LLOYDS BANKING GROUP

ANNUAL REPORT AND ACCOUNTS 2013

Becoming the best bank for customers

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The 2013 Annual Report and Accounts incorporates the Strategic Report and the consolidated financial statements, both of which have been approved by the Board of Directors.

On behalf of the Board

Sir Winfried Bischoff
Lloyds Banking Group

5 March 2014

About us

Lloyds Banking Group is a leading UK based financial services group providing a wide range of services, mostly in the UK, to individual and business customers.

Our main business activities are retail and commercial banking, general insurance, and life, pensions and investments. We provide our services under a number of well recognised brands such as Lloyds Bank, Halifax, Bank of Scotland, TSB and Scottish Widows and through a range of distribution channels including the largest branch network in the UK.

The Group is quoted on the London Stock Exchange and the New York Stock Exchange and is one of the largest companies in the FTSE 100 index of leading UK companies.

View our report online

Our Annual Report and Accounts and other information about Lloyds Banking Group can be found at
www.lloydsbankinggroup.com

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We are creating a simpler, more agile and responsive organisation and are making a big investment in our products and services.

By becoming the best bank for customers we believe we can help Britain prosper and deliver strong and sustainable returns for our shareholders.

GROUP AT A GLANCE

A simple, low risk retail and commercial bank

focused on becoming the best bank for customers and helping Britain prosper.

80,000

We provided more than 80,000 mortgages to first-time buyers in 2013.

2013 highlights

£6.2bn

More than doubled underlying profit to £6.2bn

£415m

Returned to statutory profit before tax

-5%

Reduced costs by 5% to £9.6bn

+2%

Grew underlying income to £18.8bn, up 2%

£85m

We are one of the largest community investors in the UK, providing £85 million per annum to worthy causes.

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10.5m

We have a strong digital presence: over 10.5 million internet banking users and 1.2 billion log ons in 2013.

+6%

We grew net SME lending in a market that is contracting.

2013 highlights

+3%

Our core loan book grew across all divisions

-47%

We reduced the charge for impairment by 47%

-£35bn

We reduced non-core assets by a third, or £35 billion, to £64 billion

10.3%

We have a strong capital position, with our pro forma fully loaded common equity tier 1 ratio now increased to 10.3 per cent despite legacy charges

5

We have a multi-brand strategy with five major financial services brands serving the needs of customers in the UK market.

GROUP PERFORMANCE

Substantial strategic progress and improved performance

The significant progress we have made in improving our profitability and our capital position is testament to the strength of our business model and the commitment of our people.

António Horta-Osório
Group Chief Executive

Key highlights and outlook

In 2013, we made substantial progress on our strategy to become the best bank for customers and to create a customer focused, highly efficient, profitable and low risk bank:

- Grew lending in our core business by 3 per cent to support our customers and help Britain prosper
- Invested in our products and services for our customers, while further reducing costs and improving efficiency through our Simplification programme
- Significantly improved our financial performance, with Group underlying profit more than doubled to £6.2 billion, and a statutory profit before tax of £415 million
- Substantially strengthened our balance sheet, despite a charge for legacy business provisions totalling £3.5 billion, primarily relating to legacy Payment Protection Insurance business
- Lowered risk by reducing non-core assets and our international presence, and by growing our customer deposits and reducing our reliance on funding from the wholesale markets
- As a result, the UK government began reducing its stake in the Group in September

Looking ahead, we expect to make further progress on the execution of our strategic plan. We expect to:

- Increase lending to core customers: for retail customers, mortgage market net lending in 2014 expected to grow, supported by our target to lend around £10 billion to approximately 80,000 first-time buyers in 2014; for commercial customers, above market lending growth led by strong momentum in SME lending
- Invest in product propositions and digital capabilities across our brands and divisions, to deliver the products our customers need through the channels they prefer, while improving efficiency and customer service
- Grow our deposit base supported by our multi-brand strategy
- Achieve a low cost of equity and funds by further reducing costs and risk, resulting in a unique competitive position
- Generate, prior to any dividends, fully loaded common equity tier 1 capital of around 2.5 percentage points over the next two years, and thereafter 1.5-2 percentage points per annum
- Apply in the second half of 2014 to restart dividend payments, and to move to a dividend payout ratio of at least 50 per cent of sustainable earnings in the medium term

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Results summary

Substantial progress on strategic plan, enhancing service for customers whilst helping Britain prosper

- Continue to support the UK economy through lending to SMEs and first-time buyers with active participation in the Funding for Lending Scheme and Help to Buy
- Core loan book now growing in all divisions; returned mortgage lending to growth in the third quarter
- Launched a rebranded, revitalised Lloyds Bank and returned TSB to the high street in September
- Further strong performance in customer service with Net Promoter Scores increasing by 11 per cent over the year
- Continued reduction in FCA reportable banking complaints (excluding PPI) to 1.0 per 1,000 accounts, the lowest of any major UK bank; Halifax now at 0.8 per 1,000 accounts

Balance sheet further strengthened and risk reduced as we simplify the Group

- Strong capital build despite legacy charges, with pro forma fully loaded CET1 ratio of 10.3 per cent and core tier 1 ratio of 14.0 per cent
- Group loan to deposit ratio improved to 113 per cent (31 December 2012: 121 per cent); core ratio improved to 100 per cent
- Non-core asset reduction of £34.9 billion during the year, to £63.5 billion, ahead of plan and £2.6 billion capital accretive overall. Non-retail non-core assets reduced to £24.7 billion
- Further progress in reducing our international presence with exit from 21 countries since June 2011 now completed or announced; target for international presence of 10 countries or fewer in 2014 already achieved
- Strong leverage ratios of 4.1 per cent (pro forma CRD IV basis) and 4.5 per cent (pro forma Basel III 2014 basis)

Group underlying profit[1] and returns substantially increased; core profit and returns further improved

- Underlying profit increased by 140 per cent to £6,166 million in 2013
- Return on risk-weighted assets increased to 2.14 per cent (2012: 0.77 per cent)
- Underlying income of £18,805 million, up 2 per cent
- Banking net interest margin increased 19 basis points to 2.12 per cent, and to 2.29 per cent in the fourth quarter
- Costs reduced by 5 per cent to £9,635 million
- Credit quality continues to improve: impairment charge reduced by 47 per cent to £3,004 million; impairment charge as a percentage of average advances improved to 0.57 per cent (2012: 1.02 per cent)
- Core underlying profit increased by 24 per cent to £7,574 million
- Core return on risk-weighted assets increased from 2.54 per cent in 2012 to 3.26 per cent in 2013

Statutory profit before tax of £415 million; tangible net asset value per share of 48.5p

- Statutory profit before tax of £415 million (2012: loss of £606 million) including charge for legacy PPI business of £3,050 million
- Tangible net asset value per share at 31 December 2013 of 48.5p (31 December 2012: 51.9p); includes loss on capital accretive non-core disposals, deferred tax write-offs, adverse reserve movements, and legacy charges

Guidance reflects confidence in the future

- 2014 full year Group net interest margin expected to stabilise at around the Q4 2013 level of 2.29 per cent, excluding impact of TSB disposal
- Costs for 2014 are expected to be around £9 billion, excluding TSB running costs
- Impairment charge as a percentage of average advances expected to reduce to around 50 basis points for 2014
- Run-off portfolio (non-core non-retail assets and certain non-core retail assets) expected to reduce to c.£23 billion and non-core non-retail assets to c.£15 billion by the end of 2014
- Expect, prior to any dividends, to generate fully loaded common equity tier 1 capital of around 2.5 percentage points over the next two years, and thereafter 1.5 – 2 percentage points per annum
- Expect to apply to the PRA in the second half of 2014 to restart dividend payments, commencing at a modest level
- Progressive dividend policy expected thereafter moving to a dividend payout ratio of at least 50 per cent of sustainable earnings in the medium term

[1] The underlying basis of presentation is defined on page 52.

GROUP KEY PERFORMANCE INDICATORS

Measuring strategic performance

Our strategy

We operate a simple, low risk, customer focused UK retail and commercial banking and insurance business. Our aim is to become the best bank for customers and we'll do that by addressing our customers' needs through superior insight, tailored products, better service and our focus on building a long-term relationship with them. By leveraging our capabilities we believe we can help Britain prosper and deliver strong and sustainable returns for our shareholders.

We have more than 30 million customers and employ high quality, committed people across our iconic brands which include Lloyds Bank, Halifax, Bank of Scotland, TSB and Scottish Widows. We are creating a simpler, more agile, efficient and responsive organisation with a focus on operating sustainably and responsibly. We are focused on our core UK market which has attractive growth prospects, and where we can earn strong returns while maintaining a prudent approach to risk and a strong balance sheet.

How we measure performance

We use a range of performance measures to track progress on our strategy of becoming the best bank for customers. This progress is measured through a number of key performance indicators which are shown opposite.

Alignment of remuneration with performance

To ensure our employees act in the best interests of customers and shareholders, remuneration at all levels of the organisation is aligned to the strategic development and financial performance of the business and also takes into account specific risk management controls.

Variable remuneration including bonuses for all staff, including our Executive Directors, is based on the performance of the individual, the business area and the Group as a whole. Performance is assessed against a balanced scorecard of objectives, reviewed on a regular basis, across five areas (customer, building the business, risk, people and finance). Executive management are also eligible to participate in a Long-Term Incentive Plan, which encourages delivery on long-term financial objectives including total shareholder return and the Group's strategic objectives of becoming the best bank for customers and helping Britain prosper.

Performance measures

Unlocking the Group's potential

We are **reshaping** our business portfolio to fit our assets, capabilities and risk appetite; we are **strengthening** the Group's balance sheet and liquidity position; we are **simplifying** the Group to improve agility, efficiency and customer service; and we are **investing** to be the best bank for customers. A set of key performance indicators has been developed to track progress in each of these areas.

18 More on our strategy and KPIs

Building customer relationships

Customer relationships are key to our strategy and are critical for all our businesses. Significant differences across our four divisions mean the financial and non-financial strategic indicators for the development of customer relationships are generally tracked at a divisional level. Commentary on these is therefore included in the specific divisional sections of this report.

To assess progress towards our aim of becoming the best bank for customers we measure customer satisfaction and are publicly committed to reducing complaints. Our colleagues are a key differentiator and we use an engagement survey to assess individual motivation and organisational processes.

24 More on our divisions

30 More on customer satisfaction and customer complaints

34 More on staff engagement

Output measures

Delivering sustainable returns to shareholders

We have made significant progress against our strategic priorities in 2013. This is reflected in our improved underlying profit and stronger capital position as well as the improvement in statutory performance, despite legacy charges.

Further detail on these measures is contained in the following pages.

44 More on our Group results

Going forward, we will also track our performance against the commitments of our new Helping Britain Prosper Plan.

28 More on our Helping Britain Prosper Plan

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Balance sheet reduction (non-core assets)

£bn

We continue to make excellent progress in reshaping the business through the reduction of our non-core assets which, having stood at £300 billion at the beginning of 2009, now stand at £64 billion.

Fully loaded common equity tier 1 ratio

%

We continue to improve our common equity tier 1 ratio, which now stands at 10.3 per cent on a pro forma* fully loaded CRD IV basis.

*Including impact of announced disposals

Simplification cost savings (run rate)

£m

We have continued to make strong progress on the Simplification programme, which is a key driver of creating a lower cost, more efficient business.

Strategic investment

£m

As Simplification benefits materialise we are increasing the strategic investment in the business and have committed to invest approximately £500 million per annum by 2014 in addition to our business as usual investment programme.

Customer satisfaction (net promoter score)

%

We have made continued progress in enhancing customer satisfaction, as measured through the cross industry net promoter score metric. This measures customer service at key touch points and the likelihood of customers recommending us.

Customer complaints (FCA banking complaints* per 1,000 accounts)

Through our Simplification programme and continued focus on becoming the best bank for customers, our FCA reportable banking complaints continued to fall. We now have a target of 0.9 banking complaints per 1,000 accounts.

*Excluding PPI

Staff engagement score

%

We made strong progress in 2013 in improving staff engagement with the Employee Engagement Index (EEI) and Performance Excellence Index (PEI). The EEI measures the individual motivation of colleagues whilst the PEI measures how strongly colleagues believe the Group is committed to improving customer service.

Underlying profit before tax

£m

Statutory profit (loss) before tax

£m

Earnings per share

p

Total shareholder return

%

CHAIRMAN'S STATEMENT

This was, is, and will continue to be, a bank focused on customers' needs and building lasting relationships.

Sir Winfried Bischoff
Chairman

Overview

2013 has been a significant year for Lloyds Banking Group, and in my last year-end statement as Chairman I would like to reflect not just on the year's performance, but also on the strong position the Group has built as a result of the significant progress we have made in the past four years.

When I became Chairman in September 2009, I knew we faced many challenges as a Group, not least from the integration of two large businesses during a challenging time for financial markets and the global economy. However, I was encouraged by the great potential I could see in the Group's combined franchise, in the strength of its brands, and in the commitment of colleagues to do the best for customers. This was, is, and will continue to be, a bank focused on customers' needs and building lasting relationships.

I believed we could overcome these challenges and begin the process of restoring our customers' trust in what is a great British institution, with a strong heritage. I was also determined that the positive role the Group has played in the UK economy in the past should once again be recognised, and that Lloyds Banking Group should be a company of which we can all be proud.

The Board has taken a number of important, and in many instances difficult, decisions as we have worked towards these goals. They have included the capital restructuring of the business, the appointment of a new management team and the development and oversight of our new strategy.

A key early decision was to issue new shares in the Group in December 2009 to ensure we avoided the need for the government to take a larger stake or for the Group to face substantial further capital headwinds. I acknowledge this was painful at the time for many existing shareholders but has subsequently proved to have been the right choice for shareholders financially, as well as ensuring strength and stability, and laying the foundations for subsequent progress.

Progress in 2013

In 2013, we accelerated the delivery of our strategy and made substantial progress in creating a simple, customer focused, low risk retail and commercial bank. We more than doubled our Group underlying profit to £6.2 billion and returned to modest statutory profitability at the pre-tax level, while further reducing the risk in the business and strengthening the balance sheet. Our pro forma fully loaded common equity tier 1 ratio is now 10.3 per cent.

The significant progress enabled the UK government to sell a 6 per cent stake in the Group in September 2013, thereby reducing its holding to 32.7 per cent. This was a major milestone in our recovery, and marks the start of the journey to full re-privatisation, a key priority for the Group. We have also commenced preparatory work including the preparation of certain documents required for a possible future sale of shares in Lloyds Banking Group to the public.

We were also pleased that the first phase of the European Commission mandated business disposal, Project Verde, was successfully completed in September 2013, with TSB Bank launched onto the UK high streets. We continue to target an Initial Public Offering (IPO) of TSB Bank in 2014.

Despite this progress we have continued to be affected by legacy issues, in particular Payment Protection Insurance for which we took additional provisions of £3,050 million in the year. Though very disappointing, I am confident that our customer focused strategy along with the new customer processes and reward structures we are implementing will prevent issues of this magnitude being repeated.

As a Group we are well positioned, having established a business model and strategy which is aligned with the economic and regulatory environment. We have a strong and experienced management team to lead the further development of the business. The Group is now profitable, with a strong balance sheet and solid prudential foundations on which to build sustainable growth by serving our customers well.

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We are one of the largest community investors in the UK, providing £85 million per annum to worthy causes.

Supporting the UK economic recovery

Our simple, UK focused, low risk retail and commercial business plays a leading role in reshaping the banking industry and rebuilding the trust that is so vital in providing effective support for the economy. We are helping Britain prosper through our participation in UK government schemes such as Help To Buy and Funding for Lending, in the latter of which we have been the largest participant. I am particularly proud of our commitment to UK business since our performance is inextricably linked to that of the UK economy, and the companies that operate within it. Our SME lending grew 6 per cent in 2013 in a market that contracted, while we exceeded our target of lending £1 billion to UK manufacturing companies three months ahead of schedule, a commitment we made in recognition of the fundamental role the manufacturing sector plays in the economy.

Regulation

The regulation of the UK banking industry has changed significantly in my time as Chairman. Since the 2008 financial crisis, regulators have made great progress in enhancing the financial stability of the industry and the future regulatory framework is becoming clearer. However the challenge continues to be in striking the right balance between enhancing financial stability, and ensuring innovation, competition and growth.

The lower risk inherent in a focused retail and commercial banking model such as ours is now being recognised by regulators, as are the many changes we have implemented to achieve a strong capital, liquidity and funding position. We remain confident we will meet the latest regulatory capital requirements when finalised, including the adoption of CRD IV, and the Group is considering opportunities to raise new Additional Tier 1 capital. Discussions around the ring-fencing proposals for UK banks have continued to evolve through 2013, and although many details still remain unclear, our intention is to become a ring-fenced bank and meet the Independent Commission on Banking's 2019 deadline.

Dividends

We were pleased to announce earlier this year that given the progress the Group has made in substantially strengthening its capital position and improving its financial performance, that the PRA has now confirmed it will consider the Group's applications to make dividend payments in line with its normal procedures for other banks. In the light of this, and subject to a return to sustainable profitability and there being no major unexpected changes in the Group's business outlook or regulatory requirements, the Board expects that it will apply to the PRA in the second half of 2014 to restart dividend payments, commencing at a modest level. I fully understand the difficulties that the absence of dividends has caused our shareholders and I am particularly pleased we have now reached this position.

Directors

As announced in 2013, I will retire from the Group in April 2014. I am delighted Lord Blackwell has been chosen to succeed me as Chairman. He has an excellent understanding of the Group, having been a director of our Board and a member of the Group's Audit and Risk Committees since June 2012, and chairman of Scottish Widows plc from September 2012. He brings broad experience in banking, insurance and consultancy to the position. I am confident he will continue to take the Group forward successfully in the years ahead.

We were pleased to welcome Dyfrig John to the Board in January this year as an Independent Non-Executive Director. Dyfrig has significant banking experience in the UK and overseas, having served in a number of senior management and Board roles with HSBC and its subsidiaries, and given his position as the Chairman of Principality Building Society.

Juan Colombás was appointed to the Board in November 2013. Juan has been the Group's Chief Risk Officer and a member of the Group Executive Committee since January 2011. He is responsible for the management of risk across the Group and has over 25 years of banking experience. His appointment highlights the importance of risk management in the Group and reflects the significant work that Juan has done to reshape the risk function over the past three years.

As a Board we believe that diversity helps to improve the quality of decision making and I am pleased that we maintained at least 25 per cent female representation on the Board ahead of the 2015 deadline mandated by the Lord Davies report. I am confident that we will continue to promote diversity, both within the Board and the Group as a whole after my retirement.

One of the principal tasks of the Board is to develop a strategy which achieves long-term success and generates sustainable returns for shareholders. In turn, this needs to be underpinned by the high standards of corporate governance which are critical to the success of any business today. They must be driven by the Board, led by the Chairman, and be embedded in the thinking and processes of the business. As a Board, we are confident we have an excellent management team, and strong governance, to enable us to build a business that will deliver sustainable success in the future.

Community and culture

Lloyds Banking Group has a presence in practically every community across the UK. We attach great importance to supporting these communities, both locally and nationally. This not only strengthens our business, but also helps to rebuild trust and confidence in the banking sector and underlines the positive role banks should play in society as a whole. Our commitment to these communities is demonstrated through a variety of initiatives which continue to focus on our values of *putting customers first, keeping it simple* and *making a difference together.*

Actively supporting charitable causes has always been key to the Group and I am proud to say we have already exceeded our initial £2 million target of fundraising for our 'Charity of the Year' Alzheimer's Society and Alzheimer Scotland, one year into our two year partnership with the charity. This will allow the delivery of the first phase of the Live Well campaign, the first ever UK-wide dementia carers programme. Through our Community Fund, now in its second year, we are helping local people across the UK have a positive effect in their communities. In the past year the fund issued grants to over 1,500 local good causes in nearly 400 communities across the UK.

In addition to these areas of current focus, we are one of the largest community investors in the UK, providing £85 million per annum to worthy causes through various initiatives, including our charitable foundations.

We celebrated the graduation of our first cohort of Lloyds Scholars in the summer. The scheme is a key part of our investment in the long-term economic future of the UK and helps young people from lower income households take their first steps on the career ladder. We also encourage our Scholars to volunteer in their local communities during the academic year to add to the Group's wider support of communities.

Within Lloyds Banking Group we recognise the value of diversity in our colleagues. Having a broad and representative mix of backgrounds and experiences allows us to be more creative and maximise opportunities. The Group's diversity networks enjoyed a successful year in 2013 with more events, increased membership, and a wider awareness among colleagues. The Group's recent commitment to ensuring that women hold 40 per cent of our top jobs by 2020 further demonstrates the importance of diversity in the Group. The make-up of our workforce increasingly reflects the communities we serve, an important factor in helping the business to understand them better and help them to prosper.

CHAIRMAN'S STATEMENT

Corporate and social responsibility

Now more than ever, it is clear that doing business responsibly creates a more stable and successful future for the bank and for everyone it interacts with. During my years as Chairman, we have done a great deal to rebuild customer trust and colleague pride. Not only have we introduced more rigorous responsible business practices, but our renewed focus on helping Britain prosper has helped us to articulate how we contribute to the UK's long-term financial wellbeing.

We manage our business practices through our Responsible Business Committee (RBC), which reports to the Group Executive Committee on a quarterly basis, and to the Board via the RBC's Chair, Anita Frew, one of our Non-Executive Directors. In 2013, we continued to improve our governance structures, and now have all areas of the business represented on the RBC, to ensure effective management across the five pillars of our Codes of Responsible Business – customers, colleagues, communities, the environment, and relationships with our stakeholders. These developments will help to drive more positive outcomes, and move us closer to being the best bank for customers – which in turn will create sustainable value for shareholders.

The launch of our Helping Britain Prosper Plan in 2014 formalises our promise to make a difference in the areas where society's needs overlap most closely with our core business services. Through seven commitments, backed by over 20 specific targets, I believe we can lead the industry in creating change in a meaningful and measurable way.

Remuneration

The Remuneration Committee undertook a further review of colleague and executive remuneration in 2013. Anthony Watson, the Committee's Chairman, provides his annual review of our approach elsewhere in the report but, given the importance of remuneration to our stakeholders and the Group, I want as Chairman to give some context to the decisions we have taken.

We continue to believe that remuneration policy at all levels, including for senior executives, needs to incentivise staff to deliver strong, sustainable growth whilst reflecting the work required to reshape and transform the Group. We strongly believe that we should align rewards to the longer term, sustainable success of our business and through this the delivery of value to shareholders.

In 2012, despite improved underlying performance, we took the decision to reduce the bonus pool significantly below on-target levels. This reflected the views of our stakeholders, the uncertain economic outlook and the statutory loss for that year. For 2013, underlying performance was stronger, the economy is recovering, and the Group returned to pre-tax profit on a statutory basis. This improved performance, as shareholders are well aware, has been reflected in our share price, which rose 65 per cent in 2013, building on the 85 per cent increase in 2012.

In the light of the better results in 2013, the total bonus pool for the year has been increased by approximately 8 per cent to £395 million. This once again is significantly below on-target levels, but recognises the efforts of our employees in transforming the Group to a lower risk business and returning it to statutory profit.

Group bonus scheme awards remain a very small percentage of revenues at approximately 2 per cent, and represent approximately 6 per cent of pre-bonus underlying profit before tax, compared to 12 per cent in 2012. Cash bonuses are capped at £2,000 with additional amounts paid in shares and subject to deferral and performance adjustment. The average value of bonuses paid per employee remains below £4,500.

We are beginning to regain the trust of our customers and the Group is increasingly seen as a leader in the banking industry.

Recent European legislation has introduced a cap on the variable element of remuneration at 100 per cent of fixed remuneration, rising to 200 per cent if shareholders provide their consent. To manage the impact of the legislation, we intend to make changes to our executive remuneration structure through the introduction of fixed share awards. The awards would be delivered over five years to support the alignment of executive and shareholder interests. These changes will be subject to appropriate shareholder approval at the 2014 AGM. There will be no increase to maximum remuneration at face value as a result of these changes.

The 2013 bonus awards for executives have been determined against robust financial performance measures, and will continue to be deferred into shares, not vesting before 2017. In recognition of the Group's performance in 2013, the Remuneration Committee has decided to make an annual performance award to António Horta-Osório, the Group's Chief Executive Officer, of £1.7 million, payable in shares, with a five year deferral period. The award is subject to an additional condition requiring the share price to remain above 73.6p on average for any 126 consecutive trading days in the five years following grant or the UK government selling at least 50 per cent of its shareholding during the three years following grant. The shares will not be released before 2019. António has led the Group through a strong year resulting in the Group having the best performing share price amongst the FTSE 100 banks in 2013.

I am pleased to note that after many years of not meeting the performance conditions under the Long Term Incentive Plan (LTIP), the strong performance on strategic and financial targets since 2011 resulted in the vesting of a portion of awards under the Plan. The LTIP remains a core part of our reward strategy and the alignment of performance conditions with the Group's strategic objectives ensures payouts, when they do occur as in this year, are aligned to shareholders' objectives.

Outlook

Investors have begun to value the simplicity and transparency of our UK focused retail and commercial banking business model, as set out in 2011. The perceptions of the Group among other influential stakeholders are also improving. Above all, despite some continuing setbacks, we are beginning to regain the trust of our customers and the Group is increasingly seen as a leader in the banking industry.

In closing I would like to thank my fellow Board members, the senior leadership team and all colleagues for everything we have accomplished together at Lloyds Banking Group in my years here. Throughout my time I have been deeply impressed by the collegiate approach taken by management and colleagues in delivering goals, and their desire to do the best for customers. They have executed our strategy with great commitment and enthusiasm. I have also had great support from our shareholders large and small and I am grateful to them for their advice.

The significant progress on our strategy is demonstrated by much improved financial results. However, we will always be mindful not to become complacent or let past success diminish our future efforts. In April I will hand over to Lord Blackwell a strong bank that is well-placed competitively and looks to the future with a good deal of confidence, which I share. I wish the Group another successful year in 2014 and prosperity for many years ahead.

Sir Winfried Bischoff
Chairman

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A commitment to good governance

The Board is committed to achieving long-term success for the Group, and governance plays an integral part in ensuring consistency and rigour in decision making to allow us to maximise shareholder value over time.

This remains uppermost in our minds when applying the principles of the UK Corporate Governance Code published by the Financial Reporting Council. The Board aims to exceed these principles as we believe that good governance is a key contributor to the Group's long-term success.

Our Board

The Board has seen a number of changes this year, and in line with the provisions of the UK Corporate Governance Code and the interests of good corporate governance, all Directors are required to submit themselves for re-election on an annual basis. We are committed to ensuring we have the right balance of skills and experience within the Board, and we annually review its composition, and the diversity of backgrounds of its members.

The Salz Review

The Salz Review was published in April 2013. Whilst the review focused on issues and cultural behaviours that are specific to Barclays, it contains important lessons for all banks, and raises the expectation that all banks will consider whether selected issues exist in their own organisations. With that in mind the Nomination & Governance Committee which is chaired by Sir Winfried Bischoff asked for a full analysis of the Group's performance against the 34 Salz recommendations. The findings of this analysis are set out on page 90.

28 More on our responsible business

78 More on corporate governance

100 More on executive remuneration

Board oversight – key topics

Throughout 2013 the Board continued to review the Group's corporate strategy, the operation of the business and our results within a framework of prudent and effective controls, including the assessment and management of risks. This framework allowed us to deal with key topics arising throughout the year, including:

- the establishment of a committee to oversee the search and selection of a new Chairman of the Board, which is explained on page 82
- the ongoing review of Board composition, including a number of new appointments which are explained on page 90
- a full analysis of the Group's performance against the 34 Salz Review recommendations, which is explained on page 90
- the ongoing review and challenge of the Group's strategy and long term objectives, and the approval of the five year operating plan and annual budget
- the ongoing review of the regulatory framework and the implementation of changes to achieve a strong capital, liquidity and funding position
- the launch of TSB bank, an independent banking operation with approximately 600 branches across Britain
- ongoing oversight of conduct issues with an emphasis on embedding a culture of 'doing the right thing'
- an ongoing review of the adequacy of provisions in relation to legacy conduct issues such as Payment Protection Insurance (PPI) and the sale of interest rate hedging products to certain small and medium-sized businesses
- continued close scrutiny and control over executive remuneration arrangements, including adapting the structure to the requirements of CRD IV. We continued to maintain open and effective engagement with shareholders on a range of remuneration matters
- a Board Effectiveness Review in which all board members participated, expressed their views, had individual meetings with the Chairman and collectively discussed at the Board the overall findings of 75 different assessments

GROUP CHIEF EXECUTIVE'S REVIEW

We have reshaped, strengthened and simplified our business to create a low risk, efficient retail and commercial bank that is focused on our customers and on helping Britain prosper.

António Horta-Osório
Group Chief Executive

Summary

In 2013 the Group delivered a strong performance, underpinned by the rapid progress we have made on our strategic objectives, many of which we have now delivered ahead of plan. Since we set these objectives in June 2011, we have substantially reduced costs and risk, strengthened our balance sheet and capital base and increased investment in our core franchise, creating a unique competitive position with a low cost of equity. We continue to be well placed to support our customers and the UK economic recovery and to deliver strong and sustainable returns to shareholders above our cost of equity. As a result of this progress, we have substantially improved our underlying performance, returned the Group to profitability in spite of additional legacy costs and in September the UK government began returning the Group to full private ownership. We have also confirmed that the Board expects that it will apply to the Prudential Regulatory Authority (PRA) in the second half of 2014 to restart dividend payments, commencing at a modest level.

Results overview

We delivered a substantially improved financial performance in 2013. Group underlying profit more than doubled to £6,166 million when compared to 2012, reflecting improved profitability in the core business and a significant reduction in non-core losses.

On an underlying basis, the Group net interest margin increased 19 basis points to 2.12 per cent, total costs reduced 5 per cent to £9,635 million and the impairment charge fell by 47 per cent to £3,004 million, more than offsetting a fall in other income, which was down 2 per cent, mainly driven by the non-core asset reductions made in the year, which overall were capital accretive. As a result, the Group return on risk-weighted assets improved 137 basis points to 2.14 per cent.

We made excellent progress in our core business, where we have returned lending to growth in all our banking divisions, and underlying profit rose 24 per cent to £7,574 million. This growth in profit was largely driven by an 8 per cent increase in net interest income, and a 21 per cent reduction in the impairment charge. The return on risk-weighted assets in the core business improved by 72 basis points to 3.26 per cent.

On a statutory basis, the Group reported a profit before tax of £415 million, compared to a pre-tax loss of £606 million in 2012. Strong performance in our core business and reduced non-core losses were the main drivers behind the improvement which, together with gains on the sale of government securities of £787 million, was partly offset by charges of £3,455 million for legacy issues, principally Payment Protection Insurance (PPI). Our statutory result also included the costs of our Simplification programme and preparations for the TSB disposal (together £1,517 million), and losses on asset sales, including those from capital accretive non-core asset disposals, of £687 million.

Strengthening the balance sheet

Over the course of 2013 we made further progress in strengthening the balance sheet and reducing risk, while continuing to manage down our wholesale funding.

We substantially strengthened our capital position, with our pro forma fully loaded common equity tier 1 ratio increasing by 2.2 percentage points to 10.3 per cent, despite the additional legacy charges during the year. This uplift was driven by capital generation in the core business, as well as management actions including the reshaping of our core business portfolio, the substantial reduction of non-core assets in a capital accretive manner and the payment of dividends of £2.2 billion to the Group by the Insurance business. We reduced non-core assets by £34.9 billion, while at the same time releasing approximately £2.6 billion of capital.

The Group's funding structure and liquidity position remain robust. We further reduced wholesale funding by £32.0 billion, representing a 19 per cent decrease in the year, with the proportion of funding with a maturity of less than a year at 32 per cent. We continue to maintain a strong liquidity position including £89.3 billion of cash and highly rated, low risk securities.

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The 4 per cent increase in customer deposits, together with non-core asset reduction, drove a further improvement in the Group's loan to deposit ratio to 113 per cent at the end of 2013 from 121 per cent at the end of 2012, with the core loan to deposit ratio improving to 100 per cent by the end of 2013.

In acknowledgement of the significant progress we have made in improving the Group's capitalisation and transforming its financial profile, the rating agencies Fitch and Standard & Poor's upgraded Lloyds Bank's standalone rating to 'bbb+' in September and December 2013 respectively, and affirmed their long-term credit ratings on Lloyds Bank at 'A'.

Legacy

Our results and capital position reflect further provisions for legacy issues taken in 2013 totalling £3,455 million which had a material effect on our statutory performance. We remain committed to resolving these issues, while treating our customers fairly. Of these provisions, £3,050 million related to PPI and £130 million related to the sales of interest rate hedging products to certain small and medium-sized businesses.

We increased our provision for PPI by £1,800 million in the fourth quarter principally based on revised expectations for complaint volumes, uphold rates, and related administrative costs. Further detail on the provisions for legacy issues is given in the Summary of Group results on page 45.

Reshaping the Group to increase our focus on the UK and our core customers

We made a number of asset disposals during 2013, including the sales of our shares in St. James's Place and the announced disposal of our German life insurance operation, Heidelberger Leben. We also continued to increase our focus on our core UK business and reduce our international presence, completing the sales of our Australian and Spanish banking businesses and have now exited, or announced the exit from, 21 countries or overseas branches since June 2011. Following completion of these exits, we will operate in nine countries, achieving our target of operating in 10 countries or fewer by the end of 2014.

In November 2013, we announced that we had agreed to sell our asset management business Scottish Widows Investment Partnership (SWIP) to Aberdeen Asset Management (Aberdeen) for a consideration valued at the time at up to £660 million. We also agreed to enter into a long-term strategic relationship with Aberdeen which is expected to result in a stronger asset management partner for the Group and its customers, combining Aberdeen's and SWIP's strengths across asset classes once the sale completes, which is expected in the first quarter of 2014.

We continue to refresh our operating structure and from the beginning of 2014 our unified Wealth business will be integrated into the Retail division. This will allow us to sharpen our focus on delivering value-added Wealth services to eligible retail customers and will represent a key growth opportunity. We have also moved our Business Banking unit, which services approximately one million small business customers with less complex needs, into Retail, allowing us to draw on the collective expertise of Retail and Commercial Banking colleagues to manage these customer relationships in a way which leverages existing Retail infrastructure, via branch, telephony and digital channels.

Our Asset Finance business is the foundation of a newly created Consumer Finance division, which will also include our consumer and corporate credit card business. Bringing these business units together will increase management focus and allow us to capitalise on growth opportunities, continuing our good momentum in asset-backed lending and with the aim of growing our market presence in credit cards. Consumer Finance will work in close partnership with Retail and Commercial Banking to ensure we continue to offer our customers excellent customer service.

5%
Reduction in costs

£6.2bn
Underlying profit

Substantial further progress in our Simplification programme

Our Simplification programme remains central to the successful delivery of our strategy, both in terms of realising further cost savings and efficiencies, and in improving the products and services we offer our customers. Through Simplification, we have made excellent progress in improving and rationalising processes, and reducing layers, suppliers and our non-branch property portfolio. The ongoing programme realised approximately £0.6 billion in further cost savings in 2013, generating a total of around £1.5 billion annual run-rate savings since inception and having identified further opportunities we are now increasing our target run-rate savings by a further £100 million to £2.0 billion by the end of 2014. The total spent on the programme to the end of 2013 was £1.7 billion.

We have now fully automated the collection of maturity instructions from term deposit customers, reducing completion time by approximately 85 per cent, substantially reducing error rates and have completed the transfer of 1.7 million mortgage accounts to a single mortgage platform. Similarly, we have made great strides in delayering the organisation, increasing spans of control and simplifying the Group so that 98 per cent of employees are now within seven layers. During 2013 we also made significant progress in reducing the number of legal entities, which are now down to 929, a reduction of over 40 per cent since the start of the Simplification programme in 2011, and the number of Group suppliers was further reduced by 14 per cent to 9,066 in 2013, to around half the level at the start. Meanwhile we exited 19 non-branch properties in 2013, reducing the overall total to 161.

All of these changes help to put us firmly on the path to being the best bank for customers, enabling better service by making day-to-day tasks easier and freeing up colleague time to focus on our customers' needs.

Investing in the business

We are reinvesting a significant proportion of the savings realised from Simplification to further improve processes and the quality of customer interaction through branches, via the telephone and digital channels.

In the second half of the year, we relaunched the Lloyds Bank brand, building on its 250-year heritage of serving the people and businesses of Britain, to take its place alongside our key high street banking brands, Halifax and Bank of Scotland. The relaunch of Lloyds Bank followed the separation of TSB, which has brought another new challenger to the high street. The Group has received an agreement in principle from the European Commission to pursue an Initial Public Offering of TSB as planned in 2014 and to extend the deadline for the completion of the TSB divestment to the end of 2015.

We are continuing to develop and grow our Halifax challenger brand, including extending its geographical reach into Scotland, and in 2013 Bank of Scotland began its first ever national campaign targeting lending to small and medium-sized enterprises (SMEs). In Insurance, 2014 has already seen us relaunch the Scottish Widows brand, refining its focus on providing a more secure financial future for our customers and demonstrating our continued commitment to be a leader in the life planning and retirement market.

GROUP CHIEF EXECUTIVE'S REVIEW

Our strong portfolio of differentiated brands underlines our commitment to service and to helping our customers with the things that really matter – planning for the future, enabling them to purchase their home and protecting their families – as well as supporting UK business. Brand revitalisation is being reinforced by an extensive programme of branch refurbishment and investment in telephony and digital channels. We have so far refurbished over 1,500 branches since the Strategic Review, creating bright, modern environments incorporating screenless counters. We have also introduced active management of our banking halls, increased colleague training and extended opening hours at selected branches, enhancing the overall branch banking experience for our customers. In turn, this has resulted in a further 11 per cent improvement in Net Promoter Scores and a fall in Group reportable banking complaints to 1.0 per 1,000 accounts (excluding PPI). This level of complaints represents the lowest of any major UK bank, with Halifax leading the way amongst our brands with 0.8 complaints per 1,000 accounts, and we expect to maintain this industry leading position.

In telephone banking, we launched a number of improvements to our automated Interactive Voice Recognition (IVR) system in 2013, incorporating the latest speech recognition software to get things right first time when customers call us. With simplified menu structures, increased service functionality and improved call routing, nearly two-thirds of all calls are fulfilled at point of IVR first contact.

Our digital channels go from strength to strength, with active internet banking users now increased to over 10.5 million and mobile banking users to more than four million, and over 1.2 billion log-ons in 2013. We have now created a new Digital, Marketing and Customer Development function to capitalise on our achievements to date, focusing our investment and ensuring our success in Retail is replicated by sharing digital product development across all divisions.

In Commercial Banking we continue to strengthen our capabilities and position ourselves for growth. In 2013, we launched a new Global Transaction Banking platform to support clients in payments, liquidity management and working capital financing, thereby deepening our client relationships by fulfilling a broader spectrum of their product needs.

In General Insurance, we have redesigned our claims process to make it more efficient and simpler and as a result, the majority of our Home Claims customers are receiving their settlements 30 per cent faster. Customers making a claim are now looked after by a dedicated advisor throughout the life of their claim and regular contact is maintained.

Supporting our customers and the economic recovery

Lloyds Banking Group is the UK's largest retail and commercial lender, and in 2013 we continued to deliver on our pledge to help Britain prosper and support sustainable economic recovery. We were the first bank to access funding from the government's Funding for Lending (FLS) scheme, and are its largest lender, having committed over £37 billion of gross new lending with net core growth of £13 billion since the start of the scheme. We remain committed to passing on the benefits of this low cost funding to our UK customers.

In Retail, we helped more than 80,000 new homeowners to purchase their first home, exceeding our target of 60,000 and advancing mortgages totalling over £9.7 billion. Through our participation in government schemes such as Help to Buy in the Halifax and Bank of Scotland brands (now also launched under the Lloyds Bank brand in 2014), we are providing strong support for the recovery in the housing market, by facilitating access to mortgage financing for creditworthy home buyers at up to 95 per cent of property purchase values.

6%

Increase in SME lending

80,000+

Mortgages provided to first-time buyers

September 2013 saw the introduction of a new industry-wide service to make it easier and quicker for customers to switch their current account. Key Lloyds Banking Group brands are taking part in this scheme, which allows customers to switch their accounts within seven working days. During the course of the year switch-ins have exceeded switch-outs by approximately 144,000, particularly driven by switching into our challenger brand, Halifax. This is testament to some of the product innovations we have implemented, including loyalty schemes such as Halifax's Cashback Extras, and Everyday Offers at Lloyds Bank and Bank of Scotland, recognising and rewarding the faith placed in us by our customers to provide a consistent, high quality service.

In Commercial Banking, we continue to strengthen our client relationships, supporting businesses of all sizes from SMEs to Global Corporates. We have demonstrated our focus to support clients consistently through the economic cycle with net lending to SMEs growing by 6 per cent in 2013 despite a market contraction of 3 per cent; committing over £1.3 billion to the UK manufacturing sector by the end of September, exceeding our £1 billion target three months early; and providing finance to approximately 120,000 start-up enterprises, beating our target by 20,000. In 2013 we continued to approve eight out of 10 business loan and overdraft applications from SMEs. Meanwhile the Hire Purchase and Leasing team within Commercial Finance achieved record monthly lending levels. We have further supported loan growth by launching a partnership to deliver mobile card payment solutions to small businesses which is cutting technology costs and opening up growth opportunities.

For the ninth year running we were awarded the title of 'Business Bank of the Year' at the FDs' Excellence Awards, which are supported by the Confederation of British Industry and the Institute of Chartered Accountants in England and Wales.

In Insurance, we have seen excellent growth in our Corporate Pensions area, stimulated by the market changes as a result of the Retail Distribution Review and the support we are giving to our customers in managing the transition to auto-enrolment. We also launched an enhanced annuity product in both the intermediary and direct channels, expanding our offering, while enabling our retail bank customers to secure a higher retirement income via a new online comparison tool. We continue to enhance our market-leading bancassurance protection proposition as we look to address the UK population's protection gap. In 2013, we addressed the protection needs of 200,000 new customers and paid out around £200 million in claims to existing customers. In General Insurance, in the aftermath of the October and December storms, our Home Claims teams worked hard to offer seamless service at a distressing time for many of our customers.

Within Asset Finance, we were pleased to announce a partnership between our Black Horse business and Jaguar Land Rover which will see us provide lending facilities to over 200 motor dealerships to cover vehicle stock and personal finance to customers seeking to purchase a car. Black Horse also enabled customers to make payments via mobile devices this year. Within Wealth, we also now provide better support and faster advice through a newly inaugurated Private Banking client centre while harnessing the latest customer relationship management technology, halving the time from initial contact to customer interview.

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Regulation

2013 was an important year for the UK's supervisory framework for financial services companies, with two new bodies coming into existence in April, the Prudential Regulatory Authority and the Financial Conduct Authority, replacing the FSA. While uncertainty remains in relation to the impact of many reforms affecting our industry, both in the UK and from abroad, there is now greater clarity on regulatory capital requirements. Our simplified, low risk, UK focused model is closely aligned to the new regulatory landscape, and with the reshaping we have undertaken, we are better positioned than ever to adapt to the changes we may face in the future and conduct our day-to-day business in a way that puts our customers' needs first. We also continue to work with the relevant authorities on the evolution of regulation connected to the Financial Services (Banking Reform) Act, although we expect the majority of our operations to be within the ring-fence which this legislation will create when it comes into effect at the start of 2019.

Colleagues

Our success relies on the dedication of colleagues, the service they provide to our customers and the long-term partnerships they build with them. Our stated aim of becoming the best bank for customers would not be possible without their talent and hard work. I would like to personally thank all colleagues for their tremendous efforts that have enabled us to move further and faster towards our goals in 2013.

I would also like to take this opportunity to thank our Chairman, Sir Winfried Bischoff, who will retire from the Group in April 2014. His stewardship and guidance, in a challenging operating environment both from a regulatory and economic perspective, have been invaluable. I look forward to working closely with Lord Blackwell, who will take over as Chairman from April, on the next steps in the evolution of the Group.

We are committed to attracting, retaining and developing our people. Over 51,000 Lloyds Banking Group customer facing colleagues have achieved the Chartered Banker Foundation Standard for Professional Bankers. This Standard enables bankers to demonstrate to colleagues and customers that they have the knowledge and skills to perform their role, that they take responsibility for acting ethically and professionally, and that they adhere to the Chartered Banker Code of Professional Conduct to deliver the best outcomes for our customers.

Colleague feedback is highly valued and in 2013, Community Bank and Telephone Banking colleagues made almost 3,000 suggestions, contributing towards a culture of continuous improvement and innovation, enabling us to deliver more tangible enhancements to our customer offering than ever before. Also vital are our Back to the Floor days which take our senior leaders from the wider Group back into the branches and operational centres to experience our services and processes first hand, giving them important insights into how improvements are being implemented.

11%

Increase in customer service scores

40%

2020 target for senior roles held by women

Our 2013 Colleague Survey had the highest ever participation rate, reaching over 75 per cent. There were improvements in scores across all key categories and we compare favourably with other UK companies. Notably the Employee Engagement Index (EEI), which shows the extent to which colleagues feel motivated to contribute to the success of the Group, and are willing to apply discretionary effort to help the business succeed, rose to 64 per cent, 16 points higher than in 2012. Meanwhile, the Performance Excellence Index (PEI), which shows how strongly colleagues believe the Group is committed to delivering, and continuously improving, high quality products and services to customers, rose to 76 per cent, 8 points higher than in 2012. There are many factors that influence these scores; the ongoing delivery of our strategy, the achievement of key milestones, together with the recent start of our return to full private ownership, have all contributed to the improvement in engagement.

I am also delighted to have announced, as part of our Helping Britain Prosper Plan, that we are moving towards a target of 40 per cent of our most senior roles being held by women by 2020. We do recognise however, that there is more to be done on our journey to being the best bank for customers and amongst the best-rated companies in the UK by our colleagues.

I am proud that, amongst many other accolades received during the year, we were named 'Best Bank (UK)' at the 2013 Euromoney Awards and 'Bank of the Year' at The Banker's 2013 Awards. These awards reflect the strong capabilities and diligence of our people who continue to support the delivery of our strategy.

Dividends

In the second half of 2013, the Group commenced discussions with the PRA on the timetable and conditions for resuming dividend payments. Given the progress the Group has made in substantially strengthening its capital position and improving its financial performance, the PRA has now confirmed that it will consider the Group's applications to make dividend payments in line with its normal procedures for other banks.

In the light of this, and subject to a return to sustainable profitability and there being no major unexpected changes in the Group's business outlook or regulatory requirements, the Board expects that it will apply to the PRA in the second half of 2014 to restart dividend payments, commencing at a modest level. The Board expects thereafter to have a progressive dividend policy with the aim of moving, over the medium term, to a dividend payout ratio of at least 50 per cent of sustainable earnings.

Outlook

We have made further substantial progress in 2013 on our strategy to be the best bank for customers. We delivered a significantly improved financial performance while increasing investment in our core franchise and people, strengthening our balance sheet and capital position, reducing costs and risk, and addressing legacy issues.

There is still a lot to do and we are not complacent, but the progress we have made means we have a simpler, more efficient, low risk business, which given the additional investments we are making, is well placed to serve our customers and to help Britain prosper. We therefore remain confident in the Group's prospects, despite continued regulatory uncertainty, and in our ability to generate strong and sustainable returns for our shareholders.

António Horta-Osório
Group Chief Executive

MARKET OVERVIEW

Given our UK focus, our financial performance is inextricably linked to the performance of the UK economy, its regulatory environment and the competitive environment.

UK economic trends

The UK economy started to grow again in 2013

As with many developed economies, the shift from rising debt in the pre-crisis decade to a period of debt repayment in recent years has proved a difficult transition for the UK economy. Many countries cutting back on private spending and government spending at the same time resulted in self-perpetuating cycles of weak growth and confidence, with exports unable to compensate for weak domestic demand.

However, progress on consumer and bank debt reduction has been greater in the UK than across much of Europe, and consequently UK economic growth picked up significantly in 2013, much more so than in the Eurozone. Business and consumer confidence increased as the Eurozone economy stabilised, following the European Central Bank's commitment to purchase government bonds of countries experiencing financing difficulties and from a slowdown in their mandated pace of government deficit reduction. UK consumers appear to have reduced their precautionary saving, and the appetite for unsecured credit, particularly for car purchase, increased, helping consumer spending growth to accelerate to 2.4 per cent in 2013, up from 1.5 per cent in 2012.

Government initiatives have supported recovery

A number of government initiatives have helped support recovery. The Bank of England initially introduced 'forward guidance' for Bank Rate, ruling out any increase until the unemployment rate had fallen significantly, hoping to limit concerns that interest rates might rise before the economy was much stronger, and although the guidance has since been updated, this helped provide reassurance. The government launched a two-pronged Help to Buy scheme to help first-time house buyers struggling to raise deposits as well as existing home-owners constrained by low levels of equity in their current properties. Alongside the improving economy, this contributed to a rise in house prices of 6 per cent in 2013 compared to 2 per cent in 2012. The Funding for Lending scheme, introduced in 2012, continued to support the economy with its beneficial impact on banks' funding costs and consequent lowering in interest rates on lending products, although its support for mortgage lending has now been withdrawn. Our participation in both of these schemes has not only been beneficial to the Group but also illustrates our commitment to and focus on supporting the UK economy and helping Britain prosper.

Recovery has so far been weak

Early estimates suggest that the UK economy grew by 1.8 per cent in 2013 compared to 0.3 per cent in 2012. However, given how much the economy shrank during the 2008-9 recession, recovery so far has been weak in a historical UK context and is only now outperforming the Eurozone. The weak Eurozone economy continues to drag on the UK – the UK's overseas trade balance remained close to 1.5 per cent of GDP in 2013, as in 2012, with export growth estimated at below 1 per cent in 2013. Further improvement in external trade is necessary if the economy is to make up some of the gap between current output and the pre-crisis trend, without increasing debt again.

Unemployment, although still well above its pre-crisis level, fell relatively quickly through 2013 from 7.8 per cent at the end of 2012 to 7.2 per cent in the final quarter of 2013. Low interest rates have helped to keep company failures subdued, falling to just 0.6 per cent of active companies in 2013, close to its pre-crisis low.

Growth expected to improve

The most likely outlook is for continued recovery in 2014, with faster growth than in 2013. But the recovery will still be held back by consumers' subdued appetite to borrow and government deficit reduction in the UK and across much of the Eurozone. The current consensus for 2014 GDP growth is 2.7 per cent, close to the long-term average, and unemployment should continue to fall. However, with growth in wages and companies' unit labour costs remaining subdued, Bank Rate is expected to remain unchanged at 0.5 per cent through 2014.

Recovery compared to other countries

UK GDP, real terms

Risks to sustained recovery remain

Risks to this outlook are more evenly balanced than in recent years. In the short-term, the rise in confidence and the renewed buoyancy in house prices could lead growth to accelerate by more than expected. However, downside risks also remain, mainly from outside the UK. The Eurozone still doesn't have in place the full cross-country risk sharing necessary to ensure the long term stability of the Euro, so financial market turbulence remains a possibility if some countries' governments or banks are revealed to be less robust than they currently appear. In the US, the unsustainable long-term trajectory of government debt could still result in sharp spending cuts despite the recent bi-partisan agreement. Such scenarios would significantly impact the UK economy, which would, in turn, have a negative impact on the Group's income, funding costs and impairment charges.

The effect on our markets

The weak economic recovery has kept many of our markets subdued. Growth in UK households' deposits slowed to 3.7 per cent in 2013 from 5.7 per cent in 2012. Net new mortgage lending amounted to just 0.9 per cent of outstanding balances during 2013, the fifth consecutive year around 1 per cent or less. Unsecured consumer borrowing, net of repayments, increased by 4.7 per cent in 2013, the second consecutive year of positive net borrowing, but at less than 1 per cent of income this remains only one third of the level of the early 2000s. Non-financial company deposits with UK banks and building societies rose by 8.8 per cent in 2013, up from 4.9 per cent in 2012 while they reduced their borrowing from banks for the fifth consecutive year. Overall levels of corporate debt have however remained fairly flat relative to GDP in recent years, as large corporates have been refinancing bank debt in bond markets.

As the economic recovery continues, we expect demand for credit from households and small and medium-sized businesses to increase, but growth is likely to stay well below pre-crisis rates as the appetite to borrow remains constrained by recent experience. With Bank Rate not expected to rise until 2015, arrears are expected to continue to decline.

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Regulation

The regulatory landscape is now clearer but significant change is still expected. In particular, within the UK over the next few years we will need to implement the recommendations relating to ring-fencing and culture established within the Banking Reform Act (2013). Key regulatory developments in 2013 are outlined below.

Financial Services (Banking Reform) Act 2013

The Financial Services (Banking Reform) Act gained Royal Assent on 18 December 2013. The Act implements the recommendations of the Independent Commission on Banking and the Parliamentary Commission on Banking Standards. It includes provisions for criminal sanctions and the new Senior Persons Regime. It also requires banks to ring-fence some retail and SME activities from investment banking activities and conform to additional capital requirements beyond those required by Basel III. Importantly for the Group, given we are primarily a UK focused retail and commercial bank, the majority of our operations are likely to be within the ring-fence.

Capital Requirements Directive IV (CRD IV)

Final rules following the outcome of the Prudential Regulatory Authority's consultation on future capital requirements were issued in December 2013, and have implemented the European Union's new capital requirements legislation, known as CRD IV, in the UK from 1 January 2014.

Recovery and resolution mechanisms

The European Commission published the Recovery and Resolution Directive on 6 June 2012. This should come in to force on 1 January 2015. The Directive requires all firms to develop a recovery plan and contribute to a resolution fund. It also proposes new early intervention powers for supervisors and introduces new powers for regulators at resolution stage. This was in line with the recommendations of the Financial Stability Board. The UK has pre-empted the European legislative process, with firms already required to prepare recovery plans.

UK supervisory structure

The Financial Services Act 2012 confirmed the responsibilities of the Financial Policy Committee for 'macro-prudential regulation' and formalised the replacement of the FSA with two new bodies for prudential and conduct regulation: the Prudential Regulation Authority and the Financial Conduct Authority. The new institutions came into being on 1 April 2013.

Other regulatory reforms

The Group is also implementing a broader range of regulatory changes, which includes accounting standards, the Dodd-Frank Act, Benchmarks, Foreign Account Tax Compliance Act (FATCA), the updated Markets in Financial Instruments Directive Review, and updates to the Deposit Guarantee Scheme, amongst others.

Customer drivers

In the competitive open markets in which we operate, customers are benefiting from an increasing range of products and services from a growing choice of providers. The expectations and demands of customers continue to rise.

Access to convenient branches remains important for many customers, but demand for a quality multi-channel banking proposition is now more prevalent. More customers expect to be able to manage their finances whenever and wherever is most convenient for them, whether by telephone, online, or using smart phones. Service remains one of the key drivers of customer satisfaction and customers are less accepting of poor service given the competitive nature of the market.

In the current low interest rate environment, many customers are motivated by their desire to achieve better value for money, but security and reputation remain important factors. Customers want clear and transparent products delivered with good service and access to helpful, relevant, expert advice when they need it. Product innovation is also important for some, whereas long-standing relationships remain important for others.

There are some clear customer trends emerging, but we recognise that every customer, whether an individual or an organisation, has particular needs and we must engage with them accordingly. Fundamentally, every customer has a choice and will select the provider that can most effectively fulfil their personal needs.

We are seeing a number of new or expanding players make an increasing impact into an already highly competitive sector and the TSB business, which we intend to float on the London Stock Exchange through an Initial Public Offering (IPO) in 2014, will have the capability of being another strong and effective challenger. An enhanced industry-wide switching service was launched in September 2013, giving customers increased confidence to change provider when dissatisfied or offered a better deal elsewhere.

Technological developments are already reshaping the banking industry and we expect this change to accelerate in the coming years. We anticipate an influx of new entrants, with business models that do not rely on expensive branch networks, offering innovative digital banking services. These new entrants are likely to have expertise and experience in digital product offerings, with strong funding positions, credible challenger brands, and in some cases pre-existing customer bases.

From a regulatory perspective, the new conduct regulator, the Financial Conduct Authority, has a competition duty giving it an explicit mandate to tackle competition issues, such as hurdles to switching or barriers to entry, swiftly and effectively.

Our strategy, as outlined on the next few pages, reflects these market conditions and the changing needs of customers. Above all it recognises that we operate in a competitive market where additional challengers continue to emerge and the only way of ensuring success is by focusing on the ever-changing needs of our customers.

Market trends

Key opportunities

- Economic environment: significant progress in reducing the Group's risk profile and strengthening the balance sheet along with strategic actions taken in the last couple of years means we are better positioned to benefit as the economy recovers.
- Customer requirements: our differentiated customer focused strategy along with our comprehensive multi-channel distribution network, well recognised brands and high quality people mean we are well positioned to address changing customer needs.
- Regulatory environment: greater clarity emerging on regulatory requirements.

Key challenges

- Economic environment: continuing economic uncertainty in the Eurozone.
- Regulatory environment: uncertainty remains around the implementation of key elements of the proposals on ring-fencing.
- Competition: it is likely that an increasingly competitive market for lending and deposits will require us to innovate and offer attractive new products.

BUSINESS MODEL AND STRATEGY

Unlocking the Group's potential

Customers are at the heart of the organisation and by leveraging our strategic assets and capabilities effectively we believe we can help Britain prosper and deliver strong and sustainable returns for our shareholders.

Our business model

Lloyds Banking Group is a leading financial services group with a simple, low risk, customer focused, UK retail and commercial banking business model.

We provide a range of services, primarily in the UK, to individuals and commercial customers and by focusing on the needs of customers and operating sustainably and responsibly, we believe we will help Britain prosper and create value for our shareholders.

The foundations for providing effective customer service are: our range of iconic and distinct brands, our broad multi-channel distribution network, our financial strength, our efficient systems and processes, our high quality, committed colleagues and our UK focus.

We want to meet our customers' financial needs, help them succeed and create value for them. We do this using our distinctive strengths, in particular our superior customer insight, simpler tailored products and relationship focus, whether that be through banking, insurance, investment, debt financing or risk management products.

Our focus on creating a simpler, more efficient and agile organisation is enabling us to provide a better product and service proposition at a fair price while delivering more efficient processes and reducing our cost base.

The UK financial services market remains one of the largest in the world and, although our business model and strategy have been formulated in the context of a cautious outlook for the UK economy, they remain appropriate for all stages of the economic cycle, whilst providing real differentiation and positioning us well for future regulatory reform.

Ultimately as a simple, low risk, customer focused UK retail and commercial bank, we can rebuild the trust of our customers and other stakeholders, help Britain prosper and deliver strong and sustainable returns for our shareholders.

How we create value

A simple, low risk, customer focused UK banking model, delivering the right products with good service at a fair price.

Simple, tailored products addressing customer needs…

- Lending
- Deposit taking
- Insurance
- Investment
- Debt financing
- Risk management

…delivered through our four divisions.

Unique and effective service proposition…

- A range of iconic and distinctive brands
- Broad multi-channel distribution network: branch, telephone and digital
- High quality, committed colleagues
- Efficient systems and processes
- Financial strength
- UK focus

Creating distinctive value for customers through…

- Superior consumer insight
- Relationship focus
- Using our cost advantage for the benefit of customers

Enabling sustainable value creation.

Becoming the best bank for customers

Targeting strong, sustainable returns for our shareholders

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Our vision

Our aim is to be the best bank for customers and to create value for them by investing where we can make a real difference.

Customers are at the heart of everything we do, whether that be through our distribution network, our brands or our people. This commitment is supported by our Group values of *putting customers first, keeping it simple* and *making a difference together.*

Our strategy

We are creating a simpler, more agile, efficient and responsive customer focused organisation concentrating on operating sustainably and responsibly and helping Britain prosper. We are reshaping and simplifying the business and investing a portion of the savings made from our Simplification programme in customer related growth initiatives.

We are reshaping our business portfolio to fit our assets, capabilities and risk appetite. We are strengthening our balance sheet by continuing to reduce our non-core assets and applying a conservative approach to, and prudent appetite for, risk. We have reduced our international presence in order to focus on our core UK customers.

We are unlocking the potential in our franchise and delivering value to customers and shareholders by creating a simpler organisation. Opportunities exist to increase the efficiency of operations and processes and reduce costs whilst addressing changing customer needs and the external environment more effectively.

Our customer focus remains the key driver for strategy and business decision making and we are making substantial customer-related investment. Our strategy reflects our customers' needs for product simplicity and transparency, access to credit, demands for access through multiple channels, value for money products and services and the importance of our staff in managing customer relationships.

We are delivering our strategy though a clear action plan focused on **reshaping** our business portfolio to fit our assets, capabilities and risk appetite, **strengthening** our balance sheet and liquidity position, **simplifying** the Group to improve agility, efficiency and customer service and **investing** to be the best bank for customers. Our progress against this plan and the key priorities for 2014 are described on the next few pages.

Following the significant progress we have made against our original strategic plan, we expect to announce an update on our strategy in the second half of 2014 which will also incorporate the key elements of our new Helping Britain Prosper Plan.

28 More on our Helping Britain Prosper plan

Our action plan for success

We are making significant progress on all four key elements of our action plan to deliver our strategy. This is outlined in more detail on the next few pages:

Reshape

our business portfolio to fit our assets, capabilities and risk appetite.

20 More on Reshape

Strengthen

the Group's balance sheet and liquidity position.

21 More on Strengthen

Simplify

the Group to improve agility, efficiency and customer service.

22 More on Simplify

Invest

to be the best bank for customers.

23 More on Invest

DELIVERING OUR ACTION PLAN

Reshape

our business portfolio to fit our assets, capabilities and risk appetite.

Aim

We focus on attractive UK customer segments and their product needs to deliver a sustainable statutory return on equity of between 12.5 and 14.5 per cent. In order to reshape our business, we have been focusing on reducing non-core assets, improving our asset quality and reducing our international presence. We will invest in businesses which offer strong returns and attractive growth in line with our core customer strategy and within a conservative capital and liquidity framework.

Priorities for 2014

- Continue to reduce our non-core assets in a capital accretive manner with particular focus on non-retail non-core assets.
- Continue to improve our asset quality ratio towards our new Group target of around 50 basis points.

In addition, we continue to refresh our operating structure and, from 2014, our unified Wealth business will be integrated into the Retail division to allow us to sharpen our focus on delivering value-added Wealth services to eligible retail customers. We have also moved our Business Banking unit into Retail, allowing us to manage customer relationships in a way which leverages existing Retail infrastructure, via branch, telephony and digital channels. Our Asset Finance business is the foundation of a newly created Consumer Finance division, which will also include our consumer and corporate credit card business. Bringing these business units together will increase management focus and allow us to capitalise on growth opportunities, continuing our good momentum in asset-backed lending and with the aim of growing our market presence in credit cards. We have also created a new Digital, Marketing and Customer Development function focusing our investment and ensuring our success in Retail is replicated by sharing digital product development across all divisions.

Key initiatives and progress in 2013

We made significant progress in reshaping our business to become a simpler, low risk, customer focused organisation in 2013. As a result we have already achieved a number of our original targets in this area ahead of schedule.

Continued reduction in non-core assets

In 2013 we further reduced our assets, by £34.9 billion to £63.5 billion, significantly ahead of both our original £90 billion target and the revised £70 billion target, and ahead of the original 2014 target date. We have now reduced non-core assets by around £100 billion since the strategic review in June 2011, and these disposals continue to be capital accretive in aggregate.

Dealing with our non-core assets prudently and efficiently allows us to focus energy and resource on our core business. The accelerated reduction of our non-core assets has enabled us to accelerate the reduction in our wholesale funding to reshape the business portfolio to fit our assets and capabilities.

Due to the excellent progress in this area we will now report on a run-off portfolio comprising our non-core non-retail assets (c.£25 billion) and certain non-core retail assets including Ireland and Hong Kong (c.£8 billion).

A prudent appetite for risk

We have a conservative approach to risk across the business and disciplined controls are in place over the risk profile of all new business. We are comfortable that our existing portfolios are adequately provisioned.

The impairment charge continues to fall, and the overall quality of our portfolio continues to improve. As a result, our asset quality ratio at 57 basis points is now within our target range of 50-60 basis points, and we have now upgraded our target to around 50 basis points.

Reshaping our international presence

The strategic reshaping of our international footprint supports our ambition to help Britain prosper, as we focus on countries where we can service customers with ties to the UK. Following significant disposals in 2013 including Australia, we have now exited, or announced the exit from, 21 countries. In doing so, we have exceeded both our original target of less than 15 countries by the end of 2014 and our updated target of 10 countries or fewer by the end of 2014, more than a year ahead of plan, while retaining businesses that will benefit UK centric customers.

Performance against our targets

Return on equity

Target - - - -

12.5-14.5%

We continue to expect our strategy will deliver a statutory return on equity of between 12.5 and 14.5 per cent in the medium term.

Non-core assets

2014 target - - - -

<£70bn

Excellent progress continues to be made in reshaping the business through the reduction of our non-core assets which, having stood at £300 billion at the beginning of 2009, now stand at £64 billion.

Asset quality ratio (AQR)

2014 target - - - -

50-60 basis points

Having attained our original AQR guidance of 50-60 basis points in 2013, we are now targeting around 50 basis points.

International presence

2014 target - - - -

<15 countries

Our international target of fewer than 15 countries, subsequently updated to fewer than 10 countries, has now been achieved with 21 countries now exited, or exit announced.

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Strengthen

the Group's balance sheet and liquidity position.

Aim

We continue to strengthen our balance sheet and liquidity position to ensure the financial stability of the Group. We will further increase our capital ratios and maintain a stable funding base whilst meeting our regulatory requirements.

Priorities for 2014

- Build on our strong capital position and further increase our capital ratios to support our dividend policy whilst ensuring evolving regulatory requirements are met.
- Continue to optimise our liquidity position in light of evolving regulatory policy.

Key initiatives and progress in 2013

We made excellent progress in further strengthening the balance sheet and reducing risk, whilst growing core lending in the year. The transformation of the Group's funding position is now substantially complete with wholesale funding reduced, customer deposits up and our loan to deposit ratio further improved. We have also achieved both a strong capital position and a strong liquidity position.

Strong capital position

We have significantly strengthened the Group's capital position and ratios during 2013, with the estimated pro forma fully loaded common equity tier 1 ratio improving by 2.2 per cent to 10.3 per cent.

This improvement was driven by:

- Capital generation in our core business
- A decrease in risk-weighted assets from non-core asset reductions
- Business disposals including the sale of St. James's Place and US residential mortgage-backed security portfolios
- Dividends totalling £2.2 billion paid by the insurance business to the Group
- Improving economic conditions

The pro forma fully loaded CRD IV leverage ratio was 4.1 per cent including tier 1 instruments and 3.4 per cent excluding tier 1 instruments. The Group's pro forma Basel III leverage ratio was 4.5 per cent including tier 1 capital and 3.8 per cent excluding tier 1 capital.

Maintaining a stable funding base

The transformation of the Group's funding position is now complete as we further improved our general funding, supported by a growing customer deposit base. The reduction in non-core assets, together with the continued growth in customer deposits this year, has reduced the Group's wholesale funding requirement by £32.0 billion, to £137.6 billion and our core loan to deposit ratio target of 100 per cent has now been met.

Continue to exceed regulatory liquidity requirements

Our liquidity position remains strong, with primary liquid assets of £89.3 billion. These represent 4.2 times our money-market funding with a maturity of less than one year and approximately two times our wholesale funding with a maturity of less than one year, providing a substantial buffer in the event of market dislocation. In addition to primary liquid assets, the Group has significant secondary liquidity holdings of £105.4 billion.

Performance against our targets

Fully loaded common equity tier 1 ratio

We have continued to improve our common equity tier 1 ratio, and expect to generate, prior to any dividends, fully loaded common equity tier 1 capital of around 2.5 percentage points over the next two years, and thereafter 1.5-2 percentage points per annum.

Group loan to deposit ratio

We have continued to improve our loan to deposit ratio which is now ahead of our target and we will look to further reduce it going forward.

Core loan to deposit ratio

We have now achieved our 100 per cent target for the core business.

DELIVERING OUR ACTION PLAN

Simplify

the Group to improve agility, efficiency and customer service.

Aim

We are targeting a leading cost position through the delivery of our Simplification programme, which continues to focus on creating a more efficient organisation, reducing costs in the business whilst improving the customer and colleague experience. Together with our low risk business model, UK focus and strong competitive position, we expect this to deliver a low cost of equity and, in turn, a sustainable competitive advantage.

The previous target of £1.9 billion of run rate savings by the end of 2014 has been further improved to £2.0 billion as the programme enters its final year. The savings are being achieved through a series of Simplification initiatives focused on operations and processes, sourcing, channels and products, and the creation of a more agile organisation.

Priorities for 2014

- Further automation to streamline our key processes and operations.
- Increased development and utilisation of digital distribution channels.
- Maintained focus on sourcing and further reduction in the number of suppliers.

