procurement benefits totalling £174 million were achieved, split £126 million against the ongoing cost base and £48 million within the £1,096 million integration costs.

Over the last year, the Group has mobilised its integration programme, building systems integration plans whilst delivering financial benefits and making good progress towards creating a truly integrated organisation.

For example, the Group has published proposals to harmonise employee terms and conditions across the Group, launched a single Group Intranet to improve communication and ease contact between colleagues and enhanced the IT infrastructure to allow colleagues full connectivity at the Group's buildings. A single consistent framework of risk policies is in place, comprising 71 detailed risk policies applicable across the combined Group.

Savings to date have been driven largely from role reductions resulting from deployment of the new Group organisational design adopting the Lloyds TSB approach. The overwhelming majority of role reductions in 2009 were achieved through redeployment, natural turnover and voluntary redundancy. Only a small proportion left via compulsory redundancy. In addition the Group has ceased occupancy of 83 properties during 2009, well ahead of the start of year target of 50.

Procurement benefits in 2009 have also been significant at £174 million with approximately £1.5 billion of spend having gone through e-auctions and the Group has in parallel reviewed and consolidated key supplier contracts with over 90 per cent of spend now being through its top 1,000 suppliers.

The Group has progressed well through the IT design and is now focused on building and delivering an integrated technical infrastructure. Preparations for system integration and data migration are in full flight with the scale up of IT equipment to handle increased volumes. Detailed plans are in place, along with testing requirements that are fully commensurate with an integration of this scale.

In the circular to shareholders regarding the acquisition of HBOS, it was stated that annual cost savings of £1.5 billion (run-rate) were expected to be achieved by the end of 2011 at a cost of approximately 140 per cent. The Group is now expecting £2 billion of savings at an implementation cost to synergy ratio of around 155 per cent. The increase in the ratio of implementation costs to annualised cost savings has been driven principally by a recognition of the relative complexity of the HBOS systems and processes.

The synergies achieved in the year of £534 million include a number of one-off savings, which have been excluded from the sustainable run-rate benefits. There has also been an increase in the rate of savings in the year resulting in a sustainable run-rate benefit of £766 million. The target run-rate of £750 million announced in November 2009 has therefore been surpassed, a key factor in determining the increase to the overall run-rate target to £2 billion.

With the programme now well underway and ahead of its financial targets, the Group is confident of delivering the new target, which is analysed below by division.

	2009	2011		
	Synergy run-rate £m	Current view of synergy targets £m	Allocation of Group Operations target to divisions £m	Current view by market facing division £m
Retail	157	378	489	867
Wholesale	157	282	250	532
Wealth and International	115	213	29	242
Insurance	99	162	77	239
Group Operations	209	907	(907)	–
Central items	29	58	62	120
	766	2,000	–	2,000

OUR PEOPLE

BUILDING LONG LASTING RELATIONSHIPS THROUGH PEOPLE

We are a business based on building deep and lasting relationships with our customers through the efforts of our people. Colleagues are our most valuable resource, as it is our colleagues who will build these relationships. Managing our colleagues effectively is therefore fundamental to the success of the business and achieving our vision of being the best financial services organisation.

Creating a great place to work is a core priority to enable the Group to be recognised, both within the financial services sector, but also more generally in the UK employment market, as the best organisation to work for.

In creating a great place to work, we believe we will attract and retain talented and high performing people. We offer excellent learning and development opportunities so that our colleagues can build fulfilling careers within the organisation.

We are building a high commitment, high performance organisation. We are clear about what we expect from our colleagues and what they can expect from us. Our values guide us in all our relationships whether they be with colleagues, customers or the wider community. In Lloyds Banking Group, our values are that we: take ownership; act wisely; make it simple; stretch ourselves; and succeed together.

INTEGRATION

2009 was significant in relation to people integration. We have successfully managed the initial stages, working at pace to establish controls and embed risk management practices, by defining and implementing the new organisational structure and selecting for it. The top 400 leaders were in place by month three and over 35,000 colleagues went through selection in 2009. Inevitably in bringing the two organisations together, there has been an opportunity to rationalise and this has led to a reduction in roles. Where possible we have either redeployed colleagues to other areas of the Group or reduced numbers through natural attrition. Where it has been necessary for colleagues to leave the company, this has been achieved by offering voluntary severance and by making less use of contractors and agency colleagues. Compulsory redundancies are always a last resort.

The focus has been on enabling the business to integrate, while also building foundations for the future to ensure the organisation can attract, retain and develop the best talent. People have been at the heart of the change programme, and a robust communications process has been followed to ensure that colleagues are aware of the changes before they happen. We have four recognised Unions who have been consulted about all proposed changes.

COLLEAGUE ENGAGEMENT

We believe that to create a high commitment, high performance organisation, we need high levels of colleague engagement. The Group uses a comprehensive, confidential online engagement survey that all colleagues can access, to help us measure and assess current levels of colleague engagement across the organisation. The results are reviewed on a quarterly basis so the outcomes can be analysed and action plans developed.

In 2009, we extended the scope of the Colleague Survey to include all UK and International colleagues across both Lloyds TSB and HBOS legacy organisations. We achieved a record response rate of 81 per cent in 2009 which represents a significant improvement on previous response rates achieved by Lloyds TSB between 2005 and 2008. This is regarded as 'best in class', particularly given the frequency and scope of the Group survey.

The overall Engagement Index[1] for the newly formed Lloyds Banking Group finished the year at 72 index points for 2009, 2 points above the target. Outputs from the survey are used to inform local action planning activities across the Group.

TALENT, RECRUITMENT AND RETENTION

Recruiting, retaining and developing talented people continues to be a high priority for the Group. Top performers are attracted to the Group because of our strong brand and values; together with top class development and career opportunities.

Developing colleagues and having depth in our leadership succession plans is vital in supporting our growth strategy. In autumn 2009, an 'Organisational Capability Review' was completed to review the succession pipeline, identify top talent and review capability gaps and development plans. As a result, we have strong succession and development plans for all our senior leaders across the Group and have collected qualitative data on our top 500 colleagues. We are retaining people for an average tenure across our business of 12 years.

In 2009 we recruited 141 people into our Graduate Leadership Programme, offered 42 internships and 10 industrial placements under the five generalist and specialist streams. Following the launch of the new Lloyds Banking Group Graduate Programme in 2009, our focus has been on attracting top talent into the organisation who have the potential to become senior business leaders of the future. We have also introduced a 'customer facing' element to the main programme so that all our graduates gain core banking 'front-line' experience.

Looking forward to 2010 we will be expanding the foundation element to include a Risk placement so that our graduates get first hand experience in financial services control processes. We are consistently identified in The Times Top 100 organisations for graduate recruitment and in 2009 the Lloyds TSB heritage climbed to 39th.

We actively track and manage retention of our highest performers, retaining 95 per cent of top performers in 2009.

PERFORMANCE MANAGEMENT

Our business strategy is translated into the Group's balanced scorecard and this is aligned at each level of the organisation. This ensures colleagues understand how their personal objectives relate to the strategy. Contribution is measured against five factors: building the business; customer service; risk management; personal development and financial control. In addition, colleagues are also measured on how they achieve their goals against the core values of the company.

Through twice yearly formal reviews and regular feedback, all our people understand how their performance impacts on colleagues, customers and our overall business success. Together, these act as effective processes for differentiating high performance and addressing and managing underperformance.

[1] The Engagement Index is based on the result of a survey conducted quarterly, asking Lloyds Banking Group colleagues the same 13 questions used by Lloyds TSB since 2005 which reflect both the drivers and outcome of engagement. The data captures the percentage of total responses received which were favourable for each question, combined into a simple average overall score.

LEARNING AND DEVELOPMENT

We are committed to ensuring that all colleagues have the technical, management and leadership skills that will enable Lloyds Banking Group to deliver the high performance needed to be recognised as the best financial services company.

TECHNICAL CAPABILITIES

To deliver great service and results we ensure that we equip our colleagues with a range of appropriate technical capabilities to enable them to support our customers effectively. Our business-focused learning programmes cover critical business skills such as risk, relationship and financial management.

As part of this we support a range of programmes linked to professional qualifications or relevant external certification; these provide colleagues with relevant performance benchmarks and professional qualifications. Such programmes enable us to develop our colleagues in line with recognised industry standards and provide confidence to customers and other stakeholders.

This year the quality of our programmes has been recognised with two external awards; 'Best use of synchronous e-learning' at the annual E-Learning Age Awards and the 2009 Security Training Initiative of the Year Award at the Security Excellence Awards.

LEADERSHIP AND MANAGEMENT CAPABILITY

Line managers have a vital role in helping bring our values to life for colleagues and a key focus remains the development and strengthening of management and leadership skills. In 2009 we have placed particular emphasis on performance management and leading during a period of rapid change.

LEARNING @ LLOYDS BANKING GROUP

During 2009 we have developed and launched our new group wide learning portal, 'Learning @ Lloyds Banking Group'. This website, which is accessible from both the corporate intranet and Internet, provides all colleagues with access to a range of learning and development resources.

In addition to our successful internally developed content our learning and development teams work with best-practice suppliers to develop and deliver learning. We continue to use a range of delivery media including award winning on-line modules and face-to-face workshops to support skills development.

In 2009 the number of on-line assessments totalled over 899,000. We delivered an average of 2.9 days formal learning per full time equivalent (FTE), which is commensurate with the continued investment in colleague development.

TRAINING DAYS

	2009	2008	2007
Number of days formal learning per FTE	**2.9**	2.9	2.3

DIVERSITY AND INCLUSION

Diversity and Inclusion remains a high priority for Lloyds Banking Group. In a challenging economic climate we believe more than ever that our success depends on building strong and enduring relationships with diverse groups – colleagues, customers and suppliers.

In 2009 we have begun to build a leading edge diversity and inclusion strategy for Lloyds Banking Group, consulting with colleagues across the group and using the best elements of the respective Lloyds TSB and HBOS diversity programmes.

Our executive management team has one of the highest female representations in the FTSE 100, with three female directors.

Elsewhere we have continued our focus on race, disability and sexual orientation.

In 2009 we sponsored Doing Seniority Differently, a groundbreaking piece of research by RADAR[2] into the career experiences of senior managers with a disability or long-term health condition. We will sponsor a new network of senior disabled professionals in 2010.

We continue to make progress on sexual orientation. Lloyds TSB won first place in Stonewall's[3] 2009 Index of the best UK employers for lesbian, gay and bisexual (LGB) people. Following consultation with LGB colleagues we will refresh our sexual orientation programme for 2010. We continue to work closely with Stonewall, and in 2009 colleagues from Lloyds Banking Group attended their leadership programme.

In 2009 Lloyds TSB was named by the charity Working Families as one of the UK's Top 20 Employers for working parents, and we will continue to focus on ensuring all colleagues can achieve a good balance between their work and their lives outside.

REWARD

Ensuring that we offer a Total Reward package that is market competitive and supports our strategy to attract and retain talented people to the business, continues to be a key driver for our reward framework. Throughout 2009, we have been developing and consulting with our unions about proposals for harmonised Terms and Conditions of employment. This will provide our colleagues with a market competitive Total Reward package while also supporting choice for our people, enabling us to support the diverse nature of our workforce.

Our harmonised reward package will support our 'One Bank' approach and reflect the importance of linking individual and Group performance to rewards within a strong risk framework. Reward is a key element of how Lloyds Banking Group sets out what it means to work for the Company and reflects the relationship we have with our people and the culture of the organisation.

There has been a renewed focus in the regulatory environment, specifically relating to the link between business risk and the reward arrangements for individuals. In compliance with these requirements we have reviewed our governance arrangements to ensure they are best practice and comply with the FSA and G20 positions. They also ensure that our rewards are managed fairly and consistently, in line with our Group values.

This has been a challenge for the industry as a whole and has required us to operate within a framework of interest from an increasing number of stakeholders, including organisations such as the FSA and UKFI.

In 2009 we won two Industry awards for our benefits provision, including Most Effective Use of a Voluntary Benefits Plan and Most Effective All Employee Share Scheme Strategy. This has set the standard to achieve for the reward package moving forward.

[2]RADAR is the UK's leading pan disability charity.
[3]Stonewall is the UK's leading sexual orientation campaigning organisation.

CORPORATE RESPONSIBILITY

SUPPORTING OUR BUSINESS STRATEGY

Our objective is to be recognised as the best financial services company in the UK by customers, colleagues and shareholders. We will do this by building deep, lasting customer relationships which help our customers achieve what is important to them. We want to be recognised and recommended as a trusted brand by customers, a good employer by colleagues and a valued contributor in the community.

Our corporate responsibility strategy is helping us to deliver this vision. That means:

– Demonstrating financial strength and stability
– Building deep, lasting customer relationships; exceeding their expectations whenever they touch one of our brands
– Being an employer of choice and maximising our colleagues' potential
– Understanding, engaging, and investing in the communities in which our business is based;
– Being committed to environmental protection and better managing our impacts.

We assess our progress against these objectives on an ongoing basis. Our active approach to corporate responsibility ensures that the Group makes a positive contribution to communities all over the UK. This helps us achieve a competitive advantage and deliver business success, despite a difficult economic environment. The Group contributed more than £29 million in 2009 to local charities and community organisations through our charitable Foundations.

EMBEDDDING CORPORATE RESPONSIBILITY ACROSS THE GROUP

The board considers individual corporate responsibility issues throughout the year, and reviews our performance at the end of it. In 2009, we established a new corporate responsibility steering group, comprising senior executives from across the Group. Chaired by Angie Risley, Group HR Director, and reporting to the group chief executive, the steering group meets on a regular basis to review strategy, monitor progress and make sure we achieve our objectives.

Most of our corporate responsibility activity takes place in the business divisions. It is driven by a network of senior managers, who act as corporate responsibility champions. They ensure that we conduct our business in a responsible way and inform our corporate responsibility strategy.

In 2009, the former Lloyds TSB Group Code of Conduct was adopted across all of our operations. The Code of Conduct sets out the core values and standards that govern the way we conduct our business. The Code is underpinned by individual corporate responsibility policies which set minimum requirements for all our business activities. A rolling review process is also underway, benchmarking our corporate responsibility policies against best practice. In 2009, for example, we issued a revised Environmental Policy.

PERFORMANCE IN INDEPENDENT CORPORATE RESPONSIBILITY BENCHMARKS

We are included in the FTSE4Good Ethical Index; the Dow Jones Sustainability Index; the Carbon Disclosure Project's Leadership Index and we are ranked Platinum in Business in the Community's Corporate Responsibility Index.

OUR STAKEHOLDERS

Our key stakeholders are those who are impacted significantly by the business or who might impact on it. These include our shareholders, customers, colleagues, suppliers and wider society and the environment. Our commitment to our shareholders is covered in the chairman's statement, the group chief executive's review and throughout this annual report and accounts. In the following pages we cover our approach to customers, communities and climate change.

OUR PEOPLE

Our approach to colleagues is covered separately on pages 50 and 51. Issues covered in this section include diversity, colleague engagement, reward and learning and development. Our philosophy is based on the premise that our people are a great asset for the Group and important advocates of our strategy and contribution to society. We are focused on bringing our corporate responsibility strategy to life with our colleagues through a range of internal communications throughout the year.

OUR CUSTOMERS

We are dedicated to building deep, lasting customer relationships that distinguish us as the best bank in the UK. We want to build a great organisation, which is recognised for operating to high standards and is built on strong customer relationships. We lent nearly £70 billion in new lending to homeowners and businesses in 2009. Lloyds TSB was voted the most trusted brand by Reader's Digest readers in 2009, for the 9th year running, and came 1st in the Superbrands Retail Banks Sector survey.

CUSTOMER ADVOCACY

During 2009, we implemented consistent customer advocacy metrics across the new Group. The Net Promoter Score was introduced as a measure of customer advocacy in Lloyds TSB in 2008. It was then rolled out in our Halifax and Bank of Scotland brands in the second half of 2009. This metric measures customer recommendation of our products and services, rather than customer satisfaction, and, as a result, will give us a better insight into the service we deliver.

Four thousand customers across the three brands are interviewed each month, in addition to surveys conducted with customers through specific channels or products, to establish the likelihood that they would recommend one of our brands to friends or colleagues. This gives us good insight on how we are doing. It also informs what we need to address to improve customer advocacy.

Our vision is to be the best financial services company in the UK. We will know we have achieved this when our customers tell us so by recommending us more than any other bank. So we have put in place several initiatives to improve customer advocacy. These include Net Promoter Score targets for each of our main brands, and linking these targets to retail colleagues' performance – particularly those colleagues in customer-facing roles.

PLAYING OUR PART IN THE UK'S ECONOMIC RECOVERY

Lloyds Banking Group is UK's largest retail bank. We have over 30 million individual and corporate customers. We play a very active part in the UK economy and its recovery. We take part in 12 of the Government's various financial initiatives aimed at: helping customers enter the housing market; helping small businesses start up; and helping customers in financial difficulty.

HELPING HOUSEHOLDS

Lloyds Banking Group is the UK's largest mortgage lender. In 2009, we wrote £34.7 billion of new mortgages.

We are the largest provider of finance to first time home buyers. In 2009, through our Lloyds TSB brand, we launched the market leading 'Lend a Hand' mortgage. This three year mortgage offers first time buyers a 95 per cent loan-to-value mortgage at 4.39 per cent by taking a legal charge on a savings account belonging to their parents. The legal charge means the parents retain ownership of their savings while earning a competitive fixed interest rate of 3.5 per cent.

We are the biggest provider of finance to the social housing sector. We are committed to funding housing associations to improve existing housing stock and build new affordable housing, both for rental and shared ownership. By the end of 2009 we had committed £14 billion to social housing and had a market share of around 23 per cent.

We worked with the Council of Mortgage Lenders, Department of Communities and Local Government, Ministry of Justice, the Civil Justice Council and the financial advice sector throughout the year on the development of Government initiatives for customers facing difficulty. We are now participating in the Homeowner Mortgage Support Scheme, the Mortgage Rescue Scheme and the Support for Mortgage Interest scheme. We are fully committed to doing everything reasonably possible to support customers in financial difficulties and keep them in their homes. Through this focus, the level of Lloyds Banking Group repossessions has remained well below the Council of Mortgage Lenders industry average.

WORKING WITH SMALL AND MEDIUM SIZED ENTERPRISES

We are committed to helping small to medium sized enterprises (SMEs) in the difficult current economic climate. We grew our market share in lending to SMEs in 2009. Bank of Scotland has returned to lending and is open for business. We approved over 59,000 overdrafts and over 47,000 loans for small businesses with a turnover of less than £1 million. During the year we opened in excess of 100,000 new accounts for SMEs, including a 23 per cent share of the start-up market.

In November 2009, we further underlined our support for UK businesses with the launch of a new 2012 SME Charter, setting out a series of commitments that form a three year programme of support for SMEs to help them grow as the recovery gains momentum. The Charter aims to encourage enterprise, boost access to finance and provide clear and fairer pricing for customers, as well as help 300,000 new start-ups across the country by 2012.

We will be running 200 nationwide seminars every year for the next three years, providing expert guidance and support for up to 90,000 SMEs on starting up, employment, exporting, bidding for London 2012 contracts, sustainability and finance.

We are using our Partnership of London 2012 to promote the Olympic and Paralympic Games' benefits to British businesses, many of them our customers. The Lloyds TSB Official Business Guide for London 2012 is helping companies of all sizes across the country seize the commercial opportunities. It offers practical financial advice and lists useful sources of support. More than 2,000 business guides have been downloaded and over 45,000 distributed.

The Group has also extended the opportunity for customers without adequate capital to borrow under the Government's Enterprise Finance Guarantee Scheme. We are one of the most active participants in the Scheme, offering almost a third of the total loans made under the Scheme.

RESPONSIBLE LENDING AND ADVICE

We have a responsible lending programme with internal management reporting and accountability. Our customer-facing employees are trained to offer the necessary advice and support to help customers manage their borrowing.

PROVIDING CONSUMER CREDIT

As a responsible lender, we wish to ensure customers only borrow what they can afford to repay. Each customer's circumstances are different and we use an affordability model, to better assess a customer's ability to repay, in order to achieve this.

We will only offer a loan facility after carefully assessing customers' financial circumstances and believe that a loan would be appropriate. We take into account customers' current and past management of financial products to ensure we make the most informed decision possible.

We have robust systems in place to ensure that our credit card lending is suitable to the financial circumstances of our customers. We check customers' ability to make repayments at the time at which the account is opened, and then on a regular monthly basis to ensure that the borrowing remains suitable to their circumstances. We proactively contact customers showing signs of financial distress to discuss a range to solutions to help them manage short term difficulties.

HELPING CUSTOMERS MANAGE THEIR BORROWING

Lloyds TSB, Halifax and Bank of Scotland have dedicated Customer Support and Money Management units to provide specialist help to customers who are worried about their financial situation. We have an ongoing programme to train customer-facing colleagues to provide advice and support to customers on managing their borrowing. We proactively contact customers that are showing signs of pressure on their finances. We help them find an appropriate solution, either through more effective budgeting, or by rescheduling their borrowing with us. In 2009 we handled over a million calls with customers in difficulty. We also support independent money advice networks, including the Money Advice Trust and the Consumer Credit Counselling Service. In 2009 we contributed more than £6 million to the financial advice sector.

HELPING THE FINANCIALLY EXCLUDED

Our financial inclusion strategy is aligned with the Government's aims to increase access to banking and credit while, at the same time, developing consumers' financial capability.

We have a 40 per cent market share of customers belonging to the lowest income groups. With over 4 million accounts, the Group is the largest provider of social banking accounts in the UK. These accounts offer facilities such as direct debits but do not provide overdrafts. Through these accounts, customers are able to pay household bills by direct debit, saving them money when compared with other methods of payment. We also work with credit unions throughout the UK, managing their accounts and offering practical advice and support to help them improve and extend their service to communities.

We have committed £4 million to a new 'further education' financial capability project, working with The Treasury, the Department for Business, Innovation and Skills and the FSA, to improve the range of web based resources available to financial capability bodies across the further education and skills sector in the UK. The programme aims to develop the capacity of further education colleges, providers of publicly funded training for apprenticeships, providers of local authority adult and prison education to improve the financial skills of the 10 million adults and young people which they serve. We plan to launch the programme in 2010.

Much of the Group's charitable giving is channelled through the Lloyds TSB Foundations, which cover England and Wales, Scotland, Northern Ireland and the Channel Islands. In 2009, the Lloyds TSB Foundations received £29 million in grants from the Group to support their work in some of the most vulnerable communities in the UK.

The Foundations currently fund a number of financial inclusion and financial capability projects, including grants for Citizens Advice Bureaux (CAB) in England, Wales, Scotland and the Channel Islands, to support their work in providing advice and information to disadvantaged people. The Lloyds TSB Foundation for England and Wales recently announced a grant for Calderdale's Citizen's Advice Bureau worth £50,000 to support the salary of a volunteer co-ordinator to enable the recruitment and support of an additional 30 volunteer advisors to respond to the increasing demand for its services.

PROTECTING OUR CUSTOMERS AGAINST FINANCIAL CRIME

We take protecting our customers and their assets extremely seriously. We continue to invest in activities to deter, detect and prevent fraud and we operate systems designed to ensure that our products and services are not abused for the purposes of laundering the proceeds of crime or for facilitating terrorism. These include transaction monitoring tools to identify and analyse suspicious account activity; and processes to verify customers and check the transactions that they make.

We also work to ensure our customers are aware of how to protect themselves from financial crime. Our various brand websites contain information to assist customers in understanding how to mitigate the risks of common types of internet fraud. We run regular financial crime awareness campaigns, support industry education initiatives and sponsor the charity Crimestoppers.

OUR COMMUNITIES

Our main contribution to society is as a major employer and purchaser of goods and services. We are one of the UK's biggest private sector employers and have a presence in almost every community. Our economic contribution to society is supported by our active investment in these communities and our community giving programme.

OUR COLLEAGUES IN THE COMMUNITY

Our Charity of the Year relationship with the British Heart Foundation (BHF) went from strength to strength in 2009. Over £2 million has been raised between June 2008 and December 2009 through a variety of colleague, customer and shareholder fundraising initiatives. The funds are already being used to fund 15 specialist BHF Heart Nurses in communities across the UK, supporting over 8,400 heart patients.

Recognising the value of longer-term relationships, we have extended our partnership with the BHF for a further 6 months to conclude at the end of 2010. During this time we will continue to engage our colleagues in fundraising activities and raise additional funds for the BHF.

OUR COMMUNITY PROJECTS

As the Official Banking and Insurance Partner of the London 2012 Olympic and Paralympic Games, we have a compelling vision: 'To inspire and support young people, communities and businesses all over Britain on their journey to London 2012 and beyond'. London 2012 will touch every person in Britain and our employees and branches have a vital role to play in this.

We support the next generation of sporting talent through our Lloyds TSB Local Heroes Programme, providing funding to more than 250 emerging young athletes each year across Britain, at a time when they need it most.

Lloyds TSB National School Sport week is the biggest community sport programme in the UK and uses the power of the London 2012 Games to inspire young people to understand the benefits of sport and take part in more sporting activity. The programme is delivered in partnership with the charity Youth Sport Trust.

Working with teachers, schools and young ambassadors nationwide, it aims to support the Government's objective of offering young people the opportunity to participate in five hours of sport and physical activity a week, as well as encourage links to sports clubs in the wider community. Young people are encouraged to try a new Olympic or Paralympic sport and live the Olympic and Paralympic values. Sporting and PE achievements are celebrated and profiled as part of the programme to help maximise its impact and value for children, teachers and parents.

Over 10,500 schools and three million young people across England and Wales took part in the programme in 2009. 71 per cent of pupils tried a new sport and 91 per cent of teachers said the week inspired young people to do more sport. In 2010 the programme will be launched in Scotland in partnership with sportscotland, under our Bank of Scotland brand.

In 2009 Bank of Scotland partnered with the Scottish Football Association, the Scottish Government's 'cashback for communities' scheme and the Scottish Sun newspaper to launch 'Coaches for Communities'; an initiative which aims to get more people involved in youth football in Scotland by providing free football coaching. 'Coaches for Communities' provided training to 1,250 people, including 30 of our employees, leading to a Level One Early Touches qualification. Once qualified, the Scottish FA and the Scottish Schools' Football Association will link participants up with a local community group or team in their area.

The initiative builds on Bank of Scotland's on-going support for grassroots football in Scotland. Through a partnership with the Scottish FA, the bank supports programmes which operate in all 32 local authorities across Scotland to deliver football training and leagues involving over 300 schools and 10,000 young people.

WORKING WITH OUR SUPPLIERS

Our suppliers are important to us. We want to ensure we treat them fairly and pay them on time. In 2009, we became signatories to the new Prompt Payment Code. We commit to pay suppliers on time and not change the payment terms agreed at the outset of the contract. The Code requires that we provide clear guidance on payment procedures, including redress for any disputes, and encourage similar good practice amongst our suppliers and other businesses.

We consider a range of factors when selecting suppliers, including their social, ethical and environmental credentials. In 2009, we launched a dedicated intranet site across the Group which provides colleagues with information, guidance and tools on incorporating social, environmental and ethical criteria in all of our sourcing activities; in the selection of suppliers and as part of supplier audits. We have collaborative relationships with suppliers, facilitating continuous improvement and implementing joint improvement plans. This ensures consistency across the Group in our approach to corporate responsibility in the supply chain.

PAYMENT OF SUPPLIERS

	2009[1]	2008	2007	2006
Number of payments	**763,917**	335,713	320,579	344,422
Value (£bn)	**5.22**	2.67	2.20	2.29
Average time to pay (days)	**28.33**	26.03	28.78	29.72
Number/amount of compensation payments for late settlement	**No payments**	No payments	No payments	No payments

[1] 2009 data represents the combined new Group. Historical data is Lloyds TSB only.

OUR ENVIRONMENTAL AGENDA

We have a long-standing commitment to managing our environmental impacts. We first introduced an environmental policy in 1996. In 2009, we reviewed the policy against best practice to ensure that it is fit for purpose across the whole of the Group. Further work will be undertaken during 2010 to produce and embed an enhanced and integrated environmental management system.

CLIMATE CHANGE

The UK Government is committed to reducing the country's carbon emissions by 80 per cent from 1990 levels by 2050. A central part of its strategy is the introduction of a mandatory climate change and energy savings scheme, the Carbon Reduction Commitment Energy Efficiency Scheme, due to start in April 2010. We qualify as a participant in this scheme, which requires a collective 22 per cent emissions reduction from participants by 2012. We fully understand our obligations and are committed to driving down CO_2 emissions. We are developing a carbon management policy and strategy to deliver a single approach for the new combined Group, and continue to invest significant capital in carbon reduction projects across the Group's estate.

In 2009 we chaired an initiative with Business in the Community and the Cambridge Programme for Sustainability Leadership to create a Guide for Carbon Management in the Supply Chain. The guide has helped inform our approach and, as a freely downloadable resource, we are also encouraging our suppliers and customers to use it to help manage carbon risks in the supply chain.

Lloyds Banking Group is represented by Group Executive Director Truett Tate on the 'Corporate Leaders Group on Climate Change'. This group of leading businesses released the 'Copenhagen Communiqué', widely viewed as the progressive voice of business, for the Copenhagen Climate Change talks in December 2009.

BUSINESS TRAVEL

In 2009 we introduced a common travel policy across the organisation. It supports a focus on sustainable travel and helped us deliver a 13 per cent reduction in the costs of travel.

The Group's Sustainability Network holds events and runs awareness campaigns to encourage colleagues to play their part. Travel reduction was one of the Network's key themes in 2009, inspiring colleagues to take steps to reduce their travel footprints.

We achieved a reduction of 143,000 journeys in 2009 compared with 2008. Across the combined Group, the volume of teleconferences increased by over 40 per cent to over 1.1 million. We will continue to promote virtual conferencing technologies to colleagues as an environmentally friendly, cost efficient alternative to travelling.

ENVIRONMENTAL RISK MANAGEMENT

We have introduced policies and procedures to reduce the environmental impact of our lending activities. We aim to reduce environmental impacts through effective risk management. In 2009 we implemented an integrated Groupwide Environmental Risk Policy to manage these risks. The Policy requires transactions to be assessed for material risks as part of the credit sanctioning process.

EQUATOR PRINCIPLES

Lloyds Banking Group is a signatory to the Equator Principles. The Equator Principles are voluntary guidelines for the financial industry to manage social and environmental issues in project financing.

During 2009 we implemented a harmonised groupwide approach to monitoring and reporting Equator Principles transactions, and training colleagues on the Equator Principles. An Equator Principles Review Group has been formed, comprising experts from both Risk and Project Finance teams, and supported by external environmental consultants. This Group is responsible for reviewing all new Equator Principle transactions, to ensure that each transaction is compliant and is consistent with the Group Environmental Risk Policy, prior to being sanctioned.

Equator Principles reporting January to December 2009:

DEALS

	Equator Principle risk category			
	Category A higher risk	Category B medium risk	Category C lower risk	Total
Completed	–	7	7	14
In Progress	–	4	1	5
Not Completed	–	1	0	1
	0	12	8	20

GEOGRAPHY OF COMPLETED TRANSACTIONS

	Category A higher risk	Category B medium risk	Category C lower risk	Total
US	–	2	2	4
Europe	–	4	5	9
Middle East	–	1	0	1
	0	7	7	14

INDUSTRY OF COMPLETED TRANSACTIONS

	Number	£m
Renewables	4	89
Infrastructure	7	376
Energy and utilities	3	72
	14	537

SUMMARY

Our approach to our key stakeholders underpins our vision to be recognised as the best financial services company in the UK. We proactively manage our relationships with all of them.

Understanding what the customer wants is at the heart of our business. Our new approach to measuring customer advocacy helps provide more insight into the service we deliver.

We regularly communicate with employees on corporate responsibility issues. Indeed, engaging colleagues in our corporate responsibility agenda is central to its success and we will focus on this throughout 2010.

We have a crucial role to play in the recovery of the UK economy. Our support for households and small businesses was further underlined in 2009 by our participation in twelve Government schemes designed to help them.

RISK MANAGEMENT

THE GROUP'S APPROACH TO RISK

The Group's approach to risk is founded on robust corporate governance practices and a risk management culture which guides the way all employees approach their work, the way they behave and the decisions they make. The board takes the lead by establishing the 'tone at the top' and approving professional standards and corporate values for itself, senior management and other colleagues. The board ensures that senior management implements strategic policies and procedures designed to promote professional behaviour and integrity. The board also ensures that senior management implements risk policies and risk appetites that either limit, or where appropriate, prohibit activities, relationships, and situations that could diminish the quality of corporate governance. All colleagues including the group chief executive are assessed against a balanced scorecard that explicitly addresses their risk performance.

This board level engagement, coupled with the direct involvement of senior management in group-wide risk issues at group executive committee level, ensures that issues are escalated on a timely basis and appropriate remediation plans are put in place. The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by senior management. Key decisions are always taken by more than one person.

The group business risk committee and the group asset and liability committee are chaired by the group chief executive and include all members of the group executive committee. The aggregate group wide risk profile and portfolio appetite are discussed at these monthly meetings. The risk oversight committee, chaired by the deputy group chairman, comprises non-executive directors and oversees the Group's risk exposures. This second-line-of-defence committee is supported by the chief risk officer, who is independent of the front line business units, is a full member of the group executive committee and reports to the group chief executive. The chief risk officer regularly informs the risk oversight committee of the aggregate risk profile and has direct access to the deputy group chairman and the members of the risk oversight committee.

The Group has a conservative business model embodied by a risk culture founded on prudence and accountability, where everyone understands that they are accountable for the risks they take and that the needs of customers are paramount. The focus has been and remains on building and sustaining long-term relationships with customers, through good and bad economic times. The approach is supported by a 'through the cycle' approach to risk with strong central control and monitoring.

RISK AS A STRATEGIC DIFFERENTIATOR

The maintenance of a strong control framework remains a priority for the new Lloyds Banking Group and is the foundation for the delivery of effective risk management. The Group optimises performance by allowing divisions and business units to operate within approved capital, liquidity and risk parameters and within the Group's policy framework. The Group's approach to risk management ensures that business units remain accountable for risk whilst realising individual strategies to meet business performance targets. The combination of divisional and group risk management maintains effective independent oversight.

The Group continues to enhance its capabilities by providing to the board both qualitative and quantitative data including stress testing analysis on risks associated with strategic objectives to facilitate more informed and effective decision making. The Group's ability to take risks which are well understood, consistent with its strategy and plans and which are appropriately remunerated, is a key driver of shareholder return.

As part of its integration initiative, the Group has been rolling out the methodology and financial control framework that was used by the heritage Lloyds TSB Group; this includes compliance with the requirements of the US Sarbanes Oxley Act. This project is due to complete in time for reporting in February 2011.

Risk analysis and reporting capabilities support the identification of opportunities as well as risks and it provides an aggregate view of the overall risk portfolio. Risk mitigation strategies clearly aligned with responsibilities and timescales are monitored at group and divisional level.

Reflecting the importance the Group places on risk management, risk is included as one of the five principal criteria within the Group's balanced scorecard on which individual staff performance is judged. Business executives have specified risk management objectives, and incentive schemes take account of performance against these.

Although the layout of the Risk Management section has been left largely unchanged from previous years, more quantitative and qualitative information has been provided for Credit and Liquidity.

STATE AID

The Group is subject to European state aid obligations as a result of the aid it received from HM Treasury. In November 2009 the College of Commissioners approved the Group's restructuring plan, which is designed to address any competition distortions arising from the benefits of state aid. The Group agreed with HM Treasury in the deed relating to its withdrawal from GAPS that it will comply with the terms of the European Commission's decision. This has placed a number of requirements on the Group including the disposal of certain portions of its business over the course of the next four years, including in particular the disposal of some parts of its retail banking business. This will require the Group to work closely with EU and UK authorities to demonstrate that it is complying with the terms of the European Commission's decision.

HM Treasury currently holds approximately 41.3 per cent of the Group's ordinary share capital. There is a risk that this shareholding could in future be used to seek to exercise influence over the affairs or strategic business plans of the Group, particularly if other Government priorities or HM Treasury's interests as a major shareholder in other financial institutions do not align with their interests purely as a shareholder in the Group.

United Kingdom Financial Investments has been appointed manager of HM Treasury's shareholding and the framework document between UKFI and HM Treasury states that UKFI will manage the UK financial institutions in which HM Treasury holds an interest 'on a commercial basis and will not intervene in day-to-day management decisions of the Investee Companies (as defined therein)'. This document also makes it clear that such institutions will continue to be separate economic units with independent powers of decision and 'will continue to have their own independent boards and management teams, determining their own strategies and commercial policies including business plans and budgets'.

In addition, the Group has made a number of undertakings to HM Treasury associated with the state aid it has received, including the provision of additional lending to certain mortgage and business sectors, and other matters relating for instance to corporate governance and staff remuneration. These commitments could limit the operational flexibility of the Group or lead HM Treasury to seek to influence the strategy of the Group in other ways.

RISK GOVERNANCE

The Group has rolled out the heritage Lloyds TSB approach to risk appetite, policies, delegations and risk committee structure and has continued to embed these across all risk disciplines and into the business. Having achieved alignment of all high level group principles and appetites on the date of acquisition, the Group has continued to embed these at all levels.

The risk governance structure is intended to strengthen risk evaluation and management, whilst also positioning the Group to manage the changing regulatory environment in an efficient and effective manner. The risk governance structure for Lloyds Banking Group is shown in table 1.1.

BOARD AND COMMITTEES

The board, assisted by its key risk committees (risk oversight committee and group audit committee), approves the Group's overall risk management framework. The board also reviews the Group's aggregate risk exposures and concentrations of risk to seek to ensure that these are consistent with the board's appetite for risk. The role of the board, audit committee and risk oversight committee are shown in the corporate governance section on pages 100 to 104, and further key risk oversight roles are described below.

In particular, the **risk oversight committee**, which comprises non-executive directors, oversees the development, implementation and maintenance of the group's overall risk management framework and its risk appetite, strategy, principles and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice. The risk oversight committee regularly reviews the Group's risk exposures across the primary risk drivers and the detailed risk types.

The **group executive committee** assisted by the group business risk committee and the group asset and liability committee, supports the group chief executive in ensuring the effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, whilst also reviewing the Group's aggregate risk exposures and concentrations of risk. The GEC's duties are described in greater detail on page 102.

The **group asset and liability committee** is responsible for the strategic management of the Group's assets and liabilities and the profit and loss implications of balance sheet management actions. It is also responsible for the risk management framework for market risk, liquidity risk, capital risk and earnings volatility. Group asset and liability committee is supported by the **senior asset and liability committee** this senior level committee, which is responsible for the review of documentation relating to the management of assets and liabilities in the Group's balance sheet and the escalation of issues of group level significance to group asset and liability committee.

The **group business risk committee** reviews and recommends the Group's risk appetite and risk management framework, high-level group policies and the allocation of risk appetite. Group business risk committee periodically reviews risk exposures and risk/reward returns and monitors the development, implementation and effectiveness of the Group's risk governance framework. Within the scope of its work the committee also considers reputational risk and any issues which could have a materially adverse impact on the Group.

The group business risk committee is supported by the following committees:

- The **group compliance and operational risk committee**, which is responsible for proactively identifying current and emerging significant compliance and operational risks or accumulation of risks and control deficiencies across the Group and reviewing associated oversight plans to ensure pre-emptive risk management action. The committee also seeks to ensure that adequate divisional engagement occurs to develop, implement and maintain the Group's compliance and operational risk management framework.
- The **group credit risk committee**, which is responsible for the development and effectiveness of the Group's credit risk management framework, clear description of the Group's credit risk appetite, setting of high level Group credit policy, and compliance with regulatory credit requirements. On behalf of the group business risk committee, the group credit risk committee monitors and reviews the Group's aggregate credit risk exposures and concentrations of risk.
- The **group model governance and approvals committee**, which is responsible for setting the control framework and standards for models across the Group, including establishing appropriate levels of delegated authority, the approval of models that are considered to be material to the Group (including credit risk rating systems), and the principles underlying the Group's economic capital framework.
- The **group insurance risk committee**, which is responsible for the development and effectiveness of the Group's insurance risk management framework, clear articulation of the Group's insurance risk appetite, setting of high level insurance risk policy, and ensuring compliance with regulatory insurance requirements. On behalf of the group business risk committee, the group insurance risk committee monitors and reviews the Group's aggregate insurance risk exposures and provides proactive and robust challenge around insurance risk and business activities giving rise to insurance risk.
- During the year, the Group has created **divisional financial control committees** to provide governance over financial statements. The meetings provide review and challenge as to the veracity of the results, press release and supporting analyst information addressing the processes that have been followed in drawing them up. Items of focus are key assumptions and areas of subjectivity in the results and ensuring proper remediation of control issues that impact internal controls over financial reporting, the Group's auditors also report findings from their audit work.

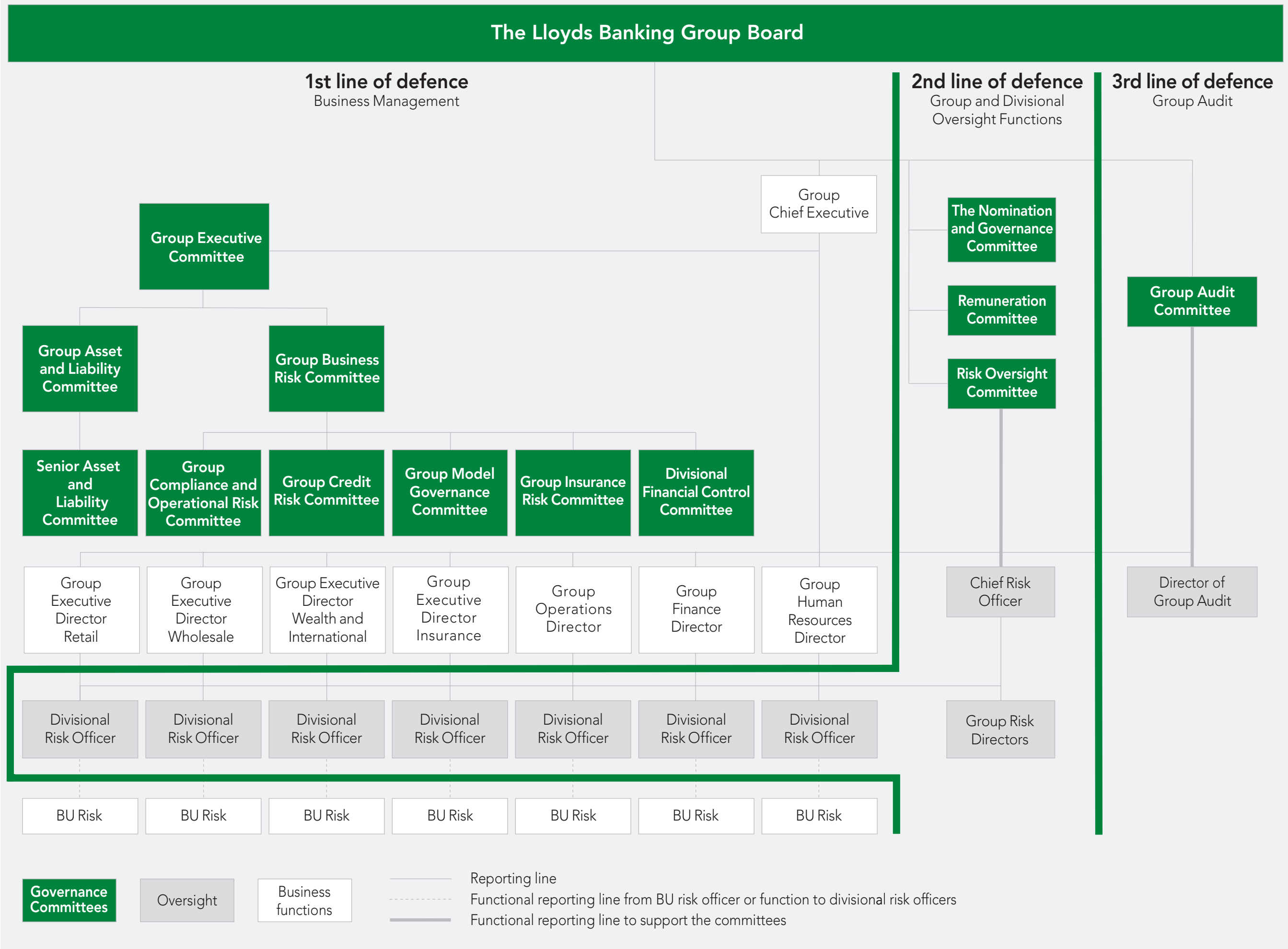
The group risk directors and divisional risk officers meet on a regular basis under the chairmanship of the chief risk officer to review and challenge the risk profile of the Group and seek to ensure that mitigating actions are appropriate. Aggregate risk reports are reviewed by this group before submission to group business risk committees and then to risk oversight committee.

Group executive directors have primary responsibility for measuring, monitoring and controlling risks within their areas of accountability and are required to establish control frameworks for their businesses that are consistent with the Group's high level policies and within the parameters set by the board, group executive committee and group risk. Compliance with policies and parameters is overseen by the risk oversight committee, the group business risk committee, the group asset and liability committee, group risk and the divisional risk officers.

RISK MANAGEMENT OVERSIGHT

The chief risk officer, oversees and promotes the development and implementation of a consistent group-wide risk management framework. The chief risk officer, supported by the group risk directors and the divisional risk officers, provides objective challenge to the Group's senior management. The group executive committee and the board receive regular briefings and guidance from the chief risk officer to ensure awareness of the overarching risk management framework and a clear understanding of their accountabilities for risk and internal control.

TABLE 1.1: RISK GOVERNANCE STRUCTURES



Group risk directors who report directly to the chief risk officer, are allocated responsibility for certain specific risk types and are responsible for ensuring the adequacy of the framework for their risk types as well as the oversight of the risk profile across the Group. Divisional risk officers have dual reporting lines to their own divisional executive and also to the chief risk officer and are responsible for the risk profile within their own divisions. This matrix approach enables the group executive committee members to fulfil their risk management accountabilities.

Divisional risk officers provide oversight of risk management activity for all risks within each of the Group's divisions. Reporting directly to the group executive directors responsible for the divisions and to the chief risk officer, their day-to-day contact with business management, business operations and risk initiatives seeks to provide an effective risk oversight mechanism.

The director of group audit provides independent assurance to the audit committee and the board that risks within the Group are recognised, monitored and managed within acceptable parameters. Group audit is fully independent of group risk, seeking to ensure objective challenge to the effectiveness of the risk governance framework.

RISK MANAGEMENT IN THE BUSINESS

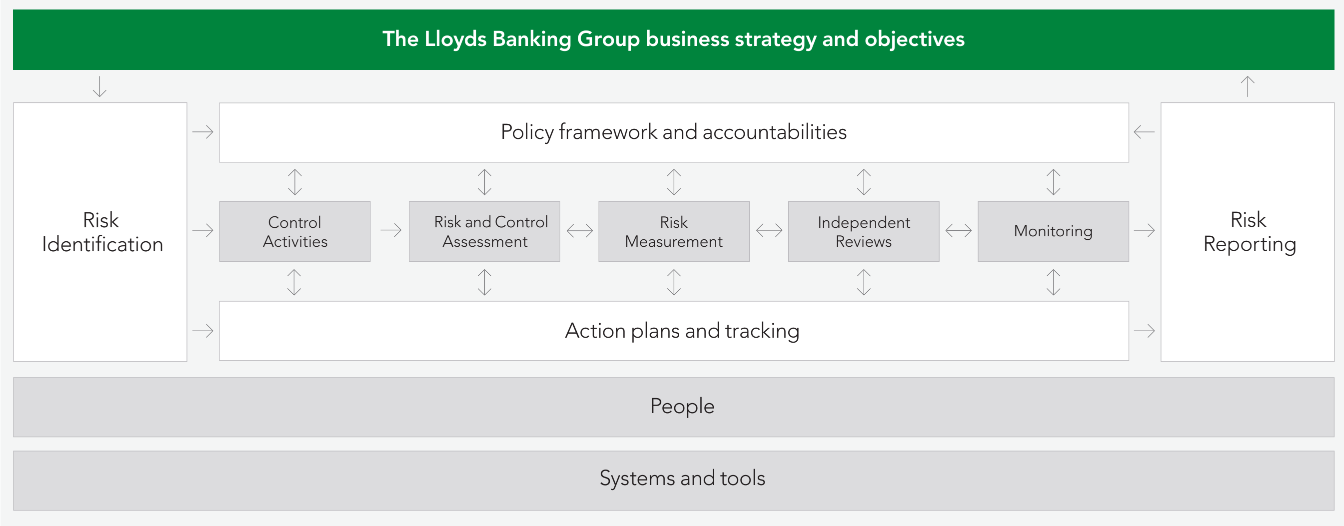
Line management are directly accountable for the management of risks arising in their individual businesses. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group's risk appetite.

All business units, divisions and group functions complete a control self assessment annually (see page 104), reviewing the effectiveness of their internal controls and putting in place a programme of enhancements where appropriate. Managing directors of each business and each group executive committee member certify the accuracy of their assessment.

Risk management in the business forms part of a tiered risk management model, as shown above, with the divisional risk officers and group risk providing oversight and challenge, as described above, and the chief risk officer and group committees establishing the group-wide perspective.

This approach seeks to provide the Group with an effective mechanism for developing and embedding risk policies and risk management strategies which are aligned with the risks faced by its businesses. It also seeks to facilitate effective communication on these matters across the Group.

TABLE 1.2: **RISK MANAGEMENT FRAMEWORK**



RISK MANAGEMENT FRAMEWORK

The Group's risk management principles and risk management framework cover the full spectrum of risks that a group, which encompasses both banking and insurance businesses, would encounter.

The Group uses an enterprise-wide risk management framework for the identification, assessment, measurement and management of risk. It seeks to maximise value for shareholders over time by aligning risk management with the corporate strategy, assessing the impact of emerging risks from legislation, new technologies or the market, and developing risk tolerances and mitigating strategies. The framework seeks to: strengthen the Group's ability to identify and assess risks, aggregate group-wide risks and define the group risk appetite, develop solutions for reducing or transferring risk, and where appropriate, exploit risks to gain competitive advantage, thereby seeking to increase shareholder value. The principal elements of the risk management framework are shown in table 1.2. The framework above comprises 11 interdependent activities which map to the components of the internal control integrated framework issued by the Committee of Sponsoring Organisations of the Treadway Commission.

The framework is dynamic and allows for proportionate adjustment of policies and controls where business strategy and risk appetite is amended in response to changes in market conditions.

The Lloyds Banking Group business strategy and objective is used to determine the Group's high level risk principles and risk appetite measures and metrics for the primary risk drivers (see table 1.3). The risk appetite is proposed by the group chief executive and reviewed by various governance bodies including the group executive committee and the risk oversight committee. Responsibility for the approval of risk appetite rests with the board. The approved high level appetite and limits are delegated to individual group executive committee members by the group chief executive.

The more detailed description of the risk principles and distribution of the risk appetite measures amongst the divisions and businesses are determined by the group chief executive, in consultation with the group business risk committee and the group asset and liability committee.

The risk principles are executed through the **policy framework and accountabilities.** These principles are supported by the policy levels below:

Principles – high level principles for the six primary risk drivers

High level group policy – policy statements for each of the main risk types aligned to the risk drivers

Detailed group policy – detailed policy that applies across the Group

Divisional policy – local policy that specifically applies to a division

Business unit policy – local policy that specifically applies to a business unit

Divisional and business unit policy is only produced by exception and is not necessary unless there is a specific area for which a particular division or business unit requires a greater level of detail than is appropriate for group level policy. The governance arrangements for development of, and compliance with, group, divisional and business unit policy and the associated accountabilities are clearly outlined to all colleagues. Colleagues are expected to be aware of policies and procedures which apply to them and their work and to observe the relevant policies and procedures. Line management in each business area has primary responsibility for ensuring that group policies and the relevant local policies and procedures are known and observed by all colleagues within that area.

Group and divisional risk functions have responsibility for overseeing effective implementation of policy. Group audit provides independent assurance to the board about the effectiveness of the Group's control framework and adherence to policy. Policies are reviewed annually to ensure they remain fit for purpose.

Execution of the Group's risk management framework is dependent upon a clear and consistent **risk identification** using a common language to define risks and to categorise them (see table 1.3 below).

Proportionate **control activities** are in place to design mitigating controls, to transfer risk where appropriate and seeks to ensure executives are content with the residual level of risk accepted.

Risk and control assessments are undertaken to assess the effectiveness of current mitigations and whether risks taken are consistent with the Group's risk appetite (this includes the annual control self-assessment exercise).

The impact of risks and issues (including financial, reputational and regulatory capital) are determined through effective **risk measurement** including modelling, stress testing and scenario analysis.

The outcomes of **independent reviews** (including internal and external audit and regulatory reviews) are integrated into risk management activities and action plans.

Risk reporting is standardised through the use of standard definitions to enable risk aggregation. Divisions monitor their risk levels against their risk appetite, seeking to ensure effective mitigating action is being taken where appropriate. Divisional risk reports are reviewed by each divisional executive committee to ensure that respective senior management are satisfied with the overall risk profile, risk accountabilities and progress on any necessary **action plans and tracking**. Reporting, including that of performance against relevant limits or policies, is in place to provide a level of detail appropriate to the exposures concerned and regular information is provided to group risk for review and aggregate reporting. Any significant issues identified in the **monitoring** process are appropriately reported, and an escalation process is in place to report significant losses to appropriate levels of management. Regular reports are prepared by group risk on risk exposures and material issues to the group asset and liability committee, group business risk committee, group executive committee, risk oversight committee and the board.

At group level, a consolidated risk report is produced which is reviewed and debated by the group business risk committee, group executive committee, audit committee, risk oversight committee and the board to ensure that they are satisfied with the overall risk profile, risk accountabilities and mitigating actions. The consolidated risk report provides a regular assessment of the aggregate residual risk for the primary risk drivers, comparing the assessment with the previous quarter and providing a forecast for the next 12 months.

PRINCIPAL RISKS

At present the most significant risks faced by the Group, which are derived from the primary risk drivers detailed in table 1.3 below, include:

Risk: Definition	Features
Credit: The risk of reductions in earnings and/or value, through financial loss, as a result of the failure of the party with whom the Group has contracted to meet its obligations (both on and off balance sheet).	Arising in the Retail, Wholesale and Wealth and International divisions, reflecting the risks inherent in the Group's lending activities and in the Insurance division in respect of investment of own funds. Over the last two years the deteriorating economic outlook, both in the UK and overseas, brought about by the banking crisis has impacted the financial services industry resulting in further high profile losses and writedowns. The Group is impacted by the economic downturn and a further worsening of the business environment could adversely impact earnings. This poses a major risk to the Group and its lending to: – Retail customers (including those in Wealth and International), where reducing affordability and/or asset values arising from a combination of house price falls, continuing high, or increasing levels of unemployment, consumer over-indebtedness, and rising interest rates impacts both secured and unsecured retail exposures. – Wholesale customers (including those in Wealth and International): where companies are facing increasingly difficult business conditions, resulting in corporate default levels rising and leading to increases in corporate impairment. The Group has high levels of exposure in both the UK and internationally, including Ireland, USA, Australia and Spain. There are particular concentrations to: financial institutions, commercial real estate, and joint ventures, with high leverage and exposures through capital structure. The Group follows a through the economic cycle, relationship based, business model with risk management processes, appetites and experienced staff in place.

AUDITED INFORMATION

Risk: Definition	Features
Legal and regulatory: The risk of regulatory action leading to fine and/or public censure and/or successful legal action being taken against the Group as a result of failure to meet one or more legal and/or regulatory requirements either in the UK or overseas.	The industry is currently subject to a wide range of international and UK consultations on proposals to change the regulatory requirements. For example the Basel Committee on Banking Supervision has issued proposals with respect to capital and liquidity requirements for banks ('Strengthening the resilience of the banking sector' and 'International framework for liquidity risk measurement, standards and monitoring') and draft proposals have also been issued for new capital requirements for insurers (Solvency II). In the UK we have seen the Turner review and more recently, proposals have been issued for governance, recovery and resolution ('Living Wills') arrangements and also, potentially conduct of business requirements, which could have significant implications for past business as well as future product offerings for customers. There is a high level of uncertainty both as to the financial outcome in terms of specific requirements and the speed of implementation in the UK and internationally. The Group is currently assessing the impacts of these regulatory proposals, and will participate in the consultation and calibration processes to be undertaken by the various regulatory bodies during 2010. The Group currently meets and exceeds its regulatory capital requirements and expects to continue to do so. However, the FSA could impose more stringent capital and liquidity requirements, and/or introduce new ratios and/or change the manner in which it applies existing requirements to recapitalised banks, including those within the Group. Any one or combination of these events could result in the Group being forced to raise further capital or to divest assets. The Group has made good preparations for the FSA's new liquidity regime (ILAS) and is ready to meet the reporting implications later in the year. Lloyds Banking Group's policy is to maintain high levels of compliance with regulatory requirements and it will organise its business to maintain this level of compliance as the requirements become clearer, being mindful of maintaining an appropriate balance between risk and reward.
Liquidity and funding: Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient.	Arising in the banking business of the Group and impacting the Retail, Wholesale and Wealth and International divisions reflecting the risk that the Group is unable to attract and retain either retail, wholesale or corporate deposits or issue debt securities. Like all major banks, the Group is dependent on confidence in the short and longer term wholesale funding markets; should the Group, due to exceptional circumstances, be unable to continue to source sustainable funding and provide liquidity when necessary, it could impact its ability to fund its financial obligations. The key dependencies for successfully funding the Group's balance sheet include the continued functioning of the money and capital markets at their current levels; successful right sizing of the Group's balance sheet; the continuation of HM Treasury facilities in accordance with the terms agreed; limited further deterioration in the UK's and the Group's credit rating and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or UK Government support schemes. A return to the extreme market conditions of 2008 would place a strain on the Group's ability to meet its financial commitments. Liquidity risk is managed within a board approved framework using a range of metrics to monitor the Group's profile against its stated appetite and potential market conditions.

Risk: Definition	Features
Customer treatment: The risk of regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment.	Customer treatment and how the Group manages its customer relationships affects all aspects of Lloyds Banking Group's operations and is closely aligned with achievement of Lloyds Banking Group's strategic aim – to create deep long lasting relationships with its customers. There is currently a high level of scrutiny regarding the treatment of customers by financial institutions from the press, politicians and regulatory bodies. The Office of Fair Trading's (OFT) investigation and legal test case in respect of unarranged overdraft charges on personal current accounts concluded in 2009, for further details see note 52 (Notes to the consolidated financial statements). The OFT is however continuing to discuss its concerns in relation to the personal current account market with the banks, consumer groups and other organisations under the auspices of its Market Study into personal current accounts. In October 2009, the OFT published voluntary initiatives agreed with the industry and consumer groups to improve transparency of the costs and benefits of personal current accounts and improvements to the switching process. The OFT aims to report on progress in respect of further changes it believes are required to make the market work in the best interest of bank customers by the end of March 2010. The Group regularly reviews its product range to ensure that it meets regulatory requirements and is competitive in the market place. Treating Customers Fairly remains the key principle underpinning the FSA's consumer protection objective. An additional challenge for Lloyds Banking Group is ensuring the fair treatment of customers during integration of the two heritage businesses. As a result the customer relationship management risks posed by integration are carefully considered through the integration governance process in place. If Lloyds Banking Group is unable to demonstrate the fair treatment of its customers there is the risk of increased complaints from customers, the potential for regulatory action (which could include reviews of past business and/or the payment of fines and compensation) and adverse media coverage (leading to reputational damage in the marketplace). The Group has policies, procedures and governance arrangements in place to facilitate the fair treatment of customers.
People: The risk of reduction in earnings and/or value, through financial or reputational loss, from failure to retain, train, reward, recruit and incentivise appropriately skilled staff, inappropriate staff behaviour or industrial action.	The delivery of Lloyds Banking Group's objectives is underpinned by the ability to attract, retain and develop the best talent in the industry. The challenges to the people agenda have never been greater with increased regulatory and public interest in remuneration practices, the effects of the Government shareholding and the impacts of integration. Lloyds Banking Group welcomes the regulation of remuneration provided there is an international consensus and will comply with the FSA Code. The Group has managed the initial stages of integration, working to establish control by defining and implementing the new organisational structures and continues to manage the relationship with colleagues during this period of change. The Group has policies, procedures and governance arrangements in place to ensure the effective management of people risk as the Group integrates and grows its business. The Group has published proposals to harmonise employee terms and conditions across the Group and is consulting with the various representative unions. The Group actively manages its relationships with unions, but is aware of the danger of industrial action, business disruption and reputational impact arising from union behaviour and communications. People risk is closely monitored as a key risk indicator, as well as being subject to oversight by the board.
Integration: The risk that Lloyds Banking Group fails to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or incurs unanticipated costs and losses associated with, the acquisition of HBOS plc.	The integration of the two legacy organisations presents one of the largest integration challenges that has been seen in the UK financial services industry. There is a risk that the Group may fail to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from the acquisition of HBOS plc by Lloyds TSB Group plc, or may incur unanticipated costs and losses associated as a result. As a consequence, the Group results may suffer as a result of operational, financial management and other integration risks. The risk of failure to deliver synergy benefits or to meet publicly stated targets could potentially result in a loss of shareholder or market confidence with negative perceptions of the Group's integration strategy. As the Group goes through the integration process there is a danger of losing key staff potentially impacting upon integration plans. The Group has created an integration executive board, chaired by the group operations director, to oversee the integration process. The Group is now one year into the integration programme and has a fully developed and functioning governance framework to manage these risks, with clear understanding of the dependencies and phased deliverables through to 2012. The programme is ahead of plan.

TABLE 1.3: **RISK DRIVERS**

Primary risk drivers	Business Risk	Credit Risk	Market Risk	Insurance Risk	Operational Risk	Financial Soundness
Detailed risk types	Strategy setting Execution of strategy	Retail Wholesale	Interest rate Foreign exchange Equity Credit spread	Mortality Longevity Morbidity Persistency Property Expenses Unemployment	Legal and regulatory Customer treatment People Integration Business process risk Financial crime risk Security risk Change Governance	Capital Liquidity and funding Financial and prudential regulatory reporting Disclosure Tax

RISK DRIVERS
The Group's risk language is designed to capture the Group's 'primary risk drivers'. A description of each 'primary risk driver', including definition, appetite, control and exposures, is included below. These are further sub divided into 29 more granular risk types to enable more detailed review and facilitate appropriate reporting and monitoring, as set out in table 1.3.

Through the Group's risk management processes, these risks are assessed on an ongoing basis and seek to ensure optimisation of risk and reward and that, where required, appropriate mitigation is in place. Both quantitative and qualitative factors are considered in assessing the Group's current and potential future risks.

BUSINESS RISK

DEFINITION
Business risk is defined as the risk that the Group's earnings are adversely impacted by a sub optimal business strategy or the sub optimal implementation of the strategy. In assessing business risk, consideration is given to internal and external factors.

RISK APPETITE
Business risk appetite is encapsulated in the Group's budget and medium-term plan, which are sanctioned by the board on an annual basis. Divisions and business units plans are aligned to the Group's overall business risk appetite.

EXPOSURES
The Group's portfolio of businesses exposes it to a number of internal and external factors:

– internal factors: resource capability and availability, customer treatment, service level agreements, products and funding and the risk appetite of other risk categories; and

– external factors: economic, technological, political, social and ethical, environmental, legal and regulatory, market expectations, reputation and competitive behaviour.

MEASUREMENT
An annual business planning process is conducted at group, divisional and business unit level which includes a quantitative and qualitative assessment of the risks that could impact the Group's plans. Within the planning round, the Group conducts both scenario analysis and stress tests to assess risks to future earning streams. Stress testing and scenario analysis are fully embedded in the Group's risk management practice. The Group assesses a wide array of scenarios including economic recessions, regulatory action and scenarios specific to the operations of each part of the business.

MITIGATION
As part of the annual business planning process, the Group develops a set of management actions to prevent or mitigate the impact on earnings in the event that business risks materialise. Additionally, business risk monitoring, through regular reports and oversight, results in corrective actions to plans and reductions in exposures where necessary.

Revenue and capital investment decisions require additional formal assessment and approval. Formal risk assessment is conducted as part of the financial approval process. Significant mergers and acquisitions by business units require specific approval by the board. In addition to the standard due diligence conducted during a merger or acquisition, group risk conducts, where appropriate, an independent risk assessment of the target company.

MONITORING
The Group's strategy is reviewed and approved by the board. Reputational risk is covered at a number of levels throughout the organisation, which includes the group executive committee and the group business risk committee. Regular reports are provided to the group executive committee and the board on the progress of the Group's key strategies and plans. Group risk conducts oversight to seek to ensure that business plans remain consistent with the Group's strategy.

APPROACH
The Group has adapted the heritage Lloyds TSB business risk approach which includes stress testing the medium term plan to changes in economic assumptions. The output of this stress testing is used to determine investment decisions.

CREDIT RISK

DEFINITION
The risk of reductions in earnings and/or value, through financial or reputational loss, as a result of the failure of the party with whom the Group has contracted to meet its obligations (both on and off balance sheet).

RISK APPETITE
Credit risk appetite is set by the board and is described and reported through a suite of metrics derived from a combination of accounting and credit portfolio performance measures which in turn use the various credit risk rating systems as inputs. These metrics are supported by a comprehensive suite of policies, sector caps, product and country limits to manage concentration risk and exposures within the Group's approved risk appetite.

This statement of the Group's overall appetite for credit risk is reviewed and approved annually by the board. With the support of the group credit risk committee and group business risk committee, the group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that credit risk appetite is further delegated to an appropriate level within their areas of responsibility.

EXPOSURES
The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients. The credit risk exposures of the Group are set out in note 54 to the financial statements. Credit risk exposures are categorised as 'retail' arising in the Retail and Wealth and International Divisions and 'wholesale' arising in the Wholesale and Wealth and International Divisions.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer as required. These commitments can take the form of loans and overdrafts, or credit instruments such as guarantees and standby, documentary and commercial letters of credit. With respect to commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most retail commitments to extend credit can be cancelled and the credit worthiness of customers is monitored frequently. In addition, most wholesale commitments to extend credit are contingent upon customers maintaining specific credit standards, which are regularly monitored.

Credit risk can also arise from debt securities, private equity investments, derivatives and foreign exchange activities. Note 18 to the financial statements shows the total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2009. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. Such amounts are reflected in note 54 on page 231.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers. A significant proportion of the investments are held in unit linked and with profit funds where the shareholder risk is limited, subject to any guarantees given.

MEASUREMENT
In measuring the credit risk of loans and advances to customers and to banks at a counterparty level, the Group reflects three components: (i) the 'probability of default' by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and their likely future development, from which the Group derives the 'exposure at default'; and (iii) the likely loss ratio on the defaulted obligations (the 'loss given default').

The Group assesses the probability of default of individual counterparties using internal rating models tailored to the various categories of counterparty. In its principal retail portfolios and a growing number of wholesale lending portfolios, exposure at default and loss given default models are also in use. They have been developed internally and use statistical analysis, combined, where appropriate, with external data and subject matter expert judgement. Each rating model is subject to a rigorous validation process, undertaken by independent risk teams, which includes benchmarking to externally available data, where possible. All material rating models are authorised by the group model governance committee.

Each probability of default model segments counterparties into a number of rating grades, each representing a defined range of default probabilities. Exposures migrate between classifications if the assessment of the obligor probability of default changes. Each rating system is required to map to a master scale, which supports the consolidation of credit risk information across portfolios through the adoption of a common rating scale. Given the differing risk profiles and credit rating considerations, the underlying risk reporting has been split into two distinct master scales, a retail master scale and a wholesale master scale.

(Note 54 to the financial statements provides an analysis of the portfolio and page 68 relates to the divisional analysis that is set out on pages 69 to 75.)

The rating systems described above assess probability of default, exposure at default and loss given default, in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment (see note 2(H) to the consolidated financial statements on page 138). Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the expected loss models that are used for internal operational management and banking regulation purposes.

MITIGATION
The Group uses a range of approaches to mitigate credit risk.

Internal control
- Credit principles and policy: group risk sets out the Group credit principles and policy according to which credit risk is managed, which in turn is the basis for divisional and business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process. Divisional and business unit policy includes lending guidelines, which define the responsibilities of lending officers and provide a disciplined and focused benchmark for credit decisions.
- Counterparty limits: Limits are set against all types of exposure in a counterparty name, in accordance with an agreed methodology for each exposure type. This includes credit risk exposure on individual derivative transactions, which incorporates potential future exposures

from market movements. Aggregate facility levels by counterparty are set and limit breaches are subject to escalation procedures.

– Credit scoring: In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring). Divisional risk departments review scorecard effectiveness and approve changes, with material changes being subject to group risk approval.

– Individual credit assessment and sanction: Credit risk in wholesale portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk. The Group's credit risk appetite criteria for counterparty underwriting are the same as that for assets intended to be held over the period to maturity.

– Controls over rating systems: The Group has established an independent team in group risk that sets common minimum standards, designed to challenge the discriminatory powers of systems, accuracy of calibration and seeks to ensure consistency over time and across obligors. Internal rating systems are developed and implemented by independent risk functions either in the business units or divisions with the business unit managing directors having ownership of the systems. Line management takes responsibility for ensuring the validation of the respective internal rating systems, supported and challenged by specialist functions in their respective division.

– Cross-border and cross-currency exposures: Country limits are authorised by the Country Limits Panel taking into account economic and political factors.

– Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite. Credit policy is aligned to the Group's risk appetite and restricts exposure to certain high risk and more vulnerable sectors and segments. Note 20 to the accounts provides an analysis of loans and advances to customers by industry (for wholesale customers) and product (for retail customers). Exposures are monitored to prevent excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. The Group's large exposures are reported in accordance with regulatory reporting requirements.

– Stress testing and scenario analysis: The credit portfolio is also subjected to stress-testing and scenario analysis, to simulate outcomes and calculate their associated impact. Events are modelled at a group wide level, at divisional and business unit level and by rating model and portfolio, for example, for a specific industry sector.

– Specialist expertise: Credit quality is maintained by specialist units providing, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business.

– Daily settlement limits: Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risk arising from the Group's market transactions on any single day.

– Risk assurance and oversight: Divisional and group level oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Risk assurance teams are engaged where appropriate to conduct further credit reviews if a need for closer scrutiny is identified.

Collateral

The principal collateral types for loans and advances are:

– mortgages over residential and commercial real estate;

– charges over business assets such as premises, inventory and accounts receivable;

– charges over financial instruments such as debt securities and equities; and

– guarantees received from third parties.

The Group maintains guidelines on the acceptability of specific classes of collateral.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where securities are held as part of reverse repurchase or securities borrowing transactions or where a collateral agreement has been entered into under a master netting agreement. Collateral or other security is also not usually obtained for credit risk exposures on derivative instruments, except where the Group requires margin deposits from counterparties.

It is the Group's policy that collateral should always be realistically valued by an appropriately qualified source, independent of the customer, at the time of borrowing. Collateral is reviewed on a regular basis in accordance with business unit credit policy, which will vary according to the type of lending and collateral involved. In order to minimise the credit loss, the Group may seek additional collateral from the counterparty as soon as impairment indicators are identified for the relevant individual loans and advances.

The Group considers risk concentrations by collateral providers and collateral type, as appropriate, with a view to ensuring that any potential undue concentrations of risk are identified and suitably managed by changes to strategy, policy and/or business plans.

Master netting agreements

Where it is efficient and likely to be effective (generally with counterparties with which it undertakes a significant volume of transactions), the Group enters into master netting agreements. Although master netting agreements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis, they do reduce the credit risk to the extent that, if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting agreements can change substantially within a short period since it is affected by each transaction subject to the agreement.

Other credit risk transfers

The Group also undertakes asset sales, securitisations and credit derivative based transactions as a means of mitigating or reducing credit risk, taking into account the nature of assets and the prevailing market conditions.

MONITORING

- Portfolio monitoring and reporting: In conjunction with group risk, businesses and divisions identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by senior management. Group risk in turn produces an aggregated review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to both the group credit risk committee and to the group business risk committee.
- The performance of all rating models is comprehensively monitored on a regular basis, to seek to ensure that models continue to provide optimum risk differentiation capability, the generated ratings remain as accurate and robust as possible and the models assign appropriate risk estimates to grades/pools. All models are monitored against a series of agreed key performance indicators. In the event that monthly monitoring identifies material exceptions or deviations from expected outcomes, these will be escalated to the group model governance committee.

APPROACH

The Group has largely adopted the heritage Lloyds TSB credit risk approach, including governance structure, sanctioning processes and risk appetite controls and framework. Integrated, prudent through the cycle credit policies and procedures have mostly all been established and implemented across the Group, supported by robust early warning indicators and triggers.