Performance against our targets

Cost savings (Simplification run rate savings)

2014 target - - - -

£2.0bn

We have increased our Simplification programme run rate cost savings target from £1.9 billion to £2.0 billion, having delivered £1,457 million of run rate cost savings by the end of 2013.

Cost:income ratio

Target - - - -

42-44%

The cost:income ratio improved in 2013 and we continue to believe the cost savings we are already delivering along with investment initiatives will further reduce this ratio over time.

Key initiatives and progress in 2013

The Simplification programme is central to the successful delivery of our strategy and we continue to make good progress in driving further cost savings and efficiencies across the business whilst improving the customer experience. The success of this approach is evidenced in our achievement of run rate cost savings of £1,457 million at the end of 2013 which have also enabled us to improve our cost:income ratio in the year to 51.2 per cent. We have a strong pipeline of further initiatives underway and, given previous Integration and Simplification experience, are confident that we can meet our enhanced £2.0 billion run rate costs savings target by the end of 2014.

The benefits of the Simplification programme extend far beyond cost reduction. The changes we are making help to put us firmly on the path to being the best bank for customers, enabling better service by making day-to-day tasks easier and freeing up colleague time to focus on our customers' needs.

Our customer experience improvements continue to be reflected in falling complaint levels and improved customer advocacy scores. Our FCA reportable banking complaints (excluding PPI) are down to 1.0 per 1,000 accounts, 18 months ahead of our original target, giving us the lowest complaint level of any major UK bank at the end of 2013. Net Promoter customer advocacy scores continue their upwards trend across all three branded channels, and are now up a third since the start of Simplification.

Operations and processes

We have delivered over 300 process, policy and system improvements as part of our Simplification journey, improving the customer experience, increasing productivity, and reducing risk, errors, complexity and costs. Particular achievements in 2013 included automating our ISA transfer process so that 80 per cent of transfers are now completed at 'first point of contact', a reduction of 85 per cent in the time taken to process fixed rate deposit maturities, and the redesign of our General Insurance claims process with the majority of claims now being settled 30 per cent faster. We also completed the transfer of 1.7 million mortgage accounts so that all accounts for our core brands are now managed on a single mortgage system.

Channels and products

We continue to streamline and simplify our product suite, and migrate products and features to our digital and telephony distribution channels. We are the largest provider of digital banking services in the UK and saw a continued increase in internet and mobile customers during 2013.

Sourcing

Simplification in sourcing means transforming how we acquire goods and services to achieve cost savings across the Group, as well as providing a more straightforward experience for colleagues. Since the programme began we have halved our total number of suppliers, and almost 82 per cent of spend is now concentrated with our top 100 suppliers.

More agile organisation

We have made great strides in creating a more agile organisation through de-layering our management structure and increasing spans of control. We have also made significant progress in reducing the number of legal entities, which are now down to 929, a reduction of over 40 per cent since the start of the Simplification programme.

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Invest

to be the best bank for customers.

Aim

As part of the strategic review we outlined our intention to increase our strategic investment by approximately £500 million annually by 2014, equivalent to approximately one third of the savings from our Simplification initiatives, to grow our core income.

Our investment is subject to disciplined tests, including alignment with our strategy to be the best bank for customers, financial returns and fit to our risk appetite. The investment will primarily be focused on becoming the best bank for personal customers, becoming the best partner for our business customers and enhancing our insurance proposition.

Priorities for 2014

- Continued investment in our digital proposition to optimise service capability for individual and business customers.
- Revitalise Scottish Widows as a specialised retirement brand.
- Targeted investment in specific market segments including consumer lending, insurance and commercial.

Performance against our targets

Strategic investment

As Simplification benefits materialise we are increasing the strategic investment in the business and have committed to invest approximately £500 million per annum by 2014 in addition to our business as usual investment programme.

Key initiatives and progress in 2013

During 2013, we were able to invest a further £342 million due to the Simplification savings already made. This investment in the core franchise is allowing us to provide greater levels of service and support to customers.

Investing to be the best bank for personal customers

Retail continued to invest in customer initiatives, in particular product proposition and distribution channels. We relaunched the Lloyds Bank brand and continued to upgrade our branch networks, with over 1,500 refurbishments since the strategic review and our customers are also benefitting from extended opening hours and the installation of WiFi and tablets in a number of Lloyds Bank and Halifax branches.

At the same time, we are continuing to transform our digital proposition in line with customers' growing appetite and to support delivery of services to smart phones. Our Money Manager and International Payments services provide improved access and control for online users, whilst mobile banking enhancements have enabled over four million customers to regularly use these services. Our online customer base increased to over 10.5 million, with internet users initiating over 1.2 billion log ons in 2013.

In our Wealth business, we rolled out a new point of sale system and introduced a pilot of the improved Customer Relationship Management technology, while continuing to invest in products and propositions in the Asset Finance business, including new website functionality which allows customers to obtain car finance quotes online.

Investing to be the best partner for our business customers

As part of Commercial Banking's strategy to be the best bank for clients, we continued to invest in our core infrastructure, implementing upgrades to deliver scalability, reduced operational risk and enhanced functionality in our Transaction Banking and Markets business. We launched a new mobile card payment solution for our small business clients and further enhanced its currency functionality. We played a leading role in the development of the UK retail bond market and became a market maker on the London Stock Exchange for retail bond investors. We also continued to invest in enhancing our online capabilities.

Investing in the insurance proposition

Insurance is a core part of our customer proposition and we continue to invest in our core systems, products and processes for the integrated UK Life and Pensions and Investments and General Insurance businesses. Within the Life and Pensions business we are improving our market leading pensions and protection products, which help customers protect themselves today and prepare for a secure future. Supporting customers through auto-enrolment is driving growth and we have already supported over 300 major employers in this area. In addition, we completed the roll out of our enhanced annuities product in both the intermediary and direct channels as a key step to expanding our participation in the annuity market. We see enormous potential to serve the retirement needs of our retail bank customers and are addressing this by leveraging Group expertise and investing in the capability of the direct channel.

In General Insurance we are enhancing our systems capability to improve the competitiveness of our offering and investing in our home insurance proposition to improve the flexibility and customer focus of our products.

DIVISIONAL OVERVIEW

Retail

The Retail division is a leading provider of current accounts, savings, personal loans, credit cards and mortgages in the UK.

With its strong stable of brands including Lloyds Bank, Halifax, Bank of Scotland and TSB it serves over 30 million customers through the largest banking branch network in the UK and comprehensive digital, telephone and mobile services. Retail is also a major general insurance and bancassurance distributor, offering a wide range of long-term savings, protection and general insurance products.

From 2014, our Wealth business will move into the Retail division, ensuring we can better service the needs of our wealthier Retail customers. Retail Business Banking will also transfer to the Retail division as we work to be the Group's small business champion, by leveraging the Retail infrastructure. At the same time, Credit Cards will move out of the Retail division into the new Consumer Finance division to support this growth area.

Strategy

Retail's goal is to be the best bank for customers in the UK. We will do this by building deep and enduring relationships that deliver real value to our customers; by delivering greater choice and flexibility through our multiple brands and channels; by increasing our agility which will enable us to respond more quickly and better align our products and services to our customers' needs; and by continuing to improve customer service and reducing customer complaints. This will increase customer advocacy and deliver lower customer acquisition costs and improved customer retention.

Progress against strategic initiatives

- Significant progress made in our strategy to be the best bank for customers in the UK driven by continued investment in our products, services and distribution.
- Further enhancements delivered to simplify the business resulting in customer service scores improving 11 per cent and complaints (excluding PPI) decreasing to 1.0 per 1,000 accounts.
- The iconic Lloyds Bank brand relaunched and TSB created as a new challenger bank.
- Continued innovation and investment to refresh our core product range.
- New everyday banking propositions launched featuring cashback services to reward loyalty.
- Ongoing development of our multi-channel offering. Our active online customer base has increased to over 10.5 million and mobile users to over four million.
- Exceeded lending commitment to new-to-market buyers, helping one in four to buy their first home, exceeding our target of 60,000 by over 20,000 at year end.
- Core loan book returned to growth in the third quarter supported by strong performance in our mortgage portfolio.
- We continue to support local communities.

Performance summary

	2013 £m	2012 £m	Change %
Net interest income	**7,536**	7,195	5
Other income	**1,410**	1,462	(4)
Total underlying income	**8,946**	8,657	3
Total costs	**(4,096)**	(4,199)	2
Impairment	**(1,101)**	(1,270)	13
Underlying profit	**3,749**	3,188	18

2013 financial highlights

- Underlying profit increased 18 per cent to £3,749 million, driven by improved margins, reduced costs and favourable impairments.
- Return on risk-weighted assets increased to 4.11 per cent from 3.21 per cent in 2012, driven primarily by improved income and continuing effective credit risk management.
- Net interest income increased 5 per cent. Other income down 4 per cent. Total underlying income increased 3 per cent.
- Total costs down 2 per cent to £4,096 million, primarily as a result of the Simplification programme and ongoing cost management activity.
- Impairment reduced 13 per cent to £1,101 million, with unsecured remaining stable and secured charges decreasing.
- Loans and advances to customers were broadly in line with 2012 at £341.9 billion and gross new mortgage lending increased to £36.9 billion.
- Customer deposits increased 3 per cent driven by growth in relationship balances.

Performance indicators

Underlying profit before tax £m

Active online customers million

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Key brands

LLOYDS BANK HALIFAX BANK OF SCOTLAND TSB SCOTTISH WIDOWS

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Commercial Banking

The Commercial Banking division supports our business clients from small businesses to large corporates, with a range of propositions fully segmented according to client needs.

The division operates a client centric approach, primarily focused on UK and UK-linked businesses, with client segments comprising Small and Medium-sized Enterprises (SME), Mid Markets, Global Corporates and Financial Institutions.

Strategy

Commercial Banking's strategy is to be the best bank for our clients. We have put clients at the centre of our business model and meet their needs with a suite of core banking products from Lending and Transaction Banking to Financial Markets and Capital Markets, delivering the full capability of the bank to our clients and serving their needs as they move up the value chain. Our strategy is driven by three guiding principles; to be client centric, UK focused and capital efficient with a rigorous focus on executing our plans according to these core principles. This will be delivered through the formation of a simpler leaner organisation, sharper prioritisation of resources to support our core clients and focused investment in product capability to better serve our clients' needs. All of this will contribute to the delivery of strong and sustainable Commercial Banking returns over time.

Progress against strategic initiatives

- Continue to execute our strategy to be the best bank for clients.
- Reshaped our SME and Mid Markets segments to better serve clients and improved relationship returns in Global Corporates and Financial Institutions through continued focus on capital optimisation.
- Strengthened the balance sheet and funding position by increasing the volume and quality of deposits within Transaction Banking and by reducing non-core assets by 50 per cent and non-core risk-weighted assets by 59 per cent.
- Continued to invest in our core infrastructure, with ongoing benefits from the Simplification programme and tight cost management enabling significant upgrades to deliver scalability and functionality in our Transaction Banking and Markets businesses.
- Simplified our geographic footprint by exiting Spain and Australia and improved service delivery to frontline staff and end-to-end client support by streamlining infrastructure and processes.
- Played a prominent role in supporting the UK economy: net growth in SME lending of 6 per cent against market contraction of 3 per cent; 80 per cent acceptances on SME loan and overdraft applications; supported approximately 120,000 business start-ups; committed over £36 billion through Funding for Lending; and committed over £1.3 billion to UK manufacturing in the year to end September 2013.
- Played a leading role in the development of the UK retail bond market, becoming a market maker on the London Stock Exchange for retail bond investors, providing the market with continuous pricing in bonds and gilts.
- Awarded Business Bank of the Year at the FD's Excellence Awards for the ninth year in a row.

Performance summary

	2013 £m	2012 £m	Change %
Net interest income	**2,426**	2,206	10
Other income	**2,708**	2,932	(8)
Total underlying income	**5,134**	5,138	–
Total costs	**(2,392)**	(2,516)	5
Impairment	**(1,167)**	(2,946)	60
Underlying profit	**1,575**	(324)	

2013 highlights

- Returned to profitability with underlying profit of £1,575 million driven by reduction in impairments, increased core income, partially offset by lower non-core income from our capital accretive asset reduction strategy.
- Core underlying profit up by 25 per cent to £2,193 million due to increased income and lower impairment charges. Core return on risk-weighted assets increased by 38 basis points to 1.74 per cent.
- Core net interest margin increased 31 basis points through disciplined pricing of new business, in addition to reduced funding cost driven by increased high quality deposits contributing to a reduction in the Group's requirement for wholesale funding.
- Core lending increased by 7 per cent driven by strong performance in SME, Mid Markets and Global Corporates.
- Non-core loans and advances to customers decreased by £15.8 billion, as a result of the Group's asset reduction strategy.

Performance indicators

Underlying profit (loss) before tax £m

SME net lending growth 2013 (core) %

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Key brands

LLOYDS BANK · BANK OF SCOTLAND · SCOTTISH WIDOWS · AMC · LDC

DIVISIONAL OVERVIEW

Wealth, Asset Finance and International

Wealth, Asset Finance and International comprised our UK and international wealth businesses, our UK and international asset finance and online deposit businesses along with our international retail businesses.

With the reshaping of our international footprint and the move of Wealth into the Retail division, our Wealth, Asset Finance and International division will become Consumer Finance from 2014. This new division will include Credit Cards, Asset Finance and the European online deposit businesses.

Strategy

The UK Wealth business provides strong growth opportunities for the Group. Its goal is to be recognised as the wealth advisor of choice to appropriate Retail and Commercial Banking customers alongside targeted customer acquisition. We aim to grow the customer deposits and funds under management that we manage on behalf of franchise customers, whilst improving margins and operating efficiency. In Asset Finance, we have been refocusing the business into sectors which fit our risk appetite and are looking to deliver focused, profitable growth while completing the run-down or disposal of portfolios which are closed to new business. The addition of the credit card business to the new Consumer Finance division will provide significant growth opportunities.

Progress against strategic initiatives

- International presence reduced to nine countries, achieving our target of fewer than 10 by the end of 2014.
- Wealth improved client service and accessibility through a new Private Banking Client Centre and the roll out of a new point of sale system.
- Asset Finance continued to invest in infrastructure and growth initiatives, resulting in a 3.2 per cent fleet growth for Lex Autolease and a 28.6 per cent increase in new business volumes for Black Horse motor finance.
- Reinforced the focus on our banking businesses through the announced sale of Scottish Widows Investment Partnership and the sales of St. James's Place.
- Total cost reductions of 13 per cent driven by simplification initiatives and disposals enabled reinvestment for future growth opportunities.

Performance summary

	2013 £m	2012 £m	Change %
Net interest income	**870**	799	9
Other income	**1,809**	2,043	(11)
Total underlying income	**2,679**	2,842	(6)
Total costs	**(1,991)**	(2,291)	13
Impairment	**(730)**	(1,480)	51
Underlying loss	**(42)**	(929)	95

2013 highlights

- Losses reduced by 95 per cent to £42 million driven by lower impairments in non-core, mainly in Ireland, and strong profitable growth in the core business.
- Core underlying profits increased by 38 per cent to £632 million (86 per cent excluding St. James's Place) driven by strong income growth in Wealth and Asset Finance, and cost savings.
- Core return on risk-weighted assets increased from 5.07 per cent to 6.67 per cent, largely as a result of repricing of liabilities.
- Net interest income in the core business increased by 84 per cent driven by strong and improving margins in Wealth and in the Online Deposits businesses within Asset Finance, and by growth in Black Horse motor finance volumes.
- Total cost reductions of 13 per cent driven by simplification initiatives and run-down of non core business.
- Impairment charges reduced by £750 million to £730 million, including a reduction of £637 million in the Irish portfolio.
- Core loans and advances to customers increased by 23 per cent driven by Asset Finance and primarily the UK motor finance business.
- Non-core assets reduced by 37 per cent following the sale of our Australian Asset Finance and Spanish retail businesses, and other reductions in our non-core portfolio mainly within Ireland.

Performance indicators

Underlying loss before tax £m

International presence (countries)

60 More financial information on Wealth, Asset Finance and International

Key brands

LLOYDS BANK · Scottish Widows · blackhorse · BANK OF SCOTLAND · Lex Autolease

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Insurance

The Insurance division is one of the UK's largest insurers and provides long-term savings, protection and investment products and general insurance products to customers in the UK and Europe.

The UK Life, Pensions and Investments business (UK LP&I) provides long-term savings, protection and investment products distributed through the bancassurance, intermediary and direct channels of the Lloyds Bank, Halifax, Bank of Scotland, TSB and Scottish Widows brands.

The General Insurance business is a leading distributor of home insurance in the UK, with products sold through the branch network, direct channels and strategic corporate partners. It operates primarily under the Lloyds Bank, Halifax, Bank of Scotland and TSB brands.

Strategy

The UK population is under protected and not saving enough for the future. Our Insurance division is focused on helping our customers to protect themselves today whilst preparing for a secure financial future. Our objective is to be the best insurance and retirement savings business for customers; providing simple, trusted, value for money products accessible through multiple channels.

Progress against strategic initiatives

- We focus on four key markets: Pensions, Protection, Annuities and Home Insurance, where we believe the division can leverage its position as part of the Group with over 30 million retail customers, rich customer transaction data, centres of best practice and top quality brands.
- In Pensions, where we have over 1 million individual and a significant number of corporate customers, we supported almost 300 major employers, through auto enrolment, including many of the 17 per cent of FTSE 350 companies who have their corporate pension arrangements with Scottish Widows.
- In Protection, we continued to progress development of our intermediary proposition, leveraging our platform and capabilities to extend this to our wealthier customers.
- In Annuities, we began the delivery of our enhanced annuity proposition and continued to support our annuity strategy with the acquisition of attractive, higher yielding assets to match long duration liabilities.
- In Home Insurance, we invested to improve customer focus. For instance, we introduced a dedicated claims advisor to each claimant resulting in significantly faster claims settlement.
- We increased the focus on our UK business following the agreed sale of our German life insurance business Heidelberger Leben.
- We relaunched the Scottish Widows brand, demonstrating our continued commitment to being a leader in the life planning and retirement market.

Performance summary

	2013 £m	2012 £m	Change %
Net interest income	**(103)**	(78)	(32)
Other income	**2,236**	2,294	(3)
Insurance claims	**(356)**	(365)	2
Total underlying income	**1,777**	1,851	(4)
Total costs	**(687)**	(744)	8
Underlying profit	**1,090**	1,107	(2)

2013 highlights

- Underlying profit down 2 per cent to £1,090 million, driven by changes in intra group commission arrangements and run-off legacy creditor books, partly offset by lower claims and costs. Return on required equity up from 12 per cent to 13 per cent.
- Costs improved by 8 per cent, reflecting the benefits of simplifying our business model and processes.
- Total UK LP&I sales down 1 per cent to £9,934 million primarily due to the Group's decision to stop providing investment advice to retail customers with savings below £100,000. Corporate pensions grew by 21 per cent, reflecting the strength of our proposition and the conversion of pipeline generated in the run up to implementation of the Retail Distribution Review.
- The strong underlying profitability and capitalisation of the Insurance business has enabled us to remit £2.2 billion of dividends to the Group during 2013 whilst maintaining a strong capital base.

Performance indicators

Underlying profit before tax £m

LP&I (UK) (PVNBP) sales £m

62 More financial information on Insurance

Key brands

LLOYDS BANK TSB SCOTTISH WIDOWS BANK OF SCOTLAND HALIFAX

RELATIONSHIPS AND RESPONSIBILITY

Building valuable relationships

We have one strategy for delivering sustainable success – being the best bank for customers – and doing business responsibly is inherent in this strategy. António Horta-Osório, Group Chief Executive

With over 30 million individual and business customers and a presence in communities across the country, we are very well placed to serve the country's households, businesses and communities, and to make a significant contribution to the future strength and prosperity of the UK. We have one strategy for delivering sustainable success – being the best bank for customers, and doing business responsibly is inherent in this strategy.

Being responsible enables us to build colleagues' pride in a business that does the right thing and helps to rebuild public trust in the banking industry. We recognise that the biggest shift we need to make is cultural; we need responsible business to become business as usual for colleagues. The shift in culture is already underway. We can only achieve our customer focused strategy by building a sound reputation founded on the highest standards of behaviour.

Being a responsible business

Our approach to responsible business is governed by our Responsible Business Committee (RBC). Chaired by Anita Frew, one of our Non-Executive Directors, who, in this capacity reports directly to the Group Board, the RBC develops our principles, sets priorities and ensures responsible business is embedded throughout our operations. The Group Responsible Business team manages our day-to-day responsible business activities. To help us decide what information to include in our responsible business reporting, we have engaged with a representative cross-section of our stakeholders (including colleagues and external parties) to review our approach to materiality and prioritise the issues. For 2013, we have reported against our five pillars of responsible business covering customers, colleagues, communities, other stakeholders and the environment. These five pillars encompass all of our most important relationships and are integral to our strategy to be the best bank for customers. We report here on our recent success and priorities in each of these areas.

To ensure the highest standards of responsible behaviour, all colleagues are required to work in accordance with our Code of Personal Responsibility and Code of Business Responsibility. These codes set out how we do business and what customers and stakeholders can expect. They are governed by the RBC. They cover the full breadth of our responsibilities, under the five pillars of responsible business and are aligned to our Group Values.

Our Codes of Responsibility underpin our Group Ethics Policy and set out clear guidelines for responsible behaviour across our business. We adhere to the principles of the United Nations Declaration of Human Rights and support the UN Guiding Principles on Business and Human Rights, and the International Labour Organisation Fundamental Conventions and this is outlined within our Code of Business Responsibility.

Certain sectors carry inherent social, ethical and environmental risks. Our policies and procedures support colleagues working in our relationship management and risk teams in understanding how to approach, assess and manage these risks. We are signatories to the Equator Principles, which provide a framework for determining, assessing and managing environmental and social risk in project finance transactions. Our Code of Business Responsibility states that we do not finance any activities prohibited by International conventions supported by the UK government. You can read about our approach to managing environmental risk and the Equator Principles in the risk management section on page 162.

Our focus on doing business responsibly is recognised by our continued presence in the FTSE4Good socially responsible investment index, our position in CDP (Carbon Disclosure Project) and our platinum status in the Business in the Community CR Index.

Our Responsible Business Report provides an update on our responsible business activities in 2013. You can read the full report on our website at www.lloydsbankinggroup-cr.com.

The Helping Britain Prosper Plan

We see ourselves as having a clear role to play in helping Britain prosper and, as a significant UK retail and commercial bank, we are already doing more than our peers to help people manage their finances. To demonstrate that responsible business is fully integrated into our broader business strategy, our management structures and the way we measure performance, we have launched a new Helping Britain Prosper Plan (see opposite page). This simple but ambitious Plan sets out seven long-term commitments and aspirations to help Britain prosper, covering the areas where we can make the biggest difference for our customers across households, businesses and communities.

People across Britain are facing some big issues – a lack of affordable housing, the challenge of finding a job or escaping the trap of financial exclusion, the health issues that arise as more of us live longer and the difficulties of starting or running a successful business in tough times. The Helping Britain Prosper Plan is our response to some of these big issues; the ones we're best placed to help our customers tackle.

We're the first UK bank to launch a plan like this. We're doing it because we're sure of our purpose: to be a responsible, sustainably successful business that helps Britain prosper. We also believe that the Helping Britain Prosper Plan is a way to rebuild trust with our customers by demonstrating that we're focused on the issues they face. Customers will be able to see from the Plan that their concerns are also our concerns. Other stakeholders will be able to benchmark our future performance against the Plan.

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The Helping Britain Prosper Plan

1 We'll help more customers get on the housing ladder – and more customers climb up it

		2014 target	2017 target
1.1	Number of first-time buyers supported through delivering the most comprehensive mortgage proposition in the UK mortgage market	>80,000	1 in 4
1.2	Share of new build mortgages provided (for first-time buyers, second steppers and private rented)	1 in 4	1 in 4

2 We'll help our customers plan and save for later life

		2014 target	2017 target
2.1	Number of customers we help to plan for later life through company pension schemes	1.1m (cumulative)	1.3m (cumulative)
2.2	Number of customers we help post-retirement through providing a continuing annuity income	0.55m (cumulative)	0.6m (cumulative)

3 We'll take a lead in financial inclusion to enable all individuals to access, and benefit from, the products and services they need to make the most of their money

		2014 target	2017 target
3.1	Amount of additional funding provided to support Credit Unions per year	£1m	£1m
3.2	Share of social banking accounts we will support	1 in 4	1 in 4
3.3	Number of community support workers accredited to deliver financial education on the front line[1]	1,830 (cumulative)	4,000 (cumulative)
3.4	Maintain a category gold award with the Business Disability Forum (BDF) by achieving a high score across the 10 areas[2] that lead to a disability confident organisation	>90% score	>90% score

4 We'll help businesses to start up and scale up, and we will procure responsibly

		2014 target	2017 target
4.1	Increased amount of net lending to SMEs on an annual basis (total cumulative)	>£1bn (£28bn)	>£1bn (>£31bn)
4.2	Number of start-up businesses we will help get off the ground	>100k	1 in 5
4.3	Increased amount of new lending provided to support UK manufacturing businesses per year	£1bn	£4bn (cumulative)
4.4	Number of entrepreneurs supported through the Lloyds Bank and Bank of Scotland Social Entrepreneurs programmes	>750 (cumulative)	1,300 (cumulative)
4.5	% of supplier invoices paid within 30 days (% payment within 60 days)	95% (100%)	99% (100%)

5 We'll help businesses and individuals succeed with expert mentoring and training

		2014 target	2017 target
5.1	Number of colleagues trained to mentor SMEs & social entrepreneurs through the Business Finance Taskforce accredited scheme and the Lloyds Bank and Bank of Scotland Social Entrepreneurs programme	1,000 (cumulative)	1,700 (cumulative)
5.2	Number of new Lloyds Banking Group Apprenticeship positions created with permanent employment	2,450 (cumulative)	5,000 (cumulative)
5.3	% of Lloyds Banking Group Apprenticeships taken up by external candidates from the UK's most disadvantaged areas	N/A	30%
5.4	Number of undergraduates from low income families supported by the Lloyds Scholars programme	360 (cumulative)	720 (cumulative)
5.5	% of Lloyds Scholars (from low income families) who have secured a job within 6 months of graduating from University[3]	90%	90%

6 We'll be the banking Group that brings communities closer together to help them thrive

		2014 target	2020 target
6.1	Number of paid volunteer hours used by colleagues to support community projects	800,000 (cumulative)	>2.3 million (cumulative)
6.2	Number of community organisations supported by our volunteers or funding	6,500	10,000
6.3	£ donated to the Bank's Foundations to help tackle disadvantage	£16.5m	>£100m (cumulative)
6.4	£ raised by colleagues for our Charity of the Year (including Matched Giving) to support those in need in our communities	£1.7m	£12m (cumulative)

7 We'll better represent the diversity of our customer base and our communities at all levels of the Group

		2014 target	2020 target
7.1	% of senior roles[4] to be held by women	29%	40%
7.2	We will consistently increase the engagement levels of ethnic minority colleagues in all roles	66 (Colleague Survey score)	>70[5]
7.3	We will consistently increase the engagement levels of disabled colleagues in all roles	55 (Colleague Survey score)	>70[5]
7.4	We will consistently increase the engagement levels of LGBT colleagues in all roles	60 (Colleague Survey score)	>70[5]

[1] Through Money for Life's Teach Others and Money Mentors programmes
[2] Includes Commitment; Know-how; Adjustments; Recruitment; Retention; Products and Services; Suppliers and Partners; Communication; Premises; Information and Communication Technology
[3] This % is based on the number of Scholars who are actively seeking employment
[4] Senior roles refers to top 8,000 individuals
[5] UK High Performing norm – target will change if High Performing norm changes

N.B: All of these metrics are subject to review in the Autumn pending the outcomes of Group Strategic Review

For further details of the Plan, including how it was developed, please refer to our Responsible Business Report at www.lloydsbankinggroup-cr.com.

RELATIONSHIPS AND RESPONSIBILITY CUSTOMERS

We focus on doing the best we can for all our customers, in branches, on the phone and via digital channels and living up to our values of *putting customers first, keeping it simple* and *making a difference together.*

Aim

Our aim is to be the best bank for customers. This means being the best bank for households, for businesses and for communities. We will achieve this by focusing on UK customers and those connected to the UK; delivering customer expectations; simplifying processes, policies and systems; investing in growth initiatives; maintaining an appropriate risk appetite that protects our customers; and ensuring the business has the strength of funding and capital to continue to make progress and to face challenges.

Priorities for 2014

- Make sure all our colleague reward structures take customer service standards into account.
- Help more customers get on the housing ladder and more customers climb up it, including supporting more than 80,000 first-time buyers.
- Help customers secure new build mortgages.
- Help at least 100,000 SME start-ups.
- Increase our new lending support to UK manufacturing businesses by £1 billion.
- Reduce customer banking complaints to 0.9 per 1,000 accounts.
- Improve our systems, processes and products to keep it simple for customers.
- Help 45,000 customers post-retirement through providing a continuing annuity income.

Achievements in 2013

- Supported 120,000 SME start-ups.
- A 6 per cent year-on-year net increase in loans to SMEs compared with an industry net reduction of 3 per cent.
- Beat our commitment to lend £6.5 billion to 60,000 first-time buyers.
- The best customer satisfaction ratings our high street brands have ever achieved.

Performance in 2013

Customer complaints (FCA banking complaints* per 1,000 accounts)

Through our Simplification programme and continued focus on becoming the best bank for customers, our FCA reportable banking complaints continued to fall.

*Excluding PPI

Customer satisfaction (net promoter score)

%

We have developed a comprehensive customer experience programme measuring customer service and their likelihood to recommend us. This is measured through the cross industry net promoter score metric where we have seen continued progress.

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Supporting our customers

We currently serve around 30 million individual and business customers. We want to provide them with the right products, setting the best service standards and achieving the best outcomes.

Supporting home buyers

In 2013, we lent £9.7 billion to help more than 80,000 first-time buyers get on the property ladder – accounting for one in four of all first-time buyer mortgages in Britain this year. Altogether we advanced £22.3 billion in new mortgage lending to customers buying homes, an increase of 37 per cent on 2012.

Supporting funding schemes

We were the first British bank to participate in the Funding for Lending Scheme. Since its launch in mid-2012 we have committed more than £37 billion to help customers, including lending to businesses and mortgages for personal customers. Through Halifax we provided one in three of all mortgages completed via the UK government's NewBuy scheme to support purchases of new build properties.

We also helped customers, particularly first-time buyers, who can only afford small deposits through Lloyds innovative Lend a Hand and Local Lend a Hand mortgage schemes. We accept deposits as low as 5 per cent if these are backed-up by a family member or friend's savings or secured by a Local Authority indemnity.

We are a leading supporter of the government's Help to Buy scheme. Lloyds Banking Group accounted for approximately 60 per cent of new Help to Buy mortgage lending under both the equity loan and mortgage guarantee elements of the scheme.

Supporting Britain's businesses

We serve hundreds of thousands of business customers. SMEs and Mid-market businesses are the life-blood of the British economy so we focus our attention on their needs, and we also serve many larger businesses and organisations.

Supporting SMEs

This year we've increased lending to SMEs by 6 per cent compared with 2012 (despite an industry-wide reduction in funding of 3 per cent). We've greatly simplified the lending process and reduced the time it takes SMEs to secure funds. This year we approved eight out of 10 business loan and overdraft requests, comparable with pre-2008 levels. We have committed to deliver £1.6 billion of new net lending to SMEs in 2014. We are a signatory to the Lending Code; a voluntary code covering dealings with consumers, micro-enterprises and charities with an income of less than £1 million.

Making a difference together

In addition to the Funding for Lending Scheme, we participate in several other joint schemes designed to help businesses access finance. These include the Enterprise Finance Guarantee Scheme (EFG), through which we have offered almost 6,000 loans to customers, worth a total of £480 million and 25 per cent of all EFG loans to date. We are providing £100 million to SMEs through the Regional Growth Fund and made significant investments in the Business Growth Fund, Scottish Investment Bank and Big Society Capital.

Exceeding our SME commitments

We launched our SME charter in 2010, pledging to support 300,000 new SMEs over three years to the end of 2012. We beat this target, helping 350,000 SMEs and pledged to help a further 100,000 new businesses start up in 2013. We again beat our target, by helping 120,000 new businesses.

We also met our pledge to respond to 90 per cent of lending appeals within 15 working days (rather than the industry standard of 30 working days).

Building our brands

In September 2013, we relaunched the Lloyds Bank brand and launched TSB as a new challenger to the high street. The creation of the two brands follows a ruling by the European Commission in 2009 requiring Lloyds Banking Group to divest part of its business. The flotation of TSB will further strengthen competition in our sector.

Encouraging enterprise and manufacturing

For the second consecutive year, we've run the Lloyds TSB Enterprise Awards, inviting entries from British businesses run by university students or recent graduates. This year, 484 businesses entered and a total of 28 were awarded cash prizes or mentoring support. We will host the Awards again in 2014.

In the third quarter of 2012 we launched our Manufacturing Commitment to provide £1 billion in new lending to SME and mid-sized manufacturing businesses by September 2013. We met our target three months ahead of schedule; by September 2013 we were 30 per cent above this target.

Supporting low carbon businesses

As a potential source of funds and support for low carbon businesses we continue to support the UK government's target to meet 15 per cent of the UK's energy demand from renewable sources by 2020. As an active participant in the Project Finance Market, at the end of 2013 we were involved in renewable energy projects across the UK with a combined capacity of 3580MW, enough to power 3.5 million homes.

Battling the elements

Throughout 2013, we went the extra mile to help insurance customers affected by floods, high winds and in one instance, a tornado. The Home Insurance team deployed rapid response units to the worst affected areas, so that customer claims could be assessed quickly and funds released to complete vital repairs. Following the major storm that hit Britain in October 2013 colleagues successfully handled more than 1,700 claims in a single day, 10 times higher than normal business levels. As of December 2013, we had helped over 215,000 customers by resolving their claim, including 38,000 escape of water claims, 35,000 storm claims, 25,000 theft claims and 3,500 fire claims.

Including all our customers

Being the best bank for customers means offering simple, relevant products to people at all levels of society. Not just those enjoying relative prosperity, but also those facing financial difficulties, coping with disabilities, striving to buy their first home or find their first job.

Our Financial Inclusion Steering Group

To help us become more integrated in the way we serve customers at risk of financial exclusion, early in 2013 we set up a Financial Inclusion Steering Group chaired by Sara Weller, Non-Executive Director. The Group brings together colleagues from all areas of the business to provide a single point of focus for financial inclusion.

Providing basic bank accounts and support to SMEs

This year, we provided over 280,000 new basic bank accounts and helped over 110,000 customers upgrade from basic to more mainstream accounts. As of December 2013 we had over 22,000 active small business customers in the most deprived areas of the UK. We increased the loan facilities available to SMEs in these prioritised areas from £524 million in 2012 to £633 million in 2013.

RELATIONSHIPS AND RESPONSIBILITY CUSTOMERS

Helping ex-offenders make a fresh start

In partnership with the National Offender Management Service, we offer more basic banking facilities to recent offenders and prisoners preparing for release, than any of our competitors. Basic accounts allow people in this situation to receive income payments, pay bills and purchase goods as they reintegrate back into society.

Helping customers in financial difficulty

Many of our customers need our help to get their finances back on track. This year we issued 60,000 credit cards to help customers who have very limited credit history gain access to credit facilities. Our Credit Operations team tailors solutions for customers to get their finances back on track. In 2013 they had 5.5 million customer conversations.

Helping customers with disabilities

To be the best bank for customers, our products and services need to be accessible to everyone, including people with physical disabilities. We set up a Disability Services Support Team in 2012 and became the first bank to introduce a British Sign Language video service for customers with hearing impairments. In 2013 we were shortlisted in the Organisational Achievement Category of the Signature Awards, which highlight 'excellence in communication with deaf people'.

This year, we introduced 'talking ATMs' to help customers who are visually or hearing impaired and we plan to roll these out to all our branches in time. We've also made the Lloyds Bank customer website more accessible to customers with a range of disabilities, including visual impairments and dyslexia. The Halifax and Bank of Scotland websites will be updated in 2014.

Leading our industry to help customers with Dementia

This year we worked with the Alzheimer's Society to create their Dementia-Friendly Financial Services Charter. We co-launched the Charter with the Alzheimer's Society on 30 October 2013. We led a steering group of 24 other financial services organisations, who have committed to improve dementia awareness amongst their employees. We have already started to implement some of its recommendations, including the creation of 'Dementia-Friends', in branches.

Improving the quality of our products and services

We need to keep pace with customers' changing needs by providing simple, tailored products and services that make a positive difference. Improving customer satisfaction is also the best way to reduce customer complaints and build trust in our brands.

Simplifying our products and services

We improved the way we use mobile interfaces and voice recognition technologies to make it easier for customers to reach us quickly and navigate to the right choices. We now have more than 10 million customers using our digital services, including four million mobile banking users.

We also simplified our telephone banking services, making it easier for colleagues to access customers' information and action their requests quickly. As a result, we reduced call times by up to three minutes. We also improved our service for general insurance customers by assigning a dedicated advisor to every claim. To date, 130,000 claims have been handled this way, delivering a 40 per cent reduction in follow up calls and on average, 30 per cent faster settlement times.

Tracking our brand and reputation

We use the 'Net Promoter Score' to track the reputation of our brands and overall customer satisfaction. NPS is a standard business metric based on the likelihood of customers recommending a brand to others. In 2013 our high street brands achieved an aggregate score of 55 per cent, an improvement from 49 per cent in 2012.

Customer complaints data for 2013

Our customer complaints fell year-on-year, with a 36 per cent reduction in complaints including PPI. We now receive fewer banking complaints per 1,000 accounts than any other major high street bank in Britain. In 2013, the Group received 1 complaint per 1,000 accounts (Halifax: 0.8, Lloyds TSB: 1.1, Bank of Scotland 0.9). This is a reduction of 33 per cent compared with the second half of 2011, when the Group figure was 1.5 complaints per 1,000 accounts. We aim to reduce this further to 0.9 in 2014.

Supporting our customers

In September 2013 we launched the revitalised Lloyds Bank across almost 1,300 high street branches, marking another milestone in its 250 year history. The launch of the brand reinforces our commitment to better serve our customers and deliver a stronger more competitive banking industry in the UK.

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Welcome back to local banking

In September 2013 we launched TSB across 631 branches, bringing a credible, new competitor to the market. The flotation of TSB will further strengthen competition. At its launch TSB had around 4.5 million customers and will have 8,000 employees, including 4,500 branch staff.

Dealing with complaints more effectively

We have worked hard to improve the way we deal with customer complaints. We invested in our successful phone-a-friend service, providing 40,000 branch and call centre colleagues with instant access to a dedicated specialist advice team. We now resolve more than 90 per cent of all complaints at first contact and faster than ever before thanks to our 24 hour, seven days a week complaints handling service.

Getting to the root of the problem

This year our Root Cause Analysis team has carried out detailed analysis of the reasons why customers complain. The team contributed to a monthly reduction of around 1,555 complaints by talking with customers and colleagues, then making the appropriate changes in our processes and responses.

Shifting from avoidance to achievement

We have made a big shift in the way we define, measure, incentivise and reward colleagues in relation to customer satisfaction this year – moving from a focus on 'making the sale' towards a focus on improving service and achieving positive outcomes for customers. We believe customer complaints will reduce as a consequence of this shift.

Dealing with legacy issues

We still have some legacy issues, including the mis-selling of PPI, to deal with and we fully acknowledge that these are still a cause for concern amongst many customers and stakeholders. We were the first bank to offer redress to customers who were mis-sold PPI products and we're continuing to deal with every outstanding complaint to ensure a fair outcome. Just as importantly, we are implementing processes and procedures to prevent such events happening again.

Protecting our customers' best interests

Our customers need to be sure that their money and personal details are safe with us. As one of Britain's largest financial businesses we face hundreds, sometimes thousands, of cyber-threats every day. This is why we consistently invest in technology and colleague training to maximise security.

Combating cyber-crime

Since 2011, we have invested £248 million to improve the security of our IT infrastructure, including £138 million this year. Our Group-wide hub 'Prevent and Protect', provides a wealth of information to help colleagues stay aware of the threats and take appropriate action. Most of the work we do is invisible to customers, but it has contributed to a downward trend in levels of fraud across our online retail channels in 2013.

Combating financial crime and money laundering

We can identify unusual activity related to customers' accounts and have processes in place to check customers' identities. We have invested in advanced transaction monitoring technologies as part of our Group-wide Global Anti-Money Laundering Programme and have refreshed our Group-wide Fraud Prevention training module, rolling out an interactive version for all colleagues.

This year our whistleblowing service, a confidential service for colleagues worried about possible wrong-doing that may affect colleagues, customers or the Group, recorded 443 new contacts, compared with 532 last year. 53 per cent of these were resolved appropriately and advice was given to the remaining 47 per cent to raise concerns through other, more appropriate, routes.

RELATIONSHIPS AND RESPONSIBILITY COLLEAGUES

We want colleagues to live our values, to work in line with our Codes of Responsibility and to feel pride in their contributions to a successful customer-focused business.

Aim

Our ambition is to be a bank where our colleagues give their best and want to build their career. Our people are at the heart of our business and are critical in ensuring that we deliver our strategy to be the best bank for customers and through this, help Britain prosper. Each colleague has access to the training and development opportunities that enable them to do their role well. This grows talent internally, to drive our business in a sustainable way.

At Lloyds Banking Group, we want the diversity of our employee base to reflect the population of the UK and who our customers are: the better we reflect our marketplace, the better we can serve it. We also encourage our colleagues to work closely with the community to build lasting relationships that are the foundation for our business in the future.

Priorities for 2014

- Build colleagues' pride and trust in our Group.
- Help colleagues fulfil their potential through relevant learning and development.
- Do even more to build a diverse workforce and inclusive workplace.
- Put customers at the heart of our performance and reward structures.
- Nurture the next generation of leaders, strengthening our succession and talent pipeline.

Achievements in 2013

- Launched the Agile Future Forum, highlighting the benefits of agile working for businesses in the 21st century.
- Offered 1,000 apprenticeship places to young people, building on the success of our 2012 National Apprenticeship pilot.
- 76 per cent of all executive vacancies filled from within Lloyds Banking Group.
- More than 51,000 customer facing colleagues have now attained the Foundation Standard for Professional Bankers – the highest of any bank in Britain.
- Increased the percentage of women on our Board to 27 per cent.
- Invested in a new technology platform and content to enhance colleague development opportunities.

Performance in 2013

Staff engagement score %

The Employee Engagement Index (EEI) measures the individual motiviation of colleagues whilst the Performance Excellence Index (PEI) measures how strongly colleagues believe the Group is committed to improving customer service.

Line management index %

The Line Management Index (LMI) shows how our colleagues feel about their individual Line Manager.

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Engaging colleagues with our values

We ask colleagues to work in line with our three values: *putting customers first*, *keeping it simple* and *making a difference together*.

Embedding our values

In 2013, around 97 per cent of colleagues completed training on our Codes of Responsibility and we completed the first phase of a Group-wide cultural assessment.

Colleague survey

This year we received the highest response rate to date, with 76 per cent of colleagues participating, compared to 74 per cent in 2012.

- Our Performance Excellence Index score was 76 per cent (up on 2012 by 8 percentage points), 12 percentage points above the UK average
- Our Employee Engagement Index score was 64 per cent (up on 2012 by 16 percentage points), 3 percentage points above the UK average
- Our Line Management Index score was 81 per cent (up on 2012 by 4 percentage points), 14 percentage points above the UK average

In addition to these improved scores, the survey shows that participating colleagues' confidence and trust in our organisation and leadership improved by 22 percentage points compared with 2012, reaching 70 per cent which is 8 percentage points above the UK average.

Mobilising colleagues to build a diverse, inclusive business

We want to build a colleague team that truly reflects 21st century Britain, in which differences are welcomed and everyone is treated fairly and with dignity and respect.

Diversity and inclusion

Our 2013 Colleague Engagement Survey results showed significantly higher engagement scores for female colleagues and improvements in colleagues' perceptions of the Group's commitment to diversity and inclusion.

		2013		2012
Gender		**Number**	**%**	%
Board	Male	**8**	**73**	73
	Female	**3**	**27**	27
Senior managers	Male	**5,911**	**73**	74
	Female	**2,217**	**27**	26
Colleagues	Male	**38,860**	**41**	41
	Female	**55,150**	**59**	59

	2013	2012
Disability[1]		
% of colleagues who disclose they have a disability	**1.5%**	1.5%
Ethnic background[1]		
% of colleagues from an ethnic minority	**6%**	7%
Ethnic minority managers	**6%**	6%
Ethnic minority senior managers	**3%**	3%
Sexual orientation[1]		
% of colleagues who disclose they are lesbian, gay, bisexual or transgender	**1%**	1%

[1] Data source: HR system (HRIS). Apart from gender data, all diversity information is based on colleagues' voluntary self-declaration. As a result this data is not fully representative; our systems do not record any diversity data for the proportion of colleagues who have not declared this information.

Our diversity networks

We have four colleague diversity networks: Breakthrough – network for women; Access – disability network; GEM – Group ethnic minority network; and Rainbow – Lesbian, Gay, Bisexual and Transgender network. Our sexual orientation programme was rated in the top 20 of the Stonewall Workplace Equality index for the past two years with our Rainbow Network achieving 'Star Performer' status.

Commitment to gender equality

We want to improve gender diversity amongst our senior managers and achieved 27 per cent female representation at board level in 2013. We are focused on building a sustainable pipeline of talented women and were included in *The Times* Top 50 employers for women for the second year in succession.

Support for colleagues with disabilities

We are committed to being a disability confident organisation, which provides equal opportunities for people with disabilities. We plan to launch a work experience programme for disabled people in 2014, following a successful pilot in 2013.

Support for colleagues from ethnic minority backgrounds

This year we ran 10 Career Development Programme courses to support the career development of more than 100 talented colleagues from ethnic minority backgrounds. This year, 28 per cent of our new graduates joining us were from ethnic minorities.

Flexible working

We are committed to building a culture that encourages innovative agile working policies and practices.

Parents and carers

We provide one of the best packages for working parents and carers in the UK. This includes guidance for colleagues and line managers, e-learning modules for new parents and a parent's forum.

Empowering colleagues to do their very best

All colleagues can identify the training they need and access it through a new, more effective learning management system called Discover Learning, which we launched in July 2013.

Developing future leaders

In line with our commitment to bring in talented people, we've expanded the scope and scale of our Graduate Programme. We also doubled the number of colleagues participating in our Future Executives Programme.

Apprenticeships

Building on the success of our 2012 National Apprenticeship pilot, we set a target to offer 1,000 apprenticeship places by the end of 2013 and achieved it by November.

Supporting colleagues' wellbeing, health and safety

Colleagues who are healthy, happy and safe at work, with access to support when facing financial, physical or emotional issues, generally perform their best.

Wellbeing

We work closely with BUPA, Health Management Limited, Validium and other partners to promote and enable colleagues' general health and wellbeing. For example, Validium runs our successful Employee Assistance Programme.

Health and safety in the workplace

We have policies and standards in place to help colleagues work safely and responsibly at all times. Health and safety training is mandatory for all colleagues and we complete regular audits, inspections and maintenance programmes to help improve safety standards.

Reported accidents in 2013

We worked hard to improve safety across the Group and for the third year running achieved a reduction in the number of accidents. In 2013, accidents reduced by 10 per cent compared with 2012.

Rewarding and incentivising colleagues

We try to achieve the right balance on remuneration: recognising the need to manage the Group's finances prudently, but also to incentivise colleagues. We continue to evolve our reward structures, making them fairer for all colleagues and linked more directly with performance for customers.

Remuneration

We offer competitive salaries and aim to award competitive variable pay (bonus and incentives) relevant to particular roles.

RELATIONSHIPS AND RESPONSIBILITY COMMUNITIES

As Britain's largest retail and commercial bank, serving around 30 million customers, our brands are familiar on the high street and in almost every community. By supporting these communities, we can benefit many local people, build trust in our brands, and sow the seeds for future growth.

Aim

Our brands are familiar on the high street in almost every local community. Through our community-focused programmes and investment activity we can benefit many local people and build trust in our brands.

Last year the Group invested £85 million in a range of flagship programmes and initiatives. Despite the challenging economic environment the Group committed to keep its investment at this level for the period of its strategic plan.

Priorities for 2014

- Increase participation in, and impact of, our community programmes.
- Maintain momentum in colleague involvement in community volunteering with more emphasis on skills-based support.
- Meet our charitable fundraising targets and support for our Foundations.
- Support colleagues in their volunteering activity as we strive towards 2.3 million volunteering hours by 2020.

Achievements in 2013

- Invested £8 million in our Money for Life programme since its launch to help young people manage their finances better.
- Helped 154 social entrepreneurs through our Social Entrepreneurs programme.
- Raised £2.5 million for our charity of the year, Alzheimer's Society and Alzheimer Scotland, beating our year end target.
- 34,000 colleagues volunteered help local good causes through our Day to Make a Difference programme.
- Donated £29 million to the Lloyds Bank, Lloyds TSB and Bank of Scotland Foundations.

Performance in 2013

Colleague volunteers

In 2013, the Group supported over 34,000 colleagues in volunteering for charities and community groups. The Foundations also provided Matched Giving to some of these organisations for colleagues' time spent volunteering outside of working hours.

Total community investment

£m

Our Community Investment total includes support for financial inclusion, community initiatives, leveraged colleague fundraising, sponsorship and support for grass roots charities.

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Developing our community investment programmes

Our community programmes are focused on the ways in which we believe we can make the greatest difference to local people and local communities. All of our programmes involve colleagues, offering them the opportunity to use their skills and expertise for the benefit of the local communities in which they work and live.

Our community programmes cover four key areas:

- Investing in education, employability and enterprise
- Supporting local communities
- Fundraising and community events
- Supporting colleagues to make a difference

You can read about all of our community investment programmes in detail in our 2013 Responsible Business Report at www.lloydsbankinggroup-cr.com

Investing in education, employability and enterprise

The ability to manage money well is essential in 21st century Britain, and there are calls from many quarters to make financial education compulsory in schools. Unfortunately many young adults lack the skills required to manage their money effectively. We're doing what we can to help address this issue.

Our Money for Life programme

In 2009, we launched Money for Life, our financial capability and personal money skills programme, aimed at improving the knowledge, confidence and skills of UK communities. Designed for people and adults in further education, and the work-based learning and community learning sectors, the programme enables and empowers participants to manage their money more effectively. We've invested £8 million in this award-winning programme since its launch.

Lloyds Scholars programme

The Lloyds Scholars programme offers students from lower income households a complete support package to help them meet the costs of a university education and improve their employment prospects. Working in partnership with eight leading universities, we supplement financial support with invaluable vocational support, provided by mentors from the business and through paid internships and development workshops. Since 2011, we've supported 240 students.

Social Entrepreneurs programme

In 2012, we partnered with the School of Entrepreneurs to launch our Lloyds Bank and Bank of Scotland Social Entrepreneurs programmes. These programmes help social entrepreneurs build businesses that support enterprise, create new jobs and have a positive social impact on their local communities. We aim to help more than 1,300 social entrepreneurs start-up or scale-up over the next five years of the programme, providing them with grants of between £4,000 to £25,000 and the support of a business mentor. This year 154 social entrepreneurs received grants through the programme. We will invest £5.9 million in the programme over five years, leveraged with £7 million of additional funding from the Big Lottery.

Supporting local communities

We invest in a number of local charities and community groups that work to bring communities closer together. We also use the Group's resources and colleagues' skills and expertise to help communities prosper.

Our Foundations

In 2013 we donated more than £29 million to the Lloyds Bank, Lloyds TSB and Bank of Scotland Foundations, enabling them to make grants to local, regional and national charities across the UK.

Community Fund

We support local organisations through our Community Fund. In 2013, colleagues nominated over 4,600 good causes for the Community Fund, from which, they shortlisted 1,568 organisations in 392 communities across Britain. Over 2.7 million votes were cast for local good causes – online, by SMS or in our Lloyds Bank and Bank of Scotland branches – with grants of either £300 or £3,000 awarded to those that received the most votes. More than 450,000 people across Britain will benefit as a consequence of the Community Fund awards.

Giving Extra Awards

This year we launched the Halifax Giving Extra Awards, to recognise and reward people who give extra in their local communities. We awarded vouchers, worth £250 to £5,000 to 67 winners. They can donate these vouchers to the good cause of their choice.

Fundraising and community events

Colleagues support and raise funds for local organisations in many different ways. They participate in national and local community events. They raise thousands of pounds for charities across Britain.

Charity of the year

Our Charity of the Year for 2013/14, chosen by colleagues, is Alzheimer's Society and Alzheimer Scotland. In 2013 we raised £2.5 million to support the first UK dementia carers programme.

Great Scottish Run and Cardiff Half Marathon

This year, colleagues participating in the 2013 Bank of Scotland Great Scottish Run and Lloyds Bank Cardiff Half Marathon raised over £44,000 for our Charity of the Year. More than 600 colleagues ran alongside thousands of other runners.

Supporting colleagues to make a difference

Colleagues can volunteer their time and skills through our Day to Make a Difference scheme. During 2013 we saw a marked increase in skill-based volunteering activities, with colleagues, including senior executives, involved in activities that included employability skills training for young adults, literacy and numeracy classes for school kids, mentoring for SMEs and business advice for local charities.

Over the past three years, colleagues have volunteered over 650,000 hours in their local communities and consequently we're on track to achieve our target of 1 million volunteering hours by 2015.

RELATIONSHIPS AND RESPONSIBILITY OTHER STAKEHOLDERS

We can't succeed without the trust and support of our stakeholders who include central and local government, suppliers, investors and non-governmental organisations (NGOs).

Aim

The Group is committed to working responsibly and acting professionally with all our external stakeholders. Our approach to stakeholders is set out in our Code of Business Responsibility.

Achievements in 2013

- Shared our views on culture, ethics and standards with the Parliamentary Commission on Banking Standards.
- Liaised with the Treasury Select Committee prior to the launch of TSB.
- Discussed the Current Account Switching Service and ring-fencing with HM Treasury and regulators.
- Shared our views about the future of care funding in Britain with the UK government.
- Launched a review of our approach to responsible business in our supply chain.
- Worked closely with our unions as we implement our ongoing change programmes.

Priorities for 2014

- Roll out our new Supplier Code of Conduct and auditing suppliers against it.
- Pay 95 per cent of our suppliers within 30 days.
- Presentations for shareholders to explain the Helping Britain Prosper Plan.
- Continue to work with the UK government in its efforts to improve standards in the banking sector.
- Continue to engage with equity and debt investors to ensure they are well briefed on our strategic and financial performance.

Government and regulators

We engage regularly with the UK government, the European Commission, the European Parliament and other bodies to assist in the formulation of public policy around consumer issues, financial inclusion, financial education and finance for the green economy. We also produce economic and social research that champions consumer interests, for example the Halifax House Price Index, which is frequently used to inform government policy.

As a responsible business we understand the importance of explaining our approach to paying and managing tax as clearly and transparently as possible. The Group's tax strategy and tax policy has been approved by the Group Board. We are consistently one of the UK's largest tax payers and in 2013 we paid a total of £1.7 billion in UK tax. We also collected a further £2.2 billion for the government (for example VAT and PAYE).

Suppliers

We want to source goods and services in ways that are responsible, sustainable and constitute best value for our customers and shareholders. We can also use our influence to help suppliers to match the same high standards.

Our Group Sourcing team has committed to make responsible business practices integral to our sourcing activities by the end of 2014. This year we've made significant progress towards achieving this goal, developing a coherent plan that covers all aspects of our sourcing activities. The plan, which evolves and expands our current approach, was approved by the Responsible Business Committee in June 2013. It addresses sourcing activities across the Group, using our existing Group Sourcing Policy as a starting point, along with supplier standards through the creation of a new Supplier Code of Conduct. This new Code will set minimum standards across six key dimensions: human rights, ethical standards, environmental standards, governance, health and safety, and community.

Investors and rating agencies

We regularly interact with our equity and debt investors through presentations, one-to-one and general meetings and undertook more than 650 investor meetings in 2013. We also manage relationships with the main rating agencies: Standard & Poor's, Fitch & Moody's.

Investor trust and their feedback are important considerations when formulating our ongoing strategy and a review of our investor interaction was undertaken in 2013 which provided positive feedback on our approach. Given the increasing focus within the business on operating sustainably and responsibly, we plan to deliver a series of investor presentations on our Helping Britain Prosper Plan in 2014.

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RELATIONSHIPS AND RESPONSIBILITY ENVIRONMENT

Working continually to reduce environmental impact

Our ability to help Britain prosper in a sustainable way is inextricably linked to wider environmental issues. Man-made climate change and global trends such as resource scarcity, extreme weather and rising energy and commodity prices have an impact on our stakeholders and our own operations.

Aim

We aim to manage our own environmental impacts and support the drive towards a low carbon, more resource efficient economy.

Achievements in 2013

- Achieved a reduction in energy use of 12.7 per cent against our 2009 baseline, resulting in cost avoidance of £8.7 million in 2013 and cost avoidance of £22 million since 2010.
- Achieved a reduction in water consumption of 18 per cent against our 2009 baseline.
- Diverted 95 per cent of our operational waste from landfill – beating our 2020 target of 92 per cent.
- Engaged colleagues in our Environmental Action Plan through our Sustainability Network.
- Worked for positive environmental change through many different external bodies, including the Corporate Leaders Group for Climate Change, Climatewise, AIM4C and the Banking & Environment Initiative (BEI).

Priorities for 2014

- Invest £7 million in specific energy efficiency projects.
- Continue to engage SMEs to help them understand how to become more sustainable and realise the benefits to their businesses.
- Complete the environmental accreditation of even more of our property estate.

Managing our carbon emissions

Despite our continuing efforts throughout 2013 to move closer to our Environmental Action Plan (EAP) targets, our overall carbon emissions have increased slightly compared to 2012 by 1.2% (on a like-for-like basis). This has mainly been down to increased gas use during cold winter conditions, increased electricity use as a result of the hot conditions in summer 2013 and increased business travel. The underlying trend is that we continue to improve our efficiency and we remain committed to delivering our EAP.

Please refer to page 75 in the Director's report for a comprehensive overview of our emissions reporting.

Using scarce resources more efficiently

During 2013, we've made progress against our EAP targets.

	2020 target	Progress to 2020 target	2012	**2013**
Energy	30% reduction in energy consumption*	42%	657Gwh	**678Gwh**
Paper	20% reduction in paper consumption	75%	26,565 tonnes	**27,220 tonnes**
Business travel	20% reduction in our business travel	95%	315m kms	**334m kms**
Waste	92% of waste diverted from landfill	>100%	94%	**95%**
Water	20% reduction in water consumption	90%	1,075,016 m^3	**1,059,999 m^3**
Buildings	20% of m^2 floor area environmentally accredited	23%	1.5%	**4.7%**

* Target excludes IT data centres and the use of oil as a fuel.

Supporting the green economy

We work together with government and others stakeholders to understand how we can help businesses that provide low carbon products and services or green technologies along with mainstream businesses who wish to do more in this emerging sector.

We work with SMEs to help them to understand and maximise the commercial benefits of sustainable business practices. Early in 2013, Lloyds Bank and Bank of Scotland both launched versions of our new online tool, REDUCE – a free resource that enables SMEs to create and implement their own sustainable business plan.

RISK OVERVIEW

Effective risk management, governance and control

Managing risk effectively is important for any bank and fundamental to our strategy. We are now a more efficient, low risk, UK focused retail and commercial bank. This has been achieved by maintaining a conservative business model which embodies a risk culture founded on a prudent appetite for risk.

Our approach to risk is founded on an effective control framework and a strong risk management culture which guides how our employees approach their work, the way they behave and the decisions they make. The amount and type of risk that we are prepared to seek, accept or tolerate, otherwise known as risk appetite, works in tandem with our strategy and is approved by the Board. Our risk appetite is then embedded within policies, authorities and limits across the Group.

Risk as a strategic differentiator

The Group strategy and risk appetite were developed together to ensure one informed the other in creating a strategy that delivers on becoming the best bank for our customers whilst helping Britain prosper and creating sustainable growth over time.

Risks are identified, managed and mitigated using our Risk Management Framework (see page 41). The principal risks we face, which could significantly impact the delivery of our strategy, are discussed on pages 133 to 196.

We believe effective risk management can be a strategic differentiator, in particular:

- **Sustainable growth**
  The role of risk is to support the business in delivering sustainable growth, which is achieved through informed risk decision making and superior risk and capital management, supported by a consistent risk-focused culture across the Group.
- **Conservative approach to risk**
  We have a fully embedded conservative approach to, and prudent appetite for, risk with risk culture and appetite driven from the top.
- **Strong control framework**
  This framework is the foundation for the delivery of effective risk management as it ensures appropriate engagement in developing risk appetite and that business units operate within approved parameters.
- **Effective risk analysis, management and reporting**
  This identifies opportunities as well as risks and ensures risks are managed appropriately and consistently with strategy. Our principal risks and performance against risk appetite are monitored and reported regularly to senior management using quantitative and qualitative analysis and are subject to relevant stress testing. This enables us to understand the risk in the business at both an individual risk type and aggregate portfolio level.
- **Business focus and accountability**
  Managing risk effectively is a key focus and is one of the five criteria within the Group Balanced Scorecard on which business areas and individual performance are judged. Our approach to risk means that businesses remain accountable for risk but a strong and independent risk function also helps ensure adherence to the Group's risk and control frameworks. Continued investment in risk systems and processes will also help differentiate our risk management approach.

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Achievements in 2013

Impairment
Our impairment charge improved by 47 per cent to £3,004 million, mainly driven by the reduction in non-core assets and the sustained improvement in Group asset quality.

Complaints
During 2013 banking complaints fell to 1.0 per 1,000 accounts (excluding PPI), compared with 1.5 at the end of 2011, and 2.4 at the start of 2010. Our 2014 reduction target was met and exceeded by September 2013.

Loan to deposit ratio
Our funding position remains strong with an improved loan to deposit ratio of 113 per cent, from 121 per cent at 31 December 2012. The core loan to deposit ratio fell to 100 per cent from 101 per cent at 31 December 2012.

Credit ratings
Credit ratings reflected the progress the Group had made on delivery of its strategy. During 2013 both Fitch and Standard & Poor's upgraded Lloyds Bank's standalone rating to bbb+, therefore affirming its long-term credit rating at A.

Improved capital position
Our common equity tier 1 (CET1) capital position has continued to build to 10.3 per cent on a pro forma fully loaded CRD IV basis, increasing by 2.2 per cent in the year, in line with our capital generative strategy.

Non-core asset reduction
We made substantial capital accretive non-core asset reductions during the year and, together with additional sales announced in October, our full year 2014 target of less than £70 billion of non-core assets was achieved by Q3 2013. Our year end position of £63.5 billion is ahead of plan.

State aid commitments
In line with strengthening the balance sheet, we continued our commitment to reduce our assets and met our target in December 2012, two years ahead of the mandated completion date. In May 2013, we received formal confirmation from the European Commission that we were released from this commitment.

Risk transformation
The Risk Transformation Programme has driven the clarity on where risk allocates transformational investment funding in order to deliver the most efficient and effective returns for the Group. This has ensured that the investments made deliver the benefits required and underpin the Group's targeted objective of sustainable growth.

Priorities for 2014

- **Deliver the strategic plan**
  Underpin the Group's strategy to be the best bank for customers and support sustainable growth in the UK economy.
- **Customer focus**
  Put our customers at the heart of our business through a clear conduct led approach and a strong understanding of all our stakeholders, supported by the codes of responsibility, applied to both current activities and historic legacy issues.
- **Operational agility**
  Evolve risk into an agile, flexible function that supports the business in its next phase of growth with effective working across the Group.

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Risk governance

Risk management strategy and risk appetite are developed and reviewed in tandem with Group strategy. The Group uses an enterprise-wide risk management framework to ensure a robust and consistent approach to risk management is applied across all business areas and all risk types in order to drive improvements in its risk profile in line with risk appetite.

The framework articulates individual and collective accountabilities for risk management, risk oversight and risk assurance and supports the discharge of responsibilities to customers, shareholders and regulators. It establishes a common risk language which assigns risks to which the Group is exposed into categories which are used consistently to support risk aggregation and reporting. It will evolve and be periodically updated to reflect any changes in the nature of our business and the external environment.

The framework outlines the key risk management activities undertaken consistently across the Group for all types of risk.

Governance is maintained through delegation of authority from the Board, down through the management hierarchy, supported by a committee based structure designed to ensure that our risk appetite, policies, procedures, controls and reporting are fully in line with regulations, law, corporate governance and industry good-practice.

Our approach to risk is founded on a robust control framework and a strong risk management culture which ensures that business units remain accountable for risk and therefore guides the way all employees approach their work, behave and make decisions. 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 promptly escalated and remediation plans are initiated where required. The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by both the Board and senior management. A strong control framework remains a priority for the Group and is the foundation for the delivery of effective risk management. Performance is optimised by allowing business units to operate within approved parameters.

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RISK OVERVIEW

The most significant risks faced by the Group which could impact on the success of delivering against the Group's strategic objectives together with key mitigating actions are outlined below.

Principal risks	Key mitigating actions
Credit risk As a provider of credit facilities to personal and commercial customers, together with financial institutions and sovereigns, any adverse changes in the economic and market environment we operate in, or the credit quality and/or behaviour of our borrowers and counterparties would reduce the value of our assets and increase our write-downs and allowances for impairment losses, adversely impacting profitability.	• Credit policy incorporating prudent lending criteria aligned with the Board approved risk appetite to effectively manage credit risk. • Clearly defined levels of authority ensure we lend appropriately and responsibly with separation of origination and sanctioning activities. • Robust credit processes and controls including well-established committees to ensure distressed and impaired loans are identified, considered and controlled with independent credit risk assurance.
Conduct risk As a major financial services provider we face significant conduct risk, including selling products to customers which do not meet their needs; failing to deal with customers' complaints effectively; not meeting customers' expectations; and exhibiting behaviours which do not meet market or regulatory standards.	• Customer focused conduct strategy implemented to ensure customers are at the heart of everything we do. • Product approval, review processes and outcome testing supported by conduct management information. • Clearer customer accountabilities for colleagues, including rewards with customer-centric metrics. • Learn from past mistakes, including root cause analysis.
Market risk We face a number of key market risks including interest rate risk across the Banking and Insurance businesses. However, our most significant market risk is from the Defined Benefit Pension Schemes where asset and liability movements impact on our capital position.	• A rates hedging programme is in place to reduce liability risk. • Board approved pensions risk appetite covering interest rate, credit spreads and equity risks. • Credit assets and alternative assets are being purchased by the pension schemes as equities are sold. • Stress and scenario testing.
Operational risk We face a number of key operational risks including fraud losses and failings in our customer processes. The availability, resilience and security of our core IT systems is the most significant.	• Continually review IT system architecture to ensure systems are resilient, readily available for our customers and secure from cyber attack. • Implement actions from IT resilience review conducted in 2013 to reflect enhanced demands on IT, both in terms of customer and regulator expectations.
Funding and liquidity risk Our funding and liquidity position is supported by a significant and stable customer deposit base. However, a deterioration in either our or the UK's credit rating or a sudden and significant withdrawal of customer deposits would adversely impact our funding and liquidity position.	• Hold a large pool of liquid primary assets to meet cash and collateral outflows. • Maintain a further large pool of secondary assets which can be used to access Central Bank liquidity facilities. • Stress test the Group's liquidity position against a range of scenarios.
Capital risk Our future capital position is potentially at risk from adverse financial performance and the introduction of higher capital requirements for distinct risks, sectors or as a consequence of a specific UK regulatory requirement. For example in 2013, the PRA introduced significant additional capital requirements on an adjusted basis that major UK banks are required to meet.	• Close monitoring of actual capital ratios to ensure that we comply with current regulatory capital requirements and are well positioned to meet future requirements. • Internal stress testing results to evidence sufficient levels of capital adequacy for the Group under various scenarios. • We can accumulate additional capital in a variety of ways including raising equity via a rights issue or debt exchange and by raising tier 1 and tier 2 capital.
Regulatory risk Due to the nature of the industry we operate in we have to comply with a complex and demanding regulatory change agenda. Regulatory initiatives we have been working on in 2013 include CRD IV, Mortgage Market Review, Dodd-Frank and Foreign Account Tax Compliance Act 2010. The sanctions for failing to comply far outweigh the costs of implementation.	• The Legal, Regulatory and Mandatory Change Committee ensures we drive forward activity to develop plans for regulatory changes and track progress against those plans. • Continued investment in our people, processes and IT systems is enabling us to meet our regulatory commitments.
State aid HM Treasury currently holds 32.7 per cent of the Group's share capital. We continue to operate without government interference in day-to-day management decisions, however there is a risk that a change in government priorities could result in the current framework agreement being replaced, leading to interference in the operations of the Group. Failure to meet the EU State aid commitments arising from this government support could lead to sanctions.	• Most EU State aid commitments now met with the divestment of the rebranded (TSB) retail banking business outstanding. • Now progressing the divestment of TSB through an Initial Public Offering subject to regulatory and European Commission approval, to ensure best value for our shareholders and certainty for our customers and colleagues. • The divested business, rebranded TSB, has operated as a separate business within Lloyds Banking Group since September 2013.