Following a prioritised appointment process an integrated credit risk management structure is in place throughout the Group, using the most experienced and skilled resources from both heritages. Substantial work has been undertaken to analyse portfolios and where necessary the Group has taken actions to manage effectively its exposure through the economic downturn. These actions have included revised credit criteria for key products and a withdrawal from those business sectors that are outside of the Group's risk appetite.

The Group has formed a group level Credit Risk Assurance function with experienced credit professionals from both heritages. Together with Divisional Risk senior management, this team has carried out an independent risk-based review of the high risk wholesale and retail books. Nearly £150 billion of high risk wholesale assets, primarily HBOS commercial real estate and corporate exposures, have been reviewed by the team. This has required a detailed file by file review of the original credit application, subsequent management papers and an understanding of the supporting collateral. In addition, portfolio level analysis and investigation, together with statistically robust sampling of accounts, have been carried out for over £300 billion of retail assets. These comprehensive reviews have greatly enhanced the Group's knowledge and understanding of the legacy portfolios and have enabled the Group to assess and manage these exposures confidently and effectively.

To support corporate customers that encounter difficulties during the current economic downturn the Group has continued to expand its dedicated Business Support Unit (BSU) model. Teams have been strengthened in both Wholesale and Wealth and International to deal with the rise in work loads experienced during the year as the recessionary conditions took hold both in the UK and overseas. In Wholesale three teams have been created to cover Corporate Real Estate, Corporate and Commercial, and Specialist Finance customers experiencing difficulties. In Wealth and International teams have been created in Ireland and Australia. Under this model, relationship management passes early and fully to BSU; because the BSU specialists receive the customers at an earlier stage in the process they have more time to develop effective solutions. The strategy is to work alongside management teams and key stakeholders to turnaround businesses in distress and re-establish these as viable entities. Where a turnaround is not feasible, exposure is minimised through a combination of appropriate asset sales, restructuring and work out strategies.

To support UK Retail customers who are encountering financial difficulties the Group has launched a cross-channel support programme. Lloyds TSB branches and telephony units have at least one trained Financial Health Specialist providing customers with budgeting and money management advice. In the Group's Halifax and Bank of Scotland businesses, customers have a dedicated telephone support line with trained specialists able to guide them through any financial difficulties. Support is also available for all customers online, and via a specially developed support brochure. For those customers requiring more intensive help, assistance is provided through dedicated support units where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies where they have multiple credit facilities that require restructuring.

Within Collections and Recoveries the sharing of best practice and alignment of policies across the Group, has helped to drive more effective customer outcomes and achieve operational efficiencies. The Group has strengthened resources in Collections and Recoveries to help customers in distress by offering advice and access to a wider range of options such as short-term repayment plans or the government backed Homeowners' Mortgage Support and Mortgage Rescue schemes. A core element of our relationship management approach is to contact customers showing signs of financial distress, discussing with them their circumstances and offering solutions to prevent their accounts falling into arrears. This year, nearly a quarter of a million customers have been contacted who were not yet in arrears.

The Group follows a through the economic cycle, relationship based, business model with robust risk management processes, appropriate appetites and experienced staff in place. These robust policies and procedures define chosen target market and risk acceptance criteria. These have been, and will continue to be, tightened and fine tuned as appropriate and include the use of early warning indicators to help anticipate future areas of concern and allow us to take early and proactive mitigating actions.

CREDIT RISK MANAGEMENT IN 2009

To understand the trends in each portfolio the comparatives for 2008 have been provided for the combined businesses which are unaudited. Consequently pages 67 to 75 covering credit risk management in 2009 are unaudited.

KEY HIGHLIGHTS

– As a result of the significant impairments taken in the first half of 2009 following in-depth reviews of the Group's high risk portfolios and a more favourable macroeconomic environment in the second half of 2009, the Group's total impairment charge levels have reduced in the second half of the year.
– Whilst the path of the economic recovery remains uncertain, the Group continues to expect the 2010 charge to be significantly lower than the total 2009 charge.
– The Group has largely adopted the heritage Lloyds TSB's credit risk approach and is implementing prudent, 'through the cycle' credit policies and procedures across the Group.
– The Group has expanded its BSU model and strengthened the resources within Collections and Recoveries to support the more timely engagement with customers experiencing difficulties and drive more effective customer outcomes.

The Group's total impairment losses increased by £9,108 million to £23,988 million in 2009. Impairment losses for loans and advances as a percentage of average gross loans and advances to customers, increased to 3.25 per cent from 1.81 per cent in 2008. This was principally due to the material deterioration in UK economic conditions in 2009. The rapid economic and asset value declines, together with aggressive lending polices in the heritage HBOS business, caused wholesale impairment losses to increase substantially during 2009. This was especially so in the HBOS Corporate Real Estate portfolio which has been particularly vulnerable to the deterioration in asset values as well as the HBOS (UK and US) Corporate portfolios.

The Group's gross loans and advances to customers, before impairment provisions and fair value adjustments, decreased by £44.9 billion to £660.0 billion. The reduction in gross advances was primarily driven by the alignment of heritage risk appetites in Retail, a reduction in wholesale lending in Corporate Markets and a reduction in Wealth and International before allowing for a transfer of £7 billion of advances from the Wholesale division to Wealth and International during the year in respect of the European loan portfolio.

Total impaired loans increased by £27,529 million to £58,833 million at 31 December 2009 and as a percentage of closing loans and advances to customers increased to 8.9 per cent from 4.4 per cent at 31 December 2008 driven by the deterioration in the economic environment, and in particular by declines in commercial real estate values and higher unemployment. The Group's coverage ratio (impairment provisions as a percentage of impaired loans) has decreased to 44.2 per cent from 45.2 per cent in 2008. Whilst the ratio has increased within Wholesale and Wealth and International, the overall fall is due to the write-off of unsecured loans and advances within Retail that had been provided against in earlier years, as reported at the half-year. The Group believes it has adequate coverage.

The Group remains cautious about a number of downside risks, including a renewed macro-economic deterioration in the UK and Ireland. However, based on its latest economic assumptions, the Group expects a significantly lower impairment charge in 2010 compared to 2009.

TABLE 1.4: IMPAIRMENTS ON GROUP LOANS AND ADVANCES

As at 31 December 2009	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Retail	**378,005**	**11,015**	**2.9**	**3,806**	**34.6**
Wholesale	**210,934**	**35,114**	**16.6**	**17,179**	**48.9**
Wealth and International	**69,402**	**12,704**	**18.3**	**5,003**	**39.4**
Hedging and other items	**1,663**				
	660,004	**58,833**	**8.9**	**25,988**	**44.2**
Impairment provisions	**(25,988)**				
Fair value adjustments	**(7,047)**				
	626,969				
As at 31 December 2008					
Retail	386,007	10,106	2.6	4,842	47.9
Wholesale	247,138	18,470	7.5	8,263	44.7
Wealth and International	67,481	2,728	4.0	1,047	38.4
Hedging and other items	4,284	–	–	–	–
	704,910	31,304	4.4	14,152	45.2
Impairment provisions	(14,152)				
Fair value adjustments	(13,512)				
	677,246				

[1] Impairment provisions include collective unimpaired provisions.

To understand how the above portfolios are classified for internal monitoring purposes the following table sets out the Group's loans and advances according to asset quality. Please also refer to page 232 of the financial statements.

The definitions used below of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and wholesale customers are not the same, reflecting the different characteristics of these exposures and the way they are managed internally. Wholesale lending has predominantly been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending have predominantly been determined using internal rating models and for Retail mortgages also incorporate expected recovery levels and, where applicable expert judgement. Good quality lending includes the lower assessed default probabilities and all loans with low expected losses in the event of default, with other categories reflecting progressively higher risks and lower expected recoveries.

TABLE 1.5: **ASSET QUALITY BY DIVISION**

As at 31 December 2009 **Asset type**	**Asset quality**	**Retail Division £m**	**Wholesale Division £m**	**Wealth and International Division £m**	**Fair value hedging and other items £m**	**Total £m**
Retail – mortgages	Good	**318,559**	**–**	**15,825**	**1,098**	**335,482**
	Satisfactory	**7,014**	**–**	**2,600**	**–**	**9,614**
	Lower	**504**	**–**	**242**	**–**	**746**
	Below standard, but not impaired	**876**	**–**	**574**	**–**	**1,450**
	Past due, but not impaired	**11,726**	**–**	**861**	**–**	**12,587**
	Impaired	**7,196**	**–**	**756**	**–**	**7,952**
						367,831
Retail – other	Good	**16,179**	**12,681**	**2,777**	**(894)**	**30,743**
	Satisfactory	**7,666**	**3,838**	**1,150**	**–**	**12,654**
	Lower	**955**	**436**	**89**	**–**	**1,480**
	Below standard, but not impaired	**2,591**	**740**	**221**	**–**	**3,552**
	Past due, but not impaired	**663**	**709**	**501**	**–**	**1,873**
	Impaired	**3,819**	**2,384**	**148**	**–**	**6,351**
						56,653
Wholesale	Good	**13**	**52,292**	**8,230**	**1,275**	**61,810**
	Satisfactory	**124**	**47,729**	**11,711**	**188**	**59,752**
	Lower	**120**	**40,416**	**5,450**	**–**	**45,986**
	Below standard, but not impaired	**–**	**13,605**	**4,719**	**–**	**18,324**
	Past due, but not impaired	**–**	**3,374**	**1,748**	**(4)**	**5,118**
	Impaired	**–**	**32,730**	**11,800**	**–**	**44,530**
						235,520
		378,005	**210,934**	**69,402**	**1,663**	**660,004**
As at 31 December 2008 Asset type	Asset quality	Retail Division £m	Wholesale Division £m	Wealth and International Division £m	Fair value hedging and other items £m	Total £m
Retail – mortgages	Good	328,560	–	19,672	82	348,314
	Satisfactory	1,896	–	1,331	–	3,227
	Lower	125	–	246	–	371
	Below standard, but not impaired	109	–	447	–	556
	Past due, but not impaired	14,171	–	839	–	15,010
	Impaired	4,756	–	356	–	5,112
						372,590
Retail – other	Good	17,035	15,395	3,258	539	36,227
	Satisfactory	8,050	3,601	2,568	–	14,219
	Lower	891	482	79	–	1,452
	Below standard, but not impaired	2,624	877	114	–	3,615
	Past due, but not impaired	754	947	203	–	1,904
	Impaired	5,350	1,900	18	–	7,268
						64,685
Wholesale	Good	15	72,003	6,438	3,555	82,011
	Satisfactory	102	81,594	16,806	108	98,610
	Lower	1,568	38,508	6,865	–	46,941
	Below standard, but not impaired	–	10,170	3,681	–	13,851
	Past due, but not impaired	1	5,091	2,206	–	7,298
	Impaired	–	16,570	2,354	–	18,924
						267,635
		386,007	247,138	67,481	4,284	704,910

LEVERAGE FINANCE LENDING

Leverage finance exposures arise in Wholesale and in Wealth and International. The Group defines leverage as that business booked within Lloyds Acquisition Finance in Wholesale and the equivalent business in Lloyds International. The portfolio is well spread by sector with the majority of the exposures being UK focused.

TABLE 1.6: LEVERAGE FINANCE LENDING

As at 31 December 2009	Drawn £bn
Wholesale division	**14.4**
Wealth and International division	**3.2**
	17.6[1]
As at 31 December 2008	
Wholesale division	14.9
Wealth and International division	3.3
	18.2

[1] Total includes £4.8 billion relating to unsuccessful syndications and £0.3 billion in syndication.

RETAIL

KEY HIGHLIGHTS

– Impairment losses have increased by 14 per cent to £4,227 million particularly reflecting the impact of increases in unemployment during 2009 on the unsecured charge, partly offset by a lower secured impairment charge as the housing market stabilised.

– New lending quality has remained strong, with lower arrears evident.

– Average loan-to-value on new mortgage lending has reduced to 59.3 per cent, compared to 63.1 per cent during 2008.

– Management actions taken, coupled with more favourable recent economic trends, have reduced overall volumes of customers entering Collections in the second half of the year.

– The path of economic recovery in the UK remains uncertain; however, based on current trends, the Group expects impairment losses in 2010 to be lower than 2009.

Retail impairment losses increased by £532 million to £4,227 million in 2009, driven primarily by deteriorating economic conditions in the latter part of 2008 and the first half of 2009. Impairment losses were lower in the second half of 2009, compared to the first half, driven by lower secured impairment losses. The improvement in secured impairment losses reflected increases in UK house prices, slowing unemployment growth, better affordability with lower interest rates and management actions. Impairment losses for loans and advances, as a percentage of average loans and advances to customers, increased to 1.11 per cent from 0.97 per cent in 2008.

Retail's gross loans and advances have reduced by £8 billion to £378 billion, as a result of management actions to align heritage risk appetites with a focus on lending to lower risk segments, such as unsecured franchise customers, and the write-off of £2.1 billion of unsecured loans and advances which had been provided against in earlier years, as reported at the half-year.

Total impaired loans increased by £909 million to £11,015 million at 31 December 2009 and as a percentage of closing advances to customers, increased to 2.9 per cent from 2.6 per cent at 31 December 2008. This is lower than the £11,394 million reported at 30 June 2009, as there was a gradual improvement in the second half of the year in secured loans, with unsecured lending remaining stable.

The Group is cautious about a number of potential downside risks, including lagged effects of high unemployment, a potential for recent house price increases to reverse, the challenges to affordability if interest rates were to rise ahead of real wage growth and other potential pressures on future affordability. However, based on its latest economic assumptions, the Group's expectation is for recent trends to continue and for Retail to report a lower impairment charge in 2010 compared to 2009.

TABLE 1.7: **IMPAIRMENTS ON RETAIL LOANS AND ADVANCES**

As at 31 December 2009	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Secured	**345,900**	**7,196**	**2.1**	**1,693**	**23.5**
Unsecured[2]	**32,105**	**3,819**	**11.9**	**2,113**	**55.3**
Total Retail	**378,005**	**11,015**	**2.9**	**3,806**	**34.6**
Impairment provisions	**(3,806)**				
Fair value adjustments	**(3,141)**				
	371,058				

As at 31 December 2008	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Secured	349,646	4,756	1.4	1,403	29.5
Unsecured[2]	36,361	5,350	14.7	3,439	64.3
Total Retail	386,007	10,106	2.6	4,842	47.9
Impairment provisions	(4,842)				
Fair value adjustments	(4,088)				
	377,077				

[1] Impairment provisions include collective unimpaired provisions.

[2] The reduction in unsecured advances and impairment provisions reflects the write-off of £2.1 billion of unsecured loans and advances to customers which had been provided against in prior years.

The Retail division's loans and advances to customers are analysed in the following table:

TABLE 1.8: **LOANS AND ADVANCES TO CUSTOMERS**

As at 31 December	2009 £m	2008 £m
Secured:		
Mainstream	**270,069**	274,237
Buy to let	**44,236**	41,364
Specialist	**31,595**	34,045
	345,900	349,646
Unsecured:		
Credit cards	**12,301**	13,802
Personal loans	**16,940**	18,102
Bank accounts	**2,629**	2,788
Others, including joint ventures[1]	**235**	1,669
	32,105	36,361
	378,005	386,007

[1] Following the Group's acquisition of the remaining shares in the joint venture with AA, unsecured lending by that entity is now reported in 'Personal Loans' and 'Credit Cards' headings, previously these balances were included in 'Others'.

SECURED

The UK mortgage market for both house purchase and re-mortgaging slowed considerably in 2009, with gross market lending falling to £143 billion from £254 billion in 2008. The re-mortgage market is the main contributor to this fall, as reductions in base rate have brought the interest rate on standard variable mortgages to below new business rates across the industry, thereby reducing the incentive for borrowers to re-mortgage.

Gross new mortgage lending by Retail in 2009 was £35 billion compared to £78 billion for 2008, representing a market share of gross new lending of 24 per cent compared with 31 per cent in 2008. Overall, mortgage balances outstanding at 31 December 2009 were £345.9 billion, a reduction of £3.7 billion in the year.

In March 2009, the Group committed to increasing its planned gross lending to homebuyers by £3 billion in the following 12 months. The lending provided under this commitment continues to adhere to the Group's risk appetite. The Group's risk appetite is consistent with the criteria that had proved to be a prudent and successful approach for Lloyds TSB.

Secured impairment losses were £789 million in 2009, a reduction of £506 million compared with 2008. The main drivers of the reduction are internal activities (risk and collections policies) and better than anticipated external factors (interest rates, house prices and unemployment). The combination of these factors has resulted in a reduction in impaired loans in the second half of the year. As a percentage of average gross loans and advances to customers, secured impairment losses decreased to 0.23 per cent in 2009 from 0.38 per cent in 2008.

Management actions taken have resulted in new lending quality improving to pre-recessionary levels, with fewer customers now going into arrears. Specialist lending is now closed to new business and this book is in run-off.

Although impaired loans in the year increased to £7,196 million, Retail has seen a steady reduction in the second half of the year from £7,612 million at June 2009. Impaired secured loans, as a percentage of closing advances, increased to 2.1 per cent at 31 December 2009 from 1.4 per cent in 2008.

The percentage of mortgage cases greater than three months in arrears (excluding possessions) increased to 2.3 per cent at 31 December 2009 compared to 1.8 per cent at 31 December 2008. Based on the most recent published figures by the Council of Mortgage Lenders, the Group is performing marginally better than the industry average.

TABLE 1.9: **MORTGAGES GREATER THAN THREE MONTHS IN ARREARS (EXCLUDING POSSESSIONS)**

As at 31 December	Number of cases		Total mortgage accounts		Value of debt[1]		Total mortgage balances	
	2009 Cases	2008 Cases	**2009 %**	2008 %	**2009 £m**	2008 £m	**2009 %**	2008 %
Mainstream	**57,837**	46,543	**2.1**	1.5	**6,407**	4,796	**2.4**	1.7
Buy to let	**7,557**	6,950	**1.9**	2.0	**1,159**	1,053	**2.6**	2.5
Specialist	**13,848**	12,634	**6.6**	5.6	**2,498**	2,342	**7.9**	6.9
	79,242	66,127	**2.3**	1.8	**10,064**	8,191	**2.9**	2.3

[1] Value of debt represents total book value of mortgages in arrears but not in possession.

Provisions held against secured assets appropriately reflect the risk of further losses from events that have already occurred. This includes adequate allowance for losses yet to emerge on accounts currently on repayment plans or benefiting from the very low interest rate environment.

The possessions stock has fallen by 32 per cent in 2009, from 4,011 to 2,720 properties. Currently, average proceeds from the sale of repossessed properties are in excess of average valuations assumed in Retail's provisioning models.

The average loan-to-value ratio for new mortgages and further advances written in 2009 was 59.3 per cent compared with 63.1 per cent in 2008. The average indexed loan-to-value ratio on the mortgage portfolio was 54.8 per cent compared with 54.9 per cent in 2008 and 13.0 per cent of the mortgage portfolio had an indexed loan-to-value ratio in excess of 100 per cent (£44.8 billion), compared with 16.2 per cent (£56.8 billion) in 2008.

TABLE 1.10: ACTUAL AND AVERAGE LTVS ACROSS THE PRINCIPAL MORTGAGE PORTFOLIOS

As at 31 December 2009	Mainstream %	Buy to let %	Specialist[1] %	Total %
Less than 60%	**34.4**	**12.0**	**14.3**	**29.7**
60% to 70%	**11.9**	**11.3**	**9.7**	**11.6**
70% to 80%	**15.2**	**20.2**	**17.0**	**16.0**
80% to 90%	**14.3**	**19.1**	**21.5**	**15.6**
90% to 100%	**12.2**	**21.4**	**20.3**	**14.1**
Greater than 100%	**12.0**	**16.0**	**17.2**	**13.0**
	100.0	**100.0**	**100.0**	**100.0**
Average loan to value:				
Stock of residential mortgages	**51.0**	**75.2**	**72.3**	**54.8**
New residential lending	**58.3**	**65.6**	**73.7**	**59.3**
Impaired mortgages	**71.1**	**91.5**	**85.6**	**76.5**
As at 31 December 2008	Mainstream %	Buy to let %	Specialist %	Total %
Less than 60%	34.3	11.1	14.8	29.6
60% to 70%	10.7	9.6	9.4	10.5
70% to 80%	12.7	15.6	15.7	13.3
80% to 90%	13.6	20.3	21.4	15.2
90% to 100%	13.5	22.1	20.8	15.2
Greater than 100%	15.2	21.3	17.9	16.2
	100.0	100.0	100.0	100.0
Average loan to value:				
Stock of residential mortgages	52.2	77.0	71.7	54.9
New residential lending	60.7	73.1	73.1	63.1
Impaired mortgages	67.3	89.9	85.6	74.1

[1] Specialist lending is now closed to new business and is in run-off.

UNSECURED

Consumer Banking has aligned risk appetite across the business to focus on lending to its existing customers. Personal loan balances outstanding at 31 December 2009 were £16.9 billion (31 December 2008: £18.1 billion), the reduction reflected lower demand, a tightening of lending criteria and the write-off of unsecured loans and advances which had been provided against in earlier years, as reported at the half-year.

In credit cards, Retail's combined brands are market leaders in terms of new credit card issuance. Credit card balances outstanding at 31 December 2009 were £12.3 billion (31 December 2008: £13.8 billion). In addition, the Group was the leading UK debit card issuer in 2009.

The impairment charge for unsecured lending was £3,438 million in 2009, an increase of £1,037 million on 2008 which reflects the higher unemployment levels seen in the year. Consistent with the Group's statements at the half-year, Retail's impairment losses on unsecured lending were higher in the second half of the year, largely driven by the standardisation of the treatment for concessionary repayment plans; if this charge was excluded, impairment losses were stable.

In the second half of 2009 there were signs of improved underlying performance in all portfolios; management actions reduced the delinquency rates on new business. If current trends continue, Retail believes impairment losses in 2010 will be lower than in 2009.

Total impaired unsecured loans were £3.8 billion (31 December 2008: £5.4 billion) and represented 11.9 per cent of closing advances compared to 14.7 per cent at 31 December 2008. Provisions as a percentage of impaired loans decreased to 55.3 per cent (31 December 2008: 64.3 per cent). The reduction in both the level of impaired loans and the impairment provisions coverage reflected the write-off of £2.1 billion of unsecured loans which had been provided against in the prior years, as reported at the half-year.

Personal loans: Impaired personal loans decreased to 10.5 per cent of closing advances (31 December 2008: 11.6 per cent) and provisions, as a percentage of closing advances, decreased to 5.9 per cent (31 December 2008: 7.0 per cent).

Credit cards: Impaired credit cards advances were 13.6 per cent of closing advances (31 December 2008: 20.2 per cent) and provisions, as a percentage of closing advances, decreased to 7.1 per cent (31 December 2008: 13.6 per cent).

Bank accounts: Impaired loans decreased to 13.6 per cent of closing advances (31 December 2008: 17.0 per cent) and provisions, as a percentage of closing advances, decreased to 8.9 per cent (31 December 2008: 10.6 per cent).

WHOLESALE

KEY HIGHLIGHTS

- Established robust credit risk control framework and risk appetite largely based on Lloyds TSB's approach, and rolled out across Wholesale. Divisional Risk continue to undertake robust and continuous oversight and challenge to the business.
- Significant resources deployed into the Business Support Units focused on key asset classes.
- As a result of significant impairments taken in the first half of 2009, notably in HBOS Corporate Real Estate and HBOS (UK and US) Corporate portfolios, the Group expects this to represent the peak of total impairments given the Group's economic assumptions. However, the Group expects the volume of underlying impairments from traditional trading and manufacturing businesses to increase in 2010, as the full impact of economic conditions filters into business insolvencies and asset values. This is a factor of a typical lag effect as the economy passes through the recession. However, the effects of this negative trend should be significantly less than the benefit of lower absolute impairments from the HBOS Corporate Real Estate and HBOS (UK and US) Corporate portfolios.

– Volume of individual cases passing into Business Support Units continued to rise in the second half of 2009.

– The Group remains cautious about the extent of corporate recovery in 2010.

Wholesale division impairment losses increased by £5,289 million to £15,683 million in 2009. Impairment losses for loans and advances as a percentage of average loans and advances to customers increased to 5.92 per cent in 2009 from 3.32 per cent in 2008. Higher levels of failures, notably in HBOS Corporate Real Estate and real estate related transactions, and the HBOS (UK and US) Corporate portfolio, drove a significant increase in impairments. However, impairment losses reduced significantly in the second half of 2009, amounting to £5,945 million, compared with £9,738 million in the first half, a reduction of £3,793 million, or 39 per cent.

Wholesale's gross loans and advances to customers have decreased by £36.2 billion to £210.9 billion. Since the date of acquisition, all business originated in Wholesale has been evaluated in accordance with the risk appetite and credit control criteria that had proved to be a prudent and successful approach for Lloyds TSB. Early assessment of HBOS portfolios identified those areas where there was close alignment with the Lloyds TSB heritage, those which could continue to be supported once the more restrictive appetite and policy were aligned and those where it was clear that there would be limited appetite to lend. As agreed with the UK government, the Group's lending commitment is also subject to, and considered in the light of, the Group's risk appetite and credit control criteria.

Total impaired loans increased by £16,644 million to £35,114 million at 31 December 2009. Impaired loans as a percentage of closing advances was 16.6 per cent as at 31 December 2009 compared with 7.5 per cent as at 31 December 2008, with impairment provisions as a percentage of impaired loans increasing to 48.9 per cent as at 31 December 2009 from 44.7 per cent as at 31 December 2008. Detailed reviews of vulnerable portfolios have largely been completed and, where appropriate, remedial risk mitigating actions are underway. The HBOS impairment methodology has now been aligned with the Group's methodology, and this is reflected in the impairment charge for the year and the first half in particular. The position has stabilised during the second half with a lower rate of impairment compared with the first half.

The Lloyds TSB approach to credit risk management, with a focus on ensuring its risk appetite and credit policies reflect a prudent through the cycle approach to lending, impairment assessment and review is being embedded across the enlarged Wholesale division and remains a key focus in 2010.

TABLE 1.11: **IMPAIRMENTS ON WHOLESALE LOANS AND ADVANCES**

As at 31 December 2009	**Loans and advances £m**	**Impaired loans £m**	**Impaired loans as a % of closing advances %**	**Impairment provisions[1] £m**	**Impairment provisions as a % of impaired loans %**
Corporate Markets:					
Corporate	**67,293**	**7,930**	**11.8**	**3,933**	**49.6**
Commercial	**26,551**	**2,597**	**9.8**	**972**	**37.4**
Real Estate	**55,490**	**18,016**	**32.5**	**8,791**	**48.8**
Specialist Finance	**16,088**	**2,956**	**18.4**	**1,621**	**54.8**
Wholesale Markets	**31,286**	**1,646**	**5.3**	**631**	**38.3**
Total Corporate Markets	**196,708**	**33,145**	**16.8**	**15,948**	**48.1**
Treasury and Trading	**1,394**	**–**	**–**	**–**	**–**
Asset Finance	**12,832**	**1,969**	**15.3**	**1,231**	**62.5**
Total Wholesale	**210,934**	**35,114**	**16.6**	**17,179**	**48.9**
Reverse repos	**1,108**				
Impairment provisions	**(17,179)**				
Fair value adjustments	**(3,055)**				
Total loans and advances	**191,808**				

As at 31 December 2008	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of Impaired loans %
Corporate Markets:[2]					
Corporate	81,482	2,615	3.2	1,736	66.4
Commercial	26,785	1,759	6.6	597	33.9
Real Estate	59,481	9,536	16.0	3,318	34.8
Specialist Finance	26,816	2,049	7.6	1,271	62.0
Wholesale Markets	35,652	1,114	3.1	475	42.6
Total Corporate Markets	230,216	17,073	7.4	7,397	43.3
Treasury and Trading	2,775	–	–	–	–
Asset Finance	14,147	1,397	9.9	866	62.0
Total Wholesale	247,138	18,470	7.5	8,263	44.7
Reverse repos	3,230				
Impairment provisions	(8,263)				
Fair value adjustments	(7,543)				
Total loans and advances	234,562				

[1] Impairment provisions include collective unimpaired provisions.

[2] As part of the process of allocating assets to the new management structure, the legacy HBOS portfolios have been resegmented and the 2008 comparative numbers are presented on an organisational basis consistent with 2009.

CORPORATE

The Corporate (UK and US) portfolios felt the impact of the adverse economic environment in the first half of 2009 but this has stabilised during the second half with a lower rate of impairments raised against the portfolio and a slower rate of new cases being transferred into Business Support Units. A higher volume of impaired cases is expected in 2010 as the lag from the UK recession bites. This impact is expected to be biased toward the mid size franchise, of which the HBOS heritage portfolio is characterised by high levels of obligor concentration to riskier counterparties many with a property related component, thereby impacting the level of the impairment charge in 2009. The significant level of impairments taken in 2009 in the HBOS corporate business is not expected to be repeated.

As part of its funding, liquidity and general hedging requirements Lloyds Banking Group maintains relationships with many major financial institutions throughout the world. Credit quality in general is improving in the sector, helped significantly by the support mechanisms established by Governments, Central Banks and regulators. This is reflected in the firmer trend in market prices now quoted for bank debt. Some economies continue to experience difficulties, either through low growth or high borrowing levels, and banking sectors in these countries remain under strain.

The position in North America has stabilised with a lower rate of impairments in the second half of 2009. The Group retains some material single obligor concentrations on weaker credits. Concentrations remain in gaming, residential real estate and to some poorer sub prime non-bank financial institutions loan originators. Although the portfolio is appropriately impaired, a weakening in some of the Group's gaming exposures could well result in the need for further impairments during 2010.

COMMERCIAL

Impairment has been marginally higher than originally expected this year, reflecting the harsher economic conditions that the Group's customers have experienced. The Group continues to refine its risk management and forecasting tools to reflect the economic environment and further increase control, monitoring and support of customers. In addition, the roll out of a combined Lloyds TSB and Bank of Scotland credit policy and risk strategy will benefit the business going forward, and the Group's prudent through the cycle lending policies will ensure that asset quality remains appropriately robust.

Portfolio metrics and stress testing analysis suggest continued material impairments through the short to medium term, as expected at this stage of the economic cycle. Over time, impairment losses as a percentage of advances are expected to trend towards more normalised levels reflective of the historic performance of the Lloyds TSB heritage portfolio. However, in line with past experience, the impairment improvement is expected to show some lag behind the upturn in the economy.

CORPORATE REAL ESTATE

The Corporate Real Estate portfolio has endured a significant level of stress as a consequence of the unprecedented scale and pace of deterioration in the property sector coupled with the previous aggressive lending appetite in the heritage HBOS business. Whilst we remain cautious, the current outlook for the property sector is now a little more positive with higher levels of equity being raised, yields stabilising and negative rental growth abating. However, a sustained recovery is not predicted until 2011. Against this backdrop, Corporate Real Estate is focusing its attention on improving the risk profile of the existing portfolio and applying conservative and prudent lending policies in relation to new business. Clearly the management of the distressed portfolio is key not only to mitigating loss but also for Lloyds Banking Group as a significant player within the property sector to ensure that the strategies adopted do not adversely impact on a market that remains fragile. The Group's BSU is making great progress in the achievement of these balanced objectives with a substantial number of restructurings undertaken over the last six months.

On the property investment side there are signs of recovery in capital values but this is most evident at the prime end of the commercial market. The key concern remains the potential for an increasing level of tenant defaults against a backdrop of already depressed capital values and a continuing lack of liquidity in the market. Sustainability of cash flow has been key to the relative resilience seen in the investment market to date but a significant rise in tenant defaults would impact adversely on debt service capability and could lead to increased impairments beyond those forecast, based on the Group's current economic assumptions.

Wholesale has invested heavily in implementing the required infrastructure to deal with the stress which has been experienced in the portfolio to date and is satisfied that impairment levels are prudent, with the impairment charge for the second half reducing from the peak evidenced in the first half. Refinancing risk is an emerging issue with significant maturities due in the next few years. Against the Group's economic assumptions, 2010 is expected to continue to be difficult. However the Group has made significant strides during 2009 in putting in place robust and prudent lending policies and processes with the expectation that, in tandem with a market which is evidencing signs of recovery, Wholesale will see an improving risk profile across the portfolio together with continued reduction in impairments.

SPECIALIST FINANCE

Specialised Finance comprises Acquisition Finance and Corporate Equity.

Acquisition Finance – The Acquisition Finance (leveraged) portfolio has been impacted significantly by the economic environment, with a relatively high proportion of deals being restructured, and higher impairment levels seen than in the same period in 2008. The rate of new problem loans abated in the second half of 2009.

Corporate Equity – The risk capital (assets representing 'Equity Risk' including ordinary equity, preference shares and institutional stock) portfolio comprises the Lloyds TSB heritage Lloyds Development Capital (LDC) business, a small Project Finance business, and the HBOS heritage Integrated Finance Investments, Joint Ventures and Fund Investments businesses. All new private equity investment activity will in future be made in the name of LDC, which will continue taking equity stakes, primarily in privately owned UK businesses. With the exception of Project Finance the remaining Specialist Finance Risk Capital businesses are not considered as continuing businesses to Lloyds Banking Group and as a result are being managed for value. As a result, excluding LDC and Project Finance, there will be no 'new' investments in the portfolios and they will reduce over time as existing investments are exited.

During the first half of 2009, as a result of significant market volatility, the value of the portfolio materially reduced. In the second half of the year, the main share indices have evidenced an upward movement and this has largely offset continued pressure on earnings across the investment portfolio, together contributing to a relatively flat position across the total portfolio. While some positive signs are evident, value recovery going forward continues to be treated with caution.

WHOLESALE MARKETS

Wholesale Markets encompasses the securitisation conduits (Cancara, Grampian and Landale), a portfolio of Structured Credit Investments and Structured Corporate Finance (which covers shipping, rail, aviation, corporate asset finance and infrastructure finance). Global shipping markets, especially the dry bulk and container sectors, experienced considerable pressure during 2009, leading to higher impairment levels; while the Group expects continued sector pressure in 2010, it has forecast a lower rate of new problem cases.

2009 has seen a significant reduction in the size of the Treasury Assets portfolio, both in terms of notional exposure and Risk Weighted Assets. In addition, the potential for volatility within the portfolio has been significantly reduced. As financial market conditions have improved, write-downs of investment securities have eased. Although both Lloyds TSB and HBOS heritage portfolios contain US residential mortgage-backed securities, which are exposed to a greater risk of further impairment, it is believed that previous write-downs and acquisition fair value adjustments for HBOS Treasury assets remain adequate to cover the losses the Group expects to incur on these portfolios.

TREASURY AND TRADING

Treasury and Trading acts as the link between the wholesale markets and the Group's balance sheet management activities and provides pricing and risk management solutions to both internal and external clients. The majority of Treasury and Trading's funding and risk management activity is transacted with investment grade counterparties and much of it is on a secured basis such as Repo. Derivative transactions with wholesale counterparties are typically collateralised under CSAs.

ASSET FINANCE

The credit quality profile across the heritage Lloyds TSB Asset Finance non-retail portfolios has remained broadly stable over the last 12 months. In line with the wider economic difficulties and rise in corporate failures, there has been a rise in the number of cases requiring Business Support management although the level of defaults is no greater than in 2008. However, there has been an increased level of default in the heritage HBOS Asset Finance non-retail portfolios with the need for higher impairment charges during 2009, particularly in the daily/flexi rental end of the Fleet Operator sector and marine sector.

The Asset Finance retail portfolio has come under significant stress in 2009 in line with the broader difficult economic conditions. The rise in the impairments and expected loss has been driven by a combination of increased unemployment, falling house prices and fall in motor values although these have stabilised in 2009 following a large fall in 2008. Retail second lien secured lending has been impacted by a combination of stressed factors including the fall in house prices, since the loans were provided reducing the equity in the property, the restriction in the retail credit market limiting the ability to refinance and an increase in the number of defaults due to the stressed economy resulting in larger than anticipated increases in impairments.

For both the Asset Finance retail and non-retail portfolios the outlook for 2010 remains cautious although the Group expects impairment levels to reduce compared to 2009.

WEALTH AND INTERNATIONAL

KEY HIGHLIGHTS

- Creation of credit risk teams and the establishment of Business Support Units in Ireland and Australia supported by divisional BSU sanctioning in the UK.
- Impairment charges considered to have peaked in Wealth and International in 2009 given the Group's economic assumptions although uncertainty remains over Ireland and the impact of the continued economic decline on Bank of Scotland (Ireland) impairment levels.
- Tightening of Risk Appetite following divisional and Business Unit reviews and independent Group Credit Risk Assurance reviews of all material heritage HBOS portfolios.

Wealth and International's impairment losses have increased by £3,347 million to £4,078 million in 2009. The result was primarily driven by a severe deterioration in economic conditions in the Irish economy and to a lesser extent the Australian economy. Impairment losses for loans and advances as a percentage of average gross loans and advances to customers increased to 6.04 per cent from 1.05 per cent in 2008. Included within the total impairment charge was £2,949 million related to Ireland, £849 million related to Australia with a further £129 million arising in Wholesale Europe. The impairment charge for Wealth and International is expected to have peaked in 2009, although the Group continues to monitor economic conditions in the eurozone and Ireland in particular.

Wealth and International's gross loans and advances to customers increased by £1.9 billion to £69.4 billion following the transfer of a £7 billion European loan portfolio from Wholesale division offset by repayments in most portfolios.

Total impaired loans increased by £9,976 million to £12,704 million at 31 December 2009. As a percentage of gross loans and advances to customers impaired loans increased to 18.3 per cent from 4.0 per cent at 31 December 2008. This increase was driven by deteriorating economic conditions, particularly in Ireland, as well as the impact of the downturn on property loans and advances, in both Ireland and Australia, and concentrations in other sectors most impacted by the downturn, such as printing, media and transport.

The division has established Credit Risk Policies which have been rolled out across all of the businesses with local policies being fully aligned. Reviews of risk appetite were undertaken throughout 2009 which have reemphasised management's commitment to maximising value from existing lending portfolios, seeking to reduce sector concentrations and move to 'Trusted Advisor' status thereby maximising income from selected clients.

In order to manage impaired loans effectively, BSUs have been established in Ireland and Australia with divisional oversight provided by the Business Support Unit Sanctioning area. Reviews of Collections and Recoveries capability across the retail businesses have been undertaken to optimise processes and enhance capability.

The tables below highlight the International credit exposure in Ireland and Australia which represent approximately 60 per cent of the division's lending assets. As at December 2009 37 per cent of customer advances in Wealth and International division relate to personal lending, including mortgages. Loans to individuals are by their nature well diversified amongst a wide range of borrowers. Wholesale assets comprise 63 per cent of assets with a good spread of risk outwith the property sector. Wealth and International are seeking to reduce property concentrations to rebalance the lending portfolio, with Commercial Real Estate lending currently comprising 31 per cent of the total portfolio.

TABLE 1.12: IMPAIRMENTS ON WEALTH AND INTERNATIONAL LOANS AND ADVANCES

As at 31 December 2009	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Wealth	**9,523**	**281**	**3.0**	**100**	**35.6**
International:					
Ireland	**29,104**	**9,712**	**33.4**	**3,601**	**37.1**
Australia	**14,057**	**2,030**	**14.4**	**966**	**47.6**
Other	**16,718**	**681**	**4.1**	**336**	**49.3**
	59,879	**12,423**	**20.7**	**4,903**	**39.5**
Wealth and International	**69,402**	**12,704**	**18.3**	**5,003**	**39.4**
Impairment provisions	**(5,003)**				
Fair value adjustments	**(851)**				
	63,548				

As at 31 December 2008	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £	Impairment provisions as a % of impaired loans %
Wealth	10,485	205	2.0	70	34.1
International:					
Ireland	31,359	1,775	5.7	682	38.4
Australia	13,055	685	5.2	256	37.4
Other	12,582	63	0.5	39	61.9
	56,996	2,523	4.4	977	38.7
Wealth and International	67,481	2,728	4.0	1,047	38.4
Impairment provisions	(1,047)				
Fair value adjustment	(1,881)				
	64,553				

[1] Impairment provisions include collective unimpaired provisions.

TABLE 1.13: ANALYSIS OF GROSS LOANS AND ADVANCES BY ASSET CLASS

As at 31 December 2009	Ireland £bn	Australia £bn	Other £bn	Total £bn
Commercial Real Estate	**11.7**	**6.3**	**3.6**	**21.6**
Corporate	**9.1**	**6.1**	**6.8**	**22.0**
Sub total	**20.8**	**12.4**	**10.4**	**43.6**
Mortgages	**7.8**	**–**	**13.3**	**21.1**
Other retail	**0.5**	**1.7**	**2.5**	**4.7**
Sub total	**8.3**	**1.7**	**15.8**	**25.8**
Total loans and advances	**29.1**	**14.1**	**26.2**	**69.4**

WEALTH

Impairment losses within Wealth have increased to £71 million for 2009 (June 2009: £26 million) primarily reflecting difficult economic conditions in Spain as well as the impact of the economic downturn on the UK Private Banking and 'Expatriates' businesses.

IRELAND

The total impairment charge for Ireland is £2,949 million of which £2,929 million relates to loans and advances and the remaining £20 million is in respect of equity. Impairment losses for loans and advances in Ireland represent 9.9 per cent of average gross loans and advances to customers, which has increased from 3.4 per cent at the half-year. The most significant contributor to impairment losses in Ireland is the Commercial Real Estate portfolios which make up 61 per cent of losses, representing 15.3 per cent of average Commercial Real Estate advances. As a percentage of Commercial Real Estate assets that have an impairment allowance, total provision coverage amounts to 47 per cent. With limited new business being written and very low levels of roll-off driven by a lack of liquidity in the commercial property market, overall exposures in local currency remain almost static. The severe economic downturn has significantly influenced performance with commercial property prices falling approximately 55 per cent from their peak, house prices falling approximately 31 per cent from their peak and unemployment levels currently at 12.5 per cent.

AUSTRALIA

Impairment losses in Australia amount to £849 million, representing 6.2 per cent of average advances as compared with 3.1 per cent as at June 2009. The Australian economy has fared better than many others and did not formally enter recession. However, high sector concentrations in Property and in other sectors hardest hit by the economic downturn (Printing, Transport and Media) have resulted in increased impairment losses in 2009.

MARKET RISK

DEFINITION

The risk of reductions in earnings, value and/or reserves, through financial or reputational loss, arising from unexpected changes in financial prices, including interest rates, inflation rates, exchange rates, credit spreads and prices for bonds, commodities, equities, property and other instruments. It arises in all areas of the Group's activities and is managed by a variety of different techniques.

RISK APPETITE

Market risk appetite is defined with regard to the quantum and composition of market risk that exists currently in the Group and the direction in which the Group wishes to manage this.

This statement of the Group's overall appetite for market risk is reviewed and approved annually by the board. With the support of the group asset and liability committee, the group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that market risk appetite is further delegated to an appropriate level within their areas of responsibility.

EXPOSURES

The Group's banking activities expose it to the risk of adverse movements in interest rates, credit spreads, exchange rates and equity prices, with little or no exposure to commodity risk. The volatility of market values can be affected by both the transparency of prices and the amount of liquidity in the market for the relevant asset.

Most of the Group's trading activity is undertaken to meet the requirements of wholesale and retail customers for foreign exchange and interest rate products. However, some interest rate, exchange rate and credit spread positions are taken using derivatives and other on-balance sheet instruments with the objective of earning a profit from favourable movements in market rates.

Market risk in the Group's retail portfolios and in the Group's capital and funding activities arises from the different repricing characteristics of the Group's non-trading assets and liabilities. Interest rate risk arises predominantly from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets.

Foreign currency risk also arises from the Group's investment in its overseas operations.

The Group's insurance activities also expose it to market risk, encompassing interest rate, exchange rate, property, credit spreads and equity risk:

– With Profit Funds are managed with the aim of generating rates of return consistent with policyholders' expectations and this involves the mismatch of assets and liabilities.
– Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of those assets. (This forms part of the Value of in Force (ViF) see note 28.)
– For other insurance liabilities the aim is to invest in assets such that the cash flows on investments will match those on the projected future liabilities. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result, the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch.
– Surplus assets are held primarily in four portfolios: (a) in the long term funds of Scottish Widows plc, Clerical Medical Investment Group Limited and their subsidiaries; (b) in the shareholder funds of life assurance companies; (c) investment portfolios within the general insurance business and (d) within the main fund of Heidelberger Lebensversicherung AG.

The Group's defined benefit staff pension schemes are exposed to significant risks from the constituent parts of their assets and from the present value of their liabilities, primarily equity and real interest rate risk. For further information on pension scheme assets and liabilities please refer to note 41.

MEASUREMENT

The primary market risk measure used within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. This is used for determining the Group's overall market risk appetite and for the high level allocation of risk appetite across the Group.

Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. In addition, the use of confidence levels does not convey any information about potential loss when the confidence level is exceeded. Where VaR models are less well suited to the nature of positions, the Group recognises these limitations and supplements its use with a variety of other techniques. These reflect the nature of the business activity, and include interest rate repricing gaps, open exchange positions and sensitivity analysis. Stress testing and scenario analysis are also used in certain portfolios and at group level, to simulate extreme conditions to supplement these core measures.

Banking – trading assets and other treasury positions

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding 300 business days, the VaR for the years ended 31 December 2009 and 2008 based on the Group's global trading positions was as detailed in table 1.14.

The risk of loss measured by the VaR model is the potential loss in earnings given the confidence level and assumptions noted above. The total and average trading VaR does not assume any diversification benefit across the four risk types, with the exception of the 2008 HBOS comparatives. VaR is a statistical measure and the trading book exposures for the two independently managed heritage banks arose from different management strategies and were measured against differing risk appetites. Separate disclosures have therefore been made for each heritage trading book for 2008 as this is considered to be a more informative approach. The 2008 HBOS comparatives have also been converted from 99 per cent 1-day to 95 per cent 1-day VaR numbers. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole. The Group internally uses VaR as the primary measure for all treasury positions arising from short term market facing activity, whether trading or banking book. Therefore the numbers below will include some risks which are also included in Banking non-trading, primarily those relating to the funding of lending activities.

TABLE 1.14: BANKING – TRADING ASSETS AND OTHER TREASURY POSITIONS

Lloyds Banking Group	31 December 2009			
	Close £m	Average[1] £m	Maximum[1] £m	Minimum[1] £m
Interest rate risk	12.0	20.2	31.4	11.8
Foreign exchange risk	1.1	1.7	9.3	0.2
Equity risk	1.8	1.4	3.3	0.0
Credit spread risk	16.7	17.4	21.0	13.6
Total VaR	31.6	40.7	53.3	31.6
Lloyds TSB	**31 December 2008**			
	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	6.7	3.4	14.7	1.0
Foreign exchange risk	3.0	1.2	4.1	0.1
Equity risk	0.0	0.3	2.7	0.0
Credit spread risk	8.0	4.9	8.1	4.1
Total VaR	17.7	9.8	25.0	5.4
HBOS (unaudited)	**31 December 2008**			
	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	5.9	3.9	6.4	2.0
Foreign exchange risk	4.3	5.8	11.4	0.9
Equity risk	0.1	0.1	0.8	0.0
Credit spread risk	Suspended			
Total VaR	5.9	8.5	12.8	3.5

[1] For this table the average, minimum and maximum positions reflect the period from 19 January 2009 to 31 December 2009.

Banking – non-trading

Market risk in non-trading books consists almost entirely of exposure to changes in interest rates. This is the potential impact on earnings and value that could occur when, if rates fall, liabilities cannot be re-priced as quickly or by as much as assets; or when, if rates rise, assets cannot be re-priced as quickly or by as much as liabilities.

Risk exposure is monitored monthly using, primarily, market value sensitivity. This methodology considers all re-pricing mismatches in the current balance sheet and calculates the change in market value that would result from a set of defined interest rate shocks. Where re-pricing maturity is based on assumptions about customer behaviour these assumptions are also reviewed monthly.

A limit structure exists to ensure that risks stemming from residual and temporary positions or from changes in assumptions about customer behaviour remain within the Group's risk appetite.

The following table shows, split by material currency, Lloyds Banking Group sensitivities as at 31 December 2009 to an immediate up and down 25 basis points change to all interest rates.

TABLE 1.15: BANKING – NON-TRADING

	2009		2008 (unaudited)	
	Up 25bps £m	Down 25bps £m	Up 25bps £m	Down 25bps £m
Sterling	66.6	(66.4)	(132.5)	135.1
US Dollar	(5.5)	5.6	(15.5)	15.6
Euro	4.4	(4.4)	(0.4)	0.4
Australian Dollar	2.2	(2.3)	0.0	0.0
Other	(0.2)	0.2	0.2	(0.3)
	67.5	(67.3)	(148.2)	150.8

Base case market value is calculated on the basis of the Lloyds Banking Group current balance sheet with re-pricing dates adjusted according to behavioural assumptions. The above sensitivities show how this projected market value would change in response to an immediate parallel shift to all relevant interest rates – market and administered.

This is a risk based disclosure and the amounts shown would be amortised in the income statement over the duration of the portfolio.

The measure, however, is simplified in that it assumes all interest rates, for all currencies and maturities, move at the same time and by the same amount.

Pension schemes

Management of the assets of the Group's defined benefit pension schemes is the responsibility of the Scheme Trustees, who also appoint the Scheme Actuaries to perform the triennial valuations. The Group monitors its pensions exposure holistically using a variety of metrics including accounting and economic deficits and contribution rates. These and other measures are regularly reviewed by the Pensions Strategy Committee and used in discussions with the Trustees, through whom any risk management and mitigation activity must be conducted.

Insurance portfolios

The Group's market risk exposure in respect of insurance activities described above is measured using EEV as a proxy for economic value. The pre-tax sensitivity of EEV to standardised stresses is shown below for the years ended 31 December 2009 and 2008. The 2008 comparatives are based on a post acquisition basis assuming the legacy businesses were combined at the year end and are unaudited. During 2009, the credit spread sensitivity was changed from a 25 basis point increase to a 30 per cent widening of the spread between corporate bonds and the swap curve, including an allowance for the assumed change in the illiquidity premium. Therefore no 2008 comparative is available. Foreign exchange risk arises predominantly from overseas holdings of equities. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. Opening and closing numbers only have been provided as this data is not volatile and consequently is not tracked on a daily basis.

TABLE 1.16: **INSURANCE PORTFOLIOS**

As at 31 December	2009 £m	2008 (unaudited) £m
Equity risk (impact of 10% fall pre-tax)	**(383.6)**	(429.4)
Interest rate risk (impact of 25 basis point reduction pre-tax)	**64.0**	59.7
Credit spread risk (impact of 30% widening)	**(156.4)**	n/a

MITIGATION

Various mitigation activities are undertaken across the Group to manage portfolios and seek to ensure they remain within approved limits.

Banking – non-trading activities

Interest rate risk arising from the different repricing characteristics of the Group's non-trading assets and liabilities, and from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets, is managed centrally. Matching assets and liabilities are offset against each other and internal interest rate swaps are also used.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled.

Insurance activities

Investment holdings are diversified across markets and, within markets, across sectors. Holdings are diversified to minimise specific risk and the relative size of large individual exposures is monitored closely. For assets held outside unit-linked funds, investments are only permitted in countries and markets which are sufficiently regulated and liquid.

MONITORING

The group asset and liability committee regularly reviews high level market risk exposure including, but not limited to, the data described above. It also makes recommendations to the group chief executive concerning overall market risk appetite and market risk policy. Exposures at lower levels of delegation are monitored at various intervals according to their volatility, from daily in the case of trading portfolios to monthly or quarterly in the case of less volatile portfolios. Levels of exposures compared to approved limits are monitored locally by independent risk functions and at a high level by group risk. Where appropriate, escalation procedures are in place.

Banking activities

Trading is restricted to a number of specialist centres, the most important centre being the treasury and trading business in London. These centres also manage market risk in the wholesale non-trading portfolios, both in the UK and internationally. The level of exposure is strictly controlled and monitored within approved limits. Active management of the wholesale portfolios is necessary to meet customer requirements and changing market circumstances.

Market risk in the Group's retail portfolios and in the Group's capital and funding activities is managed within limits defined in the detailed Group policy for interest rate risk in the banking book, which is reviewed and approved annually.

Insurance activities

Market risk exposures from the insurance businesses are controlled via approved investment policies and triggers set with reference to the Group's overall risk appetite and regularly reviewed by the group asset and liability committee:

- The With Profit Funds are managed in accordance with the relevant fund's principles and practices of financial management and legal requirements.
- The investment strategy for other insurance liabilities is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. Actuarial tools are used to project and match the cash flows.
- Investment strategy for surplus assets held in excess of liabilities takes account of the legal, regulatory and internal business requirements for capital to be held to support the business now and in the future.

The Group also agrees strategies for the overall mix of pension assets with the pension scheme trustees.

INSURANCE RISK

DEFINITION

The risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claim settlements. This includes fluctuations in profits due to customer behaviour.

RISK APPETITE

Insurance risk appetite is defined with regard to the quantum and composition of insurance risk that exists currently in the Group and the direction in which the Group wishes to manage this. It takes account of the need for each entity in the Group to maintain solvency in excess of the minimum level required by the entity's jurisdictional legal or regulatory requirements.

The Group's overall appetite for insurance risk is reviewed and approved annually by the board.

EXPOSURES

The major sources of insurance risk within the Group are the insurance businesses and the Group's defined benefit staff pension schemes. The nature of insurance business involves the accepting of insurance risks which relate primarily to mortality, longevity, morbidity, persistency, expenses, property damage and unemployment. The prime insurance risk carried by the Group's staff pension schemes is related to longevity.

MEASUREMENT

Insurance risks are measured using a variety of techniques including stress and scenario testing; and, where appropriate, stochastic modelling.

Current and potential future insurance risk exposures are assessed and aggregated using risk measures based on 1-in-20 year stresses and other supporting measures where appropriate, for example those set out in Note 37.

MITIGATION

A key element of the control framework is the consideration of insurance risk by a suitable combination of high level committees/boards. For the life assurance businesses the key control bodies are the board of Scottish Widows Group Limited and the board of HBOS Financial Services Limited with the more significant risks also being subject to approval by the group executive committee and/or Lloyds Banking Group board. For the general insurance businesses the key control bodies are the boards of the legal entities including Lloyds TSB General Insurance Limited, St. Andrew's Insurance plc and the Irish subsidiaries, with the more significant risks again being subject to group executive committee and/or Lloyds Banking Group board approval. All Group staff pension schemes issues are covered by the group asset and liability committee and the group business risk committee.

The overall insurance risk is mitigated through pooling and through diversification across large numbers of uncorrelated individuals, geographical areas, and different types of risk exposure.

Insurance risk is primarily controlled via the following processes:

- Underwriting (the process to ensure that new insurance proposals are properly assessed)
- Pricing-to-risk (new insurance proposals are priced to cover the underlying risks inherent within the products)
- Claims management
- Product design
- Policy wording
- Product management
- The use of reinsurance or other risk mitigation techniques.

In addition, limits are used as a control mechanism for insurance risk at policy level.

At all times, close attention is paid to the adequacy of reserves, solvency management and regulatory requirements.

General insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Detailed modelling, including that of the potential losses under various catastrophe scenarios, supports the choice of reinsurance arrangements. Appropriate reinsurance arrangements also apply within the life and pensions businesses with significant mortality risk and morbidity risk being transferred to our chosen reinsurers.

Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present.

In respect of insurance risks in the staff pension schemes, the Group ensures that effective communication mechanisms are in place for consultation with the trustees to assist with the management of risk in line with the Group's risk appetite.

MONITORING

Ongoing monitoring is in place to track the progression of insurance risks. This normally involves monitoring relevant experiences against expectations (for example claims experience, option take up rates, persistency experience, expenses, non-disclosure at the point of sale), as well as evaluating the effectiveness of controls put in place to manage insurance risk. Reasons for any significant divergence from experience are investigated and remedial action is taken.

Insurance risk exposures are reported and monitored regularly by the group executive committee.

OPERATIONAL RISK

DEFINITION

The risk of reductions in earnings and/or value, through financial or reputational loss, from inadequate or failed internal processes and systems, operational inefficiencies, or from people related or external events.

There are a number of categories of operational risk:

Legal and regulatory risk

Legal and regulatory risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the laws, regulations or codes applicable.

Customer treatment risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate or poor customer treatment.

People risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate colleague actions and behaviour, industrial action, legal action in relation to people, or health and safety issues. Loss can also be incurred through failure to recruit, retain, train, reward and incentivise appropriately skilled staff to achieve business objectives and through failure to take appropriate action as a result of staff underperformance.

Integration risk

The risk that Lloyds Banking Group fails to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or incurs unanticipated costs and losses associated with, the acquisition of HBOS plc.

Business process risk

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from inadequate or failed internal processes and systems, people-related events and deficiencies in the performance of external suppliers/service providers.

Financial crime risk

The risk of reductions in earnings and/or value, through financial or reputational loss, associated with financial crime and failure to comply with related legal and regulatory obligations (which includes compliance with economic sanctions), these losses may include censure, fines or the cost of litigation.

Security risk

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from theft of or damage to the Group's assets, the loss, corruption, misuse or theft of the Group's information assets or threats or actual harm to the Group's people. This also includes risks relating to terrorist acts, other acts of war, geopolitical, pandemic or other such events.

Change risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from change initiatives failing to deliver to requirements, budget or timescale, failing to implement change effectively or failing to realise desired benefits.

Governance risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from poor corporate governance at group, divisional or business unit level. Corporate governance in this context embraces the structures, systems and processes that provide direction, control and accountability for the enterprise.

RISK APPETITE

The Group has developed an impact on earnings approach to operational risk appetite. This involves looking at how much the Group could lose due to operational risk losses at various levels of certainty.

In setting operational risk appetite, the Group looks at both impact on solvency and the Group's reputation.

For legal and regulatory risk the Group has minimal risk appetite for non-compliance with mandatory requirements and seeks to operate to high ethical standards. The Group encourages and maintains an appropriately balanced legal and regulatory compliance culture and promotes policies and procedures to enable businesses and their staff to operate in accordance with the laws, regulations and voluntary codes which impact on the Group and its activities.

EXPOSURES

The main sources of operational risk within the Group relate to the rate and scale of change arising from the Group's current integration programme, particularly in respect of people and business processes, and the legal and regulatory environment in which financial firms operate both in the UK and overseas.

Legal and regulatory exposure is driven by the significant volume of current legislation and regulation with which the Group has to comply, along with new legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. Following the financial crisis, the pace and extent of regulatory reform proposals both in the UK and internationally have increased significantly, and can be expected to remain at high levels. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of the Group. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of the Group, but could for instance affect the Group's future business strategy, structure or approach to funding. Further uncertainties arise where regulations are principles-based without the regulator defining supporting minimum standards either for the benefit of the consumer or firms. This gives rise to both the risk of retrospection from any one regulator and also to the risk of differing interpretation by individual regulators.

For legal and regulatory issues there are significant reputational impacts associated with potential censure which drive the Group's stance on appetites referred to above. There are clear accountabilities and processes in place for reviewing new and changing requirements. Each division and significant business areas have a nominated individual with 'compliance oversight' responsibility under FSA rules. The role of such individuals is to advise and assist management to ensure that each business has a control structure which creates awareness of the rules and regulations, to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

Lloyds Banking Group welcomes the regulation of remuneration provided there is international consensus and we will comply with the FSA code.

MEASUREMENT

Both Lloyds TSB and HBOS had operational risk management and measurement frameworks that had been granted, by the FSA, Advanced Measurement Approach (AMA) Waivers, enabling the use of an internal model for the calculation of regulatory capital.

Throughout 2009, both frameworks have continued to operate, whilst a single integrated framework has been in the course of development. The integrated framework and capital model will be rolled out during 2010 and it is anticipated that the Group will seek a variation from the FSA to operate under a single AMA waiver.

The Lloyds TSB Group capital model calculations are driven by actual loss data (internal and external) and forward looking scenarios which value potential future risk events. External industry-wide data is collected to help with validating scenarios.

The HBOS capital model calculations are driven by risk and control assessments, validated by scenarios and internal and external loss events.

MITIGATION

Both Lloyds TSB and HBOS's operational risk management frameworks consist of the following key components:

- Identification and categorisation of the key operational risks facing a business area.
- Risk assessment, including impact assessment of financial and non-financial impacts (e.g. reputational risk) for each of the key risks to which the business area is exposed.
- Control assessment, evaluating the effectiveness of the control framework covering each of the key risks to which the business area is exposed.
- Loss and incident management, capturing actions to manage any losses facing a business area.
- The development of Key Risk Indicators for management reporting.
- Oversight and assurance of the risk management framework in divisions and businesses.
- Scenarios for estimation of potential loss exposures for material risks.

The Group purchases insurance to mitigate certain operational risk events.

MONITORING

Business unit risk exposure is aggregated at divisional level and reported to group risk where a group-wide report is prepared. The report is discussed at the monthly group compliance and operational risk committee. This committee can escalate matters to the chief risk officer, or higher committees if appropriate.

The insurance programme is monitored and reviewed regularly, with recommendations being made to the Group's senior management annually prior to each renewal. Insurers are monitored on an ongoing basis, to ensure counterparty risk is minimised. A process is in place to manage any insurer rating changes or insolvencies.

The Group has adopted a formal approach to operational risk event escalation. This involves the identification of an event, an assessment of the materiality of the event in accordance with a risk event impact matrix and appropriate escalation.

FINANCIAL SOUNDNESS

Financial soundness risk has three key risk components covering liquidity and funding risk; capital risk; and financial and prudential regulatory reporting, disclosure and tax risk.

LIQUIDITY AND FUNDING RISK

DEFINITION

Liquidity risk is defined as the risk that the Group does not have sufficient financial resources to meet its commitments when they fall due, or can secure them only at excessive cost. Funding risk is further defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient.

RISK APPETITE

Liquidity and funding risk appetite for the banking businesses is set by the board and reviewed on an annual basis. This statement of the Group's overall appetite for liquidity risk is reviewed and approved annually by the board. With the support of the group asset and liability committee, the group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that liquidity risk appetite is further delegated to an appropriate level within their areas of responsibility. It is reported through various metrics that enable the Group to manage liquidity and funding constraints. The Group chief executive, assisted by the group asset and liability committee and its sub-committee the senior asset and liability committee, regularly reviews performance against risk appetite.

EXPOSURE

Liquidity exposure represents the amount of potential outflows in any future period less committed inflows. Liquidity is considered from both an internal and regulatory perspective.

MEASUREMENT

A series of measures are used across the Group to monitor both short and long term liquidity including: ratios, cash outflow triggers, liquidity gaps, early warning indicators and stress test survival period triggers. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

Details of contractual maturities for assets and liabilities form an important source of information for the management of liquidity risk. Note 54(4) sets out an analysis of assets and liabilities by relevant maturity grouping. In order to reflect more accurately the expected behaviour of the Group's assets and liabilities, measurement and modelling of the behavioural aspects of each is constructed. This forms the foundation of the Group's liquidity controls.

MITIGATION

The Group mitigates the risk of a liquidity mismatch in excess of its risk appetite by managing the liquidity profile of the balance sheet through both short-term liquidity management and long-term funding strategy. Short-term liquidity management is considered from two perspectives; business as usual and liquidity under stressed conditions, both of which relate to funding in the less than one year time horizon. Longer term funding is used to manage the Group's strategic liquidity profile which is determined by the Group's balance sheet structure. Longer term is defined as having an original maturity of more than one year.

The Group's funding and liquidity position is underpinned by its significant retail deposit base, and has been supported by stable funding from the wholesale markets with a reduced dependence on short-term funding. A substantial proportion of the retail deposit base is made up of customers' current and savings accounts which, although repayable on demand, have traditionally in aggregate provided a stable source of funding. Additionally, the Group accesses the short-term wholesale markets to raise inter-bank deposits and to issue certificates of deposit and commercial paper to meet short-term obligations. The Group's short-term money market funding is based on a qualitative analysis of the market's capacity for the Group's credit. The Group has developed strong relationships with certain wholesale market segments, and also has access to central banks and corporate customers, to supplement its retail deposit base.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group's banking businesses. The Group holds sizeable balances of high grade marketable debt securities as set out in Table 1.18 which can be sold to provide, or used to secure, additional short term funding should the need arise from either market counterparties or central bank facilities (European Central Bank, Federal Reserve, Bank of England).

MONITORING

Liquidity is actively monitored at business unit and Group level at an appropriate frequency. Routine reporting is in place to senior management and through the Group's committee structure, in particular the group asset and liability committee and the senior asset and liability committee which meet monthly. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event. Liquidity policies and procedures are subject to independent oversight.

Daily monitoring and control processes are in place to address both statutory and prudential liquidity requirements. In addition, the framework has two other important components:

- Firstly, the Group stress tests its potential cash flow mismatch position under various scenarios on an ongoing basis. The cash flow mismatch position considers on-balance sheet cash flows, commitments received and granted, and material derivative cash flows. Specifically, commitments granted include the pipeline of new business awaiting completion as well as other standby or revolving credit facilities. Behavioural adjustments are developed, evaluating how the cash flow position might change under each stress scenario to derive a stressed cash flow position. Scenarios cover both Lloyds Banking Group name specific and systemic difficulties. The scenarios and the assumptions are reviewed at least annually to gain assurance they continue to be relevant to the nature of the business.
- Secondly, the Group has a contingency funding plan embedded within the Group Liquidity Policy which has been designed to identify emerging liquidity concerns at an early stage, so that mitigating actions can be taken to avoid a more serious crisis developing.

The Group has invested considerable resource to ensure that it will satisfy the governance, reporting and stress testing requirements of the FSA's new ILAS liquidity regime. This work will continue in 2010 as further parts of the ILAS regime take effect. The Group has noted the industry move towards strategic balance sheet measures of the funding profile and has started to monitor the market's net stable funding ratio and the FSA's structural funding ratio. The Group is aware that the regulatory liquidity landscape is subject to potential change. Specifically, in relation to the consultation papers issued by the Basel Committee on Banking Supervision ('Strengthening the resilience of the banking sector' and 'International framework for liquidity risk measurement, standards and monitoring') the Group is actively participating in the industry-wide consultation and calibration exercises taking place through 2010.

During the year, the individual entities within the Group, and the Group, complied with all of the externally imposed liquidity and funding requirements to which they are subject.

APPROACH

The Group has adopted the heritage Lloyds TSB liquidity and funding approach which involves reduced risk appetite and increasing the diversity of funding sources, supported by extensive analysis of funding needs and strong governance.

LIQUIDITY AND FUNDING MANAGEMENT IN 2009

To understand the trends in liquidity and funding the comparatives have been provided for 2008 for the combined businesses. Consequently, pages 83 to 85 covering liquidity and funding management in 2009 are unaudited.

During 2009, the Group has seen a stabilisation in the customer deposit base, in marked contrast to the volatility observed by parts of the heritage HBOS businesses in the second half of 2008. The customer loan/deposit ratio improved slightly to 169 per cent compared with 177 per cent at the previous year end. The challenge facing the Group over the medium term is to continue to access the term funding markets, and for the Group to continue to reduce its utilisation of government sponsored funding schemes. The combination of a clear focus on right-sizing the balance sheet, developing the Group's retail liability base, and strategically accessing the capital markets will enable the Group to continue to strengthen its funding base.

In keeping with the Group's strategy of right-sizing the balance sheet, total funding has reduced by £73 billion. During the year the Group has reduced its dependency on the repo market whilst also reducing its wholesale funding requirements. Additionally there has been a managed reduction in certain types of non-bank deposits, in particular certain aggressively priced corporate deposits which were sourced from HBOS customers during the crisis in the second half of 2008. Actions taken to right size the balance sheet have reduced the portion of the Group's funding that is derived from wholesale markets.

TABLE 1.17: GROUP BALANCE SHEET

As at 31 December	2009 £bn	2008[1] £bn	2009 Change %
Assets			
Loans and advances to customers	**627.0**	677.2	(7.4)
Wholesale assets[2]	**153.6**	189.2	(18.8)
Banking assets	**780.6**	866.4	(9.9)
Total assets	**1,027.3**	1,126.7	(8.8)
Liabilities			
Non-bank deposits[3]	**371.2**	381.0	(2.6)
Wholesale funding	**325.5**	342.9	(5.1)
Repo	**63.1**	116.9	(46.0)
Total equity	**44.1**	35.7	23.5
Total funding	**803.9**	876.5	(8.3)
Total liabilities and shareholders' equity	**1,027.3**	1,126.7	(8.8)

[1] Adjusted to reflect the completion of the assessment of the fair value of the identifiable net assets of the HBOS Group.

[2] Wholesale assets comprise balances arising from banking businesses and includes cash and balances at central banks, loans and advances to banks, debt securities and available-for-sale financial assets.

[3] Non-bank deposits comprise balances arising from banking businesses and consist of customer deposits.

The global upheaval in the financial markets that occurred during 2008 has abated during the latter part of 2009. The steps taken in 2008 by HM Treasury, through the introduction of the Government Credit Guarantee ('CGS') for senior funding and other facilities including the Special Liquidity Scheme have together continued to provide assurance of liquidity support to the banking markets. Notwithstanding the improvement in market liquidity during 2009, the Group continues to be reliant upon these facilities in order to maintain its wholesale funding position. At 31 December 2009, the Group's overall support from government and central bank sponsored funding facilities totalled £157 billion, with a significant portion maturing over the course of the next two years. The Group's balance sheet reduction plans will avoid the necessity to refinance much of this funding.

The key dependencies on successfully funding the Group's balance sheet include the continued functioning of the money and capital markets at their current levels; successful rightsizing of the Group's balance sheet; the continuation of HM Treasury facilities in accordance with the terms agreed; limited further deterioration in the UK's and the Group's credit rating and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or UK Government support schemes. A return to the extreme market conditions of 2008 would place a strain on the Group's ability to meet its financial commitments.

GROUP RETAIL AND WHOLESALE FUNDING MIX

Loans and advances to customers is set out on page 67.

Wholesale funding has been analysed between that monitored by the London Treasury and Trading operations and the Group's overseas Treasury operations. The wholesale funding shown excludes any repo activity.

The composition and quality of wholesale deposits are regularly reviewed by management and comprises deposits from corporates and government agencies that roll over on a regular basis and are reinvested.

TABLE 1.18: WHOLESALE FUNDING BY TYPE

As at 31 December	2009 £bn	2009 %	2008 £bn	2008 %
Bank deposits	**48.6**	**7.0**	54.9	7.6
Debt securities in issue:				
Certificates of deposit	**50.9**	**7.3**	77.5	10.7
Medium term notes	**89.7**	**12.9**	63.5	8.8
Covered bonds	**28.1**	**4.0**	29.1	4.0
Commercial paper	**35.0**	**5.0**	28.9	4.0
Securitisation	**35.8**	**5.1**	43.6	6.0
	239.5	**34.3**	242.6	33.5
Subordinated debt	**37.4**	**5.4**	45.4	6.3
Total wholesale (excluding non-bank deposits)	**325.5**	**46.7**	342.9	47.4
Customer deposits	**371.2**	**53.3**	381.0	52.6
Total Group funding[1]	**696.7**	**100.0**	723.9	100.0

[1] Excludes repos and total equity.

TERM FUNDING

The Group has been able to take advantage of the improved market sentiment, by extending the duration of its money market funding, and by successfully accessing the term debt markets in unguaranteed format and through the issuance of Permanent RMBS. The reduction in the volume of money market funding has contributed to an improvement in the Group's term funding ratio (wholesale funding with a remaining life of over one year) which has improved to 50 per cent at 31 December 2009 from 44 per cent at the previous year end. The Group's long term target for this ratio is 40 per cent, this seeks to ensure that maturing liabilities are spread over subsequent years.

Lloyds Banking Group has continued to extend the term of its wholesale funding. The following significant capital market transactions were undertaken in 2009:

- £13.5 billion rights issue
- €5 billion public senior unguaranteed debt
- £4 billion public RMBS
- US$2 billion tier 1 capital securities

Lloyds Banking Group will continue to access the term capital markets, and has already successfully executed benchmark transactions in January 2010:

- US$5 billion equivalent of public senior term funding
- £2.5 billion equivalent of public RMBS

The Group had limited access to the term capital markets for large periods of 2009 due to highly market sensitive on-going negotiations around the Government Asset Protection Scheme and market recapitalisation.

Total wholesale funding is analysed by residual maturity as follows:

TABLE 1.19: WHOLESALE FUNDING BY RESIDUAL MATURITY

As at 31 December	2009 £bn	2009 %	2008 £bn	2008 %
Less than one year	**161.8**	**49.7**	192.3	56.1
One to two years	**48.8**	**15.0**	29.8	8.7
Two to five years	**68.7**	**21.1**	62.2	18.1
More than five years	**46.2**	**14.2**	58.6	17.1
Total wholesale funding	**325.5**	**100.0**	342.9	100.0

During the period the Group has changed the definition of wholesale to align with that used by other international market participants to include interbank deposits, debt securities in issue and subordinated debt within this category.

The table below illustrates the Group's holding of highly liquid unencumbered assets. This liquidity is available for deployment at immediate notice and is a key component of the Group's liquidity management process.

TABLE 1.20: ELIGIBLE COLLATERAL

As at 31 December	2009 £bn	2008 £bn
Primary liquidity[1]	**88.4**	46.2
Secondary liquidity[2]	**62.4**	58.3
	150.8	104.5

[1] Primary liquidity is defined as FSA eligible liquid assets (UK Gilts, US Treasuries, Euro AAA government debt, unencumbered cash balances held at central banks).

[2] Secondary liquidity comprises a diversified pool of highly rated unencumbered collateral (including retained issuance)

The following tables reconcile figures reported on page 84 with those in the balance sheet.

TABLE 1.21: RECONCILIATION OF WHOLESALE FUNDING FIGURE FROM TABLE 1.18 TO THE BALANCE SHEET

As at 31 December 2009	Included in funding analysis £bn	Repos and conduits £bn	Fair value and other accounting methods £bn	Balance sheet £bn
Bank deposits	**48.6**	**27.6**	**6.3**	**82.5**
Debt securities in issue	**239.5**	**–**	**(6.0)**	**233.5**
Subordinated debt	**37.4**	**–**	**(2.7)**	**34.7**
Total wholesale funding	**325.5**	**27.6**		
Customer deposits	**371.2**	**35.5**	**–**	**406.7**
	696.7	**63.1**		

As at 31 December 2008	Included in funding analysis £bn	Repos and conduits £bn	Fair value and other accounting methods £bn	Balance sheet £bn
Bank deposits	54.9	95.8	4.4	155.1
Debt securities in issue	242.6	3.0	4.1	249.7
Subordinated debt	45.4	–	(3.2)	42.2
Total wholesale funding	342.9	98.8		
Customer deposits	381.0	18.1	10.1	409.2
	723.9	116.9		

CAPITAL RISK

DEFINITION

Capital risk is defined as the risk that the Group has insufficient capital to provide a sufficient resource to absorb losses or that the capital structure is inefficient.

RISK APPETITE

Capital risk appetite is set by the board and reported through various metrics that enable the Group to manage capital constraints and shareholder expectations. One of the key metrics is the Group's core tier 1 capital ratio for which the board has set a target of more than 7 per cent. The chief executive, assisted by the group asset and liability committee, regularly reviews performance against risk appetite. The board formally reviews capital risk on an annual basis.

EXPOSURE

A capital exposure arises where the Group has insufficient regulatory capital resources to support its strategic objectives and plans, and to meet external stakeholder requirements and expectations. The Group's capital management approach is focused on optimising value for shareholders.

MEASUREMENT

The Group's regulatory capital is divided into tiers depending on level of subordination and ability to absorb losses. Core tier 1 capital as defined in the FSA letter to the British Bankers Association in May 2009, comprises mainly shareholders' equity and minority interests, after deducting goodwill, other intangible assets and 50 per cent of the net excess of expected loss over accounting provisions and certain securitisation positions. Accounting equity is adjusted in accordance with FSA requirements, particularly in respect of pensions and available for sale assets. Tier 1 capital, as defined by the European Community Banking Consolidation Directive as implemented in the UK by the Financial Services Authority's General Prudential Sourcebook (GENPRU), is core tier 1 capital plus tier 1 capital securities. Tier 2 capital, defined by GENPRU, comprises qualifying subordinated debt after deducting 50 per cent of the excess of expected loss over accounting provisions, and certain securitisation positions. Total capital is the sum of tier 1 and tier 2 capital after deducting investments in subsidiaries and associates that are not consolidated for regulatory purposes. In the case of Lloyds Banking Group, this means that the net assets of its life assurance and general insurance businesses are excluded from its total regulatory capital.

A number of limits are imposed by the FSA on the proportion of the regulatory capital base that can be made up of subordinated debt and preferred securities, for example the amount of qualifying tier 2 capital cannot exceed that of tier 1 capital. The Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

The Capital Resources Requirement (CRR), is 8 per cent of risk weighted assets and represents the capital required under Pillar 1 of the Basel II framework. In addition, the FSA currently sets Individual Capital Guidance (ICG) for each UK bank calibrated by reference to the CRR, to address the requirements of pillar 2 of the Basel II framework.

A key input into the FSA's ICG setting process is each bank's Internal Capital Adequacy Assessment Process. The FSA's approach is to monitor the available capital resources in relation to the ICG requirement. The Group has been given an ICG by the FSA and the board has also agreed a formal buffer to be maintained in addition to this requirement. The FSA has made it clear that each ICG remains a confidential matter between each bank and the FSA.

In addition to the minimum requirement for total capital, the FSA has made further statements to explain the approach it has taken to the capital framework. These include core tier 1 and tier 1 targets under stressed conditions.

The Group undertook an extensive series of stress analysis during the year to determine the adequacy of the Group's capital resources against the FSA minimum requirements.

The Group is subject to extensive regulation and regulatory supervision in relation to the levels of capital in its business. Specifically in relation to the consultation papers issued by the Basel Committee on Banking Supervision 'Strengthening the resilience of the banking sector' the group is participating in the industry-wide consultation and calibration exercises taking place through 2010.

MITIGATION

The Group has developed procedures meant to ensure that compliance with both current and potential future requirements are understood and that policies are aligned to its risk appetite.

The Group is able to raise equity either via a rights issue, placing or an open offer. Placing and open offers were completed in January as part of the Group's participation in the recapitalisation of the banking sector and in June when the Group repaid preference shares which were issued to HM Treasury as part of GAPS, and a rights issue and liability management exercise was completed in December.

The Group is also able to raise Tier 2 capital by issuing subordinated liabilities. The cost and availability of subordinated liability finance are influenced by credit ratings of both the Group and the UK's sovereign rating. A reduction in these ratings could increase the interest rate payable and could reduce market access.

The Group has in issue enhanced capital notes (ECNs) which will convert to core tier 1 capital in the event that Group's published core tier 1 ratio (as defined by the FSA in May 2009) falls below 5 per cent.

MONITORING

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Group's budgeting and planning processes with updates of expected ratios reviewed regularly during the year by the group asset and liability committee. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios is made to the senior asset and liability committee and to the group asset and liability committee. As part of this reporting any guidance to the market is regularly reviewed.

TABLE 1.22: CAPITAL RESOURCES

	2009 £m	2008 £m
Core tier 1		
Ordinary share capital and reserves	**44,275**	9,573
Regulatory post-retirement benefit adjustments	**434**	435
Available-for-sale revaluation reserve	**914**	2,982
Cash flow hedging reserve	**305**	15
Other items	**231**	(108)
	46,159	12,897
Less deductions from core tier 1		
Goodwill and other intangible assets	**(5,779)**	(2,256)
Other deductions	**(445)**	(1,099)
Core tier 1 capital	**39,935**	9,542
Perpetual non-cumulative preference shares		
Preference share capital	**2,639**	1,966
Innovative tier 1 capital instruments		
Preferred securities	**4,956**	3,169
Less: restriction in amount eligible	**–**	(976)
Total tier 1 capital	**47,530**	13,701
Tier 2		
Available-for-sale revaluation reserve in respect of equities	**221**	8
Undated subordinated debt	**2,575**	5,189
Innovative capital restricted from tier 1	**–**	976
Eligible provisions	**2,694**	21
Dated subordinated debt	**20,068**	5,091
Deductions from tier 2		
Other deductions	**(445)**	(1,099)
Total tier 2 capital	**25,113**	10,186
Supervisory deductions		
Unconsolidated investments – life	**(10,015)**	(4,208)
Unconsolidated investments – other	**(1,551)**	(550)
Total supervisory deductions	**(11,566)**	(4,758)
Total capital resources	**61,077**	19,129
Risk-weighted assets (unaudited)	**493,307**	170,490
Ratios (unaudited)		
Core tier 1 ratio	**8.1%**	5.6%
Tier 1 capital ratio	**9.6%**	8.0%
Total capital ratio	**12.4%**	11.2%

As part of the exchange offer announced in November 2009, certain preference shares, preferred securities and undated subordinated notes issued by the Group were exchanged for new ordinary shares with settlement in February 2010. Had the exchange settled in December 2009, the core tier 1 ratio would have been 8.4 per cent (unaudited).

TIER 1 CAPITAL

Core tier 1 capital increased by £30.4 billion largely reflecting the issuance of share capital during the year and retained profits.

Tier 1 capital increased by £33.8 billion principally as a result of the increase in core tier 1 capital. The remainder of the increase reflects the inclusion of HBOS tier 1 instruments, an increase in innovative securities of £2 billion as part of a liability management exercise to exchange upper tier 2 debt and a further issuance of £1.2 billion innovative securities in December 2009. This increase is offset by the effects of the offer of enhanced capital notes during December 2009; as part of the Group's recapitalisation and exit from GAPS, certain preference shares and preferred securities were exchanged for enhanced capital notes included within tier 2 capital.

TABLE 1.23: MOVEMENTS IN CORE TIER 1 AND TIER 1 CAPITAL DURING THE YEAR

	Core tier 1 £m	Tier 1 £m
As at 31 December 2008	9,542	13,701
Profit attributable to ordinary shareholders	**2,827**	**2,827**
Issue of ordinary shares	**29,139**	**29,139**
Recognition of HBOS tier 1 capital instruments	**–**	**5,653**
Movement in goodwill and other intangible assets	**(2,526)**	**(2,526)**
Movement in tier 1 securities relating to ECNs exchange offer	**–**	**(5,447)**
Innovative securities exchange	**–**	**1,959**
Innovative issuance	**–**	**1,235**
Other movements	**953**	**989**
As at 31 December 2009	**39,935**	**47,530**

TIER 2 CAPITAL

Tier 2 capital has increased in the period by £14.9 billion, largely due to the acquisition of HBOS. The liability management exercises undertaken reduced tier 2 capital and increased tier 1 capital. The enhanced capital notes exchange offer completed during 2009 resulted in the exchange of certain existing tier 1 and tier 2 securities for tier 2 notes valued at £7.2 billion for regulatory purposes. Under certain specified conditions, these securities would convert to ordinary share capital and increase core tier 1 capital.

SUPERVISORY DEDUCTIONS

Supervisory deductions mainly consist of investments in subsidiary undertakings that are not within the banking group for regulatory purposes. These investments are primarily the Scottish Widows and Clerical Medical life and pensions businesses.

RISK WEIGHTED ASSETS – (unaudited)

The following table sets out the Group's risk weighted assets that primarily arise in its banking businesses.

TABLE 1.24: ANALYSIS OF RISK WEIGHTED ASSETS

As at 31 December	2009 (unaudited) £bn	2008 (unaudited) £bn
Credit risk	**452.1**	149.6
Operational risk	**25.3**	12.3
Market and counterparty risk	**15.9**	8.5
	493.3	170.4
Divisional analysis		
Retail	**128.6**	49.7
Wholesale	**286.0**	106.8
Insurance	**1.1**	0.1
Wealth and International	**63.2**	11.0
Group Operations and Central items	**14.4**	2.8
	493.3	170.4

Risk-weighted assets increased by £322.9 billion to £493.3 billion, principally as a result of the acquisition of HBOS plc which had risk-weighted assets of £328.0 billion at 31 December 2008. Subsequent to the acquisition, deteriorating economic conditions have led to increased average risk weightings. This has been offset, primarily within Whoesale, by a reduction in exposures due to impairments and asset run-off, and movements due to currency retranslations.

TABLE 1.25: ANALYSIS OF CAPITAL RATIOS

	Lloyds TSB Bank Group		BOS Group	
	2009 £m	2008 £m	2009 £m	2008 (unaudited) £m
Tier 1	**18,307**	13,574	**25,565**	17,328
Tier 2	**7,677**	10,437	**14,112**	15,238
Supervisory deductions	**(5,182)**	(4,758)	**(1,062)**	(919)
Total capital	**20,802**	19,253	**38,615**	31,647
RWAs (unaudited)	**174,472**	170,490	**322,866**	326,703
Ratios (unaudited)				
Core tier 1	**7.1%**	5.5%	**7.5%**	4.7%
Tier 1	**10.5%**	8.0%	**7.9%**	5.3%
Total capital	**11.9%**	11.3%	**12.0%**	9.7%

Capital is managed at Group level and surplus capital is retained, where possible, at Lloyds Banking Group holding company level as this provides the Group with maximum flexibility on how to deploy its capital.

Capital ratios increased from the prior year in both Lloyds TSB and BOS Group primarily due to capital downstreamed in the year by Lloyds Banking Group.

FINANCIAL AND PRUDENTIAL REGULATORY REPORTING, DISCLOSURE AND TAX RISK

DEFINITION

The risk of reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial, prudential regulatory and tax reporting, failure to manage the associated risks of changes in taxation rates, law, ownership or corporate structure and the failure to disclose information about the Group on a timely basis.

RISK APPETITE

The risk appetite is set by the board and reviewed on an annual basis. It includes complying with disclosure requirements within prescribed timescales and avoiding the need for restatement of published financial and prudential regulatory reporting, publicly disclosed information or tax reporting.

EXPOSURE

Exposure represents the sufficiency of the Group's policies and procedures to maintain adequate books and records to support statutory, prudential and tax reporting, to prevent and detect financial reporting fraud and to manage the Group's tax position.

MITIGATION

The Group maintains a system of internal controls, which is designed to be consistently applied and enable the preparation and disclosure of financial reporting, prudential regulatory reporting and tax returns in accordance with International Financial Reporting Standards, statutory and regulatory requirements. The system of internal control is designed to ensure that accounting policies are consistently applied, transactions are recorded and undertaken in accordance with delegated authorities and that assets are safeguarded and liabilities are properly recorded.

MONITORING

The Group has in place a disclosure committee whose responsibility is to review all significant disclosures made by the Group and to assist the group chief executive and group finance director fulfil their responsibilities under the Listing Rules and regulations emanating from the US Sarbanes-Oxley Act of 2002. A programme of work is undertaken and is designed to support an annual assessment of the effectiveness of internal controls over financial reporting, in accordance with the requirements of section 404 of the US Sarbanes-Oxley Act. It also has in place an assurance mechanism over its prudential regulatory reporting; additionally, monitoring activities are designed to identify and maintain tax liabilities and to assess the impact of emerging regulation and legislation on financial, prudential regulatory and tax reporting.

LIFE INSURANCE BUSINESSES

At 31 December 2009, the principal subsidiaries involved in the Group's life insurance operations were Scottish Widows plc (Scottish Widows) and Clerical Medical Investment Group Limited (Clerical Medical). These subsidiaries hold the only large with-profit funds managed by Lloyds Banking Group.

BASIS OF DETERMINING REGULATORY CAPITAL OF THE LIFE INSURANCE BUSINESSES

AVAILABLE CAPITAL RESOURCES

Available capital resources represent the excess of assets over liabilities calculated in accordance with detailed regulatory rules issued by the FSA. Additional rules may apply depending on the nature of the fund, as detailed below.

Statutory basis. Assets are generally valued on a basis consistent with that used for accounting purposes (with the exception that, in certain cases, the value attributed to assets is limited) and which follows a market value approach where possible. Liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses and mortality. Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets in accordance with the FSA rules. Other assumptions are based on recent actual experience, supplemented by industry information where appropriate. The assessment of liabilities does not include future bonuses for with-profits policies that are at the discretion of management, but does include a value for policyholder options likely to be exercised.

'Realistic' basis. The FSA requires each life insurance company which contains a with-profit fund in excess of £500 million to also carry out a 'realistic' valuation of that fund. The Group has two such funds; one within Scottish Widows and one within Clerical Medical. The word 'realistic' in this context reflects the terminology used for reporting to the FSA and is an assessment of the financial position of a with-profits fund calculated under a prescribed methodology.

The valuation of with-profits assets in a with-profits fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in a with-profits fund (a relatively small amount of business in the case of Scottish Widows and Clerical Medical), it includes the present value of the anticipated future release of the prudent margins for adverse deviation. The realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

The realistic valuation of liabilities is carried out using a stochastic simulation model which values liabilities on a basis consistent with tradable market option contracts (a 'market-consistent' basis). The model takes account of policyholder behaviour on a best-estimate basis and includes an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities. Further details regarding the stochastic simulation model are given in the section entitled 'Options and guarantees' on page 94.

REGULATORY CAPITAL REQUIREMENTS

Each life insurance company must retain sufficient capital to meet the regulatory capital requirements mandated by the FSA; the basis of calculating the regulatory capital requirement is given below. Except for Scottish Widows and Clerical Medical, the regulatory capital requirement is a combination of amounts held in respect of actuarial reserves, sums at risk and maintenance expenses (the Long-Term Insurance Capital Requirement) and amounts required to cover various stress tests. The regulatory capital requirement is deducted from the available capital resources to give 'statutory excess capital'.

For Scottish Widows and Clerical Medical, no amount is required to cover the impact of stress tests on the actuarial reserves. However, a further test is required in respect of the with-profit funds, which compares the level of 'realistic excess capital' to the 'statutory excess capital' of each with-profit fund. In circumstances where the 'realistic excess capital' position is less than 'statutory excess capital', the company is required to hold additional capital to cover the shortfall, but only to the extent it exceeds the value, calculated in a prescribed way, of internal transfers from the with-profit fund. Any additional capital requirement under this test is referred to as the With-Profits Insurance Capital Component. The 'realistic excess capital' is calculated as the difference between realistic assets and realistic liabilities of the with-profit fund with a further deduction to cover various stress tests.

The determination of realistic liabilities of the with-profit funds includes the value of internal transfers expected to be made from each with-profit fund to the non-profit fund held within the same life insurance entity. These internal transfers include charges on policies where the associated costs are borne by the non-profit fund. The With-Profits Insurance Capital Component may be reduced by the value, calculated in the stress test scenario, of these internal transfers, but only to the extent that credit has not been taken for the value of these charges in deriving actuarial reserves for the relevant non-profit fund.

CAPITAL STATEMENT

The following table provides more detail regarding the capital resources available to meet regulatory capital requirements in the life insurance businesses. The figures quoted are based on management's current expectations pending completion of the annual financial returns to the FSA. The figures allow for a transfer of £261 million and an anticipated transfer of £147 million from long-term funds to the UK life shareholder funds as at 31 December 2009.

Following the acquisition of the life companies within HBOS plc, the format of the capital position statement has been revised to accommodate the reporting of all life assurance businesses within the Group.

TABLE 1.26: **CAPITAL RESOURCES**

	Scottish Widows With Profit Fund £m	Clerical Medical With Profit Fund £m	UK non-profit funds £m	UK life shareholder funds £m	Overseas life business £m	Total life business £m
As at 31 December 2009						
Shareholders' funds:						
Held outside the long-term funds	–	–	–	1,048	651	1,699
Held within the long-term funds	–	–	8,011	–	405	8,416
Total shareholders' funds	–	–	8,011	1,048	1,056	10,115
Adjustments onto a regulatory basis:						
Unallocated surplus within insurance business	310	772	–	–	–	1,082
Value of in-force business	–	–	(5,513)	–	(793)	(6,306)
Other differences between IFRS and regulatory valuation of assets and liabilities	–	–	253	(154)	108	207
Estimated share of 'realistic' liabilities consistent with the FSA reporting treatment	(407)	(40)	–	–	–	(447)
Qualifying loan capital	–	–	–	1,165	–	1,165
Support arrangement assets	354	–	(354)	–	–	–
Available capital resources	257	732	2,397	2,059	371	5,816

AUDITED INFORMATION

	Scottish Widows With Profit Fund £m	UK non-profit funds £m	UK life shareholder funds £m	Overseas life business £m	Total life business £m
As at 31 December 2008 (statutory basis)					
Shareholders' funds					
Held outside the long-term funds	–	–	865	2	867
Held within the long-term funds	–	3,762	-	13	3,775
Total shareholders' funds	–	3,762	865	15	4,642
Adjustments onto a regulatory basis:					
Unallocated surplus within insurance business	293	–	–	–	293
Value of in-force business	–	(1,893)	–	–	(1,893)
Other differences between IFRS and regulatory valuation of assets and liabilities	–	25	(317)	(4)	(296)
Estimated share of 'realistic' liabilities consistent with the FSA reporting treatment	(406)	–	–	–	(406)
Qualifying loan capital	–	–	604	–	604
Support arrangement assets	371	(371)	–	–	
Available capital resources	**258**	**1,523**	**1,152**	**11**	**2,944**

Available capital resources for with-profit funds are presented in the table on a 'realistic' basis.

FORMAL INTRA-GROUP CAPITAL ARRANGEMENTS

Scottish Widows has a formal arrangement with one of its subsidiary undertakings, Scottish Widows Unit Funds Limited, whereby the subsidiary company can draw down capital from Scottish Widows to finance new business which is reinsured from the parent to its subsidiary. Scottish Widows has also provided subordinated loans to its fellow group undertaking Scottish Widows Bank plc.

Constraints over available capital resources

SCOTTISH WIDOWS

Scottish Widows was created following the demutualisation of Scottish Widows Fund and Life Assurance Society in 2000. The terms of the demutualisation are governed by a Court-approved Scheme of Transfer (the 'Scheme') which, inter alia, created a With Profit Fund and a Non-Participating Fund and established protected capital support for the with-profits policyholders in existence at the date of demutualisation. Much of that capital support is held in the Non-Participating Fund and, as such, the capital held in that fund is subject to the constraints noted below.

Requirement to maintain a Support Account: The Scheme requires the maintenance of a 'Support Account' within the Non-Participating Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Participating Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account (or,if greater, the excess of realistic liabilities for business written before demutualisation over the relevant assets) in assessing the realistic value of assets available to the With Profit Fund. At 31 December 2009, the estimated value of surplus admissible assets in the Non-Participating Fund was £1,627 million (31 December 2008: £1,523 million) and the estimated value of the Support Account was £222 million (31 December 2008: £200 million).

Further Support Account: The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Participating Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Participating Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2009, the estimated net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £3,823 million (31 December 2008: £3,605 million) and the estimated combined value of the Support Account and Further Support Account was £2,495 million (31 December 2008: £2,582 million).

Other restrictions in the Non-Participating Fund: In addition to the policies which existed at the date of demutualisation, the With Profit Fund includes policies which have been written since that date.
As a result of statements made to policyholders that investment policy will usually be the same for both types of business, there is an implicit requirement to hold additional regulatory assets in respect of the business written after demutualisation. The estimated amount required to provide such support at 31 December 2009 is £132 million (31 December 2008: £171 million). Scottish Widows has obtained from the FSA permission to include the value of this support in assessing the realistic value of assets available to the With Profit Fund. There is a further test requiring that no amounts can be transferred from the Non-Participating Fund of Scottish Widows unless there are sufficient assets within the Long Term Fund to meet both policyholders' reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

CLERICAL MEDICAL

The surplus held in the Clerical Medical With Profit Fund can only be applied to meet the requirements of the fund itself or distributed accordingly to the prescribed rules of the fund. Shareholders are entitled to an amount not exceeding one ninth of the amount distributed to policyholders in the form of bonuses. The use of capital within the fund is also subject to the terms of the scheme of demutualisation effected in 1996 and the conditions contained in the Principles and Practices of Financial Management of the fund. Capital within the Clerical Medical Non-Profit Fund is available to meet the With Profit Fund requirements.

OTHER LIFE INSURANCE BUSINESSES

Except as described above capital held in UK non-profit funds is potentially transferable to other parts of the Group, subject to meeting the regulatory requirements of these businesses. There are no prior arrangements in place to allow capital to move freely between life insurance entities or other parts of the Group.

Overseas life business includes several life companies outside the UK, including Germany and Ireland. In all cases the available capital resources are subject to local regulatory requirements, and transfer to other parts of the Group is subject to additional complexity surrounding the transfer of capital from one country to another.

MOVEMENTS IN REGULATORY CAPITAL

The movements in the Group's available capital resources in the life business can be analysed as follows:

TABLE 1.27: **MOVEMENTS IN AVAILABLE CAPITAL RESOURCES**

	Scottish Widows With Profit Fund £m	Clerical Medical With Profit Fund £m	UK non-profit funds £m	UK life shareholder funds £m	Overseas life business £m	Total life business £m
As at 31 December 2008	258	–	1,523	1,152	11	2,944
Acquisition of life businesses	**–**	**511**	**1,205**	**1,342**	**250**	**3,308**
Changes in estimations and in demographic assumptions used to measure life assurance liabilities	**–**	**19**	**(208)**	**43**	**36**	**(110)**
Changes in regulatory requirements	**–**	**–**	**–**	**–**	**–**	**–**
Dividends and capital transfers	**–**	**–**	**(438)**	**(453)**	**(14)**	**(905)**
Change in support arrangements	**(17)**	**–**	**17**	**–**	**–**	**–**
New business and other factors	**16**	**202**	**298**	**(25)**	**88**	**579**
As at 31 December 2009	**257**	**732**	**2,397**	**2,059**	**371**	**5,816**

WITH-PROFIT FUNDS

Available capital in the Scottish Widows With Profit Fund has decreased from £258 million at 31 December 2008 to an estimated £257 million at 31 December 2009.

Available capital in the Clerical Medical With Profit Fund has increased from £511 million at acquisition to an estimated £732 million at 31 December 2009.

UK NON-PROFIT FUNDS

Available capital in the UK non-profit funds has increased from £1,523 million at 31 December 2008 to an estimated £2,397 million at 31 December 2009. The acquisition of Clerical Medical resulted in a £1,205 million increase. Further increases due to new business were offset by changes in assumptions and actual and proposed transfers to the UK life shareholders funds.

UK LIFE SHAREHOLDER FUNDS

Available capital in the UK life shareholder funds has increased from £1,152 million at 31 December 2008 to an estimated £2,059 million at 31 December 2009. The acquisition of Clerical Medical resulted in a £1,342 million increase. Redemption of subordinated debt (shown within dividends and capital transfers) has been partly offset by actual and proposed transfers from the long term funds.

OVERSEAS LIFE BUSINESS

The acquisition of Clerical Medical business resulted in a £250 million increase. Further increases were due to new business and changes in assumptions.

Analysis of policyholder liabilities reported in the balance sheet in respect of the group's life insurance business is as follows. With-profit fund liabilities are valued in accordance with FRS 27.

TABLE 1.28: **ANALYSIS OF POLICYHOLDER LIABILITIES**

	Scottish Widows With Profit Fund £m	**Clerical Medical With Profit Fund £m**	**UK non-profit funds £m**	**Overseas life business £m**	**Total life business £m**
As at 31 December 2009					
With-profit fund liabilities	**13,347**	**10,225**	**5**	**–**	**23,577**
Unit-linked business (excluding that accounted for as non-participating investment contracts)	**–**	**–**	**32,816**	**6,864**	**39,680**
Other life insurance business	**–**	**–**	**11,449**	**183**	**11,632**
Insurance and participating investment contract liabilities	**13,347**	**10,225**	**44,270**	**7,047**	**74,889**
Non-participating investment contract liabilities	**–**	**–**	**45,328**	**1,020**	**46,348**
Total policyholder liabilities	**13,347**	**10,225**	**89,598**	**8,067**	**121,237**

	Scottish Widows With Profit Fund £m	UK non-profit funds £m	Total life business £m
As at 31 December 2008			
With-profit fund liabilities	13,293	–	13,293
Unit-linked business (excluding that accounted for as non-participating investment contracts)	–	11,480	11,480
Other life insurance business	–	8,364	8,364
Insurance and participating investment contract liabilities	13,293	19,844	33,137
Non-participating investment contract liabilities	–	14,243	14,243
Total policyholder liabilities	13,293	34,087	47,380

CAPITAL SENSITIVITIES

SHAREHOLDERS' FUNDS

Shareholders' funds outside the long-term business fund, other than those used to match regulatory requirements, are mainly invested in assets that are less sensitive to market conditions.

WITH-PROFIT FUNDS

The with-profit realistic liabilities and the available capital for the with-profit funds are sensitive to both market conditions and changes to a number of non-economic assumptions that affect the valuation of the liabilities of the fund. The available capital resources (and capital requirements) are sensitive to the level of the stock market, with the position worsening at low stock market levels as a result of the guarantees to policyholders increasing in value. However, the exposure to guaranteed annuity options increases under rising stock market levels. An increase in the level of equity volatility implied by the market cost of equity put options also increases the market consistent value of the options given to policyholders and worsens the capital position.

The most critical non-economic assumptions are the level of take-up of options inherent in the contracts (higher take-up rates are more onerous), mortality rates (lower mortality rates are generally more onerous) and lapses prior to dates at which a guarantee would apply (lower lapse rates are generally more onerous where guarantees are in the money). The sensitivity of the capital position and capital requirements of the with-profit funds is partly mitigated by the actions that can be taken by management.

OTHER LONG-TERM FUNDS

Outside the with-profit funds, assets backing actuarial reserves in respect of policyholder liabilities are invested so that the values of the assets and liabilities are broadly matched. The most critical non-economic assumptions are mortality rates in respect of annuity business written (lower mortality rates are more onerous). Reinsurance arrangements are in place to reduce the Group's exposure to deteriorating mortality rates in respect of life insurance contracts. In addition, poor cost control would gradually depreciate the available capital and lead to an increase in the valuation of the liabilities (through an increased allowance for future costs).

Assets held in excess of those backing actuarial reserves are invested across a range of investment categories including fixed interest securities, equities, properties and cash. The mix of investments is determined in line with the policy of Lloyds Banking Group to minimise the working capital (defined as available capital less minimum required capital) required to ensure all capital requirements continue to be met under a range of stress tests.

OPTIONS AND GUARANTEES

The Group has sold insurance products that contain options and guarantees, both within the with-profit funds and in other funds.

OPTIONS AND GUARANTEES WITHIN THE WITH-PROFIT FUNDS

The most significant options and guarantees provided from within the with-profit funds are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies.

For those policies written in Scottish Widows pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up within the With Profit Fund of Scottish Widows called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2009 of £1.6 billion (2008: £2.0 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

As noted above, under the realistic capital regime of the FSA, the liabilities of the with-profit funds are valued using a market-consistent stochastic simulation model. This model is used in order to place a value on the options and guarantees which captures both their intrinsic value and their time value.

The most significant economic assumptions included in the model are:

– Risk-free yield. The risk-free yield is defined as spot yields derived from the UK gilt yield curve.
– Investment volatility. The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2009, the 10 year equity-implied at-the-money assumption was set at 26.6 per cent (31 December 2008: 34.6 per cent). The assumption for property volatility was 15 per cent (31 December 2008: 15 per cent). The volatility of interest rates has been calibrated to the implied volatility of swaptions which was broadly 15 per cent (31 December 2008: 16 per cent).

The model includes a matrix of the correlations between each of the underlying modelled asset types. The correlations used are consistent with long-term historical returns. The most significant non-economic assumptions included in the model are management actions (in respect of investment policy and bonus rates), guaranteed annuity option take-up rates and assumptions regarding persistency (both of which are based on recent actual experience and include an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities), and assumptions regarding mortality (which are based on recent actual experience and industry tables).

OPTIONS AND GUARANTEES OUTSIDE THE WITH-PROFIT FUNDS

Certain personal pension policyholders in Scottish Widows, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £64 million (31 December 2008: £65 million) in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £3 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £11 million.

FIVE YEAR FINANCIAL SUMMARY

The statutory financial information set out in the table below has been derived from the annual report and accounts of Lloyds Banking Group plc for each of the past five years.

The financial statements for each of the years presented have been audited by PricewaterhouseCoopers LLP, independent auditors.

	2009	2008[6]	2007[6]	2006[6]	2005[6]
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**23,278**	9,868	10,696	11,098	10,543
Operating expenses	**(15,984)**	(6,100)	(5,568)	(5,300)	(5,481)
Trading surplus	**7,294**	3,768	5,128	5,798	5,062
Impairment	**(16,673)**	(3,012)	(1,796)	(1,555)	(1,299)
Gain on acquisition	**11,173**	–	–	–	–
Profit before tax	**1,042**	760	3,999	4,249	3,810
Profit for the year	**2,953**	798	3,320	2,908	2,545
Profit for the year attributable to equity shareholders	**2,827**	772	3,288	2,804	2,483
Total dividend for the year[1]	**–**	648	2,026	1,927	1,915
	31 December 2009	31 December 2008	31 December 2007	31 December 2006	31 December 2005
Balance sheet data (£m)					
Share capital	**10,472**	1,513	1,432	1,429	1,420
Shareholders' equity	**43,278**	9,393	12,141	11,155	10,195
Net asset value per ordinary share	**68p**	155p	212p	195p	180p
Customer deposits	**406,741**	170,938	156,555	139,342	131,070
Subordinated liabilities	**34,727**	17,256	11,958	12,072	12,402
Loans and advances to customers	**626,969**	240,344	209,814	188,285	174,944
Total assets	**1,027,255**	436,033	353,346	343,598	309,754
	2009	2008	2007	2006	2005
Share information					
Basic earnings per ordinary share	**7.5p**	6.7p	28.9p	24.8p	22.0p
Diluted earnings per ordinary share	**7.5p**	6.6p	28.7p	24.5p	21.8p
Total dividend per ordinary share[1]	**–**	11.4p	35.9p	34.2p	34.2p
Market price (year end)	**50.7p**	126.0p	472.0p	571.5p	488.5p
Number of shareholders (thousands)	**2,834**	824	814	870	920
Number of ordinary shares in issue (millions)[2]	**63,775**	5,973	5,648	5,638	5,603
	2009	2008	2007	2006	2005
Financial ratios (%)[3]					
Dividend payout ratio	**–**	83.9	61.6	68.7	77.1
Post-tax return on average shareholders' equity	**8.8**	7.0	28.1	26.6	25.5
Cost:income ratio[4]	**68.7**	61.8	52.1	47.8	52.0
	31 December 2009	31 December 2008	31 December 2007	31 December 2006	31 December 2005
Capital ratios (%)[5]					
Total capital	**12.4**	11.2	11.0	10.7	10.9
Tier 1 capital	**9.6**	8.0	8.1	8.2	7.9

[1] Annual dividends comprise both interim and estimated final dividend payments. Under IFRS, the total dividend for the year represents the interim dividend paid during the year and the final dividend which will be paid and accounted for during the following year.

[2] This figure excludes 81 million (2005 to 2008: 79 million) limited voting ordinary shares.

[3] Averages are calculated on a monthly basis from the consolidated financial data of Lloyds Banking Group.

[4] The cost:income ratio is calculated as total operating expenses as a percentage of total income (net of insurance claims).

[5] Capital ratios for 2009 and 2008 are in accordance with Basel II requirements; ratios for 2007 and earlier years reflect Basel I.

[6] Restated for IFRS 2 (Revised) and to separate share of results of joint ventures and associates from total income.

THE BOARD

NON-EXECUTIVE DIRECTORS

Sir Winfried Bischoff
Chairman

Chairman of the nomination and governance committee and a member of the remuneration and risk oversight committees

Joined the board and was appointed chairman on 15 September 2009. Previously chairman of Citigroup Inc. from December 2007 to February 2009. He joined J Henry Schroder & Co in January 1966 and became managing director of Schroders Asia in 1971, group chief executive of Schroders Plc in 1984 and chairman in 1995. Following the acquisition of Schroders' investment banking business by Citigroup in 2000 became chairman of Citigroup Europe before being appointed acting chief executive officer of Citigroup in 2007 and subsequently as chairman in the same year. A non-executive director of Eli Lilly and Company, and The McGraw Hill Companies Inc. in the United States, and chairman of the UK Career Academy Foundation. A member of the Akbank International advisory board. Aged 68.

Lord Leitch
Deputy Chairman
Senior Independent Director

Member of the audit, nomination and governance, and remuneration committees and chairman of the risk oversight committee

Joined the board in 2005 and was appointed deputy chairman in May 2009. Appointed chairman of Scottish Widows in 2007. Held a number of senior and general management appointments in Allied Dunbar, Eagle Star and Threadneedle Asset Management before the merger of Zurich Group and British American Tobacco's financial services businesses in 1998. Subsequently served as chairman and chief executive officer of Zurich Financial Services United Kingdom, Ireland, Southern Africa and Asia Pacific, until his retirement in 2004. Chairman of the Government's Review of Skills (published in December 2006) and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster. Former chairman of the National Employment Panel. Aged 62.

Dr Wolfgang C G Berndt
Independent Director

Member of the nomination and governance committee and chairman of the remuneration committee

Joined the board in 2003. Joined Procter and Gamble in 1967 and held a number of senior and general management appointments in Europe, South America and North America, before retiring in 2001. A non-executive director of Cadbury, GfK AG and MIBA AG. Aged 67.

Sir Julian Horn-Smith
Independent Director

Member of the nomination and governance, remuneration and risk oversight committees

Joined the board in 2005. Held a number of senior and general management appointments in Vodafone from 1984 to 2006 including a directorship of that company from 1996, group chief operating officer from 2001 and deputy chief executive officer from 2005. Previously held positions in Philips from 1978 to 1982 and Mars GB from 1982 to 1984. A non-executive director of De La Rue, Digicel Group and Emobile (Japan), a director of Sky Malta, a member of the Altimo International advisory board and a senior advisor to UBS and CVC Capital Partners in relation to the global telecommunications sector. Pro vice-chancellor of University of Bath. A former chairman of The Sage Group. Aged 61.

T Timothy Ryan, Jr
Independent Director

Member of the audit and risk oversight committees

Joined the board on 1 March 2009. President and chief executive of the Securities Industry and Financial Markets Association. Held a number of senior appointments in JP Morgan Chase from 1993 to 2008 including vice chairman, financial institutions and governments, from 2005. A director of the US-Japan Foundation, Great-West Life Annuity Insurance Co. and Putnam Investments and a member of the Global Markets Advisory Committee for the National Intelliegence Council. A former director in the Office of Thrift Supervison, US Department of the Treasury and Koram Bank and the International Foundation of Election Systems. Aged 64.

Martin A Scicluna
Independent Director

Chairman of the audit committee and a member of the risk oversight committee

Joined the board in September 2008. Chairman of Deloitte UK from 1995 to 2007 and a member of the board from 1991 to 2007. Joined the firm in 1973 and was a partner from 1982 until he retired in 2008. A member of the board of directors of Deloitte Touche Tohmatsu from 1999 to 2007. Chairman of Great Portland Estates. A member of the council of Leeds University and a governor of Berkhamsted School. Aged 59.

Anthony Watson CBE
Independent Director

Member of the audit and risk oversight committees

Joined the board on 2 April 2009. Previously chief executive of Hermes Pensions Management. Held a number of senior appointments in AMP Asset Management from 1991 to 1998. A non-executive director of Hammerson, Vodafone and Witan Investment Trust, a member of the Norges Bank Investment Management advisory board and chairman of Marks and Spencer Pension Trust, Asian Infrastructure Fund and Lincoln's Inn investment committee. A former chairman of MEPC and of the Strategic Investment Board (Northern Ireland) and a former member of the Financial Reporting Council. Aged 64.

EXECUTIVE DIRECTORS

J Eric Daniels
Group Chief Executive

Joined the board in 2001 as group executive director, UK retail banking before his appointment as group chief executive in June 2003. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. A non-executive director of BT Group. Aged 58.

Archie G Kane
Group Executive Director Insurance (Board Representative for Scotland)

Joined the group in 1986 and held a number of senior and general management appointments before being appointed to the board in 2000, as group executive director, IT and operations. Appointed group executive director, insurance and investments in October 2003. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. Chairman of the Association of British Insurers and a member of The Takeover Panel. Aged 57.

G Truett Tate
Group Executive Director Wholesale

Joined the group in 2003 as managing director, corporate banking before being appointed to the board in 2004. Served with Citigroup from 1972 to 1999, where he held a number of senior and general management appointments in the USA, South America, Asia and Europe. He was president and chief executive officer of eCharge Corporation from 1999 to 2001 and co-founder and vice chairman of the board of Chase Cost Management Inc from 1996 to 2003. A non-executive director of BritishAmerican Business Inc. Chairman of Arora Holdings and a director of Business in the Community and a director and trustee of In Kind Direct. Aged 59.

Tim J W Tookey
Group Finance Director

Joined the group in 2006 as deputy group finance director, before being appointed acting group finance director in April 2008. Appointed to the board in October 2008 as group finance director. Previously finance director for the UK and Europe at Prudential from 2002 to 2006 and group finance director of Heath Lambert Group from 1996 to 2002. Prior to that, he spent 11 years at KPMG. Aged 47.

Helen A Weir CBE
Group Executive Director Retail

Joined the board in 2004 as group finance director. Appointed as group executive director, UK retail banking in April 2008. Group finance director of Kingfisher from 2000 to 2004. Previously finance director of B&Q, having joined that company in 1995 from McKinsey & Co where she was a senior manager. Began her career at Unilever. Member of the Financial Services Practitioner Panel and the Said Business School Advisory Board. Chair of the British Bankers' Association Retail Committee. A former member of the Accounting Standards Board. Fellow of the Chartered Institute of Management Accountants. Aged 47.

Harry F Baines
Company Secretary

APPOINTMENTS FROM 1 MARCH 2010

Glen R Moreno
Senior Independent Director

Chairman of the risk oversight committee and a member of the remuneration committee

Chairman of Pearson, the media group, since October 2005. He is a director of Fidelity International, one of the world's largest fund management companies, and chairman of its audit committee. From 1987 to 1991 he was chief executive of Fidelity International. Until mid 2009, he was a non-executive director and senior independent director of Man Group, the FTSE 100 financial services group, and acting chairman of UKFI. He was a group executive at Citigroup; from 1969 to 1987 he held a number of senior positions at the bank in Europe and Asia. Aged 66

David L Roberts
Independent Director

Member of the audit and remuneration committees

Executive director, member of the group executive committee and chief executive, International Retail and Commercial Banking at Barclays until December 2006. He joined Barclays in 1983 and held various senior management positions, including chief executive, Personal Financial Services and chief executive, Business Banking. He was also a non-executive director of BAA until June 2006 and a non-executive director of Absa Group Limited, one of South Africa's largest financial services groups, until October 2006. From 2007 to 2009 he was also the chairman and chief executive of BAWAG P.S.K. AG, the second largest retail bank in Austria. He is currently a member of the strategy board for Henley Business School, non-executive chairman of The Mind Gym and a non-executive director of Campion Willcocks. Aged 47.

DIRECTORS' REPORT

RESULTS

The consolidated income statement shows a profit attributable to equity shareholders for the year ended 31 December 2009 of £2,827 million.

PRINCIPAL ACTIVITIES, BUSINESS REVIEW, FUTURE DEVELOPMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company is a holding company and its subsidiary undertakings provide a wide range of banking and financial services through branches and offices in the UK and overseas. A review of the development and performance of the business during the financial year and an indication of the likely future developments are given on pages 4 to 94. Key performance indicators are shown on page 5. Information regarding the financial risk management objectives and internal control policies of the Company and its subsidiary undertakings in relation to the preparation of consolidated financial statements is given within the corporate governance report on pages 100 to 104. The financial risk management objectives and internal control policies in relation to the use of financial instruments, is given on pages 56 to 94 and in notes 53 and 54 on pages 221 to 243.

GROUP STRUCTURE

On 16 January 2009, Lloyds TSB Group plc changed its name to Lloyds Banking Group plc, following the acquisition of HBOS plc.

POST BALANCE SHEET EVENTS

Details are given in note 57 on page 248.

DIRECTORS

Biographical details of directors are shown on pages 96 and 97. Particulars of their emoluments and interests in shares in the Company are given on pages 105 to 125.

Six directors stood down from the board during the year, as follows: Mr J P du Plessis (17 April), Mr Ewan Brown (5 June), Sir Victor Blank (15 September), Mr P N Green (23 October), Sir David Manning (2 November) and Ms C J McCall (31 December).

Mr T T Ryan and Mr Anthony Watson joined the board on 1 March 2009 and 2 April 2009, respectively.

Sir Winfried Bischoff joined the board on 15 September 2009 and Mr G R Moreno and Mr D L Roberts have been appointed directors from 1 March 2010. In accordance with the articles of association, they offer themselves for election at the annual general meeting.

Dr W C G Berndt, Mr J E Daniels and Mrs H A Weir retire at the annual general meeting and offer themselves for re-election.

DIRECTORS' INDEMNITIES

The directors have entered into individual deeds of indemnity with the Company which constituted 'qualifying third party indemnity provisions' and 'qualifying pension scheme indemnity provisions' for the purposes of the Companies Act 2006. These deeds were in force during the whole of the financial year or from the date of appointment in respect of the three directors who joined the board in 2009. The indemnities remain in force for the duration of a director's period of office. Deeds for existing directors are available for inspection at the Company's registered office.

SHARE CAPITAL

Information about share capital is shown in note 45 on pages 203 to 205; in the corporate governance report on pages 100 to 104; and in the directors' remuneration report on pages 105 to 125.

CHANGE OF CONTROL

The Company is party to significant contracts that are subject to change of control provisions in the event of a takeover bid as follows:

The Company is party to a deed of covenant with each of the four Lloyds TSB Foundations (the 'Foundations') which hold limited voting shares in the Company (the limited voting shares are further described in note 45 on page 205). Under the terms of the deeds of covenant, the Company makes an annual payment to each of the Foundations. In the event of a successful offer for more than 50 per cent of the issued ordinary share capital of the Company, each limited voting share would convert to an ordinary share under the terms of the Company's articles of association. The payment obligation under the deeds of covenant would come to an end one year following the conversion of the limited voting shares.

EMPLOYEES

Lloyds Banking Group is committed to providing employment practices and policies which recognise the diversity of our workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief.

In the UK, Lloyds Banking Group belongs to the major employer groups campaigning for equality for the above groups of staff, including Employers' Forum on Disability, Employers' Forum on Age, Stonewall and the Race for Opportunity. Our involvement with these organisations enables us to identify and implement best practice for our staff.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions.

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds Banking Group.

DONATIONS

The income statement includes a charge for charitable donations totalling £33,477,000 in 2009 (2008: £29,603,000), including £28,228,000 (2008: £28,997,000) which will be paid under the deeds of covenant to the four Lloyds TSB Foundations during 2010.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Company has signed up to the 'Prompt Payment Code' published by the Department for Business Innovation and Skills (BIS), regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from BIS as shown on page 261.

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

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 2006, is 32. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2009 bears to the aggregate of the amounts invoiced by suppliers during the year.

DIRECTORS' RESPONSIBILITY STATEMENT

Each of the current directors, whose names and functions are shown on pages 96 and 97 of this annual report, confirms that, to the best of his or her knowledge:

– the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and Group; and
– the management report contained in the business review includes a fair review of the development and performance of the business and the position of the Company and Group, together with a description of the principal risks and uncertainties they face.

AUDITORS AND AUDIT INFORMATION

Each person who is a director at the date of approval of this report confirms that, so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006.

Resolutions concerning the re-appointment of PricewaterhouseCoopers LLP as auditors and authorising the audit committee to set their remuneration will be proposed at the annual general meeting.

On behalf of the board

Harry F Baines
Company Secretary
25 February 2010

Company number 95000

CORPORATE GOVERNANCE

Lloyds Banking Group aspires to the highest standards of corporate governance. The events of the past two years have led to unprecedented challenges for the Group and the markets as a whole. Throughout this period we have constantly reviewed and refreshed our approach to corporate governance to ensure that it is robust, well embedded and at the forefront of best practice.

This report gives detailed information on our corporate governance arrangements for 2009 and outlines how we apply the principles of the 2006 Combined Code (the 'Code'). The Company believes it has complied throughout the year with all of the provisions of section 1 of the Code.

THE BOARD AND ITS COMMITTEES

At the year end, the board comprised the chairman, five executive directors and seven independent non-executive directors. Sir Winfried Bischoff succeeded Sir Victor Blank as chairman on 15 September 2009. Details of his selection and appointment process are set out on page 102. Details of other directors that joined and left the board during 2009 are shown on page 98.

The board considers that it is of an appropriate size to oversee the Group's businesses, with a suitable diversity of backgrounds and mix of experience and expertise to maximise its effectiveness. The composition of the board is kept under continuous review by the chairman, with the support of the nomination and governance committee, to ensure the right balance of skills and experience. All director appointments are subject to detailed due diligence which includes a robust search and selection process overseen by the nominations and governance committee. On 11 February 2010, the Company announced the appointments of Mr Moreno and Mr Roberts to take effect on 1 March 2010. Their details are included in the biographies on pages 96 and 97.

The chairman is responsible for leading the board and ensuring its effectiveness while the group chief executive manages the Group's business – these are distinct functions.

The chairman is responsible for the clarity and timeliness of information provided to the board and for facilitating the effective contribution of all directors and ensures that directors receive appropriate induction and ongoing training.

The chairman has a key role in the development (jointly with the group chief executive) of the Group's strategy, as well as oversight of strategy implementation and performance delivery. He ensures that there is a constructive, close working relationship with the group chief executive and the rest of the board.

MEETINGS

Responding to the challenges faced by the Company, the board held 28 meetings during 2009. In addition there was regular contact with directors outside of these meetings. The time commitment demanded of directors, in particular, non-executive directors, was far in excess of that anticipated in the normal course of business. All directors showed themselves to be willing and able to devote the additional time required often at short notice and at unsociable hours.

INDEPENDENCE

All the non-executive directors are considered by the board to be independent both in character and judgment and free of relationships or circumstances which could affect their judgement. Throughout the year at least half of the board comprised independent non-executive directors.

INDUCTION AND TRAINING

All new directors and committee members receive a full and tailored induction. The primary aim of the induction programme is to provide directors with a comprehensive introduction to the Group; its individual businesses; business models; strategy; and risks. This enables directors to make an early, informed and effective contribution to board debates, based on an understanding of the key challenges facing the Group, the Group's businesses, and the business model. The induction programme is supplemented by ongoing training and development.

The current induction and training programmes are being reviewed and enhanced to ensure that they meet the requirement for a 'substantive and personalised' programme as recommended by the Walker Review of Corporate Governance of UK Banking Industry published in November 2009.

BOARD EVALUATION

In autumn 2009, the board, supported by JCA Group, conducted a rigorous process of evaluating its effectiveness, and the effectiveness of its principal committees. The process included confidential, unattributable, one-on-one interviews with every board member and with UKFI and the Group's external auditors. The review covered corporate governance, board effectiveness, strategy development, risk management and board and committee organisation, composition, operation and dynamics. In addition, although early in his tenure, the review also considered the performance of the chairman, including the effectiveness of his relationships with the group chief executive and other members of the board. The outcomes of the review were subsequently discussed by the board as a whole.

The review was conducted during a period of significant change for the board with several members leaving and a number of relatively new members.

The board members individually and collectively considered that the board is working as an effective whole. After the significant challenges faced by the Group and the board in 2009, the review highlighted the importance of returning to a more normal operating mode by focusing on delivering the integration, developing the future strategy, and reviewing the operations and risk management for the Group as a whole and within each of the key areas. In addition, the review encouraged continued vigorous debate in the board and committees and emphasised the importance of succession plans for the management team and non-executive directors. An action plan has been developed to ensure that the chief conclusions of the review are addressed in a timely manner. As part of this, it has been agreed that issues of risk, liquidity and funding should receive particularly high attention in 2010.

ELECTION AND RE-ELECTION OF DIRECTORS

All directors are subject to election by shareholders at the first annual general meeting (AGM). Following their appointment, Sir Winfried Bischoff, Mr Moreno and Mr Roberts will stand for election at the forthcoming AGM.

The Company requires all directors to stand for re-election at intervals of no more than three years. At the 2010 AGM, Dr Berndt, Mr Daniels and Mrs Weir will retire and seek re-election by shareholders.

The chairman has endorsed the effectiveness and commitment of all directors standing for election or re-election at the AGM, and the senior independent director has given a similar endorsement in respect of the chairman's election.

COMPANY SECRETARY AND INDEPENDENT ADVICE

The Company Secretary, Mr Baines, is responsible for advising the board on corporate governance matters and, in conjunction with the chairman, for ensuring good information flows between the board, its committees, non-executive directors and senior executives. All directors have access to his advice and services. Additionally, if required in the furtherance of their duties, non-executive directors (along with any other members of the board's main committees) are entitled to seek independent, professional advice at the Company's expense.

DIRECTORS' CONFLICTS OF INTEREST

The board, as permitted by the Group's articles of association, has authorised all potential conflicts of interest declared by individual directors. Decisions regarding these conflicts of interest could only be taken by directors who had no interest in the matter. In taking the decision, the directors acted in a way they considered, in good faith, would be most likely to promote the Company's success. The directors had the ability to impose conditions, if thought appropriate, when granting authorisation. Any authorities given will be reviewed at least every 15 months. No director is permitted to vote on any resolution or matter where he or she has an actual or potential conflict of interest.

RELATIONS WITH SHAREHOLDERS

The investor relations team has primary, day-to-day responsibility for managing communications with institutional shareholders through a combination of briefings to analysts and institutional shareholders (both at the interim and year end results and throughout the year), site visits and individual discussions between institutional shareholders and board members and key senior executives. Regular dialogue with shareholders helps to ensure that the Company's strategy is understood and that any queries or other issues are addressed in a constructive way. In 2009, there has been extensive and regular engagement with institutional shareholders and UKFI, the body set up to manage the Government's investments in banks. The board receives weekly reports on market and investor sentiment and opinion which helps it develop a balanced understanding of the views of major shareholders.

The company secretary oversees communications with private shareholders. Shareholders are encouraged to attend and participate in the Group's AGM.

AUDIT COMMITTEE

The audit committee comprises Mr Scicluna (chairman), Lord Leitch, Mr Ryan and Mr Watson. The committee's terms of reference are available from the company secretary and are displayed on our website, www.lloydsbankinggroup.com.

During the year, the audit committee received reports from, and held discussions with, management and the external auditors. In discharging its duties, the committee has approved the auditors' terms of engagement, including their remuneration and, in discussion with them, has assessed their independence and objectivity (more information about which is given in note 11 to the consolidated financial statements, in relation to the procedure for approving fees for audit and non-audit work) and recommended their re-appointment at the AGM. The committee also reviewed the financial statements published in the name of the board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures; the scope of the work of the group audit department, reports from that department and the adequacy of its resources; the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations (more information about which is given in the note about internal control on page 104); the results of the external audit and its cost effectiveness; and reports from the external auditors on audit planning and their findings on accounting and internal control systems. Procedures for handling complaints regarding accounting, internal accounting controls or auditing matters and for staff to raise concerns in confidence have been established by the committee. The committee also had a meeting with the auditors, without executives present, and a meeting with the group audit director alone.

CHAIRMAN'S COMMITTEE

The chairman's committee, comprising the chairman, deputy chairman and the group chief executive, meets to assist the chairman in ensuring the effectiveness and efficiency of board meetings. The committee exercises specific powers delegated to it by the board from time to time.

NOMINATION AND GOVERNANCE COMMITTEE

To ensure that the Group's governance arrangements take due account of best practice developments, the nomination and governance committee has expanded its terms of reference to expressly include governance issues.

The nomination and governance committee is chaired by Sir Winfried Bischoff. Lord Leitch, Dr Berndt and Sir Julian Horn-Smith are members. The committee reviews the structure, size and composition of the board; oversees the selection process for prospective directors; makes recommendations to the board on potential appointments and re-appointments of directors at the end of their specified term; and considers board succession. Following expansion of its terms of reference, it also reviews the board's governance arrangements and oversees the Company's implementation of governance requirements eg under the Walker Review and Combined Code.

The committee is responsible for overseeing the process for appointments of new non-executive directors and making recommendations to the board. In 2009, two new non-executive director appointments were announced. A further two appointments were announced on 11 February 2010. All appointments are subject to a rigorous search and selection process.

In addition, on 26 July 2009, the appointment of Sir Winfried Bischoff as chairman of Lloyds Banking Group was recommended to, and approved by, the board, following the process set out below.

The committee's terms of reference are available from the company secretary and are displayed on our website, www.lloydsbankinggroup.com.

Chairman's succession

On 18 May 2009, following Sir Victor Blank's decision to step down from the board, a sub-committee of the nomination committee was established to oversee the chairman's succession. The committee was chaired by Sir Julian Horn-Smith. Membership was made-up entirely of independent non-executive directors, namely Dr Berndt, Mr Green, Sir David Manning and Mr Watson. There was an open invitation to other non-executive directors to attend meetings. Ms McCall was a regular attendee; Mr Ryan and Mr Scicluna also attended a number of meetings. As deputy chairman, Lord Leitch was kept advised of developments and, towards the latter end of the process, was invited to join meetings. The committee was advised by the group human resources director and the head of secretariat. Sir Victor Blank did not participate in any part of the process.

Following a tender process, the committee appointed Jan Hall of JCA Group, as executive search advisor.

The sub-committee met 10 times. Activities included agreeing the role specification and selection criteria; reviewing applicant profiles and agreeing short lists; reviewing shareholder feedback and ultimately recommending the appointment of Sir Winfried Bischoff to the board. In conjunction with the remuneration committee, the committee also proposed the terms and conditions of appointment for the new chairman. Between meetings, there were regular updates on progress.

Short listed candidates were subject to an extensive interview process, initially by panels of committee members along with other directors. Ms McCall and Lord Leitch also participated in the interview process. All executive and non-executive directors were given the opportunity to meet the candidates prior to any decision being made. Detailed referencing and due diligence, both formal and informal, was also carried out. The appointment was subject to, and received, approval from the Financial Services Authority.

The views of institutional shareholders including UKFI were sought prior to any decision being made. Those shareholders consulted confirmed that they were satisfied that the search and selection process had been robust and extensive.

REMUNERATION COMMITTEE

Information about the remuneration committee's membership and work is given in the directors' remuneration report on pages 105 to 125. Its terms of reference are available from the company secretary and are displayed on the Company's website, www.lloydsbankinggroup.com.

RISK OVERSIGHT COMMITTEE

The risk oversight committee comprises Lord Leitch (chairman), Sir Winfried Bischoff, Sir Julian Horn-Smith, Mr Ryan, Mr Scicluna and Mr Watson. There is a standing invitation for all other non-executive directors to attend meetings of the committee. The risk oversight committee's duties include overseeing the development, implementation and maintenance of the Group's overall risk management framework, and its risk appetite, strategy, principles and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice. The committee also oversees the Group's risk exposures; facilitates the involvement of non-executive directors in risk issues and aids their understanding of these issues; oversees adherence to Group risk policies and standards and considers any material amendments to them; and reviews the work of the group risk division.

GROUP EXECUTIVE COMMITTEE

The group executive committee, comprising the group chief executive, all the group executive directors (as shown on page 97), together with the chief risk officer, the group human resources director and the director of group operations, meets to assist the group chief executive in performing his duties. Specifically, the committee considers the development and implementation of strategy, operational plans, policies and budgets; the monitoring of operating and financial performance; the assessment and control of risk; the prioritisation and allocation of resources; and the monitoring of competitive forces in each area of operation. The committee, assisted by its sub-committees, the group business risk and group asset and liability committees, also supports the group chief executive in endeavouring to ensure the development, implementation and effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, and in reviewing the Group's aggregate risk exposures and concentrations of risk.

ATTENDANCE AT MEETINGS

The attendance of directors at board meetings and at meetings of the audit, nomination and governance, remuneration and risk oversight committees during 2009 were as follows:

	Board meetings						
	Regular	Ad hoc	Total	Audit committee	Nomination and governance committee	Remuneration committee	Risk oversight committee
Number of meetings during the year	9	19	28	8	2	13	4
Current directors who served during 2009							
Dr W C G Berndt	9	15	24		2	13	
Sir Winfried Bischoff[1]	3	7	10 (max 10)			3 (max 3)	1 (max 1)
J E Daniels	9	19	28				
Sir Julian Horn-Smith	8	17	25		2	8	3
A G Kane	9	19	28				
Lord Leitch[2]	8	19	27	7	2	4 (max 5)	4
T T Ryan[3]	7	14	21 (max 22)	5 (max 5)			3 (max 3)
M A Scicluna	9	18	27	8			4
G T Tate	8	18	26				
T J W Tookey	9	19	28				
Anthony Watson[4]	7	11	18 (max 20)	3 (max 3)			2 (max 2)
H A Weir	9	19	28				
Former directors who served during 2009							
Sir Victor Blank[5]	6	11	17 (max 18)			10 (max 10)	3 (max 3)
Ewan Brown[6]	4	6	10 (max 12)	4 (max 5)			2 (max 2)
J P du Plessis[7]	2	6	8 (max 9)	3 (max 4)	1 (max 1)		1 (max 2)
P N Green[8]	7	10	17 (max 22)	6 (max 7)	1 (max 2)	7 (max 11)	
Sir David Manning[9]	7	15	22 (max 26)		1 (max 1)	12 (max 12)	4
C J McCall[10]	9	11	20			7 (max 12)	

[1] Appointed to the board, nomination and governance, remuneration and risk oversight committees on 15 September 2009.
[2] Appointed to the remuneration committee on 4 August 2009.
[3] Appointed to the board, audit and risk oversight committees on 1 March 2009.
[4] Appointed to the board on 2 April 2009. Appointed to the audit and risk oversight committees on 6 May 2009.
[5] Left the board on 15 September 2009.
[6] Left the board on 5 June 2009.
[7] Left the board on 17 April 2009.
[8] Left the board on 23 October 2009.
[9] Left the board on 2 November 2009.
[10] Appointed to the remuneration committee on 23 January 2009. Left the board on 31 December 2009.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the annual report, the directors' remuneration report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the consolidated and parent company financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. The directors consider that in preparing the financial statements on pages 127 to 260 the Company and the Group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

The directors have responsibility for ensuring that the Company and the Group keep proper accounting records which disclose with reasonable accuracy the financial position of the Company and the Group and which enable them to ensure that the financial statements and the directors' remuneration report comply with the Companies Act 2006 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and the Group and to prevent and detect fraud and other irregularities.

A copy of the financial statements of the Company is placed on our website, www.lloydsbankinggroup.com. The directors are responsible for the maintenance and integrity of statutory and audited information on the Company's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

COMPLIANCE WITH THE BRITISH BANKERS' ASSOCIATION DRAFT CODE FOR FINANCIAL REPORTING DISCLOSURE

In October 2009, the British Bankers' Association published a draft Code for Financial Reporting Disclosure (the 'Disclosure Code'). The draft Disclosure Code sets out five disclosure principles together with supporting guidance. The principles are that UK banks: commit to providing high quality, meaningful and decision-useful disclosures; commit to ongoing review of, and enhancement to, their financial instrument disclosures for key areas of interest; will assess the applicability and relevance of good practice recommendations to their disclosures acknowledging the importance of such guidance; will seek to enhance the comparability of financial statement disclosures across the UK banking sector; and will clearly differentiate in their annual reports between information that is audited and information that is unaudited.

The Group and other major UK banks have voluntarily adopted the draft Disclosure Code in their 2009 financial statements. The Group's 2009 financial statements have therefore been prepared in compliance with the draft Disclosure Code's principles.

INTERNAL CONTROL

The board of directors is responsible for the establishment and review of Lloyds Banking Group's system of internal control, which is designed to ensure effective and efficient operations, quality of internal and external reporting, internal control, and compliance with laws and regulations. It should be noted, however, that such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. In establishing and reviewing the system of internal control, the directors have regard to the nature and extent of relevant risks, the likelihood of a loss being incurred and the costs of control. It follows, therefore, that the system of internal control can only provide reasonable but not absolute assurance against the risk of material loss.

The directors and senior management are committed to maintaining a control-conscious culture across all areas of operation. This is communicated to all employees by way of published policies and procedures and regular management briefings. A requirement to comply with internal control risk policies is a key component of individual staff objectives expressed in the balanced scorecard. Key business risks are identified, and these are controlled by means of procedures such as physical controls, credit, trading and other authorisation limits and segregation of duties. In addition, there is an annual control self assessment exercise whereby the key businesses and head office functions review specific controls and attest to the accuracy of their assessments. The assessment covers all enterprise-wide risk management categories and is in accordance with the principles of the Combined Code. As in previous years, this exercise was completed for the year ended 31 December 2009. All returns have been satisfactorily completed and appropriately certified.

The effectiveness of the internal control system is reviewed regularly by the board and the audit committee, which also receives reports of reviews undertaken around Lloyds Banking Group by group risk and group audit. The audit committee receives reports from the Company's auditors, PricewaterhouseCoopers LLP (which include details of significant internal control matters that they have identified), and has a discussion with the auditors at least once a year without executives present, to ensure that there are no unresolved issues of concern.

AUDITOR INDEPENDENCE AND REMUNERATION

Both the board and the external auditors have safeguards in place to protect the independence and objectivity of the external auditors. The audit committee has a comprehensive policy to regulate the use of auditors for non-audit services. This policy sets out the nature of work the external auditors may not undertake, which includes work which will ultimately be subject to external audit, internal audit services and secondments to senior management positions in the Group that involve decision-making. It also includes the Group's policy on hiring former external audit staff. For those services that are deemed appropriate for the auditors to carry out, the policy sets out the approval process that must be followed for each type of assignment. The chairman of the audit committee must be consulted regarding potential instructions in respect of defined non-audit services with a value above defined limits.

Each year the audit committee establishes a limit on the fees that can be paid to the external auditors in respect of non-audit services and monitors quarterly the amounts paid to the auditors in this regard. The external auditors also report regularly to the committee on the actions that they have taken to comply with professional and regulatory requirements and current best practice in order to maintain their independence. This includes the rotation of key members of the audit team. Total auditor remuneration analysed between audit and other services is shown in note 11 to the accounts on page 158.

GOING CONCERN

The going concern of the Company and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the directors have considered a number of key dependencies which are set out in the risk management section under Principal Risks: Liquidity and Funding on page 61 and Financial Soundness on pages 81 to 89 and additionally have considered projections for the Group's capital and funding position. Having considered these, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

DIRECTORS' REMUNERATION REPORT

This is a report made by the board of Lloyds Banking Group plc, on the recommendation of the remuneration committee. It covers the current and proposed components of the remuneration policy and details the remuneration for each serving director during 2009.

CONTENT OF REMUNERATION REPORT

– Statement by the chairman of the remuneration committee
– Remuneration decisions for 2009/10 key highlights
– Governance and risk management, including the role, membership and advisors to the committee
– Directors' remuneration policy
– Remuneration for 2010
– Remuneration for 2009
– Dilution limits
– Pensions
– Service agreements
– External appointments
– Performance graph
– Audited information

STATEMENT BY THE CHAIRMAN OF THE REMUNERATION COMMITTEE

It is my privilege once again to introduce the board's report on remuneration policy and practice.

INTRODUCTION

This last year has been one of the most challenging for remuneration in banking, following on from 2008 which was a year of unprecedented change and turmoil across the sector. The committee is also aware that remuneration is a sensitive issue for society as well. At the same time, the Group has been faced with the immense task of integrating the Lloyds TSB and HBOS businesses - one of the biggest integrations ever undertaken in the sector and where considerable progress has been made during the first year of the three year programme, as described elsewhere in this report. In making decisions on remuneration, the remuneration committee has continually had to balance the current operating environment and the fact that the Group is in a loss making position with the need to motivate the executives to run the business in a way to maximise the returns for the shareholder, including the tax payer. The committee has sought to strike this balance by maintaining the prudent approach to reward overall that it has adopted in previous years, whilst ensuring that the right incentives are in place to reward future performance. At the same time the committee has during 2009 built on the work of 2008 to ensure that the Group's remuneration policy and arrangements comply with the FSA Code of Practice on Remuneration.

A PRUDENT REMUNERATION POLICY

The committee reviewed very carefully the decisions made in respect of remuneration for 2009. There were no salary increases for executives, executives waived any entitlement to annual incentives in respect of the 2008 performance year and the Long Term Incentive Plan (LTIP) opportunity was reduced from 2008 levels by up to 175 per cent of salary. Awards under the annual incentive plan for 2009 have been made based on a rigorous assessment of performance against targets. In reaching its decisions, the committee has sought to take into account the Group's performance against the main financial targets where the outcomes were better than expected as well as the delivery of a number of milestones that are a key part of the Group's medium term recovery plan. It is important to note that 100 per cent of the award will be deferred into shares and released in 2012 unless subject to clawback at that time.

The committee's approach has continued in the review of remuneration for 2010, with any decisions on remuneration discussed extensively by the committee and shareholders consulted ahead of any decisions made. The committee does have concerns that by continuing to hold base pay levels at 2008 levels, remuneration for the executive directors is likely to become uncompetitive versus our peer group. However, by adding the share price related element to the 2010 LTIP it is hoped that this will go some way to addressing this. But this is an area that will be kept under close and continuous review by the committee and one where we will continue to engage with shareholders during 2010 as their views are essential in this debate.

Extensive work has been undertaken in 2009 and will continue in 2010 to ensure compliance with the FSA Code of Practice on Remuneration. The terms of reference of the remuneration committee were revised during 2009 to extend the remit of the committee to include the overall remuneration policy and philosophy for all colleagues, whilst retaining direct responsibility for the remuneration for certain colleagues. Divisional remuneration committees were introduced in 2009 to provide a robust framework for decisions on remuneration throughout the Group. The role of risk in remuneration decision making has been formalised and the chief risk officer now attends remuneration committee meetings as appropriate and divisional and group risk officers are members of the divisional remuneration committees. This work will continue in 2010 as the FSA refines its Code and takes into account the recommendations in Sir David Walker's review of corporate governance in UK banks and other financial industry entities. The committee will take into account any change in disclosure requirements as they are formalised and reflect them in the 2010 report.

2010 REMUNERATION DESIGN

The committee has determined that the design of remuneration for 2010 will remain broadly as for 2009. There will again be no base pay increases for executive directors in 2010, with base pay levels held at 2008 levels. The structure and annual incentive opportunity remain unchanged from 2009. The maximum LTIP opportunity has been increased from the 2009 level (which reflected the extraordinary circumstances of that year). However, the maximum level of award made to executive directors remains below 2008 levels, by up to 100 per cent of base salary and is lower than the historical sector average. Performance conditions for the LTIP will continue to be based on EPS and economic profit, with an additional performance measure for 2010 related directly to achieving stretching share price performance over the next three years. Following discussions with shareholders two key changes have been made to the proposed design of the 2010 LTIP. Firstly the performance conditions have been made even more stretching. Secondly, further alignment of the interests of the executive directors with those of the shareholders has been created through an additional requirement that any shares vesting in 2013 as a result of the share price performance element of the 2010 LTIP must be retained for a further two years. Furthermore, and reflecting shareholder representation on this matter, the committee will review performance against the targets for the 2010 annual incentive plan at the end of the year, taking into account the overall operating performance of the business in determining how much of any bonus will be paid out. The committee also reserves the right to exercise its discretion in reducing any payment that otherwise would have been earned, if they deem this appropriate.

CONCLUSION

Our approach to remuneration has been developed with extensive input and consultation from both our shareholders and regulators during 2009 and the early part of 2010. The remuneration committee believes that this approach strikes the best balance possible given the unique circumstances that exist for the Group at this time and the need to continue to motivate and retain the management team. The committee does have concerns that by continuing to hold base pay levels at 2008 levels, remuneration for the executive directors is likely to become uncompetitive versus our peer group. However, by adding the share price related element to the 2010 LTIP it is hoped that this will go some way to addressing this. But this is an area that will be kept under close and continuous review by the committee and one where we will continue to engage with shareholders during 2010 as their views are essential in this debate. The committee believes that the approach this year achieves an appropriate balance between recognition of the sensitivity of the current environment and this longer term policy objective.

We therefore recommend this report to shareholders and ask for your support at the forthcoming AGM.

Dr Wolfgang Berndt
Chairman, remuneration committee

REMUNERATION DECISIONS FOR 2009/2010 KEY HIGHLIGHTS

In 2010, our remuneration package will continue to have the same main elements as for 2009:

– Base salary
– Annual incentive
– Long-term incentive plan

In addition, executive directors participate in pension arrangements and receive benefits such as life assurance and medical insurance.