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Key risk indicators

Impairment charge

Asset quality ratio[1]

Commentary
Through non-core asset reduction and effective risk management of both existing and new business, we have seen sustained improvements in credit quality and reduction in impairments.

Banking complaints per 1,000 accounts[1] (excl. PPI)

Commentary
We are continuing our journey to embed the conduct strategy and be the industry leader for complaints performance.

Pensions deficit

Commentary
Volatility in the Defined Benefit Pension Schemes is reducing as we target rates hedging and equity sales.

Availability of core systems

Commentary
Through effective control activities interruptions to customer service and operational losses for 2013 have remained within the Board approved appetite limits.

Primary liquidity/ wholesale funding <1 yr maturity

Core loan to deposit ratio[1]

Commentary
The primary and secondary liquidity assets provide a substantial buffer in the event of an extended market dislocation.

The Group is now in a position where the core loan book is fully funded by core deposits.

CRD IV fully loaded CET1 ratio[1]

Risk-weighted assets (prevailing rules)

Commentary
Significant progress has been made in strengthening the balance sheet and capital position through our strongly capital generative strategy.

Legal, regulatory and mandatory investment spend

Commentary
We continue to build constructive relationships with our regulators in order to effectively manage the regulatory change agenda.

Government shareholding

Commentary
We continue to work closely with the European Commission, HM Treasury, PRA, FCA and the Monitoring Trustee appointed by the European Commission to ensure the successful implementation of the Restructuring Plan and mitigate customer impact.

Future focus

- Continue to support the UK economy through appropriate lending to SMEs and first-time buyers.

133 More on credit risk

- Continued reduction in complaint levels and improvements in complaints handling.

163 More on conduct risk

- Continue to effectively manage the Defined Benefit Pension Scheme to secure pensions provisions to members and minimise the impact on the Group.

164 More on market risk

- Increased investment in IT resilience.
- Risk appetite monitoring for critical business processes.

169 More on operational risk

- Continue to meet all current regulatory ratios and ensure we meet all future regulatory ratios.
- Further reduction of the loan to deposit ratio.

171 More on funding and liquidity risk

- Implement remaining non-core run-off and disposals to be net capital accretive.
- Expect, prior to any dividend, to generate fully loaded CET1 capital of around 2.5 percentage points over the next 2 years.

178 More on capital risk

- Ongoing constructive engagement with regulators.
- Continued compliance with the regulatory change agenda.

192 More on regulatory risk

- TSB will be divested through an Initial Public Offering, subject to regulatory and European Commission approval.
- Continue to support the government in the process of returning the Group back to private ownership.

[1] These key risk indicators are also key performance indicators (KPIs).
[2] Pro forma basis.

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SUMMARY OF GROUP RESULTS

Overview

In 2013, we significantly improved the Group's profitability and further strengthened our capital position, while improving margins, and reducing costs and non-core assets as we simplified and de-risked the business. Income grew as funding costs fell, core lending increased and we benefited from gains on the sales of shares in St. James's Place. This growth in income, combined with lower operating costs and impairments resulted in an increase in core underlying profits to £7.6 billion. The Group also returned its lending to core corporate customers to growth in the first half of 2013, and to mortgage customers in the second half, while non-core asset reductions continued to be capital accretive overall, with underlying losses from the non-core portfolio declined significantly.

Significantly improved Group underlying and statutory profitability

Group underlying profit more than doubled, increasing by £3,601 million to £6,166 million compared to 2012. The return on risk-weighted assets improved to 2.14 per cent from 0.77 per cent, driven by increased earnings and by risk-weighted asset reductions, predominantly in the non-core business. Core underlying profit before tax grew 24 per cent to £7,574 million, primarily reflecting reduced impairment charges and stronger net interest income.

Underlying income grew by 2 per cent to £18,805 million, including the gain of £540 million from the sales of shares in St. James's Place. Excluding the gain on sales and income from St. James's Place (together St. James's Place effects), total underlying income was unchanged with a stronger contribution from net interest income offsetting a reduction in other income. Group net interest income improved by 5 per cent to £10,885 million as a result of improved net interest margin and growth in core lending volumes. Other income decreased by 6 per cent excluding St. James's Place effects, primarily as a result of non-core disposals made during the course of the year.

We maintained our focus on cost control and efficiency, with total costs falling by 5 per cent to £9,635 million, in line with the upgraded guidance given in the first quarter of 2013. The impairment charge improved by 47 per cent to £3,004 million, driven by the reduction in non-core assets and the sustained improvement in Group asset quality.

Core underlying profit improved to £7,574 million from £6,112 million and the return on risk-weighted assets increased to 3.26 per cent from 2.54 per cent. Excluding St. James's Place effects, the return on risk-weighted assets was 3.00 per cent. Core underlying income increased 6 per cent to £18,244 million, and by 4 per cent excluding St. James's Place effects given improved net interest income from core loan growth and higher margins. The core net interest margin increased by 17 basis points to 2.49 per cent, driven mainly by improved deposit margins. Core other income increased 3 per cent to £7,606 million but excluding St. James's Place effects was down 2 per cent reflecting current economic conditions and the regulatory environment.

Core costs decreased by 1 per cent, driven by further savings from the Simplification programme and the deconsolidation of St. James's Place, partially offset by additional staff related costs and inflation. The core impairment charge decreased 21 per cent to £1,521 million with the reduction primarily attributable to Commercial Banking impairments, which reduced by 40 per cent year-on-year reflecting better quality new business and lower defaults due to the low interest rate environment.

Non-core losses reduced by 60 per cent to £1,408 million year-on-year, largely as a result of the reduction in non-core assets which was also the primary driver of the 61 per cent reduction in the impairment charge to £1,483 million.

The Group statutory profit before tax of £415 million for 2013 compared to a pre-tax loss of £606 million in 2012, driven by the improvement in underlying profit and a lower provision for legacy issues of £3,455 million compared to the £4,225 million charge in 2012. In 2013 the Group was subject to a higher effective tax rate than the UK statutory rate primarily due to an additional tax charge arising from the impacts on the net deferred tax asset of the reduction in the UK Corporation tax rate, the disposal of our Australian operation and policyholder tax. The loss after tax was £802 million and the loss per share was 1.2p, compared to the loss per share of 2.1p in 2012.

Lower risk, stronger balance sheet with core loan growth and a substantially enhanced capital position

We have now substantially completed our work to transform the balance sheet, by strengthening our funding, liquidity and capital position, and reducing non-core assets, and we returned core corporate and mortgage lending to growth in 2013.

We reduced non-core assets by £34.9 billion to £63.5 billion during the year, with non-retail non-core assets reduced to £24.7 billion. Non-core asset reductions continue to be capital accretive overall and, together with core underlying profit generation and management actions, resulted in a considerable strengthening of our capital ratios. The Group's pro forma fully loaded CRD IV common equity tier 1 ratio improved to 10.3 per cent from 8.1 per cent at 31 December 2012, in spite of the additional legacy charges, changes to pension accounting following the implementation of IAS 19R and other statutory items.

Core loans and advances grew by £11.6 billion or 3 per cent to £436.9 billion, primarily driven by increases in Commercial Banking and Wealth, Asset Finance and International. We also returned Retail secured lending to growth, as expected in the third quarter and delivered £1.9 billion of further loan growth in our core book in the fourth quarter.

SUMMARY OF GROUP RESULTS

Underlying income

	Total			Core		
	2013 £ million	2012 £ million	Change %	2013 £ million	2012 £ million	Change %
Net interest income	**10,884**	10,331	5	**10,637**	9,864	8
Other income	**7,259**	7,726	(6)	**6,945**	7,092	(2)
Total underlying income excluding St. James's Place	**18,143**	18,057	–	**17,582**	16,956	4
St. James's Place	**662**	329		**662**	329	
Total underlying income	**18,805**	18,386	2	**18,244**	17,285	6
Banking net interest margin	**2.12%**	1.93%	19bp	**2.49%**	2.32%	17bp
Average interest-earning banking assets	**£510.9bn**	£543.3bn	(6)	**£420.5bn**	£423.7bn	(1)
Loan to deposit ratio	**113%**	121%	(8)pp	**100%**	101%	(1)pp

Group underlying income increased by 2 per cent to £18,805 million and, excluding St. James's Place effects, was broadly unchanged at £18,143 million, with strong growth in net interest income offsetting the reduction in other income. The growth in core income more than offset the decline in non-core income which resulted from the continued reduction of non-core assets.

Net interest income (excluding St. James's Place effects) increased by 5 per cent to £10,884 million in 2013, and grew for the fourth successive quarter. The growth reflected increased core lending and the improved net interest margin, partly offset by reduced net interest income from the smaller non-core asset portfolio.

The improvement in Group net interest margin to 2.12 per cent for the full year, and to 2.29 per cent in the fourth quarter, was principally driven by a strong performance in deposit margin, which more than offset a small decline in asset margin and an 8 basis points reduction from repositioning our government bond portfolio. The net interest margin also benefited, relative to our expectations at the beginning of the year, from the effect of repositioning our structural hedge. This repositioning is now largely complete and provides the Group with a greater level of protection from changes in net interest income from movements in interest rates.

Core net interest income increased 8 per cent principally as a result of the significant improvement in margin.

Other income excluding St. James's Place fell by 6 per cent to £7,259 million, reflecting the significant reduction in non-core assets and lower sales of bancassurance and protection products in the core business, partly as a result of changes in our product offering following implementation of the Retail Distribution Review (RDR). Around £400 million of the decline in other income excluding St. James's Place related to businesses sold in the year.

Total costs

	2013 £ million	2012 £ million	Change %
Core	**9,149**	9,254	1
Non-core	**486**	870	44
Total costs	**9,635**	10,124	5
Cost:income ratio	**51.2%**	55.1%	(3.9)pp
Simplification savings annual run-rate	**1,457**	847	

Total costs fell by 5 per cent to £9,635 million driven by around £600 million of savings from Simplification initiatives, and the effect of disposals in the year, partly offset by staff related costs and inflation. Total costs include a bank levy charge of £238 million (2012: £179 million). We continue to expect costs in 2014 to reduce to around £9 billion, excluding TSB running costs.

Core costs fell 1 per cent to £9,149 million driven by strong cost management, benefits from the Simplification programme and the deconsolidation of St. James's Place from the beginning of April. These reductions were partly offset by additional staff related costs, inflation and the increase in the bank levy. Non-core costs fell 44 per cent due to the significant reduction in non-core assets.

The Group continues to make good progress on Simplification, improving service for customers through more streamlined end-to-end processes, and, among other initiatives, centralising support functions, reducing layers of management and rationalising its supplier base. We continue to reinvest a part of these savings in the core business.

At 31 December 2013, we had achieved annual run-rate cost savings of £1,457 million from our initiatives to simplify the Group, an increase of £610 million since 31 December 2012. We have now increased our expectations for annual run-rate cost savings from the Simplification programme at the end of 2014 from £1.9 billion to £2.0 billion.

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Impairment

	2013 £ million	2012 £ million	Change %
Core	**1,521**	1,919	21
Non-core	**1,483**	3,778	61
Total impairment charge	**3,004**	5,697	47

	2013 %	2012 %	Change %
Asset quality ratio:			
Core	**0.35**	0.44	(9)bp
Non-core	**1.61**	3.08	(147)bp
Group	**0.57**	1.02	(45)bp
Impaired loans as a % of closing advances:			
Core	**2.6**	3.0	(0.4)pp
Non-core	**30.0**	32.1	(2.1)pp
Group	**6.3**	8.6	(2.3)pp
Provisions as a % of impaired loans:			
Core	**40.6**	41.2	(0.6)pp
Non-core	**54.8**	50.7	4.1pp
Group	**50.1**	48.2	1.9pp

The impairment charge reduced by 47 per cent to £3,004 million reflecting the improved credit quality of the core portfolio, continued prudent management of impaired loans and a further reduction in non-core assets. The asset quality ratio improved by 45 basis points to 0.57 per cent, and is now within the target range for the Group set out in our Strategic Review of 50 to 60 basis points. The core asset quality ratio remains low at 0.35 per cent.

The 21 per cent decrease in the core impairment charge to £1,521 million was primarily driven by lower impairment in Commercial Banking, which was down 40 per cent compared to 2012 given the improvement in the economic environment together with higher releases in 2013 compared to the same period in 2012. The significant improvement in the non-core impairment charge of 61 per cent compared to 2012 reflected reductions in the Corporate Real Estate and Irish portfolios following asset disposals.

Impaired loans as a percentage of closing advances reduced substantially to 6.3 per cent, from 8.6 per cent at 31 December 2012, driven by the reduced non-core portfolio and improvements in both the Retail and Commercial Banking portfolios. Provisions as a percentage of impaired loans increased from 48.2 per cent at 31 December 2012 to 50.1 per cent.

SUMMARY OF GROUP RESULTS

Statutory profit

Statutory profit before tax was £415 million compared to a pre-tax loss of £606 million in 2012. Further detail on the reconciliation of underlying to statutory results is included on page 231.

	2013 £ million	2012[1] £ million
Underlying profit	**6,166**	2,565
Asset sales, liability management and volatile items:		
Asset sales	**(687)**	(660)
Sale of government securities	**787**	3,207
Liability management	**(142)**	(229)
Own debt volatility	**(221)**	(270)
Other volatile items	**(457)**	(478)
Volatility arising in insurance businesses	**668**	312
Fair value unwind	**(228)**	650
	(280)	2,532
Simplification and Verde costs:		
Simplification costs	**(830)**	(676)
Verde costs	**(687)**	(570)
	(1,517)	(1,246)
Legacy items:		
Payment protection insurance provision	**(3,050)**	(3,575)
Other regulatory provisions	**(405)**	(650)
	(3,455)	(4,225)
Other items:		
Past service pensions (charge) credit	**(104)**	250
Amortisation of purchased intangibles	**(395)**	(482)
	(499)	(232)
Profit (loss) before tax – statutory	**415**	(606)
Taxation	**(1,217)**	(781)
Loss for the year	**(802)**	(1,387)
Loss per share	**(1.2)p**	(2.1)p

[1] Restated to reflect the implementation of IAS 19R and IFRS 10.

Asset sales, liability management and volatile items

Asset sales included gains on the sale of government securities of £787 million (2012: £3,207 million) and a net loss of £687 million (after a related fair value unwind benefit of £1,384 million), principally from the significant reduction in non-core assets. Despite net losses in the year, non-core disposals were capital accretive in aggregate contributing to the £2.6 billion of capital generated by non-core reduction. The level of net losses from asset sales incurred in 2013 is not expected to be repeated in 2014.

The Group's statutory profit before tax is affected by insurance volatility caused by movements in financial markets generating a variance against expected returns, and policyholder interests volatility which primarily reflects the gross up of policyholder tax included in the Group tax charge. The statutory result included £668 million of positive insurance and policyholder interests volatility (2012: positive volatility of £312 million), reflecting the rise in equity markets in the period.

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Simplification and Verde costs

Simplification programme costs in 2013 were £830 million and the total spent on the programme to the end of 2013 was £1,691 million. This had delivered annual run-rate cost savings of £1,457 million by December 2013. Our expectations for annual run-rate cost savings by the end of 2014 have now increased from £1.9 billion to £2.0 billion. We now expect the total costs to be around £2.5 billion by the end of 2014, of which £2.4 billion is anticipated to be directly expensed through the profit and loss account.

The Group continues to progress the European Commission (EC) mandated business disposal (Verde), with an Initial Public Offering (IPO) planned for 2014. Subject to meeting a number of criteria, this plan has been agreed in principle by the EC but remains subject to final regulatory and EC approval. The Project Verde branches were rebranded in September 2013, and now operate as TSB as a separate business within the Lloyds Banking Group. The costs of building TSB were £687 million in the year and, from inception to the end of December 2013, have totalled £1,468 million. We expect to complete the build of TSB at a cost in 2014 of around £200 million with further dual running and transaction costs of around £150 million.

PPI

The Group made a further provision in the fourth quarter for expected PPI costs of £1,800 million, which brought the amount provided in 2013 for PPI to £3,050 million, and the total amount provided to £9,825 million. Total costs incurred in the three months to 31 December 2013 were £687 million, including £165 million of administration costs, and as at 31 December 2013, £2,807 million of the total provision remained unutilised.

The volume of PPI complaints continues to fall. Average monthly complaint volumes (excluding complaints where no PPI was held) reduced to approximately 37,000 in the fourth quarter of 2013, and were 24 per cent below volumes in the third quarter, and 56 per cent below the fourth quarter of 2012. While fourth quarter volumes fell in line with our revised end of third quarter expectations, following further statistical modelling and the results of the most recent customer survey, we are now forecasting a slower decline in future volumes than previously expected. The additional provision taken in the fourth quarter is based on the assumption that we will receive approximately a further 550,000 complaints. Together with an increase in administrative costs, this revised forecast for future complaint volumes accounts for approximately £1.1 billion of the £1.8 billion additional provision taken in the fourth quarter.

A revision of our forecasts for uphold rates and response rates to proactive mailings together account for approximately £0.4 billion of the increased provision, and reflect forecast rates above our recent experience. The Group has also increased its estimates for remediation costs, which principally relate to the re-review of previously defended complaints, and this accounts for approximately £0.3 billion of the increased provision.

Since the commencement of the PPI redress programme in 2011 we estimate we have contacted, settled or provided for approximately 40 per cent of the policies sold since 2000, covering both customer-initiated complaints and actual and expected proactive mailings undertaken by the Group. The proactive mailings arise from a detailed Past Business Review, carried out by the Group as agreed with the Financial Conduct Authority (FCA), as a result of which the Group is contacting customers identified as having the highest likelihood of required redress. These mailings are expected to be substantially complete by the end of the first half of 2014. In terms of customer-initiated complaints, the fourth quarter monthly average run-rate of approximately 37,000 complaints is around 70 per cent below its peak and complaints have declined in each of the last six quarters.

The total amount provided for PPI represents our best estimate of the likely future costs, albeit a number of risks and uncertainties remain, in particular complaint volumes, uphold rates, average redress costs, the scope and cost of proactive mailings and remediation, and the outcome of the FCA Enforcement Team investigation. The cost of these factors could differ materially from our estimates, with the risk that a further provision could be required.

Other provisions

A further provision of £130 million was made in the fourth quarter relating to the sale of interest rate hedging products to certain small and medium-sized businesses. This brings the amount provided to £530 million, of which £218 million relates to administration costs. As at 31 December 2013, £368 million of the total provision remained unutilised.

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and governmental authorities in relation to a range of matters; a provision is held against the costs expected to be incurred. In 2013 these provisions were increased by a further £200 million, in respect of matters affecting the Retail, Commercial and Wealth and Asset Finance businesses, bringing the total amount to £300 million, of which £75 million had been utilised at 31 December 2013. This includes a fine of £28 million from the FCA following an investigation into its historic systems and controls governing legacy incentive schemes for branch advisors.

Other provisions also included an additional £75 million recognised in the first half of 2013 for claims relating to policies issued by Clerical Medical Insurance Group Limited in Germany, bringing the total provision to £400 million, of which £246 million remains unutilised at 31 December 2013.

Other items

The Group recognised a charge for other statutory items of £499 million in the period, compared to a charge of £232 million in 2012. This comprises a charge for the amortisation of intangible assets of £395 million, and a charge of £104 million as a result of changes to early retirement and commutation factors in two of the Group's principal defined benefit schemes (2012: £250 million gain related to a change in policy in respect of discretionary pension increases).

Taxation

The tax charge for 2013 was £1,217 million. This reflected a higher effective tax rate than the UK statutory rate primarily due to an additional tax charge arising from the impact on the net deferred tax asset of the reductions in UK corporation tax rate to 21 per cent from 1 April 2014 and 20 per cent from 1 April 2015; the write-down of a deferred tax asset in respect of Australian trading losses following the sale of our Australian operations; and policyholder taxes. We expect the effective tax rate in future periods will be in the range of 20-25 per cent, subject to policyholder tax and any possible effect from disposals such as Verde.

SUMMARY OF GROUP RESULTS

Balance sheet

	At 31 Dec 2013	At 31 Dec 2012[1]	Change %
Risk-weighted assets and capital ratios			
Core risk-weighted assets	**£224.9bn**	£237.4bn	(5)
Non-core risk-weighted assets	**£39.0bn**	£72.9bn	(47)
Total risk-weighted assets	**£263.9bn**	£310.3bn	(15)
Core tier 1 capital ratio	**14.0%**	12.0%	2.0pp
Tier 1 capital ratio	**14.5%**	13.8%	0.7pp
Total capital ratio	**20.8%**	17.3%	3.5pp
Pro forma fully loaded risk-weighted assets[2]	**£271.9bn**	£321.1bn	(15)
Pro forma fully loaded common equity tier 1 ratio[2]	**10.3%**	8.1%	2.2pp
Pro forma fully loaded CRD IV leverage ratio[2,3]	**4.1%**	3.8%	0.3pp
Pro forma fully loaded Basel III leverage ratio (2014 rules)[2,3,4]	**4.5%**		
Fully loaded risk-weighted assets	**£271.1bn**	£321.1bn	(16)
Fully loaded common equity tier 1 ratio	**10.0%**	8.1%	1.9pp
Fully loaded CRD IV leverage ratio[3]	**4.0%**	3.8%	0.2pp
Fully loaded Basel III leverage ratio (2014 rules)[3,4]	**4.4%**		

[1] Comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

[2] Pro forma ratios include the benefit of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.

[3] Includes the full value of tier 1 instruments reported under the prevailing rules as at 31 December 2013.

[4] Estimated in accordance with January 2014 revised Basel III leverage ratio framework.

We have significantly strengthened the Group's capital ratios in the year. The Group's pro forma fully loaded common equity tier 1 (CET1) ratio has increased to 10.3 per cent from 8.1 per cent at 31 December 2012. The improvement was driven by capital generation in the core business, the decrease in risk-weighted assets from non-core asset reductions, improving economic conditions and a number of management actions. These management actions included the disposal of St. James's Place, the announced disposals of Scottish Widows Investment Partnership and Heidelberger Leben, the sale of a US residential mortgage-backed security (RMBS) portfolio and a number of overseas businesses as well as dividends of £2.2 billion from the Insurance business to the Group. This improvement in the capital ratio was partially offset by charges for legacy items, losses on disposal of non-core assets, and other statutory items including the effects of changes to pension accounting and the costs of Simplification and Verde.

The Group's total capital ratio under prevailing rules improved to 20.8 per cent, with £25.4 billion of tier 1 and tier 2 securities contributing to the £54.8 billion capital base.

The Group's pro forma fully loaded CRD IV leverage ratio, including tier 1 capital, increased to 4.1 per cent from 3.8 per cent at the end of 2012 and to 3.4 per cent from 3.1 per cent excluding tier 1 capital. In January 2014 the Basel Committee published a revised Basel III definition of leverage ratio, and we anticipate that CRD IV will be amended in due course to align with this definition. As at 31 December 2013 the Group's pro forma Basel III leverage ratio was 4.5 per cent including tier 1 capital, and 3.8 per cent excluding tier 1 capital.

Given its improved capital strength the Group will no longer seek to fund the payment of coupons on certain hybrid capital securities through the issuance of equity.

In addition, the PRA has now confirmed that it will consider the Group's application to make dividend payments in line with its normal procedures for other banks. In arriving at this assessment, the PRA considered the Group's financial plans including any actions contained therein. The PRA's assessment was made in the context of previous announcements as to UK regulatory capital targets and expectations, including the PRA's news release on capital standards issued on 29 November 2013. Subject to a return to sustainable profitability and there being no major unexpected changes in the Group's business outlook or regulatory requirements, the Board expects that it will apply to the PRA in the second half of 2014 to restart dividend payments.

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	At 31 Dec 2013	At 31 Dec 2012[1]	Change %
Funding and liquidity			
Core loans and advances to customers[2]	**£436.9bn**	£425.3bn	3
Funded assets	**£510.2bn**	£538.7bn	(5)
Non-core assets	**£63.5bn**	£98.4bn	(35)
Non-retail non-core assets	**£24.7bn**	£48.5bn	(49)
Customer deposits[3]	**£438.3bn**	£422.5bn	4
Wholesale funding	**£137.6bn**	£169.6bn	(19)
Wholesale funding <1 year maturity	**£44.2bn**	£50.6bn	(13)
Of which money-market funding <1 year maturity[4]	**£21.3bn**	£25.0bn	(15)
Loan to deposit ratio	**113%**	121%	(8)pp
Core loan to deposit ratio	**100%**	101%	(1)pp
Primary liquid assets	**£89.3bn**	£87.6bn	2

[1] Restated to reflect the implementation of IAS 19R and IFRS 10.

[2] Excludes reverse repos of £0.1 billion (31 December 2012: £5.1 billion).

[3] Excludes repos of £3.0 billion (31 December 2012: £4.4 billion) (all core).

[4] Excludes balances relating to margins of £2.2 billion (31 December 2012: £4.5 billion) and settlement accounts of £1.3 billion (31 December 2012: £1.5 billion).

During 2013, lending to core customers increased by £11.6 billion to £436.9 billion with all banking divisions returning to growth. Customer deposits grew by £15.8 billion to £438.3 billion, with the core loan to deposit ratio improving to 100 per cent. The Group loan to deposit ratio also improved, falling to 113 per cent, reflecting the reduction in the non-core asset portfolio and associated wholesale funding.

Non-core assets were £63.5 billion at December 2013, 35 per cent lower than at the end of 2012. Non-core asset reductions included £6.6 billion in Australia as well as £6.7 billion in UK commercial real estate and £2.7 billion in the shipping portfolio. The higher risk non-retail element of the portfolio reduced by £23.8 billion, or 49 per cent, in the year to £24.7 billion, and is expected to reduce to around £15 billion by the end of 2014. The average risk weighting of the non-core portfolio reduced from 74 per cent to 61 per cent. Non-core asset reductions continue to be capital accretive overall, releasing approximately £2.6 billion of capital in the year.

The non-core portfolio now poses substantially less risk to the Group. As a result, approximately £31 billion of retail non-core assets including our UK and Dutch mortgage portfolios and the majority of the UK Asset Finance business will be reabsorbed into the core business, with the remaining non-core assets managed in a separate run-off unit. We will no longer report on a core/non-core basis in 2014, but will continue to report separately on those assets that remain in run-off.

The Group's wholesale funding requirement has reduced given the reduction in non-core assets and continued growth in customer deposits in the year. Together these have enabled us to reduce wholesale funding by £32 billion and, as reported at the half year, repay the full amount of the Long Term Refinancing Operation funding from the European Central Bank of €13.5 billion ahead of schedule. The Group has so far committed over £37 billion of gross new lending to British customers under the Funding for Lending Scheme (FLS) with drawings under the scheme amounting to £8 billion as at the end of 2013. The Group will continue to have a modest wholesale funding requirement and we anticipate that in 2014 this will be in the range of £5-10 billion of public issuance, while the Group's aggregate usage of wholesale funding is expected to further reduce in 2014.

The Group's liquidity position remains strong, with primary liquid assets of £89.3 billion at 31 December 2013 (31 December 2012: £87.6 billion). Primary liquid assets represent approximately 4.2 times our money-market funding with a maturity of less than one year, and are approximately 2.0 times our short-term wholesale funding, providing a substantial buffer in the event of market dislocation. In addition to primary liquid assets, the Group has significant secondary liquidity holdings of £105.4 billion (31 December 2012: £117.1 billion). Total liquid assets represent approximately 4.4 times our wholesale funding with a maturity of less than one year.

The Liquidity Coverage Ratio (LCR) is expected to become the Pillar 1 standard for liquidity in the UK in 2015, and the PRA has the ability to impose firm-specific liquidity requirements. The European Commission is to adopt further legislation by 30 June 2014 to specify the definition, calibration, calculation, and phase-in of the LCR for implementation in 2015. The Group expects to meet the new requirements ahead of the implementation dates.

The significant reduction of non-core assets and the balance sheet strengthening undertaken in the year supports the Group in becoming a lower risk bank with a stronger and more sustainable earnings outlook.

Conclusion

The Group has delivered improvements in underlying profits and core returns with growth in core lending, underlying income and net interest margin, and further reductions in costs and impairments. The continued progress in reducing balance sheet risk and the strengthening of the Group's capital ratios leaves us well positioned to continue growing our core business as we support the UK economic recovery.

George Culmer
Chief Financial Officer

SUMMARY OF GROUP RESULTS

Underlying basis segmental analysis

2013	Retail £m	Commercial Banking £m	Wealth, Asset Finance and International £m	Insurance £m	Group operations and Central items £m	Group £m
Net interest income	7,536	2,426	870	(103)	156	10,885
Other income	1,410	2,708	1,809	2,236	113	8,276
Insurance claims	–	–	–	(356)	–	(356)
Total underlying income	8,946	5,134	2,679	1,777	269	18,805
Total costs	(4,096)	(2,392)	(1,991)	(687)	(469)	(9,635)
Impairment	(1,101)	(1,167)	(730)	–	(6)	(3,004)
Underlying profit (loss)	3,749	1,575	(42)	1,090	(206)	6,166
Banking net interest margin	2.23%	1.95%	2.20%			2.12%
Asset quality ratio	0.32%	0.83%	1.79%			0.57%
Return on risk-weighted assets	4.11%	1.04%	(0.13)%			2.14%
Key balance sheet items at 31 December 2013	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers[1]	341.9	126.4	24.2		2.7	495.2
Customer deposits[2]	269.0	123.5	45.8		–	438.3
Total customer balances	610.9	249.9	70.0		2.7	933.5
Risk-weighted assets	85.7	138.5	25.9		13.8	263.9
2012	£m	£m	£m	£m	£m	£m
Net interest income	7,195	2,206	799	(78)	213	10,335
Other income	1,462	2,932	2,043	2,294	(315)	8,416
Insurance claims	–	–	–	(365)	–	(365)
Total underlying income	8,657	5,138	2,842	1,851	(102)	18,386
Total costs	(4,199)	(2,516)	(2,291)	(744)	(374)	(10,124)
Impairment	(1,270)	(2,946)	(1,480)	–	(1)	(5,697)
Underlying profit (loss)	3,188	(324)	(929)	1,107	(477)	2,565
Banking net interest margin	2.08%	1.58%	1.65%			1.93%
Asset quality ratio	0.36%	1.85%	3.12%			1.02%
Return on risk-weighted assets	3.21%	(0.18)%	(2.31)%			0.77%
Key balance sheet items at 31 December 2012	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers[1]	343.3	134.7	33.4		0.7	512.1
Customer deposits[2]	260.8	109.7	51.9		0.1	422.5
Total customer balances	604.1	244.4	85.3		0.8	934.6
Risk-weighted assets	95.5	165.2	36.2		13.4	310.3

[1] Excludes reverse repos.

[2] Excludes repos.

Underlying basis

In order to present a more meaningful view of business performance, the results of the Group and divisions are presented on an underlying basis. The key principles adopted in the preparation of the underlying basis of reporting are described below.

In order to reflect the impact of the acquisition of HBOS, the amortisation of purchased intangible assets and the unwind of acquisition-related fair value adjustments have been excluded.

The following items, not related to acquisition accounting, have also been excluded from underlying profit: the effects of certain asset sales, liability management and volatile items; volatility arising in insurance businesses; Simplification costs; Verde costs; payment protection insurance provision; insurance gross up; certain past service pensions items in respect of the Group's defined benefit pension schemes; and other regulatory provisions.

The financial statements have been restated following the implementation of IAS 19R Employee Benefits and IFRS 10 Consolidated Financial Statements with effect from 1 January 2013.

To enable a better understanding of the Group's core business trends and outlook, certain income statement, balance sheet and regulatory capital information is analysed between core and non-core portfolios. The non-core portfolios consist of businesses which deliver below-hurdle returns, which are outside the Group's risk appetite or may be distressed, are subscale or have an unclear value proposition, or have a poor fit with the Group's customer strategy. The EC mandated retail business disposal (Project Verde) is included in core portfolios.

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Underlying basis consolidated income statement – core and non-core

Core	2013 £ million	2012[1] £ million	Change %
Net interest income	**10,638**	9,868	8
Other income	**7,606**	7,417	3
Total underlying income	**18,244**	17,285	6
Total costs	**(9,149)**	(9,254)	1
Impairment	**(1,521)**	(1,919)	21
Underlying profit	**7,574**	6,112	24
Banking net interest margin	**2.49%**	2.32%	17bp
Asset quality ratio	**0.35%**	0.44%	(9)bp
Return on risk-weighted assets	**3.26%**	2.54%	72bp
Non-core			
Net interest income	**247**	467	(47)
Other income	**314**	634	(50)
Total underlying income	**561**	1,101	(49)
Total costs	**(486)**	(870)	44
Impairment	**(1,483)**	(3,778)	61
Underlying loss	**(1,408)**	(3,547)	60
Banking net interest margin	**0.41%**	0.55%	(14)bp
Asset quality ratio	**1.61%**	3.08%	(147)bp

Balance sheet and key ratios – core and non-core

Core	At 31 Dec 2013	At 31 Dec 2012	Change %
Loans and advances to customers[2]	**£436.9bn**	£425.3bn	3
Customer deposits[3]	**£435.6bn**	£419.1bn	4
Core loan to deposit ratio[4]	**100%**	101%	(1)pp
Risk-weighted assets	**£224.9bn**	£237.4bn	(5)
Non-core			
Retail non-core assets	**£38.8bn**	£49.9bn	(22)
Non-retail non-core assets	**£24.7bn**	£48.5bn	(49)
Total non-core assets	**£63.5bn**	£98.4bn	(35)
Risk-weighted assets	**£39.0bn**	£72.9bn	(47)

[1] Restated to reflect the implementation of IAS 19R and IFRS 10.

[2] Excludes reverse repos of £0.1 billion (31 December 2012: £5.1 billion).

[3] Excludes repos of £3.0 billion (31 December 2012: £4.4 billion).

[4] Loans and advances to customers excluding reverse repos divided by customer deposits excluding repos.

SUMMARY OF GROUP RESULTS

Underlying basis – core business

2013	Retail £m	Commercial Banking £m	Wealth, Asset Finance and International £m	Insurance £m	Group operations and central items £m	Group £m
Net interest income	7,525	2,444	574	(107)	202	10,638
Other income	1,400	2,480	1,748	2,221	113	7,962
Insurance claims	–	–	–	(356)	–	(356)
Total underlying income	8,925	4,924	2,322	1,758	315	18,244
Total costs	(4,092)	(2,307)	(1,658)	(670)	(422)	(9,149)
Impairment	(1,059)	(424)	(32)	–	(6)	(1,521)
Underlying profit (loss)	3,774	2,193	632	1,088	(113)	7,574
Banking net interest margin	2.40%	2.53%	8.91%			2.49%
Asset quality ratio	0.33%	0.39%	0.50%			0.35%
Return on risk-weighted assets	4.55%	1.74%	6.67%			3.26%
Key balance sheet items at 31 December 2013	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers[1]	318.2	109.5	6.5		2.7	436.9
Customer deposits[2]	269.0	121.0	45.6		–	435.6
Total customer balances	587.2	230.5	52.1		2.7	872.5
Risk-weighted assets	78.8	123.3	9.0		13.8	224.9

2012	£m	£m	£m	£m	£m	£m
Net interest income	7,163	2,242	312	(87)	238	9,868
Other income	1,446	2,442	1,964	2,245	(315)	7,782
Insurance claims	–	–	–	(365)	–	(365)
Total underlying income	8,609	4,684	2,276	1,793	(77)	17,285
Total costs	(4,193)	(2,232)	(1,795)	(710)	(324)	(9,254)
Impairment	(1,192)	(704)	(22)	–	(1)	(1,919)
Underlying profit (loss)	3,224	1,748	459	1,083	(402)	6,112
Banking net interest margin	2.25%	2.22%	5.90%			2.32%
Asset quality ratio	0.37%	0.67%	0.45%			0.44%
Return on risk-weighted assets	3.60%	1.36%	5.07%			2.54%
Key balance sheet items at 31 December 2012	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers[1]	317.3	102.0	5.3		0.7	425.3
Customer deposits[2]	260.8	107.2	51.0		0.1	419.1
Total customer balances	578.1	209.2	56.3		0.8	844.4
Risk-weighted assets	86.6	127.8	9.6		13.4	237.4

[1] Excludes reverse repos.

[2] Excludes repos.

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Underlying basis – non-core business

2013	Retail £m	Commercial Banking £m	Wealth, Asset Finance and International £m	Insurance £m	Group operations and central items £m	Group £m
Net interest income	11	(18)	296	4	(46)	247
Other income	10	228	61	15	–	314
Total underlying income	21	210	357	19	(46)	561
Total costs	(4)	(85)	(333)	(17)	(47)	(486)
Impairment	(42)	(743)	(698)	–	–	(1,483)
Underlying (loss) profit	(25)	(618)	(674)	2	(93)	(1,408)
Banking net interest margin	0.07%	0.14%	0.92%			0.41%
Asset quality ratio	0.17%	2.32%	2.03%			1.61%
Key balance sheet items at 31 December 2013	£bn	£bn	£bn	£bn	£bn	£bn
Total non-core assets	23.7	21.3	18.2	0.3	–	63.5
Risk-weighted assets	6.9	15.2	16.9			39.0

2012	£m	£m	£m	£m	£m	£m
Net interest income	32	(36)	487	9	(25)	467
Other income	16	490	79	49	–	634
Total underlying income	48	454	566	58	(25)	1,101
Total costs	(6)	(284)	(496)	(34)	(50)	(870)
Impairment	(78)	(2,242)	(1,458)	–	–	(3,778)
Underlying (loss) profit	(36)	(2,072)	(1,388)	24	(75)	(3,547)
Banking net interest margin	0.12%	0.35%	1.13%			0.55%
Asset quality ratio	0.29%	4.28%	3.42%			3.08%
Key balance sheet items at 31 December 2012	£bn	£bn	£bn	£bn	£bn	£bn
Total non-core assets	26.0	43.0	28.9	0.5	–	98.4
Risk-weighted assets	8.9	37.4	26.6			72.9

DIVISIONAL RESULTS

Retail

2013 financial highlights

- Underlying profit increased 18 per cent to £3,749 million, driven by improved margins, reduced costs and favourable impairments.
- Return on risk-weighted assets increased to 4.11 per cent from 3.21 per cent in 2012, driven primarily by favourable income and continuing effective credit risk management.
- Net interest income increased 5 per cent. Margin performance was strong, increasing 15 basis points to 2.23 per cent in 2013 from 2.08 per cent in 2012, driven by improved deposit mix and a favourable funding environment, more than offsetting reduced lending rates.
- Other income down 4 per cent, with lower income from bancassurance and protection following the Retail Distribution Review in 2012, partially offset by the benefit of a revised commission arrangement in relation to the home insurance book.
- Total costs down 2 per cent to £4,096 million, primarily as a result of the Simplification programme and ongoing cost management activity.
- Impairment reduced 13 per cent to £1,101 million, with the unsecured book remaining stable and secured charges decreasing largely due to lower impaired loan balances.
- Loans and advances to customers were broadly in line with 2012 at £341.9 billion. Gross new mortgage lending increased £10.7 billion to £36.9 billion, contributing to core lending balances returning to growth in the third quarter, increasing further in the fourth quarter.
- Customer deposits increased 3 per cent to £269.0 billion. Relationship balances (including Lloyds, Halifax, Bank of Scotland and TSB branded Personal Current Accounts and Savings Accounts) increased 6 per cent in 2013, ahead of market growth, driven by the effect of our strong product offerings, particularly in the Lloyds Bank brand.
- Risk-weighted assets decreased by £9.8 billion to £85.7 billion driven by improving house prices and an improvement in the credit quality of retail assets.

Performance summary

	2013 £m	2012[1] £m	Change %
Net interest income	**7,536**	7,195	5
Other income	**1,410**	1,462	(4)
Total underlying income	**8,946**	8,657	3
Total costs	**(4,096)**	(4,199)	2
Impairment	**(1,101)**	(1,270)	13
Underlying profit	**3,749**	3,188	18
Banking net interest margin	**2.23%**	2.08%	15bp
Asset quality ratio	**0.32%**	0.36%	(4)bp
Return on risk-weighted assets	**4.11%**	3.21%	90bp

	At 31 Dec 2013 £bn	At 31 Dec 2012 £bn	Change %
Key balance sheet items			
Loans and advances to customers[2]	**341.9**	343.3	–
Customer deposits[3]	**269.0**	260.8	3
Total customer balances	**610.9**	604.1	1
Risk-weighted assets	**85.7**	95.5	(10)

[1] Restated.

[2] Excludes reverse repos.

[3] Excludes repos.

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	Core			Non-core		
	2013 £m	2012[1] £m	Change %	**2013 £m**	2012 £m	Change %
Net interest income	**7,525**	7,163	5	**11**	32	(66)
Other income	**1,400**	1,446	(3)	**10**	16	(38)
Total underlying income	**8,925**	8,609	4	**21**	48	(56)
Total costs	**(4,092)**	(4,193)	2	**(4)**	(6)	33
Impairment	**(1,059)**	(1,192)	11	**(42)**	(78)	46
Underlying profit (loss)	**3,774**	3,224	17	**(25)**	(36)	31
Banking net interest margin	**2.40%**	2.25%	15bp	**0.07%**	0.12%	(5)bp
Asset quality ratio	**0.33%**	0.37%	(4)bp	**0.17%**	0.29%	(12)bp
Return on risk-weighted assets	**4.55%**	3.60%	95bp			

	Core			Non-core		
	At 31 Dec 2013 £bn	At 31 Dec 2012 £bn	Change %	**At 31 Dec 2013 £bn**	At 31 Dec 2012 £bn	Change %
Key balance sheet items						
Loans and advances to customers[2]	**318.2**	317.3	–	**23.7**	26.0	(9)
Customer deposits[3]	**269.0**	260.8	3	**–**	–	–
Total customer balances	**587.2**	578.1	2	**23.7**	26.0	(9)
Total non-core assets				**23.7**	26.0	(9)
Risk-weighted assets	**78.8**	86.6	(9)	**6.9**	8.9	(22)

[1] Restated.
[2] Excludes reverse repos.
[3] Excludes repos.

DIVISIONAL RESULTS

Commercial Banking

2013 financial highlights

- Returned to profitability with underlying profit of £1,575 million driven by the significant reduction in impairments as a result of lower charges across the core and non-core portfolios, increased core income partially offset by lower non-core income from our capital accretive asset reduction strategy.
- Core underlying income grew by 5 per cent to £4,924 million driven by SME, Mid Markets and Financial Institutions underpinned by strong performances in Transaction Banking and LDC and a resilient performance in Financial Markets and Capital Markets products. Income continues to be well balanced across the four client segments.
- Core underlying profit increased by 25 per cent to £2,193 million due to increased income and lower impairment charges. Core return on risk-weighted assets increased by 38 basis points to 1.74 per cent.
- Core net interest margin increased 31 basis points through disciplined pricing of new business, in addition to reduced funding costs driven by increased high quality deposits which contributed to a reduction in the Group's requirement for wholesale funding.
- Core asset quality ratio improved 28 basis points reflecting better quality origination with the low interest rate environment helping to maintain defaults at a lower level. Non-core asset quality ratio decreased 196 basis points reflecting disciplined management and deleveraging of the portfolio.
- Core lending increased by 7 per cent driven by a 6 per cent increase in SME, and a strong performance in Mid Markets and Global Corporates resulting in an 8 per cent increase in Other Commercial Banking. This has been achieved whilst reducing risk-weighted assets resulting in improved capital efficiency.
- Core customer deposits increased by 13 per cent, with increases in all client segments and growth in high quality deposits reflecting the strength of the customer franchise.
- Core risk-weighted assets decreased 4 per cent as a result of selective participation, specifically in Global Corporates, in addition to active portfolio management across all client segments to reduce risk-weighted assets in the lending and Financial Markets businesses.
- Non-core loans and advances to customers decreased by £15.8 billion, as a result of the Group's capital accretive asset reduction strategy.

Performance summary

	2013 £m	2012[1] £m	Change %
Net interest income	**2,426**	2,206	10
Other income	**2,708**	2,932	(8)
Total underlying income	**5,134**	5,138	–
Total costs	**(2,392)**	(2,516)	5
Impairment	**(1,167)**	(2,946)	60
Underlying profit (loss)	**1,575**	(324)	
Banking net interest margin	**1.95%**	1.58%	37bp
Asset quality ratio	**0.83%**	1.85%	(102)bp
Return on risk-weighted assets	**1.04%**	(0.18%)	122bp

	At 31 Dec 2013 £bn	At 31 Dec 2012 £bn	Change %
Key balance sheet items			
Loans and advances to customers[2]	**126.4**	134.7	(6)
Debt securities and available-for-sale financial assets	**4.1**	9.5	(57)
	130.5	144.2	(10)
Customer deposits[3]	**123.5**	109.7	13
Risk-weighted assets	**138.5**	165.2	(16)

[1] Restated.

[2] Excludes reverse repos.

[3] Excludes repos.

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	Core			Non-core		
	2013 £m	2012[1] £m	Change %	**2013 £m**	2012 £m	Change %
Net interest income	**2,444**	2,242	9	**(18)**	(36)	50
Other income	**2,480**	2,442	2	**228**	490	(53)
Total underlying income	**4,924**	4,684	5	**210**	454	(54)
Total costs	**(2,307)**	(2,232)	(3)	**(85)**	(284)	70
Impairment	**(424)**	(704)	40	**(743)**	(2,242)	67
Underlying profit (loss)	**2,193**	1,748	25	**(618)**	(2,072)	70
Banking net interest margin	**2.53%**	2.22%	31bp	**0.14%**	0.35%	(21)bp
Asset quality ratio	**0.39%**	0.67%	(28)bp	**2.32%**	4.28%	(196)bp
Return on risk-weighted assets	**1.74%**	1.36%	38bp			

	Core			Non-core		
	At 31 Dec 2013 £bn	At 31 Dec 2012 £bn	Change %	**At 31 Dec 2013 £bn**	At 31 Dec 2012 £bn	Change %
Key balance sheet items						
SME[2]	**28.2**	26.6	6			
Other[3]	**81.3**	75.4	8			
Loans and advances to customers[4]	**109.5**	102.0	7	**16.9**	32.7	(48)
Customer deposits[5]	**121.0**	107.2	13	**2.5**	2.5	–
Total customer balances	**230.5**	209.2	10	**19.4**	35.2	(45)
Total non-core assets				**21.3**	43.0	(50)
Risk-weighted assets	**123.3**	127.8	(4)	**15.2**	37.4	(59)

[1] Restated.

[2] SME comprises clients with turnover of up to £25 million in line with lending data supplied by the Bank of England.

[3] Includes Mid Markets, Global Corporates, Financial Institutions and Other.

[4] Excludes reverse repos.

[5] Excludes repos.

DIVISIONAL RESULTS

Wealth, Asset Finance and International

2013 financial highlights

- Losses reduced by 95 per cent to £42 million driven by lower impairments in non-core, mainly in Ireland, and strong profitable growth in the core business.
- Core underlying profits increased by 38 per cent to £632 million (86 per cent excluding St. James's Place) driven by strong income growth in Wealth and Asset Finance, and cost savings.
- Core return on risk-weighted assets increased from 5.07 per cent to 6.67 per cent, largely as a result of repricing of liabilities.
- Net interest income in the core business increased by 84 per cent driven by strong and improving margins in Wealth and in the Online Deposits businesses within Asset Finance, and by growth in Black Horse motor finance volumes.
- Core margin improved by 301 basis points from 5.90 per cent to 8.91 per cent driven by deposit pricing.
- Core other income (excluding St. James's Place and other disposals from the International portfolio) was broadly flat with growth in Asset Finance and new Wealth revenue streams offset by a reduction in trail income following implementation of the Retail Distribution Review.
- Total cost reductions of 13 per cent (8 per cent excluding St. James's Place). Savings from the run-down of non-core businesses, from simplification of the organisational structure in both Wealth and Asset Finance, and optimisation of our direct channel customer service in Wealth, enabled investment in building our customer propositions in UK Wealth and Asset Finance.
- Impairment charges reduced by £750 million to £730 million, including a reduction of £637 million in the Irish portfolio.
- Core loans and advances to customers increased by 23 per cent driven mainly by Asset Finance as a result of continued growth in UK motor finance business.
- Non-core assets reduced by 37 per cent following the sale of our Australian Asset Finance and Spanish retail businesses, and other reductions in our non-core portfolio mainly within Ireland.
- Customer deposits reduced by 12 per cent, driven by reductions in our international footprint within Wealth, and attrition in customer balances within Online Deposits, mainly driven by deposit repricing.
- Risk-weighted assets reduced by 28 per cent driven by sales and repayments of non-core assets within Asset Finance and Ireland.
- Funds under management (excluding St. James's Place and other disposals from the International portfolio) have grown by 2 per cent largely as a result of stronger equity markets.

Performance summary

				Excluding St. James's Place		
	2013 £m	2012[1] £m	Change %	**2013 £m**	2012[1] £m	Change %
Net interest income	**870**	799	9	**869**	795	9
Other income	**1,809**	2,043	(11)	**1,688**	1,718	(2)
Total underlying income	**2,679**	2,842	(6)	**2,557**	2,513	2
Total costs	**(1,991)**	(2,291)	13	**(1,947)**	(2,123)	8
Impairment	**(730)**	(1,480)	51	**(730)**	(1,480)	51
Underlying loss	**(42)**	(929)	95	**(120)**	(1,090)	89
Underlying profit (loss) by business:						
Wealth	**338**	302	12	**260**	141	84
Asset Finance	**505**	322	57	**505**	322	57
International	**(885)**	(1,553)	43	**(885)**	(1,553)	43
	(42)	(929)	95	**(120)**	(1,090)	89
Banking net interest margin	**2.20%**	1.65%	55bp	**2.20%**	1.65%	55bp
Asset quality ratio	**1.79%**	3.12%	(133)bp	**1.79%**	3.12%	(133)bp
Return on risk-weighted assets	**(0.13)%**	(2.31)%	218bp	**(0.38)%**	(2.71)%	(233)bp

[1] Restated.

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	At 31 Dec 2013 £bn	At 31 Dec 2012 £bn	Change %
Key balance sheet items			
Loans and advances to customers[2]	**24.2**	33.4	(28)
Customer deposits[2]	**45.8**	51.9	(12)
Operating lease assets	**2.8**	2.8	
Total customer balances	**72.8**	88.1	(17)
Risk-weighted assets	**25.9**	36.2	(28)

	Core			Non-core		
	2013 £m	2012[1] £m	Change %	2013 £m	2012 £m	Change %
Net interest income	**574**	312	84	**296**	487	(39)
Other income	**1,748**	1,964	(11)	**61**	79	(23)
Total underlying income	**2,322**	2,276	2	**357**	566	(37)
Total costs	**(1,658)**	(1,795)	8	**(333)**	(496)	33
Impairment	**(32)**	(22)	(45)	**(698)**	(1,458)	52
Underlying profit (loss)	**632**	459	38	**(674)**	(1,388)	(51)
Underlying profit excluding *St. James's Place*[3]	**554**	298	86			
Banking net interest margin	**8.91%**	5.90%	301bp	**0.92%**	1.13%	(21)bp
Asset quality ratio	**0.50%**	0.45%	5bp	**2.03%**	3.42%	(139)bp
Return on risk-weighted assets	**6.67%**	5.07%	160bp			

	Core			Non-core		
	At 31 Dec 2013 £bn	At 31 Dec 2012 £bn	Change %	At 31 Dec 2013 £bn	At 31 Dec 2012 £bn	Change %
Key balance sheet items						
Loans and advances to customers[2]	**6.5**	5.3	23	**17.7**	28.1	(37)
Customer deposits[2]	**45.6**	51.0	(11)	**0.2**	0.9	(78)
Operating lease assets	**2.8**	2.7	4	**–**	0.1	
Total customer balances	**54.9**	59.0	(7)	**17.9**	29.1	(38)
Total non-core assets				**18.2**	28.9	(37)
Risk-weighted assets	**9.0**	9.6	(6)	**16.9**	26.6	(36)
Funds under management	**151.8**	188.6	(20)	**–**	0.5	

[1] Restated.

[2] Excludes reverse repos on loans and advances and excluding repos on deposits.

[3] The gain relating to the sales of shares in St. James's Place is included in Central Items.

DIVISIONAL RESULTS

Insurance

2013 financial highlights

- Underlying profit down 2 per cent to £1,090 million, due to changes in intra group commission arrangements and the continued run-off legacy creditor books within General Insurance, net of lower costs and increased profit in UK Life and Pensions existing business reflecting the net benefit from a number of assumption changes. Return on equity up from 12 per cent to 13 per cent.
- Generated £692 million of operating cash net of £285 million of cash invested in writing new business.
- Costs improved by 8 per cent, reflecting the benefits of simplifying our business model and processes.
- IFRS new business margin reduced to 2.6 per cent due to changes in the basis of taxation of life protection business.
- Total UK LP&I sales down 1 per cent to £9,934 million primarily due to the Group's decision to stop providing investment advice to retail customers with savings below £100,000. Corporate pensions grew by 21 per cent, reflecting the strength of our proposition and the conversion of pipeline generated in the run up to implementation of the Retail Distribution Review.
- General Insurance Gross Written Premiums down by 8 per cent to £1,307 million reflecting the effect of the closed creditor book and as a result of our focus on value rather than volume on the home insurance portfolio.
- The strong underlying profitability and capitalisation of the Insurance business has enabled us to remit £2.2 billion of dividends to the Group during 2013 whilst maintaining a strong capital base.
- The estimated capital surplus for Pillar 1 is £2.9 billion (Scottish Widows plc, £3.9 billion in 2012) and for IGD is £2.7 billion (Insurance Group, £3.7 billion in 2012) with the decrease reflecting dividends paid during the year.

Performance summary

	2013 £m	2012[1] £m	Change %
Net interest income	**(103)**	(78)	(32)
Other income	**2,236**	2,294	(3)
Insurance claims	**(356)**	(365)	2
Total underlying income	**1,777**	1,851	(4)
Total costs	**(687)**	(744)	8
Underlying profit	**1,090**	1,107	(2)
Operating cash generation	**692**	849	(18)
UK life IFRS new business margin	**2.6%**	3.2%	(60)bp
UK life, pensions and investment sales (PVNBP)	**9,934**	10,005	(1)
General insurance total GWP	**1,307**	1,419	(8)
General insurance combined ratio	**77%**	72%	5pp
Return on equity[2]	**13%**	12%	1pp

[1] Restated.

[2] 'Return on equity' is the underlying profit less tax at the prevailing UK Corporation tax rate divided by the average amount of the Group's equity attributable to the Insurance business.

Profit by product group

	2013					2012
	Pensions & investments £m	Protection & annuities £m	General insurance £m	Other[3] £m	Total £m	Total £m
New business income	**276**	**139**	**–**	**16**	**431**	519
Existing business income	**599**	**132**	**–**	**92**	**823**	791
Assumption changes and experience variances	**(158)**	**302**	**–**	**(78)**	**66**	(31)
General Insurance income net of claims	**–**	**–**	**457**	**–**	**457**	572
Total underlying income	**717**	**573**	**457**	**30**	**1,777**	1,851
Total costs	**(360)**	**(128)**	**(160)**	**(39)**	**(687)**	(744)
Underlying profit (loss) 2013	**357**	**445**	**297**	**(9)**	**1,090**	1,107
Underlying profit 2012[4]	**404**	**289**	**409**	**5**	**1,107**	

[3] 'Other' includes the results of the European business in addition to income from return on free assets, interest expense and certain provisions.

[4] Full 2012 comparator tables for the profit and cash disclosures can be found on the Lloyds Banking Group investor site.

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New business income reduced by £88 million to £431 million driven by reduced protection and annuities new business income following changes to the basis of taxation on the life protection business in January 2013. Pensions and investments new business income increased slightly with a strong performance in corporate pensions being largely offset by reduced investments volumes following the Group's decision to stop providing investment advice to retail customers with savings below £100,000.

Existing business income increased by £32 million largely due to increased income from protection and annuities which benefited from the increased returns on higher yielding assets. Pensions and investments existing business income increased slightly with increased income in pensions being largely offset by reduced income on the declining savings and investments portfolio.

Underlying profit in the protection and annuities business included a benefit of £302 million largely as a result of changes to long-term mortality and investment return assumptions which included the benefits of investing in higher yielding assets to match long duration liabilities. This was partly offset by a charge of £158 million in the pensions and investments business driven primarily by a revision of pensions lapse assumptions and allowance for the impact of the Office of Fair Trading review on fairness of legacy pension charges.

General Insurance income reduced by £115 million to £457 million primarily due to a £77 million impact of a revised commission arrangement with Retail on the home insurance portfolio in addition to the continued run off of legacy books.

Operating cash generation

In line with emerging industry practice we have introduced an operating cash generation reporting metric. Operating cash is used to fund new business generating future cash, to pay dividends to Group, or is retained within the business to provide security for policyholders and achieve our strategic objectives. For the majority of products writing new business results in an outflow of cash for new business origination and set up costs (including commission). This cash outflow is recouped in subsequent years. However some products, where the policyholder's initial investment covers the cost of setting up the policy, do not require new business funding.

Operating cash generation is derived from underlying profit by removing the effect of movements in intangible (non-cash) items and assumption changes. Intangible items include the value of in-force life business, deferred acquisition costs and deferred income reserves.

	2013					2012
	Pensions & investments £m	Protection & annuities £m	General insurance £m	Other £m	Total £m	Total £m
Cash invested in new business	(261)	(3)	–	(21)	(285)	(264)
Cash generated from existing business	485	139	–	56	680	704
Cash generated from General Insurance	–	–	374	–	374	409
Change in intra group commission terms	–	–	(77)	–	(77)	–
Operating cash generation	224	136	297	35	692	849
Intangibles and other adjustments	133	309	–	(44)	398	258
Underlying profit (loss) before tax	357	445	297	(9)	1,090	1,107
Operating cash generation 2012	223	184	409	33		

The Insurance business generated £692 million of cash in 2013, £157 million lower than the prior year. The reduction was due to the change in intra group commission arrangements, the run-off of the legacy creditor book, and a slight increase in cash invested in new business, largely due to lower protection new business income.

The increase in intangibles is driven by the beneficial impact of assumption changes.

DIVISIONAL RESULTS

Group Operations and Central Items

Group operations

	2013 £m	2012[1] £m
Total underlying income	6	30
Direct costs:		
Information technology	(1,172)	(1,171)
Operations	(825)	(822)
Property	(876)	(892)
Support functions	(92)	(93)
	(2,965)	(2,978)
Result before recharges to divisions	(2,959)	(2,948)
Total net recharges to divisions	2,902	2,897
Underlying loss	(57)	(51)

[1] 2012 comparative figures have been amended to reflect the effect of the continuing consolidation of operations across the Group. To ensure a fair comparison of the 2013 performance, 2012 direct costs have been restated with an equivalent offsetting increase in recharges to divisions.

– Group Operations supports the Group by providing high quality services and delivering investment project capability through Information Technology (IT), Operations (including Customer Service and Global Payments) as well as Property and Sourcing. Achieving excellent service availability and high standards is a key part of our strategy to be the best bank for customers.

– Incremental cost savings of 6 per cent have been achieved through Simplification and tight cost control actions such as sourcing, the centralisation, automation and re-engineering of end-to-end processes, and consolidation and rationalisation of property and IT. These savings are offset by higher costs of supplying investment projects and the impact of regulatory costs and inflation.

– Information Technology savings were offset by increased costs from delivering Group Strategic Initiatives, such as Transaction Banking Transformation and Digital Transformation, which generate income and cost benefits in other Divisions.

– Operations costs increased slightly from 2012 to 2013 with enhancements to our customer services processes and regulatory and compliance activities, in areas such as Global Payments, offset by Simplification savings. This includes delivering Industry Accounts Switchers, Global Anti Money Laundering and Foreign Account Tax Compliance Act projects serving the rest of the Group.

– Group Property costs decreased by 2 per cent as we continued to consolidate the Group's property portfolio with savings offsetting the costs of rebranding the Branch network.

– We continue to streamline our internal operations and have reduced the number of suppliers by a further 1,467 this year, bringing the total down from over 18,000 at the start of Simplification to 9,066, well ahead of our original target of 10,000 by the end of 2014.

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Central items

	2013 £m	2012 £m
Total underlying income (expense)	**263**	(132)
Total costs	**(406)**	(293)
Impairment	**(6)**	(1)
Underlying loss	**(149)**	(426)

– Central items include income and expenditure not recharged to divisions, including the costs of certain central and head office functions.

– Total underlying income in 2013 includes the £540 million gain on the sales of shares in St. James's Place.

– Total costs in 2013 include the bank levy of £238 million (2012: £179 million).

OTHER FINANCIAL INFORMATION

Banking net interest margin

Banking net interest margin is calculated by dividing banking net interest income by average interest-earning banking assets. A reconciliation of banking net interest income to Group net interest income showing the items that are excluded in determining banking net interest income follows:

	2013 £m	2012 £m
Banking net interest income – underlying basis	**10,841**	10,480
Insurance division	**(103)**	(78)
Other net interest income (including trading activity)	**147**	(67)
Group net interest income – underlying basis	**10,885**	10,335
Fair value unwind	**(631)**	(237)
Banking volatility and liability management gains	**14**	199
Insurance gross up	**(2,930)**	(2,587)
Volatility arising in insurance businesses	**–**	8
Group net interest income – statutory	**7,338**	7,718

Average interest-earning banking assets are calculated gross of related impairment allowances, and relate solely to customer and product balances in the banking businesses on which interest is earned or paid.

Volatility arising in insurance businesses

The Group's statutory result before tax is affected by 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.

In 2013 the Group's statutory result before tax included positive insurance and policyholder interests volatility totalling £668 million compared to positive volatility of £312 million in 2012.

Volatility comprises the following:

	2013 £m	2012 £m
Insurance volatility	**218**	189
Policyholder interests volatility[1]	**564**	143
Total volatility	**782**	332
Insurance hedging arrangements	**(114)**	(20)
Total	**668**	312

[1] Includes volatility relating to the Group's interest in St. James's Place.

Insurance volatility

The Group's Insurance business has policyholder liabilities 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 gross 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	2013 %	2012 %
Investments backing annuity liabilities	**3.83**	3.89
Equities and property	**5.58**	5.48
UK government bonds	**2.58**	2.48
Corporate bonds	**3.18**	3.08

A review of investment strategy in the Group's Insurance business has resulted in investment being made in a wider range of assets. Expected investment returns in 2013 include appropriate returns for these assets. The 2013 rates also reflect the move to swap rates as the basis for calculations.

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, adjusted for significant changes in asset mix) 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 positive insurance volatility during 2013 in the Insurance division was £218 million, primarily reflecting the favourable performance of equity investments in the period relative to the expected return. This has been partially offset by an increase in the long-term level of market implied inflation and lower cash returns compared to long-term expectations.

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, pensions and investments business. In order to provide a clearer representation of the performance of the business, and consistent with the way in which it is managed, adjustments are made to remove this volatility from underlying profits. The effect of these adjustments is separately disclosed as policyholder interests volatility.

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 result is, therefore, to either increase or decrease profit before tax with a related change in the tax charge. 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.

In 2013, the statutory results before tax included a credit to other income which relates to policyholder interests volatility totalling £564 million (2012: £143 million) relating to the rise in equity markets in the period.

Insurance hedging arrangements

To protect against deterioration in equity market conditions and the consequent negative impact on the value of in-force business on the Group balance sheet, the Group purchased put option contracts in 2012 financed by selling some upside potential from equity market movements. These expired in 2013 and the charge booked in 2013 on these contracts was £9 million. New protection was acquired in 2013 to replace the expired contracts. On a mark-to-market valuation basis a loss of £105 million was recognised in relation to the new contracts in 2013.

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.

	2013	2012[1]	2011[1]	2010[1]	2009[1]
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**18,478**	20,517	20,802	24,868	22,526
Operating expenses	**(15,322)**	(15,974)	(16,459)	(13,255)	(16,065)
Trading surplus[1]	**3,156**	4,543	4,343	11,613	6,461
Impairment	**(2,741)**	(5,149)	(8,094)	(10,952)	(16,673)
Gain on acquisition	**–**	–	–	–	11,173
Profit (loss) before tax	**415**	(606)	(3,751)	296	961
(Loss) profit for the year	**(802)**	(1,387)	(2,890)	(277)	2,895
(Loss) profit for the year attributable to equity shareholders	**(838)**	(1,471)	(2,963)	(339)	2,769
	31 December 2013	31 December 2012[1]	31 December 2011[1]	31 December 2010[1]	31 December 2009[1]
Balance sheet data (£m)					
Share capital	**7,145**	7,042	6,881	6,815	10,472
Shareholders' equity	**38,989**	41,896	45,506	45,354	41,158
Net asset value per ordinary share	**55p**	60p	66p	67p	64p
Customer deposits	**441,311**	426,912	413,906	393,633	406,741
Subordinated liabilities	**32,312**	34,092	35,089	36,232	34,727
Loans and advances to customers	**495,281**	517,225	565,638	592,597	626,969
Total assets	**847,030**	934,221	970,609	991,405	1,028,080
	2013	2012[1]	2011[1]	2010[1]	2009[1]
Share information					
Basic earnings (loss) per ordinary share	**(1.2)p**	(2.1)p	(4.3)p	(0.5)p	7.3p
Diluted earnings (loss) per ordinary share	**(1.2)p**	(2.1)p	(4.3)p	(0.5)p	7.3p
Total dividend per ordinary share[2]	**–**	–	–	–	–
Market price (year end)	**78.9p**	47.9p	25.9p	65.7p	50.7p
Number of shareholders (thousands)	**2,681**	2,733	2,770	2,798	2,834
Number of ordinary shares in issue (millions)[3]	**71,368**	70,343	68,727	68,074	63,775
	2013	2012	2011	2010	2009
Financial ratios (%)[4]					
Dividend payout ratio	**–**	–	–	–	–
Post-tax return on average shareholders' equity	**(2.0)**	(3.3)	(6.7)	(0.8)	9.0
Cost:income ratio[5]	**82.9**	77.9	79.1	53.3	71.3
	31 December 2013	31 December 2012	31 December 2011	31 December 2010	31 December 2009[8]
Capital ratios (%)[6, 7, 8]					
Total capital	**20.8**	17.3	15.6	15.2	12.4
Tier 1 capital	**14.5**	13.8	12.5	11.6	9.6
Core tier 1 capital	**14.0**	12.0	10.8	10.2	8.1

[1] Restated in 2013 for IAS 19 (Revised) and IFRS 10; see note 1 on page 212.

[2] 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.

[3] This figure excludes 81 million (2008: 79 million) limited voting ordinary shares.

[4] Averages are calculated on a monthly basis from the consolidated financial data of Lloyds Banking Group.

[5] The cost:income ratio is calculated as total operating expenses as a percentage of total income (net of insurance claims).

[6] Capital ratios are in accordance with modified Basel II framework as implemented by the PRA.

[7] Capital ratios for 2012 and earlier years have not been restated to reflect the adoption of IAS 19 (Revised).

[8] Restated in 2010 to reflect a prior year adjustment to available-for-sale revaluation reserves.

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BOARD OF DIRECTORS

Non-Executive Directors

Sir Winfried Bischoff
Chairman
(retiring on 3 April 2014)

Joined the Board in September 2009

Chairman of the Nomination & Governance Committee
Member of the Remuneration Committee and the Risk Committee

Skills and experience: Sir Winfried has substantial experience of leading complex international boards in the UK and the US. His background spans a range of sectors, including banking and capital markets, finance and government regulation and public policy. Sir Winfried is a highly respected leader with the proven experience and judgement who has led the Board of Lloyds Banking Group during a period of significant progress over the past four years. Sir Winfried has a BA in Commerce from the University of the Witwatersrand, a Doctorate in Science, Honoris Causa, from City University and was made a Johnson Honorary Fellow of the University of Oxford.

External appointments: Sir Winfried is a Non-Executive Director of Eli Lilly and Company and The McGraw Hill Companies Inc. He is Chairman of the Advisory Council of TheCityUK, a Member of the Akbank International Advisory Board and from 1 May 2014, will be Chairman of the Financial Reporting Council.

Former appointments: Sir Winfried was appointed Chairman of Citigroup Europe in 2000. He became the acting Chief Executive Officer of Citigroup Inc. in 2007 and was subsequently appointed as Chairman in the same year until his retirement in February 2009. Prior to this, he was the Group Chief Executive and then Chairman of Schroders.