The following key decisions have been made for 2009/2010 remuneration:

– 2010 base salaries for executive directors will continue to be frozen at 2008 levels
– At his own request the group chief executive waived his award under the annual incentive plan for 2009
– Awards under the annual incentive plan for 2009 for executive directors amounted to between 150 per cent and 185 per cent of salary
– All awards under the annual incentive plan are deferred into shares and subject to clawback, with any awards released in 2012
– LTIP award below historic award levels at a maximum of 275 per cent of salary subject to stretching performance conditions based on EPS, economic profit and the achievement of stretching share price targets
– Any shares vesting as a result of the element of the LTIP relating to the share price targets must be retained for a further two years post vesting

The approximate make-up of the main components of our new package for executive directors on an expected value basis is shown below:

Long-term incentive	**40%**	Based on a combination of performance targets comprising earnings per share, economic profit and the achievement of stretching share price targets	**Paid in shares after three years**
Short-term incentive	**30%**	Based half on financial measures and half on a balanced scorecard of non-financial measures	**Deferred into shares until 2012, subject to clawback**
Salary	**30%**	Based on role, market competitiveness, and performance	**Paid in cash**

(The split in the components in the above chart are for executive directors. Comparable numbers for the group chief executive are: long term incentive 40 per cent, short term incentive 32 per cent and salary 28 per cent)

The 2010 package is designed to encourage a long-term and risk-based focus:

– Salary is a significant proportion of the total package, avoiding excessive leverage
– All incentives will be paid on a deferred basis at the end of three years
– Deferred annual incentive is subject to clawback; ie it is not released when information subsequently comes to light about the performance on which the incentive award is based, which had it been known prior to the determination of the awards would have affected the original award decision
– A combination of financial and non-financial measures encourages a long-term focus
– Economic profit, which is a risk-adjusted profit measure, is a core financial target target used in both the annual incentive plan and the LTIP
– Shares resulting from the vesting of the share price performance part of the LTIP must be retained for a further two years post vesting

We believe that these arrangements are well aligned with the FSA's Code of Practice on Remuneration.

GOVERNANCE AND RISK MANAGEMENT

An essential component of our approach to remuneration is the governance process that underpins it. This ensures that our policy is robustly applied and risk is managed appropriately.

The overarching purpose of the remuneration committee is to consider, agree and recommend to the board an overall remuneration policy and philosophy for the Group that is aligned to its long-term business strategy, its business objectives, its risk appetite and values, and recognises the interests of relevant stakeholders. The remuneration policy and philosophy covers the whole Group, but the committee pays particular attention to the top management group and those colleagues who perform significant influence functions for the Group and those who could have a material impact on the Group's risk profile. The committee's role is to ensure that these colleagues are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organisation, whilst ensuring that there is no reward for excessive risk taking.

The committee determines the pensions policy for all colleagues and advises on other major changes to employee benefits schemes. It also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated power for settling remuneration for the chairman, the group executive directors, the company secretary and any group employee whose salary exceeds a specified amount, currently £350,000, and/or whose short-term incentive opportunity exceeds £250,000.

The committee monitors the application of the authority delegated to the group executive committee and the divisional remuneration committees to ensure that policies and principles are being fairly and consistently applied. The committee liaises with the risk oversight committee and the risk function in relation to risk-adjusted performance measures.

All the independent non-executive directors are invited to attend meetings if they wish, and they receive the minutes and have the opportunity to comment and have their views taken into account before the committee's decisions are implemented.

The committee's terms of reference are available from the company secretary and are displayed on the Group's website, www.lloydsbankinggroup.com.

The committee met on 13 occasions during 2009, and the members were as follows:

- Dr Wolfgang Berndt (chairman)
- Sir Victor Blank (until 14 September 2009)
- Sir Winfried Bischoff (from 15 September 2009)
- Mr Philip Green (until 23 October 2009)
- Sir Julian Horn-Smith
- Lord Leitch (from 18 May 2009)
- Sir David Manning (until 2 November 2009)
- Ms Carolyn McCall (from 23 January 2009 until 31 December 2009)

The committee welcomed Lord Leitch and Ms Carolyn McCall to the committee and Sir Winfried Bischoff, on his appointment as chairman of the Group. We thank Sir Victor Blank, Mr Philip Green, Ms Carolyn McCall and Sir David Manning for their contributions to the committee during 2009 up until their departures from the Group.

We also thank all committee members for their commitment during the last year and attendance at the unprecedented number of meetings.

The committee appoints independent consultants to provide advice on specific matters according to their particular expertise. Towers Perrin, Hewitt New Bridge Street and Kepler Associates were retained by the committee during 2009 to advise on various matters relating to executive remuneration. In addition, PricewaterhouseCoopers LLP (PwC) were also retained in 2009 specifically to complete the committee's project to review executive remuneration arrangements in light of the acquisition of HBOS, given their particular expertise in the remuneration aspects of transactions. This project had commenced in 2008. As PwC are also the auditors to Lloyds Banking Group and to mitigate any threat to audit independence, Kepler Associates continue to be retained as the remuneration committee's primary independent advisors, and were commissioned to provide comment on PwC's advice.

In addition to their advice on executive remuneration, during 2009 Towers Perrin also provided market remuneration data as well as other remuneration consulting services to the Group, Hewitt New Bridge Street provided pension consulting services.

During 2009, Alithos Limited continued to provide information on behalf of the committee for the testing of total shareholder return (TSR) (calculated by reference to both dividends and growth in share price) performance conditions for the Group's long-term incentive schemes.

Mr Daniels, Mrs Risley (Group Human Resources Director) and Ms Kemp (HR Director, Total Reward) provided guidance to the committee (other than for their own remuneration). Mrs Carol Sergeant (Chief Risk Officer) also attended the committee to advise on risk matters.

The remuneration committee ensures that appropriate remuneration and governance arrangements are in place throughout the organisation, with the Group functions providing an oversight role in the development of remuneration policy and practice below the senior executive population. During 2009 as part of the review of compliance with the new FSA Code of Practice on Remuneration and the developing governance environment, the committee reviewed and adopted new terms of reference. In addition divisional remuneration committees were established to ensure a strong oversight from the group remuneration committee into the divisions.

The key developments in the committee's terms of reference are:

– Extension of its direct responsibilities to include all those colleagues who perform significant influence functions for the Group and those who could have a material impact on the Group's risk profile;
– Formalising the periodic review of the adequacy and effectiveness of the Group's remuneration policy;
– Formalising annual reporting to the board on the substance of the Group's remuneration policy and propose any substantive changes. This report will be supported by independent commentary from the chief risk officer in the context of the Group's risk appetite and by positive assurance from each group executive director that all remuneration arrangements within their division/function reflect fully the Group's overall approach to remuneration; and
– The chief risk officer will attend the remuneration committee for at least two meetings a year.

The role of the divisional remuneration committees is to ensure a strong oversight from the group remuneration committee into the divisions. Specifically:

– The relevant group executive director will be accountable for the effective implementation of the remuneration policy in their division;
– The divisional remuneration committee, which will have representation from both divisional and group reward and risk functions, will ensure that the policy is effectively and efficiently executed in the division;
– Formal positive assurance (through annual reporting) as to how the remuneration policy is being applied across the group will be provided to the group remuneration committee from each divisional remuneration committee; and
– The divisional remuneration committee will be responsible for ensuring the effective governance of divisional specific remuneration arrangements, especially the design and outcome of short-term incentive/bonus schemes.

We believe our approach is well aligned with the FSA Code of Practice on Remuneration but we will continue to work with the FSA to ensure ongoing compliance and implement changes as appropriate.

DIRECTORS' REMUNERATION POLICY

The Group's remuneration policy supports our business strategy, which is based on building long-term relationships with our customers and employees, and managing the financial consequences of our business decisions across the entire economic cycle. The policy is to position base salaries to reflect the relevant market median and the total package is designed to enable upper quartile performance to be rewarded with upper quartile remuneration levels. Overall the policy is designed to ensure that cost effective packages are provided which attract and retain executive directors and senior management of the highest calibre and motivate them to perform to the highest standards. At the same time, the objective is to align individual rewards with the Group's performance, the interests of its shareholders, and a prudent approach to risk management. In this way we balance the requirements of our various stakeholders: customers, shareholders, employees, and regulators. We believe that this approach is in line with the Association of British Insurers best practice code on remuneration as well as the FSA Code of Practice on Remuneration, as the policy seeks to reward long-term value creation whilst not encouraging excessive risk taking.

We summarise below how each of these policy objectives is met by our remuneration packages.

Policy objective	How achieved
Building long-term relationships	We build relationships with our customers and people rather than viewing them as counterparties in a money-making transaction and are in the process of extending this philosophy across the integrated Group. This means that working for the Lloyds Banking Group should be about more than pay. While our relationship with our people means that we will pay them fairly and competitively, our pay is positioned conservatively against the market and we will not seek to be among the highest payers in the sector. In setting pay for executive directors, we take account of the terms and conditions applying to other employees of the Group. Our incentive measures are not just financial. Half of the annual incentive for executives is linked to a scorecard including how they perform against targets that measure how satisfied our customers are, and the extent to which our employees feel engaged with and committed to working for the Lloyds Banking Group, both of which are important foundations of a relationship-based strategy.
Managing the financial consequences of our business through the economic cycle	Economic profit is a key measure by which we manage our business. This measure takes into account the level of capital required to generate profits as well as the risks taken. The same level of profit generated at lower risk results in higher economic profit. Economic profit also measures risk based on an assessment of how business will perform through the economic cycle. Therefore, for example, in good times, when default rates on loans are low, we adjust the economic profit measure downwards based on a higher average expected default experience over the economic cycle. This encourages us to avoid business and funding strategies that are only profitable during boom times but turn bad in a recession. Economic profit plays a prominent role in our incentive plans for executives, a role which was further enhanced in 2009, with its inclusion in the long-term incentive plan performance measures.

Policy objective	How achieved
Aligning individual rewards with Group performance and shareholders	The majority of our executives' pay is linked to stretching performance targets through annual and long-term incentives. Performance measures on the annual incentive are directly aligned to the Group's financial and non-financial performance. Executives are aligned with shareholders through the long-term incentive plan, which pays out based on performance against Group targets over a three year period, and which is paid in shares to further improve alignment with shareholders. This objective of aligning the interests of executives with those of shareholders throughout the economic cycle can be seen through the vesting outcomes of awards made to executives under the LTIP plans. In 2009, historic LTIP and option plans from 1999, 2005 and 2006 lapsed as their performance conditions were not met. The same outcome is envisaged for the 2007 LTIP with a performance period ending in 2010. Executives are required to build up a holding in Lloyds Banking Group shares of value equal to 1.5 times salary for executive directors (2 times salary for the group chief executive). They are expected to retain 100 per cent of the net-of-tax proceeds of the 2009 LTIP until they reach this target. In addition they are required to retain any shares vesting from the share price performance element of the 2010 LTIP for a further two years post vesting. Finally, we operate tough contract provisions whereby no executive has an entitlement to more than 12 months' notice, compensation on termination is limited to basic salary, and any compensation is paid monthly over 12 months and is mitigated if the executive gets another job. This approach avoids the risk of payment for failure. These requirements are among the toughest in the FTSE 100.
A prudent approach to risk management	Economic profit measures profit relative to the risk taken to generate that profit. Its use in our incentive plans therefore encourages executives to take a prudent approach to risk. We also have non-financial measures of performance against risk objectives in the plan for executives, which enables a more rounded assessment of risk-taking behaviour. For the 2009 annual incentive we increased the alignment to long-term prudent risk management by deferring all of the award. For executive directors any cash incentive earned will be deferred 100 per cent into shares and paid out in 2012. If the performance that led to the incentive is found to be unsustainable during the deferral period, then some or all of the award may be forfeited. We pay competitively but not excessively. Our prudent approach to positioning compensation means that we reduce the incentives to take excessive risk for personal gain. This means that we do not attract employees with an extreme appetite for risk. We have a robust governance framework with an independent remuneration committee reviewing all compensation decisions. This approach to governance and review is cascaded through the organisation.
Cost effective packages to attract and retain executives	We aim to ensure that the totality of remuneration for executive directors is competitive against our benchmark groups. These groups are other major UK banks, and also the top 20 companies in the FTSE 100, reflecting practices in comparably sized large UK companies across all sectors. We aim to be competitively but conservatively positioned against the market. We aim to choose incentive plan targets that are directly linked to the business strategy and priorities. This not only ensures alignment with company performance, but also means that the targets are meaningful to executives and therefore motivating. This ensures that incentive packages are valued by executives and are cost effective.

REMUNERATION FOR 2010

The remuneration committee undertook an extensive review of executive remuneration during late 2008 and into 2009 in light of the HBOS acquisition. That review in conjunction with detailed consultation with shareholders led to the remuneration decisions for 2009. The committee continued to review remuneration during 2009 in light of the FSA Code of Practice on Remuneration, the outcomes of the G20 meeting in September 2009 and Sir David Walker's review of corporate governance in UK banks and other financial industry entities. This ongoing review process has found that the structure of the remuneration package, in particular the focus on risk through the long-term incentive plan measures and balanced scorecard, was well aligned with emergent best practice in the sector.

The review process has highlighted the concern on how to maintain an appropriately competitive incentive for the senior executives of the Group, following the significant reduction in incentive levels in 2009, whilst recognising the sensitivity of the operating environment and the fact that the Group is still in a loss-making position. Following consultation with shareholders, the remuneration committee is proposing a package for 2010 that is closely based on the structure and principles of 2009, but with an additional LTIP performance measure based on the achievement of stretching share price targets. With the addition of this performance measure, the maximum LTIP award for 2010 will be 275 per cent of salary, still 100 per cent of salary lower than the 2008 maximum level. To achieve maximum vesting of this award, not only will stretching EPS and economic profit targets need to be achieved but also stretching share price targets.

SUMMARY OF REMUNERATION ELEMENTS

The key remuneration elements for 2010 are summarised below. Each individual element is then described in more detail in the subsequent sub-sections.

Element	Level/design for 2010	Key purpose
Base salary	Base pay should be set competitively relative to FTSE 20 and banking sector competitors	Meet essential commitments of executive Retention
	In light of circumstances, no increase for 2010 and base salaries held at same level as for 2008	
Annual incentive	200 per cent of salary maximum (225 per cent for group chief executive), as for 2009	Alignment with Group performance
	Based 50 per cent on Group financial targets relating to profit before tax and economic profit	Alignment with sound risk management
	Based 50 per cent on balanced scorecard covering, customers, people, risk and build franchise	Motivation of executives
	Subject to deferral and clawback	
Long-term incentive plan	275 per cent of salary maximum, split as follows:	Motivation and retention of executives
	100 per cent on earnings per share	
	100 per cent on economic profit	Alignment with sound risk management
	75 per cent on absolute share price growth	
	Any shares vesting from the absolute share price growth element retained for a further 2 years post vesting	Alignment with long-term shareholder interests
Pension	A mixture of final salary and defined contribution pension arrangements	Enable executives to build long-term retirement savings
	From April 2012, executive directors with final salary pensions will move to a defined contribution pension arrangement, with no compensation	Retention

GENERAL CONSIDERATIONS

When deciding the approach to take for remuneration in 2010, the remuneration committee considered a range of factors. The environment for remuneration in the banking sector remains very sensitive and the committee is aware of this. Consistent with best practice, shareholders were fully consulted during the process and their views have been taken into account in the decisions the committee has made. At the same time, the ongoing challenges of the HBOS integration to create the UK's leading consumer bank were also considered by the committee as is the need to retain and motivate the management team to build on the outstanding start made to this process in 2009.

BASE SALARY

Basic salaries are reviewed annually, usually in December, taking into account individual performance and market information (which is provided by Towers Perrin and supplemented with information from Kepler Associates as appropriate) and then adjusted from 1 January of the following year. The remuneration committee confirmed during the 2009 review that the FTSE 20 was the most appropriate comparator group to use to benchmark overall competitiveness of the remuneration package whilst taking particular account of the remuneration practice of our direct competitors, namely the major UK banks. The FTSE 20 is regarded as providing a realistic and relevant comparison in terms of company size and complexity, as well as being a key market for talent.

However, in recognition of the current operating environment base salaries for 2010 remain unchanged from the salaries set for 2008. Base salary increases for other employees across the Group will remain in line with any market movement, but will, in general be significantly lower than in previous years.

Name	J E Daniels	A G Kane	G T Tate	T J W Tookey	H A Weir
As at 1 January 2010	£1,035,000	£590,000	£640,000	£600,000	£625,000

ANNUAL INCENTIVE PLAN

The combination of financial and non-financial measures, which support our prudent approach to managing risk, are retained in the annual incentive plan, whilst the operation of the plan is enhanced in order to increase the alignment between risk and reward still further. The committee recognises the challenges of setting robust targets in the current operating environment. Furthermore, the committee will review the performance against the targets for the 2010 annual incentive plan at the end of the year, taking into account the overall operating performance of the business in determining how much of any bonus will be paid out. The committee reserves the right to exercise its discretion in reducing any payment that otherwise would have been earned, if they deemed this appropriate.

Consistent with the aim of ensuring that short-term financial results are only achievable sustainably, the committee has decided that the incentive will be deferred and released in tranches over a three year period. The deferred incentive will be subject to 100 per cent clawback if the performance that generated the incentive is found to be unsustainable.

The maximum annual incentive opportunity remains unchanged at 200 per cent (225 per cent for the group chief executive) of base salary for the achievement of exceptional performance targets.

The remuneration committee believes that the structure of the incentive – in particular the use of risk-adjusted and non-financial measures – has been highly successful in promoting a long-term focus within the senior management team.

LONG-TERM INCENTIVE AWARD

Given the extraordinary circumstances during 2008, the remuneration committee made a reduced maximum LTIP award of 200 per cent of salary in 2009, 175 per cent less than the maximum award for 2008. For 2010, the remuneration committee continues to believe that it is appropriate to make LTIP awards below the maximum levels that the plan allows (400 per cent) and less than the award levels for 2008 (maximum award 375 per cent). Notwithstanding the increased size and complexity of the Group since the HBOS acquisition and the concerns about retention and motivation, the committee believes that the current environment requires a demonstration of continued restraint in relation to remuneration. At the same time, the committee believes in the importance of aligning shareholder and executive motivation and therefore it has approved maximum awards for the group chief executive and executive directors for 2010 of 275 per cent of base salary of which 200 per cent of the award will be based on the same performance conditions as for 2009, namely EPS and economic profit, with the remaining 75 per cent based on the achievement of stretching share price targets.

LONG-TERM INCENTIVE PERFORMANCE MEASURES

In continuing with the same financial performance measures as for 2009, the remuneration committee has continued to create a focus on long-term performance, taking appropriate account of risk.

Performance targets have been set by reference to analysts' expectations, internal business plans, competitive performance assessments and probability modelling. Stretch performance will be equated to the remuneration committee's assessment of an upper quartile performance level or greater. Shareholders have been consulted on the targets and the targets have been made more stretching as a consequence of those discussions.

The details of the targets for the proposed measures are set out below:

Earnings per share (applying to award of 100 per cent of salary)

Earnings per share continues to be an important measure of our profitability and ability to generate cash. The committee has therefore decided to retain this well-recognised measure in our incentive system.

For the EPS element of the award, performance will be measured based on EPS growth over a three year period from the baseline EPS of 2009.

	Vesting (%)	EPS absolute percentage improvement
Threshold	25%	158%
Maximum	100%	180%

Economic profit (applying to award of 100 per cent of salary)

The use of economic profit has been very successful in introducing a long-term, risk-based approach to managing our business. Economic profit is calculated on a through-the-cycle basis, considering the impact of decisions over an entire economic cycle, encouraging prudent risk management of our portfolio.

For the economic profit element of the award, performance will be based on the compound annual growth rate (CAGR) from the 2009 base over a three year period.

	Vesting (%)	CAGR growth in EP
Threshold	25%	57% pa
Maximum	100%	77% pa

Absolute share price growth (applying to award of 75 per cent of salary)

The absolute share price element of the award will fully align shareholder and executives' interests during a period of share price recovery.

Performance will be measured based on the average absolute share price achieved during the 90 days at the end of the three year period.

	Vesting %	Absolute share price achieved
Threshold	0%	75p
Maximum	100%	114p

There will be an underpin to the absolute share price element of the award such that shares making up that element may only be released if both the EPS and the economic profit element have achieved a threshold level of vesting as above.

Any shares vesting as a result of this element of the 2010 award will be required to be held for a further two years post vesting.

Vesting between threshold and maximum will be on a straight line basis for all three elements.

PENSION

As stated last year, in April 2012, all executive directors will transition to defined contribution pension arrangements with contributions of 25 per cent of base salary for the group chief executive and other executive directors, with no compensation for ceasing final salary accrual.

OTHER SHARE PLANS

The executive directors are also eligible to participate in the Group's 'sharesave' and 'shareplan' schemes. These are 'all-employee' share schemes.

CHAIRMAN'S REMUNERATION

The chairman's remuneration comprises salary and benefits. He does not participate in the annual bonus and long-term incentive arrangements, nor is he entitled to pension benefits.

The chairman's salary was reviewed at the time of the appointment of Sir Winfried Bischoff in 2009. The review took into account the market information and also the significant amount of time the chairman would be expected to focus on the Group's activities particularly during the current period. The chairman was appointed on a salary of £700,000 per annum. His salary will next be reviewed at the end of 2010, with any adjustments effective 1 January 2011.

INDEPENDENT NON-EXECUTIVE DIRECTORS' FEES

The fees of the independent non-executive directors are agreed by the board within a total amount determined by the shareholders. Directors may also receive fees, agreed by the board, for membership of board committees. The fees are designed to recognise the various responsibilities of a non-executive director's role and to attract individuals with relevant skills, knowledge and experience. The fees are neither performance related nor pensionable and are comparable with those paid by other companies. The annual fees from 1 January 2010 are unchanged and are listed below.

Board	£65,000
Audit committee chairmanship	£50,000
Audit committee membership	£20,000
Nomination and governance committee membership	£5,000
Remuneration committee chairmanship	£30,000
Remuneration committee membership	£15,000
Risk oversight committee membership	£15,000

Independent non-executive directors who serve on the boards of subsidiary companies may also receive fees from the subsidiaries. The fees paid in 2009 to the current non-executive directors are shown in the table in the following section.

REMUNERATION FOR 2009

2009 ANNUAL INCENTIVE SCHEME

The annual incentive scheme for executive directors is designed to reflect specific goals linked to the performance of the business.

Incentive awards for executive directors are based upon individual contribution and overall corporate results. Half of the incentive opportunity is driven by corporate performance based on the stretching target relating to profit before tax and economic profit. The level of achievement against the targets for profit before tax and economic profit that results in the lower payout will determine the extent to which the target has been met. The other half of the incentive opportunity is determined by divisional achievement driven through individual performance. Individual targets relevant to improving overall business performance are contained in a balanced scorecard and are grouped under the following headings:

– Financial
– Franchise growth
– Customer service
– Risk
– People development

These targets are weighted differently for each of the executive directors, reflecting differing strategic priorities. The non-financial measures include key performance indicators relating to process efficiency, service quality and employee engagement.

The maximum annual incentive opportunity is 200 per cent (225 per cent for the group chief executive) of basic salary for the achievement of exceptional performance targets. The maximum payment under the corporate half of the annual incentive is only available if exceptional performance is achieved against the stretching corporate target. An amount equal to 50 per cent of this element of the incentive is available on the achievement of the stretching corporate target. Failure to achieve at least 90 per cent of the stretching target would result in no payment under the corporate half of the incentive.

In 2009, the Group delivered a resilient trading performance against the backdrop of a marked slow down in the UK economic environment and continued challenges in financial markets. This has been a year of substantial achievement with the creation of a sound platform for future growth of the combined franchise. Positive trends have been established in margins, costs and impairments. The interest margin improved in the second half of the year and is expected to increase in 2010, with further improvements expected in subsequent years. Costs fell by five per cent in the year as integration related savings have started to be realised, with £534 million of cost synergy savings in 2009. Impairments peaked in the first half of the year, falling off by 21 per cent in the second half. A similar rate of improvement is expected through 2010. The Group's funding and liquidity positions were also strengthened during the year.

A number of actions were taken during the year to create a robust capital position, including the £4 billion ordinary share placing and compensating open offer in June and the successful £22.5 billion equity raising at the end of the year.

Franchise growth has been strong in both Retail and Wholesale and there has been a 48 per cent improvement in cross sales income from the Lloyds TSB customers. There were strong levels of mortgage lending with over £34 billion of gross new lending. The Lloyds TSB conservative approach to risk management has been implemented across the Group. All new lending is within the Group's risk appetite. Our employee engagement index has remained high through the year and has performed well against the UK norm.

Additionally a number of significant activities were delivered on during 2009 which were not anticipated when the targets were set. These activities have contributed to placing the Group in the best position possible to grow and develop the combined franchise. They include the largest ever capital raising and the successful conclusion of negotiations with the European Commission on State Aid. These have all been achieved at the same time as delivering the 'business as usual' agenda and the integration programme.

Any payments under the plan are deferred 100 per cent in shares until June 2012 and subject to claw back.

The calculation of the annual incentive plan payments for executive directors, based on the achievement of performance against targets in respect of performance in 2009, has been independently checked. The bonuses awarded to directors are shown in the table below:

Name	A G Kane	G T Tate	T J W Tookey	H A Weir
Opportunity	200%	200%	200%	200%
Bonus awarded	£885,000	£1,120,000	£1,110,000	£1,062,000
% awarded	150	175	185	170

The group chief executive has chosen to waive any payment under the scheme for the second successive year.

2009 LONG-TERM INCENTIVE PLAN AWARDS

The current LTIP rules allow for awards to be made of up to 400 per cent of base salary. Under normal circumstances, awards are made of 300 per cent of salary with the additional 100 per cent available for circumstances that the remuneration committee deems to be exceptional. In 2008, awards were made of 375 per cent of base salary to the chief executive and two of the executive directors for retention purposes, and in light of data reviewed by the committee which showed total remuneration to be behind median both for the FTSE 20 and the other major UK banks.

Further information viewed by the committee through 2008 continued to show that total remuneration for the executive directors was materially behind the median of our peer groups, even before allowing for the increased responsibilities of running the combined bank and the magnitude of the task of integrating the two businesses. However, due to the external environment and following extensive consultation with shareholders, the committee determined that for 2009 the grant level for executive directors should be set at 200 per cent of base salary, 175 per cent less than the maximum award for 2008.

Details of the plan, including the specific performance conditions, can be found on page 124.

2009 NON-EXECUTIVE DIRECTORS' FEES (£)

	Lloyds Banking Group fees						
	Board	Audit committee	Remuneration committee	Nomination and governance committee	Risk oversight committee	SW Board Fees[1]	2009 Total
W C G Berndt	65,000		30,000	5,000			100,000
Ewan Brown (until 5 June 2009)	28,314	8,665			6,581		43,560
J P du Plessis (until 17 April 2009)	19,451	14,962		1,496	4,489		40,398
P N Green (until 23 October 2009)	52,936	16,288	12,216				81,440
Sir Julian Horn-Smith	65,000		15,000	5,000	15,000		100,000
Lord Leitch[2]	204,028	7,540		1,885	5,655	30,000	249,108
Sir David Manning (until 2 November 2009)	54,424		12,560	4,187	12,560		83,731
C J McCall (until 31 December 2009)	65,000		14,090				79,090
T T Ryan (from 1 March 2009)	54,167	16,667			12,500		83,334
M A Scicluna	65,000	41,136			15,000		121,136
Anthony Watson (from 2 April 2009)	48,504	13,095			9,821		71,420

[1] Scottish Widows Services Ltd.

[2] Lord Leitch was appointed deputy chairman on 17 May 2009 when his remuneration was consolidated into an annual fee of £300,000.

DILUTION LIMITS

The following charts illustrate the shares available for the Group's share schemes.

ALL SCHEMES (10% IN ANY CONSECUTIVE 10 YEARS)

EXECUTIVE SCHEMES (5% IN ANY CONSECUTIVE 10 YEARS)

PENSIONS

Executive directors are either entitled to participate in the Group's defined benefit pension schemes (based on salary and length of service, with a maximum pension of two thirds of final salary), or the Group's defined contribution scheme (under which their pension entitlement will be based upon both employer and employee contributions). The defined benefit schemes are closed to new entrants on recruitment.

Pension accruals under the defined benefits scheme for Messrs Daniels and Kane will continue until April 2012. Thereafter they will have the opportunity to either participate in a defined contribution scheme or to receive a cash supplement with no compensation for ceasing final salary accrual. There is no entitlement to an immediate and unreduced pension should their employment be terminated before the normal date of retirement.

SERVICE AGREEMENTS

The Group's policy is for executive directors to have service agreements with notice periods of no more than one year. All current executive directors are entitled to receive 12 months' notice from the Group, but would be required to give six months' notice if they wished to leave. Executive directors normally retire at age 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65.

It is the Group's policy that where compensation on early termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured, and that bonus payments should relate to the period of actual service, rather than the full notice period, and will be determined on the basis of performance.

Any entitlements under the pension scheme or equity plans will be in accordance with the scheme rules on leaving.

	Notice to be given by the Company	Date of service agreement/letter of appointment
Sir Winfried Bischoff	6 months	27 July 2009
J E Daniels	12 months	22 January 2009
A G Kane	12 months	23 January 2009
G T Tate	12 months	9 February 2009
T J W Tookey	12 months	26 January 2009
H A Weir	12 months	21 January 2009
Former director who served during 2009		
Sir Victor Blank	6 months	25 January 2006

Independent non-executive directors do not have service agreements and their appointment may be terminated, in accordance with the articles of association, at any time without compensation.

EXTERNAL APPOINTMENTS

The Group recognises that executive directors may be invited to become non-executive directors of other companies and that these appointments may broaden their knowledge and experience, to the benefit of the Group. Fees are normally retained by the individual directors as the post entails personal responsibility.

Executive directors are generally allowed to accept one non-executive directorship.

During 2009, Mr Daniels and Mrs Weir received fees of £75,000 and £30,208 respectively, which were retained by them, for serving as non-executive directors of other companies.

PERFORMANCE GRAPH

The graph below illustrates the performance of the Group measured by TSR against a 'broad equity market index' over the past five years. The Group has been a constituent of the FTSE 100 index throughout this five year period.

TOTAL SHAREHOLDER RETURN – FTSE 100 INDEX

DIRECTORS' EMOLUMENTS FOR 2009

	Salaries/ fees £000	Other benefits Cash £000[1]	Other benefits Non-cash £000[2]	Performance-related payments £000[3]	2009 Total £000	2008 Total £000
Current directors who served during 2009						
Executive directors						
J E Daniels	1,035	78	8		1,121	1,151
A G Kane	590	24	24	885	1,523	635
G T Tate	640	27	20	1,120	1,807	689
T J W Tookey	600	25	1	1,110	1,736	108
H A Weir	625	59	21	1,062	1,767	742
Non-executive directors						
Sir Winfried Bischoff (from 15 September 2009)	207	4			211	
W C G Berndt	100				100	100
Sir Julian Horn-Smith	100				100	100
Lord Leitch	249				249	165
T T Ryan (from 1 March 2009)	83				83	
M A Scicluna	121				121	33
Anthony Watson (from 2 April 2009)	71				71	
Former directors who served during 2009						
Sir Victor Blank[4] (until 14 September 2009)	640	5	38		683	669
Ewan Brown (until 5 June 2009)	44				44	122
J P du Plessis (until 17 April 2009)	40				40	119
P N Green (until 23 October 2009)	81				81	100
Sir David Manning (until 2 November 2009)	84				84	67
C J McCall (until 31 December 2009)	79				79	16
Others						807
	5,389	222	112	4,177	9,900	5,623

[1] The cash column under 'other benefits' includes flexible benefits payments (4 per cent of basic salary), the tax planning allowance for Mr Daniels, payments to certain directors who elect to take cash rather than a company car under the car scheme and the cash balance of a pension allowance for Mrs Weir. Sir Winfried Bischoff has elected to take cash rather than a company car.

[2] The non cash column includes amounts relating to the use of a company car, use of a company driver and private medical insurance and the cost of home security in respect of Sir Victor Blank. It also includes the value of any matching shares which are received under the terms of Shareplan, through which employees have the opportunity to purchase shares up to a maximum of £125 per month and receive matching shares on a one for one basis up to a maximum value of £30 per month, rounded down to the nearest whole share.

[3] The group chief executive waived his entitlement to any bonus in respect of 2009 performance. There were no free shares awarded under Shareplan in respect of 2009.

[4] Sir Victor Blank donated his salary from 30 September 2009 until 31 December 2009, amounting to £160,000 to charity. The Group was obligated to pay Sir Victor Blank's remuneration in lieu of services rendered during 2010 of £53,333. This was also donated to charity.

DIRECTORS' PENSIONS

The executive directors are currently members of one of the pension schemes provided by the Lloyds TSB Group with benefits either on a defined benefit or defined contribution basis. Those directors who joined the Lloyds TSB Group after 1 June 1989 and are members of a defined benefit scheme have pensions provided on salary in excess of the earnings cap through membership of or by an unfunded pension promise. Retirement pensions accrue at rates of between 1/60 and 1/30 of basic salary.

For those directors who are members of a defined benefit pension scheme, pension will continue to accrue until 5 April 2012. On 6 April 2012, defined benefit pension accrual will cease and directors will be offered the option to participate in the defined contribution pension scheme in operation at that date. Alternatively, they may choose not to join the scheme and elect to receive a pension cash allowance.

Directors have a normal retirement age of 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65. In the event of death in service, a lump sum of four times salary is payable plus, for members of a defined benefit scheme, a spouse's pension of two-thirds of the member's prospective pension. On death in retirement, a spouse's pension of two-thirds of the member's pension is payable. The defined benefit schemes are non-contributory. Members of defined contribution schemes are required to contribute.

DEFINED CONTRIBUTION SCHEME MEMBERS

During the year to 31 December 2009 the employer has made the following contributions to the defined contribution scheme:

	£000
G T Tate	**159**
T J W Tookey	**147**
H A Weir	**122**

DEFINED BENEFIT SCHEME MEMBERS

	Accrued pension at 31 December 2009 £000 (a)	Accrued pension at 31 December 2008 £000 (b)	**Change in accrued pension £000 (a)-(b)**	**Transfer value at 31 December 2009 £000 (c)**	Transfer value at 31 December 2008 £000 (d)	**Change in transfer value £000 (c)-(d)**	**Additional pension earned to 31 December 2009 £000 (e)**	**Transfer value of the increase £000 (f)**
J E Daniels	**192**	175	**17**	**3,844**	3,263	**581**	**8**	**169**
A G Kane	**357**	342	**15**	**6,889**	6,146	**743**	**–**	**–**

The disclosures in columns (a) to (d) are as required under section 421 of the Companies Act 2006.

Columns (a) and (b) represent the deferred pension to which the directors would have been entitled had they left the Group on 31 December 2009 and 2008, respectively.

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2009 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme. The basic method used to arrive at the factors has not changed during the year.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2008 on the assumption that the director left service at that date.

Column (e) is the increase in pension built up during the year, recognising (i) the accrual rate for the additional service based on the pensionable salary in force at the year end, and (ii) where appropriate the effect of pay changes in 'real' (inflation adjusted) terms on the pension already earned at the start of the year.

Column (f) is the capital value of the pension in column (e).

The disclosures in columns (e) and (f) are as required by the UK Listing Authority listing rules. The requirements of the listing rules differ from those of the Companies Act. The listing rules require the additional pension earned over the year to be calculated as the difference between the pension accrued at the end of the financial year and the pension accrued at the start of the financial year less the increase in the pension earned over the year solely due to inflation. The transfer value in column (f) can differ significantly from the change in transfer value as required by the Companies Act because the additional pension accrued over the year calculated in accordance with the listing rules makes allowance for inflation, and the change in the transfer value required by the Companies Act will be significantly influenced by changes in the assumptions underlying the transfer value calculation at the beginning and end of the financial year.

Members of the Lloyds TSB Group's pension schemes have the option to pay additional voluntary contributions: neither the contributions nor the resulting benefits are included in the above table.

Major changes to the legislation governing the provision of pensions in the UK (known as pension simplification) came into effect in April 2006. Benefits from an approved pension scheme will be limited to the Lifetime Allowance, currently £1.75 million which is equivalent to an annual pension of £87,500. Any benefit in excess of this amount will incur a tax charge for the individual. The Group has agreed that if an executive director has benefits in excess of the Lifetime Allowance they may cease to accrue benefits in the Scheme and receive a salary supplement as an alternative. This will not cost the Group more than the current arrangements. The Group will not compensate any individual in respect of any increased tax liability arising from pension simplification. To date, the executive directors affected have elected to continue to accrue benefits in the approved scheme.

DIRECTORS' INTERESTS

The interests, all beneficial, of those who were directors at 31 December 2009 in shares in Lloyds Banking Group were:

NUMBER OF SHARES

	At 1 January 2009 (or later date of appointment)	**At 31 December 2009**	At 25 February[1] 2010
Executive directors			
J E Daniels	423,018	**2,557,816**	2,558,383
A G Kane	204,061	**1,224,960**	1,225,527
G T Tate	75,072	**526,061**	526,629
T J W Tookey	2,493	**97,727**	98,294
H A Weir	61,822	**425,162**	425,729
Non-executive directors			
Sir Winfried Bischoff	–	**585,000**	
W C G Berndt	170,000	**948,429**	
Sir Julian Horn-Smith	5,000	**27,890**	
Lord Leitch	10,000	**55,787**	
T T Ryan	–	**63,451**	
M A Scicluna	10,000	**56,226**	
Anthony Watson	13,209	**51,357**	

[1] The changes in beneficial interests between 31 December 2009 and 25 February 2010 related to 'partnership' and 'matching' shares acquired under the Lloyds TSB Group Shareplan.

INTERESTS IN SHARE OPTIONS

	At 1 January 2009	Granted during the year	Exercised during the year	Lapsed during the year	At 31 December 2009	Exercise price	Exercise periods From	Exercise periods To	Notes
J E Daniels	131,484	–	–	–	**131,484**	419.25p	18/3/2007	17/3/2014	d, f
	430,547	–	–	–	**430,547**	474.25p	17/3/2008	16/3/2015	e, f
	6,906	–	–	–	**6,906**	139p	1/1/2012	30/6/2012	a, h
A G Kane	27,000	–	–	**27,000**	–	887.5p	4/3/2002	3/3/2009	b, g, i
	64,786	–	–	–	**64,786**	549.5p	6/3/2003	5/3/2010	c, g
	11,841	–	–	–	**11,841**	615.5p	8/8/2003	7/8/2010	c, g
	34,759	–	–	–	**34,759**	655p	6/3/2004	5/3/2011	c, g
	73,255	–	–	–	**73,255**	419.25p	18/3/2007	17/3/2014	d, f
	247,891	–	–	–	**247,891**	474.25p	17/3/2008	16/3/2015	e, f
	6,906	–	–	–	**6,906**	139p	1/1/2012	30/6/2012	a, h
G T Tate	64,400	–	–	–	**64,400**	419.25p	18/3/2007	17/3/2014	d, f
	27,357	–	–	–	**27,357**	403p	12/8/2007	11/8/2014	d, f
	247,891	–	–	–	**247,891**	474.25p	17/3/2008	16/3/2015	e, f
	6,906	–	–	–	**6,906**	139p	1/1/2012	30/6/2012	a, h
T J W Tookey	6,906	–	–	–	**6,906**	139p	1/1/2012	30/6/2012	a, h
H A Weir	77,868	–	–	–	**77,868**	424.75p	29/4/2007	28/4/2014	d, f
	247,891	–	–	–	**247,891**	474.25p	17/3/2008	16/3/2015	e, f
	6,906	–	–	–	**6,906**	139p	1/1/2012	30/6/2012	a, h
Other share plan									
T J W Tookey	35,305	–	**35,305**	–	–	(see page 125)	20/4/2009	19/10/2009	j
Former director who served during 2009									
Sir Victor Blank	6,906	–	–	–	**6,906**	139p	1/2/2010	31/7/2010	a, k

a Sharesave.
b Executive option granted between March 1999 and August 1999.
c Executive option granted between March 2000 and March 2001.
d Executive option granted between March 2004 and August 2004.
e Executive option granted from March 2005.
f Exercisable to the extent at which the performance condition vested.
g Not exercisable as the performance conditions had not been met.
h Not exercisable as the option has not been held for the period required by the relevant scheme.
i Option lapsed as not exercised by 10th anniversary of date of grant.
j Mr Tookey exercised his option on 8 May 2009. Market price on day of exercise was 100.70p.
k Exercisable only in the period shown.

Sir Victor Blank retired as chairman on 14 September 2009 but remained employed by the Group until 31 January 2010.

None of the other directors at 31 December 2009 had options to acquire shares in Lloyds Banking Group plc or its subsidiaries.

The market price for a share in the Company at 1 January 2009 and 31 December 2009 was 126p and 50.69p, respectively. The range of prices between 1 January 2009 and 31 December 2009 was 40.30p to 140.70p.

The following table contains information on the performance conditions for executive options granted since 1999. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

Options granted	Performance conditions
March 1999 – August 1999	Growth in earnings per share which is equal to the aggregate percentage change in the retail price index plus two percentage points for each complete year of the relevant period plus a further condition that the Company's ranking based on TSR over the relevant period should be in the top 50 companies of the FTSE 100. As the performance condition had not been met, the options lapsed in 2009.
March 2000 – March 2001	As for March 1999 – August 1999 except that there must have been growth in the earnings per share equal to the change in the retail price index plus three percentage points for each complete year of the relevant period.
March 2004 – August 2004	That the Company's ranking based on TSR over the relevant period against a comparator group (17 UK and international financial services companies including Lloyds Banking Group) must be at least ninth, when 14 per cent of the option will be exercisable. If the Company is ranked first in the group, then 100 per cent of the option will be exercisable and if ranked tenth or below the performance condition is not met. Options granted in 2004 became exercisable as the performance condition was met on the re-test. The performance condition vested at 24 per cent for Mr Tate's March option and at 14 per cent for all other options granted to executive directors during 2004.
March 2005 – August 2005	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds Banking Group) must be at least eighth, when 30 per cent of the option will be exercisable. If the Company is ranked first to fourth position in the group, then 100 per cent of the option will be exercisable and if ranked ninth or below, the performance condition is not met. Options granted in 2005 became exercisable as the performance condition was met when tested. The performance condition vested at 82.5 per cent for all options granted to executive directors.

LLOYDS TSB PERFORMANCE SHARE PLAN

Under the plan, executive directors were required to defer 50 per cent of their bonus awards in 2006 into shares in the Company, known as bonus shares. The number of bonus shares awarded was calculated after the deduction of income tax and national insurance from the deferred element of the bonus.

The bonus shares are held on behalf of the executive for a period of three years before release.

Executives received a further award of 'performance shares' on the basis of two performance shares for each bonus share. The receipt of the performance shares is dependent on the satisfaction of a TSR performance condition measured over three financial years of the Company.

The following table details the number of bonus and performance shares released in respect of their 2005 bonus.

	Bonus shares			Performance shares			
	At 1 January 2009	Released 20 March 2009	**At 31 December 2009**	At 1 January 2009	Lapsed 20 March 2009	**At 31 December 2009**	Award price
J E Daniels	50,944	50,944	**–**	172,694	172,694	**–**	566.10p
A G Kane	20,531	20,531	**–**	69,598	69,598	**–**	566.10p
G T Tate	27,358	27,358	**–**	92,738	92,738	**–**	566.10p
H A Weir	20,062	20,062	**–**	68,008	68,008	**–**	566.10p

The following table contains information on the performance conditions for performance shares. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

Performance shares awarded	Performance conditions
March 2006	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds Banking Group) must be at least eighth for any shares to be received. If ranked ninth or below no shares would be received. The maximum of two performance shares for each bonus share will be awarded only if the Company is first in the comparator group; one performance share will be awarded for each bonus share if the Company is placed fifth; and one performance share for every two bonus shares if the Company is placed eighth. Between first and fifth positions and fifth and eighth positions a sliding scale will apply. Whilst income tax and national insurance was deducted from the deferred bonus before the conversion to bonus shares, where a match of performance shares is justified, these shares will be awarded as if income tax and national insurance had not been deducted. This maintains the original design of the plan prior to the issue of guidance from HM Revenue & Customs in December 2004. The performance condition attached to the March 2006 award was not met, with Lloyds Banking Group ranked in ninth place. Bonus shares were released on 20 March 2009, at which time the performance shares lapsed.

LLOYDS TSB LONG-TERM INCENTIVE PLAN

The following are conditional share awards available under the plan. Further information regarding this plan can be found on pages 124 and 125.

	At 1 January 2009	Awarded during the year	Adjusted number of shares	Lapsed during the year	At 31 December 2009	Year of vesting	Notes
J E Daniels	507,692			507,692		2009	
	534,322		165,403		699,725	2010	a
	838,735		259,637		1,098,372	2011	a
		1,143,014	353,829		1,496,843	2012	a, b
		1,714,522	530,743		2,245,265	2012	a, b
A G Kane	288,460			288,460		2009	
	306,122		94,762		400,884	2010	a
	413,309		127,943		541,252	2011	a
		651,573	201,700		853,273	2012	a, b
		977,360	302,549		1,279,909	2012	a, b
G T Tate	297,114			297,114		2009	
	333,951		103,377		437,328	2010	a
	518,638		160,548		679,186	2011	a
		706,791	218,792		925,583	2012	a, b
		1,060,187	328,189		1,388,376	2012	a, b
T J W Tookey	54,258			54,258		2009	
	52,875		16,367		69,242	2010	a
	71,220		22,046		93,266	2011	a
		662,617	205,118		867,735	2012	a, b
		993,926	307,677		1,301,603	2012	a, b
H A Weir	288,460			288,460		2009	
	320,037		99,069		419,106	2010	a
	506,482		156,785		663,267	2011	a
		690,226	213,665		903,891	2012	a, b
		1,035,339	320,497		1,355,836	2012	a, b

a Conditional awards of shares made under this plan were adjusted on 2 July 2009 as a result of the Placing and Compensatory Open Offer. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of the capital raising event.

b Original award price 72.44p, award price post adjustment 55.31p.

The following table contains information on the performance conditions for awards made under the long-term incentive plan. The remuneration committee chose the relevant performance conditions because they were felt to be challenging, aligned to shareholders' interests and appropriate at the time.

LTIP award	Performance conditions
May 2006	For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the retail price index over the same period. If it is less than 3 per cent per annum, the EPS Award will lapse. If the increase is more than 3 per cent but less than 6 per cent per annum, then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2006 and ended on 31 December 2008. For the other 50 per cent of the award (the 'TSR Award') – it will be necessary for the Group's TSR to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award will vest where the Group's TSR is equal to median and vesting will occur on a straight line basis in between these points. Where the Group's TSR is below the median of the comparator group, the TSR Award will lapse. The relevant period commenced on 1 January 2006 and ended on 31 December 2008. When tested at the end of the relevant performance period, neither the EPS nor the TSR performance conditions were met and all awards made in 2006 lapsed.
March 2007	For 50 per cent of the award (the 'EPS Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 1 January 2007 and ending on 31 December 2009. For the other 50 per cent of the award (the 'TSR Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 8 March 2007 (the date of award) and ending on 7 March 2010.
March and April 2008	For 50 per cent of the award (the 'EPS Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010. For the other 50 per cent of the award (the 'TSR Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 6 March 2008 (the date of the March award) and ending on 5 March 2011.
April 2009	EPS: The release of 50 per cent of the shares will be dependent on the extent to which the growth in EPS achieves cumulative EPS targets over the three year period. Economic profit: The release of the remaining 50 per cent of shares will be dependent on the extent to which Lloyds Banking Group achieves cumulative Economic Profit targets over a three year period. The EPS and economic profit performance measures applying to this 2009 LTIP award were set on the basis that the Group would enter into GAPS. Now that the Group is not participating in GAPS, the remuneration committee has determined that these performance measures will be restated on a basis consistent with the EPS and economic profit measures used for the 2010 LTIP awards. This restatement will be undertaken in 2010. The current targets prior to restatement are:

EPS

	Vesting	Growth in EPS
Threshold	25%	55%
Maximum	100%	81%

Economic profit

	Vesting	Absolute Improvement in EP
Threshold	25%	100%
Maximum	100%	185%

April 2009 Integration award	Synergy Savings: The release of 50 per cent of the shares will be dependent on the achievement of target run-rate synergy savings in 2009 and 2010 as well as the achievement of sustainable synergy savings of at least £1.5 billion by the end of 2011. The award will be broken down into three equally weighted annual tranches. Performance will be assessed at the end of each year against annual performance targets based on a trajectory to meet the 2011 target. The extent to which targets have been achieved will determine the proportion of shares to be banked each year. Any release of shares will be subject to the remuneration committee judging the overall success of the delivery of the integration programme. Integration Balanced Scorecard: The release of the remaining 50 per cent of the shares will be dependent on the outcome of a Balanced Scorecard of non-financial measures of the success of the integration in each of 2009, 2010 and 2011. The Balanced Scorecard element will be broken down into three equally weighted tranches. The tranches will be crystallised and banked for each year of the performance cycle subject to separate annual performance targets across the four measurement categories of Building the Business, Customer, Risk and People and Organisation Development. Performance against the first year of the award has been assessed and all targets have been met or exceeded.

Alithos Limited provided information for the testing of the TSR performance conditions for the Company's long-term incentive schemes. EPS is the Group's normalised earnings per share as shown in the Group's report and accounts, subject to such adjustments as the remuneration committee regards as necessary for consistency.

OTHER SHARE PLAN

LLOYDS TSB GROUP EXECUTIVE SHARE PLAN 2003

Mr Tookey was granted an option under this plan to acquire 35,305 ordinary shares in Lloyds Banking Group plc. The option was not subject to any performance condition but would normally have become exercisable only if he remained an employee, and had not given notice of resignation, as at 19 April 2009. As Mr Tookey remained an employee, the option vested on 19 April 2009, and was exercised on 8 May 2009.

In addition, on 26 March 2008 (prior to his appointment as an executive director), Mr Tookey was granted an award under the Lloyds TSB Executive Retention Plan 2006. The award is satisfied in cash only and, subject to continued employment, gives Mr Tookey the right to receive an amount equal to the value of 141,880 Lloyds Banking Group shares on the date of vesting. The award was adjusted on 2 July 2009 as a result of the placing and compensatory open offer. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of the capital raising event. The award vests as to 50 per cent on 26 March 2011 and 50 per cent on 26 March 2013. Mr Tookey has agreed to reinvest the cash proceeds into Lloyds Banking Group shares. As an executive director, he is no longer eligible to be granted awards under this plan.

None of those who were directors at the end of the year had any other interest in the capital of Lloyds Banking Group plc or its subsidiaries.

The register of directors' interests, which is open to inspection, contains full particulars of directors' shareholdings and options to acquire shares in Lloyds Banking Group.

On behalf of the board

Harry F Baines
Company Secretary
25 February 2010

REPORT OF THE INDEPENDENT AUDITORS ON THE CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

We have audited the group financial statements of Lloyds Banking Group plc for the year ended 31 December 2009 which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity, consolidated cash flow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Directors' Responsibilities Statement on page 99, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group'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.

OPINION ON FINANCIAL STATEMENTS

In our opinion the group financial statements:

– give a true and fair view of the state of the group's affairs as at 31 December 2009 and of its profit and cash flows for the year then ended;
– have been properly prepared in accordance with IFRSs as adopted by the European Union; and
– have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

– the information given in the Directors' Report for the financial year for which the group financial statements are prepared is consistent with the group financial statements; and
– the information given in the Corporate Governance Statement set out on pages 100 to 104 with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following:

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; or
– we have not received all the information and explanations we require for our audit; or
– a corporate governance statement has not been prepared by the parent company.

Under the Listing Rules we are required to review:

– the directors' statement, on page 104, in relation to going concern; and
– the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

OTHER MATTER

We have reported separately on the parent company financial statements of Lloyds Banking Group plc for the year ended 31 December 2009 and on the information in the Directors' Remuneration Report that is described as having been audited.

Ian Rankin
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
25 February 2010

(a) The maintenance and integrity of the Lloyds Banking Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2009

	Note	2009 £ million	2008[1] £ million
Interest and similar income		**28,238**	17,569
Interest and similar expense		**(19,212)**	(9,851)
Net interest income	5	**9,026**	7,718
Fee and commission income		**4,254**	3,231
Fee and commission expense		**(1,517)**	(694)
Net fee and commission income	6	**2,737**	2,537
Net trading income	7	**19,098**	(9,186)
Insurance premium income	8	**8,946**	5,412
Other operating income	9	**5,490**	528
Other income		**36,271**	(709)
Total income		**45,297**	7,009
Insurance claims	10	**(22,019)**	2,859
Total income, net of insurance claims		**23,278**	9,868
Operating expenses	11	**(15,984)**	(6,100)
Trading surplus		**7,294**	3,768
Impairment	12	**(16,673)**	(3,012)
Share of results of joint ventures and associates	13	**(752)**	4
Gain on acquisition	14	**11,173**	–
Profit before tax		**1,042**	760
Taxation	15	**1,911**	38
Profit for the year		**2,953**	798
Profit attributable to minority interests		**126**	26
Profit attributable to equity shareholders		**2,827**	772
Profit for the year		**2,953**	798
Basic earnings per share	16	**7.5p**	6.7p
Diluted earnings per share	16	**7.5p**	6.6p

The accompanying notes are an integral part of the consolidated financial statements.

[1]Restated for IFRS 2 (Revised)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2009

	2009 £ million	2008[1] £ million
Profit for the year	**2,953**	798
Other comprehensive income		
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax:		
Change in fair value	**1,936**	(2,031)
Transferred to income statement in respect of disposals	**(74)**	(19)
Transferred from income statement in respect of impairment	**453**	102
Other transfers to income statement	**(67)**	(66)
	2,248	(2,014)
Movement in cash flow hedging reserve, net of tax:		
Effective portion of changes in fair value taken to other comprehensive income	**(382)**	(24)
Net gains transferred to the income statement	**92**	12
	(290)	(12)
Currency translation differences, net of tax	**(219)**	(362)
Other comprehensive income for the year, net of tax	**1,739**	(2,388)
Total comprehensive income for the year	**4,692**	(1,590)
Total comprehensive income attributable to minority interests	**107**	54
Total comprehensive income attributable to equity shareholders	**4,585**	(1,644)
Total comprehensive income for the year	**4,692**	(1,590)

[1]Restated for IFRS 2 (Revised)

CONSOLIDATED BALANCE SHEET

at 31 December 2009

	Note	2009 £ million	2008 £ million
Assets			
Cash and balances at central banks		**38,994**	5,008
Items in the course of collection from banks		**1,579**	946
Trading and other financial assets at fair value through profit or loss	17	**150,011**	45,064
Derivative financial instruments	18	**49,928**	28,884
Loans and receivables:			
Loans and advances to banks	19	**35,361**	38,733
Loans and advances to customers	20	**626,969**	240,344
Debt securities	23	**32,652**	4,416
		694,982	283,493
Available-for-sale financial assets	25	**46,602**	55,707
Investment properties	26	**4,757**	2,631
Investments in joint ventures and associates	13	**479**	55
Goodwill	27	**2,016**	2,256
Value of in-force business	28	**6,685**	1,893
Other intangible assets	29	**4,087**	197
Tangible fixed assets	30	**9,224**	2,965
Current tax recoverable		**680**	300
Deferred tax assets	42	**5,006**	833
Other assets	31	**12,225**	5,801
Total assets		**1,027,255**	436,033

The accompanying notes are an integral part of the consolidated financial statements.

The directors approved the consolidated financial statements on 25 February 2010.

Sir Winfried Bischoff
Chairman

J Eric Daniels
Group Chief Executive

Tim J W Tookey
Group Finance Director

CONSOLIDATED BALANCE SHEET
at 31 December 2009

Equity and liabilities	Note	2009 £ million	2008 £ million
Liabilities			
Deposits from banks	32	82,452	66,514
Customer deposits	33	406,741	170,938
Items in course of transmission to banks		1,037	508
Trading and other financial liabilities at fair value through profit or loss	34	28,271	6,754
Derivative financial instruments	18	40,485	26,892
Notes in circulation		981	–
Debt securities in issue	35	233,502	75,710
Liabilities arising from insurance contracts and participating investment contracts	36	76,179	33,792
Liabilities arising from non-participating investment contracts	38	46,348	14,243
Unallocated surplus within insurance businesses	39	1,082	270
Other liabilities	40	29,320	11,456
Retirement benefit obligations	41	780	1,771
Current tax liabilities		51	–
Deferred tax liabilities	42	209	–
Other provisions	43	983	230
Subordinated liabilities	44	34,727	17,256
Total liabilities		983,148	426,334
Equity			
Share capital	45	10,472	1,513
Share premium account	46	14,472	2,096
Other reserves	47	7,086	(2,476)
Retained profits	48	11,248	8,260
Shareholders' equity		43,278	9,393
Minority interests		829	306
Total equity		44,107	9,699
Total equity and liabilities		1,027,255	436,033

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders				
	Share capital and premium £ million	Other reserves £ million	Retained profits[1] £ million	Minority interests £ million	Total[1] £ million
Balance at 1 January 2008	2,730	(60)	9,471	284	12,425
Total comprehensive income	–	(2,416)	772	54	(1,590)
Dividends	–	–	(2,042)	(29)	(2,071)
Private placement of ordinary shares	760	–	–	–	760
Purchase/sale of treasury shares	–	–	16	–	16
Employee share option schemes:					
Value of employee services	–	–	43	–	43
Proceeds from shares issued	119	–	–	–	119
Repayment of capital to minority shareholders	–	–	–	(3)	(3)
Balance at 31 December 2008	3,609	(2,476)	8,260	306	9,699
Total comprehensive income	**–**	**1,758**	**2,827**	**107**	**4,692**
Dividends	**–**	**–**	**–**	**(116)**	**(116)**
Issue of ordinary shares:					
Placing and open offer	**649**	**3,781**	**–**	**–**	**4,430**
Issued on acquisition of HBOS	**1,944**	**5,707**	**–**	**–**	**7,651**
Placing and compensatory open offer	**3,905**	**–**	**–**	**–**	**3,905**
Rights issue	**13,112**	**–**	**–**	**–**	**13,112**
Issued to Lloyds TSB Foundations	**41**	**–**	**–**	**–**	**41**
Transfer to merger reserve	**(1,000)**	**1,000**	**–**	**–**	**–**
Redemption of preference shares	**2,684**	**(2,684)**	**–**	**–**	**–**
Purchase/sale of treasury shares	**–**	**–**	**45**	**–**	**45**
Employee share option schemes:					
Value of employee services	**–**	**–**	**116**	**–**	**116**
Adjustment on acquisition	**–**	**–**	**–**	**5,567**	**5,567**
Extinguishment of minority interests	**–**	**–**	**–**	**(5,035)**	**(5,035)**
Balance at 31 December 2009	**24,944**	**7,086**	**11,248**	**829**	**44,107**

[1]Restated for IFRS 2 (Revised)

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2009

	Note	2009 £ million	2008[1] £ million
Profit before tax		**1,042**	760
Adjustments for:			
Change in operating assets	55(A)	**61,942**	(43,025)
Change in operating liabilities	55(B)	**(105,927)**	80,933
Non-cash and other items	55(C)	**8,907**	(4,017)
Tax received (paid)		**301**	(810)
Net cash (used in) provided by operating activities		**(33,735)**	33,841
Cash flows from investing activities			
Purchase of available-for-sale financial assets		**(455,816)**	(144,680)
Proceeds from sale and maturity of available-for-sale financial assets		**490,561**	110,470
Purchase of fixed assets		**(2,689)**	(1,436)
Proceeds from sale of fixed assets		**2,129**	579
Acquisition of businesses, net of cash acquired	55(F)	**16,227**	(19)
Disposal of businesses, net of cash disposed	55(G)	**411**	–
Net cash provided by (used in) investing activities		**50,823**	(35,086)
Cash flows from financing activities			
Dividends paid to equity shareholders		**–**	(2,042)
Dividends paid to minority interests	55(E)	**(116)**	(29)
Interest paid on subordinated liabilities		**(2,622)**	(771)
Proceeds from issue of subordinated liabilities	55(E)	**4,187**	3,021
Proceeds from issue of ordinary shares	55(E)	**21,533**	879
Repayment of subordinated liabilities	55(E)	**(6,897)**	(381)
Repayment of capital to minority shareholders	55(E)	**(33)**	(3)
Net cash provided by financing activities		**16,052**	674
Effects of exchange rate changes on cash and cash equivalents		**(210)**	1,440
Change in cash and cash equivalents		**32,930**	869
Cash and cash equivalents at beginning of year		**32,760**	31,891
Cash and cash equivalents at end of year	55(D)	**65,690**	32,760

The accompanying notes are an integral part of the consolidated financial statements.

[1]Restated for IFRS 2 (Revised)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 BASIS OF PREPARATION

The consolidated financial statements of Lloyds Banking Group plc (prior to 16 January 2009 known as Lloyds TSB Group plc) have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU). IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and its predecessor body. The EU endorsed version of IAS 39 *Financial Instruments: Recognition and Measurement* relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts. As stated on page 104, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

To provide a more relevant presentation of the Group's financial instruments, additional line items have been added to the consolidated balance sheet to show debt securities classified as loans and receivables separately. Comparatives have been reclassified to conform to the revised presentation.

The following IFRS pronouncements relevant to the Group have been adopted in these consolidated financial statements:

(i) IAS 1 *Presentation of Financial Statements*. The revised standard prohibits the presentation of items of income and expense (that is 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All non-owner changes in equity are required to be shown in a performance statement. Entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). The Group has elected to present two statements: an income statement and a statement of comprehensive income. The financial statements have been prepared under the revised disclosure requirements; the application of this revised standard, which affects presentation only, has not had any impact on amounts recognised in these financial statements.

(ii) Amendment to IFRS 2 *Share-based Payment – 'Vesting Conditions and Cancellations'*. This amendment to IFRS 2 restricts the definition of 'vesting condition' to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as a cancellation. The main impact of this amendment for the Group arises from cancellations by employees of contributions to the Group's Save-As-You-Earn (SAYE) schemes; in the event of a cancellation the Group must recognise immediately the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Under the former IFRS 2, such cancellations would have resulted in the reversal of the costs recognised in current and prior periods in respect of the SAYE schemes concerned for the relevant employees. The amendment is applied retrospectively and has resulted in a restatement of the 2008 comparatives. The effect has been to increase operating expenses and reduce profit before tax by £43 million in 2009 (2008: £47 million) but has had no effect on the Group's balance sheet or shareholders' equity as the increased expense is offset by movements in retained profits.

(iii) Amendments to IFRS 7 *Financial Instruments: Disclosures – 'Improving Disclosures about Financial Instruments*'. The amendments require enhanced disclosures about fair value measurement and liquidity risk. In particular, the amendment requires disclosure of a three level fair value measurement hierarchy for financial instruments carried on the Group's balance sheet at fair value. As the amendments only result in additional disclosures, the amendments have not had any impact on amounts recognised in these financial statements.

(iv) IFRS 8 *Operating Segments*. This new standard replaces IAS 14 *Segment Reporting* and requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally. The segment information for the year ended 31 December 2009 and for the corresponding comparative period is presented in note 4. The application of this new standard, which affects disclosures only, has not had any impact for amounts recognised in these financial statements.

The application of the following IFRS pronouncements which all became effective in 2009 has had no material impact on these financial statements:

– Amendments to IFRIC 9 *Reassessment of Embedded Derivatives* and IAS 39 *Financial Instruments: Recognition and Measurement*. This amendment clarifies that a reassessment of embedded derivatives is required whenever a financial asset has been reclassified out of the fair value through profit or loss category.

– IFRIC 13 *Customer Loyalty Programmes*. This interpretation addresses accounting by entities who grant customer loyalty award credits to customers as part of sales transactions and which can be redeemed in the future for free or discounted goods or services. The majority of customer loyalty award schemes are operated by third parties.

– IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*. This interpretation provides guidance on accounting for hedges of net investments in foreign operations in an entity's consolidated financial statements.

– IAS 23 *Borrowing Costs*. This revised standard requires interest and other costs incurred in connection with the borrowing of funds to be recognised as an expense excepting that those which are directly attributable to the acquisition, construction or production of assets that take a substantial period of time to get ready for their intended use or sale must be capitalised as part of the cost of those assets.

– Amendments to IAS 32 and IAS 1 *Puttable Financial Instruments and Obligations Arising on Liquidation*. The amendments require some puttable financial instruments (being those which give the holder the right to put the instrument back to the issuer for cash or another financial asset) and some financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity.

1 BASIS OF PREPARATION continued

– *Improvements to IFRSs* (issued May 2008). Sets out minor amendments to IFRS standards as part of annual improvements process. Most amendments clarified existing practice.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2009 and which have not been applied in preparing these financial statements are given in note 56.

2 ACCOUNTING POLICIES

The Group's accounting policies are set out below.

(A) CONSOLIDATION

The assets, liabilities and results of Group undertakings (including special purpose entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include subsidiaries, associates and joint ventures.

(1) Subsidiaries

Subsidiaries include entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Details of the principal subsidiaries are given in note 9 to the parent company financial statements.

Investment vehicles, such as Open Ended Investment Companies (OEICs), where the Group has control, typically through acting as fund manager and the life funds having a beneficial interest greater than 50 per cent, are consolidated. The minority unitholders' interest is reported in other liabilities.

Intercompany transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

(2) Joint ventures and associates

Joint ventures are entities over which the Group has joint control under a contractual arrangement with other parties. Associates are entities over which the Group has significant influence, but not control or joint control, over the financial and operating policies. Significant influence is the power to participate in the financial and operating policy decisions of the entity and is normally achieved through holding between 20 per cent and 50 per cent of the voting share capital of the entity.

The Group utilises the venture capital exemption for investments where significant influence or joint control is present and the business unit operates as a venture capital business. These investments are designated at initial recognition at fair value through profit or loss. Otherwise, the Group's investments in joint ventures and associates are accounted for by the equity method of accounting and are initially recorded at cost and adjusted each year to reflect the Group's share of the post-acquisition results of the joint venture or associate based on audited accounts which are coterminous with the Group or made up to a date which is not more than three months before the Group's reporting date. The share of any losses is restricted to a level that reflects an obligation to fund such losses.

(B) GOODWILL

Goodwill arises on business combinations, including the acquisition of subsidiaries, and on the acquisition of interests in joint ventures and associates; goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired. Where the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities of the acquired entity is greater than the cost of acquisition, the excess is recognised immediately in the income statement.

Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. Goodwill arising on acquisitions of associates and joint ventures is included in the Group's investment in joint ventures and associates. At the date of disposal of a subsidiary, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal except where it has been written off directly to reserves in the past.

2 ACCOUNTING POLICIES continued

(C) OTHER INTANGIBLE ASSETS

Other intangible assets include brands, core deposit intangibles, purchased credit card relationships, customer-related intangibles and capitalised software enhancements. Intangible assets which have been determined to have a finite useful life are amortised on a straight line basis over their estimated useful life as follows:

Capitalised software enhancements	up to 5 years
Brands (which have been assessed as having finite lives)	10-15 years
Customer-related intangibles	up to 10 years
Core deposit intangibles	up to 8 years
Purchased credit card relationships	5 years

Intangible assets with finite useful lives are reviewed at each reporting date to assess whether there is any indication that they are impaired. If any such indication exists the recoverable amount of the asset is determined and in the event that the asset's carrying amount is greater than its recoverable amount, it is written down immediately. Certain brands have been determined to have an indefinite useful life and are not amortised. Such intangible assets are reassessed annually to reconfirm that an indefinite useful life remains appropriate. In the event that an indefinite life is inappropriate a finite life is determined and an impairment review is performed on the asset.

(D) REVENUE RECOGNITION

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

The effective interest rate is calculated on initial recognition of the financial asset or liability by estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts expected to be paid or received by the Group including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see accounting policy 2(H)).

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan once drawn. Where it is unlikely that loan commitments will be drawn, loan commitment fees are recognised over the life of the facility. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group retains no part of the loan package for itself or retains a part at the same effective interest rate for all interest-bearing financial instruments, including loans and advances, as for the other participants.

Dividend income is recognised when the right to receive payment is established.

Revenue recognition policies specific to life insurance and general insurance business are detailed below (see accounting policy 2(O)).

(E) FINANCIAL ASSETS AND LIABILITIES

On initial recognition, financial assets are classified into fair value through profit or loss, available-for-sale financial assets or loans and receivables. Financial liabilities are measured at amortised cost, except for trading liabilities and other financial liabilities designated at fair value through profit or loss on initial recognition which are held at fair value. Purchases and sales of securities and other financial assets and liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

(1) Financial instruments at fair value through profit or loss

Financial instruments are classified at fair value through profit or loss where they are trading securities or where they are designated at fair value through profit or loss by management. Derivatives are carried at fair value (see accounting policy 2(F)).

Trading securities are debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains. Such securities are classified as trading securities and recognised in the balance sheet at their fair value. Gains and losses arising from changes in their fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur.

2 ACCOUNTING POLICIES continued

Other financial assets and liabilities at fair value through profit or loss are designated as such by management upon initial recognition. Such assets and liabilities are carried in the balance sheet at their fair value and gains and losses arising from changes in fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur. Financial assets and liabilities are designated at fair value through profit or loss on acquisition in the following circumstances:

- it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on different bases. The main type of financial assets designated by the Group at fair value through profit or loss are assets backing insurance contracts and investment contracts issued by the Group's life insurance businesses. Fair value designation allows changes in the fair value of these assets to be recorded in the income statement along with the changes in the value of the associated liabilities, thereby significantly reducing the measurement inconsistency had the assets been classified as available-for-sale financial assets.
- the assets and liabilities are part of a group which is managed, and its performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, with management information also prepared on this basis. As noted in accounting policy 2(A)(2), certain of the Group's investments are managed as venture capital investments and evaluated on the basis of their fair value and these assets are designated at fair value through profit or loss.
- where the assets and liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Refer to note 3 (Critical accounting estimates and judgements: Valuation of financial instruments) and note 53(3) (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

The Group is permitted to reclassify, at fair value at the date of transfer, non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the trading category if they are no longer held for the purpose of being sold or repurchased in the near term, as follows:

- if the financial assets would have met the definition of loans and receivables (but for the fact that they had to be classified as held for trading at initial recognition), they may be reclassified into loans and receivables where the Group has the intention and ability to hold the assets for the foreseeable future or until maturity;
- if the financial assets would not have met the definition of loans and receivables, they may be reclassified out of the held for trading category into available-for-sale financial assets in 'rare circumstances'.

(2) Available-for-sale financial assets

Debt securities and equity shares that are not classified as trading securities, at fair value through profit or loss or as loans and receivables are classified as available-for-sale financial assets and are recognised in the balance sheet at their fair value, inclusive of transaction costs. Available-for-sale financial assets are those intended to be held for an indeterminate period of time and may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised directly in other comprehensive income, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement. Interest calculated using the effective interest method and foreign exchange gains and losses on debt securities denominated in foreign currencies are recognised in the income statement.

The Group is permitted to transfer, at fair value at the date of transfer, a financial asset from the available-for-sale category to the loans and receivables category where that asset would have met the definition of loans and receivables at the time of reclassification (if the financial asset had not been designated as available-for-sale) and where there is both the intention and ability to hold that financial asset for the foreseeable future. For assets transferred, gains or losses recognised in equity in respect of these assets as at the date of transfer are amortised to profit or loss over the remaining life of the asset using the effective interest method.

(3) Loans and receivables

Loans and receivables include loans and advances to banks and customers and eligible assets including those transferred into this category out of the fair value through profit or loss or available-for-sale financial assets categories. Loans and receivables are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs or, for eligible assets transferred into this category, their fair value at the date of transfer. Financial assets classified as loans and receivables are accounted for at amortised cost using the effective interest method (see accounting policy 2(D)) less provision for impairment (see accounting policy 2(H)).

The Group has entered into securitisation and similar transactions to finance certain loans and advances to customers. These loans and advances to customers continue to be recognised by the Group, together with a corresponding liability for the funding.

2 ACCOUNTING POLICIES continued

(4) Borrowings
Borrowings (which include deposits from banks, customer deposits, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense.

An exchange of financial liabilities on substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The difference between the carrying amount of a financial liability extinguished and the new financial liability is recognised in profit or loss together with any related costs or fees incurred.

When a financial liability is exchanged for an equity instrument, the new equity instrument is recognised at fair value and any difference between the original carrying value of the liability and the fair value of the new equity is recognised in the profit or loss together with any related costs or fees incurred.

(5) Sale and repurchase agreements
Securities sold subject to repurchase agreements ('repos') continue to be recognised on the balance sheet where substantially all of the risks and rewards are retained. Funds received under these arrangements are included in deposits from banks, customer deposits, or trading liabilities. Conversely, securities purchased under agreements to resell ('reverse repos'), where the Group does not acquire substantially all of the risks and rewards of ownership, are recorded as loans and receivables or trading securities. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

Securities lent to counterparties are retained in the financial statements. Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability.

(6) Derecognition of financial assets and liabilities
Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either:

– substantially all of the risks and rewards of ownership have been transferred; or
– the Group has neither retained nor transferred substantially all the risks and rewards, but has transferred control.