Lord Blackwell
Chairman (from 3 April 2014) and Independent Director

Joined the Board in June 2012

Chairman of Scottish Widows Group

Member of the Audit Committee, the Risk Committee and the Nomination & Governance Committee

Skills and experience: Lord Blackwell has extensive insurance, banking, regulatory and public policy experience gained from senior positions in a wide range of industries. Lord Blackwell's deep financial services knowledge and experience, leadership qualities and credibility with key stakeholders, made him the unanimous choice of the Board to succeed Sir Winfried as Chairman of Lloyds Banking Group. Lord Blackwell has an MA in Natural Sciences from the University of Cambridge, and a Ph.D in Finance and Economics and an MBA from the University of Pennsylvania.

External appointments: Lord Blackwell is the Chairman of Interserve plc. He is a Non-Executive Director of Ofcom (until the end of March 2014) and Halma plc.

Former appointments: Lord Blackwell is a former Senior Independent Director of Standard Life and chaired their UK Life and Pensions Board. He was a Non-Executive Director of Dixons Group and SEGRO, a member of the Board of the Centre for Policy Studies and a Non-Executive Member of the Office of Fair Trading. He was a partner of McKinsey & Co. and a Director of Group Development at NatWest Group. From 1995 to 1997, Lord Blackwell was Head of the Prime Minister's Policy Unit and was appointed a Life Peer in 1997.

David Roberts
Deputy Chairman and Independent Director

Joined the Board in March 2010

Chairman of the Risk Committee
Member of the Audit Committee, the Remuneration Committee and the Nomination & Governance Committee

Skills and experience: David has many years of experience at board and executive management level in retail and commercial banking in the UK and internationally. As Chair of the Risk Committee, he has a deep understanding of risk management, underpinned by recent, in-depth knowledge of all aspects of banking operations. David's valuable contributions to the deliberations of the Board and Committee meetings, combined with natural leadership qualities, make him an effective Deputy Chairman. David has a Diploma in Marketing from the Chartered Institute of Marketing, a degree in Mathematics & Applications from Birmingham University and an MBA from the University of Reading.

External appointments: Member of the Strategy Board of Henley Business School.

Former appointments: David joined Barclays in 1983 and held various senior management positions culminating in Executive Director, member of the Group Executive Committee and Chief Executive, International Retail and Commercial Banking, a position which he held until December 2006. He is a former Non-Executive Director of BAA and Absa Group and was Chairman and Chief Executive of BAWAG P.S.K. AG.

Carolyn Fairbairn
Independent Director

Joined the Board in June 2012

Member of the Audit Committee and the Remuneration Committee

Skills and experience: Carolyn has extensive digital and on-line, government and regulatory experience gained across a range of sectors including media and financial services. With her broad experience and strong analytical mind, Carolyn plays an active part in reviewing the strategy of the Board and contributing to the debate at Board and Committee meetings. Carolyn has a BA in Economics from the University of Cambridge, an MA in International Relations from the University of Pennsylvania and an MBA from INSEAD.

External appointments: Carolyn is a Non-Executive Director of The Vitec Group and is the Chairman of its Remuneration Committee. She is a trustee of Marie Curie and a Non-Executive Director of the Competition and Markets Authority and the UK Statistics Authority.

Former appointments: Carolyn was a Non-Executive Director of the Financial Services Authority and chaired their Risk Committee, a Director of Group Development and Strategy at ITV plc and Director of Strategy and a member of the Executive Board at the BBC. She is a former partner of McKinsey & Co. and was a policy adviser in the Prime Minister's Policy Unit. Carolyn began her career as an Economist at the World Bank.

Anita Frew
Independent Director

Joined the Board in December 2010

Member of the Audit Committee, the Risk Committee and the Nomination & Governance Committee

Skills and experience: Anita has extensive board, financial and general management experience across a range of sectors, including banking, asset management, manufacturing and utilities. Her breadth of experience and strong leadership qualities make her an effective Non-Executive Director. Anita is the Chairman of the Responsible Business Committee. She has a BA (Hons) in Business from the University of Strathclyde and a MRes in Humanities and Philosophy from the University of London.

External appointments: Anita is the Chairman of Victrex plc, having previously been its Senior Independent Director, and is a Senior Independent Director of Aberdeen Asset Management and IMI.

Former appointments: Anita was an Executive Director of Abbott Mead Vickers, Director of Corporate Development at WPP Group and a Non-Executive Director of Northumbrian Water. She has held various investment and marketing roles at Scottish Provident and the Royal Bank of Scotland.

Dyfrig John, CBE
Independent Director

Joined the Board on 1 January 2014

Member of the Audit Committee and the Risk Committee

Skills and experience: Dyfrig has spent his career in banking, principally at HSBC where he worked for 37 years. During that time he held a number of senior management and board positions in the UK and overseas including Chief Executive Officer of HSBC Bank PLC. He has the knowledge and experience to provide valuable insight and contribute effectively as a Non-Executive Director and Member of the Audit Committee and Risk Committee. Dyfrig has a Sloan Fellowship from the London Business School. He is also a fellow of the Chartered Institute of Bankers.

External appointments: Dyfrig is the Chairman of Principality Building Society and will step down from that position on 17 April 2014. He is a Member of the Welsh Rugby Union's Audit Committee.

Former appointments: Dyfrig was a Director of HSBC Bank PLC from 2003 to 2009, Chief Executive Officer from 2006 to 2009 and Deputy Chairman from 2008 to 2009. Prior to joining the Board of HSBC Bank PLC, he held a number of senior roles including Group Managing Director and member of the Group Management Board. Until recently he was a Board member of the Wales Millennium Centre.

Marc Boston
Company Secretary

Appointed January 2014

Marc joined the Group in February 2010. He is a qualified Company Secretary and solicitor with 20 years of experience in a broad range of listed entities within the financial services, retail and telecommunications sectors and with professional service firms.

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Nick Luff
Independent Director

Joined the Board on 5 March 2013

Chairman of the Audit Committee
Member of the Risk Committee

Skills and experience: Nick is a chartered accountant and has significant financial experience in the UK listed environment having served in a number of senior finance positions within a range of sectors. His background and experience enables him to fulfil the role of Audit Committee Chair and, for SEC purposes, the role of Audit Committee Financial Expert. Nick is a Mathematics graduate from the University of Oxford.

External appointments: Nick is currently the Group Finance Director of Centrica. He will step down from the Centrica Board before the end of 2014 to take up a new position as Chief Financial Officer of Reed Elsevier.

Former appointments: Nick was previously Finance Director of The Peninsular & Oriental Steam Navigation Company and Chief Financial Officer of P&O Princess Cruises plc. Until December 2010, he served as a Non-Executive Director and was the Audit Committee Chair of QinetiQ Group. Nick started his career with KPMG where he qualified as a chartered accountant in 1991.

Anthony Watson, CBE
Senior Independent Director

Joined the Board in April 2009

Chairman of the Remuneration Committee
Member of the Audit Committee, the Risk Committee and the Nomination & Governance Committee

Skills and experience: Tony is Senior Independent Director and Chair of the Remuneration Committee. He maintains close dialogue with shareholders with the aim of aligning executive reward with shareholder interests. With over 40 years of experience in the investment management industry and related sectors, he is well placed to carry out these roles. Tony is a Barrister at Law. He has a BSc (Hons) in Economics from the Queen's University Belfast, a Diploma in Security Analysis from the New York Institute of Finance and was called to the Bar of England and Wales.

External appointments: Tony is a Non-Executive Director of Vodafone Group, Senior Independent Director of Hammerson and Witan Investment Trust, Chairman of the Lincoln's Inn Investment Committee and a member of the Norges Bank Investment Management Corporate Governance Advisory Board.

Former appointments: Former Chief Executive of Hermes Pensions Management and formerly Chairman of the Asian Infrastructure Fund, MEPC and of the Strategic Investment Board (Northern Ireland). Former Member of the Financial Reporting Council and the Marks & Spencer Pension Trustees.

Sara Weller
Independent Director

Joined the Board in February 2012

Member of the Remuneration Committee and the Risk Committee

Skills and experience: With a background in retail and associated sectors, including financial services, Sara brings a broad perspective to the Board. She is a strong advocate of customers and of the application of new technology, both of which directly support Lloyds Banking Group's strategy. Sara has considerable experience of boards at both executive and non-executive level. She has an MA in Chemistry from Oxford University.

External appointments: Sara is a Non-Executive Director of United Utilities Group and Chair of their Remuneration Committee.

Former appointments: Sara is the former Managing Director of Argos. She held various senior positions at J Sainsbury including Deputy Managing Director and served on its Board between January 2002 and May 2004. She was a Non-Executive Director of Mitchells & Butler and also held senior management roles for Abbey National and Mars Confectionery.

Executive Directors

António Horta-Osório
Executive Director and Group Chief Executive

Joined the Board in January 2011

Appointed Group Chief Executive in March 2011

Skills and experience: António brings extensive experience in, and understanding of, both retail and commercial banking. This has been built over a period of more than 25 years, working both internationally as well as in the UK. António's drive, enthusiasm and commitment to customers, along with his proven ability to build and lead strong management teams, brings significant value to all stakeholders of Lloyds Banking Group. António has a Degree in Management & Business Administration from the Universidade Católica Portuguesa, an MBA from INSEAD and has completed the Advanced Management Program at Harvard Business School.

External appointments: António is a Non-Executive Director of Fundação Champalimaud and Sociedade Francisco Manuel dos Santos in Portugal and is a Governor of the London Business School.

Former appointments: António joined Grupo Santander in 1993, having previously worked for Goldman Sachs and for Citibank, and held various senior management positions culminating in becoming Executive Vice President of Grupo Santander and a member of its Management Committee. In November 2004, he was appointed as a Non-Executive Director of Santander UK and, from August 2006 until November 2010, served as its Chief Executive. António is also a former Non-Executive Director of the Court of the Bank of England.

George Culmer
Executive Director and Chief Financial Officer

Joined the Board in May 2012

Skills and experience: George is a chartered accountant and has deep operational and financial expertise including strategic and financial planning and control. He has worked in financial services in the UK and overseas for over 20 years. With a strong background in insurance and shareholder advocacy, his skills and experience enhance the Board and strengthen further the senior management team. George is a chartered accountant and has a History degree from the University of Cambridge.

External appointments: None.

Former appointments: George was an Executive Director and Chief Financial Officer of RSA Insurance Group. He is also the former Head of Capital Management of Zurich Financial Services and Chief Financial Officer of its UK operations. George previously held various senior management positions at Prudential.

Juan Colombás
Executive Director and Chief Risk Officer

Joined the Board on 29 November 2013

Skills and experience: Juan has significant banking and risk management experience, having spent 28 years working in these fields both internationally and in the UK. He has served as the Group's Chief Risk Officer and as a member of the Group Executive Committee since January 2011. Juan is responsible for developing the Group's risk framework, recommending its risk appetite and ensuring that all risks generated by the business are measured, reviewed and monitored on an ongoing basis. Juan has a BSc in Industrial Chemical Engineering from the Universidad Politécnica de Madrid, a Financial Management degree from ICADE School of Business and Economics and an MBA from the Institute de Empresa Business School.

External appointments: Member of the International Financial Risk Institute Executive Committee.

Former appointments: Juan was previously the Chief Risk Officer of Santander's UK business. Prior to this position, he held a number of senior risk, control and business management roles across the Corporate, Investment, Retail and Risk Divisions of the Santander Group.

GROUP EXECUTIVE COMMITTEE

Delivering our vision

Managing a more agile organisation

The Group benefits from the depth and diversity of experience within the management team. The complementary skill sets across the team strengthen the Group's ability to effectively adjust to changing market environments, deliver on our strategic plan and become the best bank for customers. Brief biographies of the members of the Group Executive Committee (GEC) are outlined opposite.

Board Members

António Horta-Osório
Group Chief Executive

António joined the Board in January 2011 as an Executive Director and became Group Chief Executive in March 2011.

Further details can be found on page 71.

Non-Board Members

Andrew Bester
Chief Executive Officer,
Commercial Banking

Andrew was appointed as a Group Director on 1 July 2012. He is also the Chairman of Lloyds Development Capital. Prior to joining Lloyds Banking Group, Andrew worked at Standard Chartered Bank in a variety of senior roles including Global COO of Consumer Banking, Chief Financial Officer of Consumer Banking and Co-Head of Wholesale Banking for Greater China and the Africa region. Before joining Standard Chartered, Andrew was the Group Finance Director for Xchanging. Prior to this, he worked at Deutsche Bank.

Andrew qualified as a Chartered Accountant with Deloitte & Touche. He is a member of the South African Institute of Chartered Accountants, the Chartered Institute of Management Accountants and is a Chartered Global Management Accountant. He is also a member of the Association of Corporate Treasurers. Andrew sits on the board of the Global Financial Markets Association and on the Advisory Board of the University of Cambridge Programme for Sustainability Leadership. He is also a member of the Prince of Wales's UK Corporate Leaders Group.

David Nicholson
Group Director,
Halifax Community Bank

David is Group Director of the Halifax Community Bank. He has specific responsibility for the Halifax business, its branch network and 10,500 colleagues. Halifax is playing a key role in the Group's strategy as a challenger brand, with a focus on making customers better off.

David has over 25 years experience in retail financial services. He is Chairman of the 'Your Tomorrow' pension fund trustees and is a member of the Institute of Financial Services School of Finance Board of Governors. He is also community ambassador for Yorkshire and Humberside and chairs the Group Regional Ambassador programme.

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George Culmer
Chief Financial Officer

George joined the Board as an Executive Director in May 2012.

Further details can be found on page 71.

Juan Colombás
Chief Risk Officer

Juan joined the Group as Chief Risk Officer in January 2011 and joined the Board as an Executive Director in November 2013.

Further details can be found on page 71.

Alison Brittain
Group Director, Retail

Alison joined Lloyds Banking Group in September 2011 as Group Director for the Retail Division. She has responsibility for the Lloyds Bank, Halifax and Bank of Scotland retail branch networks, remote channels and products, in addition to the Retail Business Banking and UK Wealth businesses. Alison is also a member of the FCA's Practitioner Panel and a Non-Executive Director for Marks and Spencer Group plc.

Her last role was Executive Director for Retail Distribution and a Board Director at Santander UK. She previously worked at Barclays for almost 20 years in various senior roles including Director of Barclays and Woolwich Retail Networks and Managing Director of Barclays Small Business Banking. Alison attended university in Scotland and the USA and has an MBA from Cambridge University's Judge Institute.

Mark Fisher
Director, Group Operations

Mark joined Lloyds Banking Group as the Director of Group Operations in March 2009. In September 2009 his responsibilities expanded to include Group Integration Director. Mark became the Chairman of Lloyds TSB Scotland in December 2009 and is also the Group's Executive Sponsor for disability.

Prior to joining Mark was Chief Executive Officer of ABN AMRO and was appointed as Chairman of the Managing Board in November 2007. Mark was a Director of The Royal Bank of Scotland Group from March 2006, and Chief Executive of the Manufacturing division at RBS since 2000. Other achievements have included: Chairman of the Association for Payment Clearing Services (2003 – 2007).

Mark is a career banker having joined NatWest in 1981. He was Retail Finance Director and later Chief Operating Officer before NatWest was bought by RBS.

Antonio Lorenzo
Group Director, Consumer Finance and Group Corporate Development

Antonio joined Lloyds Banking Group in March 2011. He is a Group Director with responsibility for Consumer Finance and Group Corporate Development. Until recently, Antonio led the Wealth, Asset Finance and International division, which has been fundamental in supporting the Group's agenda to both reshape its international presence and strengthen the balance sheet through significant non-core reduction and double digit deposit growth. Antonio also led the Group Strategic Review.

Antonio has over 20 years of experience in the financial services industry. He worked for Arthur Andersen for over nine years before joining Santander in 1998. During his time at Santander, he worked in a number of different finance and business roles. Antonio was part of the management team in 2004 that took over Abbey National whilst also becoming Chief Financial Officer of Santander UK.

Miguel-Ángel Rodríguez-Sola
Group Director, Digital, Marketing and Customer Development

Miguel was appointed Group Director, Digital, Marketing and Customer Development in September 2013. Previously, he was Group Strategy Director and Commercial and Shared Services Director for the Retail Division. Before joining Lloyds Banking Group in 2011, Miguel worked for over six years at the Santander Group in Spain, the USA and from 2008 in the UK. In the UK he was responsible for the Corporate and SMEs Division and later for the Retail Products and Marketing Division and for customer service.

Previous to this, Miguel worked as a Senior Partner at McKinsey & Co. for over 12 years where he specialised in the Banking, Insurance and Retail sectors in Germany, Switzerland, Spain, Italy and the USA. Miguel holds a 'Cum Laude' Bachelor Degree in Business Administration from the University of Barcelona and an MBA from IESE Business School.

Toby Strauss
Group Director, Insurance

Toby joined Lloyds Banking Group in October 2011 as Group Director for Insurance and CEO of Scottish Widows. Before joining the Group, Toby was UK Life CEO at Aviva and prior to this he was Chief Operating Officer for UK Life, having joined Aviva in 2008. He previously worked at Charcol, becoming Managing Director, before moving to JS & P(now Towry) as Chief Executive. Before that, Toby spent a number of years at McKinsey, specialising in the financial services and technology sectors. In April 2013 Toby was appointed as a Trustee of Macmillan Cancer Support.

Matthew Young
Group Corporate Affairs Director

Matt joined Lloyds Banking Group in February 2011 as Group Corporate Affairs Director. He has responsibility for internal and External Communications, Public Affairs, Regulatory Developments, Community Investment including the Group's Archives and Museums. Prior to joining the Group, he was the Communications Director at Santander UK and has also held senior positions with Abbey National and NatWest.

Matt is a member of the Board of Trustees at In Kind Direct, founded by HRH Prince of Wales in 1996. He is a member of the Guild of PR Practitioners.

DIRECTORS' REPORT

Results

The consolidated income statement shows a statutory profit before tax for the year ended 31 December 2013 of £415 million.

Dividends

The Directors do not propose to pay a final dividend in respect of the year ended 31 December 2013. Further information on ordinary dividends is shown in note 49 on page 293 and is incorporated into this report by reference.

Post balance sheet events

There have been no material post balance sheet events.

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 and uncertainties: funding and liquidity on page 42 and pages 171 to 177 and capital position on pages 178 to 192 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.

Branches, future developments and financial risk management objectives and policies

The Group provides a wide range of banking and financial services through branches and offices in the UK and overseas. Information about future developments, internal control and financial risk management systems in relation to financial reporting and financial risk management objectives and policies in relation to the use of financial instruments can be found in the following sections of the annual report, which are incorporated into this report by reference:

	Pages
Future developments	123 to 196
Internal control and financial risk management systems in relation to financial reporting	123 to 196 and page 87
Financial risk management objectives and policies in relation to the use of financial instruments	123 to 196 (and in note 54 on pages 327 to 349)

Directors

The names and biographical details of the Directors are shown on pages 70 and 71. Particulars of their emoluments and interests in shares in the Company are given on pages 100 to 122. Changes to the composition of the Board since 1 January 2013 up to the date of this report are shown in the table below:

	Joined the Board	Retired from the Board
Nick Luff	5 March 2013	
Martin Scicluna		31 March 2013
Timothy T Ryan, Jr		18 April 2013
Juan Colombás	29 November 2013	
Dyfrig John	1 January 2014	

Sir Winfried Bischoff will retire from the Board on 3 April 2014 and will be succeeded as Chairman by Lord Blackwell.

Appointment and retirement of Directors

The appointment of Directors is governed by the Company's articles of association, the UK Corporate Governance Code and the Companies Act 2006. The Company's articles of association may only be amended by a special resolution of the shareholders in a general meeting.

Juan Colombás and Dyfrig John have been appointed to the Board since the 2013 annual general meeting and will therefore stand for election at the forthcoming annual general meeting. In the interests of good governance and in accordance with the provisions of the UK Corporate Governance Code, all of the other Directors will retire and those willing to serve again will submit themselves for re-election at the forthcoming annual general meeting.

Directors' indemnities

The Directors of the Company, including the former Directors who retired during the year and since the year end, have entered into individual deeds of indemnity with the Company which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force for the duration of a Director's period of office. The deeds were in force during the whole of the financial year or from the date of appointment in respect of the Directors appointed in 2013 and 2014. Deeds for existing Directors are available for inspection at the Company's registered office. In addition, the Group had appropriate Directors and Officers Liability Insurance cover in place throughout 2013.

The Company has also granted a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' to the Directors of the Group's subsidiary companies, including to former Directors who retired during the year and since the year end. Qualifying pension scheme indemnities were also granted to the Trustees of the Group's Pension Schemes.

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Corporate governance report

The corporate governance report can be found on pages 78 to 99 and, together with this report of which it forms part, fulfils the requirements of the Corporate Governance Statement for the purpose of the Financial Conduct Authority's Disclosure and Transparency Rules (DTR).

Share capital and control

Information about share capital, restrictions on the transfer of shares or voting rights and special rights with regard to control of the Company is shown in note 45 on pages 289 and 290 and is incorporated into this report by reference.

The powers of the Directors, including in relation to the issue or buy back of the Company's shares, are set out in the Companies Act 2006 and the Company's articles of association. The Directors were granted authorities to issue and allot shares and to repurchase shares at the 2013 annual general meeting. Shareholders will be asked to renew the authorities at the 2014 annual general meeting.

The Company did not repurchase any of its shares during the year (2012: none).

Substantial shareholders

Information provided to the Company by substantial shareholders pursuant to the DTR is published via a Regulatory Information Service.

As at 31 December 2013 and the date of this report, the Company was notified under Rule 5 of the DTR that The Solicitor for the Affairs of Her Majesty's Treasury had a direct interest in 23,326,529,533 ordinary shares, representing 32.7 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.

Change of control

The Company is not party to any significant contracts that are subject to change of control provisions in the event of a takeover bid. There are no agreements between the Company and its Directors or employees providing compensation for loss of office or employment that occurs because of a takeover bid.

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 289). 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.

Research and development activities

During the ordinary course of business the Group develops new products and services within the business units.

Emissions reporting

The Group has voluntarily reported on its carbon dioxide (CO_2) emissions in its annual Responsible Business Report and Annual Report and Accounts since 2009, but new regulations introduced through an amendment to the Companies Act 2006 require changes to the scope of disclosure compared to previous years. Previously, reported scope 1 emissions covered only the emissions generated from the gas and oil in UK buildings where the Group holds the supply contract direct with the utilities supplier along with emissions generated from company-owned vehicles used for business travel; and reported scope 2 emissions covered only the emissions generated from the use of electricity in UK buildings where the Group hold the supply contract direct with the electricity supplier. This year, additional emissions included in the scope of 2013 reporting relate to: UK sites where the Group does not hold the supply contract directly with the energy supplier (shadow sites); energy consumed in international locations (non-UK sites); and gas emissions arising from the use of air-conditioning and chiller/refrigerant plant (fugitive emissions). In addition the Group is now reporting emissions in terms of CO_2 equivalent tonnes (CO_2e).

Reporting period

The reporting period for emissions (October 2012 – September 2013) differs to that of the Directors' report (January 2013 – December 2013). However, in line with the new regulations the majority of emission reporting year falls within the period of the Directors' report.

Scope of disclosure

The Group reports emissions based on an operational boundary. Reported scope 1 emissions cover: emissions generated from the gas and oil used in all the buildings the Group operates business from (UK and International); emissions generated from UK company-owned vehicles used for business travel; and fugitive emissions arising from the use of air-conditioning and chiller/refrigerant plant to service the Group's UK property portfolio. Reported scope 2 emissions cover emissions generated from the use of electricity in all the buildings the Group operates business from. Reported scope 3 emissions relate to business travel undertaken by colleagues based in the UK using rail, privately owned vehicles, hired vehicles and air travel. Emissions associated with joint ventures and investments are not included in the emissions disclosure as they fall outside the scope of our operational boundary.

The Group follows the principles of the Greenhouse Gas (GHG) Protocol Corporate Standard and Department for Environment, Food and Rural Affairs (Defra) Voluntary Reporting 2012 Guidelines to calculate its emissions in scope 1, 2 and 3.

Omissions

The Group does not have available data or estimates for business travel undertaken by colleagues based outside the UK when using company vehicles, or for fugitive emissions arising from the use of air-conditioning and chiller/refrigerant plant to service its non-UK property portfolio. Under the new regulation this activity would be part of the Group's scope 1 emissions.

DIRECTORS' REPORT

Compliance with the regulations

The Group understands the principles of the regulations to report all emissions or explain where data has been unavailable for the first year of reporting. Rather than omit material elements the Group has included estimated emissions, where actual data is not available. These are listed below. Each of these sources of emissions is being reported for the first time.

Energy consumed on non-UK sites, shadow sites and fugitive emissions

Non-UK sites – Lloyds Banking Group is a UK based retail bank with 97 per cent of employees based in the UK (2012 headcount data). The Group continues the strategic reshaping of its international footprint and intends to further reduce its presence outside the UK. As lessees the Group does not usually have access to consumption data for non-UK sites. Estimates have been based on a GHG emission value per full time equivalent colleague (FTE) for UK based operations.

Shadow sites – As the Group is not billed directly for energy consumed in these sites the Group does not have full visibility of consumption data. To allow emissions relating to these sites to be included within its emissions reporting for 2013, an estimation using an average gas/electricity consumption level per occupied square metre (obtained from sites where the Group holds the energy supply contract directly with the supplier) has been calculated. For electricity, consumption estimated in this way relates to 397 sites. For gas, consumption estimated in this way relates to 185 sites.

The CO_2e emissions relating to this subset of emissions reported are calculated using the same methodology and emissions factors that have been applied to actual billed consumption data.

Fugitive emissions – Fugitive emissions for Lloyds Banking Group arise from the use of air-conditioning and chiller/refrigerant plant to service our UK property portfolio. Actual data relating to fugitive emissions is not currently collated centrally by the Group. Therefore, for the 2013 reporting period these emissions have been estimated based on a register of assets used by its Facilities Management partner to maintain and service the Group's estate. Leakage rates and emissions factors from the 2012 Guidelines to Defra/Department of Energy and Climate Change (DECC's) GHG Conversion Factors have been applied to each asset on the register according to the gas type used within the asset.

GHG emissions – CO_2e tonnes

Scope	October 2012 – September 2013 (including additional mandatory emissions)*	October 2012 – September 2013 (like for like basis)	October 2011 – September 2012
Scope 1	73,196[1]	53,279	49,943
Scope 2	333,212[2]	291,547	293,521
Scope 3	37,827	37,827	34,740
Total	**444,235**	**382,653**	**378,204**

***Additional mandatory carbon reporting includes Scope 1 and Scope 2 emissions as described below:**

[1]Scope 1 – emissions generated from the energy billed for gas and oil where the Group does not hold the supply contract directly with the energy supplier (shadow sites), fugitive emissions and emissions generated from non-UK sites.

[2]Scope 2 – emissions generated from the energy billed for electricity for sites where the Group does not hold the supply contract directly with the energy supplier (shadow sites) and emissions generated from non-UK sites.

The Group has applied the principles of the new regulations to its previous reporting period. Please note the totals include all GHG gases and the totals are CO_2e. In previous years the Group has only reported on CO_2. The Group has restated the emissions data for the October 2011 – September 2012 reporting period, replacing estimates with actual billed data. The Group has applied the emissions factors from the 2012 Defra guidelines to both reporting periods.

Intensity ratio

As the Group uses an operational boundary for its emission reporting, an intensity ratio of GHG gases per FTE has been selected.

	October 2012 – September 2013 (including additional mandatory emissions)	October 2012 – September 2013	October 2011 – September 2012
GHG emissions per average FTE (based on 2012 FTE)	3.91	3.37	3.33

Verification

Although not required by the new mandatory regulations the Group has retained the services of PricewaterhouseCoopers LLP (PwC) to provide an independent and robust assessment of the Group's scope 1, 2 and 3 emissions. PwC's limited assurance report is included as part of the Group's 2013 Responsible Business Report, www.lloydsbankinggroup-cr.com.

Employees

Lloyds Banking Group is committed to providing employment practices and policies which recognise the diversity of its workforce. The Group will not unfairly discriminate in the recruitment or employment practices on the basis of any factor which is not relevant to individuals' performance including sex, race, disability, age, sexual orientation or religious belief. The Group works hard to ensure Lloyds Banking Group is inclusive for all colleagues.

To support the Group in this aim, Lloyds Banking Group belongs to a number of major UK employment equality campaign groups, including the Business Disability Forum, The Age and Employment Network, Stonewall and Race for Opportunity. Involvement with these organisations enables the Group to identify and implement best practice for staff. Lloyds Banking Group has a range of programmes to support colleagues who become disabled or acquire a long-term health condition. These include a workplace adjustment programme to provide physical

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equipment or changes to the way a job is done. The Group also runs residential Personal and Career Development Programmes to help colleagues deal positively with the impact of a disability and the colleague disability network, Access, provides peer support.

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.

Lloyds Banking Group is committed to providing employees with comprehensive coverage of the economic and financial issues affecting the Group. The Group has established a full suite of communication channels, including an extensive face-to-face briefing programme, which allows it to update employees on performance and any financial issues throughout the year.

Further information on employees can be found on pages 34 to 35.

Significant contracts

Details of related party transactions are set out in note 51 on pages 303 to 306.

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 Group and parent Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Company and Group for that period. In preparing these financial statements, the Directors are required to: select suitable accounting policies and then apply them consistently; make judgements and accounting estimates that are reasonable and prudent; and state whether applicable IFRSs as adopted by the European Union have been followed.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

A copy of the financial statements is placed on our website www.lloydsbankinggroup.com. The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the current Directors, who are in office and whose names and functions are listed on pages 70 and 71 of this annual report, confirm that, to the best of his or her knowledge:

– the Group financial statements, which have been prepared in accordance with IFRSs 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 strategic report and the directors' report 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 that they face.

The Directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy. The Directors have also separately reviewed and approved the new Strategic Report.

Independent auditor 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 auditor is 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 auditor is 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 auditor and authorising the Audit Committee to set its remuneration will be proposed at the annual general meeting.

On behalf of the Board

Marc Boston
Company Secretary
5 March 2014

Lloyds Banking Group plc
Registered in Scotland

Company number SC95000

CORPORATE GOVERNANCE REPORT

The Board is committed to achieving long term success for the Group and generating sustainable returns for shareholders. This is underpinned by our high standards of corporate governance, which are critical to the success of any business today.

Dear Shareholders

I am pleased to present our corporate governance report for the 2013 financial year. This report explains how the Group applies the highest principles of corporate governance, in particular those laid down in the 2012 edition of the Financial Reporting Council (FRC)'s UK Corporate Governance Code (the Code). The Code can be accessed at www.frc.org.uk.

2013 has been a significant year for Lloyds Banking Group. The Board has taken a number of important decisions as we work towards the goal of becoming the 'best bank for customers'. I am pleased to report that during the year the Board and its Committees met their key objectives and carried out their key responsibilities effectively.

Set out below are some of the key corporate governance matters considered in 2013.

Chairman succession – Following the announcement of my intention to retire before the 2014 annual general meeting, a committee of the Board was established to oversee the search and selection of my successor. I am delighted that Lord Blackwell has been chosen to succeed me as Chairman of Lloyds Banking Group. Over the past four years, the Group has made significant progress in its goal to become a strong, efficient, UK-focused retail and commercial bank. Whilst clearly some challenges remain, the performance of the Group is well on track. This gives me great confidence in its future and I wish Norman every success as he leads the Group at this important time. The appointment of Lord Blackwell as Chairman received unanimous Board approval. Full details of the selection process are outlined on page 82.

Board composition– Since last reporting, three additional directors have joined the Board. Nick Luff, who was appointed in March 2013, has significant financial experience in the UK listed environment. His background and experience enables him to fulfil the role of Audit Committee Chair and for SEC purposes the role of Audit Committee financial expert. Juan Colombás, who was appointed in November 2013, brings significant banking and risk management experience to the Board and his appointment reflects the Board's desire to elevate the importance of risk management in the Group. Dyfrig John was appointed in January 2014 to bolster the depth and breadth of retail banking experience on the Board. However, with my pending retirement, the search for additional directors with relevant banking, finance and risk experience continues.

TSB Bank – Following the European Commission's ruling in 2009 requiring the Group to divest part of its business, the Group created a fresh competitor on Britain's high streets in TSB Bank, with over 600 branches across Britain. The process required the Group to balance the need for the Group's oversight obligations with the need to deliver an independently functioning bank. A governance structure was created to ensure this was achieved. In September 2013, TSB Bank was launched as a fully operational bank and a new chairman was appointed in February 2014. For more detail, see page 81.

Changes to the remuneration reporting regime – The Remuneration Committee dedicated significant time in 2013 to assessing the impact of changes to the remuneration reporting regime on the Group's approach to executive remuneration. The Committee has striven to ensure that the remuneration policies and practices detailed in the Directors' Remuneration Policy, on pages 102 to 109, and in the Directors' Remuneration Implementation Report on pages 110 to 122, are appropriate to supporting the delivery of the Company's current and future strategy.

Board effectiveness – The Board carries out an annual evaluation of its effectiveness. In 2013, this was conducted internally. The review was overseen by the Nomination & Governance Committee and considered the Board's performance principally by reference to the balance of skills, experience, independence and knowledge of the Board, its diversity, including gender, and how the Directors work together as a unit. The review also considered my effectiveness as Chairman of the Board, the effectiveness of the Committees, the Committee Chairmen, the Senior Independent Director and the Deputy Chairman. The results of the review are set out on page 86.

Finally, I would like to thank each of the Directors for their commitment throughout 2013 and their support during the period of my chairmanship. Our high standards of corporate governance are driven by the Board and embedded in the thinking and processes of the business. The Group is now profitable with a strong balance sheet and a solid prudential foundation on which to build a sustainable future.

Sir Winfried Bischoff
Chairman

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The Board and its members

Purpose and responsibilities

The Group is led by a Board comprising a Non-Executive Chairman, independent Non-Executive Directors and Executive Directors. The Board is collectively responsible for the long term success of the Company. It achieves this by setting the strategy and overseeing delivery against it, establishing the culture, values and standards of the Group, ensuring that the Group manages risk effectively, monitoring financial performance and reporting and ensuring that appropriate and effective succession planning arrangements and remuneration policies are in place.

The role of the Directors

The roles of the Chairman and other Board members are set out below. There is a clear division of responsibility at the head of the Company. The Chairman has overall responsibility for the leadership of the Board while the Group Chief Executive manages and leads the business.

Overview of the roles of the Directors

Chairman

- Overall responsibility for the leadership of the Board and the promotion of the highest standards of corporate governance.
- Sets the Board meeting agendas to ensure that the Board devotes its time and attention to the right matters.
- Builds an effective and complementary Board.
- Plans succession in Board appointments in conjunction with the Nomination & Governance Committee.
- Ensures the Directors receive timely and relevant information and are kept advised of key developments.

Senior Independent Director

- Helps resolve shareholders' concerns.
- Acts as a sounding board for the Chairman and Group Chief Executive on Board and shareholder matters.
- Is a conduit, as required, for the views of other Non-Executive Directors on the performance of the Chairman.
- Is available to shareholders if they have concerns which contact through the normal channels has failed to resolve or is inappropriate.
- Attends sufficient meetings with major shareholders and financial analysts to understand issues and concerns.
- Conducts the Chairman's annual performance appraisal.

Group Chief Executive

- Manages the Group on a day-to-day basis, and in accordance with the strategy and long term objectives approved by the Board.
- With the exception of those matters reserved to the Board, the Group Chief Executive makes decisions on matters affecting the operations, performance and strategy of the Group's businesses.
- Provides leadership and direction to implement strategy in accordance with the goals and objectives set by the Board.
- Coordinates all activities to implement the strategy and for managing the business in accordance with the Group's risk appetite and business plan set by the Board.

Deputy Chairman

- Ensures continuity of effective Board Chairmanship during any change of chairmanship.
- Supports the Chairman in representing the Board and acting as spokesman.
- Deputises for the Chairman in the discharge of his duties.
- Is available to the Board for consultation and advice.
- Is the Chairman's point of contact with governmental and other institutions.
- Represents the Group's interests to official enquiries and review bodies.

Non-Executive Director

- Challenges constructively.
- Helps develop strategy.
- Participates actively in the decision-making process of the Board.
- Scrutinises the performance of management in meeting agreed goals and objectives.
- Provides entrepreneurial leadership of the Group within a framework of prudent effective controls.
- Sets the Group's strategic aims and reviews management's performance.
- Sets the Group's values and standards.

Executive Director

- Makes and implements decisions in all matters affecting the operations, performance and strategy of the Group's business, under the leadership of the Group Chief Executive.
- Provides specialist knowledge and experience to the Board.
- Responsible for the successful leadership and management of the Risk and Finance divisions.
- Designs, develops and implements strategic plans.
- Deals with the day-to-day operations of the Group.

The role of the Company Secretary

The Company Secretary is responsible to the Board and provides comprehensive practical support and guidance to Directors both as individuals and as a collective, with particular emphasis on supporting the Non-Executive Directors in maintaining the highest standards of probity and corporate governance. The Company Secretary is also responsible for communicating with shareholders as appropriate and ensuring that due regard is paid to their interests. All Directors, including Non-Executive Directors, have access to the services of the Company Secretary in relation to the discharge of their duties.

Access to advice

The Group also provides access, at its expense, to the services of independent professional advisers in order to assist Directors in their role, especially Non-Executive Directors, wherever this is deemed necessary. Board Committees are also provided with sufficient resources to undertake their duties.

Authority and delegation

Corporate governance framework

The Group's corporate governance framework, which is reviewed annually by the Board, comprises the board authority and the delegated executive authority.

Board authority

The board authority sets out the matters reserved to the Board. These include decisions concerning the strategy and long-term objectives of the Group, the Group's capital, medium-term plan and financial budgets, significant contracts and transactions and various statutory and regulatory approvals. The approval of the remuneration policy, risk appetite and risk management framework are also reserved to the Board. The board authority delegates responsibility for day-to-day management of the business to the Group Chief Executive and sets out the basis for delegation of authorities from the Board to Board Committees.

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The following table provides an overview of the matters reserved to the Board of Lloyds Banking Group plc. A full schedule of all matters reserved to the Board can be found on our website at www.lloydsbankinggroup.com.

Strategy and budget

Approves the Group's strategy and long-term objectives, the Medium Term Plan and the annual budget and reviews delivery against plan.

Approves strategic proposals and major operational issues.

Establishes the culture, values and standards of the Group.

Governance

Determines Board and Committee structure, size and composition.

Determines the independence of Non-Executive Directors.

Approves the governance principles, corporate governance framework, Board Committee terms of reference and key Group policies.

Risk management

Approves the Group's risk appetite and risk management framework.

Monitors the Group's aggregate risk exposures, risk/return and emerging risks.

Reviews annually the effectiveness of the Group's risk management and internal control systems.

Remuneration

Approves the overall remuneration policy and philosophy of the Company.

Approves the remuneration of Non-Executive Directors.

Approves material changes in employee share schemes and policy relating to Group pensions.

Structure, capital and transactions

Approves material changes to the Group's corporate and organisational structure and changes to capital structure.

Approves the basis for allocation of capital, investments, acquisitions, mergers or disposals.

Approves large transactions, equity investments and disposals, and intra group guarantees.

Finance, statutory and regulatory requirements

Approves financial statements, dividends and significant accounting changes.

Authorises Directors' conflicts or potential conflicts of interest.

Approves all shareholder notices, circulars, prospectuses and listing particulars.

Delegated executive authority

The Group Chief Executive, through the delegated executive authority, delegates aspects of his own authority, as permitted, to members of the Group Executive Committee. The Group Executive Committee meets weekly to scrutinise items of key business. The Group Audit Director, Group HR Director and the Company Secretary attend the weekly Group Executive Committee meetings to ensure that there is appropriate internal audit oversight, employee interests and people strategy matters are considered and that the highest standards of corporate governance are maintained.

The role of the Board Committees

The Board is supported by its Committees which make recommendations to the Board on matters delegated to them, in particular in relation to internal control, risk, financial reporting, governance and remuneration matters. This enables the Board to spend a greater proportion of its time on strategic, forward looking agenda items. Each Committee comprises Non-Executive Directors only and is chaired by an experienced Chairman. The Committee Chairs report to the Board on the activities of the Committee at each Board meeting. Terms of reference for each of the Committees can be found on our website at www.lloydsbankinggroup.com. Information on the membership, role and activities of each of the Committees can be found on pages 89 to 99.

Subsidiary governance

The Group conducts the majority of its business through a number of subsidiary entities. The Boards of the four main bank companies, Lloyds Banking Group plc, Lloyds Bank plc, HBOS plc and Bank of Scotland plc, comprise the same Directors. The Board meetings for these companies are held concurrently with the agenda split between the companies to allow decisions to be taken and scrutinised by the appropriate Board.

In addition the Group has an insurance subsidiary, Scottish Widows Group Limited, which itself also has a number of separate operating subsidiaries. The Board of Scottish Widows Group Limited, which also sits as the Board of the major subsidiaries, is chaired by a non-executive member of the Lloyds Banking Group Board and contains a balance of independent non-executive directors, Group executives and Insurance Division executives. This composition supports its legal and regulatory requirements for independent decision making within the overall framework of Group policies and controls.

To help manage the legal, regulatory and reputational risks associated with the Group's subsidiary entities, the Group requires that subsidiary boards and their directors meet minimum governance standards, as laid down in the legal entity management standards and directors' handbook as approved by the Board of Lloyds Banking Group plc.

The Group Chief Executive outlined his Group strategy in 2011 including a simplification target of reducing the number of legal entities in the Group from 1,685 to fewer than 1,000 by the end of 2014. As at 31 December 2013, the number of Group entities had reduced to 929, achieving the target one year ahead of schedule.

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The establishment of TSB Bank plc

Following the European Commission's ruling in 2009 requiring the Group to divest part of its business, the Group created a fresh competitor on Britain's high streets in TSB Bank, which was launched in September 2013. The creation of TSB Bank required the Group to balance its oversight obligations with the need to deliver an independently functioning bank. A governance structure was agreed by the Board of Lloyds Banking Group plc to ensure this was achieved. Three governance stages were identified to progress TSB Bank's transition to a fully independent stand alone bank:

Wholly-owned subsidiary

While TSB Bank remains a wholly owned subsidiary of the Group it will operate in line with the Group's risk appetite and over-arching strategic goals. Should TSB Bank need access to Group information in order to carry out its responsibilities, any conflicts are managed in accordance with existing Group guidance. In accordance with the mandate set with the TSB Bank Board, TSB Bank management will run TSB Bank but have reporting lines to their Group counterparts.

Transition to initial public offering

In January 2014, TSB Bank received a greater degree of autonomy. It has its own independent, non-executive chairman and board, with its own constitution and responsibilities. The regulatory approved executive teams have dotted reporting lines into their Group counterparts but no direct reporting lines. In accordance with its agreed strategy, plan and budget, TSB Bank is able to take independent operational decisions. Certain decisions, such as product pricing and marketing, remain subject to approval by the Group.

Following initial public offering

Once TSB Bank is listed on the London Stock Exchange, its independence will be prescribed in a relationship agreement between itself and Lloyds Banking Group. Any transactions between the Group and TSB Bank will be at arms length through a transitional service agreement and long term service agreement.

Board composition

Board size

The Board should be of sufficient size to reflect a broad range of views and perspectives whilst allowing all Directors to participate effectively in meetings. The Board currently comprises three Executive Directors, eight independent Non-Executive Directors and the Chairman who was independent on appointment. The size of the Board is within the optimal range set by the Nomination & Governance Committee. Further details on independence are set out in the Nomination & Governance Committee Report.

Balance of Non-Executive and Executive Directors

Until recently, the Board operated with two Executive Directors: the Group Chief Executive and the Chief Financial Officer. As a reflection of the importance of risk management in decisions taken by the Board, Juan Colombás, the Chief Risk Officer, was appointed to the Board in November 2013 as an additional Executive Director. His appointment has increased the number of Executive Directors on the Board to three.

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I am honoured to have been asked to become Chairman of Lloyds Banking Group. This is a great opportunity to be part of helping the bank go even further in serving its customers as it returns to full private ownership. I'd like to thank Win for the outstanding job he has done in steering the bank through a tremendous turnaround.

Lord Blackwell

Chairman succession

Following the announcement by our Chairman, Sir Winfried Bischoff, of his intention to retire before the 2014 annual general meeting, a committee of the Board was established, led by Anthony Watson, to oversee the search and selection of his successor. A job specification was prepared and with the assistance of Odgers Berndtson (who has no connection with the Group), a comprehensive long-list of potential candidates was drawn up which, based on the attributes required and the skills, availability and experience of the candidates, was reduced to a short-list of candidates. Each of the candidates was interviewed and assessed by the members of the Committee with updates on progress reported to the Nomination & Governance Committee and the Board.

It was clear from Board feedback that Lord Blackwell was considered by his fellow Directors to be a suitable candidate to succeed Sir Winfried as Chairman and at the request of the Board, he made himself available for consideration for the role. He did not take part in any of the discussions on Chairman succession following his decision to apply for the role.

On 2 December 2013, the Group announced that Lord Blackwell would be appointed as Chairman of the Group following the retirement of Sir Winfried Bischoff on 3 April 2014. The appointment received unanimous Board approval. Lord Blackwell has been a Director on the Board of Lloyds Banking Group since June 2012 where he has been a member of the Group's Audit and Board Risk Committees. He has also been the Chairman of Scottish Widows since September 2012. Lord Blackwell has broad experience in banking, insurance and management consultancy. His external ex perience, together with his experience and knowledge of Lloyds Banking Group and existing relationships with the Board, make him ideally placed to ensure a seamless handover as Chairman. Since the announcement of Lord Blackwell's appointment to the role of Chairman, he has taken steps to ensure that he can adequately meet the time commitments of the role. Lord Blackwell meets the independence criteria set out in the Code on appointment. His biography can be found on page 70.

Appointments

In 2013, the Board identified the need for a number of new Directors to supplement the banking, finance and risk experience on the Board. The following Board appointments were made:

– On 5 March 2013, Nick Luff was appointed as a Non-Executive Director and replaced Martin Scicluna as Chairman of the Audit Committee on 31 March 2013; and

– On 29 November 2013, Juan Colombás, the Chief Risk Officer, was appointed as an Executive Director.

In addition, on 1 January 2014, Dyfrig John was appointed as a Non-Executive Director.

The Nomination & Governance Committee is currently conducting a search for additional directors with relevant banking, finance and risk experience. A search is also being conducted for a new chairman of Scottish Widows Group Limited in place of Lord Blackwell.

More information on Board and Committee composition and the appointment process is set out in the Nomination & Governance Committee Report on pages 89 and 90. The Directors' biographies are set out on pages 70 and 71.

Executive Director service contracts and Non-Executive Director terms of appointment

The Chairman and Non-Executive Directors are appointed for a specified term and are subject to annual re-election by shareholders. Non-Executive Directors may have their appointment terminated, in accordance with statute and the articles of association, at any time without compensation. Executive Directors have service contracts with the Group. The Chairman, Group Chief Executive, Chief Financial Officer and Chief Risk Officer are each obliged to give six months notice of their intention to retire from their respective roles. The terms and conditions of appointment of Non-Executive Directors and Executive Director service agreements are available for inspection at the registered office address.

Election and re-election

All Directors appointed to the Board since the annual general meeting in 2013 will stand for election at the 2014 annual general meeting. All other Directors will retire and those willing to serve again will submit themselves for re-election at the annual general meeting. Biographies of all current Directors are set out on pages 70 and 71. Details of the Directors seeking election or re-election at the annual general meeting are set out in the Notice of Meeting.

Directors' and Officers' liability insurance

Throughout 2013 the Group had appropriate insurance cover in place to protect Directors, including former Directors who retired during the year, from liabilities that may arise against them personally in connection with the performance of their role. As well as insurance cover, the Group agrees to indemnify the Directors to the maximum extent permitted by law. Further information on the Group's indemnity arrangements is provided on page 74.

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Diversity policy

The Board places great emphasis on ensuring that its membership reflects diversity in the broadest sense. The combination of personalities on the Board provides a good range of perspectives and challenge and improves the quality of decision making. In 2013, the Board continued to focus on improving diversity. The percentage of female representation on the Board meets its objective of 25 per cent by 2015 as recommended by the Lord Davies Review. The following charts detail the percentage of women employed at various levels of seniority within the Group as at 31 December 2013 compared to prior years.

Developing diversity

The Board recognises that senior management is a group from which future directors may be selected. To improve the diversity in these roles, the Group has implemented a variety of initiatives which include:

– the Senior Women Leadership Programme;
– Footprints in the Snow, a senior women's role model programme;
– mandatory diverse shortlists for senior appointments;
– Sponsoring Leadership Programme, where women and colleagues from ethnic minorities are sponsored in their career by senior executives;
– the Breakthrough Women's Network, which provides support and networking opportunities for over 4,000 women across the Group; and
– the Group Disability Programme, providing equal opportunity for colleagues with disabilities.

The Group has also sponsored the First Women Awards for eight years running and has been awarded a place in *The Times* Top 50 Employers for Women in 2012 and 2013.

These initiatives, amongst others, will help the Group improve diversity. More information on the Group's diversity programmes, including details of the Group's commitment to raise the percentage of women employed in senior management roles to 40 per cent by 2020, is set out in the 2013 Responsible Business Report, which can be found on our website at www.lloydsbankinggroup-cr.com.

Conflicts of interest

All Directors of the Group and its subsidiaries must avoid any situation which might give rise to a conflict between their personal interests and those of the Group. Prior to appointment, potential conflicts of interest are disclosed and assessed to ensure that there are no matters which would prevent that person from taking on the appointment.

Directors are responsible for notifying the Chairman and Company Secretary as soon as they become aware of actual or potential conflict situations. In addition, conflicts are monitored as follows:

– the Directors are required to complete a conflicts questionnaire on appointment and annually thereafter;
– changes to the commitments of all Directors are reported to the Nomination & Governance Committee and the Board; and
– a register of potential conflicts and time commitments is regularly reviewed and authorised by the Board to ensure the authorisation status remains appropriate.

If any potential conflict arises, the articles of association permit the Board to authorise the conflict, subject to such conditions or limitations as the Board may determine. In situations where a potential conflict arises, the Director will excuse themselves from any meeting or discussion and all material in relation to that matter will be restricted including Board papers and minutes.

Anita Frew is a Non-Executive Director of the Group and Aberdeen Asset Management plc. During the year, Aberdeen Asset Management agreed to acquire Scottish Widows Investment Partnership from the Group. Anita excused herself from all discussions concerning the transaction and did not have access to any of the papers. She took the same action at Aberdeen Asset Management. On this basis, the Board approved the potential conflict of interest.

Time commitments

Non-Executive Directors are required to devote such time as is necessary for the effective discharge of their duties. On average, this equates to 35-40 days per annum (including attendance at Committee meetings). For Committee Chairs, this increases to 45-50 days with the Senior Independent Director and Deputy Chairman spending considerably more than 50 days on the Company's business. Non-Executive Directors may be expected to relinquish other appointments to ensure that they can meet the time commitments of their role. Fees paid to Non-Executive Directors reflect the time commitment and responsibilities of the role. Non-Executive Directors do not receive share options or other performance related pay. Executive Directors are restricted to taking on no more than one non-executive director role in a FTSE 100 company. The Chairman is required to commit to this being his primary role, limiting his other commitments to ensure he can spend as much time as the role requires. The Chairman's biography can be found on page 70.

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Training

Board induction

All Directors are expected to make an informed contribution based on an understanding of the Group's business model and the key challenges facing the Group and its businesses. The Chairman ensures that all Directors receive a full, formal and tailored induction on joining the Board comprising:

– a corporate induction, including an introduction to the Board and a detailed overview of the Group, its strategy, operational structures and main business activities. Non-Executive Directors are also afforded opportunities to meet with major shareholders;
– the roles and responsibilities of a Director, including statutory duties and responsibilities of an FCA approved person;
– a bespoke induction programme tailored by the Chairman to the individual needs of the Director with regard to their specific role and their skills and experience to date. This takes the form of reading materials and meetings with senior executives across the Group and sessions on the Group's business divisions; and
– a detailed induction programme across Risk, focusing on: risk appetite and the Group's risk profile; compliance and conduct risk; capital, stress testing, analytics and modelling; liquidity risk; Retail and Wealth credit risk; Commercial Banking credit risk; operational risk and financial crime; EU State aid, risk transformation, ring-fence banking, recovery and resolution planning; global non-core; and the separation of TSB Bank.

In preparation for his role as Chairman of Lloyds Banking Group, Lord Blackwell has undertaken an intensive induction and continuing business awareness programme. Since his appointment was approved, he has also joined Sir Winfried Bischoff in attending important internal and external meetings.

Professional development

The Board receives regular refresher training and information sessions throughout the year to address current business or emerging issues. This is done under the leadership of the Chairman and is delivered through a variety of business updates, including sessions on:

– capital and liquidity (including stress testing requirements);
– the approved persons regime;
– accounting developments; and
– credit rating agency developments.

These sessions also allow the Executive Directors an opportunity to consider business areas outside their direct responsibilities.

In addition, the Audit Committee hosted a series of 'deep dives' in early 2013 to which all Board members were invited, and which provided an in-depth review of the operations of each of the business divisions and of the latest accounting standards and operating methodologies. During the year the Audit Committee deep dives were replaced by business and technical updates. The Board Risk Committee also received reviews from each division. All of the Directors attend the Board Risk Committee.

Directors are also invited to attend courses, management meetings and one to one meetings with key executives. For instance, some of the Non-Executive Directors attended meetings of the Product Pricing Governance Committee, others spent a day at a PPI call centre.

Board agenda and attendance

Setting the Board agenda

The Chairman is responsible for setting the Board agenda, assisted by the Group Chief Executive and Company Secretary. A yearly planner is prepared by the Company Secretary to map out the flow of key items of business to the Board and to ensure that sufficient time is being set aside for strategic discussions.

Prior to each Board meeting the Chairman reviews the agenda and time allocation with the Group Chief Executive, the Company Secretary and other Directors as appropriate. The Group Chief Executive holds a separate Board paper review meeting to review the individual papers. That meeting is held with the Chief Financial Officer and Company Secretary, and authors of the main papers, as required.

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Board allocation of time in 2013

Effective use of the Board's time

To ensure that there is sufficient time for the Board to discuss matters of a material nature, Board dinners and/or breakfast meetings are held prior to each scheduled Board meeting. This allows the Directors greater time to discuss their views and, where relevant, form a consensus ahead of the meeting. These pre-meetings are normally attended by all members of the Board but often the pre-meetings are held without the Executive Directors present and separately, at least once a year, without the Chairman in attendance.

The Non-Executive Directors also receive regular updates from the Group Chief Executive in the form of a weekly email or briefing call.

In 2013, the Board's agenda was re-ordered to achieve a greater focus on key strategic and customer matters. As the bank works towards achieving its goal of becoming the 'best bank for customers', the Board intends to devote more time to strategic matters and also to customer related issues.

Group strategy

In addition to routine strategic discussion at Board meetings throughout the year, the Directors spent two days offsite in 2013 focusing entirely on the Group's broader strategic plan and the setting of the Group's five year operating plan.

Attendance at meetings

In 2013, a total of 10 Board meetings were held, eight of which were scheduled and two of which were ad hoc meetings. Ad hoc Board meetings are called at short notice to discuss a matter that cannot wait until the next scheduled Board meeting. Where a Director is unable to attend a meeting, the Chairman discusses the matter with the Director and seeks their support for the proposed recommendation. He also represents their views at the meeting. Each of the two ad hoc meetings held in 2013 concerned matters that had been previously approved in principle by the full Board. Board members also attended the annual general meeting held in Edinburgh.

The attendance of Directors at Board and Committee meetings is shown in the table below. Whilst all Directors are invited to, and regularly attend, other Committee meetings, only their attendance at Committees of which they are members is recorded.

	Lloyds Banking Group Board				Nomination & Governance Committee		Audit Committee		Board Risk Committee		Remuneration Committee	
	Scheduled Meetings		Ad hoc Meetings									
	Attended	Held[1]	Attended[2]	Held[1]	Attended	Held[1]	Attended	Held[1]	Attended	Held[1]	Attended	Held[1]
Current Directors who served during 2013												
Sir Winfried Bischoff	8	8	2	2	3	3	–	–	6	6	10	10
António Horta-Osório	8	8	1	2	–	–	–	–	–	–	–	–
Lord Blackwell	8	8	2	2	–	–	8	9	6	6	–	–
Juan Colombás[3]	–	–	–	–	–	–	–	–	–	–	–	–
George Culmer	8	8	–	2	–	–	–	–	–	–	–	–
Carolyn Fairbairn	7	8	1	2	–	–	9	9	–	–	10	10
Anita Frew	8	8	2	2	2	2	9	9	6	6	–	–
Nick Luff	6	6	2	2	–	–	6	6	5	5	–	–
David Roberts	8	8	1	2	3	3	9	9	6	6	10	10
Anthony Watson	8	8	2	2	3	3	9	9	5	6	10	10
Sara Weller	8	8	1	2	–	–	–	–	6	6	10	10
Former Directors who served during 2013												
Timothy T Ryan	3	3	–	1	–	–	–	–	3	3	7	7
Martin Scicluna	2	2	–	1	1	1	3	3	1	1	–	–

[1] Number of meetings held during the period that the Director held office.

[2] One of the ad hoc meetings was called at very short notice leading to a number of the Directors being unable to attend. However, each of those Directors provided their views to the Chairman in advance of the meeting so that their vote could be recorded at the meeting.

[3] There were no Board meetings in 2013 following the appointed of Juan Colombás on 29 November 2013.

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Effectiveness

Board effectiveness

The Chairman of the Board leads the rolling review of the Board's effectiveness with the support of the Nomination & Governance Committee, which he also chairs. A summary of the Board's progress against the actions arising from its external 2012 Board effectiveness review are set out below:

2012 evaluation (external)	2013 action
Refocusing of the Board agenda	The agenda has been re-ordered to ensure greater focus on key strategic matters. The length and timing of reports from the Group Chief Executive, Chief Financial Officer and each of the Board Committee Chairman have also been reviewed, to maximise the time available during the meeting for discussion on strategic, rather than operational, matters.
Working together	The pattern of Board and Committee meetings and associated events was reviewed in 2013, allowing greater opportunity for informal interaction between Board members outside the boardroom.
Continuing development	Deep dives have been replaced by bespoke training sessions on specific topics as required. A structured approach to continuing development was introduced in 2013, which included a series of workshops and focused training sessions.

2013 evaluation of Board performance

The annual evaluation of the Board's effectiveness provides an opportunity to consider ways of identifying greater efficiencies, maximising strengths and highlighting areas for further development.

Following an external review in 2012 by Independent Audit, who has no connection to the Group, the Group conducted an internal review in 2013. Overseen by the Nomination & Governance Committee, the 2013 review considered the following areas: strategy; risk and control; planning and performance; Board composition and size; culture and dynamics; relationships between management and independent Directors; governance; the Board's calendar and agenda; the quality and timeliness of information; support for Directors and Committees; and other matters.

This year's evaluation was conducted between November 2013 and January 2014 and consisted of:

– a detailed questionnaire, drafted by the Chairman in conjunction with the Company Secretary, to assess the effectiveness of the Board, its Committees and individual Directors;
– follow up interviews with the Chairman and/or Deputy Chairman as required;
– feedback to the Nomination & Governance Committee; and
– a recommended action plan.

The evaluation of the Chairman was led by the Senior Independent Director through questionnaires and interviews for those who wanted to discuss anything further. The reviews concluded that the performance of the Board, its Committees, the Chairman and each of the Directors continues to be effective.

The outcome of the Board effectiveness review has been discussed by the Board. The outcome of the evaluation of the Chairman was discussed by the Non-Executive Directors at an arranged Board dinner and at the Board meeting the following day, each in the absence of the Chairmen. If Directors have concerns about the Company or a proposed action which cannot be resolved, it is recorded in the Board minutes. No such concerns were raised in 2013.

2013 evaluation outcomes

The findings of the 2013 effectiveness review stressed the progress made under the Chairman's leadership with strong support from experienced Committee Chairs. It identified a number of key strengths including the quality of risk oversight and risk reporting, improved Board dynamics and strongly performing Committees. Inevitably, it also identified areas for further efficiencies and effectiveness as set out below.

Matters considered		
The quality and timeliness of Board and Committee papers.	The mix of skills and experience on the Board.	The focus of the Board's agenda.
Observations		
Actions taken previously have reduced the volume of papers received by the Board, but further improvements are required.	With the pending retirement of Sir Winfried Bischoff, the Board would benefit from additional banking, finance and risk expertise.	As the bank works towards achieving its goal of becoming the 'best bank for customers', the Board will need to devote more time to strategic and customer related issues.
Actions taken/to be taken		
Targeted training to senior management to ensure that papers focus on the areas most likely to lead to discussion.	The appointment of Dyfrig John in January 2014 has bolstered the depth and breadth of UK retail banking experience on the Board. Further searches continue.	The Board intends to increase further its focus on customers and customer outcomes in 2014 through more regular presentations on customer dashboards and peer analysis.

The Group will report on the progress of the above action plan in the 2014 annual report.

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Internal control

The Board is responsible for the Group's system of internal control, which is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. In establishing and reviewing the system of internal control, the Directors consider the nature and extent of the risks facing the Group, the likelihood of a risk event occurring and the costs of control. A system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can therefore only provide reasonable but not absolute assurance against the risk of material mis-statement or loss.

The Directors and senior management are committed to maintaining a robust control framework as the foundation for the delivery of effective risk management. They acknowledge their responsibilities in relation to the Group's system of internal control and for reviewing effectiveness. The Group's Policy Framework defines mandatory controls for all material risk types, and the requirement for all colleagues to comply with Policies is reinforced through the Codes of Business and Personal Responsibility, which ensure that colleagues understand they are accountable for the risks they take, and individual objectives expressed in the balanced scorecard.

The process for risk identification, measurement and control is integrated into the Group's overall framework for risk governance. The Group is forward-looking in its risk identification processes to ensure emerging risks are identified. The risk identification, measurement and control process also identifies whether the controls in place result in an acceptable level of risk. At Group level, a consolidated risk report and risk appetite dashboard are reviewed and regularly debated by the Group Risk Committee, Board Risk Committee and the Board to ensure that they are satisfied with the overall risk profile, risk accountabilities and mitigating actions. The report and dashboard provide a monthly view of the Group's overall risk profile, key risks and management actions, together with performance against risk appetite and an assessment of emerging risks which could affect the Group's performance over the life of the operating plan. This process has been in place for the year under review and up to the date of the approval of the annual report and is regularly reviewed by the Board. Information regarding the main features of the internal control and risk management systems in relation to the financial reporting process is provided within the risk management report on pages 123 to 196.

An annual control effectiveness review (CER) is undertaken to evaluate the effectiveness of the Group's control framework, with regard to its material risks, to ensure management actions are in place to address key gaps or weaknesses in the control framework and to discharge its obligations under the Turnbull guidance. Business areas and head office functions assess the controls in place to address all material risk exposures across all risk types. The CER considers all material controls, including financial, operational and compliance controls.

Senior management complete an attestation to confirm the CER findings which are reviewed and independently challenged by the Risk Division and Group Audit and reported to the Board. Action plans are implemented to address any control deficiencies. The process complies with the Internal Control Revised Guidance for Directors on the Combined Code issued by the Financial Reporting Council, and the conclusions are reported to and reviewed by the Board. The 2013 CER found that, overall, the Group is well controlled and that the control environment has improved year-on-year. This improvement is consistent with the delivery of various action plans and an improvement in the operational risk profile of the Group.

The effectiveness of the internal control system is reviewed regularly by the Board and the Audit Committee, which also receives reports of reviews undertaken by the Risk Division and Group Audit. The Audit Committee receives reports from the Company's auditor, PricewaterhouseCoopers LLP (which include details of significant internal control matters that they have identified), and has a discussion with the auditor at least once a year without executives present, to ensure that there are no unresolved issues of concern.

In 2013, the Audit Committee, in conjunction with the Board Risk Committee, concluded that the Group's systems of internal control and risk management were effective, and recommended that the Board approve them accordingly.

Shareholder relationships

The Board recognises the importance of promoting mutual understanding between the Company and its shareholders through greater engagement. In 2013, there was regular dialogue with investors with more than 450 equity investor meetings and approximately 200 debt investor meetings undertaken during the year. Many of these meetings were undertaken by senior management (primarily the Group Chief Executive and Chief Financial Officer) or other Board or GEC members. The Chairman has also attended a number of meetings to discuss governance and the Group's strategic direction. Anthony Watson, the Chairman of the Remuneration Committee and the Senior Independent Director, regularly meets the larger shareholders to listen to their views and discuss executive remuneration.

The Board is kept advised of the views of major investors by means of regular updates at Board and Committee meetings. It also receives reports on market and investor sentiment, shareholder analysis and surveys of shareholder opinions.

Investor Relations has primary responsibility for managing day-to-day communications with investors. Supported by the Group Chief Executive, Chief Financial Officer, and other members of the senior management team, they achieve this through a combination of briefings to analysts and institutional investors (both at results briefings and throughout the year), as well as individual discussions with institutional investors.

Following the announcement of our half year results in August 2013 and our full year results in February 2014, the Group Chief Executive wrote to shareholders outlining the progress made on our strategy to be the 'best bank for customers'. He has undertaken to write to shareholders twice yearly with further progress updates.

The Company Secretary oversees communications with retail shareholders. The Group's annual general meeting provides an opportunity to meet the Group's Directors and to hear more about the strategy of the Group. Shareholders are encouraged to attend the annual general meeting and to raise any questions at the meeting or in advance, using the email address shown in the Annual General Meeting pack which will be sent to shareholders in due course.

CORPORATE GOVERNANCE REPORT

Statement of compliance

UK Corporate Governance Code

The Group confirms that is has applied the main principles and complied with all provisions of the Code throughout the year ending 31 December 2013.

The British Bankers' Association Code for Financial Reporting Disclosure

In September 2010, the British Bankers' Association published a Code for Financial Reporting Disclosure (the 'Disclosure Code'). The 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 has adopted the Disclosure Code and its 2013 financial statements have been prepared in compliance with the Disclosure Code's principles.

Committee reports

The following pages contain reports from each of the Board's Committees.

Nomination & Governance Committee report

Fundamental to the Board's strategy are high standards of corporate governance designed to ensure rigour in Board discussions and decision making.

Sir Winfried Bischoff
Chairman, Nomination & Governance Committee

	Meetings attended/held in 2013[1]
Committee chairman	
Sir Winfried Bischoff	3/3
Committee members	
Anita Frew	2/2
David Roberts	3/3
Anthony Watson	3/3
Former Committee member	
Martin Scicluna	1/1

[1] Number of meetings held during the period the member held office.

Chairman's overview

During 2013, the Committee continued to keep under review the Group's governance arrangements, succession planning and the effectiveness of the Board and its Committees. In particular, considerable time was spent addressing the following matters:

Board appointments – the Committee recommended that the Board appoint a number of new directors: Nick Luff was appointed to replace Martin Scicluna as Chairman of the Audit Committee; Juan Colombás, the Chief Risk Officer, was appointed as an Executive Director as a reflection of the Board's desire to elevate the importance of risk management; and Dyfrig John was appointed as a Non-Executive Director to increase the number of directors with significant banking experience.

Board effectiveness review – the Committee considered progress against the 2012 action plan and its approach for 2013. Following an external review in 2012, it undertook an internal review in 2013, with a view to reverting to an external review in 2014 under the new Chairman of the Board. Details of the effectiveness review can be found on page 86.

Corporate governance – the Committee monitored proposed changes in regulations and ensured that plans were in place to mitigate any risks arising.

Salz Review analysis – the Committee oversaw an analysis of the Group's performance against the 34 Salz recommendations. Details can be found on page 90.

Chairman of TSB Bank – the Committee oversaw a comprehensive search for the appointment of a suitable chairman for TSB Bank plc, which culminated in the appointment of Will Samuel in February 2014. Will brings a wealth of experience to the role and is well-regarded by the market and across the financial services industry. He is a key hire and will be instrumental in building TSB Bank's independent future as a challenger to the other high street banks. The Group has previously stated its intention to float TSB Bank through an initial public offering in 2014. JCA Group assisted with the search for Will Samuel. JCA Group is not connected with the Group.

During the year the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

Committee purpose and responsibilities

The purpose of the Nomination & Governance Committee is to keep the Board's governance, composition, skills, experience, knowledge, independence and succession arrangements under review and to make appropriate recommendations to the Board to ensure the Company's arrangements are consistent with the highest corporate governance standards. The key responsibilities of the Committee are set out in the table below and examples of how it discharged its responsibilities in 2013 follow. A full list of responsibilities is detailed in the Committee's terms of reference, which can be found on our website at www.lloydsbankinggroup.com.

Nomination & Governance Committee Terms of Reference

Corporate governance

- Oversees the Board's governance arrangements to ensure that they pay due regard to best practice principles and remain appropriate.
- Monitors developing trends, initiatives or proposals in relation to board governance issues in the UK and elsewhere.
- Reviews and approves the annual corporate governance report.
- Monitors Board governance issues including the establishment of appropriate policies and practices to enable the Board to operate effectively and efficiently.
- Reviews the Group's corporate governance framework.