Financial liabilities are derecognised when they are extinguished (ie when the obligation is discharged), cancelled or expire.

(F) DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING
All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and option pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 3 (Critical accounting estimates and judgements: Valuation of financial instruments) and note 53(3) (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

Derivatives embedded in financial instruments and insurance contracts (unless the embedded derivative is itself an insurance contract) are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. In accordance with IFRS 4 *Insurance Contracts*, a policyholder's option to surrender an insurance contract for a fixed amount is not treated as an embedded derivative.

The method of recognising the movements in the fair value of the derivatives depends on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of the same. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item and the hedging instrument and the methodology that will be used to measure the effectiveness of the hedge relationship in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship is tested both at inception and throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

The Group designates certain derivatives as either: (1) hedges of the fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges); (2) hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges); or (3) hedges of net investments in foreign operations (net investment hedges). These are accounted for as follows:

2 ACCOUNTING POLICIES continued

(1) Fair value hedges
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk; this also applies if the hedged asset is classified as an available-for-sale financial asset. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity.

(2) Cash flow hedges
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income in the cash flow hedge reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(3) Net investment hedges
Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income, the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of. The hedging instrument in net investments hedges may include non-derivative liabilities as well as derivative financial instruments.

(G) OFFSET
Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. In certain situations, even though master netting agreements exist, the lack of management intention to settle on a net basis results in the financial assets and liabilities being reported gross on the balance sheet.

(H) IMPAIRMENT OF FINANCIAL ASSETS

(1) Assets accounted for at amortised cost
At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition and prior to the balance sheet date, there is objective evidence that a financial asset or group of financial assets has become impaired.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

– Delinquency in contractual payments of principal and/or interest;
– Indications that the borrower or group of borrowers is experiencing significant financial difficulty;
– Restructuring of debt to reduce the burden on the borrower;
– Breach of loan covenants or conditions; and
– Initiation of bankruptcy or individual voluntary arrangement proceedings.

For impaired debt instruments which are classified as loans and receivables, impairment losses are recognised in subsequent periods when it is determined that there has been a further negative impact on expected future cash flows. A reduction in fair value caused by general widening of credit spreads would not, of itself, result in additional impairment.

The estimated period between a loss occurring and its identification is determined by local management for each identified portfolio. In general, the periods used vary between two months and twelve months.

If there is objective evidence that an impairment loss has been incurred, an allowance is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current effective interest rate.

For the Group's portfolios of smaller balance homogenous loans, such as the residential mortgage, personal lending and credit card portfolios, allowances are calculated for groups of assets taking into account historical cash flow experience. For the Group's other lending portfolios, allowances are established on a case-by-case basis. The calculation of the present value of the estimated future cash flows of a collateralised asset or group of assets reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

If there is no objective evidence of individual impairment the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. Segmentation takes into account such factors as the type of asset, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash

2 ACCOUNTING POLICIES continued

flows are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery (as a result of the customer's insolvency, ceasing to trade or other reason) and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

Equity securities acquired in exchange for loans in order to achieve an orderly realisation are accounted for as a disposal of the loan and an acquisition of equity securities. Where control is obtained over an entity as a result of the transaction, the entity is consolidated; where the Group has significant influence over an entity as a result of the transaction, the investment is accounted for by the equity method of accounting (see accounting policy 2(A)). Any subsequent impairment of the assets or business acquired is treated as an impairment of the relevant asset or business and not as an impairment of the original instrument.

(2) Available-for-sale financial assets

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the criteria for financial assets accounted for at amortised cost set out above, this assessment involves reviewing the current financial circumstances (including creditworthiness) and future prospects of the issuer assessing the future cash flows expected to be realised and, in the case of equity shares, considering whether there has been a significant or prolonged decline in the fair value of the asset below its cost. If an impairment loss has been incurred, the cumulative loss measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that asset previously recognised, is reclassified from equity to the income statement. For impaired debt instruments, impairment losses are recognised in subsequent periods when it is determined that there has been a further negative impact on expected future cash flows; a reduction in fair value caused by general widening of credit spreads would not, of itself, result in additional impairment. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, an amount not greater than the original impairment loss is credited to the income statement; any excess is taken to other comprehensive income. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(I) INVESTMENT PROPERTY

Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital appreciation or both. The Group's investment property primarily relates to property held for long-term rental yields and capital appreciation within the life insurance funds. Investment property is carried in the balance sheet at fair value, being the open market value as determined in accordance with the guidance published by the Royal Institution of Chartered Surveyors. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices. These valuations are reviewed at least annually by an independent valuation expert. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair value are recognised in the income statement as net trading income for investment property within the life insurance funds and as other operating income for other investment property.

(J) TANGIBLE FIXED ASSETS

Tangible fixed assets are included at cost less accumulated depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):

– Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease
– Leasehold improvements: shorter of 10 years or, if lease renewal is not likely, the remaining period of the lease

Equipment:

– Fixtures and furnishings: 10-20 years
– Other equipment and motor vehicles: 2-8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

2 ACCOUNTING POLICIES continued

(K) LEASES

(1) As lessee

The leases entered into by the Group are primarily operating leases. Operating lease rentals payable are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

(2) As lessor

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee but not necessarily legal title. All other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments, together with any unguaranteed residual value, is recognised as a receivable, net of provisions, within loans and advances to banks and customers. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance lease income. Finance lease income is recognised in interest income over the term of the lease using the net investment method (before tax) so as to give a constant rate of return on the net investment in the leases. Unguaranteed residual values are reviewed regularly to identify any impairment.

Operating lease assets are included within tangible fixed assets at cost and depreciated over their estimated useful lives, which equates to the lives of the leases, after taking into account anticipated residual values. Operating lease rental income is recognised on a straight line basis over the life of the lease.

The Group evaluates non-lease arrangements such as outsourcing and similar contracts to determine if they contain a lease which is then accounted for separately.

(L) PENSIONS AND OTHER POST-RETIREMENT BENEFITS

The Group operates a number of post-retirement benefit schemes for its employees including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries, or in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method adjusted for unrecognised actuarial gains and losses. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The Group's income statement charge includes the current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10 per cent of the scheme assets or liabilities ('the corridor approach'). In these circumstances the excess is charged or credited to the income statement over the employees' expected average remaining working lives. Past service costs are charged immediately to the income statement, unless the charges are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

The Group's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date adjusted for any cumulative unrecognised actuarial gains or losses. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The Group recognises the effect of material changes to the terms of its defined benefit pension plans which reduce future benefits as curtailments; gains and losses are recognised in the income statement when the curtailments occur.

The costs of the Group's defined contribution plans are charged to the income statement in the period in which they fall due.

2 ACCOUNTING POLICIES continued

(M) SHARE-BASED COMPENSATION
The Group operates a number of equity-settled, share-based compensation plans in respect of services received from certain of its employees. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments, with a corresponding increase in equity. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement over the remaining vesting period, together with a corresponding adjustment to equity. Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and in accordance with the revised IFRS 2 the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Modifications are assessed at the date of modification and any incremental charges are charged to the income statement over any remaining vesting period.

(N) TAXATION
Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

For the Group's long-term insurance businesses, the tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on equity holders' returns. This allocation is based on an assessment of the rates of tax which will be applied to the returns under current UK tax rules.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Income tax payable on profits is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised. Deferred tax related to gains and losses on the fair value re-measurement of available-for-sale investments and cash flow hedges, where these gains and losses are recognised in other comprehensive income, is also recognised in other comprehensive income. Such deferred tax is subsequently transferred to the income statement together with the deferred gain or loss.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

(O) INSURANCE
The Group undertakes both life insurance and general insurance business.

Products sold by the life insurance business are classified into three categories:

Insurance contracts – these contracts transfer significant insurance risk and may also transfer financial risk. The Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. These contracts may or may not include discretionary participation features.

Investment contracts containing a discretionary participation feature ('participating investment contracts') – these contracts do not transfer significant insurance risk, but contain a contractual right which entitles the holder to receive, in addition to the guaranteed benefits, further additional discretionary benefits or bonuses that are likely to be a significant proportion of the total contractual benefits and the amount and timing of which is at the discretion of the Group and based upon the performance of specified assets.

Non-participating investment contracts – these contracts do not transfer significant insurance risk or contain a discretionary participation feature.

The general insurance business issues only insurance contracts.

(1) Life insurance business

(i) ACCOUNTING FOR INSURANCE AND PARTICIPATING INVESTMENT CONTRACTS

Premiums and claims
Premiums received in respect of insurance and participating investment contracts are recognised as revenue when due except for unit-linked contracts on which premiums are recognised as revenue when received. Claims are recorded as an expense on the earlier of the maturity date or the date on which the claim is notified.

2 ACCOUNTING POLICIES continued

Liabilities

– *Insurance and participating investment contracts in the Group's with-profit funds*

Liabilities of the Group's with-profit funds, including guarantees and options embedded within products written by these funds, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime, except that projected transfers out of the funds into other Group funds are recorded in unallocated surplus (see below). Further details on the realistic capital regime are given on page 89. Changes in the value of these liabilities are recognised through insurance claims.

– *Insurance and participating investment contracts which are not unit-linked or in the Group's with-profit funds*

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life insurance and annuity benefits where future mortality is uncertain.

Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs.

Changes in the value of these liabilities are recognised in the income statement through insurance claims.

– *Insurance and participating investment contracts which are unit-linked*

Liabilities for unit-linked insurance contracts and participating investment contracts are stated at the bid value of units plus, an additional allowance where appropriate (such as for any excess of future expenses over charges). The liability is increased or reduced by the change in the unit prices and is reduced by policy administration fees, mortality and surrender charges and any withdrawals. Changes in the value of the liability are recognised in the income statement through insurance claims. Benefit claims in excess of the account balances incurred in the period are also charged through insurance claims. Revenue consists of fees deducted for mortality, policy administration and surrender charges.

Unallocated surplus

Any amounts in the with-profit funds not yet determined as being due to policyholders or shareholders are recognised as an unallocated surplus which is shown separately from liabilities arising from insurance contracts and participating investment contracts.

(ii) ACCOUNTING FOR NON-PARTICIPATING INVESTMENT CONTRACTS

The Group's non-participating investment contracts are primarily unit-linked. These contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable. Investment income allocated to non-participating investment contracts are included in insurance claims.

Deposits and withdrawals are not accounted for through the income statement but are accounted for directly in the balance sheet as adjustments to the non-participating investment contract liability.

The Group receives investment management fees in the form of an initial adjustment or charge to the amount invested. These fees are in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the contract. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group defers these fees and recognises them over the estimated lives of the contracts, in line with the provision of investment management services.

Costs which are directly attributable and incremental to securing new non-participating investment contracts are deferred. This asset is subsequently amortised over the period of the provision of investment management services and is reviewed for impairment in circumstances where its carrying amount may not be recoverable. If the asset is greater than its recoverable amount it is written down immediately through fee and commission expense in the income statement. All other costs are recognised as expenses when incurred.

(iii) VALUE OF IN-FORCE BUSINESS

The Group recognises as an asset the value of in-force business in respect of insurance contracts and participating investment contracts. The asset represents the present value of the shareholders' interest in the profits expected to emerge from those contracts written at the balance sheet date. This is determined after making appropriate assumptions about future economic and operating conditions such as future mortality and persistency rates and includes allowances for both non-market risk and for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. The asset in the consolidated balance sheet is presented gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

The Group's contractual rights to benefits from providing investment management services in relation to non-participating investment contracts acquired in business combinations and portfolio transfers is measured at fair value at the date of acquisition. The resulting asset is amortised over the estimated lives of the contracts. At each reporting date an assessment is made to determine if there is any indication of impairment. Where impairment exists, the carrying value of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement.

2 ACCOUNTING POLICIES continued

(2) General insurance business
The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included in insurance premium income, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred in the balance sheet within liabilities arising from insurance contracts and participating investment contracts and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date. Claims liabilities are not discounted.

(3) Liability adequacy test
At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities net of related deferred cost assets and value of in-force business. In performing these tests current best estimates of discounted future contractual cash flows and claims handling and policy administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the income statement, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from liability adequacy tests.

(4) Reinsurance
Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured contracts and in accordance with the terms of each reinsurance contract and are regularly reviewed for impairment. Premiums payable for reinsurance contracts are recognised as an expense when due within insurance premium income. Changes in the reinsurance recoverable assets are recognised in the income statement through insurance claims.

(P) FOREIGN CURRENCY TRANSLATION
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in sterling, which is the Company's functional and presentation currency.

Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when recognised in other comprehensive income as qualifying cash flow or net investment hedges. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on equities and similar non-monetary items held at fair value through profit and loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on available-for-sale non-monetary financial assets, such as equity shares, are included in the fair value reserve in equity unless the asset is a hedged item in a fair value hedge.

The results and financial position of all group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

– The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into sterling at foreign exchange rates ruling at the balance sheet date.
– The income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions in which case income and expenses are translated at the dates of the transactions.

Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income and accumulated in a separate component of equity together with exchange differences arising from the translation of borrowings and other currency instruments designated as hedges of such investments (see accounting policy 2(F)(3)). On disposal of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation are reclassified from equity and included in determining the profit or loss arising on disposal.

2 ACCOUNTING POLICIES continued

(Q) PROVISIONS

Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

The Group recognises provisions in respect of vacant leasehold property where the unavoidable costs of the present obligations exceed anticipated rental income.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

(R) SHARE CAPITAL

(1) Share issue costs

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

(2) Dividends

Dividends paid on the Group's ordinary shares are recognised as a reduction in equity in the period in which they are paid.

(3) Treasury shares

Where the Company or any member of the Group purchases the Company's share capital, the consideration paid is deducted from shareholders' equity as treasury shares until they are cancelled. Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

(S) CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty in these financial statements, which together are deemed critical to the Group's results and financial position, are discussed below.

ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

The Group's accounting policy for losses arising on financial assets classified as loans and receivables is described in note 2(H)(1). The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date. Impairment allowances are established to recognise incurred impairment losses in the Group's loan portfolios carried at amortised cost. In determining whether an impairment has occurred at the balance sheet date the Group considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows or their timings. Where this is the case, the impairment loss is the difference between the carrying value of the loan and the present value of the estimated future cash flows discounted at the loan's original effective interest rate.

At 31 December 2009 gross loans and receivables totalled £710,362 million (2008: £287,220 million) against which impairment allowances of £15,380 million (2008: £3,727 million) had been made (see note 24). Impairment allowances are made up of two components, those determined individually and those determined collectively.

Individual component

All impaired loans which exceed a certain threshold, principally within the Group's Wholesale division, are individually assessed for impairment having regard to expected future cash flows including those that could arise from the realisation of security. The determination of these allowances often requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer and the value of the security held, for which there may not be a readily accessible market. In particular, significant judgement is required by management in the current economic environment in assessing the borrower's cash flows and debt servicing capability together with the realisable value of commercial real estate collateral. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS continued

Collective component

Impairment allowances for portfolios of smaller balance homogenous loans, such as residential mortgages, personal loans and credit card balances that are below the individual assessment thresholds, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis. Collective impairment allowances are calculated on a portfolio basis using models which take into account factors such as historical experience of accounts progression through the various stages of delinquency, historical loss rates, the credit quality of the portfolio, and the value of any collateral held, which is estimated, where appropriate, using indices such as house price indices.

The calculation of the collective impairment allowance is therefore subject to estimation uncertainty. The variables used in the collective impairment models are kept under regular review to ensure that as far as possible they reflect current economic circumstances. However, significant management judgement is applied in assessing whether current economic conditions and borrowers' behaviour are fully reflected in the historical loss data and other inputs to the impairment models.

The collective impairment allowance is sensitive to changes in economic and credit conditions, including the interdependency of house prices, unemployment rates, interest rates, borrowers' behaviour, and consumer bankruptcy trends. It is, however, inherently difficult to estimate how changes in one or more of these factors might impact the collective impairment allowance.

Given the relative size of the Group's mortgage portfolio, a key variable is UK house prices which determine the collateral value supporting loans in such portfolios. The value of this collateral is estimated by applying changes in house price indices to the original assessed value of the property. If average house prices within the Group's mortgage portfolio were 10 per cent lower than those estimated at 31 December 2009, the house price index related impact on the impairment charge would be an increase of approximately £350 million.

In the Wholesale division, the collective unimpaired provision is sensitive to the time between the loss event and the date the impairment is recognised. This is known as the loss emergence period (LEP). If the LEP moved by one month in respect of the loan portfolio assessed for collective unimpaired provisions, this would result in an increase in the collective unimpaired provision of approximately £420 million.

IMPAIRMENT OF AVAILABLE-FOR-SALE FINANCIAL ASSETS

In determining whether an impairment loss has been incurred in respect of an available-for-sale financial asset, the Group performs an objective review of the current financial circumstances and future prospects of the issuer and, in the case of equity shares, considers whether there has been a significant or prolonged decline in the fair value of that asset below its cost. This consideration requires management judgement. Among factors considered by the Group is whether the decline in fair value is a result of a change in the quality of the asset or a downward movement in the market as a whole. An assessment is performed of the future cash flows expected to be realised from the asset, taking into account, where appropriate, the quality of underlying security and credit protection available. The increase in the fair value of available-for-sale financial assets during the year was £2,234 million (2008: reduction of £2,721 million). Impairment losses in respect of available-for-sale financial assets transferred from reserves to the income statement totalled £602 million (2008: £130 million).

VALUATION OF FINANCIAL INSTRUMENTS

Financial instruments classified by management as trading and other financial assets and liabilities at fair value through profit or loss, derivative financial instruments and available-for-sale financial assets are carried at fair value which is determined as being the amount for which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Management judgement is required in determining the appropriate classification of financial instruments.

In 2009, the Group adopted '*Amendments to IFRS 7 'Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments*' which, among other matters, established a three level valuation hierarchy for disclosure of fair value measurements of financial instruments carried on the Group's balance sheet at fair value.

Management judgement is required in determining the categorisation of the Group's financial instruments that are carried at fair value. Financial instruments categorised as level 1 are valued using quoted market prices and therefore there is less judgement applied in determining fair value. However, the fair value of financial instruments categorised as level 2 and level 3 is determined using valuation techniques including discounted cash flow analysis and valuation models. These require management judgement and therefore contain significant estimation uncertainty (note 53).

In particular significant judgement is required by management in determining appropriate assumptions to be used for level 3 financial instruments. At 31 December 2009, the Group classified £7,460 million of financial assets and £235 million of financial liabilities as level 3 (note 53).

The largest asset class classified as level 3 is the Group's venture capital and unlisted equity investments. Venture capital investments are valued using International Private Equity and Venture Capital (IPEV) Guidelines which require significant management judgement in determining appropriate earnings multiples to be applied in determining fair value. Unlisted equity investments are valued using a number of different techniques which require management to select the most appropriate assumptions, including earnings multiples, valuations relative to net assets, and estimated future cash flows. Certain of the Group's asset-backed securities and derivatives, principally where there is no trading activity in such securities, are also classified as level 3. Fair value is determined using valuation models which require significant judgement in determining appropriate values for inputs including prepayment rates, probability of default, loss given default and yield curves.

The valuation techniques used are set out in note 53 on page 224. This provides details of the inputs into valuation models that have the potential to significantly impact the value determined, sets out the assumptions used for those inputs and provides the effects of applying reasonably possible alternative assumptions.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS continued

TAXATION

At 31 December 2009 the Group carried deferred tax assets on its balance sheet of £5,006 million (2008: £833 million) and deferred tax liabilities of £209 million (2008: £nil) (note 42).

This statutory presentation takes into account the ability of the Group to net deferred tax assets and liabilities only where there is a legally enforceable right of offset. Note 42 also presents the Group's deferred tax assets and liabilities by tax category. The largest category of deferred tax asset which contains significant estimation uncertainty and which requires management judgement in assessing its recoverability relates to tax losses carried forward. At 31 December 2009, the Group recognised a deferred tax asset of £5,925 million (2008 £856 million) in respect of tax losses carried forward. The significant increase reflects the taxable losses generated by certain Group companies, primarily Bank of Scotland plc in the last two years and Lloyds TSB Bank plc during 2009.

Applicable accounting standards permit the recognition of deferred tax assets only to the extent that it is probable that future taxable profits will be available to utilise the tax losses carried forward. The assessment of future taxable profits involves significant estimation uncertainty, principally relating to an assessment of management's projections of future taxable income based on business plans and ongoing tax planning strategies. These projections include assumptions about the future strategy of the Group, the economic and regulatory environment in which the Group operates, future tax legislation, customer behaviour, and the ability of the Group to deliver expected integration benefits, amongst other variables. At 31 December 2009, management has concluded that future taxable profits generated by the Group companies with tax losses carried forward are expected to be sufficient to utilise the tax losses carried forward in full.

At 31 December 2009 the Group carried an asset for current tax recoverable of £680 million (2008: £300 million) and current tax liabilities of £51 million (2008: £nil). In determining the carrying value of these balances, management have taken account of tax issues that are subject to ongoing discussion with HM Revenue & Customs and other tax authorities. Inherent in this is management's assessment of legal and professional advice, case law and other relevant guidance. The determination of the outcome of such matters requires significant management judgement in assessing the various risks and applying appropriate probability weightings in determining the carrying value of current and deferred tax balances.

PENSIONS

The net liability recognised in the balance sheet at 31 December 2009 in respect of the Group's retirement benefit obligations was £780 million (2008: £1,771 million) of which £619 million (2008: £1,657 million) related to defined benefit pension schemes. As explained in note 2(L), the Group adopts the corridor approach to pensions accounting and consequently does not recognise actuarial losses of £2,936 million (2008: £267 million). The defined benefit pension schemes' gross deficit totalled £3,555 million (2008: £1,924 million) representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

The schemes' liabilities are calculated using the projected unit credit method, which takes into account projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. The resulting estimated cash flows are discounted at a rate equivalent to the market yield at the balance sheet date on high quality bonds with a similar duration and currency to the schemes' liabilities. In order to estimate the future cash flows, a number of financial and non-financial assumptions are made by management, changes to which could have a material impact upon the overall deficit or the net cost recognised in the income statement.

Two important assumptions are the rate of inflation and the expected lifetime of the schemes' members. The assumed rate of inflation affects the rate at which salaries are projected to grow and therefore the size of the pension that employees receive upon retirement and also the rate at which pensions in payment increase. Over the longer term rates of inflation can vary significantly. At 31 December 2009 it was assumed that the rate of inflation would be 3.4 per cent per annum (2008: 3.0 per cent), although if this was increased by 0.2 per cent the overall deficit would increase by approximately £795 million and the annual cost by approximately £69 million. A reduction of 0.2 per cent would reduce the overall deficit by approximately £763 million and the annual cost by approximately £60 million.

The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience. Assumptions used by management reflect recent longevity experience and extrapolate the improving trend. An increase of one year in the expected lifetime of scheme members would increase the overall deficit by approximately £590 million and the annual cost by approximately £79 million; a reduction of one year would reduce the overall deficit by approximately £603 million and the annual cost by approximately £76 million.

The size of the overall deficit is also sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variations. At 31 December 2009 the discount rate used was 5.7 per cent (2008: 6.3 per cent); a reduction of 0.2 per cent would increase the overall deficit by approximately £985 million and the annual cost by approximately £82 million, while an increase of 0.2 per cent would reduce the net deficit by approximately £937 million and the annual cost by approximately £68 million.

FAIR VALUE OF IDENTIFIABLE NET ASSETS OF HBOS

The acquisition of the HBOS Group in January 2009 was accounted for in accordance with applicable accounting standards which require the recognition of the identifiable assets acquired and liabilities assumed at their acquisition-date fair values. As part of this process, it is also necessary to identify and recognise certain assets and liabilities which are not included on the acquiree's balance sheet, for example the value of the internally generated brands and other intangible assets.

The exercise to fair value the HBOS Group balance sheet was inherently highly subjective and required management to make a number of assumptions and estimates. The overall effect was to reduce the book value of the assets acquired by £11,975 million, after the recognition of brands

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS continued

and other intangibles not previously included on the HBOS Group balance sheet totalling £4,650 million. This was offset by a reduction in the value of the HBOS Group's liabilities of £13,216 million, resulting in a net increase in the value of the net assets acquired of £1,241 million (note 14).

The fair value adjustments to the HBOS Group's assets principally reflect a reduction of £13,512 million in the value of customer lending. For a significant proportion of these balances there was no active market and therefore in determining the acquisition-date fair values discounted cash flow models have been used. The calculations were performed using benchmark interest rates and market-based credit spreads for the different lending portfolios, having regard to management's view of the level of expected credit losses. The size of the adjustment reflects the market-wide reduction in interest rates since the lending was originated and a deterioration in the credit quality of the portfolio in the worsening economic environment.

The reduction in the value of the HBOS Group's liabilities was largely due to the lower values attributed to debt instruments issued by HBOS, for example commercial paper, medium-term notes and subordinated debt. In many cases market prices were available to value these instruments and the lower fair values reflect market concern in January 2009 over the creditworthiness of HBOS.

During 2009, the effects of the fair value adjustments have started to unwind and be recognised in the Group's income statement. The determination of the extent to which the adjustments unwind often requires significant judgement principally relating to the assessment of the extent to which losses incurred subsequent to the date of acquisition were expected and consequently reflected in the fair value adjustment made to write down the value of the lending. In the period since the acquisition impairment losses of £6,859 million have been incurred which were reflected in the acquisition fair value adjustments.

GOODWILL

At 31 December 2009 the Group carried goodwill on its balance sheet totalling £2,016 million (2008: £2,256 million), all of which relates to acquisitions made a number of years ago.

The Group reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. The impairment review is performed by projecting future cash flows, excluding finance and tax, based upon budgets and plans and making appropriate assumptions about rates of growth and discounting these using a rate that takes into account prevailing market interest rates and the risks inherent in the business. If the present value of the projected cash flows is less than the carrying value of the underlying net assets and related goodwill an impairment charge is required in the income statement. This calculation requires the exercise of significant judgement by management; if the estimates made prove to be incorrect or performance does not meet expectations which affects the amount and timing of future cash flows, goodwill may become impaired in future periods. Further details are given in note 27.

The Group's goodwill is allocated to cash generating units in the Insurance division (Scottish Widows) and in the Asset Finance business in the Wholesale division. Goodwill attributable to the Group's Asset Finance business, for which an impairment charge was recognised in the Group's financial statements for the year ended 31 December 2008, has been reviewed for impairment due to the continuing uncertainties over the short-term macroeconomic environment. As a consequence, the carrying value of the consumer finance cash generating unit within Asset Finance has been reassessed and has resulted in the related element of the goodwill being written off and the Group recognising a further impairment charge of £240 million in the year ended 31 December 2009. Further details are given in note 27.

LIFE INSURANCE BUSINESS

The Group carries in its balance sheet a value in-force asset, representing the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts, of £5,140 million at 31 December 2009 (2008: £1,893 million). The Group also recognises an acquired value in-force asset of £1,545 million at 31 December 2009 (2008: nil) representing contractual rights to benefits from providing investment management services in relation to non-participating investment contracts acquired in business combinations and portfolio transfers. The methodology used to value these assets is set out in note 2(O)(1). The valuation or recoverability of these assets requires assumptions to be made about future economic and operating conditions. These assumptions are inherently uncertain and changes could significantly affect the value attributed to these assets.

At 31 December 2009 the Group carried substantial liabilities to holders of life, pensions and investment contracts in its balance sheet. Liabilities arising from insurance contracts and participating investment contracts were £56,800 million and £18,089 million respectively (2008: £21,518 million and £11,619 million) and those arising from non-participating investment contracts totalled £46,348 million (2008: £14,243 million). The methodology used to value the liabilities is described in note 2(O)(1). Elements of the liability valuations require assumptions to be made about future investment returns, future mortality rates and future policyholder behaviour.

The process for determining key assumptions that have been made for life insurance assets and liabilities at 31 December 2009 is detailed in notes 28 and 36. The impact on profit before tax of changes in key assumptions is detailed in note 37.

GENERAL INSURANCE BUSINESS

At 31 December 2009 the Group held a provision of £502 million (2008: £183 million) in respect of the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The methodology for valuing these liabilities, which includes the use of statistical techniques, is described in note 2(O)(2).

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgement. An increase of 10 per cent in the cost of claims would result in the recognition of an additional loss of approximately £48 million. Similarly, an increase of 10 per cent in the ultimate number of such claims would lead to an additional loss of approximately £44 million; some relief would arise from reinsurance contracts held.

4 SEGMENTAL ANALYSIS

The Group is a leading financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas.

The group executive committee has been determined to be the chief operating decision maker for the Group. The Group's operating segments reflect its organisational and management structures. The group executive committee reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources. This assessment includes a consideration of each segment's net interest revenue and consequently the total interest income and expense for all reportable segments is presented on a net basis. The segments are differentiated by the type of products provided, by whether the customers are individuals or corporate entities and by the geographical location of the customer.

During 2009, following the acquisition of HBOS, the Group's activities were reorganised into four financial reporting segments: Retail, Wholesale, Wealth and International and Insurance. Consequently, the comparative information has been restated to be consistent with the reorganised structure of the Group. The segmental results and comparatives are presented on the basis reviewed by the chief operating decision maker in 2009 and therefore include the pre-acquisition results of HBOS for 2008 and for the period from 1 January 2009 to 16 January 2009.

The Retail division, with its brands including Lloyds TSB, Halifax, Bank of Scotland, Birmingham Midshires and Cheltenham & Gloucester, is a UK provider of current accounts, savings, personal loans, credit cards and mortgages serving over 30 million customers through a large branch network in the UK. The division is also a general insurance and bancassurance distributor selling a wide range of long-term savings, investment and general insurance products.

The Wholesale division serves in excess of a million businesses ranging from start-ups and small enterprises to global corporations, with a range of propositions fully segmented according to customer need. The enlarged division, following the acquisition of HBOS, comprises Corporate Markets, Treasury and Trading and Asset Finance. Corporate Markets comprises Corporate, Commercial, Corporate Real Estate, Specialist Finance and Wholesale Markets.

Wealth and International was created to give increased focus and momentum to the Group's private banking and asset management activities and to closely co-ordinate the management of its international businesses. Wealth comprises the Group's private banking, wealth and asset management businesses in the UK and overseas. International comprises corporate, commercial, asset finance and retail businesses in Australia, Ireland and continental Europe.

The Insurance division is a bancassurance provider in the UK providing a wide range of long-term savings, investment and protection products, together with individual and corporate pensions. It is also a distributor of payment protection and home insurance in the UK. The division consists of three business units: life, pensions and investments UK; life, pensions and investments Europe; and general insurance.

Other includes the results of managing the Group's technology platforms, branch and head office property estate, operations (including payments, banking operations and collections) and procurement services, the costs of which are predominantly recharged to the other divisions. It also reflects other items not recharged to the divisions, including hedge ineffectiveness. The improvement in revenue of £1,376 million in 2009 compared to 2008 primarily reflects gains arising on the extinguishment of certain existing liabilities in 2009.

Inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds.

For those derivative contracts entered into by business units for risk management purposes, the business unit retains the amount that would have been recognised on an accrual accounting basis (an amount equal to the interest element of the next payment on the swap) and transfers the remainder of the fair value of the swap to the central group segment where the resulting accounting volatility is managed though the establishment of hedge accounting relationships. Any change in fair value of the hedged instrument attributable to the hedged risk is also recorded within the central group segment. This allocation of the fair value of the swap and change in fair value of the hedged instrument attributable to the hedged risk avoids accounting asymmetry in segmental results and records volatility in the central group segment where it is managed.

4 SEGMENTAL ANALYSIS continued

	Retail £m	Wholesale £m	Wealth and International £m	Insurance £m	Other £m	Reported basis total £m
Year ended 31 December 2009						
Net interest income	7,970	4,710	1,217	(287)	(884)	12,726
Other income (net of fee and commission expense)	1,804	4,199	1,128	2,944	1,800	11,875
Total income	9,774	8,909	2,345	2,657	916	24,601
Insurance claims	–	–	–	(637)	–	(637)
Total income, net of insurance claims	9,774	8,909	2,345	2,020	916	23,964
Operating expenses	(4,566)	(4,106)	(1,544)	(974)	(419)	(11,609)
Trading surplus	5,208	4,803	801	1,046	497	12,355
Impairment	(4,227)	(15,683)	(4,078)	–	–	(23,988)
Share of results of joint ventures and associates	(6)	(720)	(21)	(22)	2	(767)
Profit (loss) before tax and fair value unwind	975	(11,600)	(3,298)	1,024	499	(12,400)
Fair value unwind	407	6,897	942	(49)	(2,097)	6,100
Profit (loss) before tax	1,382	(4,703)	(2,356)	975	(1,598)	(6,300)
External revenue	14,221	5,965	2,859	3,780	(2,224)	24,601
Inter-segment revenue	(4,447)	2,944	(514)	(1,123)	3,140	–
Segment revenue	9,774	8,909	2,345	2,657	916	24,601
Segment external assets	383,588	394,057	94,051	135,814	19,745	1,027,255
Segment customer deposits	224,149	153,389	29,037	–	166	406,741
Other segment items reflected in income statement above:						
Depreciation and amortisation	196	1,284	84	152	147	1,863
Movement in value of in-force business	–	–	(5)	1,097	–	1,092
Defined benefit scheme charges	190	112	40	39	156	537
Other segment items:						
Additions to tangible fixed assets	65	2,969	53	255	487	3,829
Investments in joint ventures and associates at end of year	30	189	123	(14)	151	479

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

4 SEGMENTAL ANALYSIS continued

	Retail £m	Wholesale £m	Wealth and International £m	Insurance £m	Other £m	Reported basis total £m
Year ended 31 December 2008						
Net interest income	8,454	5,752	1,314	(345)	(272)	14,903
Other income (net of fee and commission expense)	2,739	(302)	1,191	3,493	(188)	6,933
Total income	11,193	5,450	2,505	3,148	(460)	21,836
Insurance claims	–	–	–	(481)	–	(481)
Total income, net of insurance claims	11,193	5,450	2,505	2,667	(460)	21,355
Operating expenses	(4,963)	(4,591)	(1,476)	(1,129)	(77)	(12,236)
Trading surplus (deficit)	6,230	859	1,029	1,538	(537)	9,119
Impairment	(3,695)	(10,394)	(731)	–	(60)	(14,880)
Share of results of joint ventures and associates	7	(944)	(21)	2	4	(952)
Profit (loss) before tax	2,542	(10,479)	277	1,540	(593)	(6,713)
External revenue	15,228	(150)	1,883	6,020	(1,145)	21,836
Inter-segment revenue	(4,035)	5,600	622	(2,872)	685	–
Segment revenue	11,193	5,450	2,505	3,148	(460)	21,836
Segment external assets	393,827	517,269	86,394	127,249	1,979	1,126,718
Segment customer deposits	216,282	157,941	34,095	–	844	409,162
Other segment items reflected in income statement above:						
Depreciation and amortisation	197	1,603	71	80	343	2,294
Movement in value of in-force business	–	–	–	(625)	–	(625)
Defined benefit scheme charges	163	106	31	36	(1)	335
Other segment items:						
Additions to tangible fixed assets	127	2,241	254	411	735	3,768
Investments in joint ventures and associates at end of year	78	1,032	117	(38)	50	1,239

4 SEGMENTAL ANALYSIS continued

RECONCILIATION OF REPORTED BASIS TO STATUTORY RESULTS

The reported basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results. The table below reconciles the statutory results to the reported basis.

	Lloyds Banking Group statutory £m	Pre-acquisition results of HBOS £m	Removal of: Acquisition related[1] £m	Removal of: Volatility £m	Removal of: Insurance gross up £m	Removal of: Fair value unwind £m	Reported basis £m
Year ended 31 December 2009							
Net interest income	**9,026**	**243**	**–**	**11**	**1,280**	**2,166**	**12,726**
Other income	**36,271**	**(1,123)**	**–**	**(479)**	**(21,659)**	**(1,135)**	**11,875**
Total income	**45,297**	**(880)**	**–**	**(468)**	**(20,379)**	**1,031**	**24,601**
Insurance claims	**(22,019)**	**1,349**	**–**	**–**	**20,318**	**(285)**	**(637)**
Total income, net of insurance claims	**23,278**	**469**	**–**	**(468)**	**(61)**	**746**	**23,964**
Operating expenses	**(15,984)**	**(293)**	**4,589**	**–**	**61**	**18**	**(11,609)**
Trading surplus (deficit)	**7,294**	**176**	**4,589**	**(468)**	**–**	**764**	**12,355**
Impairment	**(16,673)**	**(456)**	**–**	**–**	**–**	**(6,859)**	**(23,988)**
Share of results of joint ventures and associates	**(752)**	**–**	**–**	**(10)**	**–**	**(5)**	**(767)**
Gain on acquisition	**11,173**	**–**	**(11,173)**	**–**	**–**	**–**	**–**
Fair value unwind	**–**	**–**	**–**	**–**	**–**	**6,100**	**6,100**
Profit (loss) before tax	**1,042**	**(280)**	**(6,584)**	**(478)**	**–**	**–**	**(6,300)**

[1] Includes gain on acquisition, integration costs, amortisation of purchased intangibles and goodwill impairment.

	Statutory basis[1] £m	HBOS statutory £m	Reclassifications £m	Removal of: Results of BankWest and St. Andrews £m	Removal of: Volatility £m	Removal of: Amortisation of purchased intangibles and goodwill impairments £m	Removal of: Insurance gross up £m	Reported basis £m
Year ended 31 December 2008								
Net interest income	7,718	8,171	1,906	(524)	(9)	–	(2,359)	14,903
Other income	(709)	(4,559)	(234)	(148)	2,358	–	10,225	6,933
Total income	7,009	3,612	1,672	(672)	2,349	–	7,866	21,836
Insurance claims	2,859	6,192	(1,570)	–	–	–	(7,962)	(481)
Total income, net of insurance claims	9,868	9,804	102	(672)	2,349	–	(96)	21,355
Operating expenses	(6,100)	(6,880)	–	400	–	258	86	(12,236)
Trading surplus (deficit)	3,768	2,924	102	(272)	2,349	258	(10)	9,119
Impairment	(3,012)	(12,050)	–	182	–	–	–	(14,880)
Share of results of joint ventures and associates	4	(956)	–	–	–	–	–	(952)
Non-operating income	–	56	(56)	–	–	–	–	–
Loss on disposal	–	(799)	(46)	845	–	–	–	–
Profit (loss) before tax	760	(10,825)	–	755	2,349	258	(10)	(6,713)

As at 31 December 2008	Statutory basis £m	HBOS statutory £m	Reclassifications £m	Lloyds TSB and HBOS share issues[2] £m	Fair value adjustments £m	Consolidation adjustments £m	Reported basis £m
Assets	436,033	689,917	15,198	16,770	(11,975)	(19,225)	1,126,718

[1] Restated for IFRS 2 (Revised)

[2] Includes £4,500 million of ordinary share capital and £1,000 million of preference shares issued by Lloyds TSB Group plc to HM Treasury on 13 January 2009 and 15 January 2009, respectively and £8,500 million of ordinary share capital and £3,000 million of preference shares issued by HBOS plc to HM Treasury on 15 January 2009 (net of costs).

4 SEGMENTAL ANALYSIS continued

GEOGRAPHICAL AREAS

The Group's activities are focused in the UK and the analyses of income and assets below are based on the location of the branch or entity recording the income or assets.

2009	UK £m	Non-UK £m	Total £m
Total income	**42,572**	**2,725**	**45,297**
Total assets	**916,734**	**110,521**	**1,027,255**

There was no individual non-UK country contributing more than 5 per cent of total income or total assets.

As the activities of the Group were predominantly carried out in the UK prior to the acquisition of HBOS, no comparative geographical analysis is presented.

5 NET INTEREST INCOME

	Weighted average effective interest rate			
	2009 %	2008 %	**2009 £m**	2008 £m
Interest and similar income:				
Loans and advances to customers	**3.58**	6.33	**24,171**	13,808
Loans and advances to banks	**1.18**	4.74	**769**	1,847
Debt securities held as loans and receivables	**3.68**	2.52	**1,469**	61
Lease and hire purchase receivables	**6.01**	7.62	**852**	706
Interest receivable on loans and receivables	**3.43**	6.11	**27,261**	16,422
Available-for-sale financial assets	**1.78**	4.58	**977**	1,147
Total interest and similar income	**3.32**	5.98	**28,238**	17,569
Interest and similar expense:				
Deposits from banks	**0.95**	3.65	**(883)**	(1,540)
Customer deposits	**1.23**	3.27	**(4,410)**	(4,932)
Debt securities in issue	**2.56**	4.10	**(6,318)**	(2,227)
Subordinated liabilities	**10.05**	5.82	**(4,325)**	(896)
Liabilities under sale and repurchase agreements	**1.95**	4.45	**(1,655)**	(256)
Interest payable on liabilities held at amortised cost	**2.13**	3.67	**(17,591)**	(9,851)
Other	**14.92**	–	**(1,621)**	–
Total interest and similar expense	**2.30**	3.61	**(19,212)**	(9,851)
Net interest income			**9,026**	7,718

Included within interest receivable is £971 million (2008: £435 million) in respect of impaired financial assets. Net interest income also includes a charge of £121 million (2008: charge of £16 million) transferred from the cash flow hedging reserve (see note 47).

6 NET FEE AND COMMISSION INCOME

	2009 £m	2008 £m
Fee and commission income:		
Current accounts	**1,088**	707
Insurance broking	**539**	549
Credit and debit card fees	**765**	581
Trust and other fiduciary fees	**395**	413
Other	**1,467**	981
	4,254	3,231
Fee and commission expense	**(1,517)**	(694)
Net fee and commission income	**2,737**	2,537

As discussed in note 2(D), fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 5. Fees and commissions relating to instruments that are held at fair value through profit or loss are included within net trading income shown in note 7.

7 NET TRADING INCOME

	2009 £m	2008 £m
Foreign exchange translation gains	**283**	66
Gains on foreign exchange trading transactions	**488**	75
Total foreign exchange	**771**	141
Investment property losses (note 26)	**(214)**	(1,058)
Securities and other gains (losses)	**18,541**	(8,269)
Net trading income	**19,098**	(9,186)

Securities and other gains (losses) comprise net gains (losses) arising on assets and liabilities held at fair value through profit or loss and for trading as follows:

	2009 £m	2008 £m
Net income (expense) arising on assets held at fair value through profit or loss:		
Debt securities, loans and advances	**4,297**	938
Equity shares	**11,475**	(7,759)
Total net income (expense) arising on assets held at fair value through profit or loss	**15,772**	(6,821)
Net expense arising on liabilities held at fair value through profit or loss – debt securities in issue	**(125)**	(232)
Total net gains (losses) arising on assets and liabilities held at fair value through profit or loss	**15,647**	(7,053)
Net gains (losses) on financial instruments held for trading	**2,894**	(1,216)
Securities and other gains (losses)	**18,541**	(8,269)

8 INSURANCE PREMIUM INCOME

	2009 £m	2008 £m
Life insurance		
Gross premiums	7,768	4,841
Ceded reinsurance premiums	(308)	(41)
Net earned premiums	7,460	4,800
Non-life insurance		
Gross premiums written	1,390	651
Ceded reinsurance premiums	(101)	(23)
Net premiums	1,289	628
Change in provision for unearned premiums (note 36(2))	171	(16)
Change in provision for ceded unearned premiums (note 36(2))	26	–
Net earned premiums	1,486	612
Total net earned premiums	8,946	5,412

Life insurance gross written premiums can be further analysed as follows:

	2009 £m	2008 £m
Life and pensions	7,070	4,182
Annuities	685	645
Other	13	14
Gross premiums	7,768	4,841

Non-life insurance gross written premiums can be further analysed as follows:

	2009 £m	2008 £m
Credit protection	417	203
Home	968	441
Health	5	7
	1,390	651

9 OTHER OPERATING INCOME

	2009 £m	2008 £m
Operating lease rental income	**1,509**	392
Rental income from investment properties (note 26)	**358**	209
Other rents receivable	**51**	32
Gains less losses on disposal of available-for-sale financial assets (note 47)	**97**	19
Movement in value of in-force business (note 28)	**1,169**	(325)
Gain on capital transactions	**1,498**	–
Other income	**808**	201
	5,490	528

GAIN ON CAPITAL TRANSACTIONS

During 2009, as part of the Group's management of capital, the Group exchanged certain existing subordinated debt securities for new securities as described below. These exchanges resulted in a gain on extinguishment of the existing liability of £1,498 million, being the difference between the carrying amount of the security extinguished and the fair value of the new security together with related fees and costs.

In the first half of 2009, undated subordinated notes issued by a number of Group companies were exchanged for innovative tier 1 securities and senior unsecured notes issued by Lloyds TSB Bank plc. These exchanges resulted in a gain of £745 million.

In July 2009, dated and undated subordinated liabilities issued by Clerical Medical Finance plc were exchanged for senior unsecured notes issued by Lloyds TSB Bank plc resulting in a gain of £30 million.

In November 2009, as part of the restructuring plan that was a requirement for European Commission approval of state aid received by the Group, the Group agreed to suspend the payment of coupons and dividends on certain of the Group's preference shares and preferred securities for the two year period from 31 January 2010 to 31 January 2012. This suspension gave rise to a partial extinguishment of the original liability, equivalent to the present value of the suspended cash flows. During December 2009, as part of the Group's recapitalisation and exit from GAPS, preference shares, preferred securities and undated subordinated notes were exchanged for enhanced capital notes. These exchanges, together with the partial extinguishment of liabilities arising from the suspension of payments of coupons, resulted in a gain of £723 million.

10 INSURANCE CLAIMS

Insurance claims comprise:

	2009 £m	2008 £m
Life insurance and participating investment contracts		
Claims and surrenders:		
Gross	**(8,010)**	(4,710)
Reinsurers' share	**146**	65
	(7,864)	(4,645)
Change in insurance and participating investment contract liabilities (note 36(1)):		
Change in gross liabilities	**(5,922)**	4,332
Change in reinsurers' share of liabilities	**177**	40
	(5,745)	4,372
Change in non-participating investment contract liabilities		
Change in gross liabilities	**(7,458)**	3,041
Change in reinsurers' share of liabilities	**–**	–
	(7,458)	3,041
Change in unallocated surplus (note 39)	**(318)**	284
Total life insurance and participating investment contracts	**(21,385)**	3,052
Non-life insurance		
Claims and claims paid:		
Gross	**(542)**	(219)
Reinsurers' share	**16**	7
	(526)	(212)
Change in liabilities (note 36(2)):		
Gross	**(111)**	24
Reinsurers' share	**3**	(5)
	(108)	19
Total non-life insurance	**(634)**	(193)
Total insurance claims (expense) credit	**(22,019)**	2,859
Life insurance gross claims can also be analysed as follows:		
Deaths	**(637)**	(289)
Maturities	**(2,107)**	(1,888)
Surrenders	**(4,225)**	(1,960)
Annuities	**(710)**	(516)
Other	**(331)**	(57)
	(8,010)	(4,710)

A non-life insurance claims development table is included in note 36.

11 OPERATING EXPENSES

	2009 £m	2008[1] £m
Staff costs:		
Salaries	**4,369**	2,230
Social security costs	**383**	176
Pensions and other post-retirement benefit schemes (note 41)	**744**	235
Restructuring costs	**412**	14
Other staff costs	**767**	323
	6,675	2,978
Premises and equipment:		
Rent and rates	**569**	318
Hire of equipment	**20**	16
Repairs and maintenance	**226**	151
Other	**341**	165
	1,156	650
Other expenses:		
Communications and data processing	**668**	455
Advertising and promotion	**335**	194
Professional fees	**540**	229
Other	**1,310**	808
	2,853	1,686
Depreciation and amortisation:		
Depreciation of tangible fixed assets (note 30)	**1,716**	648
Amortisation of acquired value of in-force non-participating investment contracts (note 28)	**75**	–
Amortisation of other intangible assets (note 29)	**769**	38
	2,560	686
Goodwill impairment (note 27)	**240**	100
Total operating expenses excluding GAPS fee	**13,484**	6,100
GAPS fee	**2,500**	–
Total operating expenses	**15,984**	6,100

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2009	2008
UK	**125,109**	64,355
Overseas	**6,891**	2,118
	132,000	66,473

[1] Restated for IFRS 2 (Revised)

The UK government has published draft legislation which, when enacted, will introduce a bank payroll tax of 50 per cent applicable to discretionary bonuses and other amounts over £25,000 awarded to bank employees in the period 9 December 2009 to 5 April 2010. The legislation has yet to be finalised and there remain significant uncertainties over aspects of its detailed application and the Group continues to assess its ultimate liability in respect of all of its schemes. However, in accordance with the requirements of IAS 19 *'Employee Benefits'* the Group has provided in full for the estimated cost of the bank payroll tax; the amount is not significant.

11 OPERATING EXPENSES continued

	2009 £m	2008[1] £m
Fees payable for the audit of the Company's current year annual report	**2.2**	1.1
Fees payable for other services:		
Audit of the Company's subsidiaries pursuant to legislation	**18.8**	8.5
Other services supplied pursuant to legislation	**4.2**	3.0
Total audit fees	**25.2**	12.6
Other services – audit related fees	**5.3**	5.3
Total audit and audit related fees	**30.5**	17.9
Services relating to taxation	**1.0**	0.5
Other non-audit fees:		
Services relating to corporate finance transactions	**0.3**	0.4
Other services	**8.9**	0.7
Total other non-audit fees	**9.2**	1.1
Total fees payable to the Company's auditors by the Group	**40.7**	19.5

During the year, the auditors also earned fees payable by entities outside the consolidated Lloyds Banking Group in respect of the following:

	2009 £m	2008[1] £m
Audits of Group pension schemes	**0.3**	0.2
Audits of the unconsolidated Open Ended Investment Companies managed by the Group	**0.6**	0.5
Reviews of the financial position of corporate and other borrowers	**19.3**	1.4
Acquisition due diligence and other work performed in respect of potential venture capital investments	**1.4**	1.0

[1] The allocation of fees between those payable for the audit of the Company's current year audit and those for the audit of the Company's subsidiaries has been restated. There is no change in total fees payable.

Other non-audit fees include the costs associated with the Group's preparations for ensuring the HBOS Group complies fully with the requirements of the Sarbanes-Oxley Act by 31 December 2010.

The following types of services are included in the categories listed above:

Audit fees: This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings. Other services supplied pursuant to legislation relate primarily to the costs associated with the Sarbanes-Oxley Act audit requirements together with the cost of the audit of the Group's Form 20-F filing.

Audit related fees: This category includes fees in respect of services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements, for example acting as reporting accountants in respect of prospectuses and circulars required by the UKLA listing rules.

Services relating to taxation: This category includes tax compliance and tax advisory services.

Other non-audit fees: This category includes due diligence relating to corporate finance, including venture capital transactions and other assurance and advisory services.

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants. Such assignments typically relate to the provision of advice on tax issues, assistance in transactions involving the acquisition and disposal of businesses and accounting advice.

The Group has procedures that are designed to ensure auditor independence, including that fees for audit and non-audit services are approved in advance. This approval can be obtained either on an individual engagement basis or, for certain types of non-audit services, particularly those of a recurring nature, through the approval of a fee cap covering all engagements of that type provided the fee is below that cap. All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant fee cap must be pre-approved by the audit committee on an individual engagement basis. On a quarterly basis, the audit committee receives a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

12 IMPAIRMENT

	2009 £m	2008[1] £m
Impairment losses on loans and receivables:		
Loans and advances to banks	(3)	135
Loans and advances to customers	15,783	2,584
Debt securities classified as loans and receivables	248	157
Total impairment losses on loans and receivables (note 24)	16,028	2,876
Impairment of available-for-sale financial assets	602	130
Other credit risk provisions (note 43)	43	6
Total impairment charged to the income statement	16,673	3,012

13 INVESTMENTS IN JOINT VENTURES AND ASSOCIATES

The Group's share of results of and investments in joint ventures and associates comprises:

	Joint ventures		Associates		Total	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Income	708	29	5	16	713	45
Expenses	(544)	(22)	(96)	(17)	(640)	(39)
Impairment	(272)	–	(114)	–	(386)	–
Insurance claims	(465)	–	–	–	(465)	–
Profit (loss) before tax	(573)	7	(205)	(1)	(778)	6
Tax	24	(2)	2	–	26	(2)
Share of post-tax results	(549)	5	(203)	(1)	(752)	4
Current assets	2,754	68	605	89	3,359	157
Non-current assets	4,662	11	1,611	44	6,273	55
Current liabilities	(2,175)	(17)	(494)	(86)	(2,669)	(103)
Non-current liabilities	(4,871)	(7)	(1,613)	(47)	(6,484)	(54)
Share of net assets	370	55	109	–	479	55
At 1 January	55	50	–	9	55	59
Adjustment on acquisition	956	–	219	–	1,175	–
Additional investments	140	–	12	–	152	–
Acquisitions	3	–	60	–	63	–
Disposals	(199)	–	(39)	(6)	(238)	(6)
Share of post-tax results	(549)	5	(203)	(1)	(752)	4
Dividends paid	(21)	–	–	(2)	(21)	(2)
Exchange and other adjustments	(15)	–	60	–	45	–
At 31 December	370	55	109	–	479	55

13 INVESTMENTS IN JOINT VENTURES AND ASSOCIATES continued

The Group's unrecognised share of losses of associates for the year is £64 million (2008: £nil) and of joint ventures is £424 million (2008: £nil). For entities making losses, subsequent profits earned are not recognised until previously unrecognised losses are extinguished. The Group's unrecognised share of losses net of unrecognised profits on a cumulative basis of associates is £64 million (2008: £nil) and of joint ventures is £424 million (2008: £nil).

The Group's principal joint venture investments at 31 December 2009 were:

	Nature of business	Type of shares held	Group's interest	Statutory accounts made up to	Principal area of operations
esure Holdings Limited (see below)	Insurance	Ordinary	70%	31 December	UK
		Preference	100%		
Sainsbury's Bank plc	Banking	Ordinary	50%	31 December	UK

All of the interests in the joint ventures above are incorporated in the UK. All interests in joint ventures are held by subsidiaries. Where entities have statutory accounts drawn up to a date other than 31 December management accounts are used when accounting for them by the Group.

Subsequent to the year end, on 11 February 2010 the Group announced the sale of its 70 per cent stake in esure to a management buyout vehicle.

14 GAIN ON ACQUISITION

On 16 January 2009, the Group acquired 100 per cent of the ordinary share capital of HBOS plc, which together with its subsidiaries undertakes banking, insurance and other financial services related activities in the UK and in certain overseas locations.

The table below sets out the fair value of the identifiable net assets acquired.

At the time of the recommended offer for HBOS in September 2008, it had become increasingly difficult for HBOS to raise funds in wholesale markets and their board sought to restore confidence and stability through an agreement to be acquired by Lloyds TSB Group plc announced on 18 September 2008 at the original terms of 0.833 Lloyds TSB Group plc shares for each HBOS share. However turbulence in the markets continued and the UK Government decided in October 2008 that it would be appropriate for the UK banking sector to increase its level of capitalisation. As a consequence of the recapitalisation of HBOS and the impact of the deteriorating market conditions the terms of the final agreed offer were revised down to a ratio of 0.605 per HBOS share.

As the fair value of the identifiable net assets acquired was greater than the total consideration paid, negative goodwill arises on the acquisition. The negative goodwill is recognised as 'Gain on acquisition' in the income statement for the year ended 31 December 2009.

	Book value as at 16 January 2009 £m	Fair value adjustments £m	Fair value as at 16 January 2009 £m
Assets			
Cash and balances at central banks	2,123	–	2,123
Items in the course of collection from banks	523	–	523
Trading and other financial assets at fair value through profit or loss	83,857	–	83,857
Derivative financial instruments	54,840	(808)	54,032
Loans and receivables:			
Loans and advances to banks	15,751	43	15,794
Loans and advances to customers	450,351	(13,512)	436,839
Debt securities	39,819	(1,411)	38,408
Available-for-sale financial assets	27,151	–	27,151
Investment properties	3,002	–	3,002
Investments in joint ventures and associates	1,152	23	1,175
Value of in-force business	3,152	561	3,713
Other intangible assets	104	4,650	4,754
Tangible fixed assets	5,721	(14)	5,707
Current tax recoverable	1,050	–	1,050
Deferred tax assets	2,556	(602)	1,954
Other assets	7,601	(905)	6,696
Total assets	698,753	(11,975)	686,778

14 GAIN ON ACQUISITION continued

	Book value as at 16 January 2009 £m	Fair value adjustments £m	Fair value as at 16 January 2009 £m
Liabilities			
Deposits from banks	87,731	109	87,840
Customer deposits	223,859	835	224,694
Items in course of transmission to banks	521	–	521
Trading and other financial liabilities at fair value through profit or loss	16,360	–	16,360
Derivative financial instruments	45,798	–	45,798
Notes in circulation	936	–	936
Debt securities in issue	191,566	(6,247)	185,319
Liabilities arising from insurance contracts and participating investment contracts	36,405	282	36,687
Liabilities arising from non-participating investment contracts	28,168	13	28,181
Unallocated surplus within insurance businesses	526	–	526
Other liabilities	14,732	(312)	14,420
Retirement benefit obligations	(474)	832	358
Current tax liabilities	58	–	58
Deferred tax liabilities	245	(142)	103
Other provisions	146	606	752
Subordinated liabilities	29,240	(9,192)	20,048
Total liabilities	675,817	(13,216)	662,601
Net assets acquired	22,936	1,241	24,177

Fair value of net assets acquired	24,177
Adjust for:	
Preference shares[1]	(3,917)
Minority interests	(1,300)
Adjusted net assets of HBOS acquired	18,960
Consideration of acquisition costs:	
Issue of 7,776 million ordinary shares of 25p in Lloyds Banking Group plc[2]	(7,651)
Fees and expenses related to the transaction	(136)
Total consideration	(7,787)
Gain on acquisition	11,173

[1] On 16 January 2009, the Group cancelled the following HBOS preference share issuances in exchange for preference shares issued by Lloyds Banking Group plc: 6.475 per cent non-cumulative preference shares of £1 each, 6.3673 per cent non-cumulative fixed to floating preference shares of £1 each and 6.0884 per cent non-cumulative preference shares of £1 each. The fair value of the Lloyds Banking Group preference shares issued is deducted from the net assets acquired for the purposes of calculating the gain arising on acquisition.

[2] The calculation of consideration is based on the closing price of Lloyds TSB ordinary shares of 98.4p on 16 January 2009; 12,852 million HBOS shares were exchanged for Lloyds Banking Group shares at a ratio of 0.605 shares per HBOS share.

The post acquisition loss before tax of HBOS plc covering the period from 17 January 2009 to 31 December 2009 which is included in the Group statutory consolidated income statement for the year to 31 December 2009 is £5,613 million.

Had the acquisition date of HBOS plc been 1 January 2009, Lloyds Banking Group consolidated total income would have been £880 million lower at £44,417 million and Lloyds Banking Group consolidated profit before tax would have been £280 million lower at £762 million.

DISPOSAL OF BUSINESS

On 12 August 2009, the Group announced the sale of Insight Investment Management Limited, a subsidiary in which the Group held a 100 per cent interest. The sale completed on 8 November 2009 and resulted in no gain or loss on disposal. Customer related intangible assets of £170 million that arose on the acquisition of HBOS were included in the disposal (note 29).

15 TAXATION

(A) ANALYSIS OF TAX CREDIT FOR THE YEAR

	2009 £m	2008 £m
UK corporation tax:		
Current tax on profit for the year	(227)	(667)
Adjustments in respect of prior years	(310)	(19)
	(537)	(686)
Double taxation relief	10	91
	(527)	(595)
Foreign tax:		
Current tax on profit for the year	(221)	(144)
Adjustments in respect of prior years	40	4
	(181)	(140)
Current tax charge	(708)	(735)
Deferred tax (note 42):		
Origination and reversal of temporary differences	2,429	625
Adjustments in respect of prior years	190	148
	2,619	773
Tax credit	1,911	38

The credit for tax on the profit for 2009 is based on a UK corporation tax rate of 28.0 per cent (2008: 28.5 per cent).

The above income tax credit is made up as follows:

	2009 £m	2008 £m
Tax (charge) credit attributable to policyholders	(410)	461
Shareholder tax credit (charge)	2,321	(423)
	1,911	38

15 TAXATION continued

	Before tax amount £m	Total tax £m	After tax amount £m
Year ended 31 December 2009			
Movements in available-for-sale financial assets:			
Change in fair value	**2,234**	**(298)**	**1,936**
Transferred to income statement in respect of disposals	**(97)**	**23**	**(74)**
Transferred to income statement in respect of impairment	**621**	**(168)**	**453**
Other transfers to income statement	**(93)**	**26**	**(67)**
	2,665	**(417)**	**2,248**
Movement in cash flow hedge:			
Effective portion of changes in fair value taken to other comprehensive income	**(530)**	**148**	**(382)**
Net gains transferred to the income statement	**121**	**(29)**	**92**
	(409)	**119**	**(290)**
Currency translation differences	**(37)**	**(182)**	**(219)**
Other comprehensive income for the year	**2,219**	**(480)**	**1,739**

	Before tax amount £m	Total tax £m	After tax amount £m
Year ended 31 December 2008[1]			
Movements in available-for-sale financial assets:			
Change in fair value	(2,721)	690	(2,031)
Transferred to income statement in respect of disposals	(19)	–	(19)
Transferred to income statement in respect of impairment	130	(28)	102
Other transfers to income statement	(91)	25	(66)
	(2,701)	687	(2,014)
Movement in cash flow hedge:			
Effective portion of changes in fair value taken to other comprehensive income	(33)	9	(24)
Net gains transferred to the income statement	16	(4)	12
	(17)	5	(12)
Currency translation differences	(1,304)	942	(362)
Other comprehensive income for the year	(4,022)	1,634	(2,388)

[1]Restated for IFRS 2 (Revised)

15 TAXATION continued

(B) FACTORS AFFECTING THE TAX CREDIT FOR THE YEAR

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to profit before tax to the tax credit for the year is given below:

	2009 £m	2008[1] £m
Profit before tax	**1,042**	760
Tax charge thereon at UK corporation tax rate of 28 per cent (2008: 28.5 per cent)	**(292)**	(217)
Factors affecting charge:		
Goodwill	**3,022**	(28)
Disallowed and non-taxable items	**447**	(116)
Overseas tax rate differences	**(352)**	(39)
Gains exempted or covered by capital losses	**(14)**	27
Policyholder interests	**(295)**	330
Tax losses where no deferred tax provided	**(332)**	–
Adjustments in respect of previous years	**(66)**	101
Effect of profit (loss) in joint ventures and associates	**(211)**	–
Other items	**4**	(20)
Tax credit on profit on ordinary activities	**1,911**	38

[1]Restated for IFRS 2 (Revised)

16 EARNINGS PER SHARE

	2009 £m	2008[1] £m
Profit attributable to equity shareholders – basic and diluted	**2,827**	772
	2009 million	2008[1] million
Weighted average number of ordinary shares in issue – basic	**37,674**	11,581
Adjustment for share options and awards	**255**	79
Weighted average number of ordinary shares in issue – diluted	**37,929**	11,660
Basic earnings per share	**7.5p**	6.7p
Diluted earnings per share	**7.5p**	6.6p

[1] Restated, see below

Basic earnings per share are calculated by dividing the net profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the year, which has been calculated after deducting 10 million (2008: 11 million restated) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

The basic and diluted weighted average number of ordinary shares in issue reflects the issue of 2,597 million ordinary shares on 13 January 2009, the issue of 7,776 million ordinary shares as purchase consideration for the acquisition of 100 per cent of the ordinary share capital of HBOS plc on 16 January 2009, the capitalisation issue of 408 million ordinary shares on 11 May 2009, the issue of 10,409 million ordinary shares on 16 June 2009 in respect of a placing and compensatory open offer, the issue of 36,505 million shares in respect of the rights issue on 27 November 2009 and the issue of 108 million ordinary shares on 11 December 2009. To the extent that such shares contain a bonus element, the average number of shares for 2009 has been adjusted to reflect that bonus element for the full year. Average shares for 2008 have been adjusted accordingly (see below).

For the calculation of diluted earnings per share the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company has dilutive potential ordinary shares in respect of share options and awards granted to employees. The number of shares that could have been acquired at the average annual share price of the Company's shares based on the monetary value of the subscription rights attached to outstanding share options and awards is determined. This is deducted from the number of shares issuable under such options and awards to leave a residual bonus amount of shares which are added to the weighted-average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

In December 2009, as part of the Group's recapitalisation and exit from GAPS, the Group entered into an agreement with holders of certain existing liabilities to exchange these for ordinary shares or for cash on 18 February 2010. The weighted average number of anti-dilutive shares arising from this transaction that have been excluded from the calculation of diluted earnings per share was 294 million at 31 December 2009. As set out in note 57, on 18 February 2010, the above exchange completed and 3,141 million new ordinary shares in Lloyds Banking Group plc were issued.

The weighted-average number of anti-dilutive share options and awards excluded from the calculation of diluted earnings per share was 393 million at 31 December 2009 (2008: 59 million).

16 EARNINGS PER SHARE continued

EARNINGS PER SHARE RESTATEMENT

Profit attributable to equity shareholders has been restated for the adoption of IFRS 2 (Revised) as explained in accounting policies (see page 133).

The weighted-average number of ordinary shares in issue have been restated to reflect the adjustment factor of 1.025 arising from the capitalisation issue on 11 May 2009, the adjustment factor of 1.310 arising from the placing and compensatory open offer on 16 June 2009, and the adjustment factor of 1.502 arising from the rights issue on 27 November 2009. The impact of these adjustments on the previously published comparatives is as follows:

	2008 £m
Profit attributable to equity shareholders as published	819
Restatement for IFRS 2 (Revised)	(47)
Restated	772
	Shares million
Weighted-average number of ordinary shares in issue (basic) as published	5,742
Restatement for capitalisation issue	144
Restatement for impact of placing and compensatory open offer	1,824
Restatement for rights issue	3,871
Restated	11,581
Weighted-average number of ordinary shares in issue (diluted) as published	5,781
Restatement for capitalisation issue	145
Restatement for impact of placing and compensatory open offer	1,837
Restatement for rights issue	3,897
Restated	11,660

17 TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

These assets are comprised as follows:

	2009			2008		
	Trading assets £m	**Other financial assets at fair value through profit or loss £m**	**Total £m**	Trading assets £m	Other financial assets at fair value through profit or loss £m	Total £m
Loans and advances to customers	**13,579**	**166**	**13,745**	283	325	608
Loans and advances to banks	**4,702**	**635**	**5,337**	–	–	–
Debt securities:						
Government securities	**2,936**	**17,025**	**19,961**	38	7,326	7,364
Other public sector securities	**6**	**700**	**706**	–	18	18
Bank and building society certificates of deposit	**2,034**	**–**	**2,034**	–	433	433
Asset-backed securities:						
Mortgage-backed securities	**–**	**520**	**520**	–	369	369
Other asset-backed securities	**891**	**1,999**	**2,890**	–	1,342	1,342
Corporate and other debt securities	**3,097**	**17,571**	**20,668**	536	11,120	11,656
	8,964	**37,815**	**46,779**	574	20,608	21,182
Equity shares:						
Listed	**–**	**55,685**	**55,685**	–	16,569	16,569
Unlisted	**–**	**28,465**	**28,465**	–	6,705	6,705
	–	**84,150**	**84,150**	–	23,274	23,274
	27,245	**122,766**	**150,011**	857	44,207	45,064

17 TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS continued

Other financial assets at fair value through profit or loss represent the following assets designated into that category:

(i) financial assets backing insurance contracts and investment contracts of £118,573 million (31 December 2008: £39,899 million) which are so designated because the related liabilities either have cash flows that are contractually based on the performance of the assets or are contracts whose measurement takes account of current market conditions and where significant measurement inconsistencies would otherwise arise;

(ii) loans and advances to customers of £166 million (31 December 2008: £325 million) which are economically hedged by interest rate derivatives which are not in hedge accounting relationships and where significant measurement inconsistencies would otherwise arise if the related derivatives were treated as trading liabilities and the loans and advances were carried at amortised cost; and

(iii) private equity investments of £1,880 million (31 December 2008: £947 million) that are managed, and evaluated, on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

The maximum exposure to credit risk at 31 December 2009 of the loans and advances to banks and customers designated at fair value through profit or loss was £166 million (2008: £325 million); the Group does not hold any credit derivatives or other instruments in mitigation of this risk. There was no significant movement in the fair value of these loans attributable to changes in credit risk which is determined by reference to the publicly available credit ratings of the instruments involved.

The carrying value of assets that are subject to stock lending arrangements was £1,752 million at 31 December 2009 (31 December 2008: £809 million) all of which the secured party is permitted by contract or custom to sell or repledge.

The Group's Wholesale division had exposure to negative basis asset-backed securities of £1,174 million (31 December 2008: £584 million) of which £970 million were protected by monoline financial guarantors (note 54).

18 DERIVATIVE FINANCIAL INSTRUMENTS

The Group holds derivatives as part of the following strategies:

– Customer driven, where derivatives are held as part of the provision of risk management products to Group customers;
– To manage and hedge the Group's interest rate and foreign exchange risk arising from normal banking business. The hedge accounting strategy adopted by the Group is to utilise a combination of fair value, cash flow and net investment hedge approaches as described in Note 54; and
– Derivatives held in policyholders funds as permitted by the investment strategies of those funds,

Derivatives are classified as trading except those designated as effective hedging instruments which meet the criteria under IAS39. Derivatives are held at fair value on the Group's balance sheet. A description of the methodology used to determine the fair value of derivative financial instruments and the effect of using reasonably possible alternative assumptions for those derivatives valued using unobservable inputs is set out in note 53.

The principal derivatives used by the Group are as follows:

– Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.
– Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date.
– Credit derivatives, principally credit default swaps, are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. The Group also uses credit default swaps to securitise, in combination with external funding, £6,455 million (2008: £8,360 million) of corporate and commercial banking loans.
– Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities, in the form of published indices on or before a specified future date.

18 DERIVATIVE FINANCIAL INSTRUMENTS continued

The fair values and notional amounts of derivative instruments are set out the following table:

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2009			
Trading and other			
Exchange rate contracts:			
Spot, forwards and futures	149,701	1,675	1,695
Currency swaps	130,954	6,853	1,787
Options purchased	11,130	678	–
Options written	11,072	–	431
	302,857	9,206	3,913
Interest rate contracts:			
Interest rate swaps	1,092,319	23,799	24,153
Forward rate agreements	840,539	441	400
Options purchased	68,267	1,700	–
Options written	57,772	–	1,656
Futures	12,938	2	7
	2,071,835	25,942	26,216
Credit derivatives	19,673	1,711	444
Embedded equity conversion feature	–	1,797	–
Equity and other contracts	27,391	1,842	1,225
Total derivative assets/liabilities – trading and other	2,421,756	40,498	31,798
Hedging			
Derivatives designated as fair value hedges:			
Currency swaps	26,162	635	107
Interest rate swaps	80,085	3,989	985
Options written	628	–	144
	106,875	4,624	1,236
Derivatives designated as cash flow hedges:			
Interest rate swaps	222,548	4,749	7,285
Futures	5,137	1	3
Currency swaps	8,937	8	144
Options purchased	2,754	4	–
	239,376	4,762	7,432
Derivatives designated as net investment hedges:			
Cross currency swaps	2,507	44	19
Total derivative assets/liabilities – hedging	348,758	9,430	8,687
Total recognised derivative assets/liabilities	2,770,514	49,928	40,485

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in Note 54(3) on page 231.

The embedded equity conversion feature of £1,797 million reflects the value at 31 December 2009 of the equity conversion feature contained in the Enhanced Capital Notes issued by the Group in December 2009 as part of the Group's recapitalisation and exit from the Government Asset Protection Scheme (see note 44).

18 DERIVATIVE FINANCIAL INSTRUMENTS continued

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2008			
Trading and other			
Exchange rate contracts:			
Spot, forwards and futures	157,572	5,788	4,102
Currency swaps	29,463	4,367	1,463
Options purchased	9,185	714	–
Options written	10,143	–	743
	206,363	10,869	6,308
Interest rate contracts:			
Interest rate swaps	368,176	11,797	12,639
Forward rate agreements	153,930	405	395
Options purchased	37,175	843	–
Options written	33,130	–	627
Futures	587	44	3
	592,998	13,089	13,664
Credit derivatives	32,495	4,257	2,670
Equity and other contracts	5,447	234	81
Total derivative assets/liabilities – trading and other	837,303	28,449	22,723
Hedging			
Derivatives designated as fair value hedges:			
Interest rate swaps (including swap options)	37,243	434	1,665
Derivatives designated as cash flow hedges:			
Interest rate swaps	867	1	91
Derivatives designated as net investment hedges:			
Cross currency swaps	6,318	–	2,413
Total derivative assets/liabilities – hedging	44,428	435	4,169
Total recognised derivative assets/liabilities	881,731	28,884	26,892

19 LOANS AND ADVANCES TO BANKS

	2009 £m	2008 £m
Lending to banks	**3,705**	3,056
Money market placements with banks	**31,805**	35,812
Total loans and advances to banks	**35,510**	38,868
Allowance for impairment losses (note 24)	**(149)**	(135)
	35,361	38,733

The Group holds collateral with a fair value of £4,171 million (31 December 2008: £10,739 million), which it is permitted to sell or repledge, of which £4,171 million (2008: £5,492 million) was repledged or sold to third parties for periods not exceeding three months from the transfer. The Group is obliged to return collateral with a fair value of £4,171 million (2008: £5,492 million).

20 LOANS AND ADVANCES TO CUSTOMERS

	2009 £m	2008 £m
Agriculture, forestry and fishing	**5,130**	3,969
Energy and water supply	**3,031**	2,598
Manufacturing	**14,912**	12,057
Construction	**10,830**	3,016
Transport, distribution and hotels	**31,820**	14,664
Postal and telecommunications	**1,662**	1,060
Property companies	**83,820**	23,318
Financial, business and other services	**66,923**	33,319
Personal:		
Mortgages	**362,667**	114,643
Other	**42,958**	25,318
Lease financing	**9,307**	4,546
Hire purchase	**8,710**	5,295
	641,770	243,803
Allowance for impairment losses (note 24)	**(14,801)**	(3,459)
	626,969	240,344

The Group holds collateral with a fair value of £1,110 million (31 December 2008: £1,736 million), which it is permitted to sell or repledge, of which £1,102 million (31 December 2008: £366 million) was repledged or sold to third parties for periods not exceeding three months from the transfer. The Group is obliged to return collateral with a fair value of £1,102 million (2008: £366 million).

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

	2009 £m	2008 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**1,374**	541
Later than 1 year and not later than 5 years	**3,577**	1,775
Later than 5 years	**7,911**	5,570
	12,862	7,886
Unearned future finance income on finance leases	**(3,428)**	(3,038)
Rentals received in advance	**(119)**	(128)
Commitments for expenditure in respect of equipment to be leased	**(8)**	(174)
Net investment in finance leases	**9,307**	4,546

20 LOANS AND ADVANCES TO CUSTOMERS continued

The net investment in finance leases represents amounts recoverable as follows:

	2009 £m	2008 £m
Not later than 1 year	**1,008**	328
Later than 1 year and not later than 5 years	**2,403**	974
Later than 5 years	**5,896**	3,244
	9,307	4,546

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. During 2009 and 2008 no contingent rentals in respect of finance leases were recognised in the income statement. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £123 million (2008: £15 million).
The unguaranteed residual values included in finance lease receivables were as follows:

	2009 £m	2008 £m
Not later than 1 year	**4**	1
Later than 1 year and not later than 5 years	**46**	29
Later than 5 years	**5**	3
	55	33

21 SECURITISATIONS AND COVERED BONDS

Loans and advances to customers include balances that have been securitised but not derecognised, including residential mortgages and commercial banking loans, the carrying values of which are set out below together with any related liabilities. Residential mortgages are not derecognised because the Group remains exposed to the majority of the risk of any default in respect of them; commercial banking loans are not derecognised because the Group has not transferred the contractual rights to receive the cash flows from those loans nor has it assumed a contractual obligation to pay the cash flows from those loans to a third party.

Beneficial interests in certain residential mortgages have been transferred to special purpose entities which issue floating rate debt securities. Neither the Group nor any entities in the Group are obliged to support any losses that may be suffered by the note holders and do not intend to offer such support. The floating rate note holders only receive payments of interest and principal to the extent that the special purpose entities have received sufficient funds from the transferred mortgages and after certain expenses have been met. In the event of a deficiency, they have no recourse whatsoever to the Group.

21 SECURITISATIONS AND COVERED BONDS continued

The Group's principal securitisation and covered bond programmes, together with the balances of the advances subject to securitisation and the carrying value of the notes in issue at 31 December, are listed below. The notes in issue are reported in note 35.

		2009		2008	
Securitisation	Type of loan	Gross assets securitised £m	Notes in issue £m	Gross assets securitised £m	Notes in issue £m
Arkle	UK residential mortgages	**32,070**	**18,141**	34,293	27,189
Ascot Black[1]	Commercial loans	**1,220**	**–**	1,434	–
Goodwood Gold[1]	Commercial loans	**2,932**	**119**	2,909	127
Doncaster Gold[1]	Commercial loans	**831**	**60**	950	48
Exeter Blue[1]	PFI/PPP and project finance loans	**877**	**45**	859	48
Kelso[1]	Corporate loans and revolving credit facilities	**595**	**7**	1,158	3
Morse[1]	Corporate loans and revolving credit facilities	**–**	**–**	1,050	–
Cooper's Hill	UK residential mortgages	**11,383**	**12,000**	–	–
Highland	UK residential mortgages	**5,937**	**6,050**	–	–
Permanent	UK residential mortgages	**38,134**	**30,512**	–	–
Mound	UK residential mortgages	**8,603**	**6,933**	–	–
Handbridge	Personal loans	**3,730**	**2,613**	–	–
Candide	Dutch residential mortgages	**4,800**	**4,663**	–	–
Prominent	Commercial loans	**898**	**787**	–	–
Chepstow Blue	Commercial loans	**3,959**	**4,050**	–	–
Derby Blue	Commercial loans	**3,231**	**3,250**	–	–
Pendeford	UK residential mortgages	**11,994**	**9,039**	–	–
Balliol	UK residential mortgages	**12,771**	**12,819**	–	–
Brae	UK residential mortgages	**7,838**	**9,588**	–	–
Dakota	UK residential mortgages	**3,832**	**3,826**	–	–
Deva	UK residential mortgages	**6,691**	**6,906**	–	–
Penarth	Credit card receivables	**5,155**	**2,699**	–	–
Tioba	UK residential mortgages	**2,094**	**2,249**	–	–
Trinity	UK residential mortgages	**11,033**	**11,466**	–	–
Wolfhound	Irish residential mortgages	**6,522**	**6,585**	–	–
Bella Trust Series	Motor vehicle loans	**443**	**470**	–	–
Other	UK residential mortgages	**63**	**169**	–	–
		187,636	**155,046**	42,653	27,415
Less held by the Group			**(117,489)**		(17,365)
Total securitisations			**37,557**		10,050
Covered Bonds					
Residential Mortgage-Backed Covered Bonds		**99,753**	**76,636**	40,608	24,000
Social Housing Loan-Backed Covered Bonds		**3,356**	**2,735**	–	–
		103,109	**79,371**	40,608	24,000
Less held by the Group			**(52,060)**		(24,000)
Total covered bonds			**27,311**		–
Total securitisations and covered bonds			**64,868**		10,050

[1] Securitisations utilising a combination of external funding and credit default swaps.

Cash deposits of £31,480 million (31 December 2008: £1,846 million) held by the Group are restricted in use to repayment of the debt securities issued by the securitisation vehicles and other legal obligations.

22 SPECIAL PURPOSE ENTITIES

In addition to the special purpose entities disclosed in note 21, which are used for securitisation and covered bond programmes, the Group sponsors three asset-backed conduits, Cancara, Grampian and Landale, which invest in debt securities and client receivables. All the external assets in these conduits are consolidated in the Group's financial statements and are included in the credit market exposures set out in note 54. The total consolidated exposures in these conduits are set out in the table below:

	Cancara £m	Grampian £m	Landale £m	Total £m
At 31 December 2009				
Loans and receivables	**3,681**	**–**	**–**	**3,681**
Debt securities:				
Classified as loans and receivables	**15**	**9,867**	**698**	**10,580**
Classified as available-for-sale (note 25)	**5,382**	**–**	**–**	**5,382**
Total debt securities	**5,397**	**9,867**	**698**	**15,962**
Total assets	**9,078**	**9,867**	**698**	**19,643**
At 31 December 2008				
Loans and receivables	5,905	–	–	5,905
Debt securities:				
Classified as loans and receivables	437	–	–	437
Classified as available-for-sale (note 25)	6,273	–	–	6,273
Total debt securities	6,710	–	–	6,710
Total assets	12,615	–	–	12,615

OTHER SPECIAL PURPOSE ENTITIES

During 2009, the Group established Lloyds TSB Pension ABCS (No 1) LLP and Lloyds TSB Pension ABCS (No 2) LLP and transferred approximately £5 billion of assets, primarily comprising notes in certain of the Group's securitisation programmes, in aggregate to these entities. The Group transferred interests in the LLPs with a fair value of approximately £1 billion in aggregate to the Lloyds TSB Group Pension Scheme No 1 and the Lloyds TSB Group Pension Scheme No 2 entitling these schemes to annual payments of approximately £215 million in aggregate until 31 December 2014 (see note 41).

23 DEBT SECURITIES CLASSIFIED AS LOANS AND RECEIVABLES

Debt securities accounted for as loans and receivables comprise:

	2009 £m	2008 £m
Asset-backed securities:		
Mortgage-backed securities	**13,322**	478
Other asset-backed securities	**17,137**	540
Corporate and other debt securities	**2,623**	3,531
	33,082	4,549
Allowance for impairment losses (see note 24)	**(430)**	(133)
	32,652	4,416

24 ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	Loans and advances to customers £m	Loans and advances to banks £m	Debt securities £m	Total £m
Balance at 1 January 2008	2,408	–	–	2,408
Exchange and other adjustments	43	–	–	43
Advances written off	(1,586)	–	(24)	(1,610)
Recoveries of advances written off in previous years	112	–	–	112
Unwinding of discount	(102)	–	–	(102)
Charge to the income statement	2,584	135	157	2,876
At 31 December 2008	3,459	135	133	3,727
Exchange and other adjustments	**95**	**17**	**49**	**161**
Advances written off	**(4,200)**	**–**	**–**	**(4,200)**
Recoveries of advances written off in previous years	**110**	**–**	**–**	**110**
Unwinding of discount	**(446)**	**–**	**–**	**(446)**
Charge to the income statement	**15,783**	**(3)**	**248**	**16,028**
At 31 December 2009	**14,801**	**149**	**430**	**15,380**

25 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2009			2008		
	Conduits £m	Other £m	Total £m	Conduits £m	Other £m	Total £m
Debt securities:						
Government securities	–	8,669	8,669	–	868	868
Other public sector securities	–	31	31	–	12	12
Bank and building society certificates of deposit	–	1,014	1,014	–	9,602	9,602
Asset-backed securities:						
Mortgage-backed securities	3,481	1,300	4,781	3,929	1,771	5,700
Other asset-backed securities	1,901	5,739	7,640	2,344	5,748	8,092
Corporate and other debt securities	–	19,904	19,904	–	2,183	2,183
	5,382	36,657	42,039	6,273	20,184	26,457
Equity shares:						
Listed	–	102	102	–	3	3
Unlisted	–	1,929	1,929	–	38	38
	–	2,031	2,031	–	41	41
Treasury bills and other bills:						
Treasury bills and similar securities	–	2,532	2,532	–	2,402	2,402
Other bills	–	–	–	–	26,807	26,807
	–	2,532	2,532	–	29,209	29,209
	5,382	41,220	46,602	6,273	49,434	55,707

Details of the Group's asset-backed conduits shown in the table above are included in note 22.

Included within asset-backed securities are £12,421 million (31 December 2008: £13,792 million) managed by the Wholesale division. Further information on these exposures is provided in note 54.

The carrying value of assets that are subject to stock lending arrangements was £4,616 million at 31 December 2009 (31 December 2008: nil) all of which the secured party is permitted by contract or custom to sell or repledge.

All assets have been individually assessed for impairment. The criteria used to determine whether an impairment loss has been incurred are disclosed in note 2(H). Included in available-for-sale financial assets at 31 December 2009 are debt securities individually determined to be impaired whose gross amount before impairment allowances was £144 million (31 December 2008: £282 million) and in respect of which no collateral was held. In addition, included in available-for-sale financial assets at 31 December 2009 are equity securities individually determined to be impaired whose gross amount before impairment allowances was £621 million (31 December 2008: £31 million).

26 INVESTMENT PROPERTIES

	2009 £m	2008 £m
At 1 January	**2,631**	3,722
Exchange and other adjustments	**(15)**	66
Adjustment on acquisition	**3,002**	–
Additions:		
Acquisitions of new properties	**151**	85
Additional expenditure on existing properties	**67**	116
Total additions	**218**	201
Disposals	**(865)**	(300)
Changes in fair value (note 7)	**(214)**	(1,058)
At 31 December	**4,757**	2,631

The investment properties are valued at least annually at open-market value, by independent, professionally qualified valuers, who have recent experience in the location and categories of the investment properties being valued.

In addition, the following amounts have been recognised in the income statement:

	2009 £m	2008 £m
Rental income	**358**	209
Direct operating expenses arising from investment properties that generate rental income	**64**	29

Capital expenditure in respect of investment properties:

	2009 £m	2008 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	**57**	82

27 GOODWILL

	2009 £m	2008 £m
At 1 January	**2,256**	2,358
Exchange and other adjustments	**–**	(2)
Impairment charged to the income statement	**(240)**	(100)
At 31 December	**2,016**	2,256
Cost[1]	**2,362**	2,362
Accumulated impairment losses	**(346)**	(106)
At 31 December	**2,016**	2,256

[1] For acquisitions made prior to 1 January 2004, the date of transition to IFRS, cost is included net of amounts amortised up to 31 December 2003.

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,016 million (31 December 2008: £2,256 million), £1,836 million (or 91 per cent of the total) has been allocated to Scottish Widows in the Group's Insurance division and £170 million (or 8 per cent of the total) to Asset Finance in the Group's Wholesale division.

The recoverable amount of Scottish Widows has been based on a value in use calculation. The calculation uses projections of future cash flows based upon budgets and plans approved by management covering a five-year period, and a discount rate of 12 per cent (gross of tax). The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. Cash flows beyond the five-year period have been extrapolated using a steady 3 per cent growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount of Scottish Widows to fall below its balance sheet carrying value.

27 GOODWILL continued

In 2009, the markets in which the Consumer Finance unit of Asset Finance operates have deteriorated further with both macroeconomic and market conditions worsening, leading to a fall off in demand and increasing arrears. This, together with continuing uncertainties over the likely short-term macroeconomic environment, has resulted in a reassessment of the carrying value of the consumer finance cash generating unit and the recognition of a goodwill impairment charge of £240 million at 31 December 2009 reflecting the write down of the entire balance of goodwill allocated to the Consumer Finance unit of Asset Finance leaving goodwill of £170 million in the Autolease unit of Asset Finance.

The recoverable amount of Asset Finance has also been based on a value in use calculation using cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 18.75 per cent (gross of tax). The cash flows beyond the five-year period are extrapolated using a growth rate of 0.5 per cent which does not exceed the long-term average growth rates for the markets in which Asset Finance participates.

28 VALUE OF IN-FORCE BUSINESS

The gross value of in-force business asset in the consolidated balance sheet is as follows:

	2009 £m	2008 £m
Acquired value of in-force non-participating investment contracts	**1,545**	–
Value of in-force insurance and participating investment contracts	**5,140**	1,893
	6,685	1,893

The movement in the acquired value of in-force non-participating investment contracts over the year is as follows:

	2009 £m	2008 £m
At 1 January	**–**	–
Adjustment on acquisition	**1,620**	–
Amortisation taken to income statement (note 11)	**(75)**	–
At 31 December	**1,545**	–

The acquired value of in-force non-participating investment contracts includes £379 million in relation to OEIC business.

The movement in the value of in-force insurance and participating investment contracts over the year is as follows:

	2009 £m	2008 £m
At 1 January	**1,893**	2,218
Adjustment on acquisition	**2,093**	–
Exchange and other adjustments	**(15)**	–
Movements in the year:		
New business	**563**	368
Existing business:		
Expected return	**(456)**	(112)
Experience variances	**84**	(46)
Non-economic assumption changes	**135**	(92)
Economic variance	**843**	(443)
Movement in the value of in-force business taken to income statement (note 9)	**1,169**	(325)
At 31 December	**5,140**	1,893

This breakdown shows the movement in the value of in-force business only, and does not represent the full contribution that each item in the breakdown contributes to profit before tax, which would also contain changes in the other assets and liabilities of the relevant businesses. Economic variance is the element of earnings which is generated from changes to economic experience in the period and to assumptions over time. The presentation of economic variance includes the impact of financial market conditions being different at the end of the reporting period from those included in assumptions used to calculate new and existing business returns.

28 VALUE OF IN-FORCE BUSINESS continued

The principal features of the methodology and process used for determining key assumptions used in the calculation of the value of in-force business are set out below:

ECONOMIC ASSUMPTIONS

Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. In practice, to achieve the same result, where the cash flows are either independent of or move linearly with market movements, a method has been applied known as the 'certainty equivalent' approach whereby it is assumed that all assets earn a risk-free rate and all cash flows are discounted at a risk-free rate.

A market consistent approach has been adopted for the valuation of financial options and guarantees, using a stochastic option pricing technique calibrated to be consistent with the market price of relevant options at each valuation date. The risk-free rate used for the value of financial options and guarantees is defined as the spot yield derived from the relevant government bond yield curve in line with FSA realistic balance sheet assumptions.

The liabilities in respect of the Group's UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds. In accordance with the approach adopted in December 2008, the value of the in-force business asset for UK annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of these corporate bond holdings. The illiquidity premium is estimated to be 75 basis points as at 31 December 2009 (31 December 2008: 154 basis points). The reduction in the illiquidity premium over 2009 has offset gains made on the assets backing the annuity liabilities, reducing the benefit within the results from the reduction in corporate bond spreads.

The risk-free rate assumed in valuing the non-annuity in-force business is the 15 year government bond yield for the appropriate territory. The risk-free rate assumed in valuing the in-force asset for the UK annuity business is presented as a single risk-free rate to allow a better comparison to the rate used for other business. That single risk-free rate has been derived to give the equivalent value to the UK annuity book, had that book been valued using the UK gilt yield curve increased to reflect the illiquidity premium described above.

The table below shows the range of resulting yields and other key assumptions at 31 December for UK business:

	2009 %	2008 %
Risk-free rate (value of in-force non-annuity business)	**4.45**	3.74
Risk-free rate (value of in-force annuity business)	**5.05**	5.22
Risk-free rate (financial options and guarantees)	**0.87 to 4.76**	1.11 to 4.24
Retail price inflation	**3.64**	2.75
Expense inflation	**4.42**	3.50

NON-MARKET RISK

An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the with-profit funds these can be asymmetric in the range of potential outcomes for which an explicit allowance is made.

NON-ECONOMIC ASSUMPTIONS

Future mortality, morbidity, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. These assumptions are intended to represent a best estimate of future experience.

Further information about the effect of changes in key assumptions is given in note 37.

29 OTHER INTANGIBLE ASSETS

	Brands £m	Core deposit intangible £m	Purchased credit card relationships £m	Customer-related intangibles £m	Capitalised software enhancements £m	Total £m
Cost:						
At 1 January 2008	–	–	–	57	240	297
Additions	–	–	–	6	80	86
At 31 December 2008	–	–	–	63	320	383
Adjustment on acquisition	596	2,770	300	984	104	4,754
Additions	–	–	–	–	63	63
Disposals of businesses (note 14)	–	–	–	(170)	–	(170)
At 31 December 2009	**596**	**2,770**	**300**	**877**	**487**	**5,030**
Accumulated amortisation:						
At 1 January 2008	–	–	–	5	143	148
Charge for the year	–	–	–	7	31	38
At 31 December 2008	–	–	–	12	174	186
Charge for the year	21	393	58	237	60	769
Disposals	–	–	–	(12)	–	(12)
At 31 December 2009	**21**	**393**	**58**	**237**	**234**	**943**
Balance sheet amount at 31 December 2009	**575**	**2,377**	**242**	**640**	**253**	**4,087**
Balance sheet amount at 31 December 2008	–	–	–	51	146	197

The majority of the customer-related intangibles as well as the brands, core deposit intangibles and purchased credit card relationships have arisen from the acquisition of HBOS. Included within brands above are assets of £380 million (31 December 2008: £nil) that have been determined to have indefinite useful lives and are not amortised. These brands use the Bank of Scotland name which has been in existence for over 300 years. These brands are well established financial services brands and there are no indications that they should not continue indefinitely.

The customer-related intangibles include customer lists and the benefits of customer relationships that generate recurring income. The purchased credit card relationships represent the benefit of recurring income generated from the portfolio of credit cards purchased and the core deposit intangible is the benefit derived from a large stable deposit base that has low interest rates.

Capitalised software enhancements principally comprise identifiable and directly associated internal staff and other costs.

30 TANGIBLE FIXED ASSETS

	Premises £m	Equipment £m	Operating lease assets £m	Total tangible fixed assets £m
Cost:				
At 1 January 2008	1,437	2,871	1,431	5,739
Exchange and other adjustments	2	18	70	90
Additions	96	341	556	993
Disposals	(19)	(82)	(493)	(594)
At 31 December 2008	1,516	3,148	1,564	6,228
Exchange and other adjustments	**19**	**(38)**	**281**	**262**
Adjustment on acquisition	**966**	**825**	**3,916**	**5,707**
Additions	**113**	**1,317**	**1,949**	**3,379**
Disposals	**(153)**	**(130)**	**(1,326)**	**(1,609)**
At 31 December 2009	**2,461**	**5,122**	**6,384**	**13,967**
Accumulated depreciation and impairment:				
At 1 January 2008	718	2,007	175	2,900
Exchange and other adjustments	1	10	21	32
Charge for the year	81	254	313	648
Disposals	(11)	(63)	(243)	(317)
At 31 December 2008	789	2,208	266	3,263
Exchange and other adjustments	**(19)**	**(12)**	**113**	**82**
Charge for the year	**132**	**450**	**1,134**	**1,716**
Disposals	**(18)**	**(49)**	**(251)**	**(318)**
At 31 December 2009	**884**	**2,597**	**1,262**	**4,743**
Balance sheet amount at 31 December 2009	**1,577**	**2,525**	**5,122**	**9,224**
Balance sheet amount at 31 December 2008	727	940	1,298	2,965

At 31 December the future minimum rentals receivable under non-cancellable operating leases were as follows:

	2009 £m	2008 £m
Receivable within 1 year	**845**	294
1 to 5 years	**1,939**	320
Over 5 years	**88**	9
	2,872	623

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2009 and 2008 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £79 million at 31 December 2009 (£102 million at 31 December 2008) is expected to be received under non-cancellable sub-leases of the Group's premises.

31 OTHER ASSETS

	2009 £m	2008 £m
Assets arising from reinsurance contracts held (note 36)	**1,875**	385
Deferred acquisition and origination costs	**533**	196
Settlement balances	**1,587**	751
Other assets and prepayments	**8,230**	4,469
	12,225	5,801

Deferred acquisition and origination costs:

	2009 £m	2008 £m
At 1 January	**196**	212
Adjustment on acquisition	**422**	–
Costs deferred, net of amounts amortised to the income statement	**(84)**	(16)
Exchange and other adjustments	**(1)**	–
At 31 December	**533**	196

32 DEPOSITS FROM BANKS

	2009 £m	2008 £m
Liabilities in respect of securities sold under repurchase agreements	**27,558**	24,888
Other deposits from banks	**54,894**	41,626
Deposits from banks	**82,452**	66,514

Included in deposits from banks were deposits of £17,253 million (31 December 2008: £2,574 million) held as collateral. The fair value of those deposits approximates the carrying amount.

33 CUSTOMER DEPOSITS

	2009 £m	2008 £m
Non-interest bearing current accounts	**9,264**	4,176
Interest bearing current accounts	**93,887**	47,109
Savings and investment accounts	**207,474**	76,144
Liabilities in respect of securities sold under repurchase agreements	**35,554**	92
Other customer deposits	**60,562**	43,417
Customer deposits	**406,741**	170,938

Included in customer deposits were deposits of £656 million (31 December 2008: £1,002 million) held as collateral. The fair value of those deposits approximates the carrying amount.

34 TRADING AND OTHER FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2009 £m	2008 £m
Liabilities held at fair value through profit or loss (debt securities)	6,160	6,748
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	21,389	–
Short positions in securities	202	6
Other	520	–
	22,111	6
Trading and other financial liabilities at fair value through profit or loss	28,271	6,754

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2009 was £5,866 million, which was £294 million lower than the balance sheet carrying value (31 December 2008: £6,517 million, which was £231 million lower than the balance sheet carrying value). At 31 December 2009 there was a cumulative £55 million decrease in the fair value of these liabilities attributable to changes in credit spread risk; this is determined by reference to the quoted credit spreads of Lloyds TSB Bank plc, the issuing entity within the Group. Of the £55 million, £11 million arose in 2009 and £36 million arose in 2008.

Liabilities designated at fair value through profit or loss represent debt securities in issue which either contain substantive embedded derivatives which would otherwise need to be recognised and measured at fair value separately from the related debt securities, or which are accounted for at fair value to significantly reduce an accounting mismatch.

35 DEBT SECURITIES IN ISSUE

	2009 £m	2008 £m
Medium-term notes issued	82,876	11,823
Covered bonds (note 21)	27,311	–
Certificates of deposit issued	50,858	33,207
Securitisation notes (note 21)	37,557	10,050
Commercial paper	34,900	20,630
Total debt securities in issue	233,502	75,710

36 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS

Insurance contract and participating investment contract liabilities are comprised as follows:

	2009			2008		
	Gross £m	Reinsurance[1] £m	Net £m	Gross £m	Reinsurance[1] £m	Net £m
Life insurance (see (1) below):						
Insurance contracts	56,800	(1,831)	54,969	21,518	(380)	21,138
Participating investment contracts	18,089	–	18,089	11,619	–	11,619
	74,889	(1,831)	73,058	33,137	(380)	32,757
Non-life insurance contracts (see (2) below):						
Unearned premiums	788	(31)	757	472	–	472
Claims outstanding	502	(13)	489	183	(5)	178
	1,290	(44)	1,246	655	(5)	650
	76,179	(1,875)	74,304	33,792	(385)	33,407

[1] Reinsurance balances are reported within other assets (note 31).

At 31 December 2009 £44,441 million (31 December 2008: £29,967 million) of liabilities arising from insurance contracts and participating investment contracts had a contractual residual maturity of greater than one year.

(1) LIFE INSURANCE

The movement in life insurance contract and participating investment contract liabilities over the year can be analysed as follows:

	Insurance contracts	Participating investment contracts	Gross £m	Reinsurance £m	Net £m
At 1 January 2008:	22,526	14,874	37,400	(340)	37,060
New business	2,915	208	3,123	(32)	3,091
Changes in existing business	(4,092)	(3,363)	(7,455)	(8)	(7,463)
Change in liabilities charged to the income statement (note 10)	(1,177)	(3,155)	(4,332)	(40)	(4,372)
Exchange and other adjustments	169	(100)	69	–	69
At 31 December 2008:	21,518	11,619	33,137	(380)	32,757
New business	4,455	122	4,577	(28)	4,549
Changes in existing business	971	374	1,345	(149)	1,196
Change in liabilities charged to the income statement (note 10)	5,426	496	5,922	(177)	5,745
Adjustment on acquisition	29,996	5,996	35,992	(1,367)	34,625
Exchange and other adjustments	(140)	(22)	(162)	93	(69)
At 31 December 2009	**56,800**	**18,089**	**74,889**	**(1,831)**	**73,058**

Liabilities for life insurance contracts and participating investment contracts can be split into with-profit fund liabilities, accounted for using the FSA's realistic capital regime (realistic liabilities) and non-profit fund liabilities, accounted for using a prospective actuarial discounted cash flow methodology, as follows:

	2009			2008		
	With-profit fund £m	Non-profit fund £m	Total £m	With-profit fund £m	Non-profit fund £m	Total £m
Insurance contracts	12,066	44,734	56,800	7,457	14,061	21,518
Participating investment contracts	11,506	6,583	18,089	5,836	5,783	11,619
	23,572	51,317	74,889	13,293	19,844	33,137

36 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

With-profit fund realistic liabilities

(i) Business description
The Group has with-profit funds within Scottish Widows plc and Clerical Medical Investment Group Limited containing both insurance contracts and participating investment contracts.

The primary purpose of the conventional and unitised business written in the with-profit funds is to provide a long-term smoothed investment vehicle to the policyholder, protecting them against short-term market fluctuations. With-profit policyholders are entitled to at least 90 per cent of the distributed profits, the shareholders receiving the balance. The policyholder is also usually insured against death and the policy may carry a guaranteed annuity option at maturity.

(ii) Method of calculation of liabilities
With-profit liabilities are stated at their realistic value, the main components of which are:

– With-profit benefit reserve, the total asset shares for with-profit policies;
– Cost of options and guarantees
– Deductions levied against asset shares; and
– Impact of the smoothing policy.

The realistic assessment is carried out using a stochastic simulation model which values liabilities on a market consistent basis. The calculation of realistic liabilities uses best estimate assumptions for mortality, persistency rates and expenses. These are calculated in a similar manner to those used for the value of in-force business as discussed in note 28.

(iii) Assumptions
Key assumptions used in the calculation of with-profit liabilities, and the processes for determining these, are:

INVESTMENT RETURNS AND DISCOUNT RATES
The realistic capital regime dictates that with-profit fund liabilities are valued on a market-consistent basis. This is achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The with-profit fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as the spot yield derived from the relevant government bond yield curve.

GUARANTEED ANNUITY OPTIONS
Certain pension contracts contain guaranteed annuity options that allow the policyholder to take an annuity benefit on retirement at annuity rates that were guaranteed at the outset of the contract. For contracts that contain such options, key assumptions in determining the cost of options are economic conditions in which the option has value, mortality rates and take up rates of other options. The financial impact is dependent on the value of corresponding investments, interest rates and longevity at the time of the claim.

INVESTMENT VOLATILITY
The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical volatility where it is not possible to observe meaningful prices.

MORTALITY
The mortality assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this is significant, and relevant industry data otherwise.

LAPSE RATES (PERSISTENCY)
Lapse rates refer to the rate of policy termination or the rate at which policyholders stop paying regular premiums due under the contract.

Historical persistency experience is analysed using statistical techniques. As experience can vary considerably between different product types and for contracts that have been in force for different periods, the data is broken down into broadly homogenous groups for the purposes of this analysis.

The most recent experience is considered along with the results of previous analyses and management's views on future experience, taking into consideration potential changes in future experience that may result from guarantees and options becoming more valuable under adverse market conditions, in order to determine a 'best estimate' view of what persistency will be. In determining this best estimate view a number of factors are considered, including the credibility of the results (which will be affected by the volume of data available), any exceptional events that have occurred during the period under consideration, any known or expected trends in underlying data and relevant published market data.

36 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

Non-profit fund liabilities

(i) Business description

The Group principally writes the following types of life insurance contracts within its non-profit funds. Shareholder profits on these types of business arise from management fees and other policy charges.

Unit-linked business – This includes unit-linked pensions and unit-linked bonds, the primary purpose of which is to provide an investment vehicle where the policyholder is also insured against death.

Life insurance – The policyholder is insured against death or permanent disability, usually for predetermined amounts. Such business includes whole of life and term assurance and long-term creditor policies.

Annuities – The policyholder is entitled to payments for the duration of their life and is therefore insured against surviving longer than expected.

German insurance and pensions business is written through the subsidiary Heidelberger Leben and comprises policies similar to the UK definitions above, except that there is participation by the policyholder in the investment, insurance and expense profits of Heidelberger Leben. A minimum level of policyholder participation is prescribed by German law. The following types of life insurance contracts are written under which there is policyholder participation in Heidelberger Leben profits:

- Unit linked endowment or pensions business;
- Traditional endowment or pensions business;
- Life insurance business in which the policyholder is protected against temporary disability; and
- Life insurance business in which the policyholder is protected against death.

(ii) Method of calculation of liabilities

The non-profit fund liabilities are determined on the basis of recognised actuarial methods and consistent with the approach required by regulatory rules. The methods used involve estimating future policy cash flows over the duration of the in-force book of policies, and discounting the cash flows back to the valuation date allowing for probabilities of occurrence.

(iii) Assumptions

Generally, assumptions used to value non-profit fund liabilities are prudent in nature and therefore contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgement and reflects management's views on the inherent level of uncertainty. The key assumptions used in the measurement of non-profit fund liabilities are:

INTEREST RATES

The rates used are derived in accordance with the guidelines set by local regulatory bodies. These limit the rates of interest that can be used by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

Margins for risk are allowed for in the assumed interest rates. These are derived from the limits in the guidelines set by local regulatory bodies, including reductions made to the available yields to allow for default risk based upon the credit rating of the securities allocated to the insurance liability.

MORTALITY AND MORBIDITY

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and include a margin for adverse deviation. For German business appropriate industry tables have been considered.

LAPSE RATES (PERSISTENCY)

Lapse rates are allowed for on some non-profit fund contracts. The process for setting these rates is as described for with-profit liabilities, however a prudent scenario is assumed by the inclusion of a margin for adverse deviation within the non-profit fund liabilities.

MAINTENANCE EXPENSES

Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviation. Explicit allowance is made for future expense inflation. For German business appropriate cost assumptions have been set in accordance with the rules of the local regulatory body.

KEY CHANGES IN ASSUMPTIONS

A detailed review of the Group's assumptions in 2009 resulted in the following key impacts on profit before tax:

– Change in persistency assumptions (£79 million decrease)

– Change in the assumption in respect of future mortality rates (£44 million increase)

These amounts include the impacts of movements in liabilities and value of the in-force business in respect of insurance contracts and participating investment contracts.

36 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

(2) NON-LIFE INSURANCE

Gross non-life insurance contract liabilities are analysed by line of business as follows:

	2009 £m	2008 £m
Credit protection	**533**	293
Home	**754**	359
Health	**3**	3
	1,290	655

For non-life insurance contracts, the methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product. Assumptions are intended to be neutral estimates of the most likely or expected outcome. There has been no significant change in the assumptions and methodologies used for setting reserves.

The reserving methodology and associated assumptions are set out below:

The unearned premium reserve is determined on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of each contract.

Claims outstanding comprise those claims that have been notified and those that have been incurred but not reported. Claims incurred but not reported are determined based on the historical emergence of claims and their average cost. The notified claims element represents the best estimate of the cost of claims reported using projections and estimates based on historical experience.

The movements in non-life insurance contract liabilities and reinsurance assets over the year have been as follows:

	Gross £m	Reinsurance £m	Net £m
Provisions for unearned premiums			
At 1 January 2008	456	–	456
Increase in the year	651	(23)	628
Release in the year	(635)	23	(612)
Change in provision for unearned premiums charged to income statement (note 8)	16	–	16
At 31 December 2008	472	–	472
Adjustment on acquisition	**487**	**(4)**	**483**
Increase in the year	**1,267**	**(101)**	**1,166**
Release in the year	**(1,438)**	**75**	**(1,363)**
Change in provision for unearned premiums charged to income statement (note 8)	**(171)**	**(26)**	**(197)**
Exchange translation	**–**	**(1)**	**(1)**
At 31 December 2009	**788**	**(31)**	**757**

36 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

These provisions represent the liability for short-term insurance contracts for which the Group's obligations are not expired at the year end.

	Gross £m	Reinsurance £m	Net £m
Claims and loss adjustment expenses			
Notified claims	188	(10)	178
Incurred but not reported	19	–	19
At 1 January 2008	207	(10)	197
Cash paid for claims settled in the year	(245)	7	(238)
Increase (decrease) in liabilities:			
Arising from current year claims	221	–	221
Arising from prior year claims	–	(2)	(2)
Change in liabilities charged to income statement (note 10)	(24)	5	(19)
At 31 December 2008	183	(5)	178
Adjustment on acquisition	**208**	**(5)**	**203**
Cash paid for claims settled in the year	**(513)**	**14**	**(499)**
Increase (decrease) in liabilities:			
Arising from current year claims	**623**	**(15)**	**608**
Arising from prior year claims	**1**	**(2)**	**(1)**
Change in liabilities charged to income statement (note 10)	**111**	**(3)**	**108**
At 31 December 2009	**502**	**(13)**	**489**
Notified claims	**289**	**(9)**	**280**
Incurred but not reported	**213**	**(4)**	**209**
At 31 December 2009	**502**	**(13)**	**489**
Notified claims	160	(5)	155
Incurred but not reported	23	–	23
At 31 December 2008	183	(5)	178

36 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

NON-LIFE INSURANCE CLAIMS DEVELOPMENT TABLE

The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The top half of the table below illustrates how the Group's estimate of total claims outstanding for each accident year has changed at successive year ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. The accident year basis is considered the most appropriate for the business written by the Group.

NON-LIFE INSURANCE ALL RISKS – GROSS

	2005 £m	2006 £m	2007 £m	2008 £m	**2009 £m**	**Total £m**
Accident year						
Estimate of ultimate claims costs:						
At end of accident year	211	208	317	205	**639**	**1,580**
One year later	207	206	311	199		
Two years later	204	204	299			
Three years later	202	204				
Four years later	201					
Current estimate in respect of above claims	201	204	299	199	**639**	**1,542**
Current estimate of claims relating to general insurance business acquired during the year	283	321	391	270		**1,265**
Current estimate of cumulative claims	484	525	690	469	**639**	**2,807**
Cumulative payments to date	(478)	(517)	(664)	(412)	**(270)**	**(2,341)**
Liability recognised in the balance sheet	6	8	26	57	**369**	**466**
Liability in respect of earlier years[1]						**26**
Total liability included in the balance sheet						**492**

[1] This balance includes £19 million of claims relating to general insurance business acquired during the year.

The liability of £492 million shown in the above table excludes £10 million of unallocated claims handling expenses.

37 LIFE INSURANCE SENSITIVITY ANALYSIS

The following table demonstrates the effect of changes in key assumptions on profit before tax and equity disclosed in these financial statements assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. These amounts include movements in assets, liabilities and the value of the in-force business in respect of insurance contracts and participating investment contracts. The impact is shown in one direction but can be assumed to be reasonably symmetrical.

	Change in variable	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m
Non-annuitant mortality[1]	**5% reduction**	**80**	**58**
Annuitant mortality[2]	**5% reduction**	**(120)**	**(86)**
Lapse rates[3]	**10% reduction**	**168**	**121**
Future maintenance and investment expenses[4]	**10% reduction**	**207**	**149**
Risk-free rate[5]	**0.25% reduction**	**56**	**40**
Guaranteed annuity option take up[6]	**5% addition**	**(7)**	**(5)**
Equity investment volatility[7]	**1% addition**	**(13)**	**(9)**
Widening of credit default spreads on corporate bonds[8]	**0.25% addition**	**(144)**	**(104)**
Increase in illiquidity premia[9]	**0.10% addition**	**78**	**56**

Assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and statutory reserving bases.

[1] This sensitivity shows the impact of reducing mortality and morbidity rates on non-annuity business to 95 per cent of the expected rate.

[2] This sensitivity shows the impact on the annuity and deferred annuity business of reducing mortality rates to 95 per cent of the expected rate.

[3] This sensitivity shows the impact of reducing lapse and surrender rates to 90 per cent of the expected rate.

[4] This sensitivity shows the impact of reducing maintenance expenses and investment expenses to 90 per cent of the expected rate.

[5] This sensitivity shows the impact on the value of in-force business, financial options and guarantee costs, statutory reserves and asset values of reducing the risk-free rate by 25 basis points.

[6] This sensitivity shows the impact of a flat 5 per cent addition to the expected rate.

[7] This sensitivity shows the impact of a flat 1 per cent addition to the expected rate.

[8] This sensitivity shows the impact of a 25 basis point increase in credit default spreads on corporate bonds and the corresponding reduction in market values. Government bond yields, the risk-free rate and illiquidity premia are all assumed to be unchanged.

[9] This sensitivity shows the impact of a 10 basis point increase in the allowance for illiquidity premia. It assumes the overall corporate bond spreads are unchanged and hence market values are unchanged. Government bond yields and the non-annuity risk-free rate are both assumed to be unchanged. The increased illiquidity premium increases the annuity risk-free rate.

38 LIABILITIES ARISING FROM NON-PARTICIPATING INVESTMENT CONTRACTS

The movement in liabilities arising from non-participating investment contracts may be analysed as follows:

	Gross £m	Reinsurance £m	Net £m
At 1 January 2008	18,197	–	18,197
New business	660	–	660
Changes in existing business	(4,614)	–	(4,614)
At 31 December 2008	14,243	–	14,243
Adjustment on acquisition	**28,181**	**–**	**28,181**
New business	**3,498**	**–**	**3,498**
Changes in existing business	**430**	**–**	**430**
Exchange translation	**(4)**	**–**	**(4)**
At 31 December 2009	**46,348**	**–**	**46,348**

39 UNALLOCATED SURPLUS WITHIN INSURANCE BUSINESSES

The movement in the unallocated surplus within long-term insurance business over the year can be analysed as follows:

	2009 £m	2008 £m
At 1 January	**270**	554
Adjustment on acquisition	**526**	–
Change in unallocated surplus recognised in the income statement (note 10)	**318**	(284)
Exchange and other adjustments	**(32)**	–
At 31 December	**1,082**	270

40 OTHER LIABILITIES

	2009 £m	2008 £m
Settlement balances	**2,070**	891
Unitholders' interest in Open Ended Investment Companies	**12,415**	4,336
Other creditors and accruals	**14,835**	6,229
Other liabilities	**29,320**	11,456

41 RETIREMENT BENEFIT OBLIGATIONS

	2009 £m	2008 £m
Charge to the income statement		
Defined benefit pension schemes	**529**	157
Other post-retirement benefit schemes	**7**	7
Total defined benefit schemes	**536**	164
Defined contribution pension schemes	**208**	71
	744	235

	2009 £m	2008 £m
Amounts recognised in the balance sheet		
Defined benefit pension schemes	**619**	1,657
Other post-retirement benefit schemes	**161**	114
	780	1,771

PENSION SCHEMES

Defined benefit schemes

The Group has established a number of defined benefit pension schemes in the UK and overseas, the three most significant being the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2 and the HBOS Final Salary Pension Scheme (HFSPS). These schemes provide retirement benefits calculated as a percentage of final salary depending upon the length of service; the minimum retirement age under the rules of the schemes at 31 December 2009 was 50.

The latest full valuations of the two Lloyds TSB schemes were carried out as at 30 June 2008; the latest full valuation of the HFSPS was carried out as at 31 December 2007. The provisional results have been updated to 31 December 2009 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2009 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

41 RETIREMENT BENEFIT OBLIGATIONS continued

The Group's obligations in respect of its defined benefit schemes are funded. During 2009, the Group's contributions to its defined benefit schemes of £1,859 million included one-off contributions to the Lloyds TSB Group Pension Scheme No 1 and Lloyds TSB Group Pension Scheme No 2 of approximately £1 billion in aggregate. These contributions took the form of interests in limited liability partnerships for each of the two schemes which contain assets of approximately £5 billion in aggregate entitling the schemes to annual payments of approximately £215 million in aggregate until 31 December 2014. Thereafter, assuming that all distributions have been made, the value of the partnership interests will equate to a nominal amount. The limited liability partnerships are fully consolidated in the Group's balance sheet (see note 22).

The Group currently expects to pay contributions of at least £500 million to its defined benefit schemes in 2010.

	2009 £m	2008 £m
Amount included in the balance sheet		
Present value of funded obligations	27,073	15,617
Fair value of scheme assets	(23,518)	(13,693)
	3,555	1,924
Unrecognised actuarial losses	(2,936)	(267)
Liability in the balance sheet	619	1,657

	2009 £m	2008 £m
Movements in the defined benefit obligation		
At 1 January	15,617	16,795
Adjustment on acquisition	7,046	–
Current service cost	395	258
Employee contributions	2	–
Interest cost	1,383	957
Actuarial losses (gains)	3,568	(1,928)
Benefits paid	(932)	(597)
Past service cost	67	21
Curtailments	–	6
Settlements	(8)	–
Exchange and other adjustments	(65)	105
At 31 December	27,073	15,617

	2009 £m	2008 £m
Changes in the fair value of scheme assets		
At 1 January	13,693	16,112
Adjustment on acquisition	6,743	–
Expected return	1,320	1,085
Employer contributions	1,859	541
Employee contributions	2	–
Actuarial gains (losses)	886	(3,520)
Benefits paid	(932)	(597)
Settlements	(12)	–
Exchange and other adjustments	(41)	72
At 31 December	23,518	13,693
Actual return on scheme assets	2,206	(2,435)

41 RETIREMENT BENEFIT OBLIGATIONS continued

ASSUMPTIONS

The principal actuarial and financial assumptions used in valuations of the defined benefit pension schemes were as follows:

	2009 %	2008 %
Discount rate	**5.70**	6.30
Rate of inflation	**3.40**	3.00
Rate of salary increases	**3.75**	3.75
Rate of increase for pensions in payment	**3.20**	2.80
	Years	Years
Life expectancy for member aged 60, on the valuation date:		
Men	**27.1**	26.4
Women	**28.2**	27.2
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**28.7**	27.3
Women	**29.8**	28.1

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 as at 31 December 2009 is assumed to live for, on average, 27.1 years for a male and 28.2 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

An analysis of the impact of a reasonable change in these assumptions is provided in note 3.

The expected return on scheme assets has been calculated using the following assumptions:

	2009 %	2008 %
Equities	**8.4**	8.2
Fixed interest gilts	**3.7**	4.5
Index linked gilts	**4.0**	4.4
Non-Government bonds	**6.7**	6.0
Property	**6.4**	6.7
Money market instruments and cash	**3.8**	4.8

The expected return on scheme assets in 2010 will be calculated using the following assumptions:

	2010 %
Equities and alternative assets	**8.3**
Fixed interest gilts	**4.5**
Index linked gilts	**4.1**
Non-Government bonds	**6.0**
Property	**7.5**
Money market instruments and cash	**4.3**

41 RETIREMENT BENEFIT OBLIGATIONS continued

Composition of scheme assets:

	2009 £m	2008 £m
Equities	**10,934**	7,040
Fixed interest gilts	**2,038**	1,452
Index linked gilts	**2,917**	1,326
Non-Government bonds	**2,148**	1,721
Property	**1,577**	1,485
Money market instruments, cash and other assets and liabilities	**3,904**	669
At 31 December	**23,518**	13,693

The assets of all the funded plans are held independently of the Group's assets in separate trustee administered funds.

The expected return on plan assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields at the balance sheet date at a term and credit rating broadly appropriate for the bonds held. Expected returns on equity and property investments are long-term rates based on the views of the plan's independent investment consultants. The expected return on equities allows for the different expected returns from the private equity, infrastructure and hedge fund investments held by some of the funded plans. Some of the funded plans also invest in certain money market instruments and the expected return on these investments has been assumed to be the same as cash.

Experience adjustments history:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligation	**27,073**	15,617	16,795	17,378	17,320
Fair value of scheme assets	**(23,518)**	(13,693)	(16,112)	(15,279)	(14,026)
	3,555	1,924	683	2,099	3,294
Experience gains (losses) on scheme liabilities	**31**	(39)	(185)	(50)	(69)
Experience gains (losses) gains on scheme assets	**886**	(3,520)	139	314	1,538

The expense recognised in the income statement for the year ended 31 December comprises:

	2009 £m	2008 £m
Current service cost	**395**	258
Interest cost	**1,383**	957
Expected return on scheme assets	**(1,320)**	(1,085)
Curtailments	**–**	6
Settlements	**4**	–
Past service cost	**67**	21
Total defined benefit pension expense	**529**	157

Defined contribution schemes

The Group operates a number of defined contribution pension schemes in the UK and overseas, principally the defined contribution sections of the Lloyds TSB Group Pension Schemes No's 1 and 2.

During the year ended 31 December 2009 the charge to the income statement in respect of defined contribution schemes was £208 million (2008: £71 million), representing the contributions payable by the employer in accordance with each scheme's rules.

41 RETIREMENT BENEFIT OBLIGATIONS continued

OTHER POST-RETIREMENT BENEFIT SCHEMES

The Group operates a number of schemes which provide post-retirement healthcare benefits and concessionary mortgages to certain employees, retired employees and their dependants. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependants) who retired prior to 1 January 1996. The Group has entered into an insurance contract to provide these benefits and a provision has been made for the estimated cost of future insurance premiums payable.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 30 June 2008; this valuation has been updated to 31 December 2009 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 7.33 per cent (2008: 7.50 per cent).

Amount included in the balance sheet:

	2009 £m	2008 £m
Present value of unfunded obligations	170	118
Unrecognised actuarial losses	(9)	(4)
Liability in the balance sheet	161	114

Movements in the other post-retirement benefits obligation:

	2009 £m	2008 £m
At 1 January	118	123
Exchange and other adjustments	(7)	2
Adjustment on acquisition	55	–
Actuarial loss (gain)	5	(8)
Insurance premiums paid	(8)	(6)
Charge for the year	7	7
At 31 December	170	118

42 DEFERRED TAX

The movement in the net deferred tax balance is as follows:

	2009 £m	2008 £m
Asset (liability) at 1 January	833	(948)
Exchange and other adjustments	107	(4)
Adjustment on acquisition	1,851	–
Disposals	16	98
Income statement credit (note 15)	2,619	773
Amount credited (charged) to equity:		
Available-for-sale financial assets (note 47)	(395)	566
Net investment hedges (note 47)	(358)	358
Cash flow hedges (note 47)	119	5
Share based compensation	5	(15)
	(629)	914
Asset at 31 December	4,797	833

42 DEFERRED TAX continued

The statutory position reflects the deferred tax assets and liabilities as disclosed in the consolidated balance sheet and takes account of the inability to offset assets and liabilities where there is no legally enforceable right of offset. The tax disclosure of deferred tax assets and liabilities ties to the amounts outlined in the table below which splits the deferred tax assets and liabilities by type.

Statutory position	2009 £m	2008 £m	Tax disclosure	2009 £m	2008 £m
Deferred tax assets	5,006	833	Deferred tax assets	8,579	2,308
Deferred tax liabilities	(209)	–	Deferred tax liabilities	(3,782)	(1,475)
	4,797	833		4,797	833

The deferred tax credit in the income statement comprises the following temporary differences:

	2009 £m	2008 £m
Accelerated capital allowances	1,039	318
Pensions and other post-retirement benefits	(199)	(104)
Long-term assurance business	(188)	458
Allowances for impairment losses	(128)	2
Trading losses	4,000	97
Tax on fair value of acquired assets	(2,022)	–
Other temporary differences	117	2
	2,619	773

Deferred tax assets and liabilities are comprised as follows:

	2009 £m	2008 £m
Deferred tax assets:		
Pensions and other post-retirement benefits	424	496
Allowances for impairment losses	474	103
Other provisions	232	51
Derivatives	155	114
Available-for-sale asset revaluation	936	567
Tax losses carried forward	5,925	856
Other temporary differences	433	121
	8,579	2,308

	2009 £m	2008 £m
Deferred tax liabilities:		
Accelerated capital allowances	(92)	(561)
Long-term assurance business	(1,530)	(655)
Tax on fair value of acquired assets	(1,913)	–
Effective interest rates	(88)	(2)
Other temporary differences	(159)	(257)
	(3,782)	(1,475)

42 DEFERRED TAX continued

DEFERRED TAX ASSETS

Deferred tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through future taxable profits is probable. Group companies have recognised deferred tax assets of £5,925 million (2008: £856 million) in relation to tax losses carried forward. After reviews of medium-term profit forecasts, the Group considers that there will be sufficient profits in the future against which these losses will be offset.

Deferred tax assets of £487 million (31 December 2008: £252 million) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits. Capital losses can be carried forward indefinitely.

Deferred tax assets of £349 million (31 December 2008: nil) have not been recognised in respect of trading losses carried forward, mainly in certain overseas companies as there are limited predicted future trading profits. Trading losses can be carried forward indefinitely.

In addition, deferred tax assets have not been recognised in respect of unrelieved foreign tax carried forward as at 31 December 2009 of £53 million (31 December 2008: £60 million), as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. These tax credits can be carried forward indefinitely.

DEFERRED TAX LIABILITIES

Future transfers from Scottish Widows plc's long-term business funds to its Shareholder Fund will be subject to a shareholder tax charge. Under IAS 12, no provision is required to be made to the extent that the timing of such transfers is under Scottish Widows plc's control. Accordingly, deferred tax liabilities of £90 million (2008: £90 million) have not been recognised.

Scottish Widows plc has a taxable difference of £152 million (2008: £152 million) in respect of its holding of a life insurance subsidiary. No deferred tax liability is required to be recognised in respect of this taxable temporary difference under IAS 12 as Scottish Widows plc does not intend to dispose of this subsidiary company.

43 OTHER PROVISIONS

	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Restructuring provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2009	30	34	14	28	124	230
Exchange and other adjustments	(1)	1	–	–	7	7
Transfers	–	157	–	–	–	157
Adjustment on acquisition	–	503	2	40	207	752
Provisions applied	–	(105)	(1)	–	(128)	(234)
Charge (release) for the year	43	(130)	101	40	17	71
At 31 December 2009	**72**	**460**	**116**	**108**	**227**	**983**

43 OTHER PROVISIONS continued

PROVISIONS FOR CONTINGENT LIABILITIES AND COMMITMENTS
Provisions are held in cases where the Group is irrevocably committed to advance additional funds, but where there is doubt as to the customer's ability to meet its repayment obligations.

CUSTOMER REMEDIATION PROVISIONS
The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes have been found to be deficient. During 2009 management has reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and £130 million has been released to the income statement. At 31 December 2009 the remaining provisions held relate to past sales of a number of products, including mortgage endowment policies, sold through the branch networks.

RESTRUCTURING
Provisions are made for staff and other costs related to Group restructuring initiatives at the point at which the Group becomes irrevocably committed to the expenditure.

VACANT LEASEHOLD PROPERTY
Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income, compared to the head rent, and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on a biennial basis and will normally run off over the period of under-recovery of the leases concerned, currently averaging five years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

OTHER
Other provisions include the provisions which the Group carries in respect of its obligations relating to UIC Insurance Company Limited (UIC), which is in provisional liquidation. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a reinsurance contract, which is subject to asbestosis and pollution claims in the US. The ultimate cost of settling the Group's exposure in respect of the insurance business of UIC and the timing remains uncertain. The provision held represents management's current best estimate of the cost after having regard to the financial condition of UIC and actuarial estimates of future claims.

44 SUBORDINATED LIABILITIES

	2009 £m	2008 £m
Preference shares	**1,983**	1,408
Preferred securities	**2,917**	4,088
Undated subordinated liabilities	**4,826**	5,638
Enhanced capital notes	**9,047**	–
Dated subordinated liabilities	**15,954**	6,122
	34,727	17,256

As part of the Group's recapitalisation and agreement not to enter GAPS which included a £13.1 billion rights issue (net of costs) (note 45), on 1 December, 10 December and 15 December 2009, the Group issued a total of £8,554 million of enhanced capital notes in exchange for certain existing preference shares, preferred securities and undated subordinated liabilities.

The ECNs contain an equity conversion feature (based on a fixed definition as defined by the Financial Services Authority in May 2009) that requires them to convert into ordinary shares if the consolidated core tier 1 ratio of the Group falls below 5 per cent. The conversion feature meets the definition of an embedded derivative and has been recorded separately as a derivative asset (note 18). The ECNs are guaranteed by either the Company or Lloyds TSB Bank plc. These guarantees are subordinated to the claims of senior creditors, rank equally with the claims of the holders of dated subordinated liabilities and are senior to the claims of holders of undated subordinated liabilities, preferred securities and shareholders of the respective guarantor.

The securities in this note will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The claims of holders of preferred shares and securities are generally junior to those of the holders of undated subordinated liabilities, which in turn are junior to the claims of holders of the dated subordinated liabilities. The subordination of the enhanced capital notes ranks equally with that of the dated subordinated liabilities. The Group has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the year (2008: none). No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the Financial Services Authority.

	Note	2009 £m	2008 £m
Preference shares			
6% Non-cumulative Redeemable Preference Shares	a	**–**	–
6.369% Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)	c, e	**–**	584
6.267% Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	c, e	**327**	824
9¼% Non-cumulative Irredeemable £1 preference shares (£300 million)	b, c, e	**197**	–
9¾% Non-cumulative Irredeemable £1 preference shares (£100 million)	b, c, e	**72**	–
6.413% Fixed-to-Floating Rate US$1 series A preference shares (US$750 million)	b, c, e	**115**	–
5.92% Fixed-to-Floating Rate US$1 series B preference shares (US$750 million)	b, c, e	**90**	–
6.657% Fixed-to-Floating rate US$1 preference shares (US$750 million)	b, c, e	**28**	–
7.875% Non-cumulative callable preference shares (US$1,250 million)	c, d, e	**680**	–
7.875% Non-cumulative callable preference shares (€500 million)	c, d, e	**417**	–
6.475% fixed rate non-cumulative callable preference shares (£186 million)	b, c, e	**45**	–
6.0884% fixed-to-floating rate non-cumulative callable preference shares (£745 million)	b, c, e	**10**	–
6.3673% fixed-to-floating non-cumulative callable preference shares (£335 million)	b, c, e	**2**	–
		1,983	1,408

As described in note 51, in January 2009 the Company issued £1,000 million 12 per cent fixed-to-floating non-cumulative callable preference shares to HM Treasury as part of the recapitalisation of the Lloyds Banking Group and a further £3,000 million 12 per cent fixed-to-floating non-cumulative callable preference shares in respect of the recapitalisation of the HBOS Group. These shares were redeemed out of the proceeds from the placing and compensatory open offer in June 2009 (see note 45) and are excluded from the table above.

44 SUBORDINATED LIABILITIES continued

a Since 2004, the Company has had in issue 400 6 per cent non-cumulative preference shares of 25p each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company. The holder of the 400 25p 6 per cent preference shares has waived its right to payment for the period from 1 March 2010 to 1 March 2012.

b On 16 January 2009 so as to improve the position of HBOS preference shareholders and simplify the Group's capital structure following the acquisition of HBOS the Group replaced certain HBOS preference share issuances in exchange for preference shares with similar terms and conditions issued by the Company.

c As part of the Group's recapitalisation and exit from GAPS, following an exchange offer, on 1 December , 10 December and 15 December 2009, certain holders of certain series elected to exchange some or all of the preference shares they held for enhanced capital notes issued by LBG Capital No. 1 plc and LBG Capital No. 2 plc or equity issued by Lloyds Banking Group plc.

d On 19 January 2009 the Company issued US$1,250,000,000 7.875 per cent non-cumulative callable preference shares and €500,000,000 7.875 per cent non-cumulative callable preference shares by exercising its option to convert preferred securities into preference shares. Both issues are callable on 29 November 2013.

e As described in note 9, in November 2009, as part of the state aid restructuring plan, the Group agreed to suspend the payment of coupons on these instruments for the two year period from 31 January 2010 to 31 January 2012.

	Note	2009 £m	2008 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)	c	**645**	756
7.375 % Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	c, d	**306**	459
7.875% Perpetual Capital Securities (€500 million)	a	**–**	472
7.875% Perpetual Capital Securities (US$1,250 million)	a	**–**	921
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	c	**456**	512
7.834% Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	c, d	**43**	248
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	c, d	**82**	720
6.071% Non-cumulative Perpetual Preferred Securities of US$1,000 each (US$750 million)	b, c	**240**	–
6.85% Non-cumulative Perpetual Preferred Securities of US$1,000 each (US$1,000 million)	b, c	**–**	–
6.461% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A of £1,000 each (£600 million)	b, c	**398**	–
8.117% Non-cumulative Perpetual Preferred Securities Series 1 of £1,000 each (Class A) (£250 million)	b, c	**234**	–
7.754% Non-cumulative Perpetual Preferred Securities Series 2 of £1,000 each (Class B) (£150 million)	b, c	**93**	–
7.881% Guaranteed Non-voting Non-cumulative Preferred Securities (£245 million)	b, c	**151**	–
7.627% Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities (€415 million)	b, c	**259**	–
4.939% Non-voting Non-cumulative Perpetual Preferred Securities (€750 million)	b, c, d	**10**	–
		2,917	4,088

a On 16 January 2009 Lloyds TSB Bank plc exercised the option to convert these securities into preference shares.

b Arising on acquisition of HBOS.

c As part of the Group's recapitalisation and exit from GAPS, following an exchange offer, on 1 December 2009, 10 December and 15 December 2009 certain holders of certain series elected to exchange some or all of the notes they held for enhanced capital notes issued by LBG Capital No. 1 plc and LBG Capital No. 2 plc.

d As described in note 9, in November 2009, as part of the state aid restructuring plan, the Group agreed to suspend the payment of coupons on these instruments for the two year period from 31 January 2010 to 31 January 2012.

44 SUBORDINATED LIABILITIES continued

	Note	2009 £m	2008 £m
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:	b		
Series 1 (US$750 million)	e	408	515
Series 2 (US$500 million)	e	262	343
Series 3 (US$600 million)	e	326	412
11¾% Perpetual Subordinated Bonds (£100 million)	e	102	100
5⁵/₈% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	b, e	–	1,212
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	b	–	144
6⁵/₈% Undated Subordinated Step-up Notes callable 2010 (£410 million)	b, c, e	5	409
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million) (Scottish Widows plc)	a	547	536
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)	e	–	189
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	b, c, e	–	455
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)	b, c, e	–	241
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	b, c, e	–	186
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)	c, e	–	444
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	c, e	10	452
13% Step-up Perpetual Capital Securities callable 2019 (£784 million)	e	9	–
13% Euro Step-up Perpetual Capital Securities callable 2019 (€532 million)	e	47	–
12% Fixed to Floating Rate Perpetual Tier 1 Capital Securities callable 2024 (US$2,000 million)		1,235	–
13% Sterling Step-up Perpetual Capital Securities callable 2029 (£700 million)	e	666	–
5.625% Cumulative Callable Fixed to Floating Rate Undated Subordinated Notes (£500 million)	b, c, d, e	1	–
4.875% Undated Subordinated Fixed to Floating Rate Instruments (€750 million)	b, c, d, e	60	–
Floating Rate Undated Subordinated Notes (€500 million)	b, c, d, e	41	–
5.375% Undated Fixed to Floating Rate Subordinated Notes (US$1,000 million)	d, e	3	–
5.125% Undated Subordinated Fixed to Floating Notes (€750 million)	b, c, d, e	39	–
5.75% Undated Subordinated Step-up Notes (£600 million)	b, c, d, e	2	–
6.05% Fixed to Floating Rate Undated Subordinated Notes (€500 million)	b, c, d, e	50	–
Perpetual Regulatory Tier One Securities (£300 million)	d	204	–
7.5% Undated Subordinated Step-up Notes (£300 million)	b, c, d, e	4	–
3.50% Undated Subordinated Yen Step-up Notes (JPY 42.5 billion)	d	267	–
8.625% Perpetual Subordinated Notes (£200 million)	b, c, d, e	18	–
7.375% Undated Subordinated Guaranteed Bonds (£200 million) (Clerical Medical Finance plc)	d, f	35	–
Floating Rate Undated Subordinated Step-up Notes (€300 million)	b, c, d, e	58	–
Floating Rate Primary Capital Notes (US$250 million)	d, e	146	–
10.25% Subordinated Undated Instruments (£100 million)	b, c, d, e	1	–
12% Perpetual Subordinated Bonds (£100 million)	d, e	22	–
8.75% Perpetual Subordinated Bonds (£100 million)	d, e	6	–
13.625% Perpetual Subordinated Bonds (£75 million)	d, e	33	–
9.375% Perpetual Subordinated Bonds (£50 million)	d, e	26	–
5.75% Undated Subordinated Step-up Notes (£500 million)	b, c, d, e	3	–
4.25% Perpetual Fixed/Floating Rate Reset Subordinated Guaranteed Notes (€750 million) (Clerical Medical Finance plc)	d, f	190	–
		4,826	5,638

44 SUBORDINATED LIABILITIES continued

a Scottish Widows plc may elect to defer interest on these securities although in that event Scottish Widows plc cannot declare or pay a dividend on any ordinary share capital until any deferred payments have been made.

b Following an exchange offer, on 7 January 2009 certain holders elected to exchange all or some of the notes they held for innovative Tier 1 securities issued by Lloyds TSB Bank plc.

c Following an exchange offer, on 25 March 2009 certain holders elected to exchange all or some of the notes they held for senior unsecured notes issued by Lloyds TSB Bank plc.

d Arising on acquisition of HBOS.

e As part of the Group's recapitalisation and exit from GAPS, following an exchange offer, on 1 December, 10 December and 15 December certain holders of certain series elected to exchange some or all of the notes they held for enhanced capital notes issued by LBG Capital No. 1 plc and LBG Capital No. 2 plc.

f Following an exchange offer, on 30 June 2009, certain holders elected to exchange all or some of the notes for senior unsecured notes by Lloyds TSB Bank plc.

	Note	2009 £m	2008 £m
Enhanced capital notes			
7.5884% Enhanced Capital Notes due 2020 (Series 1) (£732 million)		**690**	–
7.8673% Enhanced Capital Notes due 2019 (Series 2) (£331 million)		**316**	–
7.975% Enhanced Capital Notes due 2024 (Series 3) (£102 million)		**96**	–
7.869% Enhanced Capital Notes due 2020 (Series 8) (£596 million)		**572**	–
8.875% Enhanced Capital Notes due 2020 (Series 12) (€125 million)		**117**	–
9.334% Enhanced Capital Notes due 2020 (Series 14) (£208 million)		**218**	–
6.439% Enhanced Capital Notes due 2020 (Series 15) (€710 million)		**557**	–
6.385% Enhanced Capital Notes due 2020 (Series 18) (€662 million)		**517**	–
11.04% Enhanced Capital Notes due 2020 (Series 19) (£736 million)		**871**	–
15% Enhanced Capital Notes due 2019 (Series 21) (£775 million)		**1,125**	–
15% Enhanced Capital Notes due 2019 (Series 22) (€487 million)		**646**	–
15% Enhanced Capital Notes due 2029 (Series 23) (£68 million)		**108**	–
9.125% Enhanced Capital Notes due 2020 (Series 27) (£148 million)		**153**	–
11.125% Enhanced Capital Notes due 2020 (Series 31) (£39 million)		**45**	–
7.375% Enhanced Capital Notes due 2020 (Series 32) (€95 million)		**80**	–
Floating Rate Enhanced Capital Notes due 2020 (Series 33) (€53 million)	a	**42**	–
12.75% Enhanced Capital Notes due 2020 (Series 34) (£57 million)		**74**	–
8.07% Enhanced Capital Notes due 2020 (Series 35) (¥20,000 million)		**156**	–
7.625% Enhanced Capital Notes due 2020 (Series 36) (€226 million)		**193**	–
6.75% Enhanced Capital Notes due 2020 (Series 37) (¥17,000 million)		**121**	–
7.625% Enhanced Capital Notes due 2019 (Series 39) (£151 million)		**142**	–
9% Enhanced Capital Notes due 2019 (Series 40) (£97 million)		**100**	–
8.125% Enhanced Capital Notes due 2019 (Series 41) (£4 million)		**4**	–
14.5% Enhanced Capital Notes due 2022 (Series 42) (£79 million)		**115**	–
9.875% Enhanced Capital Notes due 2023 (Series 44) (£57 million)		**62**	–
11.25% Enhanced Capital Notes due 2023 (Series 45) (£95 million)		**115**	–
10.5% Enhanced Capital Notes due 2023 (Series 46) (£69 million)		**78**	–
11.875% Enhanced Capital Notes due 2024 (Series 47) (£35 million)		**45**	–
9% Enhanced Capital Notes due 2029 (Series 49) (£107 million)		**108**	–
8.5% Enhanced Capital Notes due 2032 (Series 50) (£104 million)		**100**	–
16.125% Enhanced Capital Notes due 2024 (Series 52) (£61 million)		**100**	–
7.875% Enhanced Capital Notes due 2020 (US$986 million)		**599**	–
8% Fixed to Floating Rate Undated Enhanced Capital Notes callable 2022 (US$1,259 million)	b	**639**	–
8.5% Undated Enhanced Capital Notes callable 2021 (Series 2) (US$277 million)	b	**143**	–
		9,047	–

a Interest is payable quarterly in arrears at a rate of 3 month EURIBOR +3.1 per cent per annum.

b Issued in upper tier 2 format.

44 SUBORDINATED LIABILITIES continued

Enhanced capital notes are a new liability class developed for the purposes of the liability management exercise conducted by Lloyds Banking Group in the final quarter of 2009. With the exception of the two series identified in note b, the ECNs were issued in lower tier 2 format and are convertible into ordinary shares on the breach of a defined trigger. The trigger on the ECNs offered in the exchange will be if the published core tier 1 ratio of the Group falls below 5 per cent (as defined by the Financial Services Authority in May 2009).

	Note	2009 £m	2008 £m
Dated subordinated liabilities			
9 1/2% Subordinated Bonds 2009 (£100 million)		–	100
6 1/4% Subordinated Notes 2010 (€400 million)		375	404
12% Guaranteed Subordinated Bonds 2011 (£100 million)	a	108	100
7.70% Notes 2010 (US$500 million)	b	327	–
9 1/8% Subordinated Bonds 2011 (£150 million)		152	149
4 3/4% Subordinated Notes 2011 (€850 million)		771	836
6.50% Notes 2011 (US$150 million)	b	102	–
5.50% Subordinated Fixed Rate Notes 2012 (€750 million)	b	654	–
6.25% Instruments 2012 (€12.8 million)	b	10	–
6.125% Notes 2013 (€325 million)	b	296	–
4.25% Subordinated Guaranteed Notes 2013 (US$1,000 million)	b	594	–
5 7/8% Subordinated Guaranteed Bonds 2014 (€750 million)		768	821
5 7/8% Subordinated Notes 2014 (£150 million)		154	149
11% Subordinated Bonds 2014 (£250 million)	b	304	–
6 5/8% Subordinated Notes 2015 (£350 million)		335	320
4.875% Subordinated Notes 2015 (€1,000 million)	b	875	–
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)		296	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)		445	480
Callable Floating Rate Subordinated Notes 2016 (€500 million)	b	374	–
Subordinated Notes 2016 (€500 million)	b	389	–
Notes 2016 (US$750 million)	b	367	–
Subordinated Lower Tier II Notes 2017 (€1,000 million)	b	704	–
Subordinated Callable Notes 2017 (US$1,000 million)	b	464	–
Subordinated Callable Floating Rate Instruments 2017 (Aus$400 million)	b	209	–
6.75% Subordinated Callable Fixed/Floating Rate Instruments 2017 (Aus$200 million)	b	101	–
5.109% Callable Fixed to Floating Rate Notes 2017 (Can$500 million)	b	263	–
Lower Tier II Subordinated Notes 2017 (£500 million)	b	474	–
5.625% Subordinated Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)		979	992
10.5% Subordinated Bonds 2018 (£150 million)	b	165	–
6.75% Subordinated Fixed Rate Notes 2018 (US$2,000 million)	b	917	–
6.375% Instruments 2019 (£250 million)	b	227	–
4.375% Callable Fixed to Floating Rate Subordinated Notes 2019 (€750 million)	b	602	–
6.9625% Subordinated Fixed to Floating Rate Notes due 2020 callable 2015 (£750 million)		755	754
Subordinated Floating Rate Notes 2020 (€100 million)		89	96
9.375% Subordinated Bonds 2021 (£500 million)	b	268	–
5.374% Subordinated Fixed Rate Notes 2021 (€160 million)	b	132	–
6.45% Fixed/Floating Subordinated Guaranteed Bonds 2023 (€400 million) (Clerical Medical Finance plc)	b, c	171	–
6.5% Subordinated Fixed Rate Notes 2023 (€175 million)	b	128	–
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		322	309
9 5/8% Subordinated Bonds 2023 (£300 million)		333	312
4.50% Fixed Rate Step-up Subordinated Notes due 2030 (€750 million)	b	478	–
6.00% Subordinated Notes 2033 (US$750 million)	b	477	–
		15,954	6,122

a Issued by a group undertaking under the Company's subordinated guarantee.

b Arising on acquisition of HBOS.

c Following an exchange offer on 30 June 2009, certain holders elected to exchange all or some of the notes for senior unsecured notes issued by Lloyds TSB Bank plc.

45 SHARE CAPITAL

(1) AUTHORISED SHARE CAPITAL

As permitted by the Companies Act 2006, the Company removed references to authorised share capital from its articles of association at the annual general meeting on 5 June 2009. This change took effect from 1 October 2009.