Effectiveness and succession planning

- Oversees the annual evaluation of the performance of the Board and its Committees, recommending actions for addressing any findings.
- Leads the Board selection and appointment process for new Directors.
- Conducts an annual review of the adequacy of succession arrangements for Executive Directors, members of the Group Executive Committee and their direct reports.

Composition, skills and independence

- Reviews the appropriate structure, size and composition of the Board, having regard to the balance of skills, experience, independence, knowledge and leadership needs of the Group.
- Reviews the independence of Non-Executive Directors, the re-appointment or re-election of Directors and their suitability to continue in office.
- Reviews the role, including capabilities and time commitment, of the Chairman, Deputy Chairman, Senior Independent Director, Non-Executive Directors, the Group Chief Executive and Executive Directors.

CORPORATE GOVERNANCE REPORT

Committee composition, skills and experience

To ensure a broad representation of independent views, including perspectives from each of the Committees, membership of the Nomination & Governance Committee comprises the Chairman, the Deputy Chairman, the Senior Independent Director, the Chairmen of the Risk and Remuneration Committees and one other independent Non-Executive Director. Anita Frew joined the Committee in 2013. Her experience as Chair and Senior Independent Director on other boards as well as her length of service and perspective further complements the composition of the Committee. The Group Chief Executive attends meetings as appropriate.

Corporate Governance

The Committee oversaw the Board's governance arrangements to ensure that they reflected best practice and remain fit for purpose. In 2013, the Committee received regular corporate governance updates from the Company Secretary. The reports detailed the impact emerging regulation would have on the Board and its corporate governance practices. The Committee considered these matters and made recommendations to the Board on how best to respond. The corporate governance framework, comprising the board authority and the delegated executive authority sets out the responsibilities of the Board and its Committees and details the authorities delegated to management. In 2013, the Committee recommended changes to the framework to reflect changes to the organisational design, best practice and regulatory requirements.

Salz Review

Following the publication of the Salz Review '*An Independent Review of Barclays' Business Practices*' in April 2013, the Chairman requested that the Nomination & Governance Committee oversee a full analysis of the Group's performance against the 34 Salz recommendations with reporting to the Board. The assessment provided assurance that the practices criticised in the Salz Review were not prevalent within the Group. The Group is seeking to embed a customer centric culture, which includes changing the way the Group measures colleague performance and incentivises them. The corporate culture is expressed through the Group's Values and Code of Personal Responsibility. The cultural change programme is focussed on changing the way the Group measures colleague performance and incentivises them. It is supplemented by a Group-wide cultural assessment that is helping measure progress and build momentum as we help our 94,000 colleagues adapt to new ways of working by focusing on achieving successful outcomes for our customers rather than successful sales figures.

The Salz recommendations will be subjected to regular review by the Committee and the Board to ensure the desired outcomes are being realised and embedded throughout the business. Further information on the Group's Responsible Business agenda can be downloaded from www.lloydsbankinggroup-cr.com.

Succession planning

The Nomination & Governance Committee oversees the Board's arrangements for the longer term succession of Board and Committee members. Non-Executive Director succession planning is addressed as part of the ongoing review of Board composition. The policy takes account of the need to regularly refresh the intake of Non-Executives to bring new, diverse perspectives to the Board and its deliberations, to ensure appropriate representation on each of the Board's Committees and to plan for longer term succession. The Chairman is responsible for developing and maintaining a succession plan in relation to the Group Chief Executive who is in turn, primarily responsible for developing and maintaining a succession plan for key leadership positions in the senior executive team. For information on diversity, please refer to page 83.

Board and Committee composition

The Nomination & Governance Committee assists the Chairman in his assessment of the skills, experience, knowledge, composition and diversity of the Board and its Committees. During 2013, the Committee identified the need to appoint a number of directors. In March 2013, Nick Luff joined the Board as a Non-Executive Director and, in due course, succeeded Martin Scicluna as Chairman of the Audit Committee. Mr Luff, who has over 10 years experience as a finance director, has recent and relevant financial expertise and a sound understanding of internal reporting and controls.

In November 2013, the Group announced the appointment of Juan Colombás to the Board. Mr Colombás has been the Group's Chief Risk Officer and a member of the Group Executive Committee since January 2011. The appointment of Mr Colombás increases the number of Executive Directors on the Board from two to three and demonstrates the Board's desire to elevate the importance of risk management in the Group. It also reflects the significant work that Mr Colombás has done to reshape the risk function within Lloyds Banking Group over the past three years. As part of Mr Colombás' development, he attended Board meetings from February 2013 onwards prior to his appointment to the Board in November 2013.

Dyfrig John, who joined the Board in January 2014, has significant UK retail banking experience, having served in various senior management roles throughout his career, most notably for HSBC Bank Plc as its Deputy Chairman and Chief Executive Officer, UK and Europe.

The search for additional directors with relevant banking, finance and risk experience continues, as well as for a Director to replace Lord Blackwell as Chairman of Scottish Widows. A description of the Board's policy on diversity is set out on page 83. The biographies of Mr Luff, Mr Colombás and Mr John can be found on pages 70 and 71. The JCA Group assisted with the search for Nick Luff and Dyfrig John and are assisting with the search for the Chairman of Scottish Widows. JCA Group is not connected with the Group.

Effectiveness

The Nomination & Governance Committee developed an action plan to address the issues identified out of the 2012 external Board effectiveness review. Full details of this action plan, and the 2013 effectiveness review and outcomes are set out on page 86.

Independence

The Nomination & Governance Committee is responsible for the ongoing assessment of the independence of Non-Executive Directors. In assessing independence, the Committee did not rely solely on the Code criteria but considered whether, in fact, the Non-Executive Director was demonstrably independent and free of relationships and other circumstances that could affect their judgement as well as relevant external factors. It did this with reference to the individual performance and conduct in reaching decisions. It also took account of any relationships that had been disclosed and authorised by the Board. Based on its assessment for 2013, the Nomination & Governance Committee is satisfied that, throughout the year, all Non-Executive Directors remained independent as to both character and judgement.

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Audit Committee report

The Audit Committee spent extensive time in 2013 considering the significant judgements in the Group's financial reporting, including reviewing the assumptions made by management in determining the provision for PPI redress.

Nick Luff
Chairman, Audit Committee

	Meetings attended/held in 2013[1]
Committee chairman	
Nick Luff	6/6
Committee members	
Lord Blackwell[2]	8/9
Carolyn Fairbairn	9/9
Anita Frew	9/9
David Roberts	9/9
Anthony Watson	9/9
Former Committee member	
Martin Scicluna	3/3

[1] Number of meetings held during the period the member held office.

[2] The views of the Directors who are unable to attend meetings are provided to the Committee Chairman for representation at the meeting.

Chairman's overview

I succeeded Martin Scicluna as Chairman of the Audit Committee on 31 March 2013 and am pleased to be able to continue his good work. During the year, the Audit Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

The Committee spent considerable time reviewing the adequacy of provisions relating to Payment Protection Insurance (PPI) every quarter. Two additional meetings were convened specifically for this purpose. Assessing the appropriate level for the provision involves considerable judgment, with significant uncertainty around the expected volume of future reactive complaints, the impact of proactive past business reviews and the operational costs of the PPI programme. Recognising these uncertainties, the Committee also oversaw enhancements to the disclosures relating to PPI at the year end.

In addition to PPI, in the context of financial reporting, the Committee maintained a focus on loan impairments and other conduct related provisions, deferred tax assets and valuation of assets and liabilities arising in the insurance business. The Committee reviewed the Annual Report and Accounts as well as the Interim Reports prior to approval by the Board.

Under the Committee's oversight, significant progress was made during 2013 in improving the effectiveness of Group Audit. A new charter for Group Audit was adopted, the Committee reviewed the audit plan in greater depth, and the formal reporting line for the Group Audit Director was changed such that the reporting line is to the Chairman of the Audit Committee. Group Audit provided strong support for the Committee's work during the year, in relation to both financial reporting, and internal control and risk management.

The Committee continues to be satisfied with the effectiveness of the external audit. Reviewing the audit plan with PricewaterhouseCoopers LLP (PwC) enabled the Committee to ensure audit work focused on key risk areas and helped identify areas where improvements could be made to the focus of their work. In light of concerns expressed by the Financial Reporting Council on aspects of the quality of audits of financial institutions, the Committee ensured that the work done by the external auditor on loan impairments addressed the areas of concern and understood more the audit work undertaken on key IT systems. Looking forwards, a key issue for the Committee in 2014 will be when to conduct a tender for the external audit, taking into account the recommendations and requirements of various regulatory bodies on the subject.

Committee purpose and responsibilities

The purpose of the Audit Committee is to monitor and review the Group's financial reporting arrangements, the effectiveness of the internal controls and the risk management framework, and the internal and external audit processes. The Audit Committee reports to the Board on how it discharges its responsibilities and makes recommendations to the Board, all of which have been accepted during the year.

The key responsibilities of the Committee are set out in the table on the next page. A full list of responsibilities is detailed in the Committee's terms of reference, which can be found on our website at www.lloydsbankinggroup.com.

Committee composition, skills and experience

The Audit Committee acts independently of the executive to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control.

All members of the Committee are independent Non-Executive Directors with recent and relevant experience in finance and/or banking. During 2013, Nick Luff succeeded Martin Scicluna as the Chairman of the Audit Committee. Nick is a chartered accountant and has significant financial experience in the UK listed environment which enables him to fulfil the role of Audit Committee Chair and, for SEC purposes, the role of Audit Committee Financial Expert.

CORPORATE GOVERNANCE REPORT

Financial reporting

During the year, the Committee considered the following significant financial issues/judgements in relation to the Group's financial statements and disclosures, with input from management, Group Audit and the external auditor:

Key issues/judgements in financial reporting	Audit Committee review and conclusions
Payment Protection Insurance (PPI) Determining the adequacy of the provision for redress payments in connection with mis-selling of PPI is highly judgemental and requires the Group to make a number of assumptions, including the number of complaints that will be received in the future, response rates to proactive mailings, uphold rates for complaints received, average redress payments and related administrative costs. In the 2013 full year results, an additional provision of £3.1 billion was reflected for expected PPI costs. The provision brought the total amount set aside by the Group to cover PPI costs to £9.8 billion.	The Audit Committee spent considerable time in 2013 challenging the assumptions made by management in determining the provision for PPI redress. The key assumption that the Audit Committee focused on was future complaints volumes and associated operational costs. Management used a combination of analyses to forecast future complaint volumes, including statistical modelling and customer surveys. The Audit Committee challenged the appropriateness of these methods for forecasting complaint volumes, giving consideration to the total PPI policies sold by the Group. Group Audit provided assurance to the Audit Committee that the process was undertaken in a controlled manner using reasonable, consistent and supportable assumptions and inputs. In 2013, the Audit Committee concluded that the processes followed by management in determining the provision for PPI redress were appropriate, although they will be considered periodically against actual claims experience. The Audit Committee considered the appropriateness of disclosures in the News Release and this Annual Report and Accounts. The Audit Committee oversaw enhancements made to the PPI disclosure to ensure that they reflected the continuing uncertainty that remains around the ultimate actual cost of PPI, that appropriate sensitivities are provided to allow an understanding of the key assumptions underlying the provision and that changes in the provision were appropriately explained. The Audit Committee was satisfied that the PPI provision and disclosures were appropriate. The disclosures relating to PPI are set out in note 43: 'Other provisions' on page 281 of the financial statements.
Other conduct provisions The Group has a number of other provisions for conduct related matters, all of which are judgemental and require the Group to make a number of assumptions. In the 2013 full year results, an additional provision of £130 million was made for derivatives mis-sold to small and medium-sized enterprises (SMEs), taking the total provision to £530 million. There is a provision of £400 million in relation to the Group's insurance branch business in Germany, and a number of other smaller provisions that total some £200 million in relation to other conduct and compliance matters.	The Audit Committee spent time understanding and assessing the provision for other conduct related matters. For derivatives mis-sold to SMEs, the Audit Committee understood the basis for determining forecast average redress payments based on experience to date, and the adequacy of provisions made for operational costs for the expected duration of the programme. More broadly, the Audit Committee challenged management on their processes and controls for ensuring that all conduct related matters were identified and that exposures and associated provisions were appropriately quantified where necessary. The Audit Committee was satisfied that the provisions for other conduct matters were appropriate. The disclosures relating to other conduct provisions are set out in note 43: 'Other provisions' on page 281 of the financial statements.

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Key issues/judgements in financial reporting	Audit Committee review and conclusions
Allowance for impairment losses on loans and receivables Determining the appropriateness of impairment losses is judgemental and requires the Group to make a number of assumptions. In the 2013 full year results, a charge of £2,726 million was reflected for impairment losses.	The Audit Committee received regular reports in relation to impairment provisioning from management during 2013, presented by the Credit Risk Officers responsible for determining provisions in each of the divisions. Key assumptions challenged by the Audit Committee included the criteria for determining when a loan was impaired (particularly as it related to the Group's strategy) and whether previous provisions were appropriate when these subsequently changed for loans that were already impaired. Group Audit performed work to assess the effectiveness of impairment governance and processes and reported their findings to the Audit Committee. The audits considered whether management oversight, review processes and key judgements were adequately supported by quantitative analysis and detailed management information. The work carried out by Group Audit considered the basis for adjustments and calibrations to model output results and found these to be reasonable and supported by observed performance. The Audit Committee was satisfied that the impairment provisions were appropriate. The disclosures relating to impairment provisions are set out in note 54: 'Financial risk management' on pages 327 to 349 of the financial statements.
Recoverability of the deferred tax asset The recoverability of the deferred tax asset in respect of carry forward losses requires the consideration of the future levels of taxable profit in the Group. The Group's total deferred tax asset at 31 December 2013 included £6,338 million in respect of trading losses carried forward. Based on the Group's forecast taxable profit, the losses are expected to be fully utilised by 2019.	The Audit Committee considered the recognition of deferred tax assets, in particular the forecast taxable profits based on the Group's five year operating plan, the split of these forecasts by legal entity and the impact of the adjustment to the pension deficit on the implementation of IAS 19(R). The Audit Committee agreed with management's judgement that the deferred tax assets were appropriately supported by forecast taxable profits, taking into account the Group's long-term financial and strategic plans. The disclosures relating to deferred tax are set out in note 3: Critical accounting estimates and judgements on page 225 and note 42: 'Deferred tax' on pages 279 and 280 of the financial statements.
Uncertain tax positions The Group has a number of open tax matters which requires the Group to make judgements as to the likely outturn for the purposes of calculating its tax position.	The Audit Committee understood the uncertain tax positions of the Group, including the respective views of the Group and the relevant tax authorities. The Audit Committee also understood the external advice obtained by management to support the views taken by the Group. The Audit Committee was satisfied that the disclosures made in respect of uncertain tax positions were appropriate. The relevant disclosures are set out in Note 52: 'Contingent liabilities and commitments' on page 308 of the financial statements.
Retirement benefit obligations Determining the value of the defined benefit obligation is judgemental and requires the Group to determine a number of economic and non-economic actuarial assumptions.	The Audit Committee considered the assumptions underlying the calculation of defined benefit liabilities, in particular the discount rate applied to future cash flows and the rate of pension increases. The Audit Committee was satisfied that the value and disclosures made in respect of retirement benefit obligations were appropriate. The relevant disclosures are set out in Note 41: 'Retirement benefit obligations' on pages 271 to 279 of the financial statements.
Value-In-Force (VIF) asset and insurance liabilities Determining the value of the VIF asset and insurance liabilities is judgemental and requires the Group to determine a number of economic and non-economic actuarial assumptions, including longevity, persistency, expenses, credit risk and illiquidity premiums.	The Audit Committee considered and challenged the calculation of the value of expected future net cash flows from currently in-force insurance contracts and the liabilities arising from those contracts. The Audit Committee was satisfied that the value of the VIF asset and insurance liabilities were appropriate. The disclosures are set out in Note 28: 'Value of in-force business' and Note 36: 'Liabilities arising from insurance contracts and participating investment contracts', on pages 257 to 258 and 262 to 268, respectively, of the financial statements.

CORPORATE GOVERNANCE REPORT

Group Audit

During 2013 the Audit Committee monitored the effectiveness of Group Audit and their audit programme, approving the audit plan and budget and confirming that appropriate resources were in place to execute the plan effectively. Group Audit carried out over 400 audits in 2013 of varying size and complexity. Certain thematic audits focused on the Group's embedding of the risk appetite, the integrity of the risk management framework, customer outcomes, corporate culture, business applications and strategic risks. A number of these audits supported the Group's implementation of the new CIIA Code recommendations. The overall findings from Group Audit are presented to the Audit Committee with specific review of the findings from the most significant audit activity.

Internal control and risk management

Details of the internal control and risk management systems in relation to the financial reporting process is given within the risk management report on page 123. Specific matters that the Audit Committee considered during 2013 included:

- the scope of the work being undertaken as part of the Finance Transformation programme, in particular the implementation of a new consolidation system for the Group;
- the extent of work being performed by the Finance teams across the Group and considering the adequacy of resources in place to ensure that the control environment continued to operate effectively; and
- assessing control deficiencies identified as part of the assessment of the effectiveness of internal controls over financial reporting in accordance with the requirements of the US Sarbanes Oxley Act.

The Audit Committee was satisfied that internal controls over financial reporting were appropriately designed and operating effectively.

Whistleblowing

Throughout 2013 the Committee received reports from management on the Group's Whistleblowing line activity, a summary of key cases and the effectiveness of the Whistleblowing Governance Structure. The Committee oversaw the following key developments in 2013:

- Independent Call Handling: the existing whistleblower hotline was replaced in 2013 by a 24 hour, multilingual service, managed externally by an independent service provider;
- Mandatory Training: Group-wide mandatory Whistleblowing training was developed and rolled out across the Group, raising awareness of the regime; and
- Victimisation: changes introduced by the Enterprise and Regulatory Reform Act prompted measures to ensure whistleblowers are protected from harassment by co-workers.

External audit

Auditor independence and remuneration

Both the Board and the external auditor have safeguards in place to protect the independence and objectivity of the external auditor. The Audit Committee has a comprehensive policy to regulate the use of the auditor for non-audit services. This policy sets out the nature of work the external auditor may not undertake and guidance on the hiring of former external audit staff.

In some cases, PwC are selected over another service provider due to their detailed knowledge and understanding of the business. Any allowable non-audit services with a value above a defined fee limit requires prior approval from the Audit Committee Chairman. The total amount paid to the auditor in 2013 is shown in note 11 to the financial statements on pages 238 to 240.

How the Audit Committee assessed the effectiveness of the external audit process

In 2013, the Group engaged an external provider, Independent Audit, to conduct a review of the effectiveness of the external audit process. The review included seeking views of Audit Committee members, senior executives across the business and members of Group Audit, through a questionnaire and a number of one to one interviews, together with consideration of the reports provided by PwC to the Audit Committee. The review concluded that the external audit process was effective and identified a number of areas where further enhancements could be made.

Independent Audit is not connected with the Group.

Tenure of the external auditor

PwC has been the auditor of Lloyds Banking Group plc since 1995. A tender has not been conducted since. Prior to that, PwC and its predecessor firms were also the auditors to certain of the Group's predecessor companies.

The Committee considers each year whether to put the external audit to tender. With the current audit partner required to rotate off the audit after the 2015 audit, the Committee is considering whether to conduct a tender in the second half of 2014, with a view to appointing a new audit firm, or reappointing PwC, with effect from 1 January 2016, subject to shareholder approval at the AGM in 2015. A final decision will be made during the year, after consideration of the requirements of proposed EU legislation that may restrict the period for which PwC could be reappointed before a mandatory change of auditor is required.

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Board Risk Committee report

The Group's strategy and strong risk discipline has led to a safer, low risk bank.

David Roberts
Chairman, Board Risk Committee

	Meetings attended/held in 2013[1]
Committee chairman	
David Roberts	6/6
Committee members	
Sir Winfried Bischoff	6/6
Lord Blackwell	6/6
Anita Frew	6/6
Nick Luff	5/5
Anthony Watson[2]	5/6
Sara Weller	6/6
Former Committee members	
Martin Scicluna	1/1
Timothy T Ryan	3/3

[1] Number of meetings held during the period the member held office.
[2] The views of the Directors who are unable to attend meetings are provided to the Committee Chairman for representation at the meeting.

Chairman's overview

I am pleased to report the Board Risk Committee fulfilled its responsibilities and met its key objectives, whilst the annual Board effectiveness review concluded the Committee continued to operate effectively. The Committee maintains an appropriate balance of its scheduled review of key risks, whilst maintaining a dynamic approach so that emerging risks are appropriately escalated and considered and management actions and plans are constructively challenged. The Committee continued its focus on improving the quality of the information presented to it in order to better understand the current and emerging risks facing the Group, as well as ensuring the Group's risk management frameworks, policies, practices and procedures remain appropriate for the risks faced, and are fully embedded within the business. The development of a suitable 'risk culture' remains a critical component of effective risk management and the Committee will continue to oversee management's efforts in this regard.

In 2013, the UK economy continued to recover against a background of tight fiscal policy, restrictive credit conditions, weak consumer purchasing power and muted global growth. In addition, the regulatory and political environment tightened, with increased focus on conduct risk. Notwithstanding these external challenges, I am pleased to report the Group's strategy and risk discipline has led to a safer, low risk bank.

Juan Colombás, Chief Risk Officer, and a member of the Group Executive Committee since January 2011, was appointed to the Board in November 2013. His appointment reflects the importance of risk management within the Group and the significant work he has done to reshape the risk function, including driving the conduct strategy.

Committee purpose and responsibilities

The purpose of the Board Risk Committee is to monitor the Group's compliance with the Board's approved risk appetite, risk management framework and risk culture. The key responsibilities of the Board Risk Committee are set out in the table below and examples of how it discharged its responsibilities follow. A full list of responsibilities is detailed in the Committee's terms of reference, which can be found on our website at www.lloydsbankinggroup.com.

Board Risk Committee Terms of Reference

Risk management

Oversees the development, implementation and maintenance of the Group's overall risk management framework and its risk appetite, strategy, principles and policies.

Oversees the Group's risk exposures and risk/return.

Provides input into the alignment of executive remuneration to risk performance.

Risk principles and policy

Reviews new and material amendments to the risk principles and policy, recommended by the Group Chief Executive and Chief Risk Officer.

Oversees adherence to Group risk principles, policies and standards and any action taken resulting from material policy breaches.

Risk Division

Reviews and discusses with the Chief Risk Officer the scope of work of the Risk Division, its plans, the issues identified as a result of its work, how management is addressing these issues and the effectiveness of systems of risk management.

Reviews the appointment, resignation or dismissal of the Chief Risk Officer.

Reviews the adequacy of the Risk Division's resources, its authorities and standing within the Company.

CORPORATE GOVERNANCE REPORT

Committee composition, skills and experience

The Chair of the Board Risk Committee, David Roberts, has a deep understanding of risk management, underpinned by in-depth knowledge of all aspects of banking operations, having spent his career in banking. David is supported on the Committee by Non Executive Director members who have a variety of industry backgrounds, including banking, financial services and retail, who bring scrutiny and fresh perspective to the risk management framework of the Group. The Committee composition therefore includes core banking and risk knowledge, together with the breadth that brings wider knowledge from other sectors and a clear awareness of customer needs. As a reflection of the degree of importance attached to risk in the Group, all Directors attend the Board Risk Committee meetings, including those Directors who are not members. The Group Audit Director and the external auditor also attend Board Risk Committee meetings.

Key matters considered by the Committee

Set out below are some of the key matters considered in 2013.

Issue	Approach
Board risk appetite	The Committee reviewed each of the Board risk appetite statements and metrics and recommended the risk appetite to the Board as part of its annual review.
Consolidated risks	At each meeting, the Committee considered and challenged management's assessment and future projected status of all of the major and emerging risks and tracks the risks against appetite.
Conduct risk	The Committee received a presentation on conduct risk at each of its meetings with particular focus on learning from past failings, the Group's conduct strategy, meeting customer needs and outcome testing.
Divisional risks	The Committee received 'deep dive' updates of the risk profile and emerging issues from each of the Divisions.
Stress testing	The Committee reviewed the results of the application of economic stress test scenarios against the five year operating plan and approved risk appetite limits. The Committee also received regular reports from the Group Chief Economist on the macro-economic outlook.
Capital and liquidity	The Committee received regular reports on the capital and liquidity position of the Group under stress including the impact of regulatory changes.
Remuneration	The Committee reviewed, ahead of the Remuneration Committee, the internal independent control function's risk assessments of the Group and its Divisions, to ensure that the awards proposed clearly consider the observance of risk appetite and demonstration of strong risk management. The Committee also received updates on rewards and incentive schemes, to ensure they aligned with appropriate culture and sustainable performance.
Insurance risk	The Committee agrees the specific insurance risk appetite, which aligns with the Group risk appetite, and monitors against this as part of the suite of risk reporting.
Operational risk	The Committee receives regular updates across the spectrum of operational risk from business areas and from Risk Division presentations, including incident management approaches, the advanced measurement approach, records management, and IT including cyber risk. The Committee also received reports from the Anti-Money Laundering Officer, and regular divisional and second line oversight presentations.
Macro economic conditions	The Committee received regular updates on the macro economic conditions and risks from the Chief Economist, to enable it to effectively challenge strategy and risk appetite.
Regulatory developments	The Committee received regular updates from management on regulatory developments and assessed the impact of those developments on the Group's risk profile.
IT resilience	The Committee set the framework for, and oversaw, an external review of IT resilience and considered the Group's exposure to cyber risk.

Examples of how the Board Risk Committee discharged its responsibilities in 2013 are set out below.

Risk appetite

Lloyds Banking Group defines risk appetite as 'the amount and type of risk that our organisation is prepared to seek, accept or tolerate'. The risk appetite evolves in tandem with the Group's strategy and is embedded within policies, authorities and limits across the Group. Further details on the Group's risk appetite can be found in the risk report on pages 123 to 196.

The Board Risk Committee carried out its annual review of the Group's risk appetite in April 2013 for recommendation to the Board. The review considered the statements and risk appetite metrics under each category of identified risk which included: funding and liquidity; capital; market; earnings; operational risk; regulatory and conduct; people and risk culture; and credit. In July, the Board Risk Committee reviewed and recommended additional operational risk appetite metrics which had been developed following the earlier April discussion.

Performance against each of the risk appetite metrics is considered by the Committee at each of its meetings. Debate also takes place on emerging risks and reputational risks, and where appropriate management are asked to review, revise, or subsequently present proposals or further information.

TSB Bank plc is required to operate within the Group's risk appetite. The Committee considered TSB Bank's risk appetite and metrics on two occasions during the year and reported to the Board that TSB Bank's risk appetite was appropriate.

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Insurance risk

The Board Risk Committee reviewed the insurance divisional risk appetite to ensure that it was specifically relevant to the Insurance Division, its separate prudential needs, and the separate categories of risks that are relevant to the insurance business. The insurance business has its own separate board and risk committee.

Quality of risk reporting

The consolidated risk report has been significantly enhanced to provide the Board Risk Committee and the Board with a deep understanding of the current and emerging risks on a Group and divisional basis. The summary risk appetite dashboard tracks the movement over time of the risk assessment for each category of risk and a separate dashboard has been created to track the reputational and financial impact of key risks. These dashboards allow the Committee to isolate key risks quickly and, given the quality of supporting information provided, challenge management on their assessment of the risks.

Conduct risk

The Board Risk Committee received a presentation from management on conduct risk at each of its meetings. The presentations during the year included: reviews of prior conduct issues and regulatory investigations to identify lessons learnt; the review of conduct issues under management; reviews of the Group's conduct strategy and its embedded status including reports from Group Audit; sales processes and product governance, including the progress of annual product risk assessments, the results of outcome testing including mystery shopping results and complaint metrics; rewards and incentives; and specific deep dives, including reviews of certain products prior to and following their launch.

Capital and stress testing

The Committee received regular presentations from management on capital and leverage, the evolving prudential regulatory expectations, including outputs from the Financial Policy Committee of the Bank of England, and appropriate updates on the rating agency views of the Group.

Stress testing was conducted to assess the Group's risk profile against approved risk appetite and acts as a discussion basis with the regulator for the setting of the capital planning buffer. The Committee reviewed the results of the 'low interest rate' and 'high interest rate' stress test scenarios designed by the regulator and of specific stress scenarios designed by management in conjunction with the Group's Chief Economist which included rating downgrades, together with management's mitigating actions. The Committee was satisfied with the results and recommended to the Board that the indicative capital planning buffer was appropriate.

IT resilience

IT resilience received particular regulatory focus and media attention during the year due to the much publicised IT failings within the industry. The Board Risk Committee oversaw a review of IT resilience to ensure a rapid and robust identification of residual risks across the IT architecture and supporting IT capabilities. A review was conducted with the findings and proposed remedial actions reported to the Board. As part of the review, the Group defined critical economic functions and IT capabilities in order that key IT systems were identified and a detailed plan was developed. The high level risk appetite was defined in consultation with key stakeholders and approved by the Board. The Board Risk Committee set the framework for the review which will be conducted annually and reported independently to the Board who are now responsible for oversight.

Cyber risk

The Board Risk Committee also reviewed and agreed levels of risk appetite, strategy and planned investment to deal with changes in the cyber risk landscape.

Risk management framework review

The Chief Risk Officer provides the Board Risk Committee with an annual review of the status of the Group's governance and internal control framework for endorsement and recommendation to the Board. The 2013 review was for the first time conducted against the nine components of the Group's risk management framework (see Risk Overview, page 40), which include the arrangements for the cascade of delegated authority from the Board to its Committees and the Group Chief Executive, and the status of the risk governance and Group policy frameworks.

The 2013 review concluded that the Group's risk management framework is effective in design, its corporate governance arrangements are stable and the policy framework is also stable following a substantive review and refresh in 2011/12.

Alongside the risk management framework review, the Board Risk Committee also considered the approach and key findings of the annual control effectiveness review (see page 87), before referring it to the Audit Committee to review in conjunction with Group Audit's control framework assessment.

Risk Division

The Board Risk Committee is supported by the Risk Division and a number of management committees looking at different risk areas within the business. In 2013, the Committee conducted an annual review of the adequacy of the Risk Division's resources, its authority and standing within the Group. The review scrutinised the Risk Division's annual plan, which sets out how the Risk Division will achieve clear outcomes from individual teams in a structured and measurable manner.

The Committee concluded that the Risk Division is adequately resourced and continues to have sufficient authority and standing within the Group. This outcome further reflects the importance of risk management in the Group. The Committee received six monthly progress updates from management detailing the Risk Division's key achievements. Where activity deviates from the plan, actions are agreed to address any operational gaps. More information on the Group's approach to risk management can be found on pages 123 to 196.

CORPORATE GOVERNANCE REPORT

Remuneration Committee report

The Remuneration Committee was responsive to, and dealt effectively with, the quickening pace of regulatory change and uncertain market conditions during 2013.

Anthony Watson
Chairman, Remuneration Committee

	Meetings attended/held in 2013[1]
Committee chairman	
Anthony Watson	10/10
Committee members	
Sir Winfried Bischoff	10/10
Carolyn Fairbairn	10/10
David Roberts	10/10
Sara Weller	10/10
Former Committee member	
Timothy Ryan	7/7

[1] Number of meetings held during the period the member held office.

Chairman's overview

I am pleased to report good progress has been made on remuneration matters and their governance over the past year. The Remuneration Committee met its key objectives and carried out it responsibilities and the annual effectiveness review concluded that the Committee continued to operate effectively.

The Committee considered remuneration governance and refined the design of incentive plans whilst being mindful of market and regulatory developments. The changes have led to more consistent and effective consideration of risk in reward management across the Group. This ensures a robust framework exists to mitigate key regulatory and people risks associated with reward decisions and supports sustainable growth, consistent with the risk appetite framework agreed by the Board. The Committee is working with the Risk Division to further embed effective risk management into the culture of the organisation.

In addition to the responsibilities set out below, the Committee looked at TSB Bank remuneration strategy, policy and governance. This included the treatment of bonuses for colleagues transferred to TSB Bank and salaries for senior executives. External developments, principally through CRD IV and the Salz Review, were considered and factored into the annual review of Group incentive plans.

Committee purpose and responsibilities

The 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 with its long term business strategy, its business objectives, its risk appetite, values and the long term interests of the Group that recognises the interests of relevant stakeholders. The key responsibilities of the Remuneration Committee are set out in the table below and examples of how it discharged its responsibilities follow. A full list of responsibilities is detailed in the Committee's terms of reference, which can be found on our website at www.lloydsbankinggroup.com.

Committee composition, skills and experience

The Committee is comprised of Non-Executive Directors from a wide background to provide a balanced and independent view on remuneration matters. The Chairman, Anthony Watson, has over 40 years experience in the investment industry related sectors and is well placed to lead the Committee. Remuneration Committee meetings are attended by Deloitte LLP who act as the Group's remuneration consultant. Deloitte is not connected with the Group.

Remuneration Committee Terms of Reference

Executive remuneration

Determines and approves the contracts of employment, the terms of any performance related pay schemes and subsequently, individuals' performance against targets, in respect of the Group Chief Executive, the Company Secretary, Code Staff and any individual whose total compensation exceeds £750,000 per annum.

Sets the policy and principles to be applied by the Group Executive Committee in relation to any performance related pay schemes for individuals who are considered to be in a significant influence function or have material impact on the risk profile of the Group including all Code Staff.

Reviews and approves the remuneration of all senior officers in the risk management and compliance functions.

Remuneration reporting

Reports annually to the Board the substance of the Company's remuneration policy and proposes any substantive changes.

Recommends to the Board the contents of the Directors' remuneration policy and implementation reports.

Remuneration policy

Reviews annually the report from the Group HR Director on the operation of the Remuneration Governance Policy and its effectiveness.

Monitors the application of the authority delegated to the Group Chief Executive and the Divisional/ Business Area Remuneration Committees.

Liaises as required with the Board Risk Committee and Risk Division in relation to risk-adjusted performance measures.

Commissions an annual review of the risks arising from the Group's remuneration policies.

Recommends the approval by shareholders of the design of any longer term performance related pay schemes, and any significant changes to existing schemes.

Determines the eligibility and targets for any longer term performance related pay schemes, and subsequently reviews performance against these targets and proposes any awards.

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Executive remuneration

Gender remuneration review

The Group is committed to the principle of equal pay and intends that all colleagues should be paid fairly regardless of their age, gender, race, disability or other personal characteristics. To test this principle, the Committee commissioned a review into the differences in base pay between genders in senior executive roles, where bias was most likely to arise.

The review concluded that the average position to market does not show gender bias in any division, function or grade. Although no definitive bias was identified in this study, the Committee now receives annual reports on the topic to ensure there are no adverse changes.

Strategic reward review

A key pillar of the Group's People Strategy is to ensure our reward approach supports the Group's strategic goals. In late 2012, the Committee commissioned a strategic reward review. The objective was to optimise the current total remuneration spend across the Group in order to create a compelling, affordable and integrated reward proposition that aligns with our vision of being the best bank for customers. A broad range of proposals were considered culminating in a number of specific Committee recommendations, which were evolutionary in nature and address a number of key strategic issues.

Remuneration reporting

Changes to the remuneration reporting regime

The Committee dedicated significant time in 2013 to assessing the impact of changes to the remuneration reporting regime on the Group's approach to executive remuneration.

The Group's remuneration policy report sets out the parameters of the directors' remuneration package. The remuneration policy was developed by the Committee having considered the ways in which the Group can strengthen and simplify the alignment of remuneration with its business performance and relative to shareholder returns. The policy is subject to a binding shareholder vote at the 2014 annual general meeting and requires that a majority of shareholders vote in favour of the policy before it can be implemented.

The Directors' remuneration report on pages 100 to 122 summarises the amounts awarded to executive management and to be awarded in accordance with the policy, together with various other information to help shareholders understand the Committee's decisions over the past year. Many of the changes to the report under the new regulations are technical in nature and did not require substantial Committee involvement however, some sensitive disclosures did require the Committee's guidance.

The report is subject to an advisory vote at the 2014 annual general meeting. Whilst the outcome of this resolution is not binding on the Group, it does provide a clear indication to the Committee of whether its decisions are supported by the shareholders.

The Committee has striven to ensure that the remuneration policies and practices detailed in the remuneration policy and remuneration report are appropriate to supporting the delivery of the Group's current and future strategy.

Governance

Remuneration Governance Policy

The purpose of the remuneration governance policy is to provide a framework to support robust governance in line with the Group's risk appetite and aligned with the Group's business strategy, objectives, values and long-term interests.

The governance policy is designed to achieve compliance with European Commission regulation and the PRA Remuneration Code and supports consistent and effective risk management that accepts risk-taking only within the tolerated risk appetite of the Group and in line with our business strategy, objectives, values and long-term interests.

Effective management of remuneration governance and risk allows the Group to attract and retain individuals of the required calibre to deliver the Group's business strategy, drive appropriate behaviour from colleagues and avoid unexpected risks.

A number of controls are in place to ensure compliance with the governance policy, PRA Remuneration Code and to mitigate risk. The main controls are summarised below:

– an annual self-assessment of the Committee regarding its ability to fulfil its responsibilities;
– an annual attestation by members of the Group Executive Committee that remuneration decisions in the Divisions for which they are responsible have been made in accordance with the governance policy and are aligned with Group strategy and risk appetite; and
– an annual self-assessment by divisional/functional remuneration committees against the responsibilities set out within their terms of reference. Where areas for improvement are identified, action plans are designed and implemented.

The Committee reviews annually a report from the Group HR Director on the operation of the remuneration governance policy and its effectiveness. In 2013, the report concluded that effective systems and controls are in place for all requirements of the governance policy and that it delivers outcomes in line with the Group's values, reward principles and the PRA Remuneration Code.

DIRECTORS' REMUNERATION REPORT

Statement by the Chairman of the Remuneration Committee

On behalf of the Board and as Chairman of the Group's Remuneration Committee, I am pleased to present the Directors' Remuneration Report for the year ended 31 December 2013, which, in accordance with the new reporting regulations, is split into two parts:

– The Directors' Remuneration Policy, setting out the framework within which we operate and which will be subject to a binding vote.

– The Directors' Remuneration Implementation Report, which outlines how policy was implemented in 2013 and how the Directors' Remuneration Policy is intended to apply in 2014, and which will be subject to an advisory vote.

Linking remuneration to business strategy

The Committee continues to place great importance on ensuring that remuneration supports the business strategy. This is achieved principally through the variable pay plans:

– Annual bonus plan, which rewards for the delivery of financial targets (Economic Profit and Underlying Profit) and balanced scorecard objectives. These objectives are reviewed by the Committee annually to ensure alignment with the longer-term strategy. In determining awards, the Committee applies its judgement to adjust for any current or legacy issues. All awards for Executive Directors under the bonus plan are subject to deferral and may be adjusted prior to release if the Committee deems it appropriate.

– Long-term incentive plan, which is designed to support value creation for shareholders by measuring financial targets (currently Economic Profit and Total Shareholder Return) and strategic targets, which ensure a focus on strategic objectives, in particular those related to our customers. Performance is measured over three years and Executive Directors are required to hold the shares which vest for a further two years, thereby maintaining a link with shareholder experience after the award has vested.

Changes in our pay structure in 2014

Recent European regulatory changes have introduced a cap on the variable element of remuneration at 100 per cent of fixed remuneration which may be increased to 200 per cent, but only with shareholder approval. The Committee strongly believes in pay for performance, in providing a competitive package that allows us to attract and retain the key talent necessary to deliver the strategy set by the Board, and in ensuring that fixed costs are properly managed.

We are, therefore, seeking separate approval to allow us to award variable remuneration up to a maximum of 200 per cent of fixed remuneration. These changes have also led the Committee to review the remuneration package for directors and for staff under the scope of the regulation.

We are proposing to introduce an additional fixed element in the remuneration package. This will take the form of a fixed share award, made annually, which will deliver shares over a period of five years. This will enable us to comply with the regulations and maintain the competitiveness of the package and, in particular, the alignment with shareholders.

Therefore, whilst we have increased the fixed element of the package for Executive Directors, over 75 per cent will remain aligned with shareholders' interests.

Key changes for Executive Directors for 2014:

– Base salary for the Chief Risk Officer has been increased to reflect his additional responsibilities as a member of the Board; salaries for other Executive Directors are unchanged.

– Fixed share awards will be introduced for 2014 to ensure an appropriate balance of fixed and variable pay. These shares will be delivered over five years to support the alignment of executive and shareholder interests. The level of award will be set initially at 85 per cent of base salary for the Group Chief Executive and 70 per cent for other Executive Directors, but will be kept under review and may be amended in future years.

– Bonus opportunities have been reduced to reflect the increase in fixed pay. The maximum bonus opportunity will be 140 per cent of salary for the Group Chief Executive and 100 per cent of salary for other Executive Directors (compared with 225 per cent and 200 per cent of salary last year). In addition, the expected value of the bonus is reduced to 30 per cent of the maximum opportunity.

– Long-term incentive will remain at up to 300 per cent of base salary and will follow a similar approach to 2013, but with some changes in performance measures and weighting to reflect the strategy; for example, cost:income ratio and new customer measures replace previous cost and non-core asset reduction measures.

– Shareholding requirement: the existing requirements (200 per cent of salary for the Group Chief Executive, 150 per cent for other Executive Directors and 100 per cent for other members of the Group Executive Committee) will remain, but will also be applied to the fixed share award so the total requirement will increase. In addition, deferred bonus awards will no longer be included in the calculation so individuals will need to hold more than before.

– The overall impact is to encourage an appropriate balance of risk and reward, where the latter is competitive, compliant and aligned to the interests of shareholders, within what is prescribed by the new European requirements.

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Board changes

The appointment of Juan Colombás to the Board on 29 November 2013 highlights the importance of risk management in the Group. Juan previously attended at least two meetings of the Remuneration Committee annually, but will now attend all meetings to support the consideration of risk in the Committee's decision making, other than any part of a meeting which discusses his own remuneration.

Performance of the Group in 2013

In 2013, we accelerated the delivery of our strategy and made substantial progress in creating a simple, customer-focused, low risk retail and commercial bank. The Group's underlying profit more than doubled to £6.2 billion and a modest statutory profit was returned at the pre-tax level. The capital position was further strengthened.

Remuneration outcomes for 2013

The key challenges for the Remuneration Committee have been to determine how to remunerate appropriately for the strong underlying performance in 2013, whilst ensuring that adjustments are made for legacy issues, most notably the additional financial provision for PPI.

The Committee sought to achieve an appropriate balance by applying collective adjustments to the bonus pool and individual adjustments to bonus awards where necessary. A number of legacy issues were taken into account – for example, the additional provision for PPI and the substantial fine levied by the Financial Conduct Authority in respect of past controls around incentives. The Committee considered other factors, such as affordability in the context of our overall financial results. The impact of these considerations was to apply a significant reduction to what the overall bonus pool would have been. The Committee determined that a bonus pool of £395 million was appropriate and represents 6 per cent of pre-bonus Underlying Profit (compared to 12 per cent in the prior year). The average value of bonus per employee is approximately £4,500.

We are committed to managing executive reward through the strict application of challenging performance targets. Performance against the financial measures of the annual bonus plan for Executive Directors exceeded the maximum targets, and performance against balanced scorecard objectives was also strong. Taking into account the legacy issues noted above, the Committee determined that bonus awards of between 63 per cent and 72 per cent of maximum opportunity should be made to Executive Directors. For long-term incentive plan (LTIP) awards made in 2011, the performance to the end of 2013 was creditable, but targets have not been fully met and therefore these awards will vest at a rate of 54 per cent for members of the Group Executive Committee, including Executive Directors. These are the first LTIP awards to vest for some years and reflect the Group's return to profitability under the current management.

Considerations of stakeholders' views

We are committed to maintaining regular dialogue with our stakeholders and take careful consideration of their views when making our decisions.

During the year, we consulted with our main regulators, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). We also consulted extensively with UK Financial Investments (UKFI) and a number of our other major shareholders to gather their views and feedback on all significant aspects of remuneration, including our approach for addressing the regulatory changes. We are grateful for the generally supportive feedback we have received for the changes proposed from our shareholders.

We continue to believe that the remuneration policies and practices fairly reward our directors, support the delivery of the Group's strategy and the delivery of shareholder value. I therefore hope you will support the resolutions relating to remuneration at the forthcoming Annual General Meeting.

Anthony Watson, CBE
Chairman, Remuneration Committee

DIRECTORS' REMUNERATION REPORT

Directors' Remuneration Policy

Our policy is intended to ensure that our remuneration proposition is both cost effective and enables us to attract and retain executives of the highest calibre. Our objective is to align individual reward 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 major stakeholders: our customers, shareholders, employees, and regulators.

The policy is based on principles which are applicable to all employees within the Group and in particular the principle that the reward package should support the delivery of our strategic goal to be the 'Best Bank for Customers'. It embeds a performance-driven and meritocratic culture, encourages effective risk disciplines and is in line with relevant regulations and codes of best practice. There is no significant difference between the policy for Executive Directors and that for other senior employees. If a significant difference for any individual were proposed, this would be subject to approval by the Remuneration Committee (within regulatory requirements).

The policy set out below will formally apply, subject to shareholder approval, from the date of the Annual General Meeting in 2014. It is currently intended that approval of the remuneration policy will be sought at three year intervals unless amendments to the policy are required in which case further shareholder approval will be required.

Consideration of shareholders' and employees' views

We are committed to regular dialogue with stakeholders. During the year, the Remuneration Committee has consulted extensively with UK Financial Investments (UKFI) and a number of other shareholders and key stakeholders, such as the Group's main regulators, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

Formal consultation on the remuneration of Executive Directors is not undertaken with employees. However, surveys are undertaken semi-annually on employee engagement and discussion on the Group's remuneration approach takes place with union representatives during the annual pay review cycle and on relevant employee reward matters.

Remuneration policy table for Executive Directors

Base salary	
Purpose and link to strategy	Base salary reflects the role of the individual taking account of responsibilities and experience, and pay in the Group as a whole. It helps to recruit and retain Directors and forms the basis of a competitive remuneration package.
Operation	Base salaries are typically reviewed annually with any increases normally taking effect from 1 January. When determining and reviewing base salary levels, the Committee ensures that decisions are made within the following two parameters: – An objective assessment of the individual's responsibilities and the size and scope of their role, using objective job-sizing methodologies. – Pay for comparable roles in comparable publicly listed financial services groups, of a similar size. The Committee also takes into account base salary increases for employees throughout the Group. Base salaries as at January 2014 are detailed below in the Implementation Report on page 111. As disclosed in previous reports, since his appointment, the Group Chief Executive (GCE) has a reference salary of £1.22 million which is used to calculate certain elements of long-term remuneration and the pension allowance.
Maximum potential	The Committee will make no increase which it believes is inconsistent with the two parameters above. Increases will normally be in line with the increase awarded to the overall employee population. However, a greater salary increase may be appropriate in certain circumstances, such as a new appointment made on a salary below a market competitive level, where phased increases are planned, or where there has been an increase in the responsibilities of an individual.
Performance measures	N/A
Fixed Share Award	
Purpose and link to strategy	To ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for Executive Directors with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements.
Operation	The Fixed Share Award will be delivered in Lloyds Banking Group shares, released over five years with 20 per cent being released each year following the year of award.
Maximum potential	The maximum award is 100 per cent of base salary. The actual awards for the year are stated in the Implementation Report.
Performance measures	N/A
Pension	
Purpose and link to strategy	Our pension policy aims to support Executive Directors in building long-term retirement savings.
Operation	Executive Directors are entitled to participate in the Group's defined contribution scheme with company contributions set as a percentage of salary. An individual may elect to receive some or all of their pension contribution as a cash allowance.

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Maximum potential	The maximum allowance for the GCE is 50 per cent of reference salary less any flexible benefit allowance. The maximum allowance for other Executive Directors is 25 per cent of base salary.
Performance measures	N/A
Benefits	
Purpose and link to strategy	To provide suitable benefits as part of a competitive package.
Operation	Benefits may include those currently provided and disclosed in the Implementation Report. Core benefits include a company car or car allowance, private medical insurance, life assurance and other benefits that may be selected through the Group's flexible benefits plan. Additional benefits may be provided to individuals in certain circumstances such as relocation. This may include benefits such as accommodation, relocation, and travel. The Committee retains the right to provide additional benefits depending on individual circumstances. When determining and reviewing the level of benefits provided, the Committee ensures that decisions are made within the following two parameters: – An objective assessment of the individual's responsibilities and the size and scope of their role, using objective job-sizing methodologies. – Benefits for comparable roles in comparable publicly listed financial services groups of a similar size.
Maximum potential	The Committee will make no increase in the benefits currently provided which it believes is inconsistent with the two parameters above. The Group's flexible benefits allowance is capped at 4 per cent of base salary.
Performance measures	N/A
All-employee plans	
Purpose and link to strategy	Executive Directors are eligible to participate in HMRC approved all-employee schemes which encourage share ownership.
Operation	Executive Directors may participate in these plans in line with HMRC guidelines currently prevailing (where relevant), on the same basis as other eligible employees.
Maximum potential	Participation levels may be increased up to HMRC limits as amended from time to time. With effect from April 2014, the monthly savings limits for SAYE is £500. The maximum value of shares that may be purchased under SIP in any year is £1,800 with a two for one match (although currently a one for one match is operated) and the maximum value of free shares that may be awarded in any year is £3,600.
Performance measures	N/A, following HMRC rules.
Annual bonus	
Purpose and link to strategy	Incentivise and reward the achievement of the Group's annual financial and strategic targets.
Operation	Measures and targets are set annually and awards are determined by the Committee after the year end based on performance against the targets set. The annual bonus may be delivered partly in cash and partly deferred into cash, shares, notes or other debt instruments including contingent convertible bonds. Deferral levels are set at the time of award and in compliance with regulatory requirements (which currently require that at least 60 per cent of variable pay is deferred and at least 50 per cent of variable pay is paid in shares or other instruments). Deferred awards normally vest after three years and the Committee may adjust awards in the event of any variation of share capital, demerger, special dividend or distribution or amend the terms of the plan in accordance with the plan rules. At the time of the release, Executive Directors receive an amount (in cash or shares) equal to the interest that would have accrued on the deferred component, if deferral is made in notes or debt instruments, or dividends paid or payable if deferred in shares, between the date of grant and the vesting of the award on the number of shares which have vested. The Committee applies its judgement to determine the payout level commensurate with business and/or individual performance. The Committee may reduce the level of deferred award (including to zero), apply additional conditions to the vesting, or delay the vesting of deferred awards to a specified date or until conditions set by the Committee are satisfied, where it considers it appropriate as a result of an event occurring before vesting.
Maximum potential	The maximum annual bonus opportunities are 140 per cent of base salary for the GCE and 100 per cent of base salary for other Executive Directors.

DIRECTORS' REMUNERATION REPORT

Performance measures	Measures and targets are set annually by the Committee in line with the Group's strategic business plan and further details are set out in the Implementation Report for the relevant year. At least 50 per cent of the awards are weighted towards financial measures, with the balance on strategic objectives. For example, for 2014, the measures will include Economic Profit and Underlying Profit as well as specific strategic objectives including risk, customer and employee measures. All assessments of performance are ultimately subject to the Committee's judgement, but no award will be made if threshold performance is not met for financial measures and the individual is rated 'Developing performer' or below. The expected value of the bonus is 30 per cent of maximum opportunity. The Committee retains the right to change the measures and weighting of those measures, including following feedback from regulators, shareholders and/or other stakeholders. The Committee is, however, committed to providing transparency in its decision making in respect of bonus awards and will disclose historic target and measure information together with information relating to how the Group has performed against those targets in the Implementation Report for the relevant year unless this information is deemed to be commercially sensitive.
Long-term incentive plan	
Purpose and link to strategy	Incentivise and reward the achievement of the Group's longer-term objectives, to align executive interests with those of shareholders and to retain key individuals.
Operation	Awards are made in the form of conditional shares or nil cost options. Award levels are set at the time of grant, in compliance with regulatory requirements, and may be subject to a discount in determining total variable remuneration under the rules set by the European Banking Authority (EBA). Vesting will be subject to the achievement of performance conditions measured over a period of three years, or such longer period, as determined by the Committee. On vesting, Executive Directors receive an amount (in cash or shares) equal to the dividends which would have been paid during the vesting period on shares vesting. The Committee retains full discretion to amend the payout levels should the award not reflect business and/or individual performance. The Committee may reduce (including to zero) the level of the award, apply additional conditions to the vesting, or delay the vesting of awards to a specified date or until conditions set by the Committee are satisfied, where it considers it appropriate as a result of an event occurring before vesting. Executive Directors are required to hold the shares which vest for a further two years.
Maximum potential	The maximum annual award for Executive Directors will normally be 300 per cent of salary excluding dividend equivalents (this being the reference salary in the case of the GCE). Under the plan rules, awards can be made up to 400 per cent of salary in exceptional circumstances excluding dividend equivalents.
Performance measures	Measures and targets are set by the Committee annually and are set out in the Implementation Report each year. At least 60 per cent of awards are weighted towards typical market (e.g. Total Shareholder Return (TSR)) and/or financial measures (e.g. Economic Profit), with the balance on strategic measures. For example, for 2014, the measures and respective weighting will be Economic Profit (30 per cent); absolute TSR (30 per cent); strategic measures (40 per cent) split into: cost:income ratio (10 per cent), customer satisfaction (10 per cent), net promoter score (10 per cent), SME lending (5 per cent), and share of first-time buyer market (5 per cent). 25 per cent will vest for threshold performance and 50 per cent for on-target performance. The measures are chosen to support the 'Best Bank for Customers' strategy and to align management and shareholder interests. Targets are set by the Committee to be stretching within the context of the strategic business plan. Measures are selected to balance profitability, achievement of strategic goals and to ensure the incentive does not encourage inappropriate risk taking. Measures and targets are set annually by the Committee and limited details can therefore be provided in the remuneration policy. Further details on the metrics in place for the awards made in 2013, and those on which the 2014 awards will be based, are provided in the Implementation Report. For future awards, the Committee will disclose in the Implementation Report for the relevant year historic measure and target information, together with how the Group has performed against those targets, unless this information is deemed to be commercially sensitive.
Shareholding guidelines	Executive Directors are required to build up a holding of a value of 200 per cent of base salary and fixed share award for the GCE and 150 per cent for other Executive Directors. Details of holding are shown in the Implementation Report.

Discretion in relation to annual bonus and long-term incentive plans

The Committee retains discretion with regards to the operation and administration of these plans, including :

– the timing and size of awards, subject to policy maximums;

– adjustments required in certain circumstances (e.g. rights issues, corporate restructuring events and special dividends);

– adjustment of targets if events occur which cause it to determine that the conditions are no longer appropriate;

– amending the plan rules in accordance with their terms.

Legacy awards and restrictions on payments

The Committee reserves the right to make any remuneration payments/awards and any payments/awards for loss of office, notwithstanding that they are not in line with the policy set out above where the terms of the payment/award were agreed (i) before the policy came into effect or (ii) at a time when the relevant individual was not a Director of the Group and, in the opinion of the Committee, the payment/award was not in consideration for the individual becoming a Director of the Group. Such payments/awards are set out in the Implementation Report for the relevant year. They include payments in relation to deferred bonus awards and long-term incentive awards granted in 2012 and 2013.

Illustration of application of remuneration policy

The charts below illustrate possible remuneration outcomes under the following three scenarios:

1. The maximum that may be paid, assuming full bonus payout and full vesting under the long-term plan.
2. The expected value of remuneration for performance midway between threshold and maximum, assuming 30 per cent of maximum annual bonus opportunity and 50 per cent vesting under the long-term incentive plan.
3. The minimum that may be paid, where only the fixed element is paid (salary, benefits, pension and the fixed share award).

No share price growth has been assumed and dividends have not been included. The amounts are based on salaries as at 1 January 2014 and assume fixed share awards and bonuses which reflect the implementation of the policy in 2014 as set out below. They also assume long-term incentive grants of 300 per cent of salary, which is normally the maximum award.

António Horta-Osório

Value of package (*£000*)

George Culmer

Value of package (*£000*)

Juan Colombás

Value of package (*£000*)

DIRECTORS' REMUNERATION REPORT

Approach to recruitment and appointment to the Board

In determining appropriate remuneration arrangements on hiring a new Executive Director, the Committee will take into account all relevant factors. This may include the experience and calibre of the individual, local market practice, the existing remuneration arrangements for other executives and the business circumstances. The Committee will seek to ensure that arrangements are in the best interests of both the Group and its shareholders and will seek not to pay more than is necessary.

The Committee may make awards on hiring an external candidate to 'buy-out' remuneration arrangements forfeited on leaving a previous employer. In doing so the Committee will take account of relevant factors including any performance conditions attached to these awards, the form in which they were granted (e.g. cash or shares) and the timeframe of awards. Any such award made will be made in accordance with the PRA's Remuneration Code and made on a comparable basis to those forfeited.

The package will normally be aligned with the remuneration policy as described in the table above. However, the Committee retains the discretion to make appropriate remuneration decisions outside the standard policy to facilitate the recruitment of an individual of the calibre required and in exceptional cases.

This may, for example, include the following circumstances:

– An interim recruit, appointed to fill an Executive Director role on a short-term basis.
– Exceptional circumstances requiring the Chairman to take on an executive function on a short-term basis.
– An Executive Director recruited at a time in the year when it would be inappropriate to provide a bonus or LTIP award for that year, for example, where there may be insufficient time to assess performance. In this situation the Committee may feel it appropriate to transfer the quantum in respect of the months employed during the year to the subsequent year so that reward is provided on a fair basis.
– An Executive Director recruited from a business or location where benefits are provided that do not fall into the definition of 'variable remuneration forfeited' but where the Committee considers it reasonable to buy-out these benefits.
– Transitional arrangements for overseas hires, which might include relocation expenses and accommodation.

Any discretion is however limited to the maximum level of variable remuneration (excluding buy-out awards) that may be awarded to new Executive Directors which is equal to 200 per cent of fixed remuneration, including any discount permitted by the European Banking Authority for long-term incentive awards. In making any such remuneration decisions, the Committee will apply appropriate performance measures in line with those applied to other Executive Directors.

Service agreements

The service contracts of all current Executive Directors are terminable on 12 months' notice from the Group and six months' notice from the individual. The Chairman also has a service agreement. His engagement may be terminated on six months' notice by either the Group or the individual.

	Notice to be given by the Group	Date of service agreement
Sir Winfried Bischoff	6 months	27 July 2009
António Horta-Osório	12 months	3 November 2010
George Culmer	12 months	16 May 2012
Juan Colombás	12 months	30 November 2010

Under his contract (dated 3 November 2010), the GCE is entitled to an amount equivalent to base salary and pension allowance as a payment in lieu of notice if notice to terminate is given by the Group. If notice to terminate is given by the GCE, he is entitled to an amount equivalent to base salary if the Group chooses to make a payment in lieu of notice. Such payments in lieu will be made in monthly instalments subject to mitigation. He is also entitled to six months' notice from the Group in the event of his long-term incapacity. As part of a buyout of a pension forfeited on joining from Santander, the GCE is also entitled to the provision of an unfunded unapproved retirement benefit scheme (UURBS), subject to performance conditions as described further in the Implementation Report. In all other respects, the terms of the GCE's contract in relation to payments for loss of office match those set out below for new directors.

Under terms agreed when joining the Group, Juan Colombás is entitled to a conditional lump sum benefit, payable either (i) on reaching normal retirement age unless he voluntarily resigns or is dismissed for cause, or (ii) on leaving due to long-term sickness or death, as described further in the Implementation Report.

The service contracts and letters of appointments are available for inspection at the Company's registered office.

Notice periods

Newly-appointed Executive Directors will be employed on contracts that include the following provisions:

– The individual will be required to give six months' notice if they wish to leave and the Group will give 12 months' notice other than for material misconduct or neglect or other circumstances where the individual may be summarily dismissed by written notice. In exceptional circumstances, new joiners will be offered a longer notice period (typically reducing to 12 months within two years of joining).
– In the event of long-term incapacity, if the Executive Director does not perform their duties for a period of at least 26 weeks (in aggregate over a 12 month period), the Group shall be entitled to terminate the executive's employment by giving three months' notice.
– At any time after notice to terminate is given by either the Group or the Executive Director, the Group may require the Executive Director to take leave for some or all of the notice period.
– At any time, at its absolute discretion, the Group may elect to terminate the individual's employment by paying to the Executive Director, in lieu of the notice period, an amount equivalent to base salary, subject to mitigation as described more fully in the termination payments section of this report, below.

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Termination payments

It is the Group's policy that where compensation on termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured. Where it is appropriate to make a bonus payment to the individual, this should relate to the period of actual service, rather than the full notice period. Any bonus will be determined on the basis of performance as for all continuing employees and will remain subject to performance adjustment (malus). Generally, on termination of employment, bonus awards, long-term incentive awards and other rights to payments will lapse except where termination falls within one of the reasons set out below. In the event of redundancy, the individual may receive a payment in line with statutory entitlements at that time. If an Executive Director is dismissed for gross misconduct, the Executive Director will receive normal contractual entitlements until the date of termination and all deferred bonus awards and long-term incentive awards will lapse.

	Base salary	Fixed Share Award	Pension, benefits and other fixed remuneration
Resignation	In the case of resignation to take up new employment, paid until date of termination (including any period of leave required by the Group). In the case of resignation for other reasons, base salary will be paid in monthly instalments for the notice period (or any balance of it), offset by earnings from new employment during this period.	Awards continue and are released at the normal time and the number of shares subject to the award in the current year will be reduced to reflect the fact that the Executive Director has left early.	Paid until date of termination including any period of leave required by the Group (subject to individual benefit scheme rules).
Redundancy or termination by mutual agreement	Paid until date of termination (including any period of leave required by the Group). In respect of the balance of any notice period, base salary will be paid in monthly instalments, offset by earnings from new employment during this period.	Awards will normally continue and be released at the normal time and the number of shares subject to the award in the current year will be reduced to reflect the fact that the Executive Director has left early unless, in the case of mutual agreement, the Committee determines that exceptional circumstances apply in which case shares may be released on termination.	Paid until date of termination including any period of leave required by the Group (subject to individual benefit scheme rules).
Retirement/ill health, injury, permanent disability/death	Paid until date of retirement/death. For ill health, injury, permanent disability, paid for the applicable notice period (including any period of leave required by the Group).	Awards will normally continue and be released at the normal time and the number of shares subject to the award in the current year will be reduced to reflect the fact that the Executive Director has left early except for death where shares are released on termination, or unless, in the case of permanent disability, the Committee determines that exceptional circumstances apply in which case shares may be released on termination.	Paid until date of death/ retirement (subject to individual benefit scheme rules). For ill health, injury, permanent disability, paid for the notice period including any period of leave required by the Group (subject to individual benefit scheme rules).
Change of control or merger	N/A	Unless the Committee decides otherwise, awards will be released on the date of the corporate event and the number of shares subject to the award in the current year will be reduced to reflect the fact that the Executive Director has left early unless the Committee determines that awards will be exchanged for awards over shares in the acquiring company or such other company as the Committee determines.	N/A
Other reason where the Committee determines that the executive should be treated as a good leaver	Paid until date of termination (including any period of leave required by the Group). In respect of the balance of any notice period, base salary will be paid in monthly instalments, offset by earnings from new employment during this period.	Awards continue and are released at the normal time and the number of shares subject to the award in the current year will be reduced to reflect the fact that the Executive Director has left early.	Paid until date of termination including any period of leave required by the Group (subject to individual benefit scheme rules).

DIRECTORS' REMUNERATION REPORT

	Annual bonus[1]	Long-term incentive[2]	Chairman and Non-Executive Director fees[3]
Resignation	Forfeited, including unvested deferred elements (2010 deferred bonus not subject to forfeiture but continues to be subject to performance adjustment) unless the Committee determines otherwise in exceptional circumstances.	Unvested award lapses on date of leaving (or on notice of leaving) unless the Committee determines otherwise in exceptional circumstances.	Paid until date of leaving Board.
Redundancy or termination by mutual agreement	Accrued up until date of termination (current year). Deferred bonus paid in line with normal timeframes and subject to performance adjustment. The Committee may allow awards to vest early if it considers it appropriate.	Pro-rated award (for months worked in performance period) released at end of period, subject to performance objectives being met. The Committee may allow awards to vest early if it considers it appropriate.	Paid until date of leaving Board.
Retirement/ill health, injury, permanent disability	Accrued up until date of termination (current year). Deferred bonus paid in line with normal timeframes and subject to performance adjustment. The Committee may allow awards to vest early if it considers it appropriate.	Pro-rated award (for months worked in performance period) released at end of period, subject to performance objectives being met. The Committee may allow awards to vest early if it considers it appropriate.	Paid until date of leaving Board.
Death	Accrued up until date of termination (current year). Deferred bonus paid on death in cash, unless the Committee determines otherwise.	Pro-rated award (for months worked) released to Estate as soon as practicable after date of death. Performance conditions will not apply.	Paid until date of leaving Board.
Change in control or merger[2]	Accrued up until date of termination (current year). Deferred bonus vests to the extent determined by the Committee.	Pro-rated award (for months worked in performance period) released on date of change in control, subject to performance objectives being met at the time of the transaction. Instead of vesting, awards may be exchanged for equivalent awards over the shares or acquiring company or another company.	Paid until date of leaving Board.
Other reason where the Committee determines that the executive should be treated as a good leaver	Accrued up until date of termination (current year). Deferred bonus paid in line with normal timeframes and subject to performance adjustment. The Committee may allow awards to vest early if it considers it appropriate.	Pro-rated award (for months worked in performance period) released at end of period, subject to performance objectives being met. The Committee may allow awards to vest early if it considers it appropriate.	Paid until date of leaving Board.

[1] If any annual bonus is to be paid to the Executive Director for the current year, this will be determined on the basis of performance for the period of actual service, rather than the full notice period (and so excluding any period of leave required by the Group).

[2] Reference to change of control or merger includes a compromise or arrangement under section 899 of the Companies Act 2006 or equivalent. Fixed share awards may also be released/exchanged in the event of a resolution for the voluntary winding up of the Company; a demerger, delisting, distribution (other than an ordinary dividend) or other transaction, which, in the opinion of the Committee, might affect the current or future value of any award; or a reverse takeover, merger by way of a dual listed company or other significant corporate event, as determined by the Committee. In the event of a demerger, special dividend or other transaction which would in the Committee's opinion affect the value of awards, the Committee may allow a long-term incentive award to vest to the extent relevant performance conditions are met to that date and if the Committee so determined, on a time pro-rated basis to reflect the number of months of the performance period worked.

[3] The Chairman is entitled to six months' notice.

On termination, the Executive Director will be entitled to payment for any accrued but untaken holiday calculated by reference to base salary and fixed share award.

The cost of legal, tax or other advice incurred by an Executive Director in connection with the termination of their employment and/or the cost of support in seeking alternative employment may be met up to a maximum of £100,000.

Additional payments may be made where required to settle legal disputes, or as consideration for new or amended post-employment restrictions.

Where an Executive Director is in receipt of expatriate or relocation expenses at the time of termination (as at the date of the AGM no current Executive Directors are in receipt of such expenses), the cost of actual expenses incurred may continue to be reimbursed for up to 12 months after termination or, at the Group's discretion, a one-off payment may be made to cover the costs of premature cancellation. The cost of repatriation may also be covered.

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Chairman and Non-Executive Directors

The table below sets out the remuneration policy that will apply, subject to shareholder approval, to Non-Executive Directors (NEDs) from the date of the Annual General Meeting in 2014.

Chairman and Non-Executive Director fees	
Purpose and link to strategy	To provide an appropriate reward to attract and retain a high-calibre individual with the relevant skills, knowledge and experience.
Operation	The Committee is responsible for evaluating and making recommendations to the Board with regards to the Chairman's fees. The Chairman does not participate in these discussions. The GCE and the Chairman are responsible for evaluating and making recommendations to the Board in relation to the fees of the NEDs. When determining fee levels, the following are considered: – The individual's skills and experience. – Comparable fees at FTSE companies of a similar size to Lloyds Banking Group, including the major UK banks. The Chairman receives an all inclusive fee, which is reviewed periodically plus benefits including life assurance, car allowance, medical insurance and transportation. The Committee retains the right to provide additional benefits depending on individual circumstances. NEDs are paid a basic fee plus additional fees for the chairmanship/membership of committees and for membership of Group companies/boards/non-board level committees. Additional fees are also paid to the senior independent director and to the deputy chairman to reflect additional responsibilities. 2014 fee levels are stated in the Implementation Report. Any increases normally take effect from 1 January of a given year. When determining and reviewing fee and benefit levels, the Committee ensures that decisions are made within the following two parameters: – An objective assessment of the individual's responsibilities and the size and scope of their role, using objective sizing methodologies. – Pay for comparable roles in comparable publicly listed financial services groups, of a similar size. Fees and benefits as at January 2014 are detailed below in the Implementation Report on page 112. The Chairman and the NEDs are not entitled to receive any payment for loss of office (other than in the case of the Chairman's fees for the six month notice period) and are not entitled to participate in the Group's bonus, share plan or pension arrangements. NEDs are reimbursed for expenses and any tax arising from these expenses. Where appropriate, the Group will also meet the costs and any tax arising from travel for business purposes.
Maximum potential	The Committee will make no increase in fees or benefits currently provided which it believes is inconsistent with the two parameters above.
Performance metrics	None

Letters of appointment

The Group's policy is for independent NEDs to have letters of appointment, not service agreements. Non-Executive appointments may be terminated, in accordance with the Articles of Association, at any time.

	Date of letter of appointment
David Roberts	February 2010
Lord Blackwell	May 2012
Carolyn Fairbairn	February 2012
Anita Frew	November 2010
Dyfrig John	October 2013
Nick Luff	February 2013
Anthony Watson	February 2009
Sara Weller	January 2012

The service contracts and letters of appointments are available for inspection at the Company's registered office.

DIRECTORS' REMUNERATION REPORT

Directors' Remuneration Implementation Report

Consideration of matters relating to directors' remuneration

The members of the Committee during 2013 were:

– Anthony Watson (chairman)
– Sir Winfried Bischoff
– Carolyn Fairbairn
– David Roberts (also chairman of the Board Risk Committee)
– Timothy Ryan (until 18/04/13)
– Sara Weller

During 2013, the Committee met 10 times and considered the following principal matters:

– Review of remuneration arrangements for senior executives
– Determination of the appropriate remuneration packages for a number of senior new hires
– Determination of bonus pools based on Group performance and adjustment for risk
– Performance conditions for the Long-Term Incentive Plan
– Bonus and salary awards for Executive Directors and key senior managers
– Approval of remuneration and terms of service that fall within the Committee's terms of reference, including new hires
– Feedback from the Committee Chairman on his meetings with the PRA and shareholders

Committee members are thanked for their commitment during the last year and attendance at meetings.

The Committee appoints independent consultants to provide advice on specific matters according to their particular expertise. During the year, Deloitte LLP advised the Committee. Deloitte was appointed following a competitive tendering process. Deloitte has voluntarily signed up to the Remuneration Consultants' Code of Conduct. The Committee has evaluated Deloitte during 2013 and has judged its advice as objective and independent.

During 2013, Deloitte provided information on behalf of the Committee for the testing of Total Shareholder Return (TSR) performance conditions for the Group's long-term incentive plans (calculated by reference to both dividends and growth in share price). In addition, Deloitte LLP provided the Group with advice on taxation and other consulting services, and assurance services. Deloitte's fees for 2013 amounted to £324,300.

António Horta-Osório (Group Chief Executive), Rupert McNeil (Group HR Director) and Paul Hucknall (HR Director, Performance & Reward) provided guidance to the Committee (other than for their own remuneration). Juan Colombás (Chief Risk Officer) and George Culmer (Chief Financial Officer) also attended the Committee to advise as and when necessary on risk and financial matters.

Statement of voting at general meeting

The proposals on the remuneration offered to our Executive Directors in 2013 were detailed within the Directors' Remuneration Report for 2012 and were voted on at the 2013 Annual General Meeting. The shareholder votes submitted at the meeting, either directly, by mail or by proxy, were as follows:

	Votes cast (number of shares – millions)	Percentage of votes cast
Votes in favour	46,949	95.91%
Votes against	2,003	4.09%
Abstentions	4,052	–

As mentioned in the Chairman's statement, we are committed to an ongoing dialogue with our shareholders. Shareholders have different views, notably on incentive scheme design and whilst we do take all comments into consideration, there will inevitably be some diverging views, notably on the structure of such schemes and on the choice of performance measures.

The Committee believes that the proposed structure of the Group's remuneration is appropriate, given the regulatory requirements. We have consulted extensively with our major shareholders but we also welcome feedback from all of our shareholders on our remuneration arrangements and on this report.

One particular element of feedback from proxy voting agencies was that they were looking for more information on the determination of the bonus payments. We have provided greater detail in this year's report.

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Implementation of the policy in 2014

As mentioned in the Chairman's statement and remuneration policy above, the Group is required to comply with the Prudential Regulation Authority's (PRA) Remuneration Code (the 'Code'), as amended on 1 January 2014 to implement the fourth amendment of the Capital Requirements Directive ('CRD IV'). Under the Code, the Group and certain employees who have a material impact on the Group's risk profile ('Code Staff') including Executive Directors, are subject to certain rules regarding the provision of remuneration.

This has led the Committee to carry out a fundamental review of the remuneration structure for Directors and other Code Staff. It is proposed to operate our policy in the following way in 2014:

Base salary	Salaries for Executive Directors effective from 1 January 2014 are as follows: Group Chief Executive (GCE): £1,061,000 Chief Financial Officer (CFO): £720,000 Chief Risk Officer (CRO): £710,000 The salary for the CRO has been increased to £710,000 with effect from 1 January 2014 to reflect his additional responsibilities as a member of the Board.
Fixed Share Award	As stated in the Chairman's letter, we have introduced an additional element in the package in order to ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for Executive Directors, with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements. The actual levels of award set for 2014 are as follows (which will be released in shares over a five year period): GCE: £900,000 CFO: £504,000 CRO: £497,000
Pension	In line with the remuneration policy, Executive Directors are entitled to a cash allowance in lieu of pension contributions. The level of allowances has not been increased for 2014. GCE: 50 per cent of reference salary less flexible benefit allowance CFO: 25 per cent of base salary CRO: 25 per cent of base salary The GCE is also entitled to the provision of an unfunded unapproved retirement benefit scheme (UURBS), subject to performance conditions, as described further in the Implementation Report.
Benefits	For 2014, the benefits provided to Executive Directors include a car allowance, transportation, private medical insurance, life assurance and other benefits selected through the flexible benefit allowance which is capped at 4 per cent of base salary. The CRO's benefits in respect of relocation end in January 2014.
All employee plans	Executive Directors are eligible to participate in the Sharesave and Sharematch scheme on the same basis as other employees.
Annual bonus	
Opportunity	The maximum annual bonus opportunity is 140 per cent of base salary for the GCE and 100 per cent of base salary for other Executive Directors. All assessments of performance are ultimately subject to the Committee's judgement, but no award will be made if threshold performance for the financial measure is not met and the individual is rated 'Developing performer' or below. The expected value of the bonus is 30 per cent of the maximum opportunity.
Performance measures and targets	For 2014 the annual bonus will be based on: – Financial measures (underlying profit and economic profit) – 50 per cent – Balanced scorecard (BSC) objectives comprising five categories (finance, building the business, customer, risk and people) – 50 per cent The Committee considers the targets that apply to these measures to be commercially sensitive but will provide information on the level of payout relative to the performance achieved in next year's Implementation Report. The Committee applies its judgement to determine the payout level commensurate with business and/or individual performance in determining the final BSC rating.
Long-term incentive plan	
Opportunity	The maximum annual long-term incentive award for Executive Directors is 300 per cent of salary. Awards in 2014 will be made as follows: GCE: 300 per cent of reference salary CFO: 275 per cent of base salary CRO: 275 per cent of base salary

DIRECTORS' REMUNERATION REPORT

Performance measures and targets

During 2013, the Committee consulted widely with various shareholders on appropriate performance measures and, in particular, on how management can be incentivised through the long-term incentive plan to successfully deliver the Group's overall strategic objective of delivering long-term sustainable returns to shareholders. Based on the feedback, the awards made in 2014 will vest based on Lloyds Banking Group's performance against the following key measures:

– Economic Profit (30 per cent)
– Absolute Total Shareholder Return (30 per cent)
– Strategic Measures (40 per cent)

We believe these measures capture risk management and profit growth and appropriately align management and shareholder interests.

The following table provides a breakdown of these measures and the targets applicable.

Category	Measure	Basis of payout range	Metric	Weighting
Financial	Economic Profit	Set relative to 2016 targets	Threshold: £2,154m Maximum: £3,231m	30%
	Absolute TSR	Growth in share price including dividends over 3 year period	Threshold: 8% pa Maximum: 16% pa	30%
	Cost:income ratio	Set relative to 2016 targets	Threshold: 48.9% Maximum: 46.5%	10%
Customer	Customer satisfaction (Total FCA reportable complaints per 1,000 accounts)[a]	Set relative to 2016 targets	Threshold: 1.15 Maximum: 1.05	10%
	Net promoter score	Major Group average ranking over 2016	Threshold: 3rd Maximum: 1st	10%
Helping Britain Prosper	SME lending	Set relative to targets for SME lending growth over 3 year period	Threshold: 14% Maximum: 18%	5%
	Share of first-time buyer market	Set relative to targets for market share over 3 year period	Threshold: 20% Maximum: 25%	5%

[a] Measure excludes PPI complaints, but includes Banking, Home Finance, General Insurance, Life, Pensions and Investment complaints.

Chairman and Non-Executive Director fees in 2014

The annual fee for the Chairman is unchanged at £700,000.

The annual Non-Executive Director fees were reviewed in 2013 and increased as listed below with effect from 1 July 2013:

	2013	2014
Basic fee	£65,000	£65,000
Deputy Chairman	£100,000	£100,000
Senior Independent Director	£60,000	£60,000
Audit Committee Chairmanship	£50,000	£50,000
Remuneration Committee Chairmanship	£30,000	£50,000
Board Risk Committee Chairmanship	£40,000	£50,000
Audit Committee membership	£20,000	£20,000
Remuneration Committee membership	£15,000	£20,000
Board Risk Committee membership	£15,000	£20,000
Nomination & Governance Committee membership*	£5,000	£5,000

* Where individual is not already Chairman of another Committee.

Non-Executive Directors may receive more than one of the above fees.

For 2014, the benefits provided to the Chairman include a car allowance, medical insurance, life assurance and transportation.

The following pages contain information that is required to be audited in compliance with the Directors' Remuneration requirements of the Companies Act 2006. All narrative and quantitative tables are unaudited unless otherwise stated.

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Remuneration outcome for 2013

Executive Directors (audited)

The following table summarises the total remuneration delivered during 2013 in relation to service as an Executive Director.

	António Horta-Osório		George Culmer[f]		Juan Colombás[g]		Totals	
£000	2013	2012	2013	2012	2013	2012	2013	2012
Base salary	1,061	1,061	720	451	58	–	1,839	1,512
Benefits	113	113	37	17	15	–	165	130
Pension allowance[a]	568	568	286	–	14	–	868	568
Other remuneration[b]	173	171	301	–	2	–	476	171
Annual bonus[c]	1,700	1,485	910	700	78	–	2,688	2,185
Long-term incentive[d]	3,128	–	–	–	41	–	3,169	–
Conditional pension buy-out[e]	732	–	–	–	–	–	732	–
Total remuneration	7,475	3,398	2,254	1,168	208	–	9,937	4,566
Less: Buy-out amounts	(904)	(171)	(300)	–	(2)	–	(1,206)	(171)
Total remuneration less buy-outs	6,571	3,227	1,954	1,168	206	–	8,731	4,395

[a] Following changes to the amount of tax relief available on pension contributions in each year, Directors may elect to receive some or all of their allowances as cash. The breakdown of payments made in cash and contributions into the pension scheme are shown below. Note that the amount for 2012 in respect of António Horta-Osório has been restated from £549,000 to include £18,170 of employer contributions to pension scheme. Note that the amount for 2013 in respect of George Culmer includes £106,000 carried over from 2012 and delivered in 2013.

[b] Other remuneration payments comprise contractual cash payments to António Horta-Osório, George Culmer and Juan Colombás as part of the buyout of their benefits from their previous employers in addition to income from all employee share plans of £960.

[c] In addition to deferral and performance adjustment, the GCE's bonus will only vest if the Group's share price remains above 73.6 pence on average for any 126 consecutive trading days in the five years following grant or the UK government sells at least 50 per cent of its shareholding (as at February 2014) in the Group at any time during the three years following grant. If either condition is met earlier than the third anniversary of grant, vesting will still only occur on the third anniversary. In this event, the award will be subject to a further two year holding period following vesting up to a maximum of five years in total.

[d] The long-term incentive vesting was confirmed by the Remuneration Committee at its meeting on 20 February 2014. The closing share price on that date of 81.13 pence has been used to calculate the value.

[e] The GCE has a conditional unfunded pension commitment, subject to share price performance. This was a partial buyout of a pension forfeited on joining from Santander. It is an unfunded unapproved retirement benefit scheme (UURBS). The UURBS provides benefits on a defined benefit basis at a normal retirement date of 65. The UURBS applies for a maximum of six years following the commencement of employment and the maximum allowance over that period is 26.5 per cent of the higher of the GCE's base salary and reference salary in the 12 months before retirement or leaving, subject to performance conditions. No additional benefit is due in the event of early retirement. The rate of pension accrual in each year depends on share price conditions being met. An annual pension entitlement of £36,600 was accrued in 2013.

[f] George Culmer joined the Group as an Executive Director on 16 May 2012. The 2012 figures therefore reflect a part-year.

[g] Amounts shown reflect the period from 29 November 2013 when Juan Colombás was appointed as an Executive Director. Total remuneration for 2013 was £3,193,000. Under terms agreed when joining the Group, the CRO is entitled to a conditional lump sum benefit of £718,996 either (i) on reaching normal retirement age unless the CRO voluntarily resigns or is dismissed for cause, or (ii) on leaving due to long-term sickness or death.

Pension and benefits (audited)

Pension/Benefit £	António Horta-Osório	George Culmer	Juan Colombás
Contribution to pension scheme	18,170	52,345	3,799
Cash allowance in lieu of pension contribution	549,390	233,318	10,689
Car or car allowance	12,000	7,704	1,085
Flexible benefits payments	42,440	28,800	2,318
Private medical insurance	23,841	592	1,039
Transportation	35,200	–	299
Relocation	–	–	9,794

Annual bonus

For each Executive Director, the 2013 bonus was based on performance against:

- Profit measures (50 per cent): Underlying Profit and Economic Profit
- Balanced scorecard objectives (50 per cent): reflecting the strategic priorities specific to the Executive Director, but based on consistent categories:
  - Financial
  - Building the business
  - Customer service
  - Risk
  - People development

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Balanced scorecard outcomes are recorded through a rating, based on a rating scale ranging from 'Under performer' (at the lowest level), through 'Developing', 'Good', 'Strong' and up to 'Top' which is the highest rating. Each of these ratings may be further differentiated by the addition of 'minus' or 'plus'.

Detailed performance assessments are prepared annually in respect of the Group and each of the divisions and presented for review by the Committee. The assessments are also reviewed by the Risk Committee. For the Group's senior 'Code Staff', including the Executive Directors, a further review is undertaken to ensure that adequate consideration has been given to risk factors. Based on the financial and balanced scorecard assessment, the Committee applies its judgement in determining the bonus outcomes. It takes into consideration any other factors, particularly in relation to legacy issues, such as the additional provision for PPI and the substantial fine levied by the Financial Conduct Authority in respect of controls around Bancassurance incentives arrangements.

Annual bonus for 2013

The Group's performance against 2013 targets for the two financial measures is shown below.

António Horta-Osório

The maximum annual bonus opportunity of the Group Chief Executive (GCE) was 225 per cent of basic salary. For 2013, the Group outperformed the financial targets as shown above. The balanced scorecard used to inform the decisions of the Committee is the overall Group's scorecard. The GCE's balanced scorecard assessment for 2013, as confirmed by the Committee on 23 January 2014, reflected a number of considerations in 2013, including:

- Successful implementation of the Group's strategy of becoming the best bank for customers.
- Substantially improved financial performance: underlying profit increased by 140 per cent to £6,166 million in 2013.
- A return to statutory profitability at the pre-tax level.
- Strengthening the balance sheet and reducing risk: pro forma fully loaded common equity tier 1 ratio increasing by 2.2 percentage points to 10.3 per cent.
- Non-core assets reduced by 35 per cent from £98.4 billion to £63.5 billion; reductions continue to be capital accretive overall, contributing to the release of approximately £2.6 billion of capital in the year.
- The Group's share price in 2013 increased by 65 per cent, making it the second best performing among the world's top 50 banks and well above the FTSE100 increase of 14 per cent.
- Further progress in the simplification programme: cost savings of approximately £0.6 billion realised in 2013.
- The first phase of the European Commission mandated business disposal, Project Verde, was successfully completed in September 2013, with TSB Bank launched onto the UK high streets. An Initial Public Offering (IPO) of TSB Bank in 2014 remains a target.
- Successful relaunch of the Lloyds Bank brand in the second half of the year.
- Further reductions in the number of customer complaints, now down to 1.0 per 1,000 accounts (excluding PPI), the lowest of any major UK bank.
- The Group has so far committed over £37 billion of gross new lending to British customers under the Funding for Lending Scheme (FLS) with drawings under the scheme amounting to £8 billion as at the end of 2013.
- SME lending grew 6 per cent in 2013 in a market that contracted, while our target of lending £1 billion to UK manufacturing companies was exceeded three months ahead of schedule.
- The sale by the UK government of 6 per cent of its stake in the Group in September 2013, thereby reducing its holding to 32.7 per cent. A major milestone in our recovery, and marks the start of the journey to full re-privatisation, which is a key priority for the Group.

The Committee agreed a balanced scorecard rating for 2013 of 'Strong plus' for the GCE. This is one of the highest ratings on the Group's performance scale, surpassed only by a 'Top minus' or 'Top' rating.

George Culmer

The maximum bonus opportunity of the Chief Financial Officer (CFO) was 200 per cent of basic salary. For 2013, the Group outperformed the financial targets as shown above. The balanced scorecard used to inform the decisions of the Committee is the overall scorecard for the Finance function. The CFO's balanced scorecard assessment for 2013, as confirmed by the Committee on 23 January 2014, reflected a number of considerations in 2013, including:

- Excellent management of Group Capital, Funding and Liquidity in a challenging environment.
- The underlying impairment charge improved by 47 per cent to £3,004 million, driven by the reduction in non-core assets and the sustained improvement in Group asset quality.
- Core impairment charge decreased 21 per cent to £1,521 million with the reduction primarily attributable to Commercial Banking impairments, which reduced by 40 per cent year-on-year reflecting better quality new business and lower defaults due to the low interest rate environment.

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– Good progress in delivering the Finance transformation, including changes to core accounting systems.
– Return on risk-weighted assets improved to 2.14 per cent from 0.77 per cent, driven by increased earnings and by risk-weighted asset reductions, predominantly in the non-core business.
– Core underlying profit before tax grew 24 per cent to £7,574 million, primarily reflecting reduced impairment charges and stronger net interest income.
– Maintained focus on cost control and efficiency, resulted in total costs falling by 5 per cent to £9,635 million.
– Substantially completed work to transform the balance sheet, by strengthening our funding, liquidity and capital position, and reducing non-core assets.
– The Group's wholesale funding requirement has reduced given the reduction in non-core assets and continued growth in customer deposits in the year. These have, together, enabled us to reduce wholesale funding by £32 billion and repay the full amount of the Long Term Refinancing Operation funding from the European Central Bank of €13.5 billion ahead of schedule.

The Committee agreed a balanced scorecard rating for 2013 of 'Strong plus' for the CFO.

Juan Colombás

The maximum bonus opportunity of the Chief Risk Officer (CRO) was 200 per cent of basic salary. For 2013, the Group outperformed the financial targets as shown above. The balanced scorecard used to inform the decisions of the Committee is the overall scorecard for the Risk Division. The CRO's balanced scorecard assessment for 2013, as confirmed by the Committee on 23 January 2014, reflected a number of considerations in 2013, including:

– Excellent progress across a range of Risk metrics – non-core reductions, impairments, capital and liquidity management.
– Non-core assets reduced by 35 per cent from £98.4 billion to £63.5 billion; reductions continue to be capital accretive overall, contributing to the release of approximately £2.6 billion of capital in the year.
– The underlying impairment charge improved by 47 per cent to £3,004 million, driven by the reduction in non-core assets and the sustained improvement in Group asset quality.
– Strong management of the Group's conduct strategy programme, which addresses every area of the organisation and is driving improvements in the customer experience.
– Good progress in delivering the Risk transformation, which is ahead of plan.
– Close control over the management of the Risk Appetite and the understanding of the control environment.
– Maintaining high level of responsiveness to our regulators with whom we strive for a strong working relationship.
– Overseeing delivery of remediation plans for legacy issues.
– Ensuring 100 per cent of product reviews were completed on time.
– Improvements in mitigating operational risks and regulatory breaches.

The Committee agreed a balanced scorecard rating for 2013 of 'Strong plus' for the CRO.

Application of the Committee's judgement

Using a purely mechanical assessment of the financial and BSC performance measures for the GCE, CFO and CRO would have resulted in bonuses close to maximum levels.

As with the bonus pool determination for the wider Group, the Committee has applied its judgement to adjust for other considerations in determining individual awards, such as affordability, market positioning, year on year performance and the impact of one-off items on the statutory financial out-turn. The Committee considered that using a purely mechanical approach to determining the 2013 bonus pool and individual awards was not appropriate and therefore applied its judgement to reduce awards for the Executive Directors, Group Executive Committee and for the Group pool overall.

Accordingly, the Committee determined that a bonus of £1,700,000 (71 per cent of maximum) was appropriate for the GCE, £910,000 (63 per cent of maximum) for the CFO and £860,000 (67 per cent of maximum) for the CRO taking into consideration affordability, the need for consistency with the members of the Group Executive Committee and overall Group performance during 2013. This judgement-based reduction was also in line with the reduction applied to the overall pool for discretionary awards across the Group.

The bonuses awarded are summarised in the table below:

Name	António Horta-Osório	George Culmer	Juan Colombás
Maximum opportunity (% of base salary)	225%	200%	200%
% awarded for 2013	160.2%	126.4%	134.2%
Bonus awarded for 2013	£1,700,000	£910,000	£860,000

Deferral

Bonus awards for Executive Directors are deferred into shares and subject to performance adjustment until at least March 2016. The GCE's award is subject to deferral for five years and to performance adjustment and forfeiture provisions during the first three years. The GCE's award is subject to an additional condition that the share price must remain above 73.6 pence on average for any 126 consecutive trading days in the five years following grant or the UK government sells at least 50 per cent of its shareholding during the three years following grant.

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If either condition is met earlier than the third anniversary of grant, vesting will still only occur on the third anniversary. In this event, the award will be subject to a further two year holding period following vesting up to a maximum of five years in total.

Consistent with the aim of ensuring that short-term financial results are only rewarded if they promote sustainable growth, the 2013 annual bonus is subject to deferral in shares until at least 2015. This deferred amount is subject to performance adjustment (malus).

The Committee reserves the right to exercise its discretion in reducing any payment that otherwise would have been earned, if they deem appropriate.

In this respect, the Committee has recommended to the Board that it should exercise its discretion to adjust the value of certain 2010 and 2011 bonus awards, on a basis equivalent to that applied in the previous year.

Long-term awards made in March 2011 vesting for the period ended on December 2013

At the end of the performance period, it has been assessed that awards will vest at 54 per cent of maximum.

	Threshold	Maximum	Vesting at threshold	Vesting at maximum	Actual performance	Vesting % of maximum
EPS 33.33% of award	6.4p	7.8p	25%	100%	6.6p	36.5%
Economic profit 33.33% of the award	£567m	£1,534m	25%	100%	£1,737m	100.0%
Annualised absolute total shareholder return 33.33% of award	8%	14%	25%	100%	8%	25.3%

Percentage change in remuneration of GCE versus the wider employee population

Figures for 'All Employees' are calculated using figures for UK-based colleagues subject to the Group Annual Bonus Plan, which is considered to be the most appropriate group of employees for these purposes.

	% change in base salary (2012 – 2013)	% change in bonus (2012 – 2013)	% change in benefits (2012 – 2013)
Group Chief Executive	0%	14.5%	0%
All Employees	2.3%*	14.1%*	2.3%*

*Adjusted for movements in staff numbers and other impacts to ensure a like for like comparison.

Relative spend on pay (£m)

Underlying Profit has been used for comparison on the basis that it reflects performance, excluding legacy issues and one-off events.

Payments within the reporting year to past directors (audited)

As part of arrangements on leaving the Group, contractual payments of monthly salary and benefits were made in respect of January 2013 totalling £76,746 to Mr T Tate.

Loss of office payments (audited)

There were no payments for the loss of office made to former Directors during 2013.

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Chairman and Non-Executive Directors (audited)

	Fees £000		Taxable benefits £000		Total £000	
Current Non-Executive Directors	**2013**	2012	**2013**	2012	**2013**	2012
Sir Winfried Bischoff	**700**	700	**17**[1]	15	**717**	715
Lord Blackwell	**233**	101	**–**	–	**233**	101
Carolyn Fairbairn	**103**	58	**–**	–	**103**	58
Anita Frew	**105**	100	**–**	–	**105**	100
Nick Luff (from 05/03/13)	**108**	–	**–**	–	**108**	–
David Roberts	**248**	202	**–**	–	**248**	202
Anthony Watson	**204**	152	**–**	–	**204**	152
Sara Weller	**103**	87	**–**	–	**103**	87
Former Non-Executive Directors						
Timothy Ryan (until 18/04/13)	**29**	115	**–**	–	**29**	115
Martin Scicluna (until 31/03/13)	**33**	130	**–**	–	**33**	130
Totals	**1,866**	1,645	**17**	15	**1,883**	1,660

[1] Taxable benefits are made up of car allowance of £12,000, private medical benefit of £566, and transportation of £4,864.

Breakdown of Non-Executive Directors' fees (£000s)

	Board fee	Deputy Chairman	Senior Independent Director	Audit committee	Remuneration committee	Board Risk committee	SWG board fees[1]	Other Fees[2,3]	2013 Total
Lord Blackwell	**65**			**20**		**18**	**130**		**233**
Carolyn Fairbairn	**65**			**20**	**18**				**103**
Anita Frew	**65**			**20**		**17**		**3**	**105**
Nick Luff	**54**			**39**		**15**			**108**
David Roberts	**65**	**100**		**20**	**18**	**45**			**248**
Timothy Ryan	**20**				**4**	**5**			**29**
Martin Scicluna	**16**			**13**		**4**			**33**
Anthony Watson	**65**		**60**	**20**	**40**	**19**			**204**
Sara Weller	**65**				**18**	**17**		**3**	**103**

[1] Scottish Widows Group Ltd.

[2] Fees for chairing the Responsible Business Steering Group (a non-Board level committee).

[3] Fees for chairing the Finance Inclusion Committee (a non-Board level committee).

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Historical TSR performance

The chart below shows the historical TSR of Lloyds Banking Group plc compared with the FTSE 100 as requested by the regulations, rebased as at 1 January 2008. The FTSE 100 index has been chosen as it is a widely recognised equity index of which Lloyds Banking Group plc has been a constituent throughout this period.

Total shareholder return indices – Lloyds Banking Group and FTSE 100

To provide further context, we have also shown below Lloyds Banking Group's annual TSR change compared with the FTSE 100 and against a European Banking index calculated for each period since 1 January 2008. We believe this highlights more clearly the positive impact of the current management team which was formed in 2011.

1 year total shareholder return

Historical GCE remuneration outcomes

	GCE	2009	2010	2011	2012	2013
GCE single figure of remuneration £000	J E Daniels	1,121	2,572	855	–	**–**
	António Horta-Osório	–	–	1,765	3,398	**7,475**
Annual bonus payout (% of maximum opportunity)	J E Daniels	Waived	62%	0%	–	**–**
	António Horta-Osório	–	–	Waived	62%	**71%**
Long-term incentive vesting (% of maximum opportunity)	J E Daniels	0%	0%	0%	–	**–**
	António Horta-Osório	–	–	0%	0%	**54%**

Notes: J E Daniels served as Group Chief Executive until 28 February 2011; António Horta-Osório was appointed Group Chief Executive from 1 March 2011. J E Daniels declined to take a bonus in 2008 and 2009 and António Horta-Osório declined to take a bonus in 2011.

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Outstanding share awards

Directors' interests (audited)

Shareholding guidelines

Executive Directors are required to build up a holding in Lloyds Banking Group plc shares of value equal to 150 per cent of gross salary (200 per cent of gross salary for the Group Chief Executive) and are expected to achieve these targets within three years from the later of 1 January 2012 and their date of joining the Board. They are required to retain any shares vesting from LTIP awards granted from 2012 onwards for a further two years post vesting (although vested shares would count towards the shareholding requirement). Members of the Executive Committee are required to build up a shareholding of 100 per cent of their gross salary. As at 31 December 2013, all Executive Directors significantly exceeded the requirements.

	Number of Shares			Number of Options		Total Shareholding		Value
	Owned outright	Unvested subject to continued employment	Unvested subject to performance	Unvested subject to continued employment	Vested unexercised	Totals	Total at 27 February 2014	Expected value at 31 December 2013 (£000s)[2]
Executive Directors								
António Horta-Osório[1]	1,411,685	3,012,781	24,224,312	22,156	4,005,764	32,676,698	32,677,068[3]	12,400
George Culmer	877,951	1,420,166	8,674,086	2,265,972	2,216,187	15,454,362	15,454,732[3]	7,401
Juan Colombás	1,409,048	1,989,077	10,809,619	–	535,231	14,742,975	14,742,975	5,661
Non-Executive Directors								
Sir Winfried Bischoff	1,300,000	–	–	–	–	1,300,000	n/a	n/a
Lord Blackwell	50,000	–	–	–	–	50,000	n/a	n/a
Carolyn Fairbairn	–	–	–	–	–	–	n/a	n/a
Anita Frew	300,000	–	–	–	–	300,000	n/a	n/a
David Roberts	968,641	–	–	–	–	968,641	n/a	n/a
Nick Luff	80,000	–	–	–	–	80,000	n/a	n/a
Anthony Watson	476,357	–	–	–	–	476,357	n/a	n/a
Sara Weller	150,000	–	–	–	–	150,000	n/a	n/a

[1] Shareholdings held by António Horta-Osório are either wholly or partially in the form of ADRs.

[2] Awards subject to performance under the Long-Term Incentive Plan had an expected value of 30 per cent of face value at grant (using current accounting assumptions). Values are based on the 31 December 2013 closing price of 78.88 pence. Full face value of awards are £25,775,379 for António Horta-Osório, £12,190,401 for George Culmer and £11,629,259 for Juan Colombás.

[3] The changes in beneficial interests for António Horta-Osório and George Culmer relate to 'partnership' and 'matching' shares acquired under the Lloyds Banking Group Share Incentive Plan between 31 December 2013 and 27 February 2014.

A summary of transactions undertaken in the year, including share plan awards vested plus open market purchases and sales made by Directors, is shown on page 122.

As a result of the above shareholdings, the position for each Executive Director is as follows:

		Shareholding requirement		Current shareholding		Requirement met
	Base salary (£000s)	% of base salary	Number of shares (at 31/12/13 closing price of £0.7888)	% of base salary[1]	Number of shares as at 31/12/13[2]	
Executive Directors						
António Horta-Osório	1,061	200%	2,690,162	402%	5,417,449	Yes
George Culmer	720	150%	1,369,168	338%	3,094,138	Yes
Juan Colombás	710	150%	1,350,152	216%	1,944,279	Yes

[1] Current shareholding percentage of base salary shareholding figure is calculated using the 31/12/13 closing price of 78.88 pence.

[2] Shares owned outright plus vested but unexercised options have been used to calculate current shareholding figures.

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 plc.

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Breakdown of shares interests (audited)

Long-term incentive plan awarded in 2013

Awards in 2013 were made over shares with a value of 300 per cent of reference salary for the GCE (7,425,441 shares with a face value of £3,660,000), 275 per cent for the CFO (4,017,041 shares with a face value of £1,980,000) and 275 per cent for the CRO (3,576,283 shares with a face value of £1,762,750). The share price used to calculate face value is the average price over the five days prior to grant (18 March to 22 March 2013), which was 49.29 pence.

The performance conditions attached to these awards are set out in the table below. The performance period ends on 31 December 2015.

Measure	Basis of payout range	Metric	Weighting
Economic Profit	Payout range set relative to 2015 targets	Threshold: £1,254m Maximum: £1,881m	35%
Absolute TSR	Growth in share price including dividends	Threshold: 8% pa Maximum: 16% pa	30%
Customer satisfaction (FCA reportable banking complaints per 1,000 customers excluding PPI)	Payout range set relative to targets over 3 year period	Threshold: 1.05 Maximum: 0.95	10%
Total costs (adjusted)	Payout range set relative to 2015 targets	Threshold: <=£9,323m Maximum: <=£8,973m	10%
Non-core assets at end of 2015 (excluding UK Retail)	Payout range set relative to 2015 targets	Threshold: <=£37bn Maximum: <=£28bn	10%
SME lending	Payout range set relative to performance against market in lending to SMEs over 3 year period	Threshold: at market Maximum: 4%	5%

For each measure, 25 per cent will vest for threshold performance, 50 per cent for on-target performance and 100 per cent for maximum performance.

SAYE interests awarded in 2013

The Executive Directors are eligible to participate in the Group's 'sharesave' and 'sharematch' plans. In 2013, the GCE and CFO were each granted SAYE options over 22,156 shares (with an exercise price of 40.62 pence per share and a face value of £11,250). The share price used to calculate the face value is the price on grant (12 April 2013), which was 50.78 pence.

Deferred bonus awarded in 2013

Bonus is deferred into shares normally released at the end of a three year period. The face value of the share awards in respect of bonuses granted in March 2013 was £1,485,000 (3,012,781 shares) for the GCE and £700,000 (1,420,166 shares) for the CFO. The share price used to calculate face value is the average price over the five days prior to grant (18 March to 22 March 2013), which was 49.29 pence.

Interests in share options (audited)

	At 1 January 2013	Granted during the year	Exercised during the year	Lapsed during the year	At 31 December 2013	Exercise price	Exercise periods From	Exercise periods To	Notes
António Horta-Osório	1,452,401	–	–	–	1,452,401	–	15/6/2011	30/3/2021	a
	662,116	–	–	–	662,116	–	31/1/2012	30/3/2021	a
	1,452,401	–	–	–	1,452,401	–	15/6/2012	30/3/2021	a
	438,846	–	–	–	438,846	–	31/1/2013	30/3/2021	a
	1,707,763	–	–	1,707,763	–	–	15/6/2013	30/3/2021	a, d
	–	22,156	–	–	22,156	40.62p	1/6/2016	30/11/2016	e
George Culmer	2,216,187	–	–	–	2,216,187	–	1/4/2013	31/3/2018	b, c
	2,243,816	–	–	–	2,243,816	–	1/4/2014	31/3/2019	b, c
	–	22,156	–	–	22,156	40.62p	1/6/2016	30/11/2016	e
Juan Colombás	235,499	–	–	–	235,499	–	15/6/2011	30/3/2021	a
	299,732	–	–	–	299,732	–	15/6/2012	30/3/2021	a
	606,357	–	–	606,357	–	–	–	–	a, d
Former Directors who served during 2013									
None									

[a] Share buy-out award granted on 30 March 2011 for the loss of deferred share awards forfeited on leaving the Santander Group. Awards are consistent with those forfeited and have a nil option price.

[b] Not exercisable as the option has not been held for the period required by the relevant scheme.

[c] Executive share award granted on 6 August 2012 for the loss of deferred share awards forfeited on leaving RSA Insurance Group plc.

[d] Share buy-out awards lapsed as the performance conditions were not met.

[e] Sharesave.

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None of the other directors at 31 December 2013 had options to acquire shares in Lloyds Banking Group plc or its subsidiaries.

The market price for a share in the Group at 1 January 2013 and 31 December 2013 was 47.92 pence and 78.88 pence, respectively. The range of prices between 1 January 2013 and 31 December 2013 was 46.305 pence to 80.37 pence.

Nil cost options granted in March 2011 lapsed as the performance conditions (relative TSR against a bespoke comparator group) were not met.

Lloyds Banking Group long-term incentive plan (audited)

The following table shows conditional shares awarded under the plan. Further information regarding this plan can be found on pages 111 and 120.

	At 1 January 2013	Awarded during the year	Vested during the year	Lapsed during the year	At 31 December 2013	End of performance period	Expected value (£000s)[b]	Notes
António Horta-Osório	7,154,187	–	–	–	**7,154,187**	31/12/2013	5,643	
	9,644,684	–	–	–	**9,644,684**	31/12/2014	7,608	
	–	**7,425,441**			**7,425,441**	31/12/2015	5,857	a
George Culmer	4,657,045	–	–	–	**4,657,045**	31/12/2014	3,673	
	–	**4,017,041**	–	–	**4,017,041**	31/12/2015	3,169	a
Juan Colombás	3,087,272	–	–	–	**3,087,272**	31/12/2013	2,435	
	4,146,064	–	–	–	**4,146,064**	31/12/2014	3,270	
	–	**3,576,283**	–	–	**3,576,283**	31/12/2015	2,821	a

[a] Award price 49.29 pence

[b] Values are based on the 31 December 2013 closing price of 78.88 pence.

Additional disclosures

Emoluments of the eight highest paid senior executives*

The following table sets out the emoluments of the eight highest paid senior executives (excluding Executive Directors) in respect of the 2013 performance year.

	Executive							
	8	7	6	5	4	3	2	1
	£000	£000	£000	£000	£000	£000	£000	£000
Fixed								
Cash based	**400**	**700**	**480**	**843**	**500**	**656**	**700**	**754**
Total fixed	**400**	**700**	**480**	**843**	**500**	**656**	**700**	**754**
Variable								
Upfront cash	**2**	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Deferred cash	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Upfront shares	**358**	**334**	**238**	**226**	**272**	**334**	**458**	**374**
Deferred shares	**540**	**504**	**360**	**342**	**411**	**504**	**690**	**564**
Long term incentive plan	**0**	**0**	**571**	**491**	**739**	**1,385**	**1,231**	**1,592**
Total variable pay	**900**	**840**	**1,171**	**1,061**	**1,424**	**2,225**	**2,381**	**2,532**
Pension cost	**80**	**175**	**96**	**133**	**125**	**164**	**175**	**189**
Total remuneration	**1,380**	**1,715**	**1,747**	**2,037**	**2,049**	**3,045**	**3,256**	**3,475**

Variable pay in respect of performance year 2013. LTIP values shown reflect awards for which the performance period ended on 31 December 2013. Pension costs based on a percentage of salary according to level.

* Includes members of the Group Executive Committee and Senior Executive level colleagues.

DIRECTORS' REMUNERATION REPORT

Directors' interests – summary of awards vested, purchases and sales made by directors in 2013 (unaudited)

	Holding at 1 January 2013 (or appointment date)	Transactions during the year	Number of Shares	Notes	Holding at 31 December 2013
Executive Directors					
António Horta-Osório	1,407,780	29/10/13	920	Purchase 230 ADRs for connected person	
		Monthly	2,985	Share Incentive Plan purchase and matching shares	**1,411,685**
George Culmer	874,966	Monthly	2,985	Share Incentive Plan purchase and matching shares	**877,951**
Juan Colombás	1,409,048	None	–	–	**1,409,048**
Non-Executive Directors					
Sir Winfried Bischoff	1,300,000	None	–	–	**1,300,000**
Lord Blackwell	50,000	None	–	–	**50,000**
Carolyn Fairbairn	–	None	–	–	**–**
Anita Frew	300,000	None	–	–	**300,000**
Nick Luff	80,000	None	–	–	**80,000**
David Roberts	968,641	None	–	–	**968,641**
Anthony Watson	476,357	None	–	–	**476,357**
Sara Weller	150,000	None	–	–	**150,000**

On behalf of the Board

Anthony Watson, CBE
Chairman, Remuneration Committee

Risk management

All narrative and quantitative tables are unaudited unless otherwise stated. The audited information is required to comply with the requirements of relevant International Financial Reporting Standards.

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RISK MANAGEMENT

Risk management is at the heart of our strategy to become the best bank for customers.

Our mission is to support the business in delivering sustainable growth. This is achieved through informed risk decision making and superior risk and capital management, supported by a consistent risk-focused culture across the Group.

The Risk Overview (pages 40 to 43) provides a summary of Risk Management within the Group. It highlights the important role of risk as a strategic differentiator, risk achievements in 2013 and priorities for 2014 along with a brief overview of the Group's risk governance structure and the principal risks faced by the Group and key mitigating actions.

This full risk management section provides a more in-depth picture of how risk is managed within the Group, detailing the Group's appetite for risk (page 124), emerging risks (page 126), approach to stress testing, risk governance and committee structure (pages 127 to 132) and a full analysis of the primary risk drivers (pages 133 to 196) – the framework by which risks are identified, managed, mitigated and monitored.

Each risk driver is described and managed using the following standard headings: definition, appetite, exposure, measurement, mitigation and monitoring.

40 See Risk Overview

The Group's approach to risk

The Group operates a prudent approach to risk with rigorous management controls to keep the Group safe, support sustainable business growth and minimise losses within risk appetite. The Group has a strong and independent risk function (Risk Division) with a mission to maintain a robust control framework, identify and escalate emerging risks and support sustainable business growth within risk appetite through good risk reward decisioning.

Risk culture

The Board ensures that senior management implements risk policies and risk appetites that either limit or, where appropriate, prohibit activities, relationships and situations that could be detrimental to the Group's risk profile.

The Group has a conservative business model embodied by a risk culture founded on a prudent approach to managing risk. The Group refreshed its Codes of Business and Personal Responsibility in 2013 reinforcing its approach where colleagues are accountable for the risks they take and the needs of customers are paramount.

The focus remains on building and sustaining long-term relationships with customers whatever the economic climate.

Risk appetite

- The Group defines risk appetite as 'the amount and type of risk that the Group is prepared to seek, accept or tolerate.'
- The Group's strategy operates in tandem with its high level risk appetite which is supported by more detailed metrics and limits. An updated Risk Appetite Statement was approved by the Board in 2013. This incorporated recommendations from the Non-Executive Directors and is fully aligned with Group strategy.
- Risk appetite is embedded within principles, policies, authorities and limits across the Group.
- Risk appetite will continue to evolve to reflect external market developments and the composition of the Group.
- The Group optimises performance by allowing business units to operate within approved risk appetite and limits.

Governance and control

- Governance is maintained through delegation of authority from the Board down through the management hierarchy, supported by a committee-based structure designed to ensure open challenge and that the Group's risk appetite, principles, policies, procedures, controls and reporting are fully in line with regulations, law, corporate governance and industry good-practice.
- 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 promptly escalated and remediation plans are initiated where required.
- The Group's approach to risk is founded on a robust control framework and a strong risk management culture which ensures that business units remain accountable for risk and therefore guides the way all employees approach their work, behave and make decisions.
- The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by both the Board and senior management.
- A strong control framework remains a priority for the Group and is the foundation for the delivery of effective risk management.

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Risk decision making and reporting

- Taking risks which are well understood, consistent with strategy and with appropriate margin is a key driver of shareholder value.
- Risk analysis and reporting supports the identification of opportunities as well as risks.
- An aggregate view of the Group's overall risk profile, key risks and management actions, and performance against risk appetite, is reported to and discussed monthly at the Group Risk Committee (and as a subset at the Group Asset and Liability Committee), with regular reporting to the Board Risk Committee and the Board.
- Rigorous stress testing exercises are carried out to assess the impact of a range of adverse scenarios with different probabilities and severities to inform strategic planning.
- The Chief Risk Officer regularly informs the Board Risk Committee (BRC) of the aggregate risk profile and has direct access to the Chairman and members of the Board Risk Committee. The Chief Risk Officer was appointed to the Board on 29 November 2013.

Table 1.1: **Exposure to risk arising from the business activities of the Group**

The table below provides a high level guide to the how the Group's business activities are reflected in its risk measures and balance sheet.

	Lloyds Banking Group				
Division	**Retail**	**Commercial Banking**	**Wealth, Asset Finance & International**	**Insurance[1]**	**Group Operations & Central Items**
Business activities	The Retail division is a leading provider of current accounts, savings, personal loans, credit cards and mortgages	The Commercial Banking division supports business clients from small businesses to large corporates, with a range of propositions fully segmented according to client needs	Wealth, Asset Finance & International comprises UK and international wealth businesses, UK and international asset finance and online deposit businesses along with international retail business	The Insurance division is one of the UK's largest insurers and provides long-term savings, protection and investment products and general insurance products to customers in the UK and Europe	Group Operations provides high quality services and delivers investment project capability through IT, Operations, Property and Sourcing
RWAs:					
– credit risk	**£70,900m**	**£111,482m**	**£22,439m**	**–[1]**	**£13,559m[2]**
– counterparty credit risk	**–**	**£7,643m**	**£6m**	**–[1]**	**£145m**
– operational risk	**£14,777m**	**£8,376m**	**£3,441m**	**–[1]**	**–**
– market risk	**–**	**£11,040m**	**–**	**–[1]**	**£42m**
TOTAL	**£85,677m**	**£138,541m**	**£25,886m**	**–[1]**	**£13,746m**

[1] As a separate regulated entity with its own Board, the Insurance Division maintains its own regulatory risk capital and liquidity requirements, including appropriate management buffers. The Insurance Division operates within the Group's overall risk framework against agreed risk appetites, with Risk Division, represented by the Insurance Divisional Risk Officer, and Group Audit providing assurance to both the Insurance Board and Group Board through the respective risk and audit committees.

[2] Predominantly relates to various non-financial assets, including fixed assets, cash, items in the course of collection, prepayments, sundry debtors and deferred tax assets, the RWAs for which are reported within credit risk for regulatory capital purposes.

Principal risks

The Group's principal risks are shown in the Risk Overview (pages 42 to 43). The Group's emerging risks are shown overleaf. Full analysis of the Group's risk drivers are on pages 133 to 196.

RISK MANAGEMENT

Emerging risks

The Group considers the following to be risks that have the potential to increase in significance and affect the performance of the Group.

Competition

Interventions by the competition authorities in response to a return to profitability or to perceived or actual market inefficiencies could change the competition landscape and possibly impact market structures and margins. This risk is underlined by the creation of the new Competition and Markets Authority and the introduction of a competition mandate for the FCA.

Key mitigating actions

– Implementation of the Group's Conduct Strategy, applying value for money principles, and ensuring that the customer is at the heart of the Group's business planning.
– The Group is working with the FCA on using behavioural economics and customer trials to improve customer outcomes.
– Application of the risk management framework to competition risks across the Group.

Evolution of conduct expectations

The Consumer Credit regulatory regime is in a period of transition and will be transferred from the Office of Fair Trading (OFT) to the FCA in April 2014 to complement its current mandate. It is possible that the FCA will adopt a different approach and apply a wide range of enforcement powers.

Key mitigating actions

– Rigorous implementation of Conduct Strategy across the Group.
– Proactive regulatory advice and challenge to be applied across the Group.
– Programmes in place to deliver redress for customers where identified.
– Continue work to prepare for the FCA approach on consumer credit regulation.

Ring-fencing and resolution planning

Ring-fencing legislation and final rules on Resolution Planning will impact the Group's strategy and the capacity/cost to serve customers effectively. The dimensions of the ring-fence may challenge the Group's future shape and the scope of its activities while an effective Resolution Plan may prompt structural change in order to make the Group more resolvable in a crisis. Without a robust Resolution Plan, the Group could face higher costs of capital/liquidity.

Key mitigating actions

– Ongoing engagement with HM Treasury, PRA and the BoE on the evolving UK regulatory framework, and impact of EU Directives.
– Coordinated scenario analysis and planning through the Ring-Fencing and Resolution Programme under GEC sponsorship.
– Mobilisation of resources across the Group to assess impacts and propose potential responses aligned to Group strategy.

Evolving requirements on capital

While there is now greater clarity on regulatory capital requirements, there remains some uncertainty as UK and European regulatory frameworks continue to evolve. For example, in 2013, the PRA introduced significant additional capital requirements on an adjusted basis that major UK banks are required to meet. Areas of uncertainty include the calibration of the leverage ratio in the UK, evolving CRD IV technical standards and potential changes to the calculation of capital requirements (i.e. risk-weighted assets).

Key mitigating actions

– The Group has made significant progress and continues to deliver on its strategy of strengthening the balance sheet, including its capital position, to improve the resilience of the Group.
– The Group has strong governance, processes and controls which, combined with the Group's proactive management of risk, result in an appropriate level of capital.

Technology

Internet and mobile technologies are changing customer behaviour, leading to changes in the banking model. Major changes in payments are also expected over next two to five years. The cyber risk landscape has continued to evolve over the last 18 months.

Key mitigating actions

– Increased focus on digital, demonstrated by the creation of the 'Digital, Marketing and Customer Development' function.
– IT resilience improvement programme following the 2013 review.
– Development of customer focused IT risk appetite and refreshed cyber strategy with refined risk appetite.

Culture

A cultural change is needed in banking to restore trust, with greater evidence of genuinely client-centred behaviour and enterprise-wide management of risks.

Key mitigating actions

– Further embedding and implementation of the Group's Risk Management Framework.
– Continuing work to embed a strong, customer-centric and robust risk culture, alongside wider Group Cultural Transformation activities.
– Engagement in Chartered Banker: Professional Standards Board and roll out of the Foundation Standards and planning for the Leadership Standards.
– Assessment of Group actions against the findings of the Barclays Salz Review and response to the various components of the Banking Reform Act.

Scottish independence

The impact of a 'yes' vote in favour of Scottish independence is uncertain. The outcome could have a material impact on compliance costs, the tax position, and cost of funding for the Group.

Key mitigating actions

– Monitoring and assessment of the potential impact on the Group's business and impact on customers of a vote in favour of Scottish independence.

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Stress testing

Overview

Stress testing is recognised as an essential risk management tool within the Group by the Board, senior management, the businesses and the risk and finance functions. Stress testing is embedded in the planning process of the Group and is applied to the base case plan. This allows senior management and Board to assess the base case plan in adverse circumstances and to adjust strategies/propose mitigating actions if the plan does not meet risk appetite in a stressed scenario. A rigorous review and challenge process ensures that senior management are actively involved in stress testing.

The Group uses scenario stress testing to:

– Provide an assessment of strategic plans against Board Risk Appetite, alongside a comparison of portfolio performance in adverse circumstances against risk appetite limits, to ensure the Group is managed within risk appetite.
– Drive the development of potential actions and contingency plans to mitigate the impacts of adverse scenarios. Stress testing also links directly to the Group's recovery planning process.
– Support the Internal Capital Adequacy Assessment Process (ICAAP) and setting of Individual Capital Guidance (ICG).
– Meet the standards required and information needs of internal and external stakeholders, including regulators.

At least on an annual basis, the Group conducts a detailed macroeconomic stress testing exercise based on the five-year operating plan, which is supplemented with higher-level refreshes of the stress testing exercise when necessary. The exercise aims to highlight the key vulnerabilities of the Group to adverse changes in the economic environment and to ensure that there are adequate financial resources in the event of a downturn. The exercise includes a range of economic scenarios, including the 'PRA Anchor Scenarios' (these are the PRA's published supervisory recommended scenarios for the UK, details of which are publicly available on the Bank of England's website). Ad hoc stress testing exercises are also undertaken to assess emerging risks, as well as in response to regulatory requirements. The Group also takes part in regular external, industry-wide stress testing exercises, such as those run by the European Banking Authority and will take part in the forthcoming UK-wide Bank of England stress testing exercise.

In addition to the running of macroeconomic scenarios, the Group's stress testing programme involves undertaking assessment of operational risk scenarios, liquidity scenarios, financial market disruption scenarios, market risk sensitivities, reverse stress testing and business specific scenarios (see relevant risk section for further information on risk specific level stress testing). This provides a comprehensive view of the potential impacts arising from the risks to which the Group is exposed and reflects the nature, scale and complexity of the Group.

Methodology

The Chief Economist's Office develops the macroeconomic scenarios to be used by the Group. Internal scenarios are developed based on key uncertainties for the economic outlook. A wide set of economic parameter assumptions is constructed, with over 150 metrics provided such as Gross Domestic Product, Base Rate, Unemployment, Property Indices, Insolvencies, Corporate Failures to facilitate modelling of scenarios across the Group. Where an external scenario is provided, the Chief Economist's Office broadens the supplied parameter to the level of detail required by the Group.

The stress tests at all levels must comply with all legal and regulatory requirements, and are put through a rigorous review and challenge process. This is supported by analysis and insight into impacts on customers and business drivers. The engagement of all required risk and control areas is built into the preparation process, so that the appropriate analysis of each risk drivers' impact upon the business plans are understood and documented.

The methodologies and modelling approach used for stress testing ensures that a clear link is shown between the macro-economic scenarios, the business drivers for each area and the resultant stress testing outputs. All material assumptions used in modelling are documented and justified, with a clearly communicated review and sign off process. Modelling is supported by expert judgement is subject to the Group Risk Model Governance Policy.

Below is an overview of the principal output responsibilities by team.

– Finance teams in the business prepare and review finance related stress testing results including, but not limited to, income, margins, costs, lending and deposit volumes.
– Credit Risk and Market Risk teams prepare and review risk-related stress outputs, including, but not limited to, impairment charges, risk-weighted assets, expected loss, probability of default, loss given default and trading losses.
– The Central Group Stress testing team which sits in Risk Division reviews the finance and risk stress submissions and produces a consolidated Group view of the results, including analysis packs for the Group's senior committees.

The Group Capital and Regulatory Reporting team, supported by Group Corporate Treasury, reviews all capital related stress outputs, including the calculation of indicative capital ratios. The Group Corporate Treasury team also reviews the stress outputs from divisions and evaluates the impact upon the Group's Capital and Funding Plan.

Reverse stress testing

Reverse stress testing is used to explore the vulnerabilities of the Group's strategies and plans to extreme adverse events, and to help improve contingency planning. The scenarios used in such a stress test are those that would cause a failure in the business model. Where reverse stress testing reveals plausible scenarios with an unacceptably high risk when considered against the Group's risk appetite, the Group will undertake measures to prevent or mitigate that risk, which are then reflected in strategic plans.

RISK MANAGEMENT

Governance

Clear accountabilities and responsibilities for stress testing are assigned to senior management and the risk and finance functions throughout the Group. This is formalised through the Business Planning and Stress Testing Policy and Procedure, which are reviewed at least annually.

The Group Financial Risk Committee (GFRC), chaired by the Chief Risk Officer, is the Committee that has primary responsibility for overseeing the development and execution of the Group's stress tests.

The main economic assumptions developed by the Chief Economist's Office are reviewed and challenged at Group Risk Committee (GRC), Group Executive Committee (GEC) and Board Risk Committee (BRC), and approved by the Board before being cascaded across the Group.

The stress test outputs go through a rigorous review and challenge process at divisional level, including sign-off by the divisional Finance Directors and Risk Directors. The outputs are then presented to GFRC, GRC and BRC for review and challenge, before being approved by the Board.

Risk governance

The Group's Risk Management Framework (RMF) provides a robust and consistent approach to risk management across the Group in order to drive its risk profile in line with risk appetite. It articulates individual and collective accountabilities for risk management, risk oversight and risk assurance; supports the discharge of responsibilities to customers, shareholders and regulators; and establishes a common risk language which assigns the risks to which the Group is exposed into categories which are used consistently to support risk aggregation and reporting.

The risk governance structure below is integral to implementing the RMF across the Group and by ensuring risk is appropriately represented on key committees ensures that risk management is discussed in these meetings. This structure outlines the flow and escalation of risk information and reporting from business areas and Risk Division to the Group Executive Committee (GEC) and Board. Conversely, strategic direction and guidance is cascaded down from the Board and GEC.

Table 1.2: **Risk governance structures**

The components of the RMF can be found in the Risk Overview on page 41.

RISK MANAGEMENT

Board, Executive and Risk Committees

The Group's risk governance structure (see table 1.2) strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

Assisted by the Board Risk and Audit Committees, the Board approves the Group's overall governance, risk and control frameworks and risk appetite. Refer to the Corporate Governance section on pages 78 to 99, for further information on Board committees.

The Insurance Division, as a separate regulated entity, has its own Board and governance structure. The Insurance Board, assisted by a Risk Oversight Committee and Audit Committee, approves the governance, risk and control frameworks for insurance and insurance risk appetite, ensuring it aligns with the Group's framework and risk appetite.

Table 1.3: **Executive and Risk Committees**

Committees	Risk focus
Group Executive Committee	
Group Executive Committee (GEC)	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, while also reviewing the Group's aggregate risk exposures and concentrations of risk.
The Group Executive is supported by:	
Group Risk Committee	Reviews and recommends the Group's risk appetite and governance, risk and control frameworks, material Group policies and the allocation of risk appetite. The committee also regularly reviews risk exposures and risk/reward returns and approves material risk models.
Group Asset and Liability Committee	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.
Executive Compensation Committee	Provides governance and oversight for Group-wide remuneration matters and policies.
Group Executive Committee Members' Committees	
Group Product Governance Committee	Provides strategic and senior oversight over design, launch and management of products including new product approval, annual product reviews and management of risk in the back book.
Group Financial Risk Committee	Responsible for reviewing, challenging and recommending to GEC, the Group Individual Liquidity Adequacy Assessment and Internal Capital Adequacy Assessment Process submissions, the Group Recovery Plan, and the annual stress testing of the Group's operating plan based on internal and PRA recommended scenarios, annual European Banking Authority stress tests, and other Group-wide macroeconomic stress tests.
Group Rectification Committee	Ensures appropriate control and oversight of material events which have a customer impact.
The Group Risk Committee is supplemented by the following committees to ensure effective oversight of risk management:	
Credit Risk Committees	Responsible for the development and effectiveness of the relevant credit risk management framework, clear description of the Group's credit risk appetite, setting of credit policy, and compliance with regulatory credit requirements.
Group Market Risk Committee	Monitors and reviews the Group's aggregate market risk exposures and concentrations and provides a proactive and robust challenge around business activities giving rise to market risks.
Group Operational Risk Committee	Responsible for identifying significant current and emerging 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 business area engagement occurs to develop, implement and maintain the Group's operational risk management framework.
Group Compliance and Conduct Risk Committee	Responsible for monitoring and challenging the Group's compliance and conduct risk management framework, aggregated compliance and conduct risk profile, and its alignment with agreed risk appetite.
Group Financial Crime Committee	Reviews and challenges the management of financial crime risk including the overall strategy and performance and engagement with financial crime authorities. The committee is accountable for ensuring that, at Group level, financial crime risks are effectively identified and managed within risk appetite and that strategies for financial crime prevention are effectively co-ordinated and implemented across the Group.
Group Model Governance Committee	Responsible for setting the framework and standards for model governance across the Group, including establishing appropriate levels of delegated authority and principles underlying the Group's risk modelling framework, specifically regarding consistency of approach across business units and risk types. It approves risk models other than material models which are approved by the Group Risk Committee. This also meets PRA requirements regarding the governance and approval for Internal Ratings Based models.

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How risk is managed in Lloyds Banking Group

Risk management in the business

Line management is directly accountable for identifying and managing any risks inherent or consequential 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 areas complete a control effectiveness review annually, reviewing the effectiveness of their internal controls and putting in place a programme of enhancements where appropriate. Executives from each business area and each Group Executive Committee member challenge and certify the accuracy of their assessment.

This approach provides 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.

Risk Management Framework (RMF)

The RMF (see Risk Overview, page 41) is structured around nine components which meet and align with the industry-accepted internal control framework issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO).

Role of the Board and senior management – key responsibilities of the Board and senior management include:

– setting risk appetite and approval of the RMF;
– approval of Group-wide risk principles and policies;
– the cascade of delegated authority (e.g. to Board sub-committees and the Group Chief Executive);
– effective oversight over risk management consistent with the risk appetite.

Risk appetite – the business plan is aligned to the Risk Appetite Statement so that the Group's short and medium-term business objectives match its risk tolerances which are translated into relevant risk limits for business units.

Governance frameworks – the Board-approved frameworks set out key principles for the overall management of risk in the organisation, aligned with Group strategy and risk appetite; based on a current and comprehensive risk profile that identifies all material risks to the organisation. These Governance Frameworks are underpinned by a hierarchy of policies that is coherent, consistent, and accessible.

Three Lines of Defence model – the RMF is implemented through a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities and ensures effective independent assurance activities take place covering key decisions.

– Business lines (first line) have primary responsibility for risk decisions, measuring, monitoring and controlling risks within their areas of accountability. They are required to establish effective governance, and control frameworks for their business compliant with Group Policy requirements, to maintain appropriate risk management skills, mechanisms and toolkits, and to act within Group Risk Appetite parameters set and approved by the Board.
– Risk Division (second line) is a centralised function providing oversight and independent challenge to the effectiveness of risk decisions taken by business management, providing advice and guidance reviewing, challenging and reporting on the risk profile of the Group and ensuring that mitigating actions are appropriate.
– Group Audit (third line) provides independent, objective assurance and consulting activity designed to add value and improve the organisation's operations. It helps the Group accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Mandate of the Risk Division – the objective of Risk Division is to provide both expert advice and review and challenge to the business. It also has a key role in promoting the implementation of a strategic approach to risk management reflecting the risk appetite and RMF agreed by the Board that encompasses:

– embedded and effective risk management processes;
– transparent and focused risk monitoring and reporting;
– provision of expert and high quality advice and guidance to the Board, Executives and Management on strategic issues and horizon scanning for pending regulatory changes; and
– provision of a constructive working environment in which Risk Division is trusted and respected, and promotes a constructive dialogue with the first line through advice, development of common methodologies, understanding, education, training, and development of new tools.

Risk Division, headed by the Chief Risk Officer, consists of nine risk directors and their specialist teams. These teams provide oversight and independent challenge to business management and support senior management and the Board with independent reporting on risks and opportunities. Risk directors, responsible for each risk type, meet on a regular basis under the chairmanship of the Chief Risk Officer to review and challenge the risk profile of the Group and to ensure that mitigating actions are appropriate.

The Chief Risk Officer is accountable for developing and leading an industry-wide recognised Risk function that adds value to the Group by:

– providing a regular comprehensive view of the Group's risk profile, key risks both current and emerging, and management actions;
– (with input from the business areas and Risk Division) proposing Group Risk Appetite to the Board for approval, and oversighting performance of the Group against Risk Appetite;
– developing an effective RMF meeting regulatory requirements for approval by the Board, and oversighting execution and compliance; and
– challenging management on emerging risks and providing expert risk and control advice to help management maintain an effective risk and control framework.

RISK MANAGEMENT

Risk directors
– provide independent advice, oversight and challenge to the business;
– design, develop and maintain policies, specific risk frameworks and guidance to ensure alignment with business imperatives and regulatory requirements;
– establish and maintain appropriate governance structures, culture, oversight and monitoring arrangements which ensure robust and efficient compliance with relevant risk-type risk appetites and policies;
– lead regulatory liaison on behalf of the Group including horizon scanning and regulatory development for their risk type; and
– set risk appetite and oversight of the associated risk profile across the Group.

Risk identification, measurement and control – the process for risk identification, measurement and control is integrated into the overall framework for risk governance. Risk identification processes are forward-looking to ensure emerging risks are identified. Risks are captured in comprehensive risk logs/registers, and measured using robust and consistent quantification methodologies. The measurement of risks includes the application of sound stress testing and scenario analysis, and considers whether relevant controls are in place before risks are incurred.

Risk monitoring, aggregation and reporting – identified risks are logged and reported on a monthly basis or as frequently as necessary to the appropriate committee. The extent of the risk is compared to the overall risk appetite as well as specific limits or triggers. When thresholds are breached, committee minutes are clear on the actions and timeframes required to resolve the breach and bring risk within given tolerances. There is a clear process for escalation of risks.

Culture – supporting the formal frameworks of the RMF is the underlying culture, or shared behaviours and values, which sets out in clear terms what constitutes good behaviour and good practice. In order to effectively manage risk across the organisation, the functions encompassed within the Three Lines of Defence have a clear understanding of risk appetite, business strategy and an understanding of (and commitment to) the role they play in delivering it. A number of levers are used to reinforce the risk culture, including tone from the top, governance and role definition, capability development, performance management and reward.

Resources and capabilities – appropriate mechanisms are in place to avoid over-reliance on key personnel or system/technical expertise within the Group. Adequate resources are in place to deal with customers both under normal working conditions and in times of stress, and monitoring procedures are in place to ensure that the level of available resource can be increased if required. Colleagues undertake appropriate training to ensure they have the skills and knowledge necessary to enable them to deliver fair outcomes for customers, being mindful of the Group's Conduct Strategy, Customer Treatment Policy/Standards and Financial Conduct Authority requirements.

There is ongoing investment in risk systems and models alongside the Group's investment in customer and product systems and processes. This drives improvements in risk data quality, aggregation and reporting leading to effective and efficient risk decisions.

Independent challenge

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 the Risk Division, and seeks to ensure objective challenge to the effectiveness of the risk governance framework.

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Full analysis of risk drivers

The Group's risk framework covers all types of risk which affect the Group and could impact on the achievement of its strategic objectives. A detailed description of each category is provided below.

Primary risk drivers

Credit risk[1]	Conduct risk[1]	Market risk[1]	Operational risk[1]	Funding and liquidity risk[1]	Capital risk[1]	Regulatory risk[1]	Insurance risk	People risk	Financial reporting risk	Governance risk
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[1] The Group considers these to be principal risks. See Risk Overview pages 40 to 43 for further details.

Secondary risk drivers

Concentration risk	Customer risk	Equity risk	Business process	Funding risk	Capital sufficiency risk	Prudential risk	Mortality	Resourcing	Financial and prudential regulatory reporting	Governance
Counterparty and customer risk	Product risk	Foreign exchange risk	Change	Liquidity risk	Capital efficiency risk	Compliance risk	Longevity	Performance and reward	Tax reporting and compliance	
Collateral management	Product distribution/ advice	Interest rate risk	Client money/ fiduciary obligations			Competition risk	Morbidity	Culture and engagement	Disclosure	
Country transfer risk		Credit spread risk	Conduct processes				Persistency	Talent and succession	Accounting policies and practices	
		Commodity risk	Financial crime				Property	Learning	Delegated authorities	
		Basis risk	Financial reporting processes				Expenses	Wellbeing	Pillar 3 disclosures	
		Inflation risk	Fraud				Unemployment	Legal and regulatory		
		Property risk	Governance processes							
		Alternative assets	Information security							
			IT systems							
			People processes							
			Physical security							
			Regulatory processes							
			Risk processes							
			Service provision							
			Sourcing							

Credit risk

Definition

Credit risk is defined as the risk that parties with whom the Group has contracted fail to meet their obligations (both on and off-balance sheet).

Risk appetite

Credit risk appetite is set at Board level and is described and reported through a suite of metrics derived from a combination of accounting and credit portfolio performance measures, which may include the use of various credit risk rating systems as inputs. These metrics are supported by more detailed appetite metrics at divisional and business level and 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 Risk Committee, the Group Chief Executive allocates this risk appetite across the Group.

Exposures

The principal sources of credit risk within the Group arise from loans and advances, contingent liabilities, commitments, debt securities and derivatives to customers, financial institutions and sovereigns. The credit risk exposures of the Group are set out in note 54 on page 327. Credit risk exposures are categorised as 'retail', arising primarily in the Retail and Wealth, Asset Finance and International divisions, 'commercial' and 'corporate', 'financial institutions' or 'sovereigns' arising in the Commercial Banking and Wealth, Asset Finance 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 also 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 without notice and the creditworthiness of customers is monitored frequently. Most commercial term commitments to extend credit are contingent upon customers maintaining specific credit standards, which are monitored regularly.

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Loans and advances, contingent liabilities, commitments, debt securities and derivatives also expose the Group to refinance risk. Refinance risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. If the Group does not wish to refinance the exposure then there is refinance risk if the obligor is unable to repay by securing alternative finance. This may be because the borrower is in financial difficulty, or because the terms required to refinance are outside acceptable market appetite at the time. Refinance risk exposures are managed in accordance with the Group's existing credit risk policies, processes and controls, and are not considered to be material given the Group's prudent and through the cycle credit risk appetite. Where refinance risk exists (such as in the interest only retail mortgage portfolio and the Commercial Banking non-core book) exposures are minimised through intensive account management and are impaired where appropriate.

Credit risk can also arise from debt securities, private equity investments, derivatives and foreign exchange activities. The total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2013 is shown on page 246. 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 327.

Credit risk exposures in the Insurance business largely result from holding fixed income assets in the shareholder funds (including the annuity portfolio) and from exposure to reinsurers. Second order credit risk exposure exists within the unit-linked funds, through the value of future fee income, and with-profits funds, through any guarantees.

Credit risk exposure also arises in the Group's defined benefit pension schemes from holding investments. Note 41 on page 271 provides further information on the defined benefit schemes' assets and liabilities.

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 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').

For regulatory capital purposes the Group's rating systems assess probability of default and if appropriate, exposure at default and loss given default, in order to derive an expected loss. If not appropriate, regulatory prescribed exposure at default and loss given default values are used in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for loss events that have occurred at the balance sheet date, based on objective evidence of impairment. 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. Note 2(H) on page 217 provides details of the Group's approach to the impairment of financial assets.