(2) ISSUED AND FULLY PAID SHARE CAPITAL

	2009 Number of shares	2008 Number of shares	2009 £m	2008 £m
Ordinary shares of 10p (formerly 25p) each				
At 1 January	5,972,855,669	5,647,703,945	1,493	1,412
Private placement	–	284,400,000	–	71
Placing and open offer	2,596,653,203	–	649	–
Issued on acquisition of HBOS	7,775,694,993	–	1,944	–
Capitalisation issue	407,943,501	–	102	–
Placing and compensatory open offer	10,408,535,000	–	2,602	–
Subdivision	–	–	(4,074)	–
Rights issue	36,505,088,579	–	3,651	–
Issued to the Lloyds TSB Foundations	107,740,591	–	11	–
Issued under employee share schemes	–	40,751,724	–	10
At 31 December	63,774,511,536	5,972,855,669	6,378	1,493
Limited voting ordinary shares of 10p (formerly 25p) each				
At 1 January	78,947,368	78,947,368	20	20
Capitalisation issue	1,973,683	–	–	–
Subdivision	–	–	(12)	–
At 31 December	80,921,051	78,947,368	8	20
Deferred shares of 15p each				
At 1 January	–	–	–	–
Subdivision of ordinary shares	27,161,682,366	–	4,074	–
Subdivision of limited voting ordinary shares	80,921,051	–	12	–
At 31 December	27,242,603,417	–	4,086	–
Total issued share capital			10,472	1,513

Details of preference shares that are classified as debt for accounting purposes are given in note 44.

SHARE SUBDIVISION

At the general meeting held on 26 November 2009 the Company's shareholders approved the subdivision of the ordinary shares with each ordinary share of 25 pence subdivided into one ordinary share of 10 pence and a deferred share of 15 pence. In addition, the shareholders approved the subdivision of the limited voting ordinary shares with each share of 25 pence subdivided into one limited voting ordinary share of 10 pence and a deferred share of 15 pence.

45 SHARE CAPITAL continued

Share issuances during 2009

ORDINARY SHARES
On 13 January 2009 the Company issued 2,597 million shares under a placing and open offer, subscribed for by HM Treasury as part of the recapitalisation of the banking industry by the UK Government, which raised £4,430 million (net of £70 million issue costs). This issue resulted in an increase of £649 million in share capital and an increase of £3,781 million in the merger reserve.

On 16 January 2009 the Company issued 7,776 million shares in consideration for the acquisition of HBOS, whereby 12,852 million HBOS shares were exchanged for Lloyds Banking Group shares at a ratio of 0.605 shares per HBOS share. This issue resulted in an increase of £1,944 million in share capital and an increase of £5,707 million in the merger reserve.

In lieu of a dividend the Group announced a capitalisation issue of 1 for 40 ordinary shares held and on 11 May 2009 408 million ordinary shares of 25 pence were issued. This resulted in an increase in share capital of £102 million with a corresponding decrease in the share premium account.

In June 2009 the Company issued 10,409 million shares under a placing and compensatory open offer which raised £3,905 million (net of £95 million issue costs), the proceeds of which were used to redeem the £4,000 million of 12 per cent fixed-to-floating rate non-cumulative callable preference shares of 25 pence each issued to HM Treasury earlier in the year as described in note 44. This issue resulted in an increase of £2,602 million in share capital and an increase of £1,303 million in the share premium account.

In December 2009, the Company issued 36,505 million shares in a rights issue at an issue price of 37 pence per new share as part of its recapitalisation and exit from the Government Asset Protection Scheme. This raised £13,112 million (net of £395 million of issue costs). This issue resulted in an increase of £3,651 million in share capital and an increase of £9,461 million in the share premium account.

DEFERRED SHARES
The share subdivision noted above created 27,243 million deferred shares of 15 pence each. These shares carry no voting or dividend rights and on a return of capital on a winding up of the Company will have the right to receive the paid up amount only after ordinary shareholders have received in aggregate any amounts paid up plus £10 million per ordinary share.

(3) SHARE CAPITAL AND CONTROL
There are no restrictions on the transfer of shares in the Company other than as set out in the articles of association and:

– certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws);
– pursuant to the UK Listing Authority's listing rules where directors and certain employees of the Company require the approval of the Company to deal in the Company's shares; and
– pursuant to the rules of some of the Company's employee share plans where certain restrictions may apply while the shares are subject to the plans.

Where, under an employee share plan operated by the Company, participants are the beneficial owners of shares but not the registered owners, the voting rights are normally exercised by the registered owner at the direction of the participant. Outstanding awards and options would normally vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions at that time.

In addition, the Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

Information regarding significant direct or indirect holdings of shares in the Company can be found on page 261.

The directors have authority to allot and issue ordinary and preference shares and to make market purchases of preference shares as granted at the general meeting on 26 November 2009. The authority to issue shares will expire at the annual general meeting, and the authority to make market purchases of preference shares expires on 25 November 2010. The directors also have authority to make market purchases of ordinary shares as granted at the general meeting on 5 June 2009. This authority expires either a year after the date of approval or at the annual general meeting. Shareholders will be asked, at the annual general meeting, to give similar authorities.

Subject to any rights or restrictions attached to any shares, on a show of hands at a general meeting of the Company every holder of shares present in person or by proxy and entitled to vote has one vote and on a poll every member present and entitled to vote has one vote for every share held.

Further details regarding voting at the annual general meeting can be found in the notes to the notice of the annual general meeting.

ORDINARY SHARES
The holders of ordinary shares (excluding the limited voting ordinary shares), who held 98.7 per cent of the total ordinary share capital as at 31 December 2009, are entitled to receive the Company's report and accounts, attend, speak and vote at general meetings and appoint proxies to exercise voting rights. Holders of ordinary shares (excluding the limited voting ordinary shares) may also receive a dividend (subject to the provisions of the Company's articles of association and the restrictions noted below) and on a winding up may share in the assets of the Company.

45 SHARE CAPITAL continued

Under the terms of the state aid remedies referred to in note 9, the Company is prevented from making discretionary coupon and dividend payments on certain capital instruments from 31 January 2010 until 31 January 2012. Consequently, the terms of these instruments prevent the Company from making dividend payments on ordinary shares.

LIMITED VOTING ORDINARY SHARES
The limited voting ordinary shares are held by the Lloyds TSB Foundations (the Foundations). The holders of the limited voting ordinary shares, who held 1.3 per cent of the total ordinary shares as at 31 December 2009, are entitled to receive copies of every circular or other document sent out by the Company to the holders of other ordinary shares. These shares carry no rights to dividends but rank pari passu with the ordinary shares in respect of other distributions and in the event of winding up. These shares do not have any right to vote at general meetings other than on resolutions concerning acquisitions or disposals of such importance that they require shareholder consent, or for the winding up of the Company, or for a variation in the class rights of the limited voting ordinary shares. In the event of an offer for more than 50 per cent of the issued ordinary share capital of the Company, each limited voting ordinary share will convert into an ordinary share and shall rank equally with the ordinary shares in all respects from the date of conversion.

PREFERENCE SHARES
The Company has in issue various classes of preference shares which are all classified as liabilities under IFRS and details of which are shown in note 44.

46 SHARE PREMIUM ACCOUNT

	2009 £m	2008 £m
At 1 January	**2,096**	1,298
Premium arising on private placement of ordinary shares	**–**	689
Capitalisation issue	**(102)**	–
Premium arising on Placing and Compensatory Open Offer of ordinary shares	**1,303**	–
Transfer to merger reserve[1]	**(1,000)**	–
Rights issue	**9,461**	–
Issued to Lloyds TSB Foundations	**30**	–
Redemption of preference shares[2]	**2,684**	–
Premium arising on issue of shares under share option schemes	**–**	109
At 31 December	**14,472**	2,096

[1] Distributable reserves of £1,000 million arose on the issue of preference shares in January 2009 which were classified as debt. In June 2009, these preference shares were redeemed out of the proceeds of the placing and compensatory open offer of ordinary shares and the distributable element of this issue was transferred from the share premium account to the merger reserve.

[2] In December 2009, the Group redeemed eight issues of preference shares in exchange for the issuance of enhanced capital notes. This resulted in a transfer of £26 million from the merger reserve to the capital redemption reserve and a transfer of £2,684 million from the merger reserve to the share premium account. Details of the preference shares redeemed are set out in note 44.

47 OTHER RESERVES

	2009 £m	2008 £m
Other reserves comprise:		
Merger reserve	**8,121**	343
Capital redemption reserve	**26**	–
Revaluation reserve in respect of available-for-sale financial assets	**(914)**	(2,982)
Cash flow hedging reserve	**(305)**	(15)
Foreign currency translation reserve	**158**	178
At 31 December	**7,086**	(2,476)

The merger reserve primarily comprises the premium on shares issued on 13 January 2009 under the placing and open offer and shares issued on 16 January 2009 on the acquisition of HBOS plc.

The capital redemption reserve represents transfers from the merger reserve in accordance with companies' legislation.

The revaluation reserve in respect of available-for-sale financial assets represents the cumulative after tax unrealised change in the fair value of financial assets classified as available-for-sale since initial recognition, or in the case of available-for-sale financial assets obtained on acquisitions of businesses, since the date of acquisition.

The cash flow hedging reserve represents the cumulative after tax gains and losses on effective cash flow hedging instruments that will be reclassified to the income statement in the periods in which the hedged item affects profit or loss.

The foreign currency translation reserve represents the cumulative after-tax gains and losses on the translation of foreign operations and exchange differences arising on financial instruments designated as hedges of the Group's net investment in foreign operations.

Movements in other reserves were as follows:

	2009 £m	2008 £m
Merger reserve		
At 1 January	**343**	343
Placing and open offer	**3,781**	–
Shares issued on acquisition of HBOS	**5,707**	–
Issue of preference shares[1]	**1,000**	–
Redemption of preference shares[2]	**(2,710)**	–
At 31 December	**8,121**	343

	2009 £m	2008 £m
Capital redemption reserve		
At 1 January	**–**	–
Redemption of preference shares[2]	**26**	–
At 31 December	**26**	–

[1] Distributable reserves of £1,000 million arose on the issue of preference shares in January 2009 which were classified as debt. In June 2009, these preference shares were redeemed out of the proceeds of the placing and compensatory open offer of ordinary shares and the distributable element of this issue was transferred to the merger reserve.

[2] In December 2009, the Group redeemed eight issues of preference shares in exchange for the issuance of enhanced capital notes. This resulted in a transfer of £26 million from the merger reserve to the capital redemption reserve and a transfer of £2,684 million from the merger reserve to the share premium account. Details of the preference shares redeemed are set out in note 44.

47 OTHER RESERVES continued

	2009 £m	2008 £m
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	**(2,982)**	(399)
Exchange and other adjustments	**(199)**	(541)
Change in fair value of available-for-sale financial assets	**2,234**	(2,721)
Change in fair value attributable to minority interests	**(1)**	2
Deferred tax	**(276)**	566
Current tax	**(2)**	94
	1,955	(2,059)
Income statement transfers:		
Disposals (note 9)	**(97)**	(19)
Deferred tax	**23**	–
	(74)	(19)
Impairment	**621**	130
Deferred tax	**(168)**	–
Current tax	**–**	(28)
	453	102
Other transfers	**(93)**	(91)
Deferred tax	**26**	–
Current tax	**–**	25
	(67)	(66)
At 31 December	**(914)**	(2,982)

	2009 £m	2008 £m
Cash flow hedging reserve		
At 1 January	**(15)**	(3)
Change in fair value of hedging derivatives	**(530)**	(33)
Deferred tax	**148**	9
	(382)	(24)
Income statement transfer (note 5)	**121**	16
Deferred tax	**(29)**	(4)
	92	12
At 31 December	**(305)**	(15)

	2009 £m	2008 £m
Foreign currency translation reserve		
At 1 January	**178**	(1)
Currency translation differences arising in the year	**(652)**	2,533
Foreign currency losses on net investment hedges	**814**	(3,310)
Amounts transferred to income statement in respect of hedge ineffectiveness	**–**	14
Current tax	**176**	584
Deferred tax	**(358)**	358
	632	(2,354)
At 31 December	**158**	178

48 RETAINED PROFITS

	2009 £m	2008[1] £m
At 1 January	8,260	9,471
Profit for the year	2,827	772
Dividends	–	(2,042)
Purchase/sale of treasury shares	45	16
Employee share option schemes – value of employee services	116	43
At 31 December	11,248	8,260

[1] Restated for IFRS 2 (Revised)

Retained profits are stated after deducting £48 million (2008: £40 million) representing 49 million (2008: 15 million) treasury shares held.

Value of employee services includes a credit of £111 million (2008: £59 million) reflecting the income statement charge in respect of SAYE and executive options, together with a related tax credit of £5 million (2008: tax charge £16 million). Purchase/sale of treasury shares includes a credit of £128 million (2008: £31 million) relating to the cost of other share scheme awards.

49 ORDINARY DIVIDENDS

	2009 Pence per share	2008 Pence per share	2009 £m	2008 £m
Final dividend for previous year paid during the current year	–	24.7	–	1,394
Interim dividend	–	11.4	–	648
	–	36.1	–	2,042

The directors do not propose to pay a final dividend (2008: none).

Bank of New York Nominees Limited have waived the right to all dividends on Lloyds Banking Group plc shares that they hold (holding at 31 December 2009: nil shares and at 31 December 2008: 10 shares).

In addition, the trustees of the following holdings of Lloyds Banking Group plc shares in relation to employee share schemes retain the right to receive dividends but chose to waive their entitlement to the dividends on those shares as indicated: the Lloyds TSB Group Shareplan (holding at 31 December 2009: 3,028,623 shares, at 31 December 2008: 972,151 shares, waived right to all dividends), the Lloyds TSB Group Employee Share Ownership Trust (holding at 31 December 2009: 1,301,968 shares, at 31 December 2008: 1,442,116 shares, waived right to all dividends), Lloyds TSB Group Holdings (Jersey) Limited (holding at 31 December 2009: 42,846 shares, at 31 December 2008: 41,801 shares, waived right to all but a nominal amount of 1 penny in total) and the Lloyds TSB Qualifying Employee Share Ownership Trust (holding at 31 December 2009: 1,398 shares, at 31 December 2008: 1,364 shares, waived right to all but a nominal amount of 1 penny in total).

50 SHARE BASED PAYMENTS

CHARGE TO THE INCOME STATEMENT

The charge to the income statement is set out below:

	2009 £m	2008[1] £m
Deferred bonus scheme	18	–
Executive and SAYE schemes:		
Options granted in the year	13	28
Options granted in prior years	98	31
	111	59
Share incentive plans:		
Shares granted in the year	26	10
Shares granted in prior years	102	21
	128	31
	257	90

[1] Restated for IFRS 2 (Revised)

50 SHARE BASED PAYMENTS continued

SHARE BASED PAYMENT SCHEME DETAILS

During the year ended 31 December 2009 the Group operated the following share based payment schemes, all of which are equity settled.

Deferred bonus scheme 2009

Bonuses in respect of the performance in 2009 of certain employees within the Group's Wholesale division have been recognised in these financial statements in full. Individual bonus payments of up to £2,000 for employees earning up to £39,000 are not subject to deferral and as they will be settled in cash are not included in the preceding table.

Executive schemes

The executive share option schemes were long-term incentive schemes available to certain senior executives of the Group, with grants usually made annually. Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options. The last grant of executive options was made in August 2005. These options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary. Between April 2001 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1.5 times annual salary with a maximum performance multiplier of 3.5. Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied.

PERFORMANCE CONDITIONS FOR EXECUTIVE OPTIONS

For options granted up to March 2001

Options granted	Performance conditions
March 1999 – August 1999	Growth in earnings per share which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period together with a further condition that Lloyds Banking Group plc's ranking based on total shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1999 – August 1999 except that there must have been growth in the earnings per share equal to the change in the Retail Price Index plus three percentage points for each complete year of the relevant period.

In respect of options granted between March 1999 and March 2001, the relevant period for the performance conditions began at the end of the financial year preceding the date of grant and continued until the end of the third subsequent year following commencement or, if not met, the end of such later year in which the conditions were met. Once the conditions were satisfied the options remain exercisable without further conditions. If they were not satisfied by the tenth anniversary of the grant the options would lapse.

For options granted from August 2001 to August 2004

The performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds Banking Group plc.

The performance condition was measured over a three year period which commenced at the end of the financial year preceding the grant of the option and continued until the end of the third subsequent year. If the performance condition was not then met, it was measured at the end of the fourth financial year. If the condition was not then met, the options would lapse.

To meet the performance conditions, the Group's ranking against the comparator group required to be at least ninth. The full grant of options only became exercisable if the Group was ranked first. A performance multiplier (of between nil and 100 per cent) was applied below this level to calculate the number of shares in respect of which options granted to executive directors would become exercisable, and were calculated on a sliding scale. If Lloyds Banking Group plc was ranked below median the options would not be exercisable.

Options granted to senior executives other than executive directors were not so highly leveraged and, as a result, different performance multipliers were applied to their options. For the majority of executives, options were granted with the performance condition but with no performance multiplier.

Options granted in 2004 became exercisable as the performance condition was met on the re-test. The performance condition vested at 14 per cent for executive directors, 24 per cent for managing directors, and 100 per cent for all other executives.

For options granted in 2005

The same conditions applied as for grants made up to August 2004, except that:

– the performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds Banking Group plc;

– if the performance condition was not met at the end of the third subsequent year, the options would lapse; and

– the full grant of options became exercisable only if the Group was ranked in the top four places of the comparator group. A sliding scale applied between fourth and eighth positions. If Lloyds Banking Group was ranked below the median (ninth or below) the options would lapse.

Options granted in 2005 became exercisable as the performance condition was met when tested. The performance condition vested at 82.5 per cent for all options granted.

50 SHARE BASED PAYMENTS continued

Movements in the number of share options outstanding under the executive share option schemes during 2008 and 2009 are set out below:

	2009		2008	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**11,203,628**	**490.05**	20,621,774	480.57
Exercised	**–**	**–**	(137,431)	419.25
Forfeited	**(2,418,650)**	**536.46**	(9,280,715)	470.02
Outstanding at 31 December	**8,784,978**	**476.56**	11,203,628	490.05
Exercisable at 31 December	**8,784,978**	**476.56**	9,132,197	453.77

No options were exercised during 2009 therefore the weighted average share price was £nil (2008: £4.53). The weighted average remaining contractual life of options outstanding at the end of the year was 4.3 years (2008: 5.1 years).

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn schemes to save up to £250 per month and, at the expiry of a fixed term of three, five or seven years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Group at a discounted price of no less than 80 per cent of the market price at the start of the invitation.

Movements in the number of share options outstanding under the SAYE schemes are set out below:

	2009		2008	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**190,478,449**	**152.54**	85,673,227	342.49
Adjustment on acquisition	**53,755,275**	**300.91**	–	–
Granted	**–**	**–**	215,737,733	173.80
Exercised	**–**	**–**	(40,612,608)	290.77
Forfeited	**(9,581,800)**	**397.07**	(2,394,415)	388.11
Cancelled	**(93,599,380)**	**170.24**	(62,963,491)	373.21
Expired	**(10,918,552)**	**453.64**	(4,961,997)	311.47
Outstanding at 31 December	**130,133,992**	**157.84**	190,478,449	152.54
Exercisable at 31 December	**754,554**	**317.32**	3,157,524	332.12

No options were exercised during 2009 therefore the weighted average share price was £nil (2008: £3.70). The weighted average remaining contractual life of options outstanding at the end of the year was 2.7 years (2008: 3.4 years).

Similarly as no SAYE options were granted during the year, the weighted share price was £nil (2008: £0.61). The values for the SAYE options have been determined using a standard Black-Scholes model.

For the HBOS sharesave plan, no options were exercised during 2009 therefore the weighted average share price was £nil. The options outstanding at 31 December 2009 had exercise prices in the range of £2.20 to £3.64 and a weighted average remaining contractual life of 4.0 years.

50 SHARE BASED PAYMENTS continued

OTHER SHARE OPTION PLANS

Lloyds TSB Group Executive Share Plan 2003

The plan was adopted in December 2003 and under the plan share options may be granted to senior employees. Options granted under this plan have been granted specifically to facilitate recruitment and as such were not subject to any performance conditions. The plan has now been extended to not only compensate new recruits for any lost share awards but also to make grants to key individuals for retention purposes with, in some instances, the grant being made subject to individual performance conditions.

	2009		2008	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	857,611	Nil	308,718	Nil
Granted	24,704,070	Nil	681,931	Nil
Rebasement adjustment	1,876,005	Nil	–	Nil
Exercised	(157,105)	Nil	(117,236)	Nil
Forfeited	(1,181,396)	Nil	(15,802)	Nil
Outstanding at 31 December	26,099,185	Nil	857,611	Nil
Exercisable at 31 December	33,794	Nil	–	Nil

The weighted average fair value of options granted in the year was £0.68 (2008: £2.92). The weighted average share price at the time that the options were exercised during 2009 was £0.71 (2008: £2.91). The weighted average remaining contractual life of options outstanding at the end of the year was 3.0 years (2008: 2.5 years).

Options granted under this plan were adjusted on 2 July 2009 as a result of the Placing and Compensatory Open Offer. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of the capital raising event.

HBOS share option plans

The table below includes details of the outstanding options for the HBOS Share Option Plan, the St James's Place Share Option Plan, and the 1995 and 1996 Bank of Scotland Executive Stock Option schemes. The final award under the HBOS Share Option Plan was made in 2004. Under this plan, options over shares, at market value with a face value equal to 20 per cent of salary, were granted to employees with the exception of certain senior executives. A separate option plan exists for some of the partners of St James's Place, which grants options in respect of Lloyds Banking Group plc shares. Movements in the number of share options outstanding under these schemes are set out below:

	2009	
	Number of options	Weighted average exercise price (pence)
Share option plans		
Outstanding at 16 January, date of acquisition of HBOS	13,040,430	670.01
Granted during the year	4,040,555	104.50
Exercised during the year	–	–
Forfeited during the year	(2,779,237)	689.48
Outstanding at 31 December	14,301,748	506.46
Exercisable at 31 December	8,638,542	694.19

No options were exercised during 2009. The options outstanding under the HBOS Share Option Plan and St James's Place Share Option Plan at 31 December 2009 had exercise prices in the range of £1.05 to £17.576 and a weighted average remaining contractual life of 1.4 years.

The options outstanding under the Bank of Scotland Executive Stock Option schemes at 31 December 2009 had exercise prices in the range of £8.834 to £10.009 and a weighted average remaining contractual life of 0.8 years.

OTHER SHARE PLANS

Lloyds TSB Long-Term Incentive Plan

The Long-Term Incentive Plan ('LTIP') introduced in 2006 is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of the Group over a three year period. Awards are made within limits set by the rules of the plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary. In exceptional circumstances this may increase to four times annual salary.

50 SHARE BASED PAYMENTS continued

The performance conditions for awards made in May and August 2006 are as follows:

(i) For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Price Index over the same period. If it is less than 3 per cent per annum the EPS Award will lapse. If the increase is more than 3 per cent but less than 6 per cent per annum then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2006 and ended on 31 December 2008.

(ii) For the other 50 per cent of the award (the 'TSR Award') – it will be necessary for the Group's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award will vest where the Group's total shareholder return is equal to median and vesting will occur on a straight line basis in between these points. Where the Group's total shareholder return is below the median of the comparator group, the TSR Award will lapse. The relevant period commenced on 1 January 2006 and ended on 31 December 2008.

When tested at the end of the relevant performance period, neither the EPS nor the TSR performance conditions were met and all awards made in 2006 lapsed.

The performance conditions for awards made in March and August 2007 are as follows:

(i) For 50 per cent of the award (the 'EPS Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 1 January 2007 and ending on 31 December 2009.

(ii) For the other 50 per cent of the award (the 'TSR Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 8 March 2007 (the date of the first award) and ending on 7 March 2010.

The performance conditions for awards made in March, April, August and September 2008 are as follows:

(i) For 50 per cent of the award (the EPS Award) – the performance condition is as described for May 2006 with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010.

(ii) For the other 50 per cent of the award (the TSR Award) – the performance condition is as described for May 2006, except that the comparator group comprises of 13 companies, with the relevant performance period commencing on 6 March 2008 (the date of the first award) and ending on 5 March 2011.

The current LTIP rules allow for awards to be made of up to 400 per cent of base salary. Under normal circumstances awards are made of 300 per cent of salary with the additional 100 per cent available for circumstances that the remuneration committee deems to be exceptional. In 2008, awards were made of 375 per cent of base salary to the chief executive and two of the executive directors for retention purposes, and in light of data reviewed by the committee which showed total remuneration to be behind median both for the FTSE 20, and the other major UK banks.

The performance conditions for awards made in April, May and September 2009 are as follows:

(i) EPS**:** The release of 50 per cent of the shares will be dependent on the extent to which the growth in EPS achieves cumulative EPS targets over the three-year period.

(ii) Economic profit: The release of the remaining 50 per cent of shares will be dependent on the extent to which Lloyds Banking Group achieves cumulative economic profit targets over a three-year period.

The EPS and economic profit performance measures applying to this 2009 LTIP award were set on the basis that the Group would enter into the Government Asset Protection Scheme (GAPS). Now that the Group is not participating in GAPS, the Remuneration Committee has determined that these performance measures be restated on a basis consistent with the EPS and economic profit measures used for the 2010 LTIP awards.

In addition in 2009 an additional discretionary award was made in April, May and September 2009. The performance conditions for those awards are as follows:

(i) Synergy savings: The release of 50 per cent of the shares will be dependent on the achievement of target run-rate synergy savings in 2009 and 2010 as well as the achievement of sustainable synergy savings of at least £1.5 billion by the end of 2011. The award will be broken down into three equally weighted annual tranches. Performance will be assessed at the end of each year against annual performance targets based on a trajectory to meet the 2011 target. The extent to which targets have been achieved will determine the proportion of shares to be banked each year. Any release of shares will be subject to the remuneration committee judging the overall success of the delivery of the integration programme.

(ii) Integration balanced scorecard: The release of the remaining 50 per cent of the shares will be dependent on the outcome of a Balanced Scorecard of non-financial measures of the success of the integration in each of 2009, 2010 and 2011. The Balanced scorecard element will be broken down into three equally weighted tranches. The tranches will be crystallised and banked for each year of the performance cycle subject to separate annual performance targets across the four measurement categories of Building the Business, Customer, Risk and People and Organisation Development.

Performance against the first year of the award has been assessed and all targets have been met or exceeded.

50 SHARE BASED PAYMENTS continued

	2009 Number of shares	2008 Number of shares
Outstanding at 1 January	22,237,282	13,209,081
Granted	199,293,192	10,519,609
Rebasement adjustment	10,443,102	–
Forfeited	(8,740,524)	(1,491,408)
Outstanding at 31 December	223,233,052	22,237,282

The fair value of the share awards granted in 2009 was £0.68 (2008: £2.28).

Conditional awards of shares made under this plan were adjusted on 2 July 2009 as a result of the placing and compensatory open offer. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of the capital raising event.

Performance share plan

Under the performance share plan, introduced during 2005, participating executives will be eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 and 2005 bonus. The maximum match was two performance shares for each bonus share, awarded at the end of a three year period. The actual number of shares awarded was dependent on the Group's total shareholder return performance measured over a three year period, compared to other companies in the comparator group. The maximum of two performance shares for each bonus share was awarded only if the Group's total shareholder return performance placed it first in the comparator group; one performance share for each bonus share was granted if the Group was placed fifth; and one performance share for every two bonus shares if the Group was placed eighth (median). Between first and fifth position, and fifth and eighth position, sliding scales would apply. If the total shareholder return performance was below median, no performance shares were awarded. There was no retest. Whilst income tax and national insurance was deducted from the bonus before deferral into the plan, where a match of performance shares was justified, these shares were awarded as if income tax and national insurance had not been deducted.

The performance condition attached to the March 2006 award was not met, with Lloyds Banking Group ranked in ninth place. Bonus shares were released on 20 March 2009, at which time the performance shares lapsed.

	2009 Number of shares	2008 Number of shares
Outstanding at 1 January	941,324	1,767,594
Forfeited	–	(74,691)
Lapsed	(941,324)	(375,790)
Released	–	(375,789)
Outstanding at 31 December	–	941,324

The weighted average share price at the date the shares were released during 2008 was £4.4613.

The ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life and number of options outstanding for the option schemes were as follows:

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2009									
Exercise price range									
£0 to £1	–	–	–	–	–	–	Nil	3.1	26,099,185
£1 to £2	–	–	–	139.00	2.5	107,939,699	104.50	2.3	4,019,026
£2 to £3	–	–	–	220.98	3.9	18,054,765	–	–	–
£3 to £4	–	–	–	349.18	2.0	2,842,644	394.64	5.2	721,886
£4 to £5	464.19	4.9	7,526,441	427.04	1.8	1,296,884	499.91	0.2	273,986
£5 to £6	552.02	0.2	515,527	–	–	–	573.60	0.6	53,328
£6 to £7	653.55	1.2	743,010	–	–	–	640.00	0.0	2,388,026
£7 to £8	–	–	–	–	–	–	707.40	0.2	6,845,496

50 SHARE BASED PAYMENTS continued

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2008									
£0 to £1	–	–	–	–	–	–	Nil	2.5	857,611
£1 to £2	–	–	–	139.00	3.5	178,932,603	–	–	–
£2 to £3	–	–	–	284.00	0.4	941,414	–	–	–
£3 to £4	–	–	–	344.75	1.9	7,366,320	–	–	–
£4 to £5	453.77	5.9	9,132,197	423.49	2.0	3,200,532	–	–	–
£5 to £6	551.25	1.2	741,905	588.50	0.3	37,580	–	–	–
£6 to £7	652.30	2.1	997,326	–	–	–	–	–	–
£7 to £8	–	–	–	–	–	–	–	–	–
£8 to £9	863.63	0.3	332,200	–	–	–	–	–	–

The fair value calculations at 31 December 2009 for grants made in the year are based on the following assumptions:

	SAYE	Other option schemes	Other share plans
Risk-free interest rate	**Nil**	**2.01%**	**2.23%**
Expected life	**Nil**	**2.6 years**	**3.0 years**
Expected volatility	**Nil**	**90%**	**84%**
Expected dividend yield	**Nil**	**1.7%**	**1.8%**
Weighted average share price	**Nil**	**£0.71**	**£0.71**
Weighted average exercise price	**Nil**	**Nil**	**Nil**
Expected forfeitures	**Nil**	**4%**	**4%**

Expected volatility is a measure of the amount by which the Group's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option. The historical volatility is compared to the implied volatility generated from market traded options in the Group's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

SHARE INCENTIVE PLAN

Free shares

An award of shares may be made annually to employees based on a percentage of each employee's salary in the preceding year up to a maximum of £3,000. The percentage is normally announced concurrently with the Group's annual results and the price of the shares awarded is announced at the time of award. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf. The award is subject to a non-market based condition: if an employee leaves the Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited.

No free shares were awarded in 2009 (2008: 8,862,823 shares, with an average fair value of £4.38 based on the market price at the date of award).

Matching shares

The Group undertakes to match shares purchased by employees up to the value of £30 per month; these shares are held in trust for a mandatory period of three years on the employees' behalf. The award is subject to a non-market based condition: if an employee leaves within this three year period for other than a 'good' reason, 100 per cent of the matching shares are forfeited. Similarly if the employees sell their purchased shares within three years, their matching shares are forfeited.

The number of shares awarded relating to matching shares in 2009 was 16,746,310 (2008: 4,475,264), with an average fair value of £0.69 (2008: £2.56), based on market prices at the date of award.

51 RELATED PARTY TRANSACTIONS

KEY MANAGEMENT PERSONNEL

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity; the Group's key management personnel are the members of Lloyds Banking Group plc group executive committee together with its non-executive directors.

The table below details, on an aggregated basis, key management personnel compensation:

	2009 £m	2008 £m
Compensation		
Salaries and other short-term benefits	17	8
Post-employment benefits	1	1
Share based payments	–	4
	18	13

Aggregate contributions in respect of key management personnel to defined contribution pension schemes were £0.4 million (2008: £0.2 million).

	2009 million	2008 million
Share options		
At 1 January	2	7
Granted (exercised/lapsed) (including options of former directors)	–	(5)
At 31 December	2	2

	2009 million	2008 million
Share incentive plans		
At 1 January	7	6
Granted (including entitlements of appointed directors)	17	3
Exercised/lapsed (including entitlements of former directors)	(5)	(2)
At 31 December	19	7

The tables below detail, on an aggregated basis, balances outstanding at the year end and related income and expense, together with information relating to other transactions between the Group and its key management personnel:

	2009 £m	2008 £m
Loans		
At 1 January	3	2
Advanced (including loans of appointed directors)	–	2
Repayments (including loans of former directors)	(1)	(1)
At 31 December	2	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 1.28 per cent and 24.90 per cent in 2009 (2008: 2.14 per cent and 34.01 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2008: £nil).

51 RELATED PARTY TRANSACTIONS continued

	2009 £m	2008 £m
Deposits		
At 1 January	6	5
Placed (including deposits of appointed directors)	12	27
Withdrawn (including deposits of former directors)	(14)	(26)
At 31 December	4	6

Deposits placed by key management personnel attracted interest rates of up to 6.5 per cent (2008: 6.0 per cent).

At 31 December 2009, the Group did not provide any guarantees in respect of key management personnel (2008: none).

At 31 December 2009, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £2 million with seven directors and four connected persons (2008: £3 million with eight directors and six connected persons).

SUBSIDIARIES

Details of the principal subsidiaries are given in note 9 to the parent company financial statements. In accordance with IAS 27, transactions and balances with subsidiaries have been eliminated on consolidation.

On 16 January 2009, the Company acquired 100 per cent of the ordinary share capital of HBOS plc. From this date, HBOS plc and its subsidiaries became controlled entities. In accordance with IAS 27, transactions and balances with subsidiaries have been eliminated on consolidation.

HM TREASURY

On 13 January 2009, HM Treasury subscribed for approximately 2,597 million shares in the Company which gave it a 30.2 per cent interest in the Company's ordinary share capital and consequently HM Treasury became a related party of the Company from this date. On 16 January 2009, the Company acquired HBOS plc in an all share acquisition which, together with the shares subscribed for on 13 January 2009, gave HM Treasury a 43.4 per cent interest in the Company's ordinary share capital. The material transactions entered into with HM Treasury from 13 January 2009 are described below:

Capital transactions

On 15 January 2009, the Company issued £1,000 million 12 per cent non-cumulative fixed to floating rate preference shares to HM Treasury. In addition, £3,000 million non-cumulative 12 per cent fixed to floating rate preference shares were issued by the Company to HM Treasury on 16 January 2009 in exchange for the £3,000 million non-cumulative 12 per cent fixed to floating rate preference shares which had been issued by HBOS plc to HM Treasury on 15 January 2009.

In June 2009 the Company issued 10,408 million new ordinary shares as part of a placing and compensatory open offer; HM Treasury subscribed for approximately 4,521 million of these new ordinary shares at a price of 38.43 pence per share. As placees were procured for all the new ordinary shares for which valid acceptances were not received under the placing and compensatory open offer, HM Treasury's shareholding remained at 43.4 per cent. The Company used the proceeds from this placing and compensatory open offer to redeem the £4,000 million preference shares issued by the Company to HM Treasury described above at 101 per cent of their issue price (in accordance with the terms agreed with HM Treasury) together with accrued dividends thereon.

In December 2009 the Company issued 36,505 million new ordinary shares in respect of a rights issue as part of an alternative to the Group's proposed participation in GAPS (together with a liability management exercise). The Company entered into an Undertaking to Subscribe agreement with HM Treasury whereby HM Treasury undertook, amongst other things, to take up its rights to subscribe for all of the new shares to which it was entitled under the rights issue. HM Treasury subscribed for approximately 15,854 million new shares at a price of 37 pence per share. As subscribers were procured for all the new ordinary shares for which valid acceptances were not received under the rights issue, HM Treasury's shareholding remained at 43.4 per cent. In addition, the Group paid HM Treasury a commission payment of approximately £132 million in consideration, inter alia, of HM Treasury's pre-launch commitment to participate in full in respect of its entitlements under the rights issue.

Material related party agreements in connection with capital transactions

In connection with the placing and compensatory open offer, an Open Offer Agreement dated 7 March 2009 was entered into between the Company and HM Treasury (as amended and restated, amongst other things, to include certain other parties) pursuant to which, amongst other things, HM Treasury agreed that, to the extent not placed or taken up under the compensatory open offer and subject to the terms and conditions set out in the Open Offer Agreement, HM Treasury would subscribe for the open offer shares itself at the issue price. In consideration of the provision of its services under the Open Offer Agreement, the Company agreed to pay to HM Treasury (i) a commission of 0.5 per cent of the aggregate value of the open offer shares at the issue price; and (ii) a further commission of 1 per cent of the aggregate value of the open offer shares subscribed for by HM Treasury or by placees (including HM Treasury) at the issue price.

51 RELATED PARTY TRANSACTIONS continued

The Company also agreed to (i) pay to each of HM Treasury, the joint sponsors and joint bookrunners all legal and other costs and expenses, and those of HM Treasury's financial advisors incurred in connection with the placing and compensatory open offer, the redemption of the preference shares or any arrangements referred to in the 2009 Open Offer Agreement; and (ii) bear all costs and expenses relating to the placing and compensatory open offer and the preference share redemption. The costs and commissions incurred by the joint bookrunners in connection with the rump placing were deducted from the aggregate proceeds of the rump placing. The Company also gave certain representations and warranties and indemnities to each of HM Treasury, the joint sponsors and joint bookrunners under the 2009 Open Offer Agreement. The Company's liabilities thereunder are unlimited as to time and amount. HM Treasury is entitled to novate its rights under the agreement to any entity that is wholly-owned, directly or indirectly, by HM Treasury.

Pursuant to its obligations to HM Treasury under the 2009 Open Offer Agreement, the Company entered into a Resale Rights Agreement with HM Treasury with effect from 11 June 2009, in which it agreed to provide its assistance to HM Treasury in connection with any proposed sale by HM Treasury of ordinary shares and other securities held by HM Treasury in the Company from time to time and of any securities caused by HM Treasury to be issued by any person which are exchangeable for, convertible into, give rights over or are referable to such ordinary shares or other securities issued by the Group, to be sold in such jurisdictions (other than the United States) and in such manner as HM Treasury may determine. Such assistance may include the provision by the Company of assistance with due diligence and the preparation of marketing and such other documentation (including any offering memorandum, whether or not a prospectus) as HM Treasury may reasonably request.

Pursuant to its obligations under the open offer agreement entered into by the Company with effect from 13 October 2008, the Company entered into a Registration Rights Agreement with HM Treasury on 12 January 2009, granting customary demand and 'piggyback' registration rights in the United States under the United States Securities Act of 1933, as amended, to HM Treasury with respect to any ordinary shares of the Group held by HM Treasury.

Government Asset Protection Scheme

The Company entered into a Pre-Accession Deed dated 7 March 2009 and a Lending Commitments Deed dated 6 March 2009 with HM Treasury both relating to the Company's proposed participation in GAPS. Under the Lending Commitments Deed, the Company agreed to support lending to creditworthy borrowers in the UK in a commercial manner with effect from 1 March 2009 and agreed to increase lending by £14,000 million in the 12 months commencing 1 March 2009 to support UK businesses (£11,000 million) and homeowners (£3,000 million) and to maintain similar levels of lending in the 12 months commencing 1 March 2010, subject to adjustment to reflect circumstances at the start of the 12 month period commencing 1 March 2010. This additional lending is expressed to be subject to the Group's prevailing terms and conditions (including pricing and risk assessment) and, in relation to mortgage lending, the Group's standard credit and other acceptance criteria.

Pursuant to the successful rights issue, the Company withdrew from its proposed participation in GAPS and on 3 November 2009, the Company entered into a GAPS Withdrawal Deed with HM Treasury pursuant to which, among other matters, the Company agreed that the Group would pay HM Treasury an amount of £2,500 million in recognition of the benefits to the Group's trading operations arising as a result of HM Treasury proposing to make GAPS available to the Group.

The GAPS Withdrawal Deed contained certain undertakings given by the Group to HM Treasury in connection with the state aid approval obtained from the European Commission and its withdrawal from GAPS. In particular, the Group is required to do all acts and things necessary to ensure the UK Government's compliance with its obligations under the European Commission decision approving state aid to the Group. The Company also reaffirmed its lending commitments described above. In addition, the Company's obligations under the Pre-Accession Deed referred to above (other than its commitment to inform the UK Government of certain deleveraging activities) was terminated pursuant to the GAPS Withdrawal Deed.

On 2 November 2009, the Group entered into a Cost Reimbursement Deed with HM Treasury under which the Group has agreed to pay for the UK Government's set-up costs relating to the proposed participation in GAPS and the UK Government's costs associated with the European Union's approval of state aid to the Group.

Credit Guarantee Scheme

HM Treasury launched the Credit Guarantee Scheme in October 2008 as part of a range of measures announced by the UK Government intended to ease the turbulence in the UK banking system. It charges a commercial fee for the guarantee of new short and medium-term debt issuance. The fee payable to HM Treasury on guaranteed issues is based on a per annum rate of 50 basis points plus the median five-year Credit Default Swap spread. At 31 December 2009, the Group had £49,070 million of debt issued under the CGS. During the year, fees of £498 million payable to HM Treasury in respect of guaranteed funding were included in the Group's income statement.

There were no other material transactions between the Group and HM Treasury during the period between 13 January 2009 and 31 December 2009 that were not made in the ordinary course of business or that are unusual in their nature or conditions.

51 RELATED PARTY TRANSACTIONS continued

OTHER RELATED PARTY TRANSACTIONS

Pensions funds

At 31 December 2009, customer deposits of £99 million (2008: £23 million) and investment and insurance contract liabilities of £691 million (2008: £nil) related to the Group's pension funds.

OEICs

The Group manages 382 (2008: 105) Open Ended Investment Companies (OEICs), and of these 108 (2008: 47) are consolidated. The Group invested £1,271 million (2008: £455 million) and redeemed £1,076 million (2008: £343 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £6,954 million (2008: £2,661 million) at 31 December. The Group earned fees of £217 million from the unconsolidated OEICs (2008: £206 million). The Company held no investments in OEICs at any time during 2008 or 2009.

Joint ventures and associates

In the year ended 31 December 2009, the Group provided both administration and processing services to its principal joint venture, Sainsbury's Bank plc. The amounts receivable by the Group during the year were £34 million (2008: £nil), of which £10 million was outstanding at 31 December 2009 (2008: £nil). At 31 December 2009, Sainsbury's Bank plc also had balances with the Group that were included in loans and advances to banks of £1,218 million (2008: £nil) and deposits by banks of £1,405 million (2008: £nil).

At 31 December 2009 there were loans and advances to customers of £12,235 million (2008: £nil) outstanding and balances within customer deposits of £254 million (2008: £nil) relating to other joint ventures and associates.

In addition to the above balances, the Group has a number of other associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2009, these companies had total assets of approximately £14,840 million (2008: £5,838 million), total liabilities of approximately £15,300 million (2008: £5,780 million) and for the year ended 31 December 2009 had turnover of approximately £10,570 million (2008: £2,088 million) and made a net loss of approximately £572 million (2008: net loss of £80 million). In addition, the Group has provided £6,014 million (2008: £825 million) of financing to these companies on which it received £191 million (2008: £46 million) of interest income in the year.

52 CONTINGENT LIABILITIES AND COMMITMENTS

PAYMENT PROTECTION INSURANCE

In January 2009, the UK Competition Commission (the 'Competition Commission') completed its formal investigation into the supply of Payment Protection Insurance (PPI) services (except store card PPI) to non-business customers in the UK and published its final report setting out its remedies. Prior to this the Group had made the commercial decision to sell only regular monthly premium PPI to its personal loan customers. The Competition Commission decided to adopt various remedies including a prohibition on the active sale of PPI by a distributor to a customer within seven days of the distributor's sale of credit to that customer.

On 30 March 2009, Barclays Bank plc lodged an appeal in the UK Competition Appeal Tribunal (the 'Competition Appeal Tribunal') against the Competition Commission's findings. Lloyds Banking Group was granted permission by the Competition Appeal Tribunal to intervene in the appeal. The Competition Appeal Tribunal handed down its judgment on 16 October 2009 finding in favour of Barclays in respect of its challenge to the Competition Commission's prohibition of distributors selling PPI at the credit point of sale but it did not uphold Barclays' challenge to the Competition Commission's findings on market definition. The matter has now been referred back to the Competition Commission. This may or may not result in the Competition Commission ultimately reaching a different conclusion.

On 1 July 2008 the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the FSA as an issue of wider implication. The Group has been working with other industry members and trade associations in preparing an industry response to address regulatory concerns regarding the handling of PPI complaints. On 29 September 2009, the FSA issued a consultation paper on PPI complaints handling. The FSA has escalated its regulatory activity in relation to past PPI sales generally and has proposed new guidance on the fair assessment of a complaint and the calculation of redress and a new rule requiring firms to reassess historically rejected complaints.

The statement on 29 September 2009 also announced that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. The Group has subsequently agreed in principle that it will undertake a review in relation to sales of single premium loan protection insurance made through its branch network since 1 July 2007. The precise details of the review are still being discussed with the FSA. The ultimate impact on the Group of any review and/or reassessment can only be known at the conclusion of these discussions and on publication of the FSA's final rules.

52 CONTINGENT LIABILITIES AND COMMITMENTS continued

US ECONOMIC SANCTIONS

Starting in 2007 Lloyds TSB Bank plc provided information in relation to its review of historic US Dollar payments involving countries, persons or entities subject to US economic sanctions administered by the Office of Foreign Assets Control (OFAC) to a number of authorities reported to be conducting a review of sanctions compliance by non-US financial institutions. On 9 January 2009 the settlement reached by Lloyds TSB Bank plc with both the US Department of Justice and the New York County District Attorney's Office in relation to their investigations was announced. The settlement documentation contains details of the results of the investigations including the identification of certain activities relating to Iran, Sudan and Libya which Lloyds TSB Bank plc conducted during the relevant period. In 2008, Lloyds TSB Bank plc made a provision of £180 million which fully covered the settlement amount paid to the Department of Justice and the New York County District Attorney's Office. On 22 December 2009 OFAC announced the settlement it had reached with Lloyds TSB Bank plc in relation to its investigation and confirmed that the settlement sum due to OFAC had been fully satisfied by Lloyds TSB Bank plc's payment to the Department of Justice and the New York County District Attorney's Office. No further enforcement actions are expected in relation to the matters set out in the settlement agreements. A purported shareholder filed a derivative civil action in the Supreme Court of New York, Nassau County on 26 February 2009 against certain current and former directors, and nominally against the Lloyds TSB Bank plc and Lloyds Banking Group, seeking various forms of relief following the settlement. The derivative action is at a very early stage but the ultimate outcome of the action is not expected to have a material impact on the Group.

INTERCHANGE FEES

The European Commission has adopted a formal decision finding that an infringement of European Commission competition laws has arisen from arrangements whereby MasterCard issuers charged a uniform fallback interchange fee in respect of cross-border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the fee be reduced to zero for relevant cross-border transactions within the European Economic Area. This decision has been appealed to the General Court of the European Union (the 'General Court'). Bank of Scotland plc and Lloyds TSB Bank plc (along with certain other MasterCard issuers) have successfully applied to intervene in the appeal in support of MasterCard's position that the arrangements for the charging of a uniform fallback interchange fee are compatible with European Commission competition laws. Meanwhile, the European Commission and the UK's OFT are pursuing investigations with a view to deciding whether arrangements adopted by other payment card schemes for the levying of uniform fallback interchange fees in respect of domestic and/or cross-border payment transactions also infringe European Commission and/or UK competition laws. As part of this initiative the OFT will also intervene in the General Court appeal supporting the European Commission's position. The ultimate impact of the investigations on the Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

UNARRANGED OVERDRAFT CHARGES

The Supreme Court published its judgment in respect of the fairness of unarranged overdraft charges on personal current accounts on 25 November 2009, finding in favour of the litigant banks. On 22 December 2009, the OFT announced that it will not continue its investigation into the fairness of these charges. The Group is working with the regulators to ensure that outstanding customer complaints are concluded as quickly as possible and anticipate that most cases in the county courts will be discontinued. The Group expects that some customers will argue that despite the test case ruling they are entitled to a refund of unarranged overdraft charges on the basis of other legal arguments or challenges. The Group would robustly defend any such complaints or claims and does not expect the outcome of any such complaints or claims to have a material adverse effect on its financial position.

OTHER LEGAL PROCEEDINGS

In addition , during the ordinary course of business the Group is subject to threatened or actual legal proceedings both in the UK and overseas. All such material cases are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed to properly assess the merits of the case and no provisions are held against such cases. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position.

CONTINGENT LIABILITIES AND COMMITMENTS ARISING FROM THE BANKING BUSINESS

Acceptances and endorsements arise where Lloyds Banking Group agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, where Lloyds Banking Group has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

Performance bonds and other transaction-related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs & Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

Lloyds Banking Group's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held.

52 CONTINGENT LIABILITIES AND COMMITMENTS continued

	2009 £m	2008 £m
Contingent liabilities		
Acceptances and endorsements	**59**	49
Other:		
Other items serving as direct credit substitutes	**1,494**	1,870
Performance bonds and other transaction-related contingencies	**4,555**	2,850
	6,049	4,720
	6,108	4,769

The contingent liabilities of the Group, as detailed above, arise in the normal course of its banking business and it is not practicable to quantify their future financial effect.

	2009 £m	2008 £m
Commitments		
Documentary credits and other short-term trade-related transactions	**288**	319
Forward asset purchases and forward deposits placed	**758**	613
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	**9,058**	3,056
Other commitments	**64,786**	46,006
	73,844	49,062
1 year or over original maturity	**53,693**	31,761
	128,583	81,755

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £74,477 million (2008: £46,890 million) was irrevocable.

OPERATING LEASE COMMITMENTS

Where a Group company is the lessee the future minimum lease payments under non-cancellable premises operating leases are as follows:

	2009 £m	2008 £m
Not later than 1 year	**392**	216
Later than 1 year and not later than 5 years	**1,213**	647
Later than 5 years	**1,817**	774
	3,422	1,637

Operating lease payments represent rental payable by the Group for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments.

CAPITAL COMMITMENTS

Excluding commitments in respect of investment property (note 26), capital expenditure contracted but not provided for at 31 December 2009 amounted to £203 million (2008: £92 million). Of this amount, £198 million (2008: £85 million) related to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

53 FINANCIAL INSTRUMENTS

(1) MEASUREMENT BASIS OF FINANCIAL ASSETS AND LIABILITIES

The accounting policies in note 2 describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2009								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	38,994	–	38,994
Items in the course of collection from banks	–	–	–	–	–	1,579	–	1,579
Trading and other financial assets at fair value through profit or loss	–	27,245	122,766	–	–	–	–	150,011
Derivative financial instruments	9,430	40,498	–	–	–	–	–	49,928
Loans and receivables:								
Loans and advances to banks	–	–	–	–	35,361	–	–	35,361
Loans and advances to customers	–	–	–	–	626,969	–	–	626,969
Debt securities	–	–	–	–	32,652	–	–	32,652
	–	–	–	–	694,982	–	–	694,982
Available-for-sale financial assets	–	–	–	46,602	–	–	–	46,602
Total financial assets	9,430	67,743	122,766	46,602	694,982	40,573	–	982,096
Financial liabilities								
Deposits from banks	–	–	–	–	–	82,452	–	82,452
Customer deposits	–	–	–	–	–	406,741	–	406,741
Items in course of transmission to banks	–	–	–	–	–	1,037	–	1,037
Trading and other financial liabilities at fair value through profit or loss	–	22,111	6,160	–	–	–	–	28,271
Derivative financial instruments	8,687	31,798	–	–	–	–	–	40,485
Debt securities in issue	–	–	–	–	–	233,502	–	233,502
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	76,179	76,179
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	46,348	46,348
Unallocated surplus within insurance businesses	–	–	–	–	–	–	1,082	1,082
Subordinated liabilities	–	–	–	–	–	34,727	–	34,727
Total financial liabilities	8,687	53,909	6,160	–	–	758,459	123,609	950,824

53 FINANCIAL INSTRUMENTS continued

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2008								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	5,008	–	5,008
Items in the course of collection from banks	–	–	–	–	–	946	–	946
Trading and other financial assets at fair value through profit or loss	–	857	44,207	–	–	–	–	45,064
Derivative financial instruments	435	28,449	–	–	–	–	–	28,884
Loans and receivables:								
Loans and advances to banks	–	–	–	–	38,733	–	–	38,733
Loans and advances to customers	–	–	–	–	240,344	–	–	240,344
Debt securities	–	–	–	–	4,416	–	–	4,416
	–	–	–	–	283,493	–	–	283,493
Available-for-sale financial assets	–	–	–	55,707	–	–	–	55,707
Total financial assets	435	29,306	44,207	55,707	283,493	5,954	–	419,102
Financial liabilities								
Deposits from banks	–	–	–	–	–	66,514	–	66,514
Customer deposits	–	–	–	–	–	170,938	–	170,938
Items in course of transmission to banks	–	–	–	–	–	508	–	508
Trading and other financial liabilities at fair value through profit or loss	–	6	6,748	–	–	–	–	6,754
Derivative financial instruments	4,169	22,723	–	–	–	–	–	26,892
Debt securities in issue	–	–	–	–	–	75,710	–	75,710
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	33,792	33,792
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	14,243	14,243
Unallocated surplus within insurance businesses	–	–	–	–	–	–	270	270
Subordinated liabilities	–	–	–	–	–	17,256	–	17,256
Total financial liabilities	4,169	22,729	6,748	–	–	330,926	48,305	412,877

(2) RECLASSIFICATION OF FINANCIAL ASSETS

In accordance with the amendment to IAS39 that became applicable during 2008, the Group reviewed the categorisation of its financial assets classified as held for trading and available-for-sale.

On the basis that there was no longer an active market for some of those assets, which are therefore more appropriately managed as loans, with effect from 1 July 2008, the Group transferred £2,993 million of assets previously classified as held for trading into loans and receivables. With effect from 1 November 2008, the Group transferred £437 million of assets previously classified as available-for-sale into loans and receivables. At the time of these transfers, the Group had the intention and ability to hold them for the foreseeable future or until maturity. As at the date of reclassification, the weighted average effective interest rate of the assets transferred was 6.3 per cent with the estimated recoverable cash flows of £3,524 million.

No assets have been reclassified in 2009.

53 FINANCIAL INSTRUMENTS continued

Carrying amount and fair values of reclassified assets

The table below sets out the carrying value and fair value of reclassified financial assets.

	31 December 2009		31 December 2008	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
From held for trading to loans and receivables	**1,833**	**1,822**	**2,883**	**2,926**
From available-for-sale financial assets to loans and receivables	**394**	**422**	**454**	**402**
	2,227	**2,244**	**3,337**	**3,328**

During the year ended 31 December 2009, the carrying value of reclassified assets decreased by £1,110 million due to sales and maturities of £990 million, accretion of discount of £61 million and foreign exchange and other movements of £181 million.

Additional fair value gains/(losses) that would have been recognised had the reclassifications not occurred

The table below shows the additional gains/(losses) that would have been recognised in the Group's income statement if the reclassifications had not occurred.

	2009			2008	
	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2008 £m	Total £m
From held for trading to loans and receivables	–	**208**	**208**	(347)	(347)

The table below shows the additional gains/(losses) that would have been recognised in other comprehensive income if the reclassifications had not occurred.

	2009			2008	
	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2008 £m	Total £m
From available-for-sale financial assets to loans and receivables	–	**161**	**161**	(108)	(108)

Actual amounts recognised in respect of reclassified assets

After reclassification the reclassified financial assets contributed the following amounts to the Group income statement.

	2009			2008	
	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2008 £m	Total £m
From held for trading to loans and receivables:					
Net interest income	–	**55**	**55**	31	31
Impairment losses	–	**(49)**	**(49)**	(158)	(158)
	–	**6**	**6**	(127)	(127)

	2009			2008	
	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2008 £m	Total £m
From available-for-sale financial assets to loans and receivables:					
Net interest income	–	**34**	**34**	3	3
Impairment losses	–	**(56)**	**(56)**	(23)	(23)
	–	**(22)**	**(22)**	(20)	(20)

53 FINANCIAL INSTRUMENTS continued

(3) FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The following table summarises the carrying values of financial assets and liabilities presented on the Group's balance sheet. The fair values presented in the table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

	Carrying value 2009 £m	Carrying value 2008 £m	Fair value 2009 £m	Fair value 2008 £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	**150,011**	45,064	**150,011**	45,064
Derivative financial instruments	**49,928**	28,884	**49,928**	28,884
Loans and receivables:				
Loans and advances to banks	**35,361**	38,733	**35,335**	37,954
Loans and advances to customers	**626,969**	240,344	**609,647**	235,569
Debt securities	**32,652**	4,416	**31,907**	3,931
Available-for-sale financial assets	**46,602**	55,707	**46,602**	55,707
Financial liabilities				
Deposits from banks	**82,452**	66,514	**82,366**	66,504
Customer deposits	**406,741**	170,938	**406,555**	171,119
Trading and other financial liabilities at fair value through profit or loss	**28,271**	6,754	**28,271**	6,754
Derivative financial instruments	**40,485**	26,892	**40,485**	26,892
Debt securities in issue	**233,502**	75,710	**235,170**	76,291
Liabilities arising from non-participating investment contracts	**46,348**	14,243	**46,348**	14,243
Financial guarantees	**38**	35	**38**	35
Subordinated liabilities	**34,727**	17,256	**33,660**	11,199

VALUATION METHODOLOGY

Financial instruments include financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments held by the Group. Where quoted market prices are not available, or are unreliable because of poor liquidity, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

Fair value information is not provided for items that do not meet the definition of a financial instrument. These items include intangible assets, such as the value of the Group's branch network, the long-term relationships with depositors and credit card relationships; premises and equipment; and shareholders' equity. These items are material and accordingly the Group believes that the fair value information presented does not represent the underlying value of the Group.

FAIR VALUE OF FINANCIAL INSTRUMENTS CARRIED AT AMORTISED COST

Loans and receivables

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value, as considered appropriate. For commercial and personal customers, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. The fair value for corporate loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair values of asset-backed securities and secondary loans, which were previously within assets held for trading and were reclassified to loans and receivables (see page 222), are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

53 FINANCIAL INSTRUMENTS continued

Deposits from banks and customer deposits

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Debt securities in issue and subordinated liabilities

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities and for subordinated liabilities is estimated using quoted market prices.

VALUATION OF FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE

The table below provides an analysis of the financial assets and liabilities of the Group that are carried at fair value in the Group's consolidated balance sheet, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

Valuation hierarchy

	At 31 December 2009			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Trading and other financial assets at fair value through profit or loss	103,853	43,246	2,912	150,011
Available-for-sale financial assets	12,881	31,110	2,611	46,602
Derivative financial instruments	977	47,014	1,937	49,928
Financial assets	117,711	121,370	7,460	246,541
Trading and other financial liabilities at fair value through profit or loss	511	27,760	–	28,271
Derivative financial instruments	66	40,222	197	40,485
Financial guarantees	–	–	38	38
Financial liabilities	577	67,982	235	68,794

There were no significant transfers between level 1 and level 2 during the year.

	At 31 December 2008			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Trading and other financial assets at fair value through profit or loss	38,019	5,373	1,672	45,064
Available-for-sale financial assets	30,184	22,362	3,161	55,707
Derivative financial instruments	2,147	26,601	136	28,884
Financial assets	70,350	54,336	4,969	129,655
Trading and other financial liabilities at fair value through profit or loss	6	6,748	–	6,754
Derivative financial instruments	153	26,161	578	26,892
Financial guarantees	–	–	35	35
Financial liabilities	159	32,909	613	33,681

The valuations of financial instruments have been classified into three levels according to the quality and reliability of information used to determine the fair values.

Level 1 portfolios

level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 predominantly comprise treasury bills and other government securities.

Level 2 portfolios

level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data, the instrument is considered to be level 2. Examples of such financial instruments include most over-the-counter derivatives, financial institution issued securities, certificates of deposit and certain asset-backed securities.

Level 3 portfolios

level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include the Group's venture capital and unlisted equity investments which are valued using various valuation techniques that require significant management judgement in determining appropriate assumptions, including earnings multiples and estimated future cash flows. Certain of the Group's asset-backed securities and derivatives, principally where there is no trading activity in such securities, are also classified as level 3.

53 FINANCIAL INSTRUMENTS continued

At 31 December 2009	Valuation basis/technique	Main assumptions	Carrying value £m	Effect of reasonably possible alternative assumptions £m
Trading and other financial assets at fair value through profit or loss				
Asset-backed securities	Lead manager or broker quote/ consensus pricing from market data provider	Use of single pricing source	970	74
Venture capital investments	Various valuation techniques using IPEV Guidelines	Earnings multiples	1,162	n/a
Equity investments	Various valuation techniques	Earnings, net asset value, underlying asset values, property prices, forecast cash flows	234	n/a
Unlisted equities and property partnerships in the life funds	Third party valuations	n/a	546	n/a
			2,912	
Available-for-sale financial assets				
Asset-backed securities	Lead manager or broker quote/ consensus pricing from market data provider	Use of single pricing source	744	10
Equity investments	Various valuation techniques	Earnings, net asset value, underlying asset values, property prices, forecast cash flows	1,867	n/a
			2,611	
Derivative financial instruments	Industry standard model / consensus pricing from market data provider	Prepayment rates, probability of default, loss given default and yield curves. Equity conversion feature spread	1,937	96
Financial assets			7,460	
Derivative financial liabilities	Industry standard model / consensus pricing from market data provider	Prepayment rates, probability of default, loss given default and yield curves	197	8
Financial guarantees			38	n/a
Financial liabilities			235	

Reasonably possible alternative valuations have been calculated for asset-backed securities by using alternative pricing sources and calculating an absolute difference. In respect of derivative financial instruments, reasonably possible alternative valuations have been calculated by flexing the spread between the underlying asset and the credit derivative, or adjusting market yields, by a reasonable amount.

The valuation techniques used for unlisted equities and venture capital investments vary depending on the nature of the investment. Further details of these are given below. Third party valuers have been used to determine the value of unlisted equities and property partnerships included in the Group's life insurance funds. As these factors differ for each investment depending on the nature of the valuation technique used and the inputs there is no single common factor that could be adjusted to provide a reasonable alternative valuation for these investments portfolios.

The main products where level 3 valuations have been used are described below:

Asset-backed securities

Where there is no trading activity in asset-backed securities, valuation models, consensus pricing information from third party pricing services and broker or lead manager quotes are used to determine an appropriate valuation. Asset-backed securities are then classified as either level 2 or level 3 depending on whether there is more than one consistent independent source of data. If there is a single, uncorroborated market source for a significant valuation input or where there are materially inconsistent levels then the valuation is reported as level 3. Asset classes classified as level 3 mainly comprise certain Residential Mortgage-Backed Securities, Collateralised Loan Obligations and Collateralised Debt Obligations.

53 FINANCIAL INSTRUMENTS continued

Venture capital investments

The investments in venture capital activities comprise interests in funds and unlisted equity investments that are valued using techniques that are considered appropriate for that investment. Interests in funds are valued in the same manner as investments in the life funds below.

Valuations of unlisted venture capital equities that are accounted for as trading and other financial assets at fair value through profit or loss are calculated using International Private Equity and Venture Capital Guidelines. The majority of investments are valued using the industry standard earnings model. This involves applying the relevant earnings multiple to the maintainable earnings of the business being valued. A number of earnings multiples are used in valuing the portfolio including price earnings, earnings before interest and tax and earnings before interest, tax, depreciation and amortisation. The particular multiple selected being appropriate for the type of business being valued and is derived by reference to the current market-based multiple. Consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple. Recent transactions involving the sale of similar businesses may sometimes be used as a frame of reference in deriving an appropriate multiple. Another valuation technique involved, although rarely, is the discounting of projected cash flows at the appropriate cost of capital.

Equity investments

Unlisted equities and funds accounted for as available-for-sale assets are valued using different techniques as a result of the variety of investments across the portfolio. A valuation technique is selected for each investment in accordance with the Group's valuation policy. Depending on the business sector and the circumstances of the investment unlisted equity valuations are based on earnings multiples, net asset values or discounted cash flows.

– The earnings multiple methodology is described in the section on venture capital investments above.
– Valuations using net asset values are often used for property-based businesses and use the latest valuations included in management or statutory accounts adjusted for subsequent movements in property valuations and other factors including recoverability.
– Discounted cash flow valuations use estimated future cash flows, usually based on management forecasts, with the application of appropriate exit yields or terminal multiples and discounted using rates appropriate to the specific investment, business sector or recent economic rates of return.

For fund investments the most recent capital account value calculated by the fund manager is used as the basis for the valuation and adjusted, if necessary, to align valuation techniques with the Group's valuation policy.

Unquoted equities and property partnerships in the life funds

Third party valuations are used to obtain the fair value of unquoted investments. Management take account of any pertinent information, such as recent transactions and information received on particular investments, to adjust the third party valuations where necessary.

Derivatives

Where the Group's derivative assets and liabilities are not traded on an exchange, they are valued using valuation techniques, including discounted cash flow and options pricing models, as appropriate. The types of derivatives classified as level 2 and the valuation techniques used include:

– Interest rate swaps are valued using discounted cash flow models; the most significant inputs into those models are interest rate yield curves which are developed from publicly quoted rates.
– Foreign exchange derivatives that do not contain options are priced using rates available from publicly quoted sources.
– Credit derivatives, except for the items classified as level 3, are valued using publicly available yield and credit default swap (CDS) curves; the Group uses standard models with observable inputs.
– Less complex interest rate and foreign exchange option products are valued using volatility surfaces developed from publicly available interest rate cap, interest rate swaption and other option volatilities; option volatility skew information is derived from a market standard consensus pricing service. For more complex option products, the Group calibrates its models using observable at-the-money data; where necessary, the Group adjusts for out-of-the-money positions using a market standard consensus pricing service.

Where credit protection, usually in the form of credit default swaps, has been purchased or written on asset-backed securities, the security is referred to as a negative basis ABS and the resulting derivative assets or liabilities have been classified as either level 2 or level 3 according to the classification of the underlying ABS.

The Group's level 3 derivatives include £1,797 million in respect of the value of the embedded equity conversion feature of the enhanced capital notes issued in December 2009. Level 3 derivatives also include £140 million of credit default swaps written on level 3 negative basis ABS and £197 million of embedded derivatives included in investments of synthetic CDOs. The embedded equity conversion feature is valued by comparing the market price of the ECNs with the market price of similar bonds without the conversion feature. The latter is calculated by discounting the expected ECN cash flows in the absence of a conversion using prevailing market yields for similar capital securities without the conversion feature. The market price of the ECNs was calculated with reference to multiple broker quotes. Movements in the fair value of the derivative are recorded in net trading income.

53 FINANCIAL INSTRUMENTS continued

CREDIT VALUATION ADJUSTMENT

A Credit Valuation Adjustment (CVA) is applied to the Group's over-the-counter corporate derivative exposures to adjust the counterparty credit risk-free derivative valuations provided by standard interbank lending interest rate curves. The Group uses a simulation model to develop expected future exposures and calculate a pricing reserve based on the relative credit spread of the counterparty compared to the Group. At 31 December 2009 the CVA balance was £663 million (31 December 2008 £203 million). This adjustment has been made to the valuation of over-the-counter derivative instruments classified as level 2.

Observable CDS spreads and recovery rates are used to develop the probability of default for quoted clients. Observable sector CDS curves and recovery rates are used for unquoted clients. The Loss Given Default (LGD) is based on observable recovery rates and internal credit assessments. The combination of a one notch deterioration in credit rating of derivative counterparties and a 10 per cent increase in LGD increases the CVA charge by £181 million. Current market value is used to estimate the projected exposure for products not supported by the model. For these, CVA is calculated on an add-on basis (in total contributing 10 per cent of the overall CVA balance at 31 December 2009). A separate reserve of £43 million is held against features not supported by the current CVA model including rate/credit and wrong-way risk (where exposure to the counterparty is adversely correlated with the credit quality of the counterparty). A separate provision of £25 million is held against pricing risk on collateralised counterparties.

In addition, credit valuation adjustments have been applied to the Group's credit derivative exposures with monoline insurance counterparties leaving a net exposure of £75 million as shown in note 54 on page 239.

MOVEMENTS IN LEVEL 3 PORTFOLIO

The table below analyses movements in the Level 3 financial assets portfolio.

	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Derivative assets £m	Total financial assets £m
At 31 December 2008	1,672	3,161	136	4,969
Exchange and other adjustments	**(232)**	**(205)**	**74**	**(363)**
Acquired on acquisition	**3,386**	**2,291**	**569**	**6,246**
Gains (losses) recognised in the income statement	**(114)**	**(452)**	**(1,005)**	**(1,571)**
Gains (losses) recognised in other comprehensive income	**–**	**191**	**–**	**191**
Purchases	**374**	**422**	**2,224**	**3,020**
Sales	**(465)**	**(671)**	**(61)**	**(1,197)**
Transfers into the Level 3 portfolio	**33**	**48**	**–**	**81**
Transfers out of the Level 3 portfolio	**(1,742)**	**(2,174)**	**–**	**(3,916)**
At 31 December 2009	**2,912**	**2,611**	**1,937**	**7,460**

53 FINANCIAL INSTRUMENTS continued

The table below analyses movements in the Level 3 financial liabilities portfolio.

	Derivative liabilities £m	Financial guarantees £m	Total financial liabilities £m
At 31 December 2008	578	35	613
Exchange and other adjustments	(179)	–	(179)
Acquired on acquisition	1,102	–	1,102
Gains recognised in the income statement	(47)	–	(47)
Additions	–	3	3
Redemptions	(474)	–	(474)
Transfers out of the Level 3 portfolio	(783)	–	(783)
At 31 December 2009	**197**	**38**	**235**

Transfers out of the Level 3 portfolio arise when inputs that could have a significant impact on the instrument's valuation become market observable after previously having been non-market observable. In the case of asset-backed securities this can arise if more than one consistent independent source of data becomes available. Conversely transfers into the portfolio arise when consistent sources of data cease to be available.

Included within the gains (losses) recognised in the income statement are losses of £1,542 million related to financial instruments that are held in the Level 3 portfolio at the year end. These amounts are included in other operating income.

54 FINANCIAL RISK MANAGEMENT

As a bancassurer, financial instruments are fundamental to the Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by the Group.

The primary risks affecting the Group through its use of financial instruments are: credit risk; market risk, which includes interest rate risk and foreign exchange risk; and liquidity risk. Information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk and the Group's management of capital can be found on pages 56 to 94. The following additional disclosures, which provide quantitative information about the risks within financial instruments held or issued by the Group, should be read in conjunction with that earlier information.

(1) INTEREST RATE RISK

In the Group's retail banking business interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the Bank of England's base rate. There is a relatively small volume of deposits whose rate is contractually fixed for their term to maturity.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However, a significant proportion of the Group's lending assets, for example personal loans and mortgages, bear interest rates which are contractually fixed for periods of up to five years or longer.

The Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio.

At 31 December 2009 the aggregate notional principal of interest rate swaps designated as fair value hedges was £80,085 million (2008: £37,243 million) with a net fair value asset of £3,004 million (2008: liability of £1,231 million) (note 18). The losses on the hedging instruments were £995 million (2008: losses of £584 million). The gains on the hedged items attributable to the hedged risk were £1,181 million (2008: gains of £426 million).

In addition the Group has cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next six years and the hedge accounting adjustments will be reported in the income statement as the cash flows arise. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2009 was £222,548 million (2008: £867 million) with a net fair value liability of £2,536 million (2008: £90 million) (note 18). In 2009, there is no ineffectiveness recognised in the income statement that arises from cash flow hedges (2008: nil). There were no transactions for which cash flow hedge accounting had to be ceased in 2009 or 2008 as a result of the highly probable cash flows no longer being expected to occur.

54 FINANCIAL RISK MANAGEMENT continued

(2) CURRENCY RISK

Foreign exchange exposures comprise those originating in treasury trading activities and structural foreign exchange exposures, which arise from investment in the Group's overseas operations.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to the market and liquidity risk function in London. Associated VaR and the closing, average, maximum and minimum for 2008 and 2009 are disclosed on page 77.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group hedges part of the currency translation risk of the net investment in certain foreign operations using cross currency swaps and borrowings. At 31 December 2009 the aggregate notional principal of these cross currency swaps was £2,507 million (2008: £6,318 million) with a net fair value asset of £25 million (2008: liability of £2,413 million) (note 18) and they were designated on an after-tax basis as hedges of net investments in foreign operations. In 2009, ineffectiveness of £nil before tax and £nil after tax (2008: ineffectiveness of £14 million before tax and £10 million after tax) was recognised in the income statement arising from net investment hedges.

The Group's main overseas operations are in the Americas, Asia, Australasia and Europe. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

Functional currency of Group operations

	2009 £m	2008 £m
Euro:		
Gross exposure	**2,764**	133
Net investment hedge	**(2,651)**	–
	113	133
US dollar:		
Gross exposure	**(184)**	(907)
Net investment hedge	**62**	–
	(122)	(907)
Swiss franc:		
Gross exposure	**2,552**	2,784
Net investment hedge	**(2,467)**	(2,663)
	85	121
Australian dollar:		
Gross exposure	**1,869**	–
Net investment hedge	**(1,832)**	–
	37	–
Japanese yen:		
Gross exposure	**3,220**	3,667
Net investment hedge	**(3,207)**	(3,645)
	13	22
Other non-sterling	**316**	296
	442	(335)

54 FINANCIAL RISK MANAGEMENT continued

(3) CREDIT RISK

The Group's credit risk exposure arises predominantly in the United Kingdom, the European Union, Australia and the United States.

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

	2009 £m	2008 £m
Loans and receivables:		
Loans and advances to banks	35,510	38,868
Loans and advances to customers	641,770	243,803
Debt securities	33,082	4,549
Deposit amounts available for offset[1]	(13,373)	(4,837)
Impairment allowances	(15,380)	(3,727)
	681,609	278,656
Available-for-sale financial assets (excluding equity shares)	44,571	55,666
Trading and other financial assets at fair value through profit or loss (excluding equity shares)	65,861	21,790
Derivative assets, before netting	49,928	28,884
Amounts available for offset under master netting arrangements[1]	(21,698)	(10,598)
	28,230	18,286
Assets arising from reinsurance contracts held	1,875	385
Financial guarantees	18,021	10,382
Irrevocable loan commitments and other credit-related contingencies[2]	80,585	51,659
Maximum credit risk exposure	920,752	436,824
Maximum credit risk exposure before offset items	955,823	452,259

[1]Deposit amounts available for offset and amounts available for offset under master netting arrangements do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

[2]See note 52 – Contingent liabilities and commitments for further information.

A general description of collateral held in respect of financial instruments is disclosed on page 65.

Loans and advances to banks – the Group may require collateral before entering into a credit commitment with another bank, depending on the type of the financial product and the counterparty involved, and netting agreements are obtained whenever possible and to the extent that such agreements are legally enforceable.

Available-for-sale debt securities, treasury and other bills, and trading and other financial assets at fair value through profit or loss – the credit quality of the Group's available-for-sale debt securities, treasury and other bills, and the majority of the Group's trading and other financial assets at fair value through profit or loss held is set out below. An analysis of trading and other financial assets at fair value through profit or loss is included in note 17 and a similar analysis for available-for-sale financial assets is included in note 25. The Group's non-participating investment contracts are all unit-linked. Trading and other financial assets at fair value through profit or loss which back those investment contracts were £118,573 million (2008: £39,899 million). Movements in the fair value of such assets, including movements arising from credit risk, are borne by the contract holders.

Derivative assets – the Group reduces exposure to credit risk by using master netting agreements and by obtaining cash collateral. An analysis of derivative assets is given in note 18. Of the net derivative assets of £28,230 million (31 December 2008: £18,286 million), cash collateral of £6,645 million (31 December 2008: £2,970 million) was held and a further £13,004 million was due from OECD banks (31 December 2008: £5,840 million).

Assets arising from reinsurance contracts held – of the assets arising from reinsurance contracts held at 31 December 2009 of £1,875 million (31 December 2008: £385 million), £510 million (31 December 2008: £380 million) were due from insurers with a credit rating of AA or above.

54 FINANCIAL RISK MANAGEMENT continued

Financial guarantees – these represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards.

Reverse repo and repo transactions – for reverse repo transactions which are accounted for as collateralised loans, it is the Group's policy to seek collateral which is at least equal to the amount loaned. At 31 December 2009, the fair value of collateral accepted under reverse repo transactions that the Group is permitted by contract or custom to sell or repledge was £26,732 million (2008: £5,858 million). Of this, £26,732 million (2008: £5,855 million) was sold or repledged as at 31 December 2009. The fair value of collateral pledged in respect of repo transactions, accounted for as secured borrowings, where the secured party is permitted by contract or custom to repledge was £38,102 million (31 December 2008: £5,734 million).

Loans and advances

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2009						
Neither past due nor impaired	**35,333**	**347,292**	**48,429**	**185,872**	**581,593**	**19,082**
Past due but not impaired	**–**	**12,587**	**1,873**	**5,118**	**19,578**	**–**
Impaired – no provision required	**–**	**2,034**	**449**	**6,603**	**9,086**	**–**
– provision held	**153**	**5,918**	**5,902**	**37,927**	**49,747**	**–**
Gross	**35,486**	**367,831**	**56,653**	**235,520**	**660,004**	**19,082**
Allowance for impairment losses	**(149)**	**(1,774)**	**(3,379)**	**(20,835)**	**(25,988)**	**–**
Fair value adjustments	**24**				**(7,047)**	**–**
Net	**35,361**				**626,969**	**19,082**
31 December 2008						
Neither past due nor impaired	38,716	110,148	33,571	86,707	230,426	608
Past due but not impaired	17	3,134	1,146	555	4,835	–
Impaired – no provision required	–	479	150	1,253	1,882	–
– provision held	135	882	4,327	1,451	6,660	–
Gross	38,868	114,643	39,194	89,966	243,803	608
Allowance for impairment losses	(135)	(186)	(2,345)	(928)	(3,459)	–
Net	38,733	114,457	36,849	89,038	240,344	608

The analysis of lending between retail and wholesale has been prepared based upon the type of exposure and not the business segment in which the exposure is recorded. Included within retail are exposures to personal customers and small businesses, whilst included within wholesale are exposures to corporate customers and other large institutions.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 3. All impaired loans which exceed certain thresholds, principally within the Group's Wholesale division, are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security. Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £44,675 million (31 December 2008: £2,699 million) which have associated collateral with a fair value of £10,217 million (31 December 2008: £518 million).

54 FINANCIAL RISK MANAGEMENT continued

Loans and advances which are neither past due nor impaired

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
Good quality	**34,434**	**335,482**	**30,743**	**61,810**		**18,702**
Satisfactory quality	**135**	**9,614**	**12,654**	**59,752**		**267**
Lower quality	**15**	**746**	**1,480**	**45,986**		**90**
Below standard, but not impaired	**749**	**1,450**	**3,552**	**18,324**		**23**
	35,333	**347,292**	**48,429**	**185,872**	**581,593**	**19,082**
31 December 2008						
Good quality	38,283	109,815	21,373	49,349		129
Satisfactory quality	215	264	9,192	31,042		411
Lower quality	204	–	900	5,831		56
Below standard, but not impaired	14	69	2,106	485		12
	38,716	110,148	33,571	86,707	230,426	608

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and wholesale are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Wholesale lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models. Good quality lending includes the lower assessed default probabilities and all loans with low expected losses in the event of default, with other categories reflecting progressively higher risks and lower expected recoveries.

54 FINANCIAL RISK MANAGEMENT continued

Loans and advances which are past due but not impaired

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
0-30 days	**–**	**6,018**	**1,316**	**2,347**	**9,681**	**–**
30-60 days	**–**	**2,649**	**376**	**825**	**3,850**	**–**
60-90 days	**–**	**1,702**	**74**	**825**	**2,601**	**–**
90-180 days	**–**	**2,216**	**48**	**560**	**2,824**	**–**
Over 180 days	**–**	**2**	**59**	**561**	**622**	**–**
	–	**12,587**	**1,873**	**5,118**	**19,578**	**–**
Fair value of collateral held		**10,845**	**n/a**	**n/a**	**n/a**	
31 December 2008						
0-30 days	–	1,527	853	289	2,669	–
30-60 days	–	633	259	90	982	–
60-90 days	17	424	32	70	526	–
90-180 days	–	549	2	77	628	–
Over 180 days	–	1	–	29	30	–
	17	3,134	1,146	555	4,835	–
Fair value of collateral held		2,637	n/a	n/a	n/a	

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

Collateral held against retail mortgage lending is principally comprised of residential properties; their fair value has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations. The resulting valuation has been limited to the principal amount of the outstanding advance in order to provide a clearer representation of the Group's credit exposure.

Lending decisions are based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values for non-mortgage lending are assessed more rigorously at the time of loan origination or when taking enforcement action and may fluctuate, as in the case of floating charges, according to the level of assets held by the customer. Whilst collateral is reviewed on a regular basis in accordance with business unit credit policy, this varies according to the type of lending and collateral involved. It is therefore not practicable to estimate and aggregate current fair values of collateral for non-mortgage lending.

Renegotiated loans and advances

Loans and advances that were renegotiated during the year and that would otherwise have been past due or impaired at 31 December 2009 totalled £3,919 million (31 December 2008: £144 million).

54 FINANCIAL RISK MANAGEMENT continued

Forbearance

Forbearance or repayment arrangements allow a mortgage customer to repay a monthly amount which is lower than their contractual monthly payment for a short period. This period is usually for no more than 12 months and is negotiated with the customer by the mortgage collectors. During the period of forbearance, there is no clearing down of arrears such that unless the customer is paying more than their contractual minimum payment, arrears balances will remain. When customers come to the end of their arrangement period they will continue to be managed as a mainstream collections case and if unable to recover then will move toward possession.

Customers can have their arrears balance recapitalised once they have demonstrated they can pay the original contractual minimum payment, but are unable to clear their arrears. This is usually demonstrated by the customer making six consecutive contractual monthly payments. Customers are not however able to recapitalise more than twice in a five year period. Recapitalised mortgages will return to the non-impaired book and will be managed in accordance with the recapitalised terms of the mortgage.

Repossessed collateral

	2009 £m	2008 £m
Residential property	1,353	221
Other	701	26
	2,054	247

In respect of retail portfolios, the Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Group takes physical possession of assets held as collateral against wholesale lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

Loan-to-value ratio of mortgage lending

	2009 £m	2008 £m
Analysis by loan-to-value ratio of the Group's residential mortgage lending which is neither past due nor impaired:		
Less than 70 per cent	142,614	55,040
70 per cent to 80 per cent	54,079	15,812
80 per cent to 90 per cent	52,238	15,954
Greater than 90 per cent	98,361	23,342
	347,292	110,148

54 FINANCIAL RISK MANAGEMENT continued

Debt securities, treasury and other bills – analysis by credit rating:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2009							
Debt securities held at fair value through profit or loss							
Trading assets:							
Government securities	2,100	806	–	–	–	30	2,936
Other public sector securities	–	–	6	–	–	–	6
Bank and building society certificates of deposit	–	1,037	997	–	–	–	2,034
Other asset-backed securities	331	379	181	–	–	–	891
Corporate and other debt securities	1,025	312	1,328	348	72	12	3,097
Total held as trading assets	3,456	2,534	2,512	348	72	42	8,964
Other assets held at fair value through profit or loss:							
Government securities	16,025	581	337	26	–	56	17,025
Other public sector securities	675	16	–	–	–	9	700
Asset-backed securities:							
Mortgage-backed securities	316	134	45	24	–	1	520
Other asset-backed securities	403	325	654	333	265	19	1,999
	719	459	699	357	265	20	2,519
Corporate and other debt securities	4,070	1,359	4,540	3,407	1,062	3,133	17,571
Total other assets held at fair value through profit or loss	21,489	2,415	5,576	3,790	1,327	3,218	37,815
Total held at fair value through profit or loss	24,945	4,949	8,088	4,138	1,399	3,260	46,779
Available-for-sale financial assets							
Debt securities:							
Government securities	8,222	263	35	–	–	149	8,669
Other public sector securities	–	–	–	–	–	31	31
Bank and building society certificates of deposit	22	499	452	22	19	–	1,014
Asset-backed securities:							
Mortgage-backed securities	3,820	555	215	156	35	–	4,781
Other asset-backed securities	6,080	731	448	179	186	16	7,640
	9,900	1,286	663	335	221	16	12,421
Corporate and other debt securities	2,002	7,342	8,802	1,350	228	180	19,904
Total debt securities	20,146	9,390	9,952	1,707	468	376	42,039
Treasury bills and other bills	269	2,263	–	–	–	–	2,532
Total held as available-for-sale assets	20,415	11,653	9,952	1,707	468	376	44,571
Debt securities classified as loans and receivables							
Asset-backed securities:							
Mortgage-backed securities	9,183	2,470	805	682	182	–	13,322
Other asset-backed securities	11,824	2,465	1,449	277	965	157	17,137
	21,007	4,935	2,254	959	1,147	157	30,459
Corporate and other debt securities	–	439	823	69	306	986	2,623
Total debt securities classified as loans and receivables	21,007	5,374	3,077	1,028	1,453	1,143	33,082

54 FINANCIAL RISK MANAGEMENT continued

Debt securities, treasury and other bills – analysis by credit rating:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2008							
Debt securities held at fair value through profit or loss							
Trading assets:							
Government securities	38	–	–	–	–	–	38
Corporate and other debt securities	76	187	38	68	87	80	536
Total held as trading assets	114	187	38	68	87	80	574
Other assets held at fair value through profit or loss:							
Government securities	7,025	45	138	1	–	117	7,326
Other public sector securities	–	–	–	–	–	18	18
Bank and building society certificates of deposit	96	337	–	–	–	–	433
Asset-backed securities:							
Mortgage-backed securities	207	108	23	16	–	15	369
Other asset-backed securities	206	362	391	277	105	1	1,342
	413	470	414	293	105	16	1,711
Corporate and other debt securities	3,194	864	2,911	2,142	599	1,410	11,120
Total other assets held at fair value through profit or loss	10,728	1,716	3,463	2,436	704	1,561	20,608
Total held at fair value through profit or loss	10,842	1,903	3,501	2,504	791	1,641	21,182
Available-for-sale financial assets							
Debt securities:							
Government securities	851	–	1	–	–	16	868
Other public sector securities	–	–	–	–	–	12	12
Bank and building society certificates of deposit	–	9,418	166	–	18	–	9,602
Asset-backed securities:							
Mortgage-backed securities	5,523	59	59	18	41	–	5,700
Other asset-backed securities	7,412	235	134	73	184	54	8,092
	12,935	294	193	91	225	54	13,792
Corporate and other debt securities	168	1,257	192	–	–	566	2,183
Total debt securities	13,954	10,969	552	91	243	648	26,457
Treasury bills and other bills	26,858	2,351	–	–	–	–	29,209
Total held as available-for-sale assets	40,812	13,320	552	91	243	648	55,666
Debt securities classified as loans and receivables							
Asset-backed securities:							
Mortgage-backed securities	431	6	–	31	10	–	478
Other asset-backed securities	73	72	162	53	10	170	540
	504	78	162	84	20	170	1,018
Corporate and other debt securities	18	1,204	1,663	114	–	532	3,531
Total debt securities classified as loans and receivables	522	1,282	1,825	198	20	702	4,549

There are no material amounts for debt securities, treasury and other bills which are past due but not impaired.

54 FINANCIAL RISK MANAGEMENT continued

CREDIT MARKET EXPOSURES

The Group's credit market exposures primarily relate to asset-backed securities exposures held in Wholesale division. These exposures are classified as loans and receivables (note 23), available-for-sale (note 25) and trading and other financial assets at fair value through profit or loss (note 17) depending on the nature of the investment.

	Loans and receivables £m	Available-for-sale £m	Trading and other financial assets at fair value through profit or loss £m	Net exposure as at 31 December 2009 £m	Net exposure as at 31 December 2008 £m
Asset-backed securities					
Mortgage-backed securities:					
US residential mortgage-backed securities	4,826	–	–	4,826	488
Non-US residential mortgage-backed securities	6,078	3,577	–	9,655	4,585
Commercial mortgage-backed securities	2,561	1,176	–	3,737	1,328
	13,465	4,753	–	18,218	6,401
Collateralised debt obligations:					
Corporate	86	–	–	86	–
Commercial real estate	509	–	–	509	–
Other	151	45	–	196	189
Collateralised loan obligation	4,006	1,739	–	5,745	2,319
	4,752	1,784	–	6,536	2,508
Personal sector:					
Auto loans	1,006	724	–	1,730	796
Credit cards	2,938	782	–	3,720	1,126
Personal loans	769	230	–	999	39
	4,713	1,736	–	6,449	1,961
Federal family education loan programme student loans	5,938	3,306	–	9,244	2,951
Other asset-backed securities	400	783	–	1,183	1,050
Total uncovered asset-backed securities	29,268	12,362	–	41,630	14,871
Negative basis[1]	–	59	1,174	1,233	584
Total Wholesale asset-backed securities	29,268	12,421	1,174	42,863	15,455
Direct	19,386	7,039	1,174	27,599	8,728
Conduits (note 22)	9,882	5,382	–	15,264	6,727
Total Wholesale asset-backed securities	29,268	12,421	1,174	42,863	15,455
Other asset-backed securities	1,191	–	2,236	3,427	1,066
Total asset-backed securities	30,459	12,421	3,410	46,290	16,521

[1]Negative basis means bonds held with separate matching credit default swap protection.

54 FINANCIAL RISK MANAGEMENT continued

The table below sets out Wholesale division's net exposure to US RMBS by vintage.

	Pre-2005 £m	2005 £m	2006 £m	2007 £m	Net exposure as at 31 December 2009 £m	Net exposure as at 31 December 2008 £m
Asset class						
Prime	274	282	196	107	**859**	–
Alt-A	125	806	1,525	1,511	**3,967**	488
Sub-prime	–	–	–	–	**–**	–
	399	1,088	1,721	1,618	**4,826**	488

Exposures to Monolines

During the year all exposure to sub-investment grade monolines on CDS contracts was written down to zero, leaving limited exposure to monoline insurers as set out below.

	Credit default swaps		Wrapped loans and receivables		Wrapped bonds	
	Notional £m	Exposure[1] £m	Notional £m	Exposure[2] £m	Notional £m	Exposure[3] £m
Investment grade	**1,030**	**75**	**401**	**260**	**156**	**101**
Sub-investment grade	**–**	**–**	**–**	**–**	**234**	**8**
	1,030	**75**	**401**	**260**	**390**	**109**

[1] The exposure to monolines arising from credit default swaps is calculated as the mark-to-market of the CDS protection purchased from the monoline after credit valuation adjustments.

[2] The exposure to monolines on wrapped loans and receivables and bonds is the internal assessment of amounts that will be recovered from the monoline guarantor on interest and principal shortfalls.

[3] In addition, the Group has £2,703 million of monoline wrapped bonds and £791 million of monoline liquidity commitments on which the Group currently places no reliance on the guarantor.

54 FINANCIAL RISK MANAGEMENT continued

Credit ratings

An analysis of external credit ratings as at 31 December 2009 of the Wholesale division's asset-backed securities portfolio by asset class is provided below. These ratings are based on the lowest of Moody's, Standard & Poor's and Fitch.

	Net Exposure £m	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Below B £m
Asset class								
Mortgage-backed securities								
US residential mortgage-backed securities:								
Prime	859	435	245	42	16	22	31	68
Alt-A	3,967	2,819	729	286	102	27	2	2
Sub-prime	–	–	–	–	–	–	–	–
	4,826	3,254	974	328	118	49	33	70
Non-US residential mortgage-backed securities	9,655	8,742	862	48	3	–	–	–
Commercial mortgage-backed securities	3,737	1,067	1,325	476	755	58	–	56
	18,218	13,063	3,161	852	876	107	33	126
Collateralised debt obligations								
Corporate	86	24	45	6	–	11	–	–
Commercial real estate	509	99	158	159	33	45	15	–
Other	196	–	130	–	–	–	10	56
	791	123	333	165	33	56	25	56
Collateralised loan obligation	5,745	2,200	2,206	963	111	239	18	8
	6,536	2,323	2,539	1,128	144	295	43	64
Personal sector								
Auto loans	1,730	1,430	24	74	10	192	–	–
Credit Cards	3,720	3,606	114	–	–	–	–	–
Personal loans	999	789	56	154	–	–	–	–
	6,449	5,825	194	228	10	192	–	–
Federal family education loan programme								
Student loans	9,244	9,152	92	–	–	–	–	–
Other asset-backed securities	1,183	297	1	492	246	131	16	–
Negative basis[1]								
Monolines	970	376	379	215	–	–	–	–
Banks	263	50	9	–	–	–	–	204
	1,233	426	388	215	–	–	–	204
Total as at 31 December 2009	42,863	31,086	6,375	2,915	1,276	725	92	394
Total as at 31 December 2008	15,455	13,518	436	131	260	–	–	1,110

[1]The external credit rating is based on the bond ignoring the benefit of the CDS.

54 FINANCIAL RISK MANAGEMENT continued

(4) LIQUIDITY RISK

The table below analyses assets and liabilities of the Group into relevant maturity groupings based on the remaining contractual period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

Maturities of assets and liabilities

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2009						
Assets						
Trading and other financial assets at fair value through profit or loss	**22,912**	**6,047**	**10,517**	**9,666**	**100,869**	**150,011**
Derivative financial instruments	**15,222**	**1,245**	**3,756**	**15,611**	**14,094**	**49,928**
Loans and advances to banks	**24,641**	**2,783**	**4,759**	**1,880**	**1,298**	**35,361**
Loans and advances to customers	**84,441**	**12,623**	**30,296**	**126,355**	**373,254**	**626,969**
Debt securities held as loans and receivables	**92**	**143**	**557**	**4,149**	**27,711**	**32,652**
Available-for-sale financial assets	**1,205**	**3,134**	**3,172**	**19,885**	**19,206**	**46,602**
Other assets	**44,816**	**448**	**587**	**385**	**39,496**	**85,732**
	193,329	**26,423**	**53,644**	**177,931**	**575,928**	**1,027,255**
Liabilities						
Deposits from banks	**45,877**	**15,522**	**16,612**	**1,106**	**3,335**	**82,452**
Customer deposits	**326,931**	**26,637**	**18,234**	**30,627**	**4,312**	**406,741**
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	**26,494**	**4,655**	**9,330**	**17,827**	**10,450**	**68,756**
Debt securities in issue	**37,981**	**36,321**	**33,475**	**75,912**	**49,813**	**233,502**
Liabilities arising from insurance and investment contracts	**57,797**	**1,480**	**2,975**	**12,151**	**49,206**	**123,609**
Other liabilities	**3,674**	**502**	**1,372**	**4,056**	**23,757**	**33,361**
Subordinated liabilities	**55**	**280**	**754**	**8,568**	**25,070**	**34,727**
	498,809	**85,397**	**82,752**	**150,247**	**165,943**	**983,148**
As at 31 December 2008						
Assets						
Trading and other financial assets at fair value through profit or loss	196	216	606	3,059	40,987	45,064
Derivative financial instruments	7,366	1,956	3,362	7,570	8,630	28,884
Loans and advances to banks	23,585	4,712	7,002	5,354	105	40,758
Loans and advances to customers	39,854	7,254	15,430	56,331	123,866	242,735
Available-for-sale financial assets	31,204	6,800	2,076	8,843	6,784	55,707
Other assets	9,647	590	22	249	12,377	22,885
	111,852	21,528	28,498	81,406	192,749	436,033
Liabilities						
Deposits from banks	49,579	13,580	1,399	1,956	–	66,514
Customer deposits	152,065	8,449	7,925	2,054	445	170,938
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	6,725	1,977	3,204	11,871	9,869	33,646
Debt securities in issue	24,236	26,718	8,636	12,783	3,337	75,710
Liabilities arising from insurance and investment contracts	382	983	2,695	8,117	36,128	48,305
Other liabilities	5,701	404	552	186	7,122	13,965
Subordinated liabilities	16	–	97	2,809	14,334	17,256
	238,704	52,111	24,508	39,776	71,235	426,334

54 FINANCIAL RISK MANAGEMENT continued

The above tables are provided on a contractual basis. The Group's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms and readers are, therefore, advised to use caution when using data to evaluate the Group's liquidity position.

The table below analyses financial instrument liabilities of the Group, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2009						
Deposits from banks	**46,260**	**15,250**	**19,232**	**1,229**	**892**	**82,863**
Customer deposits	**305,782**	**37,691**	**32,848**	**28,229**	**4,020**	**408,570**
Trading and other financial liabilities at fair value through profit or loss	**14,592**	**3,668**	**6,116**	**3,224**	**1,275**	**28,875**
Debt securities in issue	**40,505**	**38,431**	**34,909**	**117,856**	**25,863**	**257,564**
Liabilities arising from non-participating investment contracts	**46,040**	**4**	**58**	**185**	**186**	**46,473**
Subordinated liabilities	**75**	**1,004**	**1,745**	**15,702**	**35,737**	**54,263**
Total non-derivative financial liabilities	**453,254**	**96,048**	**94,908**	**166,425**	**67,973**	**878,608**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**10,707**	**4,844**	**8,309**	**35,793**	**38,505**	**98,158**
Gross settled derivatives – inflows	**(6,547)**	**(4,501)**	**(8,165)**	**(35,306)**	**(36,311)**	**(90,830)**
Gross settled derivatives – net flows	**4,160**	**343**	**144**	**487**	**2,194**	**7,328**
Net settled derivatives liabilities	**15,107**	**2,180**	**9,395**	**8,721**	**1,777**	**37,180**
Total derivative financial liabilities	**19,267**	**2,523**	**9,539**	**9,208**	**3,971**	**44,508**
As at 31 December 2008						
Deposits from banks	49,620	13,617	1,480	1,986	5	66,708
Customer deposits	151,164	8,258	9,675	2,303	697	172,097
Trading and other financial liabilities at fair value through profit or loss	29,479	1,077	5,295	7,203	3,818	46,872
Debt securities in issue	24,381	26,944	9,192	13,643	3,489	77,649
Liabilities arising from non-participating investment contracts	14,243	–	–	–	–	14,243
Subordinated liabilities	34	130	563	5,382	20,516	26,625
Total non-derivative financial liabilities	268,921	50,026	26,205	30,517	28,525	404,194
Derivative financial liabilities:						
Gross settled derivatives – outflows	5,210	284	4,602	990	1,154	12,240
Gross settled derivatives – inflows	(3,136)	(33)	(3,248)	–	–	(6,417)
Gross settled derivatives – net flows	2,074	251	1,354	990	1,154	5,823
Net settled derivative liabilities	1,824	640	415	350	970	4,199
Total derivative financial liabilities	3,898	891	1,769	1,340	2,124	10,022

Cash flows for undated subordinated liabilities whose terms give the Group the option to redeem at a future date are included within the table on the basis that the Group will exercise its option to redeem.

The principal amount for undated subordinated liabilities with no redemption option is included within the over five years column; interest of approximately £555 million (2008: £412 million) per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond five years.

Further information on the Group's liquidity exposures is provided on pages 81 to 85.

54 FINANCIAL RISK MANAGEMENT continued

Liabilities arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2009	**6,263**	**2,303**	**4,796**	**17,890**	**44,927**	**76,179**
As at 31 December 2008	340	927	2,626	7,030	22,869	33,792

The following tables set out the amounts and residual maturities of Lloyds Banking Group's off balance sheet contingent liabilities and commitments.

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2009					
Acceptances	**59**	**–**	**–**	**–**	**59**
Other contingent liabilities	**2,670**	**1,356**	**1,144**	**879**	**6,049**
Total contingent liabilities	**2,729**	**1,356**	**1,144**	**879**	**6,108**
Lending commitments	**82,997**	**20,497**	**18,040**	**6,003**	**127,537**
Other commitments	**921**	**105**	**14**	**6**	**1,046**
Total commitments	**83,918**	**20,602**	**18,054**	**6,009**	**128,583**
Total contingents and commitments	**86,647**	**21,958**	**19,198**	**6,888**	**134,691**

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2008					
Acceptances	49	–	–	–	49
Other contingent liabilities	1,722	1,525	402	1,071	4,720
Total contingent liabilities	1,771	1,525	402	1,071	4,769
Lending commitments	54,155	15,029	8,014	3,625	80,823
Other commitments	572	181	80	99	932
Total commitments	54,727	15,210	8,094	3,724	81,755
Total contingents and commitments	56,498	16,735	8,496	4,795	86,524

55 CONSOLIDATED CASH FLOW STATEMENT

(A) CHANGE IN OPERATING ASSETS

	2009 £m	2008 £m
Change in loans and receivables	**50,935**	(33,717)
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**12,063**	(8,990)
Change in other operating assets	**(1,056)**	(318)
Change in operating assets	**61,942**	(43,025)

55 CONSOLIDATED CASH FLOW STATEMENT continued

(B) CHANGE IN OPERATING LIABILITIES

	2009 £m	2008 £m
Change in deposits from banks	**(71,267)**	25,279
Change in customer deposits	**11,474**	13,088
Change in debt securities in issue	**(26,578)**	22,401
Change in derivative financial instruments, trading and other liabilities at fair value through profit or loss	**(27,037)**	22,565
Change in investment contract liabilities	**5,415**	(3,061)
Change in other operating liabilities	**2,066**	661
Change in operating liabilities	**(105,927)**	80,933

(C) NON-CASH AND OTHER ITEMS

	2009 £m	2008[1] £m
Depreciation and amortisation	**2,560**	686
Revaluation of investment properties	**214**	1,058
Allowance for loan losses	**16,028**	2,876
Write-off of allowance for loan losses	**(4,090)**	(1,498)
Impairment of available-for-sale financial assets	**602**	130
Impairment of goodwill	**240**	100
Change in insurance contract liabilities	**5,986**	(4,555)
Other provision movements	**95**	7
Net charge in respect of defined benefit schemes	**529**	164
Contributions to defined benefit schemes	**(1,867)**	(547)
Gain on acquisition	**(11,173)**	–
Other non-cash items	**(2,806)**	(3,324)
Total non-cash items	**6,318**	(4,903)
Interest expense on subordinated liabilities	**2,550**	896
Other	**39**	(10)
Total other items	**2,589**	886
Non-cash and other items	**8,907**	(4,017)

(D) ANALYSIS OF CASH AND CASH EQUIVALENTS AS SHOWN IN THE BALANCE SHEET

	2009 £m	2008 £m
Cash and balances with central banks	**38,994**	5,008
Less: mandatory reserve deposits[2]	**(728)**	(545)
	38,266	4,463
Loans and advances to banks	**35,361**	40,758
Less: amounts with a maturity of three months or more	**(7,937)**	(12,461)
	27,424	28,297
Total cash and cash equivalents	**65,690**	32,760

[1] Restated for IFRS 2 (Revised).

[2] Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Included within cash and cash equivalents at 31 December 2009 is £13,323 million (2008: £8,255 million) held within the Group's life funds, which is not immediately available for use in the business.

55 CONSOLIDATED CASH FLOW STATEMENT continued

(E) ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

	2009 £m	2008 £m
Share capital (including share premium account and merger reserve):		
At 1 January	**3,952**	3,073
Issued on acquisition of HBOS	**7,651**	–
Transfer to capital redemption reserve	**(26)**	–
Cash proceeds from issue of share capital:		
Private placement	**–**	760
Placing and open offer	**4,430**	–
Placing and compensatory open offer	**3,905**	–
Rights issue	**13,112**	–
Other	**41**	119
	21,488	879
At 31 December	**33,065**	3,952

	2009 £m	2008 £m
Minority interests:		
At 1 January	**306**	284
Exchange and other adjustments	**(19)**	28
Adjustment on acquisition of HBOS	**5,567**	–
Repayment of capital to minority shareholders and extinguishment of minority interests	**(5,035)**	(3)
Minority share of profit after tax	**126**	26
Dividends paid to minority shareholders	**(116)**	(29)
At 31 December	**829**	306

	2009 £m	2008 £m
Subordinated liabilities:		
At 1 January	**17,256**	11,958
Exchange and other adjustments	**133**	2,658
Adjustment on acquisition of HBOS	**20,048**	–
Issue of subordinated liabilities	**4,187**	3,021
Repayments of subordinated liabilities	**(6,897)**	(381)
At 31 December	**34,727**	17,256

55 CONSOLIDATED CASH FLOW STATEMENT continued

(F) ACQUISITION OF GROUP UNDERTAKINGS AND BUSINESSES

	2009 £m	2008 £m
Net assets acquired:		
Cash and balances at central banks	2,123	–
Derivatives, trading and other financial assets at fair value through profit or loss	137,889	–
Loans and receivables:		
Loans and advances to customers	436,839	–
Loans and advances to banks	15,794	–
Debt securities	38,408	–
	491,041	–
Available-for-sale financial assets	27,151	–
Investment properties	3,002	–
Value of in-force business	3,713	–
Intangible assets	4,754	–
Tangible fixed assets	5,707	–
Other assets	11,398	–
Deposits from banks	(87,840)	–
Customer deposits	(224,694)	–
Derivatives, trading and other financial liabilities at fair value through profit or loss	(62,158)	–
Debt securities in issue	(185,319)	–
Insurance liabilities	(36,687)	–
Liabilities arising from non-participating investment contracts	(28,181)	–
Other liabilities	(17,316)	–
Retirement benefit obligations	(358)	–
Subordinated liabilities	(20,048)	–
Preference shares	(3,917)	–
Minority interests	(1,300)	–
	18,960	–
Satisfied by:		
Issue of shares	(7,651)	–
Gain on acquisition	(11,173)	–
Cash and cash equivalents acquired, net of acquisition costs	16,341	–
	(2,483)	–
Net cash inflow arising from acquisition of HBOS	16,477	–
Acquisition of and additional investment in joint ventures	(215)	–
Net cash inflow arising from acquisitions in the year	16,262	–
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	(35)	(19)
Net cash inflow (outflow)	16,227	(19)

(G) DISPOSAL AND CLOSURE OF GROUP UNDERTAKINGS AND BUSINESSES

	2009 £m	2008 £m
Intangible assets	170	–
Other net assets and liabilities	241	–
Net cash inflow from disposals	411	–

56 FUTURE ACCOUNTING DEVELOPMENTS

The following pronouncements will be relevant to the Group but were not effective at 31 December 2009 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group. With the exception of IFRS 9 *Financial Instruments: Classification and Measurement*, the initial view is that none of these pronouncements are expected to cause any material adjustments to reported numbers in the financial statements.

IFRS 9 is the initial stage of a project to replace IAS 39 *Financial Instruments: Recognition and Measurement* and will fundamentally change the way in which the Group accounts for financial instruments. Future stages are expected to result in amendments to IFRS 9 to deal with classification and measurement of financial liabilities, amortised cost and impairment and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements from the replacement of IAS 39.

Pronouncement	Nature of change	IASB effective date
IFRS 3 *Business Combinations*	The revised standard continues to apply the acquisition method to business combinations, however all payments to purchase a business are to be recorded at fair value at the acquisition date, some contingent payments are subsequently remeasured at fair value through income, goodwill may be calculated based on the parent's share of net assets or it may include goodwill related to the minority interest, and all transaction costs are expensed.	Annual periods beginning on or after 1 July 2009.
IAS 27 *Consolidated and Separate Financial Statements*	Requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control; any remaining interest in an investee is re-measured to fair value in determining the gain or loss recognised in profit or loss where control over the investee is lost.	Annual periods beginning on or after 1 July 2009.
IFRIC 17 *Distributions of Non-cash Assets to Owners*	Provides accounting guidance for non-reciprocal distributions of non-cash assets to owners (and those in which owners may elect to receive a cash alternative).	Annual periods beginning on or after 1 July 2009.
Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – 'Eligible Hedged Items'*	Clarifies how the principles underlying hedge accounting should be applied in particular situations.	Annual periods beginning on or after 1 July 2009.
Improvements to IFRSs[1] (issued April 2009)	Sets out minor amendments to IFRS standards as part of annual improvements process.	Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 January 2010.
Amendments to IFRS 2 *Share-based Payment – 'Group Cash-settled Share-based Payment Transactions'*[1]	Clarifies that an entity that receives goods or services in a share-based payment arrangement must account for those goods or services no matter which entity in the group settles the transaction, whether or not settled in shares or cash.	Annual periods beginning on or after 1 January 2010.
Amendment to IAS 32 *Financial Instruments: Presentation – 'Classification of Rights Issues'*	Requires rights issues denominated in a currency other than the functional currency of the issuer to be classified as equity regardless of the currency in which the exercise price is denominated.	Annual periods beginning on or after 1 February 2010.
IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*[1]	Clarifies that when an entity renegotiates the terms of its debt with the result that the liability is extinguished by the debtor issuing its own equity instruments to the creditor, a gain or loss is recognised in profit or loss representing the difference between the carrying value of the financial liability and the fair value of the equity instruments issued; the fair value of the financial liability is used to measure the gain or loss where the fair value of the equity instruments cannot be reliably measured.	Annual periods beginning on or after 1 July 2010.
IAS 24 *Related Party Disclosures*[1]	Simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities	Annual periods beginning on or after 1 January 2011.
Amendment to IFRIC 14 *Prepayments of a Minimum Funding Requirement*[1]	Applies when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements and permits such an entity to treat the benefit of such an early payment as an asset.	Annual periods beginning on or after 1 January 2011.
IFRS 9 *Financial Instruments: Classification and Measurement*[1]	Replaces those parts of IAS 39 *Financial Instruments: Recognition and Measurement* relating to the classification and measurement of financial assets. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument. The available-for-sale financial asset and held-to-maturity categories in existing IAS 39 will be eliminated.	Annual periods beginning on or after 1 January 2013.

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

57 POST BALANCE SHEET EVENTS

As part of the Group's recapitalisation and exit from the GAPS the Group announced on 27 November 2009 that an aggregate amount of £1,484 million would be issued in the form of new ordinary shares of Lloyds Banking Group in exchange for certain existing preference shares, and preferred securities. The conversion price was determined as the five day weighted average price for the five trading days ending on 11 February 2010.

On 18 February 2010, the exchange completed and 3,141 million ordinary shares in Lloyds Banking Group plc were issued as consideration for the redemption of preference shares and preferred securities. In accordance with the Group's accounting policy in respect of debt for equity exchanges, a gain of £85 million was recognised on this exchange transaction.

58 APPROVAL OF FINANCIAL STATEMENTS

The consolidated financial statements were approved by the directors of Lloyds Banking Group plc on 25 February 2010.

REPORT OF THE INDEPENDENT AUDITORS ON THE PARENT COMPANY FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

We have audited the parent company financial statements of Lloyds Banking Group plc for the year ended 31 December 2009 which comprises the parent company balance sheet, the parent company statement of changes in equity, the parent company cash flow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Directors' Responsibilities Statement on page 99, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

OPINION ON FINANCIAL STATEMENTS

In our opinion the parent company financial statements:

– give a true and fair view of the state of the Company's affairs as at 31 December 2009 and of its cash flows for the year then ended;
– have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
– have been prepared in accordance with the requirements of the Companies Act 2006.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

– the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
– the information given in the Directors' Report for the financial year for which the parent company financial statements are prepared is consistent with the parent company financial statements.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

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

– adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
– the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
– certain disclosures of directors' remuneration specified by law are not made; or
– we have not received all the information and explanations we require for our audit.

OTHER MATTER

We have reported separately on the consolidated financial statements of Lloyds Banking Group plc for the year ended 31 December 2009.

Ian Rankin
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
25 February 2010

(a) The maintenance and integrity of the Lloyds Banking Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

PARENT COMPANY BALANCE SHEET

at 31 December 2009

	Note	2009 £ million	2008 £ million
Assets			
Non-current assets:			
Investment in subsidiaries	9	32,584	5,589
Loans to subsidiaries	9	7,466	3,009
Deferred tax asset	2	3	–
		40,053	8,598
Current assets:			
Derivative financial instruments		2,260	1,297
Other assets		304	205
Amounts due from subsidiaries	3	1,446	216
Cash and cash equivalents		2,837	1,201
Current tax recoverable		72	–
		6,919	2,919
Total assets		46,972	11,517
Equity and liabilities			
Capital and reserves:			
Share capital	4	10,472	1,513
Share premium account	4	14,472	2,096
Merger reserve	5	7,778	–
Capital redemption reserve	5	26	–
Retained profits	6	2,547	2,147
Total equity		35,295	5,756
Non-current liabilities:			
Subordinated liabilities	7	4,205	2,875
Current liabilities:			
Debt securities in issue	8	326	2,644
Current tax liabilities		–	116
Other liabilities		7,146	126
		7,472	2,886
Total liabilities		11,677	5,761
Total equity and liabilities		46,972	11,517

The accompanying notes are an integral part of the parent company financial statements.

The directors approved the parent company financial statements on 25 February 2010.

Sir Winfried Bischoff
Chairman

J Eric Daniels
Group Chief Executive

Tim J W Tookey
Group Finance Director

PARENT COMPANY STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2009

	Share capital and premium £ million	Merger reserve £ million	Capital redemption reserve £ million	Retained profits[1] £ million	Total[1] £ million
Balance at 1 January 2008	2,730	–	–	1,935	4,665
Total comprehensive income[2]	–	–	–	2,209	2,209
Dividends	–	–	–	(2,042)	(2,042)
Private placement of ordinary shares	760	–	–	–	760
Purchase/sale of treasury shares	–	–	–	(14)	(14)
Employee share option schemes:					
value of employee services	–	–	–	59	59
proceeds from shares issued	119	–	–	–	119
Balance at 31 December 2008	3,609	–	–	2,147	5,756
Total comprehensive income[2]	**–**	**–**	**–**	**303**	**303**
Issue of ordinary shares:					
Placing and open offer	**649**	**3,781**	**–**	**–**	**4,430**
Issued on acquisition of HBOS	**1,944**	**5,707**		**–**	**7,651**
Placing and compensatory open offer	**3,905**	**–**	**–**	**–**	**3,905**
Rights issue	**13,112**	**–**	**–**	**–**	**13,112**
Issued to Lloyds TSB Foundations	**41**	**–**	**–**	**–**	**41**
Transfer to merger reserve	**(1,000)**	**1,000**	**–**	**–**	**–**
Redemption of preference shares	**2,684**	**(2,710)**	**26**	**–**	**–**
Purchase/sale of treasury shares	**–**	**–**	**–**	**23**	**23**
Employee share option schemes:					
value of employee services	**–**	**–**	**–**	**74**	**74**
Balance at 31 December 2009	**24,944**	**7,778**	**26**	**2,547**	**35,295**

[1]Restated for IFRS 2 (Revised).

[2]Total comprehensive income comprises only the profit for the year; no income statement has been shown for the parent company, as permitted by section 408 of the Companies Act 2006.

PARENT COMPANY CASH FLOW STATEMENT

	2009 £ million	2008[1] £ million
Profit before tax	**182**	2,222
Dividend income	**(354)**	(2,294)
Fair value and exchange adjustments	**(428)**	(68)
Change in other assets	**(1,277)**	(166)
Change in other liabilities and other items	**7,020**	89
Tax (paid) received	**(70)**	77
Net cash provided by (used in) operating activities	**5,073**	(140)
Cash flows from investing activities		
Costs incurred in respect of the acquisition of HBOS plc	**(138)**	–
Additional capital injection into HBOS plc	**(8,500)**	–
Additional capital injection into Lloyds TSB Bank plc	**(5,600)**	–
Amounts advanced to subsidiaries	**(7,593)**	–
Redemption of loans to subsidiaries	**1,552**	–
Net cash used in investing activities	**(20,279)**	–
Cash flows from financing activities		
Dividends received from subsidiaries	**354**	2,294
Dividends paid to equity shareholders	**–**	(2,042)
Proceeds from issue of debt securities	**–**	1,896
Repayment of debt securities in issue	**(2,045)**	(1,744)
Proceeds from issue of subordinated liabilities	**1,000**	–
Repayment of subordinated liabilities	**(4,000)**	–
Proceeds from issue of ordinary shares	**21,533**	879
Net cash provided by financing activities	**16,842**	1,283
Change in cash and cash equivalents	**1,636**	1,143
Cash and cash equivalents at beginning of year	**1,201**	58
Cash and cash equivalents at end of year	**2,837**	1,201

[1]Restated for IFRS 2 (Revised).

The accompanying notes are an integral part of the parent company financial statements.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

The parent company has applied International Financial Reporting Standards as adopted by the European Union in its financial statements for the year ended 31 December 2009. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 *Financial Instruments: Recognition and Measurement* relaxes some of the hedge accounting requirements; the Company has not taken advantage of this relaxation, and therefore there is no difference in application to the Company between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of all derivative contracts.

The accounting policies of the parent company are the same as those of the Group which are set out in note 2 to the consolidated financial statements, except that it has no policy in respect of consolidation and investments in subsidiaries are carried at historical cost, less any provisions for impairment.

The application of the following IFRS pronouncement which became effective in 2009 has had no material impact on these financial statements:

– Amendment to IAS 27 *Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*. This amendment removes the definition of the cost method and requires the presentation of dividends as income in the separate financial statements of the investor.

2 DEFERRED TAX ASSET

The movement in the net deferred tax asset is as follows:

	2009 £m	2008 £m
At 1 January	**–**	2
Income statement credit (charge)	**3**	(2)
At 31 December	**3**	–

The deferred tax asset relates to temporary differences.

3 AMOUNTS DUE FROM SUBSIDIARIES

These comprise short-term lending to subsidiaries, repayable on demand. The fair values of amounts owed by subsidiaries are equal to their carrying amounts. No provisions have been recognised in respect of amounts owed by subsidiaries.

4 SHARE CAPITAL AND SHARE PREMIUM

Details of the Company's share capital and share premium account are as set out in notes 45 and 46 to the consolidated financial statements.

5 OTHER RESERVES

The merger reserve comprises the premium on shares issued on 13 January 2009 under the placing and open offer and shares issued on 16 January 2009 on the acquisition of HBOS plc.

The capital redemption reserve represents transfers from the merger reserve in accordance with companies' legislation.

Movements in other reserves were as follows:

	2009 £m	2008 £m
Merger reserve		
At 1 January	–	–
Placing and open offer	3,781	–
Shares issued on acquisition of HBOS	5,707	–
Issue of preference shares[1]	1,000	–
Redemption of preference shares[2]	(2,710)	–
At 31 December	7,778	–

	2009 £m	2008 £m
Capital redemption reserve		
At 1 January	–	–
Redemption of preference shares[2]	26	–
At 31 December	26	–

[1] Distributable reserves of £1,000 million arose on the issue of preference shares in January 2009 which were classified as debt. In June 2009, these preference shares were redeemed out of the proceeds of the placing and compensatory open offer of ordinary shares and the distributable element of this issue was transferred to the merger reserve.

[2] In December 2009, the Group redeemed eight issues of preference shares in exchange for the issuance of enhanced capital notes. This resulted in a transfer of £26 million from the merger reserve to the capital redemption reserve and a transfer of £2,684 million from the merger reserve to the share premium account. Details of the preference shares redeemed are set out in note 44 to the consolidated financial statements.

6 RETAINED PROFITS

	£m[1]
At 1 January 2008	1,935
Profit for the year	2,209
Dividends	(2,042)
Purchase/sale of treasury shares	(14)
Employee share option schemes: value of employee services	59
At 31 December 2008	2,147
Profit for the year	303
Purchase/sale of treasury shares	23
Employee share option schemes: value of employee services	74
At 31 December 2009	**2,547**

[1] Restated for IFRS 2 (Revised).

Details of the Company's dividends are as set out in note 49 to the consolidated financial statements.

7 SUBORDINATED LIABILITIES

	Note	2009 £m	2008 £m
Preference shares			
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	a	327	824
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)	a	–	584
7.875% Non-Cumulative Preference Shares (€500 million)	a	115	–
7.875% Non-Cumulative Preference Shares (US$1,250 million)	a	236	–
9.25% Non-Cumulative Irredeemable Preference Shares (£300 million)	a	216	–
9.75% Non-Cumulative Irredeemable Preference Shares (£100 million)	a	79	–
6.475% Non-Cumulative Preference Shares (£186 million)	a	45	–
6.0884% Non-Cumulative Fixed to Floating Rate Preference Shares (£745 million)	a	10	–
6.3673% Non-Cumulative Fixed to Floating Rate Preference Shares (£335 million)	a	2	–
6.413% preference shares (US$750 million)	a	82	–
5.92% preference shares (US$750 million)	a	167	–
6.657% preference shares (US$750 million)	a	97	–
6% Non-Cumulative Redeemable Preference Shares	c	–	–
		1,376	1,408
Undated subordinated liabilities			
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	b	117	497
6.475% Undated Subordinated Notes callable 2024 (£102 million)		72	–
6.0884% Undated Subordinated Notes callable 2015 (£732 million)		520	–
6.3673% Undated Subordinated Notes callable 2019 (£331 million)		234	–
6.369% Undated Subordinated Notes callable 2015 (£597 million)		420	–
6.413% Undated Subordinated Notes callable 2035 (US$375 million)		133	–
5.92% Undated Subordinated Notes callable 2015 (US$378 million)		135	–
6.657% Undated Subordinated Notes callable 2037 (US$316 million)		112	–
6.267% Undated Subordinated Notes callable 2016 (US$406 million)		166	–
		1,909	497
Dated subordinated liabilities			
$9\frac{1}{8}$% Subordinated Bonds 2011 (£150 million)		152	149
$5\frac{7}{8}$% Subordinated Guaranteed Bonds 2014 (€750 million)		768	821
		920	970
		4,205	2,875

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer. Any repayments of subordinated liabilities require the consent of the Financial Services Authority.

a Further information regarding these issues can be found in note 44 to the consolidated financial statements.

b In certain circumstances, these bonds would acquire the characteristics of preference share capital. They are accounted for as liabilities as coupon payments are mandatory as a consequence of the terms of the 6 per cent non-cumulative redeemable preference shares. At the callable date the coupon on these bonds will be reset by reference to the applicable five year benchmark gilt rate. Holders of certain preference shares, preferred securities and undated subordinated notes issued by Lloyds Banking Group plc, Lloyds TSB Bank plc, HBOS plc, Bank of Scotland plc and other Group funding companies were invited to exchange their holdings in these notes under two exchange offers announced on 3 November 2009. Under these exchange offers holders had the option of exchanging their holdings for enhanced capital notes (the 'ECNs') issued by LBG Capital No.1 plc or LBG Capital No.2 plc or, in certain circumstances, new ordinary shares, cash or additional ECNs. Further information regarding this can be found in the liability management section of note 44 to the consolidated financial statements.

c Since 2004, the Company has had in issue 400 6 per cent non-cumulative preference shares of 25p each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company. The holder of the 400 25p 6 per cent preference shares has waived its right to payment for the period from 1 March 2010 to 1 March 2012.

8 DEBT SECURITIES IN ISSUE

These comprise the US$528 million Thirteen-Month Extendible Short-Term Notes issued by the Company in July 2008.

9 RELATED PARTY TRANSACTIONS

On 13 January 2009 HM Treasury became a related party of the Company. Further information on the relationship and transactions with HM Treasury are given in note 51 to the consolidated financial statements.

KEY MANAGEMENT PERSONNEL

The key management personnel of the Group and parent company are the same. The relevant disclosures are given in note 51 to the consolidated financial statements.

The Company has no employees (2008: nil).

As discussed in note 50 to the consolidated financial statements, the Group provides share based compensation to employees through a number of schemes; these are all in relation to shares in the Company and the cost of providing those benefits is recharged to the employing companies in the Group on a cash basis.

INVESTMENT IN SUBSIDIARIES

On 16 January 2009, the Company acquired 100 per cent of the ordinary share capital of HBOS plc. From this date, HBOS plc and its subsidiaries became controlled entities.

	2009 £m	2008 £m
At 1 January	**5,589**	5,589
Investment in HBOS plc:		
Acquisition of ordinary share capital	**7,787**	–
Purchase of preference share capital	**3,917**	–
Additional capital injections	**9,691**	–
	21,395	–
Capital injection into Lloyds TSB Bank plc	**5,600**	–
	32,584	5,589

The principal subsidiaries, all of which have prepared accounts to 31 December and whose results are included in the consolidated accounts of Lloyds Banking Group plc, are:

	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Lloyds TSB Bank plc	England	100%	Banking and financial services
Scottish Widows plc	Scotland	100%[1]	Life assurance
HBOS plc	Scotland	100%	Holding Company
Bank of Scotland plc	Scotland	100%	Banking and financial services
HBOS Insurance & Investment Group Limited	England	100%[1]	Investment holding
St. Andrew's Insurance plc	England	100%[1]	General insurance
Clerical Medical Investment Group Limited	England	100%[1]	Life assurance
Clerical Medical Managed Funds Limited	England	100%[1]	Life assurance

[1]Indirect interest.

The principal area of operation for each of the above subsidiaries is the United Kingdom.

9 RELATED PARTY TRANSACTIONS continued

In November 2009, as part of the restructuring plan that was a requirement for European Commission approval of state aid received by the Group, Lloyds Banking Group agreed to suspend the payment of coupons and dividends on certain of the Group preference shares and preferred securities for the two year period from 31 January 2010 to 31 January 2012. The Group has agreed to temporarily suspend and/or waive dividend payments on certain preference shares which have been issued intra-group. Consequently, in accordance with the terms of some of these instruments, subsidiaries may be prevented from making dividend payments on ordinary shares during this period. In addition, certain subsidiary companies currently have insufficient distributable reserves to make dividend payments.

Subject to the foregoing, there were no further significant restrictions on any of the parent company's subsidiaries in paying dividends or repaying loans and advances. All regulated banking and insurance subsidiaries are required to maintain capital at levels agreed with the regulators; this may impact those subsidiaries' ability to make distributions.

Loans to subsidiaries:

	2009 £m	2008 £m
At 1 January	**3,009**	2,820
Exchange and other adjustments	**(395)**	189
Amounts advanced	**6,404**	–
Redemptions	**(1,552)**	–
At 31 December	**7,466**	3,009

In addition the parent company carried out banking activities through its subsidiary, Lloyds TSB Bank plc (the Bank). At 31 December 2009, the parent company held deposits of £2,837 million with the Bank (2008: £1,201 million). Given the volume of transactions flowing through the account, it is not meaningful to provide gross inflow and outflow information. Included within subordinated liabilities is £1,899 million (2008: £nil) and within other liabilities is £6,999 million (2008: £nil) due to subsidiary undertakings. In addition, at 31 December 2009 the parent company had interest rate and currency swaps with the Bank with an aggregate notional principal amount of £11,373 million and a net positive fair value of £2,260 million (2008: notional principal amount of £4,567 million and a net positive fair value of £1,297 million), of which contracts with an aggregate notional principal amount of £1,460 million and a net positive fair value of £343 million (2008: notional principal amount of £1,870 million and a net positive fair value of £501 million) were designated as fair value hedges to manage the Company's issuance of subordinated liabilities and debt securities in issue.

Related party information in respect of other related party transactions is given in note 51 to the consolidated financial statements.

10 FINANCIAL INSTRUMENTS

MEASUREMENT BASIS OF FINANCIAL ASSETS AND LIABILITIES

The accounting policies in note 2 to the consolidated financial statements describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Held for trading at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
As at 31 December 2009					
Financial assets:					
Cash and cash equivalents	–	–	–	2,837	2,837
Derivative financial instruments	343	1,917	–	–	2,260
Loans to subsidiaries	–	–	7,466	–	7,466
Amounts due from subsidiaries	–	–	1,446	–	1,446
Total financial assets	343	1,917	8,912	2,837	14,009
Financial liabilities:					
Debt securities in issue	–	–	–	326	326
Subordinated liabilities	–	–	–	4,205	4,205
Total financial liabilities	–	–	–	4,531	4,531

	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Held for trading at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
As at 31 December 2008					
Financial assets:					
Cash and cash equivalents	–	–	–	1,201	1,201
Derivative financial instruments	501	796	–	–	1,297
Loans to subsidiaries	–	–	3,009	–	3,009
Amounts due from subsidiaries	–	–	216	–	216
Total financial assets	501	796	3,225	1,201	5,723
Financial liabilities:					
Debt securities in issue	–	–	–	2,644	2,644
Subordinated liabilities	–	–	–	2,875	2,875
Total financial liabilities	–	–	–	5,519	5,519

Note 53 to the consolidated financial statements outlines the valuation hierarchy into which financial instruments measured at fair value are categorised.

The derivative assets designated as hedging instruments represent level 2 portfolios. Of derivative assets classified as held for trading (not being designated as hedging instruments) shown above, £120 million represents level 2 portfolios and £1,797 million represents level 3 portfolios. The level 3 derivatives reflect the value at 31 December 2009 of the equity conversion feature of the Enhanced Capital Notes issued in December 2009 as part of Lloyds Banking Group's recapitalisation and exit from the Government Asset Protection Scheme.

10 FINANCIAL INSTRUMENTS continued

The following reconciliation shows the movements in derivative financial instrument assets within level 3 portfolios:

	Total £m
As at 31 December 2008	–
Purchases	2,224
Losses recognised in the income statement	(427)
As at 31 December 2009	**1,797**

INTEREST RATE RISK AND CURRENCY RISK

The Company is exposed to interest rate risk and currency risk on its debt securities in issue and its subordinated debt.

As discussed in note 9, the Company has entered into interest rate and currency swaps with its subsidiary, Lloyds TSB Bank plc, to manage these risks.

CREDIT RISK

The majority of the Company's credit risk arises from amounts due from its wholly owned subsidiaries, Lloyds TSB Bank plc and HBOS plc, and subsidiaries of these companies.

LIQUIDITY RISK

The table below analyses financial instrument liabilities of the Company, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date, balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2009						
Debt securities in issue	–	326	–	–	–	326
Subordinated liabilities	–	878	53	2,316	4,323	7,570
	–	1,204	53	2,316	4,323	7,896
As at 31 December 2008						
Debt securities in issue	75	12	2,601	–	–	2,688
Subordinated liabilities	14	28	125	789	2,529	3,485
	89	40	2,726	789	2,529	6,173

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £282 million (2008: £111 million) per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The valuation techniques for the Company's financial instruments are as discussed in note 53 to the consolidated financial statements.

	Carrying value 2009 £m	Carrying value 2008 £m	Fair value 2009 £m	Fair value 2008 £m
Financial assets:				
Cash and cash equivalents	2,837	1,201	2,837	1,201
Derivative financial instruments	2,260	1,297	2,260	1,297
Loans to subsidiaries	7,466	3,009	7,816	2,139
Amounts due from subsidiaries	1,446	216	1,446	216
Financial liabilities:				
Debt securities in issue	326	2,644	326	2,644
Subordinated liabilities	4,205	2,875	3,995	1,563

11 POST BALANCE SHEET EVENTS

Details of the Company's post balance sheet events are set out in note 57 to the consolidated financial statements.

12 APPROVAL OF THE FINANCIAL STATEMENTS AND OTHER INFORMATION

The parent company financial statements were approved by the directors of Lloyds Banking Group plc on 25 February 2010.

Lloyds Banking Group plc was incorporated as a public limited company and registered in Scotland under the UK Companies Act 1985 on 21 October 1985 with the registered number 95000. Lloyds Banking Group plc's registered office is The Mound, Edinburgh EH1 1YZ, Scotland, and its principal executive offices in the UK are located at 25 Gresham Street, London EC2V 7HN.

SHAREHOLDER INFORMATION

ANALYSIS OF SHAREHOLDERS

At 31 December 2009	Shareholders		Number of ordinary shares	
Size of shareholding	Number	%	Millions	%
1 – 99	154,058	5.44	6.0	0.01
100 – 499	1,680,575	59.31	384.2	0.60
500 – 999	465,800	16.44	321.0	0.50
1,000 – 4,999	416,279	14.69	850.5	1.34
5,000 – 9,999	56,087	1.98	393.6	0.62
10,000 – 49,999	52,934	1.87	1,054.2	1.65
50,000 – 99,999	4,464	0.16	300.6	0.47
100,000 – 999,999	2,352	0.08	569.0	0.89
1,000,000 and over	993	0.03	59,895.4	93.92
	2,833,542	100.00	63,774.5	100.00

SUBSTANTIAL SHAREHOLDINGS

At the date of this report a notification had been received that The Solicitor for the Affairs of Her Majesty's Treasury had a direct interest of 41.3 per cent in the issued share capital with rights to vote in all circumstances at general meetings. No other notification has been received that anyone has an interest of 3 per cent or more in the issued ordinary share capital.

SHARE PRICE INFORMATION

In addition to listings in the financial pages of the press, the latest price of Lloyds Banking Group shares on the London Stock Exchange can be obtained by telephoning 09058 890 190.
Visit www.londonstockexchange.com for details.

SHARE DEALING FACILITIES

A full range of dealing services is available as follows:

– Internet dealing. Log on to www.lloydstsbsharedealing.com
– Telephone dealing. Call 0845 606 0560
– Internet and telephone dealing services are available between 8.00am and 4.30pm, Monday to Friday.

Details of any dealing costs are available when you log on to the share dealing website or when you call the above number.

AMERICAN DEPOSITARY RECEIPTS (ADRs)

Lloyds Banking Group shares are traded in the USA through an NYSE-listed sponsored ADR facility, with The Bank of New York Mellon as the depositary. The ADRs are traded on the New York Stock Exchange under the symbol LYG. The CUSIP number is 539439109 and the ratio of ADRs to ordinary shares is 1:4.

For details contact: The Bank of New York Mellon Shareowner Services, PO Box 358516, Pittsburgh, Pennsylvania 15252-8516.
Telephone: 877-353-1154 (US toll free), international callers: +1 201-680-6825. Alternatively visit www.bnymellon.com or email shrrelations@bnymellon.com

INDIVIDUAL SAVINGS ACCOUNTS (ISAs)

The Company provides a facility for investing in Lloyds Banking Group shares through an ISA. For details contact: Retail Investor Operations, Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. Telephone 0871 384 2244.

CORPORATE RESPONSIBILITY

A copy of the Group's corporate responsibility report may be obtained by writing to Corporate Responsibility, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN. This information together with the Group's code of business conduct is also available on the Group's website www.lloydsbankinggroup.com

THE BETTER PAYMENT PRACTICE CODE

A copy of the code and information about it may be obtained from the BIS Publications Orderline 0845 015 0010, quoting ref URN 04/606. Alternatively, visit www.payontime.co.uk for details.

SHAREHOLDER ENQUIRIES

The Company's share register and the Lloyds Banking Group Shareholder Account (formerly the HBOS Shareholder Account) are maintained by Equiniti Limited. Contact them if you have enquiries about your Lloyds Banking Group shareholding, including those concerning the following matters:

– Change of name or address
– Loss of share certificate
– Dividend information, including loss of dividend warrant or tax voucher.

Contact details for Equiniti Limited can be found on the back cover.

Equiniti operates a web based enquiry and portfolio management service for you to receive shareholder communications electronically. In addition, you can change your address or bank details and register proxy appointments and voting instructions on your shareholding online. Visit www.shareview.co.uk for details.

ANNUAL GENERAL MEETING

The annual general meeting will be held at 11.00am on Thursday 6 May 2010 at the Edinburgh International Conference Centre.

Calls to 09058 and 0871 numbers are charged at 55p and 8p per minute, respectively, from a BT landline. The price of calls from mobiles and other networks may vary. The call prices we have quoted were correct in February 2010.

GLOSSARY

Asset-Backed Securities	Asset-Backed Securities are securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages but could also include leases, credit card receivables, motor vehicles, student loans. Further information on the Group's investments in ABS is given in Note 54.
Alt-A	Alt-A is defined as loans regarded as lower risk than sub-prime, but they share higher risk characteristics than lending under normal criteria. Further information on the Group's exposure to Alt-A investments is given in note 54.
Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue.
Asset-backed commercial paper	See **Commercial Paper**
Collateralised Debt Obligations	Collateralised Debt Obligations are securities issued by a third party which reference Asset-Backed Securities (ABSs) and/or certain other related assets purchased by the issuer. Lloyds Banking Group has not established any programmes creating CDOs but has invested in instruments issued by other banking groups. These are primarily CLOs, CBOs, CREs and CDOs. Details of these investments are given in note 54.
Commercial Mortgage-Backed Securities (CMBS)	Commercial Mortgage-Backed Securities are securities that represent interests in a pool of commercial mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal). Further information on the Group's investment in CMBS is given in note 54.
Commercial Real Estate	Commercial real estate includes office buildings, industrial property, medical centres, hotels, malls, retail stores, shopping centres, farm land, multifamily housing buildings, warehouses, garages, and industrial properties.
Conduits	A financial vehicle that holds asset-backed securities which are financed with short-term loans (generally commercial paper) that use the asset-backed securities as collateral. The conduit will often have a liquidity lines provided by a bank that it can draw down on in the event that it is unable to issue funding to the market. The Group sponsors three asset-backed conduits, Cancara, Grampian and Landale. Further details are provided in note 22.
Contractual maturities	Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.
Covered mortgage bonds	A bond backed by a pool of mortgage loans. The mortgages remain on the issuer's balance sheet. The issuing bank can change the make-up of the loan pool or the terms of the loans to preserve credit quality. Covered bonds thus have a higher risk weighting than mortgage-backed securities because the holder is exposed to both the non-payment of the mortgages and the financial health of the issuer. The Group issues covered bonds as part of its funding activities (note 21).
Commercial Paper	Commercial paper is an unsecured promissory note issued to finance short-term credit needs. It specifies the face amount paid to investors on the maturity date. Commercial Paper can be issued as an unsecured obligation of the Group, or for example when issued by the Group's conduits as an asset-backed obligation (in such case it is referred to as **asset-backed commercial paper**). Commercial Paper is usually issued for periods from as little as a week up to nine months.
Credit Default Swaps	A credit default swap is also referred to as a credit derivative. It is an arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a rating agency.
Credit risk spread (or credit spread)	The credit spread is the yield spread between securities with the same currency and maturity structure but with different associated credit risks, with the yield spread rising as the credit rating worsens. It is the premium over the benchmark or risk-free rate required by the market to take on a lower credit quality.
Customer deposits	Money deposited by account holders. Such funds are recorded as liabilities of the Group. The Group includes certain **repos** within customer deposits.
Debt restructuring	This is when the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as reducing the debt or interest charged on the loan.
Delinquency	A debt or other financial obligation is considered to be in a state of delinquency when payments are overdue.
First/Second Lien	A first lien gives the holder (usually the bank lending the funds) the first right to collect compensation from the sale of the underlying collateral in the event of a default on the loan. A second lien may be issued against the same collateral but in the case of default, compensation for this debt will only be received after the first lien has been repaid.

Funded/unfunded exposures	Exposures where the notional amount of the transaction is either funded or unfunded.
Guaranteed mortgages	Mortgages for which there is a guarantor to provide the lender a certain level of financial security in the event of default of the borrower.
Home Loans	A loan to purchase a residential property which is then used as collateral to guarantee repayment of the loan. The borrower gives the lender a **lien** against the property, and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms.
Impaired loans	Impaired loans are loans where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.
Impairment allowances	Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.
Individually/Collectively Assessed	Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.
Liquidity and Credit enhancements	Credit enhancement facilities are used to enhance the creditworthiness of financial obligations and cover losses due to asset default. Two general types of credit enhancement are third-party loan guarantees (such as **guaranteed mortgages**) and self-enhancement through overcollateralisation (in the case of **covered bonds**). Liquidity enhancement makes funds available if required, for other reasons than asset default, eg to ensure timely repayment of maturing commercial paper.
Loan-to-value ratio	The loan-to-value ratio is a mathematical calculation which expresses the amount of a mortgage balance outstanding as a percentage of the total appraised value of the property. A high LTV indicates that there is less value to protect the lender against house price falls or increases in the loan if repayments are not made and interest is added to the outstanding balance of the loan.
Loans past due	Loans are past due when a counterparty has failed to make a payment when contractually due.
Monolines	A monoline insurer is defined as an entity which specialises in providing credit protection to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically provided in the form of derivatives such as **credit default swaps** referencing the underlying exposures held.
Mortgage related assets	Assets which are referenced to underlying mortgages.
Mortgage vintage	The year the mortgage was issued.
Medium Term Notes	Medium term notes are a form of corporate borrowing covering maturity periods ranging from nine months to 30 years. Details of the notes issued under the Group's medium term notes programmes are given in note 35.
Negative basis bonds	**ABS** held with a separately purchased matching **credit default swaps** to protect against the risk of default of the security. The Group refers to ABS without the benefit of CDS protection as **Uncovered ABS**. Details of the Group's exposure to negative basis bonds is given in note 54.
Negative Equity Mortgages	Negative equity occurs when the value of the property purchased using the mortgage is below the balance outstanding on the loan. Negative equity is the value of the asset less the outstanding balance on the loan.
Net Interest Income	The difference between interest received on assets and interest paid on liabilities.
Prime	Prime mortgages are those granted to the most creditworthy category of borrower.
Private equity investments	Private equity is equity securities in operating companies not quoted on a public exchange. Investment in private equity often involves the investment of capital in private companies or the acquisition of a public company that results in the delisting of public equity. Capital for private equity investment is raised by retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.
Renegotiated loans	Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower. In the latter case renegotiation can result in an extension of the due date of payment or repayment plans under which the Group offers a concessionary rate of interest to genuinely distressed borrowers. This will result in the asset continuing to be overdue and will be impaired where the renegotiated payments of interest and principal will not recover the original carrying amount of the asset. In other cases, renegotiation will lead to a new agreement, which is treated as a new loan.
Repurchase agreements or 'repos'	Short-term funding agreements which allow a borrower to sell a financial asset, such as ABS or Government bonds as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan.
Retail Loans	Money loaned to individuals rather than institutions. These include both secured and unsecured loans such as mortgages and credit card balances.

Residential Mortgaged-Backed Securities	Residential Mortgage-Backed Securities are a category of **ABS**. They are securities that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. Securitisation is the process by which ABS are created. A company sells assets to an special purpose entity which then issues securities backed by the assets. This allows the credit quality of the assets to be separated from the credit rating of the original company and transfers risk to external investors. Assets used in securitisations include mortgages to create mortgage-backed securities or residential mortgage-backed securities ('RMBS') as well as commercial mortgage-backed securities. The Group has established several securitisation structures as part of its funding and capital management activities. These generally use mortgages, corporate loans and credit cards as asset pools. A listing of these programmes with the amounts secured and associated funding raised is given in note 22.
Special Purpose Entities (SPEs)	SPEs are entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The Group uses a number of SPEs, including those set-up under **securitisation** programmes, and as **conduits**. Where the Group has control of these entities or retains the risks and rewards relating to them they are consolidated within the Group's results.
Student loan related assets	Assets which are referenced to underlying student loans. (See note 54).
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer. Details of the Group's subordinated liabilities are set out in note 44.
Sub-Prime	Sub-prime is defined as loans to borrowers typically having weakened credit histories that include payment delinquencies and potentially more severe problems such as court judgements and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, high debt-to-income ratios, or other criteria indicating heightened risk of default.
Uncovered ABS	ABS held without the benefit of separately purchased matching credit default swaps to protect against the risk of default of the security. Details of the Group's uncovered ABS are given in note 54.
Value at Risk	Value at Risk is an estimate of the potential loss in earnings which might arise from market movements under normal market conditions, if the current positions were to be held unchanged for one business day, measured to a confidence level of 95 per cent.
Wrapped loans and bonds	If a loan or bond (usually an **ABS** security) is originally issued with a credit default swap already attached, the package is called a 'wrapped bond' or 'wrapped loan'. The Group's exposure to wrapped loans and bonds is set out in note 54.
Write Downs	The depreciation or lowering of the value of an asset in the books to reflect a decline in their value, or expected cash flows.

ABBREVIATIONS

ABS	Asset-Backed Securities
ADRs	American Depositary Receipts
AGM	Annual General Meeting
AMA	Advanced Measurement Approach
BHF	British Heart Foundation
BIS	Department for Business Innovation and Skills
BSU	Business Support Unit
CAGR	Compared Annual Growth Rate
CRR	Capital Resources Requirement
CVA	Credit Valuation Adjustment
ECNs	Enhanced Capital Notes
EEV	European Embedded Value
EPS	Earnings Per Share
EU	European Union
FSA	Financial Services Authority
FTE	Full Time Equivalent
GAPS	Government Asset Protection Scheme
GDP	Gross Domestic Product
HMRC	Her Majesty's Revenue & Customs
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICG	Individual Capital Guidance
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
IPEV	International Private Equity and Venture Capital
LDC	Lloyds Development Capital
LEP	Loss Emergence Period
LGB	Lesbian, Gay and Bisexual
LGD	Loss Given Default
LIBOR	London Inter-Bank Offered Rate
LTIP	Long Term Incentive Plan
OEICs	Open Ended Investment Companies
OFAC	Office of Foreign Assets Control
OFT	Office of Fair Trading
PFI	Private Finance Initiative
PPP	Public Private Partnerships
PVNBP	Present Value of New Business Premiums
RMBS	Residential Mortgage-Backed Securities
SAYE	Save-As-You-Earn
SLS	Special Liquidity Scheme
TSR	Total Shareholder Return
UK	United Kingdom of Great Britain and Northern Ireland
UKFI	UK Financial Investment
US	United States of America
VaR	Value-at-Risk
VAT	Value Added Tax

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