The quality definition of both retail and commercial counterparties/exposures is largely based on the outcomes of credit risk (probability of default – PD) models. The Group operates a significant number of different rating models, typically developed internally using statistical analysis and management judgement – retail models rely more on the former, commercial models include more of the latter, especially in the larger corporate and more specialised lending portfolios. Internal data is supplemented with external data in model development, where appropriate.

The models vary, inter alia, in the extent to which they are point in time versus through the cycle. The models are subject to rigorous validation and oversight/governance including, where appropriate, benchmarking to external information.

In commercial portfolios the PD models segment counterparties into a number of rating grades, with each grade representing a defined range of default probabilities, and there are a number of different model rating scales. Counterparties/exposures migrate between rating grades if the assessment of the PD changes. The modelled PDs 'map' through local scales to a single Corporate (non-retail) Master Scale comprising of 19 non-default ratings. Together with four default ratings the Corporate Master Scale forms the basis on which internal reporting is completed.

In its principal retail 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.

For reporting purposes, counterparties are also segmented into a number of rating grades, each representing a defined range of default probabilities and exposures migrate between rating grades if the assessment of the counterparty probability of default changes.

Each rating model is subject to a validation process, undertaken by independent risk teams, which includes benchmarking to externally available data, where possible. The most material rating models are approved by the Group Risk Committee. Responsibility for the approval of the remaining material rating models, and the governance framework in place around all Group models, is delegated to the Group Model Governance Committee.

Mitigation

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

Internal control

Credit principles and policy: Risk Division sets out the credit principles and policy according to which credit risk is managed. Principles and policies are reviewed regularly, and any changes are subject to a review and approval process. Policies, where appropriate, are supported by lending guidelines, which also define the responsibilities of lending officers and provide a disciplined and focused benchmark for credit decisions. These policies and lending guidelines define chosen target market and risk acceptance criteria. Risk Division also use early warning indicators to help anticipate future areas of concern and allow the Group to take early and proactive mitigating actions. Risk 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. Oversight and reviews are also undertaken by Group Audit and Credit Risk Assurance.

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Controls over rating systems: The Group has established an independent team in the Risk Division that sets common minimum standards, designed to ensure risk models and associated rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements. Internal rating systems are developed and owned by the Risk Division. Line management takes responsibility for ensuring the validation of the rating systems, supported and challenged by an independent specialist group function.

Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite as well as individual limit guidelines. Credit policy is aligned to the Group's risk appetite and restricts exposure to higher risk countries and more vulnerable sectors and segments. Note 20 on page 250, provides an analysis of loans and advances to customers by industry (for commercial customers) and product (for retail customers). Exposures are monitored to prevent an excessive concentration of risk and single name concentrations. 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 certain minimum policy and/or guideline requirements. The Group's large exposures are reported in accordance with regulatory reporting requirements.

Cross-border exposures: The Board sets country risk appetite. Within this, country limits are authorised by the country limits committee, taking into account economic, financial, political and social factors. Group policies stipulate that these limits must be consistent with, and support, the approved business and strategic plans of the Group.

Specialist expertise: Credit quality is managed and controlled by a number of specialist units within Risk Division providing, for example: intensive management and control (see Intensive care of customers in financial difficulty); 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.

Stress testing and scenario analysis: The Group's credit portfolios are also subjected to regular stress testing, with stress scenario assessments run at various levels of the organisation from Group led exercises to individual divisions/portfolios exercises. For further information on the stress testing process, methodology and governance refer to page 127.

Credit risk assurance and review: A specialist team within Group Audit, comprising experienced credit professionals, is in place to perform credit risk assurance. This team carries out independent risk based internal control audits and credit quality reviews, providing an assessment of the effectiveness of internal controls, risk management practices, credit risk classification, as well as the accuracy of impairment provisions. These audits and reviews cover the diverse range of the Group's businesses and activities, and include both 'standard' risk based audits and reviews as well as bespoke assignments to respond to any emerging risks or regulatory requirement. The work of Group Audit therefore continues to provide executive and senior management (and Audit Committee) with assurance and guidance on credit quality, effectiveness of credit risk controls and Business Support Unit (BSU) work out strategies, as well as accuracy of impairments.

Credit risk assurance within Commercial Banking is also undertaken by Commercial Risk Assurance. Commercial Risk Assurance is an independent credit risk oversight function operating within Commercial Banking Risk, part of the Group's second line of defence, while Group Audit performs third line of defence assurance.

Additional mitigation for retail customers (lending to individuals in Retail and Wealth, Asset Finance and International divisions)

The Group uses a variety of lending criteria when assessing applications for mortgages and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies (CRA). The Group also assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place quantitative limits such as product maximum limits, the level of borrowing to income and the ratio of borrowing to collateral. Some of these limits relate to internal approval levels and others are hard limits above which the Group will reject the application. The Group also has certain criteria that are applicable to specific products such as for applications for a mortgage on a property that is to be let by the applicant.

The Group's lending practices within Retail have changed since 2009 in several ways: the Group has lowered its maximum loan-to-value (LTV) thresholds, which have been reduced across all mortgage product types; the Group has withdrawn from 'specialist' secured lending since early 2009 (self-certificated and sub-prime lending) and increased credit scorecard cut-offs for both secured and unsecured lending; and the Group has tightened its assessments and the maximum limit for affordability of borrowings for both secured and unsecured lending. In addition, the number of properties permitted in buy-to-let portfolios has been reduced.

For UK mortgages, the Group's policy is to reject all standard applications with a LTV greater than 90 per cent. Applications with a LTV up to 95 per cent are permitted for certain schemes, for example Help to Buy and Lend a Hand. For mainstream mortgages the Group has maximum per cent LTV limits which depend upon the loan size. These limits are currently:

Table 1.4: **Loan to value analysis**

Loan size From	To	Maximum LTV
£1	£600,000	95%
£600,001	£750,000	90%
£750,001	£1,000,000	85%
£1,000,001	£2,000,000	80%
£2,000,001	£5,000,000	70%

For mainstream mortgages greater than £5,000,000 the maximum LTV is 50 per cent. Buy-to-let mortgages are limited to a maximum of £1,000,000 and 75 per cent LTV. All mortgage applications above £500,000 are subject to manual underwriting.

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The Group's approach to underwriting applications for unsecured products in Retail takes into account the total unsecured debt held by a customer and their affordability. The Group rejects any application for an unsecured product where a customer is registered as bankrupt or insolvent, or has a County Court Judgment registered at a CRA used by the Group. In addition, for credit cards the Group rejects any applicant with total unsecured debt greater than £50,000 registered at the CRA; revolving debt-to-income ratio greater than 75 per cent; or total unsecured debt-to-income ratio greater than 100 per cent. For unsecured personal loan applications, the Group rejects any applicant with total unsecured debt greater than £50,000 registered at the CRA. Rules around refinancing of debt have also been made more stringent since 2009 as a result of the application of rules relating to the total unsecured debt held by a customer and the Group's approach in assessing affordability. This has resulted in fewer customers being eligible to refinance unsecured debt.

Credit scoring: In its principal retail portfolios, the Group uses statistically based decisioning techniques (primarily credit scoring models). The Risk Division reviews model effectiveness, while new models and model changes are referred by them to the appropriate Model Governance Committees for approval. The most material changes are approved in accordance with the governance framework set by the Group Model Governance Committee.

Additional mitigation for commercial customers

Individual credit assessment and independent sanction: With the exception of low exposures on SME customers where relationship managers have some limited delegated sanctioning authority, credit risk in commercial customer 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 and limit guidelines. Approval requirements for each decision are based on a number of factors including 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 is generally the same as that for assets intended to be held over the period to maturity.

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.

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.

Collateral

The principal collateral types for loans and advances, contingent liabilities and derivatives with commercial counterparties/customers are:

– mortgages over residential and commercial real estate;

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

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

– guarantees received from third parties.

The Group maintains appetite 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 bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, 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. Derivative transactions with wholesale counterparties are typically collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement.

It is the Group's policy that collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. Collateral is reviewed on a regular basis and will vary according to the type of lending and collateral involved. For residential mortgages, the Group adjusts open market property values to take account of the costs of realisation and any discount associated with the realisation of the collateral. 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.

Refer to note 54 for further information on collateral.

Master netting agreements

Where it is appropriate and likely to be effective, the Group seeks to enter into master netting agreements. Although master netting agreements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, 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 this is the net position of all trades under the master netting agreement.

Other credit risk transfers

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

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Monitoring

In conjunction with Risk Division, businesses 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. Risk Division in turn produces an aggregated review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the GRC and the BRC.

The performance of all rating models is monitored on a regular basis, in order to seek to ensure that models provide appropriate risk differentiation capability, the generated ratings remain as accurate and robust as practical, 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 the monitoring identifies material exceptions or deviations from expected outcomes, these will be escalated in accordance with the governance framework set by the Group Model Governance Committee.

Intensive care of customers in financial difficulty

The Group operates a number of treatments to assist borrowers who are experiencing financial stress. The material elements of these treatments through which the Group has granted a concession, whether temporarily or permanently, are set out below and in note 54 on page 327.

Retail customers

The Group's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Group by discharging the Group's regulatory and social responsibilities to support its customers and act in their best long-term interests and by bringing customer facilities back into a sustainable position which, for residential mortgages, also means keeping customers in their homes. The Group offers a range of tools and assistance to support retail customers who are encountering financial difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer. Operationally, the provision and review of such assistance is controlled through the application of an appropriate policy framework, controls around the execution of policy, regular review of the different treatments to confirm that they remain appropriate, monitoring of customers' performance and the level of payments received, and management visibility of the nature and extent of assistance provided and the associated risk.

Assistance is provided through trained colleagues in branches and dedicated telephony units, and via online guidance material. 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 when they have multiple credit facilities, including those at other lenders, that require restructuring. Within the Collections and Recoveries functions, the sharing of best practice and alignment of policies across the Group has helped to drive more effective customer outcomes and achieve operational efficiencies.

One component of the Group's relationship management approach is to contact customers showing signs of financial difficulty to discuss their circumstances and offer solutions to prevent their accounts falling into arrears.

The specific tools available to assist customers vary by territory and product and the customer's status. In defining the treatments offered to customers who have experienced financial distress, the Group distinguishes between the following categories:

- Reduced contractual monthly payment: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payments, for example temporary interest only arrangements and short-term payment holidays granted in collections. Any arrears existing at the commencement of the arrangement are retained.
- Reduced payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example short-term arrangements to pay.
- Term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment.
- Repair: a permanent account change used to repair a customer's position when they have emerged from financial difficulty, for example capitalisation of arrears.

To assist customers in financial distress, the Group also participates in, or benefits from, the following UK government sponsored programmes for households:

- Income Support for Mortgage Interest – This is a government medium-term initiative that provides certain defined categories of customers, principally those who are unemployed, access to a benefit scheme, paid for by the government, which covers all or part of the interest on the mortgage. Qualifying customers are able to claim for mortgage interest on up to £200,000 of the mortgage. All decisions regarding an individual's eligibility and any amounts payable under the scheme rest solely with the government. Payments are made directly to the Group by the appropriate government department.
- Mortgage Rescue Scheme – This is a government short-term initiative for borrowers in difficulty and facing repossession, who would have priority for re-housing by a local authority (e.g. the elderly, disabled, single parents). Eligible customers can have their property bought in full or part by the social rented sector and then remain in their home as a tenant or shared equity partner. If the property is sold outright the mortgage is redeemed in full.

Commercial customers

Early identification, control and monitoring are key in order to support the customer and protect the Group. All non-retail loans and advances (core and non-core) in Commercial Banking are reviewed at least annually by the independent Risk Division (and more frequently where required). As part of the Group's established Credit Risk Classification system, every loan and advance in the good book is categorised as either 'good' or 'watchlist'. This complements the Group's risk rating tools and is designed to identify and highlight portfolio levels of asset quality as well as individual problem credits. All watchlist names are reviewed by the business and Risk Division at least once a month, and the

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classification is updated if required. This process seeks to ensure that relationship managers act promptly to identify, and highlight to senior management those customers who have the possibility to become higher risk in the future.

It is Group policy that where forbearance has been granted for a commercial customer, it must be managed either within the Group's good book watchlist Credit Risk Classification framework or within a BSU. Any concession requested by a customer is reviewed and must be approved by the independent Risk Division. If approved and Risk Division determines that the customer is in financial difficulty, then any off market concession granted is treated as forbearance and the loan reviewed monthly. Any event that causes concern over future payments from the customer is likely to result in the asset being assessed for impairment and, if required, an impairment allowance recognised. If impairment is identified, the customer is immediately transferred to BSU and will be treated as an impaired asset. If no impairment is identified, the Risk Division will determine if the customer should remain in the good book (categorised as watchlist), or transfer to BSU for more intensive monitoring.

Customers requiring intensive care are transferred at an early stage to one of the Group's BSUs (or Customer Support for smaller Commercial Banking small and medium-sized enterprises with debt facilities below £1 million). The over-arching aim of the BSU is to provide support and work with each customer to try and resolve the issues, to restore the business to a financially viable position and thereby bring about a business turnaround. This may involve debt restructuring and forbearance.

Core BSU and Global Non-Core case officers are part of the independent Risk Division. They are highly experienced and operate in a closely controlled and monitored environment, including regular oversight and close scrutiny by senior management. Risk is minimised through a combination of appropriate work-out strategies, such as asset/loan sales and debt restructuring.

A detailed assessment is undertaken by the specialist risk team for cases in Core BSU and Global Non-Core to assist in reducing risk exposure and to highlight potential strategic options. A range of information is required to fully appraise and understand the customer's business, cashflow (and therefore debt serviceability) and will involve the Group, in addition to using its own internal sector experts, engaging professional advisers to perform asset valuations, strategic reviews and where applicable independent business reviews. The assessment may also involve:

– critically assessing customer's ability to successfully manage the business effectively in a distressed situation where turnaround is required;
– analysis of market sector factors, i.e. products, customers, suppliers, pricing and margin issues;
– performance review of operational areas that should be considered in terms of current effectiveness and efficiency and scope for improvements;
– financial analysis to model plans and factor in potential sensitivities, vulnerabilities and upsides; and
– determining the most appropriate corporate and capital structure suitable for the work-out strategy concerned.

The above assessment, monitoring and control processes continue throughout the period the case is managed within the BSU. All the analysis performed around cash flows is used to determine appropriate impairment provisions.

The Group's accounting policy for loan renegotiations and forbearance is set out in note 2 on page 213.

Income statement information set out in the credit risk tables is on an underlying basis (see page 52).

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The Group credit risk portfolio in 2013

Overview

- Impairment charge decreased by 47 per cent to £3,004 million in the year to 31 December 2013, continuing the improvement seen in 2012. The impairment charge has decreased across all divisions.
- The impairment charge as a percentage of average loans and advances to customers improved to 0.57 per cent compared to 1.02 per cent at 31 December 2012.
- Impaired loans as a percentage of closing advances reduced to 6.3 per cent at 31 December 2013, from 8.6 per cent at 31 December 2012, driven by improvements in Retail and Commercial Banking and reflecting reductions in both the core and non-core books.

Table 1.5: **Impairment charge by division**

	2013 £m	2012 £m	Change %
Retail	**1,101**	1,270	13
Commercial Banking	**1,167**	2,946	60
Wealth, Asset Finance and International	**730**	1,480	51
Central items	**6**	1	
Total impairment charge	**3,004**	5,697	47
Impairment charge as a % of average advances	**0.57%**	1.02%	(45)bp
Core			
Retail	**1,059**	1,192	11
Commercial Banking	**424**	704	40
Wealth, Asset Finance and International	**32**	22	(45)
Central items	**6**	1	
Core impairment charge	**1,521**	1,919	21
Core impairment charge as a % of average advances	**0.35%**	0.44%	(9)bp
Non-core			
Retail	**42**	78	46
Commercial Banking	**743**	2,242	67
Wealth, Asset Finance and International	**698**	1,458	52
Non-core impairment charge	**1,483**	3,778	61
Non-core impairment charge as a % of average advances	**1.61%**	3.08%	(147)bp

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Table 1.6: **Total impairment charge**

	2013 £m	2012 £m	Change %
Loans and advances to customers	**2,988**	5,654	47
Debt securities classified as loans and receivables	**1**	15	93
Available-for-sale financial assets	**15**	37	59
Other credit risk provisions	**–**	(9)	
Total impairment charge	**3,004**	5,697	47

Table 1.7: **Movement in gross impaired loans**

	2013 £m
At 1 January 2013	46,293
Classified as impaired during the year	**9,552**
Transferred to not impaired during the period	**(3,054)**
Repayments	**(1,603)**
Amounts written off	**(9,520)**
Impact of disposal of businesses and asset sales	**(9,377)**
Exchange and other movements	**(32)**
At 31 December 2013	**32,259**

Table 1.8: **Impairments on loans and advances**

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as % of closing advances %	Impairment provisions[1] £m	Impairment provision as % of impaired loans[2] %
At 31 December 2013					
Retail	344,673	7,187	2.1	2,050	32.5
Commercial Banking	132,602	14,714	11.1	6,415	43.6
Wealth, Asset Finance and International	31,450	10,358	32.9	7,242	69.9
Reverse repos and other items	2,779	–		–	
Total gross lending	511,504	32,259	6.3	15,707	50.1
Impairment provisions	(15,707)				
Fair value adjustments[3]	(516)				
Total Group (audited)	495,281				
Core					
Retail	320,520	5,819	1.8	1,734	34.8
Commercial Banking	111,883	5,131	4.6	2,441	47.6
Wealth, Asset Finance and International	6,610	406	6.1	99	24.4
Reverse repos and other items	2,779				
Total core gross lending	441,792	11,356	2.6	4,274	40.6
Impairment provisions	(4,274)				
Fair value adjustments[3]	(552)				
Total core	436,966				
Non-core					
Retail	24,153	1,368	5.7	316	24.0
Commercial Banking	20,719	9,583	46.3	3,974	41.5
Wealth, Asset Finance and International	24,840	9,952	40.1	7,143	71.8
Reverse repos and other items	–				
Total non-core gross lending	69,712	20,903	30.0	11,433	54.8
Impairment provisions	(11,433)				
Fair value adjustments[3]	36				
Total non-core	58,315				

[1] Impairment provisions include collective unimpaired provisions.

[2] Impairment provisions as a percentage of impaired loans are calculated excluding retail unsecured loans in recoveries (£881 million; core: £831 million; non-core: £50 million).

[3] The fair value adjustments relating to loans and advances were those required to reflect the HBOS assets in the Group's consolidated financial records at their fair value and took into account both the expected losses and market liquidity at the date of acquisition. The unwind relating to future impairment losses requires significant management judgement to determine its timing which includes an assessment of whether the losses incurred in the current period were expected at the date of the acquisition and assessing whether the remaining losses expected at the date of the acquisition will still be incurred. The element relating to market liquidity unwinds to the income statement over the estimated expected lives of the related assets (until 2014 for wholesale loans and 2018 for retail loans) although if an asset is written-off or suffers previously unexpected impairment then this element of the fair value will no longer be considered a timing difference (liquidity) but permanent (impairment). The fair value unwind in respect of impairment losses incurred was £512 million for the period ended 31 December 2013. The fair value unwind in respect of loans and advances is expected to continue to decrease in future years as fixed-rate periods on mortgages expire, loans are repaid or written-off, and will reduce to zero over time.

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	Loans and advances to customers £m	Impaired loans £m	Impaired loans as % of closing advances %	Impairment provisions[1] £m	Impairment provision as % of impaired loans[2] %
At 31 December 2012					
Retail	346,560	8,320	2.4	2,335	32.5
Commercial Banking	144,770	23,965	16.6	9,984	41.7
Wealth, Asset Finance and International	42,927	14,008	32.6	9,453	67.5
Reverse repos and other items	5,814	–		–	
Total gross lending	540,071	46,293	8.6	21,772	48.2
Impairment provisions	(21,772)				
Fair value adjustments[3]	(1,074)				
Total Group (audited)	517,225				
Core					
Retail	320,058	6,693	2.1	1,957	34.7
Commercial Banking	104,867	5,907	5.6	2,866	48.5
Wealth, Asset Finance and International	5,415	351	6.5	85	24.2
Reverse repos and other items	5,814	–		–	
Total core gross lending	436,154	12,951	3.0	4,908	41.2
Impairment provisions	(4,908)				
Fair value adjustments[3]	(778)				
Total core	430,468				
Non-core					
Retail	26,502	1,627	6.1	378	24.5
Commercial Banking	39,903	18,058	45.3	7,118	39.4
Wealth, Asset Finance and International	37,512	13,657	36.4	9,368	68.6
Reverse repos and other items	–	–		–	
Total non-core gross lending	103,917	33,342	32.1	16,864	50.7
Impairment provisions	(16,864)				
Fair value adjustments[3]	(296)				
Total non-core	86,757				

[1] Impairment provisions Include collective unimpaired provisions.

[2] Impairment provisions as a percentage of impaired loans are calculated excluding Retail unsecured loans in recoveries (£1,129 million; core: £1,047 million; non-core: £82 million).

[3] The fair value adjustments relating to loans and advances were those required to reflect the HBOS assets in the Group's consolidated financial records at their fair value and took into account both the expected losses and market liquidity at the date of acquisition. The unwind relating to future impairment losses requires significant management judgement to determine its timing which includes an assessment of whether the losses incurred in the current period were expected at the date of the acquisition and assessing whether the remaining losses expected at the date of the acquisition will still be incurred. The element relating to market liquidity unwinds to the income statement over the estimated expected lives of the related assets (until 2014 for wholesale loans and 2018 for retail loans) although if an asset is written-off or suffers previously unexpected impairment then this element of the fair value will no longer be considered a timing difference (liquidity) but permanent (impairment). The fair value unwind in respect of impairment losses incurred was £868 million for the period ended 31 December 2012. The fair value unwind in respect of loans and advances is expected to continue to decrease in future years as fixed-rate periods on mortgages expire, loans are repaid or written-off, and will reduce to zero over time.

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Table 1.9: **Derivative credit risk exposures**

Notional balances	Traded on recognised exchanges £bn	Traded over the counter: Settled by central counterparties £bn	Traded over the counter: Not settled by central counterparties £bn	Total £bn
At 31 December 2013				
Foreign exchange	–	11	422	433
Interest rate	234	3,881	926	5,041
Equity and other	4	–	15	19
Credit	–	–	7	7
Total	238	3,892	1,370	5,500

The fair value of derivatives settled by central counterparties was a net liability of £419 million, comprising assets of £3,220 million and liabilities of £3,639 million.

The fair value of derivatives not settled by central counterparties was £2,344 million, comprising assets of £28,808 million and liabilities of £26,464 million.

RISK MANAGEMENT

Credit risk – Retail

Overview

– The Retail impairment charge decreased by 13 per cent to £1,101 million primarily driven by a reduction in impaired loans in the secured portfolio.

– The Retail impairment charge, as an annualised percentage of average loans and advances to customers, improved to 0.32 per cent in 2013 from 0.36 per cent in 2012.

– The overall value of assets entering arrears in 2013 was lower in both unsecured and secured lending compared to 2012.

– Non-core portfolio represented 7 per cent of total retail assets at 31 December 2013 and primarily comprised of specialist mortgages, which is closed to new business and has been in run-off since 2009.

Table 1.10: **Retail impairment charge**

	2013 £m	2012 £m	Change %
Secured	**253**	377	33
Unsecured	**848**	893	5
Total impairment charge	**1,101**	1,270	13
Core			
Secured	**218**	304	28
Unsecured	**841**	888	5
	1,059	1,192	11
Non-core			
Secured	**35**	73	52
Unsecured	**7**	5	(40)
	42	78	46
Total impairment charge	**1,101**	1,270	13
Impairment charge as a % of average advances	**0.32%**	0.36%	(4)bp
Core impairment charge as a % of average advances	**0.33%**	0.37%	(4)bp
Non-core impairment charge as a % of average advances	**0.17%**	0.29%	(12)bp

Impaired loans and provisions

Retail impaired loans decreased by £1,133 million to £7,187 million compared with 31 December 2012 and, as a percentage of closing loans and advances to customers, decreased to 2.1 per cent from 2.4 per cent at 31 December 2012. Impairment provisions as a percentage of impaired loans (excluding unsecured loans in recoveries) are stable at 32.5 per cent.

Table 1.11: **Impairments on Retail loans and advances**

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans[3] %
At 31 December 2013					
Secured	323,107	5,641	1.7	1,472	26.1
Unsecured:					
Collections		665		578	86.9
Recoveries[2]		881		–	
	21,566	1,546	7.2	578	
Total gross lending	344,673	7,187	2.1	2,050	32.5
Impairment provisions	(2,050)				
Fair value adjustments	(673)				
Total	341,950				
Core					
Secured	299,085	4,327	1.4	1,158	26.8
Unsecured:					
Collections		661		576	87.1
Recoveries[2]		831		–	
	21,435	1,492	7.0	576	
Total core gross lending	320,520	5,819	1.8	1,734	34.8
Impairment provisions	(1,734)				
Fair value adjustments	(570)				
Total core	318,216				
Non-core					
Secured	24,022	1,314	5.5	314	23.9
Unsecured:					
Collections		4		2	50.0
Recoveries[2]		50		–	
	131	54	41.2	2	
Total non-core gross lending	24,153	1,368	5.7	316	24.0
Impairment provisions	(316)				
Fair value adjustments	(103)				
Total non-core	23,734				

[1] Impairment provisions include collective unimpaired provisions.

[2] Recoveries assets are written down to the present value of future expected cash flows on these assets.

[3] Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.

RISK MANAGEMENT

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans[3] %
At 31 December 2012					
Secured	323,862	6,321	2.0	1,616	25.6
Unsecured:					
Collections		870		719	82.6
Recoveries[2]		1,129		–	
	22,698	1,999	8.8	719	
Total gross lending	346,560	8,320	2.4	2,335	32.5
Impairment provisions	(2,335)				
Fair value adjustments	(915)				
Total	343,310				
Core					
Secured	297,902	4,793	1.6	1,251	26.1
Unsecured:					
Collections		853		706	82.8
Recoveries[2]		1,047		–	
	22,156	1,900	8.6	706	
Total core gross lending	320,058	6,693	2.1	1,957	34.7
Impairment provisions	(1,957)				
Fair value adjustments	(778)				
Total core	317,323				
Non-core					
Secured	25,960	1,528	5.9	365	23.9
Unsecured:					
Collections		17		13	76.5
Recoveries[2]		82		–	
	542	99	18.3	13	
Total non-core gross lending	26,502	1,627	6.1	378	24.5
Impairment provisions	(378)				
Fair value adjustments	(137)				
Total non-core	25,987				

[1] Impairment provisions include collective unimpaired provisions.

[2] Recoveries assets are written down to the present value of future expected cash flows on these assets.

[3] Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.

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

Table 1.12: **Retail loans and advances to customers**

	2013 £m	2012 £m
Secured:		
Mainstream	**246,586**	248,735
Buy to let	**52,791**	49,568
Specialist	**23,730**	25,559
	323,107	323,862
Unsecured:		
Credit cards	**9,373**	9,465
Personal loans	**9,595**	10,523
Overdrafts	**2,598**	2,710
	21,566	22,698
Total gross lending	**344,673**	346,560

Secured lending

Impairment

The impairment charge decreased by £124 million, to £253 million compared with 2012. The annualised impairment charge as a percentage of average loans and advances to customers was 0.08 per cent at 31 December 2013 compared to 0.12 per cent in 2012. Impairment provisions were £1,472 million at 31 December 2013 compared to £1,616 million at 31 December 2012. Impaired loans have fallen for four consecutive years and were £5,641 million at 31 December 2013 compared to £6,321 million at 31 December 2012. As a result of this continued trend in 2013, impairment provisions as a percentage of impaired loans increased to 26.1 per cent from 25.6 per cent at 31 December 2012.

The impairment provisions held against secured assets reflect the Group's view of appropriate allowance for incurred losses. The Group holds appropriate impairment provisions for customers who are experiencing financial difficulty, either on a forbearance arrangement or who may be able to maintain their repayments only whilst interest rates remain low.

Arrears

The value of mortgages greater than three months in arrears (excluding repossessions) decreased by £819 million to £8,818 million at 31 December 2013 compared to £9,637 million at 31 December 2012.

Table 1.13: **Mortgages greater than three months in arrears (excluding repossessions)**

	Number of cases		Total mortgage accounts %		Value of loans[1]		Total mortgage balances %	
	2013 Cases	2012 Cases	2013 %	2012 %	2013 £m	2012 £m	2013 %	2012 %
Mainstream	**52,687**	55,905	**2.1**	2.2	**5,898**	6,287	**2.4**	2.5
Buy to let	**6,338**	7,306	**1.3**	1.6	**869**	1,033	**1.6**	2.1
Specialist	**11,870**	13,262	**7.3**	7.6	**2,051**	2,317	**8.6**	9.1
Total	**70,895**	76,473	**2.3**	2.4	**8,818**	9,637	**2.7**	3.0

[1] Value of loans represents total book value of mortgages more than three months in arrears.

The stock of repossessions decreased to 2,229 cases at 31 December 2013 compared to 2,438 cases at 31 December 2012.

RISK MANAGEMENT

Secured loan to value analysis

The average indexed loan to value (LTV) on the mortgage portfolio at 31 December 2013 decreased to 52.8 per cent compared with 56.4 per cent at 31 December 2012. The average LTV for new mortgages and further advances written in 2013 was 63.6 per cent compared with 62.6 per cent for 2012.

The percentage of closing loans and advances with an indexed LTV in excess of 100 per cent decreased to 5.2 per cent at 31 December 2013, compared with 11.7 per cent at 31 December 2012.

Table 1.14: **Actual and average LTVs across the Retail mortgage portfolios**

	Mainstream %	Buy to let %	Specialist[1] %	Total %
At 31 December 2013				
Less than 60%	**37.0**	**20.4**	**20.1**	**33.1**
60% to 70%	**16.9**	**21.3**	**15.7**	**17.5**
70% to 80%	**19.8**	**26.0**	**19.3**	**20.8**
80% to 90%	**14.7**	**15.1**	**20.1**	**15.1**
90% to 100%	**7.1**	**11.1**	**14.3**	**8.3**
Greater than 100%	**4.5**	**6.1**	**10.5**	**5.2**
Total	**100.0**	**100.0**	**100.0**	**100.0**
Average loan to value:[2]				
Stock of residential mortgages	**49.5**	**66.9**	**66.2**	**52.8**
New residential lending	**63.6**	**64.0**	**n/a**	**63.6**
Impaired mortgages	**66.6**	**90.1**	**80.8**	**71.6**

	Mainstream %	Buy to let %	Specialist[1] %	Total %
At 31 December 2012				
Less than 60%	31.9	12.8	14.7	27.6
60% to 70%	12.8	12.9	9.7	12.6
70% to 80%	18.3	26.2	17.2	19.4
80% to 90%	16.6	16.5	19.1	16.8
90% to 100%	10.5	15.4	18.5	11.9
Greater than 100%	9.9	16.2	20.8	11.7
Total	100.0	100.0	100.0	100.0
Average loan to value:[2]				
Stock of residential mortgages	52.7	73.6	72.6	56.4
New residential lending	62.3	64.5	n/a	62.6
Impaired mortgages	72.2	99.3	88.1	78.3

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

[2] Average loan to value is calculated as total loans and advances as a percentage of the total collateral of these loans and advances.

Interest only mortgages

The Group provides interest only mortgages to customers, whereby payments made by the customer comprise of only interest for the term of the mortgage, with the customer responsible for repaying the principal outstanding at the end of the loan term. Retail has reduced its exposure to residential interest only mortgages throughout 2013. New residential interest only mortgages are limited to a maximum LTV of 75 per cent, with a verified repayment vehicle capable of repaying the loan. Interest only mortgages represented 0.5 per cent of new residential mortgages in 2013 (3.8 per cent in 2012).

Table 1.15: **Analysis of residential interest-only balances excluding Buy to Let mortgages**

	At 31 Dec 2013 £m	At 31 Dec 2012 £m
Interest only balances[1]	**108,504**	119,569
Impaired loans	**2,910**	3,221
Interest only balances as a % of total mortgage book	**41.0%**	44.6%
Average loan to value (%)	**55.2%**	58.9%

[1] In addition the Group has Buy to Let interest only balances of £47,261 million (2012: £44,585 million) and certain other interest only balances of £4,750 million (2012: £6,046 million).

For existing interest only mortgages, a contact strategy is in place throughout the term of the mortgage to ensure that customers are aware of their obligation to repay the principal upon maturity of the loan. The weighted-average term to maturity of the interest only balances included in the table above is 13 years; mortgages totalling £12,003 million are due to mature in the next five years, with mortgages totalling £1,846 million due to mature in the next 12 months. Treatment strategies exist to help customers who may not be able to fully repay the full amount of principal balance at maturity. Of the residential interest only mortgages which have missed the payment of principal at the end of term, balances of £959 million remain at 31 December 2013 (£523 million at 31 December 2012). The average loan to value of these accounts is 27.3 per cent at 31 December 2013 (27.0 per cent at 31 December 2012). Of these accounts, 7.4 per cent are impaired (7.2 per cent at 31 December 2012).

Unsecured lending

Impairment

In 2013 the impairment charge on unsecured loans and advances to customers reduced by £45 million compared with 2012. The annualised impairment charge as a percentage of average loans and advances to customers increased to 3.80 per cent in 2013 from 3.73 per cent in 2012.

Impaired loans decreased by £453 million since 31 December 2012 to £1,546 million at 31 December 2013 which represented 7.2 per cent of closing loans and advances to customers, compared with 8.8 per cent at 31 December 2012. The reduction in impaired loans is a result of the Group's prudent risk appetite and ongoing effective portfolio management. Retail's exposure to revolving credit products has been actively managed to ensure that it is appropriate to customers' changing financial circumstances.

Impairment provisions decreased by £141 million, compared with 31 December 2012. This reduction was driven by fewer assets entering arrears and recoveries assets being written down to the present value of future expected cash flows. Impairment provisions as a percentage of impaired loans in collections increased to 86.9 per cent at 31 December 2013 from 82.6 per cent at 31 December 2012.

RISK MANAGEMENT

Credit risk – Commercial Banking

Overview

- Commercial Banking impairment charge decreased by 60 per cent to £1,167 million, driven by lower charges mainly in the non-core portfolio, reflecting continued proactive management and deleveraging. Charges also reduced significantly in the core portfolio, reflecting better quality origination, together with higher releases in 2013 compared to the same period in 2012.
- The overall quality of the core Commercial Banking portfolio remains good with the Group's prudent through the cycle approach to risk appetite, and the continuing low interest rate environment helping to maintain defaults at a relatively low level. New business is of good quality and better than the back book average.
- The impairment charge as a percentage of average loans and advances improved to 0.83 per cent from 1.85 per cent in 2012. Core impairment charge as an annualised percentage of average loans and advances to customers improved to 0.39 per cent compared to 0.67 per cent in 2012.
- Non-core now represents 15.6 per cent of total loans and advances to customers compared to 27.6 per cent at 31 December 2012, reflecting the improved mix of the portfolio overall.

Table 1.16: **Commercial Banking impairment charge**

	2013 £m	2012 £m	Change %
Core	**424**	704	40
Non-core	**743**	2,242	67
Total impairment charge	**1,167**	2,946	60
Core impairment charge as a % of average advances	**0.39%**	0.67%	(28)bp
Non-core impairment charge as a % of average advances	**2.32%**	4.28%	(196)bp
Impairment charge as a % of average advances	**0.83%**	1.85%	(102)bp

Impaired loans and provisions

Commercial Banking impaired loans reduced substantially by 38.6 per cent to £14,714 million compared with 31 December 2012. As a percentage of closing loans and advances to customers, impaired loans reduced to 11.1 per cent from 16.6 per cent at 31 December 2012, despite a reducing portfolio. Impairment provisions as a percentage of impaired loans improved to 43.6 per cent from 41.7 per cent at 31 December 2012 driven by increased provisions made on a number of existing impaired connections and the disposal of impaired loans with lower coverage.

Core impaired loans decreased by £776 million to £5,131 million compared with £5,907 million at 31 December 2012, and as a percentage of closing loans and advances to customers decreased to 4.6 per cent from 5.6 per cent at 31 December 2012. The core impairment charge has reduced to £424 million in 2013 compared to £704 million in 2012, reflecting better quality origination and higher releases, with the low interest rate environment helping to maintain defaults at a relatively lower level.

Non-core impaired loans decreased by £8,475 million to £9,583 million compared with £18,058 million at 31 December 2012 and as a percentage of closing loans and advances to customers increased to 46.3 per cent from 45.3 per cent at 31 December 2012. The non-core impairment charge has reduced to £743 million in 2013 compared to £2,242 million in 2012, reflecting the continued deleveraging.

Table 1.17: **Impairments on loans and advances**

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
At 31 December 2013					
Total Commercial Banking	132,602	14,714	11.1	6,415	43.6
Reverse repos	120				
Impairment provisions	(6,415)				
Fair value adjustments	176				
Total	126,483				
Core					
Total Commercial Banking	111,883	5,131	4.6	2,441	47.6
Reverse repos	120				
Impairment provisions	(2,441)				
Fair value adjustments	18				
Total core	109,580				
Non-core					
Corporate Real Estate and other Corporate[2]	11,571	8,131	70.3	3,320	40.8
Specialist Finance[3]	9,017	1,368	15.2	565	41.3
Other	131	84	64.1	89	
Total Commercial Banking	20,719	9,583	46.3	3,974	41.5
Reverse repos	–				
Impairment provisions	(3,974)				
Fair value adjustments	158				
Total non-core	16,903				

[1] Includes collective unimpaired provisions of £523 million; core: £446 million; non-core: £77 million.

[2] Includes the Corporate Real Estate BSU portfolio which is now managed with other Corporate (including non-core good book Corporate Real Estate) assets which were previously disclosed in Other.

[3] Includes the specialised lending portfolio which is now managed with the Specialist Finance assets which were previously disclosed in Other.

RISK MANAGEMENT

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
At 31 December 2012					
Total Commercial Banking	144,770	23,965	16.6	9,984	41.7
Reverse repos	5,087				
Impairment provisions	(9,984)				
Fair value adjustments	(131)				
Total	139,742				
Core					
Total Commercial Banking	104,867	5,907	5.6	2,866	48.5
Reverse repos	5,087				
Impairment provisions	(2,866)				
Fair value adjustments	–				
Total core	107,088				
Non-core					
Corporate Real Estate and other Corporate[2]	21,777	14,447	66.3	5,411	37.5
Specialist Finance[3]	15,488	2,935	19.0	1,235	42.1
Other	2,638	676	25.6	472	69.8
Total Commercial Banking	39,903	18,058	45.3	7,118	39.4
Reverse repos	–				
Impairment provisions	(7,118)				
Fair value adjustments	(131)				
Total non-core	32,654				

[1] Includes collective unimpaired provisions of £894 million; core: £545 million; non-core: £349 million.

[2] Includes the Corporate Real Estate BSU portfolio which is now managed with other Corporate (including non-core good book Corporate Real Estate) assets which were previously disclosed in Other.

[3] Includes the specialised lending portfolio which is now managed with the Specialist Finance assets which were previously disclosed in Other.

Core

At 31 December 2013 £112 billion of gross loans and advances to customers in the Commercial Banking core portfolio are segmented across four different coverage segments as follows:

SME

SME serves business customers with turnover up to £25 million. Impaired loans decreased by £399 million to £2,271 million compared with £2,670 million at 31 December 2012. The impairment charge has reduced to £188 million in 2013 compared to £259 million in 2012 reflecting stable or improved portfolio credit quality across all key metrics.

The SME portfolio continues to grow within prudent and consistent credit risk appetite parameters with net lending increasing 6 per cent year-on-year. These results reflect the Group's continuing commitment to support the UK economy and government schemes such as Funding for Lending and Enterprise Finance Guarantee.

SME's control and monitoring activities have continued to play a fully effective role in identifying and supporting customers showing early signs of financial stress. As part of this, the Group's dedicated SME Business Support function continues to work with customers through their difficulties.

Mid Markets

Mid Markets serves business customers with turnover of £25 million to £750 million. The business remains predominantly UK-focused and is closely linked to the performance of the domestic economy. Impaired loans decreased by £261 million to £1,591 million compared with £1,852 million at 31 December 2012. The impairment charge has reduced to £157 million in 2013 compared to £238 million in 2012. Overall credit quality has remained stable during 2013.

The real estate business within the Group's Mid Markets portfolio is focused predominantly on unquoted private real estate portfolios. Credit quality continues to improve and the number of new non-performing customers continues to reduce. New business propositions are being written under robust policy parameters and in line with agreed risk appetite, with particular focus on cashflow. Tenant default is an area of potential focus particularly when the lending is supported by secondary or tertiary assets.

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Global Corporates

Global Corporates is a coverage business operating across the UK, Europe and North America and is responsible for the overall management of relationships with major corporate clients. Impaired loans increased slightly by £37 million to £1,173 million compared with £1,136 million at 31 December 2012. The impairment charge has reduced to £75 million in 2013 compared to £195 million in 2012.

The core portfolio related to trading companies continues to be predominantly investment grade focused; the overall portfolio asset quality remains good; and corporate balance sheets generally remain conservatively structured following a period of de-leveraging through the downturn.

The real estate business within the Group's Global Corporate portfolio is focused on the larger end of the UK property market with a bias to the quoted public listed companies and funds sector. Portfolio credit quality remains strong being underpinned by seasoned management teams with proven asset management skills generating predictable cash flows from their income producing portfolios.

Financial Institutions

Commercial Banking maintains relationships with a number of major UK and International Finance Institutions, which are predominantly investment grade rated. These relationships are either client focused or held to support the Group's funding, liquidity and general hedging requirements. The impairment charge in Financial Institutions remained low at £4 million.

Trading exposures continue to be predominantly short-term and/or collateralised with inter bank activity mainly undertaken with strong investment grade counterparties. While conditions in the Eurozone stabilised during 2013, the Group continues to adopt a conservative stance maintaining close portfolio scrutiny and oversight. Detailed contingency plans are in place and exposures to financial institutions domiciled in peripheral Eurozone countries are kept modest and managed within tight risk parameters. Overall, portfolio credit quality remains good and outlook is stable.

The majority of funding and risk management activity is transacted with investment grade counterparties including Sovereign central banks and much of it is on a collateralised basis, such as repos and swaps facing a Central Counterparty (CCP). Bilateral derivative transactions with Financial Institution counterparties are typically collateralised under a credit support annex in conjunction with the ISDA Master Agreement. The Group continues to consolidate its counterparty risk via CCPs as part of an ongoing move to reduce bilateral counterparty risk by clearing standardised derivative contracts.

Non-core

The non-core portfolio includes elements of the Corporate Real Estate and Specialist Finance portfolios which are classified as non-core.

Non-core Corporate Real Estate and other Corporate

Loans and advances to customers include the non-core Corporate Real Estate Business Support Unit (BSU) portfolio. Following successful asset reduction progress, this portfolio is now managed together with European assets and other Corporate assets previously disclosed as Other non-core.

The impairment charge in this portfolio fell to £522 million compared to £1,453 million in 2012. The fall in the impairment charge reflects lower gross charges on a reduced portfolio, favourable market movements on impaired derivatives and the continuing proactive management enabling some write backs on previously impaired loans.

The portfolio has reduced significantly ahead of expectations primarily due to the momentum on various deleveraging strategies including consensual asset sales by customers, loan sales and asset disposals which totalled £7.4 billion (net book value) in the year. The non-core Corporate Real Estate BSU element of the portfolio reduced from £15.7 billion to £8.9 billion during 2013 and there was considerable progress on the European exposure within this portfolio where loan balances fell from £3.7 billion to £0.7 billion.

Non-core specialist finance

Loans and advances to customers include the non-core Acquisition Finance (leverage lending) portfolio which falls into non-core since it is outside the Group's risk appetite, and the non-core Asset Based Finance portfolios (which include Ship Finance, Aircraft Finance and Infrastructure). Total gross loans and advances reduced by £6.5 billion from £15.5 billion to £9.0 billion as at 31 December 2013 mainly due to disposals of £4.5 billion (net book value).

Ship Finance gross drawn lending (excluding leasing) totalled £1,074 million (net £965 million) as at 31 December 2013. This portfolio still suffers some stress due to volatile asset values and ongoing financial restructures. As a consequence, impairment charges are running at similar levels to those experienced in 2012, however continued strategic disposals through 2013 have materially de-risked the residual portfolio.

Secured loan to value analysis for UK Direct Real Estate lending

The Group classifies Direct Real Estate as exposure which is directly supported by cash flows from property activities, as opposed to trading activities (such as hotels, care homes and housebuilders). The Group manages its exposures to Direct Real Estate across a number of different coverage segments.

Core UK Direct Real Estate

Approximately three quarters of loans and advances relate to commercial real estate with the remainder mostly residential real estate. A large element of the residential exposure is to professional landlords in the Group's SME business where performance has been good. Approximately two thirds of the core commercial real estate portfolio was originated under heritage Lloyds TSB credit risk criteria. The Group's risk appetite requires it to look first at the underlying cash flows as part of credit assessment, alongside key requirements for good quality counterparties and a well spread tenant profile.

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Non-core UK Direct Real Estate

The Group considers this portfolio to be appropriately provided for after taking into account the value of the collateral held. In the case of impaired UK Direct Real Estate exposures (over £5 million) there is a net property collateral shortfall of approximately £0.1 billion. This figure excludes benefits of credit mitigants such as cross collateralisation and cross guarantees. The Group makes use of a variety of methodologies to assess the value of property collateral, where external valuations are not available. These include use of market indexes, models and subject matter expert judgement. Loan to value ratios (indexed or actual if within last 12 months) for the Group's largest transactions (over £5 million) are detailed in the table below.

Table 1.18: **LTV – UK direct real estate**

	Core loans and advances (gross)		Non-core loans and advances (gross)	
	£m	%	£m	%
At 31 December 2013				
Exposures > £5 million:				
Less than 60%	4,444	42	437	7
61% to 70%	2,182	21	268	4
71% to 80%	1,159	11	145	2
81% to 100%	407	4	1,896	29
101% to 125%	385	4	766	12
More than 125%	571	5	2,961	46
Unsecured	1,342	13	23	–
	10,490	100	6,496	100
Exposures < £5 million	9,280		1,143	
Total	19,770		7,639	
At 31 December 2012[1]				
Exposures > £5 million:				
Less than 60%	3,722	35	703	7
61% to 70%	1,785	17	292	3
71% to 80%	2,028	19	886	9
81% to 100%	1,282	12	2,188	21
101% to 125%	393	4	1,398	14
More than 125%	563	5	4,405	43
Unsecured	849	8	332	3
	10,622	100	10,204	100
Exposures < £5 million	8,976		1,727	
Total	19,598		11,931	

[1] Restated to reflect a change in methodology from registered address of borrower to location of underlying collateral.

Acquisition (Leverage) Finance lending

Gross drawn lending in the core Acquisition Finance portfolio totalled £2,128 million (net £2,111 million) as at 31 December 2013. The portfolio comprises leveraged financing facilities made available, predominantly, to UK borrowers owned by private equity sponsors. The majority of transactions have been structured in the past three years and all are in line with the Group's risk appetite. Refinancing risk is not considered a material issue for the portfolio due to the relatively young vintage of the book and conservative risk parameters.

Gross drawn lending in the non-core Acquisition Finance portfolio totalled £836 million (net £667 million) as at 31 December 2013. Impairment charges in the non-core Acquisition Finance portfolio continue to decline significantly, reflecting further material reductions in the size of the portfolio and stabilising market conditions. Disposals of £1,566 million (net book value) were achieved during 2013.

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Credit risk – Wealth, Asset Finance and International

Overview

- The Wealth, Asset Finance and International impairment charge was £730 million in 2013, 51 per cent lower than 2012. The improvement was primarily driven by the Irish portfolio.
- In the Irish wholesale portfolios, 88.3 per cent (31 December 2012: 85.2 per cent) is now impaired with an impairment provisions as a percentage of impaired loans of 73.1 per cent (31 December 2012: 68.0 per cent), primarily reflecting continued deterioration in the Irish commercial property market. Net exposure in Ireland wholesale has fallen to £3.4 billion (31 December 2012: £5.4 billion).
- In the Irish retail mortgage portfolio, impairment provisions as a percentage of impaired loans decreased to 63.4 per cent (31 December 2012: 71.2 per cent), driven by the sale of a portfolio of non performing mortgages.

Table 1.19: **Impairment charge**

	2013 £m	2012 £m	Change 2012 %
Wealth	18	23	22
International:			
Ireland retail	(26)	108	
Ireland commercial real estate	219	739	70
Ireland corporate	415	398	(4)
Spain retail	17	51	67
Netherlands retail	17	23	26
Asia retail	(1)	35	
Latin America and Middle East	–	(33)	
	641	1,321	51
Asset Finance:			
United Kingdom	57	121	53
Australia	14	15	7
	71	136	48
Total impairment charge	730	1,480	51
Core			
Wealth	18	23	22
International	–	–	
Asset Finance	14	(1)	
Core impairment charge	32	22	(45)
Non-core			
Wealth	–	–	
International	641	1,321	51
Asset Finance	57	137	58
Non-core impairment charge	698	1,458	52
Impairment charge as a % of average advances	1.79%	3.12%	(133)bp
Core impairment charge as a % of average advances	0.50%	0.45%	5bp
Non-core impairment charge as a % of average advances	2.03%	3.42%	(139)bp

RISK MANAGEMENT

Impaired loans and provisions

Total impaired loans decreased by £3,650 million to £10,358 million compared with £14,008 million at 31 December 2012 and, as a percentage of closing loans and advances to customers, increased to 32.9 per cent from 32.6 per cent at 31 December 2012. This is primarily driven by reductions in Ireland wholesale.

Impairment provisions as a percentage of impaired loans increased to 69.9 per cent from 67.5 per cent at 31 December 2012. This increase was driven by the International portfolios.

Table 1.20: **Impairments on loans and advances**

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
At 31 December 2013					
Wealth	3,218	349	10.8	70	20.1
International:					
Ireland retail	5,944	1,002	16.9	638	63.7
Ireland commercial real estate	5,512	5,087	92.3	3,775	74.2
Ireland corporate	3,918	3,235	82.6	2,305	71.3
Spain retail	–	–		–	
Netherlands retail	5,478	86	1.6	45	52.3
Asia retail	1,645	109	6.6	39	35.8
Latin America and Middle East	23	17	73.9	24	
	22,520	9,536	42.3	6,826	71.6
Asset Finance:					
United Kingdom	5,712	473	8.3	346	73.2
Australia	–	–		–	
	5,712	473	8.3	346	73.2
Total gross lending	31,450	10,358	32.9	7,242	69.9
Impairment provisions	(7,242)				
Fair value adjustments	(19)				
Total	24,189				
Core					
Wealth	3,218	349	10.8	70	20.1
International	–	–		–	
Asset Finance	3,392	57	1.7	29	50.9
Total core gross lending	6,610	406	6.1	99	24.4
Impairment provisions	(99)				
Fair value adjustments	–				
Total core	6,511				
Non-core					
Wealth	–	–		–	
International	22,520	9,536	42.3	6,826	71.6
Asset Finance	2,320	416	17.9	317	76.2
Total non-core gross lending	24,840	9,952	40.1	7,143	71.8
Impairment provisions	(7,143)				
Fair value adjustments	(19)				
Total non-core	17,678				

[1] Impairment provisions include collective unimpaired provisions.

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
At 31 December 2012					
Wealth	4,325	284	6.6	73	25.7
International:					
Ireland retail	6,656	1,534	23.0	1,111	72.4
Ireland commercial real estate	7,408	6,720	90.7	4,695	69.9
Ireland corporate	5,467	4,247	77.7	2,768	65.2
Spain retail	1,458	104	7.1	94	90.4
Netherlands retail	5,689	79	1.4	41	51.9
Asia retail	1,978	80	4.0	46	57.5
Latin America and Middle East	46	36	78.3	31	86.1
	28,702	12,800	44.6	8,786	68.6
Asset Finance:					
United Kingdom	5,848	885	15.1	541	61.1
Australia	4,052	39	1.0	53	
	9,900	924	9.3	594	64.3
Total gross lending	42,927	14,008	32.6	9,453	67.5
Impairment provisions	(9,453)				
Fair value adjustments	(28)				
Total	33,446				
Core					
Wealth	4,325	284	6.6	73	25.7
International	–	–		–	
Asset Finance	1,090	67	6.1	12	17.9
Total core gross lending	5,415	351	6.5	85	24.2
Impairment provisions	(85)				
Fair value adjustments	–				
Total core	5,330				
Non-core					
Wealth	–	–		–	
International	28,702	12,800	44.6	8,786	68.6
Asset Finance	8,810	857	9.7	582	67.9
Total non-core gross lending	37,512	13,657	36.4	9,368	68.6
Impairment provisions	(9,368)				
Fair value adjustments	(28)				
Total non-core	28,116				

[1] Impairment provisions include collective unimpaired provisions.

RISK MANAGEMENT

International

Ireland

The Group continues to reduce its exposure to Ireland with gross loans and advances reducing by £4,157 million during 2013 mainly due to disposals, write-offs and net repayments.

Total impaired loans decreased by £3,177 million, or 25 per cent to £9,324 million compared with £12,501 million at 31 December 2012. The reduction was driven primarily by commercial real estate and corporate loans. Impaired loans as a percentage of closing loans and advances decreased to 60.6 per cent compared to 64.0 per cent at December 2012. Continuing weakness in the Irish real estate markets resulted in a further increase in Ireland wholesale coverage in 2013 to 73.1 per cent.

Impairment charges decreased by £637 million to £608 million compared to 2012. The impairment charge as an annualised percentage of average loans and advances to customers improved to 3.28 per cent from 5.53 per cent in 2012.

Ireland retail loans and advances to customers decreased to £5,944 million in 2013 from £6,656 million at 31 December 2012. Impaired loans as a percentage of loans and advances decreased to 16.9 per cent from 23.0 per cent at 31 December 2012. In the Irish retail mortgage portfolio impairment provisions as a percentage of impaired loans decreased to 63.4 per cent (from 71.2 per cent at 31 December 2012). These decreases have all been driven by the sale of a portfolio of non performing mortgages.

The most significant contribution to impaired loans in Ireland is the Commercial Real Estate portfolio. 92.3 per cent of the portfolio is now impaired compared to 90.7 per cent at 31 December 2012. The impairment provisions as a percentage of impaired loans increased in the year to 74.2 per cent from 69.9 per cent 31 December 2012 reflecting the continued deterioration in commercial real estate prices in Ireland.

Secured loan to value analysis – Ireland Retail Mortgages

The average loan to value (LTV) on the Irish mortgage portfolio decreased to 102.3 per cent at 31 December 2013 compared with 113.8 per cent at 31 December 2012. The percentage of loans and advances with an indexed LTV in excess of 100 per cent decreased to 53.8 per cent at 31 December 2013, compared with 63.1 per cent at 31 December 2012. The table below shows the LTV distribution of the retail mortgage portfolio.

Table 1.21: **Actual and average LTVs across the Ireland Retail mortgage portfolio**

	At 31 December 2013 Total %	At 31 December 2012 Total %
Less than 60%	**15.3**	11.7
60% to 70%	**6.0**	5.0
70% to 80%	**7.5**	5.9
80% to 90%	**8.1**	6.8
90% to 100%	**9.3**	7.5
Greater than 100%	**53.8**	63.1
Total	**100.0**	100.0
Average loan to value:		
Stock of residential mortgages	**102.3**	113.8
Impaired mortgages	**104.7**	123.5

Commercial Real Estate lending in Ireland: secured loan to value analysis

Loan to value ratios (indexed or actual if within last 18 months) for the Group's largest transactions (over €5 million) are detailed in the table below. The Group considers this portfolio to be appropriately provided for after taking into account the provisions held for each transaction and the value of the collateral held. In the case of impaired Ireland commercial real estate exposures (over €5 million) there is a net property collateral shortfall of approximately £0.2 billion. This figure excludes benefits of credit mitigants such as cross collateralisation and cross guarantees. The Group makes use of a variety of methodologies to assess the value of property collateral where external valuations are not available. These include use of market indexes, models and subject matter expert judgement.

Table 1.22: **LTV – Ireland Wholesale Commercial Real Estate**

	At 31 December 2013		At 31 December 2012	
	£m	%	£m	%
Gross exposures > €5 million:				
Less than 60%	84	2	119	2
61% to 70%	11	–	20	–
71% to 80%	15	–	27	–
81% to 100%	88	2	165	3
101% to 125%	81	2	182	3
More than 125%	3,555	83	4,927	81
Unsecured	440	11	674	11
	4,274	100	6,114	100
Gross exposures < €5 million	1,238		1,294	
Total	5,512		7,408	

Other international

Total impaired loans decreased to £212 million at 31 December 2013 compared to £299 million at 31 December 2012, driven by the sale of the Spain retail portfolio. In the Netherlands impairment provisions as a percentage of impaired loans increased to 52.3 per cent from 51.9 per cent at 31 December 2012.

Asset Finance

United Kingdom: the impairment charge reduced by 53 per cent to £57 million (of which £43 million related to non-core assets) compared with £121 million in 2012, driven by continued strong credit management and further improved credit quality. The retail portfolio saw fewer customers failing to meet their payment arrangements resulting in a lower proportion of people falling into arrears. The retail impairments also benefited from debt sale activity during the course of the year. The number of defaults in all areas of the commercial and corporate lending book was low relative to the last three years, reflecting effective previous and ongoing credit risk management actions.

Australia: the portfolio was fully disposed of in the second half of 2013.

RISK MANAGEMENT

Exposures to Eurozone countries

The following section summarises the Group's direct exposure to Eurozone countries at 31 December 2013. The exposures comprise on-balance sheet exposures based on their balance sheet carrying values and off-balance sheet exposures, and are based on the country of domicile of the counterparty unless otherwise indicated.

The Group manages its exposures to individual countries through authorised country limits which take into account economic, financial, political and social factors. In addition, the Group manages its direct risks to the selected countries by establishing and monitoring risk limits for individual banks, financial institutions, corporates and individuals.

Identified indirect exposure information is also taken into account when setting limits and determining credit risk appetite for individual counterparties. This forms part of the Group's credit analysis undertaken at least annually for counterparty and sector reviews, with interim updates performed as necessary. Interim updates would usually be triggered by specific credit events such as rating downgrades, sovereign events or other developments such as spread widening. Examples of indirect risk which have been identified are: European Banking groups with lending and other exposures to certain Eurozone countries; corporate customers with operations or significant trade in certain European jurisdictions; major travel operators known to operate in certain Eurozone countries; and international banks with custodian operations based in certain European locations.

The Group Financial Stability Forum (GFSF) monitors developments within the Eurozone, carries out stress testing through detailed scenario analysis and completes appropriate due diligence on the Group's exposures.

The GFSF has carried out a number of scenario analyses and rehearsals to test the Group's resilience in the event of further instability in certain Eurozone countries. The Group has developed and refined pre-determined action plans that would be executed in such scenarios. The plans set out governance requirements and responsibilities for the key actions which would be carried out and cover risk areas such as payments, liquidity and capital, communications, suppliers and systems, legal, credit, delivery channels and products, employees and the impact on customers.

The Group has included certain amounts on a net basis to better reflect the overall risk to which the Group is exposed. The gross IFRS reported values for the exposures to Eurozone countries are detailed in the following tables. Derivative balances are included within exposures to financial institutions or corporates, as appropriate, at fair value adjusted for master netting agreements at obligor level and net of cash collateral in line with legal agreements. Exposures in respect of reverse repurchase agreements are included on a gross IFRS basis and are disclosed based on the counterparty rather than the collateral (repos and stock lending are excluded); reverse repurchase exposures are not, therefore, reduced as a result of collateral held. Reverse repurchase exposures to institutional funds secured by UK gilts are excluded from all Eurozone exposures as detailed in the footnotes. Exposures to central clearing counterparties are shown net.

For multi-country asset backed securities exposures, the Group has reported exposures based on the largest country exposure. The country of exposure for asset backed securities is based on the location of the underlying assets which are predominantly residential mortgages not in the domicile of the issuer.

Exposures to selected Eurozone countries

The Group continues to have minimal exposure, in aggregate, which could be considered to be direct recourse to the sovereign risk of the selected countries.

Table 1.23: **Selected Eurozone exposures**

	Sovereign debt		Financial institutions						
	Direct sovereign exposures £m	Cash at central banks £m	Banks £m	Other[1] £m	Asset backed securities £m	Corporate £m	Personal £m	Insurance assets £m	Total £m
At 31 December 2013									
Ireland	–	–	30	392	177	3,851	5,308	116	9,874
Spain	6	5	554	116	23	1,857	41	24	2,626
Portugal	–	–	153	–	193	195	9	–	550
Italy	–	–	74	1	–	106	–	10	191
Greece	–	–	–	–	–	111	–	–	111
	6	5	811	509	393	6,120	5,358	150	13,352
At 31 December 2012									
Ireland	–	–	115	88	305	5,972	5,559	111	12,150
Spain	5	14	1,170	7	132	2,110	1,472	25	4,935
Portugal	–	–	118	–	224	187	10	–	539
Italy	5	–	44	–	10	150	–	37	246
Greece	–	–	–	–	–	277	–	–	277
	10	14	1,447	95	671	8,696	7,041	173	18,147

[1] Excludes reverse repurchase exposure to institutional funds domiciled in Ireland secured by UK gilts of £4,590 million (2012: £556 million) on a gross basis.

In addition to the exposures detailed above, the Group has the following exposures to sovereigns, financial institutions, asset backed securities, corporates and personal customers in the following Eurozone countries:

Table 1.24: **Other Eurozone Exposures**

	Sovereign debt		Financial institutions						
	Direct sovereign exposures £m	Cash at central banks £m	Banks £m	Other[1] £m	Asset backed securities £m	Corporate £m	Personal £m	Insurance assets £m	Total £m
At 31 December 2013									
Netherlands	–	8,683	741	188	216	2,025	5,434	798	18,085
France	–	–	1,425	17	42	3,199	115	1,017	5,815
Germany	174	1,831	1,107	495	442	1,613	–	721	6,383
Luxembourg	–	–	1	1,337	–	1,595	–	46	2,979
Belgium	–	–	700	1	–	582	–	53	1,336
All other Eurozone countries	127	–	5	–	–	306	–	172	610
	301	10,514	3,979	2,038	700	9,320	5,549	2,807	35,208
At 31 December 2012									
Netherlands	1	33,232	478	2	268	2,207	5,649	977	42,814
France	6	–	853	–	77	3,226	312	1,457	5,931
Germany	284	1,809	389	414	400	2,117	–	977	6,390
Luxembourg	–	2	–	752	–	1,841	–	71	2,666
Belgium	–	–	309	25	–	568	–	64	966
All other Eurozone countries	–	–	56	–	–	438	–	214	708
	291	35,043	2,085	1,193	745	10,397	5,961	3,760	59,475

[1] Excludes reverse repurchase exposure to institutional funds domiciled in Luxembourg secured by UK Gilts of £1,559 million (2012: £82 million) on a gross basis.

Total balances with other Eurozone countries have decreased from £59,475 million to £35,208 million. This is primarily due to a decrease in Dutch central bank balances. Derivatives with sovereigns and sovereign referenced credit default swaps are insignificant.

RISK MANAGEMENT

Environmental risk management

The Group ensures appropriate management of the environmental impact of its lending activities. The Group-wide Credit Risk principles require all credit risk to be incurred with due regard to environmental legislation and the Group's Code of Business Responsibility.

Within Commercial Banking, an electronic environmental risk screening system has been the primary mechanism for assessing environmental risk in lending transactions. This system provides screening of location specific and sector based risks that may be present in a transaction. Identified risk sees the transaction referred to the Group's expert in-house Environmental Risk team for further review and assessment, as outlined below. Where required, the Group's panel of environmental consultants provide additional expert support.

The Group provides colleague training in environmental risk management as part of the standard suite of credit risk courses. Supporting this training, a range of online resource is available to colleagues and includes environmental risk theory, procedural guidance, and information on environmental legislation and sector-specific environmental impacts.

The Group has been a signatory to the Equator Principles since 2006 and has adopted and applied the expanded scope of Equator Principles III. The Equator Principles support the Group's approach to assessing and managing environmental and social issues in Project Finance Project-Related Corporate loans and Bridge loans. Further information is contained within the Group's Responsible Business Report.

Table 1.25: **Environmental risk management approach**

UK renewable energy policy

Over the past two years, the UK government has undertaken an Electricity Market Reform review, in line with its aim to introduce a more stable investment regime – Contract for Difference (CFD). Primary legislation for this was passed in December 2013, with secondary legislation likely to be passed by July 2014. From then on, the current Renewables Obligation will run alongside CFD through to 2017. At present, it appears that given the limited availability of commercially acceptable or bankable Power Purchase Agreements under the Renewable Obligation regime, independent generators are restricting their investment in the UK.

These market reforms are intended to encourage investment of around £200 billion by 2020 in projects designed to provide clean, secure, affordable energy. Clearly, UK and EU policy have impacts on the Group's customers. It influences the decisions they take about whether or not to invest in sustainable projects or initiatives. However, the Group's focus is on promoting the commercial benefits of sustainability to its customers. The Group is working with them and the UK government to help meet Britain's renewable energy objectives.

Renewable Energy Project Finance

As an active participant in the Project Finance Market, the Group is already playing a key role in finding solutions to current and future 'green' funding requirements. For example, at the end of 2013, the Group was involved in renewable energy projects across Britain, with a combined capacity of more than 3580MW.

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Conduct risk

Definition

Conduct risk is defined as the risk of customer detriment or regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment or business conduct.

Risk appetite

The Group has no appetite for systemic unfair customer outcomes arising from any of its activities: through product design, sales or other after sales processes. This appetite is reviewed and approved annually by the Board. To achieve this, the Group has policies, processes and standards which provide the framework for businesses and colleagues to operate in accordance with the laws, regulations and voluntary codes which apply to the Group and its activities.

Exposures

Conduct risk affects all aspects of the Group's operations, all types of customers and other stakeholders. The Group faces significant conduct risks, for example, through products or services not meeting the needs of its customers, sales processes resulting in poor advice or failure to deal with a customer's complaint effectively where the Group has got something wrong and not met customer expectations. Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain aspects of the Group's current or legacy business may be determined by the Financial Conduct Authority (FCA) and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment in their opinion. The Group may also be liable for damages to third parties harmed by the conduct of its business.

Measurement

To articulate its conduct risk appetite, the Group has sought more granularity through the use of suitable conduct risk metrics and tolerances that indicate where it may potentially be operating outside its conduct appetite. Conduct Risk Appetite Metrics (CRAMs) have been designed for all products offered by the Group; these contain a range of product, sales and post-sales metrics to provide a more holistic view of conduct risks. CRAMs being put in place include complaints, FOS upheld, outcome testing, customer feedback, colleague survey, whistleblowing and rectification metrics. Strong governance is in place to ensure that CRAMs are presented at relevant governance forums for review, challenge and action. The Group will also measure how effectively the overall conduct strategy is embedded across all divisions and functions.

Mitigation

The Group takes a range of mitigating actions with respect to this risk. These actions are being embedded throughout the Group as part of the Group's Conduct Strategy.

This includes:

– Enhanced approach to business planning and strategy with customers at the heart;
– Cultural transformation, linked to the Group's values and Codes of Responsibility, to deliver the best bank for customers;
– Enhanced product governance framework to ensure products continue to offer customers value for money, and meet the needs of the relevant target market;
– Sales processes and governance framework to deliver consistently fair outcomes;
– CRAMs to identify where the Group may be operating outside its risk appetite;
– Continuing the journey to become the industry leader for complaints performance; and
– Enhanced recruitment and training, and a focus on how the Group manages colleagues' performance with clearer customer accountabilities.

The Group's leadership team is committed to embedding the Conduct Strategy within the business and to creating the right customer centric culture. The Board and Group Risk Committees receive regular reports and metrics to track progress on how the Group is meeting customer needs and minimising conduct risk.

All Group divisions have applied significant resources to the Conduct Strategy and set ambitious conduct transformation plans.

The Group's Conduct Strategy continues to evolve and be enhanced. The Group actively engages with regulatory bodies and other stakeholders in developing its understanding of current customer treatment concerns to ensure that the implementation of the Group's conduct strategy meets evolving stakeholder expectations.

Monitoring

A robust outcomes testing regime is in place to test performance of customer critical activities end-to-end. Customer metrics are proactively used when reviewing business performance and feedback loops have been established to take learnings from root cause/outcome testing.

RISK MANAGEMENT

Market risk

Definition

Market risk is defined as the risk that unfavourable market moves (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and bond prices, foreign exchange rates, equity, property and commodity prices and other instruments), lead to reductions in earnings and/or value.

Risk appetite

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 cascaded to an appropriate level within their areas of responsibility.

Exposures

Defined benefit pension schemes

The Group's defined benefit pension schemes are exposed to significant risks from the constituent parts of their assets and from the present value of their liabilities, primarily real interest rate, credit spread and equity risk. Interest rate risk arises from the liability discount rate, with partial offsets from fixed interest assets such as gilts and corporate bonds, and swaps. Credit spread risk also arises from the liability discount rate, with partial offsets from the credit portfolio. Equity risk arises from direct equity holdings.

For further information on defined benefit pension scheme assets and liabilities please refer to note 41 on page 271.

Trading portfolios

The Group's trading activity is small relative to its peers and the Group does not have a programme of proprietary trading activities. All the trading Value at Risk (VaR) resides within Commercial Banking. The average 95 per cent 1-day trading VaR was £4.1 million for the year to 31 December 2013 (2012: £7.0 million). The Group's trading activity is undertaken to meet the requirements of wholesale and retail customers for foreign exchange, credit spread and interest rate products.

Trading market risk measures are applied to all the Group's regulatory trading books where positions arise from supporting customer flow and market making. All positions are held with trading intent. Measures include daily VaR (Table 1.29), sensitivity based measures, and stress testing. The Group's trading book assets and liabilities are substantially originated by Financial Markets within the Commercial Banking division. Within the Group's balance sheet these fall under the trading assets and liabilities and derivative financial instruments (see Table 1.26 below).

Table 1.26: **Market risk linkages to the balance sheet for trading portfolios and Banking activity items**

	Balance sheet total £m	Trading books £m	Relevant notes from financial statements
31 December 2013			
Assets			
Trading and other financial assets at fair value through profit or loss	**142,683**	**42,376**	Note 17
Derivative financial instruments	**33,125**	**25,531**	Note 18
Loans and advances to customers	**495,281**	**–**	Note 20
Liabilities			
Trading and other financial liabilities at fair value through profit or loss	**43,625**	**38,319**	Note 34
Derivative financial instruments	**30,464**	**25,086**	Note 18
Customer deposits	**441,311**	**–**	Note 33

Table 1.26 above shows relevant balance sheet items relating to banking and trading activities. The trading book VaR sensitivity inputs are separately identified.

Banking activities

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 or liability.

Interest rate risk in the Group's divisional portfolios and in the Group's capital and funding activities arises from the different repricing characteristics of the Group's non-trading assets, liabilities (see loans and advances to customers and customer deposits in Table 1.26 above) and off balance sheet positions of the Group. Interest rate risk arises predominantly from the mismatch between interest rate sensitive assets and liabilities, but also to the investment term of capital and reserves, and the need to minimise income volatility.

Margin compression risk also arises from the current low rate environment, which may restrict the ability to change interest rates applying to customers in response to changes in interbank and central bank rates.

Prepayment risk arises, predominantly in the Retail division, as customer balances amortise more quickly or slowly than anticipated due to economic conditions or customer's response to changes in economic conditions.

Pipeline and pre hedge risk arises where new business volumes are higher or lower than forecasted, requiring the business to unwind or execute additional hedging at rates which may differ to what was expected.

Basis risk arises from the possible changes in spreads, for example where the bank lends with reference to a central bank rate but funds with reference to LIBOR and the spread between these widens or tightens.

Foreign currency risk arises from:

(a) translational exposure: the Group's investment in its overseas operations. Net investment exposures are disclosed (see note 54 on page 327) and it is Group policy to hedge non-functional currency exposures; and

(b) transactional exposure: where assets and liabilities are denominated in currencies other than the business' functional currency. The Group has a policy of forward hedging its forecasted currency income less impairments to year end.

Insurance portfolios

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

- With-profits funds are managed with the aim of generating smoothed returns consistent with policyholders' expectations. Exposure arises where the value of the underlying funds are insufficient to meet the obligations, termed burnthrough.
- Unit-linked funds where policyholders select their investments. Exposure arises as future fee income is dependent upon the performance of those assets. This fee income forms part of the Value of in-force business, see note 28 on page 257.
- Annuities where policyholders' future cashflows are guaranteed at retirement. Exposure arises if the assets, predominantly fixed income, backing the liabilities do not perform in line with expectations.
- Insurance's surplus assets also result in market risk exposure. These assets are held primarily in three portfolios: (i) in the long-term funds within the life insurance companies; (ii) in the corresponding shareholder funds; and (iii) in investment portfolios within the general insurance business.
- The majority of Insurance's equity risk exposure relates to unit-linked funds, through the value of future fee income, and with-profits funds, through burnthrough. Credit spread risk exposure largely results from holding fixed income assets in the annuity portfolio with the aim of providing additional returns.

Table 1.27: **Key market risks for the Group (PBT impact measured against Group single stress scenarios)**

	Risk type					
	Interest rate	Basis risk	FX	Credit spread	Equity	Inflation
Defined benefit pension schemes	●		○	●	●	●
Trading portfolios	○	○	○	○		○
Banking activities	●	○	○	●	●	○
Insurance portfolios	●		○	●	●	●

Key:

Profit before tax:

>£500m	●
£250-£500m	●
<£250m	●
<£50m	○

Measurement

Market risk is managed within a Board approved framework and risk appetite. This is supplemented by divisional market risk appetite limits and triggers. A variety of risk measures are used such as:

- Scenario/stress based measures (e.g. single factor stresses, macroeconomic scenarios);
- Percentile based measures (e.g. VaR and Stressed VaR); and
- Sensitivity based measures (e.g. sensitivity to 1 basis point move in interest rates).

Scenario based measures include the use of five different economic multi-risk scenarios which the Group introduced as part of its Board risk appetite. These assess the impact of unlikely, but plausible adverse scenarios on income, with the worst case for defined benefit pensions, trading portfolios, banking activities and insurance portfolios being reported against the Board risk appetite.

Internal market risk models for trading book activities comprise VaR, Stressed VaR and Incremental Risk Charge and these are explained in detail in the Group's Market Risk section of the Pillar III Disclosures.

Although an important market standard measure of risk, VaR has limitations. These arise from the use of limited historical data, an assumed distribution, defined holding periods, set confidence intervals and frequency of calculation. The exposure level at the confidence interval does not convey any information about potential losses which may arise if this level is exceeded. A 95 per cent confidence interval with a 1-day holding period is equivalent to an expected 1 in 20 day loss. The Group recognises these limitations and supplements the use of VaR with a variety of other techniques more suited to the nature of the business activity.

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In addition:

– Capital impact and deficit triggers are used in respect of defined benefit pensions which have a material impact on capital resources.
– Profit and loss triggers are used in the trading books in order to ensure that mitigating action is considered if profit and loss becomes volatile.
– Interest rate repricing gaps, earnings sensitivity analysis, and open foreign exchange positions are used for banking book activity, and
– Stress testing and scenario analysis are also used in certain portfolios and at Group level, to simulate the impact of extreme conditions and to understand more fully the interdependence of different parts of the balance sheet.

These measures are reviewed regularly by senior management to inform effective decision making.

Defined benefit pension schemes

Management of the assets is the responsibility of the Trustees of the schemes who are responsible for setting the investment strategy and for agreeing funding requirements with the Group. The difference between assets and liabilities determines whether there is a surplus or deficit. Any deficit must be met by the Group with additional funding agreed with the Trustees as part of a triennial valuation process.

For accounting purposes, a AA corporate bond based discount rate is used to determine present value of liabilities resulting in significant credit spread risk. Assets are marked to market.

Trading portfolios

Based on the 1-day 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 2013 and 2012 based on the Group's global trading positions is detailed in table 1.28.

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 five risk types. 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 trading book positions arising from short term market facing activity. Trading book VaR (1-day 99 per cent) is compared daily against both forecast and actual profit and loss.

The average VaR for 2013 was lower than the average over 2012 due primarily to lower credit spread and interest rate exposure and improvement in market conditions. Trading book VaR assumes no diversification across risk type, instead it is a simple sum of interest rate, foreign exchange, credit spread, and inflation risk.

Table 1.28: **Trading portfolios: VaR 1-day 95 per cent confidence level (audited)**

	Close £m	Average £m	Maximum £m	Minimum £m
At 31 December 2013				
Interest rate risk	**3.5**	**2.9**	**4.8**	**2.0**
Foreign exchange risk	**0.2**	**0.4**	**2.0**	**0.1**
Equity risk	**–**	**–**	**–**	**–**
Credit spread risk	**0.8**	**0.5**	**1.4**	**0.3**
Inflation risk	**0.2**	**0.3**	**0.7**	**0.1**
Total VaR	**4.7**	**4.1**	**6.5**	**2.7**

1-day 99 per cent VaR charts for 2013 for Lloyds Bank, HBOS and Lloyds Banking Group models can be found in the Group's Pillar III Disclosures.

	Close £m	Average £m	Maximum £m	Minimum £m
At 31 December 2012				
Interest rate risk	2.8	4.2	7.4	1.9
Foreign exchange risk	0.3	0.4	1.0	–
Equity risk	–	–	–	–
Credit spread risk	0.8	1.9	3.6	0.7
Inflation risk	0.5	0.5	1.3	0.1
Total VaR	4.4	7.0	11.4	4.1

Open market risk for the trading operations continues to be low with respect to the size of the Group and similar institutions, reflecting the fact that the Group's trading operations are customer-centric, focusing on hedging and recycling client risks.

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Banking activities

Market risk in non-trading books consists of exposure to changes in interest rates including basis risk. This is the potential impact on earnings and value that occurs due to mismatches in the timing of repricing assets and liabilities.

Interest rate risk exposure is monitored monthly using, primarily:

(a) Market value sensitivity: this methodology considers all repricing mismatches (behaviourally adjusted where appropriate) in the current balance sheet and calculates the change in market value that would result from an instantaneous 25, 100 and 200 basis points parallel rise or fall in the yield curve (subject to a floor at zero per cent).

(b) Interest income sensitivity: this measures the impact on future net interest income arising from an instantaneous 25, 100 and 200 basis points parallel rise or fall in all the yield curves over a rolling 12 month basis (subject to a floor at zero per cent). Unlike the market value sensitivities, the interest income sensitivities incorporate additional behavioural assumptions as to how and when individual products would reprice in response to such change.

(c) Value at Risk (VaR): for short dated portfolios and other accrual accounted trading portfolios, where the portfolio turns over more than once within a three month horizon, VaR is used for internal risk management.

(d) Market Value notional limit: this caps the amount of conventional and inflation-linked government bonds held by the Group for liquidity purposes.

The Group has an integrated Asset and Liability Management (ALM) system which supports non traded asset and liability management of the Group. This provides a single consolidated tool to measure and manage interest rate repricing profiles (including behavioural assumptions), perform stress testing and produce forecast outputs. Interest rate gaps are reported by currency and used to calculate the income and value sensitivities (in GBP equivalent). Repricing assumptions and customer reaction to changes in product pricing is a major determinant of the risk profile. The Group is aware that any assumptions based model is open to challenge. However, a full behavioural review is performed annually by Group ALM functions to ensure the assumptions remain appropriate, and is reviewed by Risk Division.

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.

Table 1.29 below shows, split by material currency, the Group's market value sensitivities to an instantaneous parallel up and down 25 basis points change to all interest rates.

Table 1.29: **Banking activities: market value sensitivity**

	2013		2012[1]	
	Up 25bps £m	**Down 25bps £m**	Up 25bps £m	Down 25bps £m
Sterling	**(25.1)**	**25.6**	51.4	(54.0)
US dollar	**16.3**	**(16.5)**	14.9	(16.7)
Euro	**(0.4)**	**0.6**	14.5	(8.5)
Australian dollar	**(0.7)**	**(0.1)**	1.0	(1.0)
Other	**(0.3)**	**0.3**	(0.1)	0.1
Total	**(10.2)**	**9.9**	81.7	(80.1)

[1] Restated

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.

Table 1.30 below shows the banking book income sensitivity to an instantaneous parallel up and down 25 basis points change to all interest rates.

Table 1.30: **Banking activities: net interest income sensitivity (audited)**

	2013		2012	
	Up 25bps £m	**Down 25bps £m**	Up 25bps £m	Down 25bps £m
Client facing activity and associated hedges	**48.2**	**(136.0)**	202.0	(209.3)

The market value sensitivity is driven by temporary customer flow positions not yet hedged plus other positions occasionally held within limits, by the Group's wholesale funding desks in order to minimise overall funding and hedging costs. The level of risk is low relative to the size of the total balance sheet.

The fall in net interest income sensitivity reflects further structural hedging against margin compression undertaken in 2013, and a revision of the assumptions as to how variable retail savings would reprice in a rising rate scenario.

Insurance portfolios

Market risks within the Insurance business are measured using a variety of techniques including stress and scenario testing and, where appropriate, stochastic modelling. Current and potential future market risk exposures are assessed and aggregated using a range of stresses and risk measures including 1-in-200 year stresses for Insurance's Individual Capital Assessment (ICA) and alternative stresses for profit before tax and other measures. The effect of changes in key assumptions including sensitivities to the risk-free rate, equity investment volatility, widening of credit spreads on corporate bonds and an increase in illiquidity premia, as applied to profit before tax and equity are set out in note 37.

RISK MANAGEMENT

Mitigation

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

Defined benefit pension schemes

The Group takes an active involvement in agreeing risk management and mitigation strategies with the Trustees of the schemes through whom any such activity must be conducted. An interest rate hedging programme is in place to reduce liability risk. The schemes are also reducing equity allocation and investing the proceeds in credit assets as part of a programme to appropriately de-risk the portfolio.

Trading portfolios and banking activities

The Group's policy is to optimise reward whilst managing its interest rate risk exposures within the risk appetite defined by the Board. For individual banking divisions, simple positional interest rate risk is minimal due to the Group requirement for these businesses to hedge (or match fund) promptly all open positions directly via the Group Corporate Treasury (GCT) function.

As defined within the scope of the Group IRRBB Policy, all hedgeable interest rate risk in the non-traded book should be transferred to GCT via the Interest Rate Risk Transfer Pricing (ITP) framework. GCT is responsible for managing centralised risk (both traded and non-traded) and does this through natural offsets of matching assets and liabilities, and appropriate hedging activity of the residual exposures, subject to the authorisation and mandate of Group Asset and Liability Committee within the Board Risk Appetite. Derivative desks in Financial Markets will then externalise the hedges to the market. However, certain residual interest rate risks may remain outside the centre due to differences in basis and profile mismatches, largely arising from customer behaviour.

Customer facing divisions incur foreign exchange risk in the course of providing services to their customers. GCT incurs foreign exchange risk through its various debt and capital management programmes. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled within the trading risk appetite and any residual risk is hedged in the market.

Insurance portfolios

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. Where considered appropriate, hedges are in place to reduce exposure to market risk, principally equity and interest rate risk, but also foreign currency.

For annuity 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. Further, in assessing the current value of these future cashflows, it is not always possible to achieve equally resilient levels of matching between the different capital measures that are used to assess regulatory solvency.

Monitoring

The Group Asset and Liability Committee and the Group Market Risk Committee regularly review high level market risk exposure, as part of the wider risk management framework. They also make 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 and triggers are monitored by Risk Division and where appropriate, escalation procedures are in place.

Defined benefit pension schemes

In addition to the wider risk management framework, governance of the schemes includes two specialist pensions committees (one Group Executive sub-committee and a supporting management committee).

Under this governance structure, the surplus or deficit in the schemes is tracked on a monthly basis along with various single factor and scenario stresses which consider the assets and liabilities holistically. Performance against risk appetite limits and triggers is also tracked regularly including an assessment of the impact on Group capital resources. Hedges in place and asset/liability matching positions are also actively monitored.

Trading portfolios and 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 divisional portfolios and in the Group's capital and funding activities is managed centrally within triggers defined in the Group policy for interest rate risk in the banking book, which is reviewed and approved annually.

Insurance portfolios

Ongoing monitoring is in place to track market risks. This includes monitoring the progression of market risk capital against risk appetite limits, as well as the sensitivity of profit before tax to combined market risk stress scenarios and in year market movements. Asset/liability matching positions and hedges in place are actively monitored and if necessary rebalanced to be within certain tolerances. In addition market risk is controlled via approved investment policies and mandates.

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Operational risk

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The aim of operational risk management is to manage operational risks in line with defined appetites, and to protect both customers and the Group whilst delivering sustainable growth. The Group Operational Risk framework is the method by which operational risks are managed in terms of setting risk appetite, evaluating key exposures, measuring risk, mitigating risk, and monitoring risks on an ongoing basis, as set out below.

Risk appetite

The Group's Operational Risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders. Appetite is expressed through five high level statements summarised below, each of which are defined with limits and triggers approved by the Board, and are regularly monitored by Executive and Board risk committees:

– **Customer:** The Group builds trust and does not expect its customers to be impacted negatively.
– **Reputation:** The Group manages its external profile effectively. The Group will manage and mitigate any prominent negative nationwide media coverage.
– **Financial loss:** The Group does not expect to experience cumulative fraud or operational losses above a defined level of budgeted Group income.
– **Management time and resources:** The Group does not expect internal events that divert excessive senior management time from running the business or have extensive impact on colleague time and/or morale.
– **Risk culture:** All colleagues are responsible for risk within their individual roles. The Group sets a strong tone from the top and embraces a risk culture across the business which is aligned to its strategy, vision, values and codes of responsibility. The Group encourages an open dialogue and rapid escalation of potential threats and events.

Exposures

The principal operational risks to the Group are:

– IT systems and resilience risk arising from failure to develop, deliver and maintain effective IT solutions;
– Information security risk arising from information leakage, loss or theft;
– External fraud arising from an act of deception or omission;
– Cyber risk arising from malicious attacks on the Group via technology, networks and systems; and
– Risks arising from inadequate customer facing processes, including transactions, processing and information capture.

The risks below also have potential to negatively impact customers and the Group's future results:

– The sale of TSB may result in disruption of senior management's ability to lead and manage the Group effectively. In addition, the Group is committed to providing service for TSB, with potential for customer detriment, plus reputational and financial exposure for the Group in the event of any significant issues in maintaining services.
– Terrorist acts, other acts of war or hostility, geopolitical, pandemic or other such events and responses to those acts/events may create economic and political uncertainties, which could have a material adverse effect on UK and international macroeconomic conditions generally, and more specifically on the Group's results of operations, financial condition or prospects in ways that cannot necessarily be predicted.
– Systems and procedures in place to comply with increasingly complex and detailed anti-money laundering and anti-terrorism laws and regulations may not always be fully effective in preventing third parties from using the Group as a conduit for money laundering. Should the Group be associated with money laundering, its reputation could suffer and/or it could become subject to fines, sanctions and legal enforcement; any one of which could have a material adverse effect on operating results, financial condition and prospects.

Measurement

Operational risk is managed within a Board approved framework and risk appetite, as set out above. A variety of measures are used such as: scoring of potential risks, using impact and likelihood, with impact thresholds aligned to the risk appetite statements above; assessment of the effectiveness of controls; monitoring of events and losses by size, business unit and internal risk categories.

In 2013, the highest frequency of events occurred in external fraud (61.96 per cent) and execution, delivery and process management (24.58 per cent). Clients, products and business practices accounted for 39.66 per cent of losses. Execution, delivery and process management accounted for 38.64 per cent of losses. Losses in both categories are driven by legacy issues (excluding PPI).

The table overleaf shows high level loss and event trends using Basel II categories.

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Table 1.31: **Operational risk events by risk category**

	% of total volume		% of total losses	
	2013	2012	**2013**	2012
Business disruption and system failures	**0.92**	1.08	**0.86**	1.46
Clients, products and business practices	**11.02**	15.27	**39.66**	58.65
Damage to physical assets	**0.81**	0.32	**0.45**	0.24
Employee practices and workplace safety	**0.61**	0.14	**0.36**	0.10
Execution, delivery and process management	**24.58**	24.90	**38.64**	27.19
External fraud	**61.96**	58.02	**20.01**	11.99
Internal fraud	**0.10**	0.27	**0.02**	0.37
Total	**100.00**	100.00	**100.00**	100.00

Operational risk exposure and actual losses are used by the Group to calculate the appropriate holding of operational risk regulatory capital under the Internal Capital Adequacy Assessment Process (ICAAP). The Group calculates its operational risk capital requirements using the Standardised Approach (TSA), which the Basel Committee states as being appropriate for an 'internationally active' bank.

Mitigation

The Group's control environment receives regular review and investment, with reporting on the material risks discussed monthly by senior management. Risks are managed via a range of strategies – avoidance, mitigation, transfer (including insurance), and acceptance, and contingency plans maintained for a range of potential scenarios with a regime of regular disaster recovery exercises, both Group specific and industry wide. Mitigating actions for the principal risks above include:

- The Group completed a strategic review in 2013, focused on IT resilience (the ability of IT systems to resist and/or recover from failure). Actions from the review include implementation of a new Group-wide risk appetite for IT service and availability based on the processes most time-critical to its customers, or to manage the Group. Strategic enhancements and investment are in plan over the next three years to reflect enhanced demands on IT both in terms of customer and regulator expectations.
- The Group has, and will continue to, invest in enhanced protection of customer information, including access to key systems and the security, durability and accessibility of critical records.
- The Group adopts a risk based approach to mitigate the external fraud risks it faces, reflecting the current and emerging external fraud risks within the market. This approach drives an annual programme of enhancements to the Group's technology, process and people related controls, with an emphasis on preventative controls supported by real time detective controls wherever feasible. Through Group-wide policies and operational control frameworks, the Group has developed a robust fraud operating model with centralised accountability. The Group's fraud awareness programme is a key component of its fraud control environment.
- Significant investment has been made in increasing the Group's cyber defence, for example through the IT Security Improvement Programme, to protect customers and the Group's infrastructure.
- The Group continues to place appropriate and significant focus on improving customer processing by remediating known issues and addressing root cause through its rectification programmes, and seeking to improve the overall servicing environment in key areas through the Simplification programme. In addition, incident management capability has been revised and enhanced to increase speed of response to customer impacting incidents.
- The level and impact of change involved in the sale of TSB is managed via robust change management governance and a consolidated strategic change plan. There are separate governance arrangements in place to oversee the impacts of the divestment on the retained business customers, operations and controls.
- Operational resilience measures and recovery planning defined in the Group's Business Continuity Management policy ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats including environmental and climatic issues, terrorism, economic instability, pandemic planning and operational incidents.
- The Group has adopted policies and procedures to detect and prevent the use of its banking network for money laundering and related activities, and it regularly reviews and assesses these to keep them current and effective. These activities include 'know-your-customer' requirements, training and awareness, transaction monitoring technologies and reporting of suspicions of money laundering to the applicable regulatory authorities.

Monitoring

Monitoring and reporting is undertaken at Board, Group and business area committees, in accordance with delegated limits of authority which are regularly reviewed and refreshed. Business unit risk exposure is aggregated and discussed at the monthly Group Operational Risk Committee, and matters are escalated to the Chief Risk Officer, or higher committees, if appropriate. A combination of systems, monthly reports from business areas, and oversight and challenge from the Risk Division; audit; and assurance teams ensures that key risks are regularly presented and debated by an Executive audience.

The Group maintains a formal approach to operational risk event escalation, whereby material events are identified, captured and escalated. Root causes of events are determined and action plans put in place to ensure an optimum level of control to keep customers and the business safe, reduce costs, and improve efficiency.

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.

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Funding and liquidity risk

Definition

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. 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.

Risk appetite

Funding and liquidity risk appetite for the banking business is set, reviewed and approved annually by the Board with the support of the Group Asset and Liability Committee (GALCO). Funding and liquidity risk is managed separately for the banking and Insurance businesses. Risk is reported against appetite through various metrics that enable the Group to manage liquidity and funding constraints. The Group Chief Executive, assisted by GALCO, regularly reviews performance against risk appetite.

Exposure

Liquidity exposure represents the amount of potential stressed outflows in any future period less expected inflows. Liquidity is considered from both an internal and a 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, wholesale funding maturity profile, early warning indicators and stress test survival period triggers. The Board approved liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position, with regular reporting to GALCO and the Board. 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 on page 327 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. Divisional teams form a view of customer behaviour based on quantitative and qualitative analysis and these assumptions are subject to governance via divisional asset and liability committees. This also forms the foundation of the Group's Liquidity Transfer Pricing (LTP) and the liquidity risk stress testing framework on which the Group's liquidity controls are based.

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 short-term liquidity management and through the life of the funding plan. 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. The Group manages its risk appetite and liquidity position as a coverage ratio (proportion of stressed outflows covered by primary liquid assets) rather than by reference to a quantum of liquid assets; this corresponds with the PRA and CRD IV liquidity requirements. 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 customer deposit base, and is supported by strong relationships with corporate customers and certain wholesale market segments to supplement its retail deposit base. A substantial proportion of the retail deposit base is made up of customers' current and savings accounts which, although mostly repayable on demand, have traditionally in aggregate provided a stable source of funding. Additionally, the Group accesses the short-term wholesale markets to raise interbank deposits and to issue certificates of deposit and commercial paper to meet short-term obligations. Funding concentration by counterparty is not considered significant for the Group. Where concentrations do exist (for example, maturity profile); these are limited by the internal risk appetite and considered manageable.

To assist in managing the balance sheet the Group operates a LTP Policy which:

– Allocates relevant interest expenses from GCT to the Group's banking businesses within the internal management accounts in a manner consistent with the Group Funding and Liquidity Policy;
– Helps drive the correct inputs to customer pricing and supports the overall Group balance sheet strategy; and
– Is consistent with regulatory requirements.

Relevant interest expenses allocated via LTP include term funding spreads incurred over a three month LIBOR benchmark and the cost of funding and holding liquid asset reserves. LTP makes extensive use of behavioural maturity profiles, taking account of expected customer loan prepayments and stability of customer deposits. Such behavioural maturity assumptions are subject to formal governance, reviewed at least annually, and founded on analysis and evidence of actual customer behaviour using historical data gathered over several years.

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. In addition to central bank reserves, the Group holds sizeable balances of high grade marketable debt securities as set out in table 1.34 which can be sold to provide, or used to secure, additional cash inflows should the need arise from either market counterparties or central bank facilities (Bank of England, European Central Bank and Federal Reserve).

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Liquidity risk within the Insurance business may result from the inability to sell financial assets quickly at their fair values; or from an insurance liability falling due for payment earlier than expected; or from the inability to generate cash inflows as anticipated. The shareholder (Lloyds Banking Group) is exposed to liquidity risk through the shareholder business. This is predominantly the annuity portfolio, where the aim is to invest in assets such that the cash flows on investments will match those on the projected future liabilities. Unit-linked and with-profits funds are normally expected to meet their own liquidity obligations. The shareholder's exposure to liquidity risk is actively managed and monitored within Insurance to ensure that, even under stress conditions, Insurance has sufficient liquidity as required to meet its obligations and remains within approved risk appetite. In addition, liquidity risk is controlled via approved funding and liquidity policies.

Monitoring

Liquidity is actively monitored at Group level. Routine reporting is in place to senior management and through the Group's committee structure, in particular GALCO which meets 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 internal oversight.

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group. These are a mixture of quantitative and qualitative measures including daily variation of customer balances, changes in maturity profiles, cash outflows, funding concentration, changes in primary liquidity portfolio, credit default swap (CDS) spreads and changing funding costs.

In addition, the monitoring framework has two other important components:

– Firstly, the Group carries out stress testing of its liquidity and potential cash flow mismatch position over both short (up to two weeks) and longer term (up to three months) horizons against a range of scenarios, including those prescribed by the PRA, (the idiosyncratic, market wide and combined stresses) and the Group's own scenarios reflecting possible future liquidity risks. The Group's scenarios cover US market disruption, market counterparty failure, UK sovereign rating downgrade and a Eurozone stress. The key risk driver assumptions applied to the scenarios are:

Liquidity risk driver	Market wide and Group specific stresses
Wholesale funding	Outflows calculated based on contractual maturity of wholesale funding with limited roll over
Marketable asset	Haircut widening and repos assumed not to roll on contractual maturity
Retail and commercial funding	Substantial outflows on customer deposit base
Intra-day liquidity	Liquidity required for clearing and payment systems under stressed conditions
Intra group liquidity	Requirements from the stressed position of subsidiaries
Off balance sheet	Stressed cash outflows from commitments granted. Specifically, commitments granted include the pipeline of new business awaiting completion as well as other standby or revolving credit facilities
Downgrade	Contractual outflows resulting from short and long-term rating downgrades
Franchise viability	Actions that need to be taken to maintain the Group's core business franchise and reputation

The scenarios and the assumptions are reviewed at least annually to gain assurance that they continue to be relevant to the nature of the business. The Group's liquidity risk appetite is calibrated against a number of stressed liquidity metrics. Liquidity stress tests are applied to the Group's funding plan to project possible future stressed positions. The funding plan is also stressed against a range of macroeconomic scenarios, including those prescribed by the PRA under the Pillar II 'anchor' scenario. The Group also applies its own macroeconomic stress scenarios, including a one in 20 year recession.

– Secondly, the Group maintains a Contingency Funding Plan which is designed to identify emerging liquidity concerns at an early stage, so that mitigating actions can be taken to avoid a more serious crisis developing. Contingency Funding Plan invocation and escalation processes are based on analysis of five major quantitative and qualitative components, comprising assessment of: early warning indicators, prudential and regulatory liquidity risk limits and triggers, stress testing results, event and systemic indicators and market intelligence.

For further information on the Group's 2013 stress testing results refer to page 177.

The planned introduction of the Liquidity Coverage Ratio (LCR – minimum requirement will begin at 60 per cent in January 2015 rising in equal annual steps of 10 per cent to reach 100 per cent in January 2019) and the Net Stable Funding Ratio (NSFR – 100 per cent minimum requirement in January 2018) contained within CRD IV are intended to raise the resilience of banks to potential liquidity shocks and provide the basis for a harmonised approach to liquidity risk management. The Group has invested considerable resource to ensure that it satisfies the governance, reporting and stress testing requirements of the PRA's Individual Liquidity Adequacy Standards liquidity regime and will satisfy the LCR and NSFR requirements. The Group's LCR and NSFR position is monitored and forecast. The Group notes the recommendation of the Financial Policy Committee on 18 June 2013 that, for UK banks, the minimum LCR requirement should be set at 80 per cent until 1 January 2015, rising thereafter to reach an LCR requirement of 100 per cent on 1 January 2018.

During the year, the individual entities within the Group, and the Group, complied with all of the external regulatory liquidity and funding requirements to which they are subject and expects to meet all future liquidity regulatory requirements as implemented by the PRA.

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Funding and liquidity management in 2013

The transformation of the Group funding position has been substantially completed. The continued run down of the non-core asset portfolios and the growth in customer deposits has strengthened the Group's funding position and reduced exposure to wholesale funding. The Group is now in a position where the core loan book is fully funded by core deposits (core loan to deposit ratio 100 per cent). This strong funding position has enabled the Group to undertake a number of funding related actions during the course of the year. In May 2013 the Group repaid in full the remaining €3.5 billion of outstanding Long Term Refinancing Operation (LTRO) funding from the European Central Bank having earlier repaid €10 billion in February 2013. In addition to this, during 2013, the Group repaid other term funding totalling £12.6 billion early.

In 2009 the Group entered into a number of EU State aid related obligations, one of which was reductions in certain parts of its balance sheet by the end of 2014. The Group achieved the asset reduction commitment ahead of the mandated completion date and has received formal confirmation that it has been released from this commitment from the European Commission.

Market conditions continued to improve during 2013 along with investor confidence in the UK economy. The Group has experienced reduced term issuance costs and spreads on outstanding issuance have remained significantly narrower than previous years. As well as improved market conditions, rating changes for the Group were positive. A report from Standard & Poor's published on 3 December 2013 affirmed the Lloyds Bank 'A/A-1' long/short-term rating and revised upwards the stand alone rating from 'bbb' to 'bbb+'. The ratings action was reflective of, in the opinion of Standard & Poor's, a strengthened capital position and stronger prospects for Lloyds Bank's statutory earnings.

The combination of a strong balance sheet and access to a wide range of funding markets, including government schemes, provides the Group with a broad range of options with respect to funding the balance sheet in the future.

Group funding sources

Total funded assets reduced by £28.5 billion to £510.2 billion. This reduction enabled the Group to make changes in wholesale funding which reduced by £32.0 billion to £137.6 billion, with the volume with a residual maturity less than one year reducing to £44.2 billion (£50.6 billion at 31 December 2012). The Group's term funding ratio (wholesale funding with a remaining life of over one year as a percentage of total wholesale funding) reduced to 68 per cent (70 per cent at 31 December 2012) as expected in line with maturities of wholesale term funding and limited term wholesale issuance in 2013.

The Group core loan to deposit ratio improved to 100 per cent from 101 per cent at 31 December 2012. The Group loan to deposit ratio has improved to 113 per cent compared with 121 per cent at 31 December 2012, driven by strong deposit growth and non-core asset reduction. Excluding reverse repos and repos, loans and advances to customers reduced by £16.9 billion, customer deposits increased by £15.8 billion, and there was a continued reduction in non-core assets (31 December 2013: £63.5 billion; 31 December 2012: £98.4 billion).

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Table 1.32: **Group funding position (audited)**

	2013 £bn	2012[1] £bn	Change %
Funding requirement			
Loans and advances to customers[2]	**495.2**	512.1	(3)
Loans and advances to banks[3]	**5.1**	12.5	(59)
Debt securities	**1.4**	5.3	(74)
Reverse repurchase agreements	**0.2**	–	
Available-for-sale financial assets – secondary[4]	**4.4**	5.3	(17)
Cash balances[5]	**3.9**	3.5	11
Funded assets	**510.2**	538.7	(5)
Other assets[6]	**248.6**	302.2	(18)
	758.8	840.9	(10)
On balance sheet primary liquidity assets[7]			
Reverse repurchase agreements	**0.1**	5.8	(98)
Balances at central banks – primary[5]	**46.0**	76.8	(40)
Available-for-sale financial assets – primary	**39.6**	26.1	52
Trading and fair value through profit and loss	**3.1**	(9.4)	
Repurchase agreements	**(0.6)**	(5.9)	(90)
	88.2	93.4	(6)
Total Group assets	**847.0**	934.3	(9)
Less: Other liabilities[6]	**(227.5)**	(277.8)	(18)
Funding requirement	**619.5**	656.5	(6)
Funded by			
Customer deposits[8]	**438.3**	422.5	4
Wholesale funding[9]	**137.6**	169.6	(19)
	575.9	592.1	(3)
Repurchase agreements	**4.3**	21.8	(80)
Total equity	**39.3**	42.6	(8)
Total funding	**619.5**	656.5	(6)

[1] Restated to reflect the implementation of IAS 19R and IFRS 10. See note 56, page 353.

[2] Excludes £0.1 billion (31 December 2012: £5.1 billion) of reverse repurchase agreements.

[3] Excludes £20.1 billion (31 December 2012: £19.6 billion) of loans and advances to banks within the Insurance business and £0.2 billion (31 December 2012: £0.7 billion) of reverse repurchase agreements.

[4] Secondary liquidity assets comprise a diversified pool of highly rated unencumbered collateral (including retained issuance).

[5] Cash balances and balances at central banks – primary are combined in the Group's balance sheet.

[6] Other assets and other liabilities primarily include balances in the Group's Insurance business and the fair value of derivative assets and liabilities.

[7] Primary liquidity assets are PRA eligible liquid assets including UK Gilts, US Treasuries, Euro AAA government debt and unencumbered cash balances held at central banks.

[8] Excluding repurchase agreements of £3.0 billion (31 December 2012: £4.4 billion).

[9] The Group's definition of wholesale funding aligns with that used by other international market participants; including interbank deposits, debt securities in issue and subordinated liabilities.

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Table 1.33: **Reconciliation of Group funding figure to the balance sheet (audited)**

	Included in funding analysis (above) £bn	Repos £bn	Fair value and other accounting methods £bn	Balance sheet £bn
At 31 December 2013				
Deposits from banks	12.1	1.9	–	14.0
Debt securities in issue	91.6	–	(4.5)	87.1
Subordinated liabilities	33.9	–	(1.6)	32.3
Total wholesale funding	137.6	1.9		
Customer deposits	438.3	3.0	–	441.3
Total	575.9	4.9		
At 31 December 2012[1]				
Deposits from banks	15.1	23.3	–	38.4
Debt securities in issue	120.4	–	(3.1)	117.3
Subordinated liabilities	34.1	–	–	34.1
Total wholesale funding	169.6	23.3		
Customer deposits	422.5	4.4	–	426.9
Total	592.1	27.7		

[1] Restated to reflect the implementation of IAS 19R and IFRS 10. See note 56, page 353.

Total wholesale funding by type and expected residual maturity is detailed below.

Table 1.34: **Analysis of 2013 total wholesale funding by residual maturity (audited)**

	Less than one month £bn	One to three months £bn	Three to six months £bn	Six to nine months £bn	Nine months to one year £bn	One to two years £bn	Two to five years £bn	More than five years £bn	Total at 31 Dec 2013 £bn	Total at 31 Dec 2012 £bn
Deposits from banks	9.5	0.6	0.3	–	0.7	0.3	0.2	0.5	12.1	15.1
Debt securities in issue:										
Certificates of deposit	1.0	3.4	2.4	1.3	0.9	–	–	–	9.0	10.7
Commercial paper	2.3	2.0	0.4	–	0.1	–	–	–	4.8	7.9
Medium-term notes[1]	0.8	0.4	1.8	0.1	2.2	5.7	9.5	8.6	29.1	34.6
Covered bonds	0.9	–	0.7	–	3.0	3.3	8.8	12.7	29.4	38.7
Securitisation	2.8	–	0.9	–	3.3	7.7	4.6	–	19.3	28.5
	7.8	5.8	6.2	1.4	9.5	16.7	22.9	21.3	91.6	120.4
Subordinated liabilities	0.3	0.3	0.6	0.6	0.6	3.3	5.9	22.3	33.9	34.1
Total wholesale funding[2]	17.6	6.7	7.1	2.0	10.8	20.3	29.0	44.1	137.6	169.6

[1] Medium-term notes include funding from the National Guarantee Scheme (31 December 2013: £1.4 billion; 31 December 2012: £1.4 billion).

[2] The Group's definition of wholesale funding aligns with that used by other international market participants; including interbank deposits, debt securities in issue and subordinated liabilities.

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Table 1.35: **Total wholesale funding by currency (audited)**

	Sterling £bn	US dollar £bn	Euro £bn	Other currencies £bn	Total £bn
At 31 December 2013	**44.4**	**36.1**	**48.7**	**8.4**	**137.6**
At 31 December 2012	54.3	41.6	60.2	13.5	169.6

Table 1.36: **Analysis of 2013 term issuance (audited)**

	Sterling £bn	US dollar £bn	Euro £bn	Other currencies £bn	Total £bn
Securitisation	–	0.5	–	–	0.5
Medium-term notes	–	0.6	1.3	–	1.9
Private placements[1]	0.1	0.4	1.3	0.1	1.9
Total issuance	**0.1**	**1.5**	**2.6**	**0.1**	**4.3**

[1] Private placements include structured bonds and term repurchase agreements (repos).

Term issuance for 2013 totalled £4.3 billion with the majority across medium-term notes and private placements. Utilisation of the UK government's Funding for Lending Scheme (FLS) has further underlined the Group's support to the UK economic recovery, and the Group remains committed to passing the benefits of this low cost funding on to its customers. The Group drew down £3.0 billion in 2012 and £5.0 billion in 2013 under the FLS scheme. A further £2.2 billion was drawn in January 2014, which under FLS rules, counts as funding from the 2013 scheme capacity.

Encumbered assets

The Board monitors and manages total balance sheet encumbrance via a risk appetite metric. During 2013 the Group had term issuance of £0.5 billion from securitisations and no issuance from covered bonds. Maturities have led to a reduction in externally held notes from residential mortgage backed securitisation and covered bond issuance. The table below summarises the assets encumbered through the Group's external issuance transactions.

Table 1.37: **Secured external issuance transactions**

	Notes issued £bn	Assets encumbered[3] £bn
At 31 December 2013		
Securitisations[1]	**18.6**	**31.6**
Covered bonds[2]	**30.7**	**49.6**
Total	**49.3**	**81.2**
At 31 December 2012		
Securitisations[1]	28.0	46.3
Covered bonds[2]	40.7	56.9
Total	68.7	103.2

[1] In addition the Group retained internally £38.3 billion (31 December 2012: £58.7 billion) of notes secured with £49.3 billion (31 December 2012: £71.9 billion) of assets.

[2] In addition the Group retained internally £7.6 billion (31 December 2012: £26.3 billion) of notes secured with £12.5 billion (31 December 2012: £37.5 billion) of assets.

[3] Pro-rated by programme (31 December 2012 number restated on this basis).

Total notes issued externally from secured programmes (asset backed securities and covered bonds) have fallen from £68.7 billion (assets encumbered £103.2 billion, pro-rated by programme) at 31 December 2012 to £49.3 billion (assets encumbered £81.2 billion, pro-rated by programme). A total of £45.9 billion (31 December 2012: £85.0 billion) of notes issued under securitisation and covered bond programmes have also been retained internally, most of which are held to provide a pool of collateral eligible for use at central bank liquidity facilities. This reduction in retained notes partially reflects the Group's increased use of whole loans as eligible collateral at central banks.

The Group uses secured transactions to manage short-term cash and collateral needs. Further details on repo and collateral pledges are available in note 54: Financial risk management. Internally held notes, encumbered through repo activity or assets pledged, are included in these disclosure amounts. Details on the assets within asset-backed commercial paper (ABCP) conduits are available in note 22: Structured entities.

Liquidity portfolio

At 31 December 2013, the Group had £89.3 billion (2012: £87.6 billion) of highly liquid unencumbered assets in its primary liquidity portfolio which are available to meet cash and collateral outflows and PRA regulatory requirements, as illustrated in the table overleaf. In addition the Group had £105.4 billion (2012: £117.1 billion) of secondary liquidity which is eligible for use in a range of central bank or similar facilities. This liquidity is managed as a single pool in the centre and is under the control of the function charged with managing the liquidity of the Group. It is available for deployment at immediate notice, subject to complying with regulatory requirements, and is a key component of the Group's liquidity management process.

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Table 1.38: **Liquidity portfolio**

Primary liquidity	2013 £bn	2012 £bn	Average 2013 £bn	Average 2012 £bn
Central bank cash deposits	**46.0**	76.8	**69.4**	78.3
Government bonds	**43.3**	10.8	**28.2**	21.1
Total	**89.3**	87.6	**97.6**	99.4

Secondary liquidity	2013 £bn	2012 £bn	Average 2013 £bn	Average 2012 £bn
High-quality ABS/covered bonds[1]	**1.4**	2.8	**2.0**	2.1
Credit institution bonds[1]	**0.4**	3.4	**1.2**	2.8
Corporate bonds[1]	**0.1**	0.1	**0.1**	0.1
Own securities (retained issuance)	**22.1**	44.9	**33.3**	50.2
Other securities	**4.3**	5.0	**4.8**	8.3
Other[2]	**77.1**	60.9	**75.2**	49.8
Total	**105.4**	117.1	**116.6**	113.3
Total liquidity	**194.7**	204.7		

[1] Assets rated A- or above.

[2] Includes other central bank eligible assets.

Table 1.39: **Liquidity portfolio: currency**

	Sterling £bn	US Dollar £bn	Euro £bn	Other currencies £bn	Total £bn
At 31 December 2013					
Primary liquidity	**65.3**	**13.3**	**10.5**	**0.2**	**89.3**
Secondary liquidity	**100.4**	**0.8**	**4.0**	**0.2**	**105.4**
Total	**165.7**	**14.1**	**14.5**	**0.4**	**194.7**
At 31 December 2012					
Primary liquidity	42.2	7.2	36.5	1.7	87.6
Secondary liquidity	109.2	1.6	4.7	1.6	117.1
Total	151.4	8.8	41.2	3.3	204.7

Primary liquid assets of £89.3 billion represent approximately 4.2 times (3.5 times at 31 December 2012) the Group's money market funding less than one year maturity (excluding derivative collateral margins and settlement accounts) and are approximately 2.0 times (1.7 times at 31 December 2012) all wholesale funding less than one year maturity, and thus provides a substantial buffer in the event of continued market dislocation.

In addition to primary liquidity holdings the Group has significant secondary liquidity holdings providing access to liquidity facilities at a number of central banks which the Group routinely makes use of as part of its normal liquidity management practices. Future use of such facilities will be based on prudent liquidity management and economic considerations, having regard for external market conditions. The Group considers diversification across geography, currency, markets and tenor when assessing appropriate holdings of primary and secondary liquid assets and expects to see some transition from primary to secondary assets over the course of 2014.

The Group notes that the Liquidity Coverage Ratio (LCR) will become the Pillar I standard for liquidity in the UK in 2015, and that the PRA has the ability to impose firm specific liquidity requirements. The European Commission is to adopt further legislation by 30 June 2014 to specify the definition, calibration, calculation and phase-in of the LCR for implementation in 2015. The Group expects to meet the new requirements ahead of the implementation dates.

Stress testing results

Internal stress testing results at 31 December 2013 show that the Group has liquidity resources representing 130.9 per cent of modelled outflows from all wholesale funding sources, retail and corporate deposits, intra-day requirements and rating dependent contracts under the Group's most severe liquidity stress scenario (the three month PRA combined scenario).

The Group's stress testing assumes that further credit rating downgrades may reduce investor appetite for some of the Group's liability classes and therefore funding capacity. A hypothetical idiosyncratic two notch downgrade of the Group's current long-term debt rating and accompanying short-term downgrade implemented instantaneously by all major rating agencies, could result in an outflow of £6.6 billion of cash over a period of up to one year, £3.0 billion of collateral posting related to customer financial contracts and £11.8 billion of collateral posting associated with secured funding. The Group's internal liquidity risk appetite includes such a stress scenario. The stress scenario modelling demonstrates the Group has available liquidity resources to manage such an event.

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Capital risk

Definition

Capital risk is defined as the risk that the Group has a sub-optimal amount or quality of capital or that capital is inefficiently deployed across the Group.

Risk appetite

Capital risk appetite is set by the Board, reflecting the Group's strategic plans, regulatory capital constraints and market expectations. It includes a number of minimum capital ratios in normal and stressed conditions as well as a specific measure for the Insurance business, set by the Insurance Board, taking account of the need to maintain regulatory solvency including appropriate management buffers. The Board and the Group Chief Executive, assisted by the Group Asset and Liability Committee and the Group Risk Committee, regularly review performance against the risk appetite. A key metric is the Group's common equity tier 1 (CET1) capital ratio which the Group currently aims to maintain in excess of 10 per cent.

Exposure

A capital exposure arises where the Group has insufficient 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 maintaining sufficient capital resources to prevent such exposures while optimising value for shareholders.

Measurement

The Group measures the amount of capital it holds using the regulatory framework. From 1 January 2014 this included the new Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the Prudential Regulatory Authority (PRA) policy statement PS7/13. Prior to this date, and for the purposes of determining the Group's capital resources and requirements at 31 December 2013, these have been based upon the modified Basel II framework as implemented by the PRA.

The regulatory minimum amounts of capital, under Pillar I of the Basel framework, are determined as percentages of the aggregate risk-weighted assets calculated in respect of credit risk, counterparty credit risk, operational risk and market risk (Trading Book), which are predominantly calculated using internal models that are prudently calibrated based on internal loss experience. The models are subject to a number of internal controls and external scrutiny from the PRA.

The minimum requirement for total capital is supplemented, under Pillar II of the regulatory framework, through the issuance of bank specific Individual Capital Guidance (ICG) which adjusts the Pillar I minimum for those risks not covered or not fully covered under Pillar I. A key input into the PRA's ICG setting process is a bank's own assessment of the amount of capital it needs, a process known as the Internal Capital Adequacy Assessment Process. The Group has been set specific ICG by the PRA and maintains capital at a level which exceeds this requirement. From 1 January 2015, at least 56 per cent of the ICG must be covered by CET1 capital and at least 75 per cent must be covered by tier 1 capital.

As part of the capital planning process, capital positions are subjected to extensive stress analysis to determine the adequacy of the Group's capital resources against the minimum requirements, including ICG, over the forecast period. The outputs from some of these stress analyses are used by the PRA to set a Capital Planning Buffer (CPB) for the Group. This comprises a minimum level of capital buffers over and above the minimum regulatory requirements that should be maintained in non-stressed conditions as mitigation against potential future periods of stress.

The PRA requires the ICG and the CPB to remain confidential between the Group and the PRA.

Mitigation

The Group has a capital management framework including policies and procedures that are designed to ensure that it operates within its risk appetite, continues to comply with regulatory requirements and is positioned to meet anticipated future changes to its capital requirements.

The Group is able to accumulate additional capital through profit retention, by raising equity via, for example, a rights issue or debt exchange and by raising tier 1 and tier 2 capital by issuing subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demand for capital through management actions including adjusting its lending strategy, risk hedging strategies and through business disposals. If necessary, this can include limiting new business.

Additional measures to manage the Group's capital position include seeking to strike an appropriate balance of capital held within its insurance and banking subsidiaries and through improving the quality of its capital through liability management exercises.

Monitoring

Capital is actively managed and regulatory ratios are a key factor in the Group's planning processes and stress analyses. Five year forecasts of the Group's capital position, based upon the Group's operating plan, are produced at least annually to inform the Group's capital strategy whilst shorter term forecasts are more frequently undertaken to understand and respond to variations of the Group's actual performance against the plan. The capital plans are tested for capital adequacy using a range of stress scenarios covering adverse economic conditions as well as other adverse factors that could impact the Group and the Group maintains a Recovery Plan which sets out a range of potential mitigating actions that could be taken in response to a stress.

Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios, including those in stressed scenarios, is undertaken, including submissions to the Group Asset and Liability Committee, the Group Risk Committee, Board Risk Committee and the Board.

The regulatory framework within which the Group operates continues to be enhanced as part of the global banking reforms.

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Over the course of 2013 there have been significant regulatory developments in the area of capital and the related management. The principal changes relate to the finalisation of CRD IV and subsequent consultation and finalisation of PRA requirements for their implementation in the UK and the 2013 announcement that major UK banks are expected to meet specific targets on an adjusted basis for CET1 and leverage ratios. The Group notes the final statements from the PRA on the implementation of capital requirements in the UK and will continue to work with the regulator to ensure that the Group continues to meet the regulator's capital expectations. The Group continuously evaluates the efficiency of its capital structure, management of which may result in significant one-off charges or gains, and its capital structure's alignment with the regulatory framework. With the adoption of CRD IV, the Group is considering opportunities to raise new Additional tier 1 securities which would rank senior to ordinary shares, and be automatically convertible into ordinary shares if the Group's common equity tier 1 ratio fell below a specified trigger point.

Beyond CRD IV there have been a number of draft technical standards issued for consultation which relate to both capital and leverage and both Basel and European regulatory bodies continue to develop their thinking on both capital resources and capital requirement measures. Within the UK the PRA have been active in requiring enhanced capital standards and encouraging further disclosure developments and HM Treasury have been consulting on practical aspects of the application of a counter cyclical buffer.

The Group monitors these developments very closely, participating actively in the regulatory consultation processes and analysing the potential financial impacts to ensure that the Group continues to have a strong loss absorption capacity that exceeds the regulatory requirements and the Group's risk appetite and is consistent with market expectations.

Capital management in 2013

The Group made significant progress in further strengthening its capital position in 2013 through its strongly capital generative strategy, including capital-efficient profit generation in the core business, the release of capital through non-core asset disposals and the successful delivery of management actions.

- Core tier 1 ratio, based on the capital regulations as at 31 December 2013, increased 2.0 percentage points from 12.0 per cent to 14.0 per cent.
- Pro forma fully loaded CET1 ratio under the CRD IV rules increased 2.2 percentage points from 8.1 per cent to 10.3 per cent whilst the ratio excluding pro forma impacts increased to 10.0 per cent.
- Pro forma fully loaded CRD IV leverage ratio including tier 1 instruments was 4.1 per cent and was 3.4 per cent when including only CET1 capital resources. Excluding the pro forma impacts, the fully loaded ratio including tier 1 instruments was 4.0 per cent and 3.4 per cent when including only CET1 capital resources.
- Under the January 2014 revised Basel III leverage ratio framework, the Group's fully loaded leverage ratio is estimated to improve significantly to 4.5 per cent on a pro forma basis including tier 1 instruments, and 3.8 per cent including only CET1 capital resources.

Capital position at 31 December 2013

The Group's capital position applying prevailing rules as at 31 December 2013 is set out in the following section. Additionally, information about the Group's capital position on a CRD IV basis is set out on page 183.

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Table 1.40: **Capital resources (audited)**

Capital resources	2013 £m	2012[2] £m
Core tier 1		
Shareholders' equity per balance sheet	**38,989**	43,999
Non-controlling interests per balance sheet	**347**	685
Regulatory adjustments:		
Regulatory adjustments to non-controlling interests	**(315)**	(628)
Adjustment for own credit	**185**	217
Defined benefit pension adjustment	**(78)**	(1,438)
Unrealised reserve on available-for-sale debt securities	**750**	(343)
Unrealised reserve on available-for-sale equity investments	**(135)**	(56)
Cash flow hedging reserve	**1,055**	(350)
Other items	**452**	33
	41,250	42,119
Less: deductions from core tier 1		
Goodwill	**(2,016)**	(2,016)
Intangible assets	**(1,799)**	(2,091)
50 per cent excess of expected losses over impairment provisions	**(373)**	(636)
50 per cent of securitisation positions	**(71)**	(183)
Core tier 1 capital	**36,991**	37,193
Non-controlling preference shares[1]	**1,060**	1,568
Preferred securities[1]	**3,982**	4,039
Less: deductions from tier 1		
50 per cent of material holdings	**(3,859)**	(46)
Total tier 1 capital	**38,174**	42,754
Tier 2		
Undated subordinated debt	**1,825**	1,828
Dated subordinated debt	**18,567**	19,886
Unrealised gains on available-for-sale equity investments provisions	**135**	56
Eligible provisions	**359**	977
Less: deductions from tier 2		
50 per cent excess of expected losses over impairment provisions	**(373)**	(636)
50 per cent of securitisation positions	**(71)**	(183)
50 per cent of material holdings	**(3,859)**	(46)
Total tier 2 capital	**16,583**	21,882
Supervisory deductions		
Unconsolidated investments – life	**–**	(10,104)
– general insurance and other	**–**	(929)
Total supervisory deductions	**–**	(11,033)
Total capital resources	**54,757**	53,603

[1] Covered by existing grandfathering provisions.

[2] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

Table 1.41: **Risk-weighted assets and capital ratios**

	2013 £m	2012[1] £m
Risk-weighted assets	**263,850**	310,299
Core tier 1 capital ratio	**14.0%**	12.0%
Tier 1 capital ratio	**14.5%**	13.8%
Total capital ratio	**20.8%**	17.3%

[1] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

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The movements in core tier 1, tier 1, tier 2 and total capital in the period are shown below:

Table 1.42: **Movements in capital**

	Core tier 1 £m	Tier 1 £m	Tier 2 £m	Supervisory deductions £m	Total capital £m
At 31 December 2012[1]	37,193	5,561	21,882	(11,033)	53,603
Loss attributable to ordinary shareholders	(838)	–	–	–	(838)
Share issuance	510	–	–	–	510
Pension movements:					
Implementation of IAS 19R[2]	(1,258)	–	–	–	(1,258)
Deduction of pension asset	515	–	–	–	515
Movement through other comprehensive income	(108)	–	–	–	(108)
Goodwill and intangible assets deductions	292	–	–	–	292
Excess of expected losses over impairment provisions	263	–	263	–	526
Change in treatment of material holdings	–	(5,517)	(5,516)	11,033	–
Material holdings deduction	–	1,704	1,703	–	3,407
Eligible provisions	–	–	(618)	–	(618)
Subordinated debt movements:					
Foreign exchange	–	40	98	–	138
New issuances	–	–	–	–	–
Repurchases, redemptions, amortisation and other	–	(605)	(1,420)	–	(2,025)
Other movements	422	–	191	–	613
At 31 December 2013	**36,991**	**1,183**	**16,583**	**–**	**54,757**

[1] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

[2] Includes the impact to other comprehensive income and movement in the retirement benefit asset.

Core tier 1 capital resources have decreased by £202 million in the period largely driven by movements relating to defined benefit pension schemes and attributable loss, partially offset by share issuances and reductions in excess expected losses and intangible assets. The movements relating to pension schemes primarily reflect the impact of the adoption of amendments to IAS 19, whereby valuation impacts relating to Group defined benefit schemes flow through other comprehensive income, partially offset by a reduction in the regulatory deduction of the defined benefit pension scheme asset.

Tier 1 and tier 2 capital resources have reduced primarily due to the reallocation of unconsolidated investments in Life and General Insurance businesses, which were previously deducted as supervisory deductions from total capital, to become deductions from tier 1 capital (50 per cent of the total) and tier 2 capital (also 50 per cent).

The material holdings deduction from capital, predominantly relating to the Group's investment in its Insurance businesses, has reduced by £3,407 million during the period reflecting payment by the Insurance businesses to the banking group of dividends totalling £2,155 million, elements of the Group's subordinated debt holdings in the Insurance business that have been repaid following the issuance of external subordinated debt in the period and the disposal of the Group's holding in St. James's Place.

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Table 1.43: **Risk-weighted assets**

Risk-weighted assets	2013 £m	2012 £m
Divisional analysis of risk-weighted assets:		
Retail	**85,677**	95,470
Commercial Banking	**138,541**	165,209
Wealth, Asset Finance and International	**25,886**	36,167
Group Operations and Central items	**13,746**	13,453
	263,850	310,299
Risk type analysis of risk-weighted assets:		
Foundation Internal Ratings Based (IRB) approach	**82,870**	80,612
Retail IRB approach	**85,139**	91,445
Other IRB approach	**9,221**	12,396
IRB approach	**177,230**	184,453
Standardised approach	**41,150**	73,665
Credit risk	**218,380**	258,118
Counterparty credit risk	**7,794**	12,848
Operational risk	**26,594**	27,939
Market risk	**11,082**	11,394
Total risk-weighted assets	**263,850**	310,299

Retail risk-weighted assets reduced by £9.8 billion in the year primarily due to improvements in credit quality due to effective portfolio management and the impact of positive macroeconomic factors including favourable movements in UK house prices.

The reductions of risk-weighted assets of £26.7 billion in Commercial Banking and £10.3 billion in Wealth, Asset Finance and International primarily reflect further non-core asset reduction, the move to slotting models for Commercial Real Estate (CRE) businesses and the impact of macroeconomic factors.

The reduction in Standardised approach risk-weighted assets is largely due to the roll-out of new IRB approaches, predominantly the implementation of slotting models in the UK and Ireland, and non-core disposals.

Counterparty credit risk-weighted assets reduced from £12.8 billion to £7.8 billion. Contributing to this reduction are mark-to-market changes, management actions and migration of portfolios to the Foundation IRB approach.

Table 1.44: **Risk-weighted asset movement by key driver**

	£bn	£bn
At 31 December 2012		**310.3**
Management of the balance sheet	**(1.8)**	
Disposals	**(20.7)**	
External economic factors	**(15.4)**	
Model and methodology changes	**3.2**	
Regulatory policy changes	**(5.4)**	
Other	**0.4**	
Credit risk-weighted asset movement		**(39.7)**
Counterparty credit risk-weighted asset movement		**(5.1)**
Operational risk weighted asset movement		**(1.3)**
Market risk-weighted asset movement		**(0.3)**
At 31 December 2013		**263.9**

The risk-weighted asset movements table provides an analysis of the movement in risk-weighted assets in 2013 and an insight in to the key drivers of the movements in credit risk risk-weighted assets over the course of the year as follows.

– Management of the balance sheet includes risk-weighted asset movements arising from new lending and asset run-off. During 2013 there was a small risk-weighted asset reduction of £1.8 billion in this category.

– Disposals include risk-weighted asset reductions arising from the sale of assets, portfolios and businesses. Disposals reduced risk-weighted assets by £20.7 billion, primarily reflecting non-core disposals in Commercial Banking and Wealth, Asset Finance and International.

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– External economic factors captures movements driven by changes in the economic environment. The reduction in risk-weighted assets of £15.4 billion is mainly due to changes in underlying credit quality, favourable house price movements and non-core exposures moving into default under the Foundation IRB approach.
– Model and methodology changes include the movement in risk-weighted assets arising from new model implementation, model enhancement and changes in credit risk approach applied to certain portfolios. Model and methodology changes increased risk-weighted assets by £3.2 billion.
– Regulatory policy changes represent changes required by regulatory authorities. Substantially all of the £5.4 billion reduction is due to the implementation of slotting models relating to Commercial Real Estate and other exposures in the UK and Ireland.

Within the categories above, risk-weighted asset movements can arise as a result of credit risk exposures becoming adjustments to capital resources, through expected losses, rather than being risk-weighted.

CRD IV capital and leverage information

The data in the following tables represents estimates reflecting the Group's interpretation of the CRD IV rules published on 27 June 2013 via the Official Journal of the European Union (including amendments made to the Regulation via the Corrigenda published on 30 November 2013) and the PRA policy statement PS7/13, issued on 19 December 2013. The actual capital ratios under CRD IV may differ as the final rules are assessed in their entirety, related technical standards are finalised and other guidance is issued by the relevant regulatory bodies.

A number of final draft CRD IV implementing and regulatory technical standards have already been issued by the European Banking Authority (EBA) with a number of other draft standards currently being taken through respective consultation processes. The Group has not reflected the impact of these draft standards in its CRD IV estimates, though it does not currently believe that these would make a material difference to the capital position outlined below.

Capital position on a CRD IV basis

The Group's capital position at 31 December 2013 is shown in the table below calculated on the following three bases; firstly the current prevailing regulatory framework; secondly applying the CRD IV rules including the transitional arrangements that have been in place from 1 January 2014; and thirdly on a fully loaded basis.

The transitional arrangements reflect the requirements of policy statement PS7/13, issued by the PRA on 19 December 2013. This differs from the Group's previously published statements, which allowed for the transitional phasing of CET1 deductions consistent with the FSA's previous policy guidance. This has resulted in a material reduction in the transitional CET1 capital bringing this close to the fully loaded position.

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Table 1.45: **Capital position on CRD IV basis**

	Prevailing rules as at 31 December 2013 £m	CRD IV rules	
		Transitional CRD IV rules £m	Fully loaded CRD IV rules £m
At 31 December 2013			
Core/common equity tier 1 (CET1)			
Shareholders' equity per balance sheet	38,989	38,989	38,989
Adjustment for insurance entity[1]		(1,917)	(1,917)
Regulatory adjustments:			
Non-controlling interests	32	–	–
Unrealised reserves on available-for-sale assets	615	–	–
Other adjustments	1,614	1,295	1,295
	41,250	38,367	38,367
less: deductions from core/common equity tier 1			
Goodwill and other intangible assets[1]	(3,815)	(1,979)	(1,979)
Excess of expected losses over impairment provisions	(373)	(866)	(866)
Securitisation deductions	(71)	(141)	(141)
Significant investments[1]	–	(2,909)	(3,185)
Deferred tax assets	–	(5,025)	(5,155)
Core/common equity tier 1 capital	36,991	27,447	27,041
Pro forma core/common equity tier 1 capital[2]	n/a	28,218	27,925
Additional tier 1 (AT1)			
Additional tier 1 instruments	5,042	4,486	–
less: deductions from tier 1			
Significant investments	(3,859)	(677)	–
Total tier 1 capital	38,174	31,256	27,041
Pro forma total tier 1 capital[2]	n/a	32,027	27,925
Tier 2			
Tier 2 instruments	20,392	19,870	15,636
Unrealised gain on available-for-sale equity investments	135	–	–
Eligible provisions	359	349	349
less: deductions from tier 2			
Excess of expected losses over impairment provisions	(373)	–	–
Securitisation deductions	(71)	–	–
Significant investments	(3,859)	(1,015)	(1,692)
Total capital resources	54,757	50,460	41,334
Pro forma total capital resources[2]	n/a	51,231	42,218
Risk-weighted assets	263,850	272,092	271,078
Risk-weighted assets – pro forma[2]	n/a	272,641	271,908
Core/common equity tier 1 capital ratio	14.0%	10.1%	10.0%
Tier 1 capital ratio	14.5%	11.5%	10.0%
Total capital ratio	20.8%	18.5%	15.2%
Pro forma core/common equity tier 1 capital ratio[2]	n/a	10.3%	10.3%
Pro forma tier 1 capital ratio[2]	n/a	11.7%	10.3%
Pro forma total capital ratio[2]	n/a	18.8%	15.5%
31 December 2012[3]			
Core/common equity tier 1 capital ratio	12.0%	11.6%	8.1%
Tier 1 capital ratio	13.8%	11.6%	8.1%
Total capital ratio	17.3%	16.7%	11.3%

[1] Removal of post-acquisition reserves impacts for Insurance business as under CRD IV, as implemented by PRA policy statement PS7/13, the deduction for significant investments in the equity of financial sector entities is based on cost of investment where previously this was based on net asset value. The overall impact of this change on the CRD IV ratios is negligible.

[2] Includes the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.

[3] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

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The movements in the transitional CRD IV common equity tier 1, tier 1, tier 2 and total capital positions in the period are shown below:

Table 1.46: **Movements in capital**

	Common equity tier 1 £m	Additional tier 1 £m	Tier 2 £m	Total capital £m
At 31 December 2012[1]	37,385	–	16,424	53,809
Update to transitional phasing and treatment of insurance	(10,979)	3,846	2,748	(4,385)
Loss attributable to ordinary shareholders	(838)	–	–	(838)
Share issuance	510	–	–	510
Pension movements:				
Implementation of IAS 19R[2]	(1,258)	–	–	(1,258)
Deduction of pension asset	515	–	–	515
Movement through other comprehensive income	(108)	–	–	(108)
Available-for-sale reserve	(1,014)	–	–	(1,014)
Deferred tax asset	82	–	–	82
Goodwill and intangible assets deductions	292	–	–	292
Excess of expected losses over impairment provisions	406	–	–	406
Significant investment deduction	2,075	486	729	3,290
Eligible provisions	–	–	349	349
Subordinated debt movements:				
Grandfathering[3]	–	(557)	172	(385)
Restructuring to ensure CRD IV compliance	–	–	932	932
Foreign exchange	–	(49)	(102)	(151)
Repurchases, redemptions and other	–	83	(2,048)	(1,965)
Other movements	379	–	–	379
At 31 December 2013	**27,447**	**3,809**	**19,204**	**50,460**
***Pro forma impacts*[4]**	*771*	–	–	*771*
Pro forma at 31 December 2013[4]	**28,218**	**3,809**	**19,204**	**51,231**

[1] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

[2] Includes the impact to other comprehensive income and the movement in the retirement benefit asset.

[3] Includes movement from 90 per cent to 80 per cent grandfathering and adjustment due to further clarification of grandfathering rules.

[4] Includes the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.

Common equity tier 1 capital resources have decreased by £9,938 million in the period, £9,167 million on a pro forma basis. This is substantially due to a £10,979 million adjustment relating to updated transitional phasing, reflecting PRA policy statement PS7/13 which has accelerated the phasing in of deductions (including deferred tax, significant investments and excess expected losses) to CET1 bringing this close to the fully loaded position. Movements in CET1 capital include those reflected under prevailing rules at 31 December 2013 on page 181. Incremental to these are increases largely driven by the £2,155 million in dividends from the Insurance business partially offset by negative valuation movements on available for sale assets.

Total capital resources have decreased by £3,349 million in the period, £2,578 million on a pro forma basis. Excluding the impact of updated transitional phasing, total capital increased by £1,036 million, largely reflecting movements in CET1 resources described above.

Leverage ratio

The Basel III reforms include the introduction of a leverage ratio framework designed to reinforce risk based capital requirements with a simple, transparent, non-risk based 'backstop' measure. The leverage ratio is defined as tier 1 capital divided by the exposure measure. The Basel Committee will test the proposed 3 per cent minimum requirement for the leverage ratio and have proposed that final calibrations, and any further adjustments to the definition of the leverage ratio, will be completed by 2017, with a view to migrating to a Pillar I treatment on 1 January 2018.

In line with previous reporting periods, the PRA has asked the Group to publish a leverage ratio on a fully loaded CRD IV basis, with the exposure measure adjusted to reflect the basis of the original December 2010 Basel III leverage ratio framework, as interpreted through guidance released in July 2012.

In addition to the calculation basis specified by the PRA, the Group's leverage ratio at 31 December 2013 is shown in the table below on a final CRD IV rules basis and estimated in accordance with the revised Basel III leverage ratio framework issued on 12 January 2014. In each case the ratio is presented on a 'transitional', 'fully loaded' and 'fully loaded including tier 1 instruments' basis. The inclusion of tier 1 instruments for the latter basis refers to the full recognition of tier 1 instruments that will become ineligible once the transitional phase has elapsed.

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Table 1.47: **Leverage ratio on CRD IV basis**

	Transitional £m	Fully loaded £m	Fully loaded (including tier 1 instruments)[1] £m
At 31 December 2013			
CRD IV Rules			
Total tier 1 capital for leverage ratio			
Common equity tier 1 capital	27,447	27,041	27,041
Tier 1 subordinated debt	4,486	–	5,042
Tier 1 deductions	(677)	–	–
Total tier 1 capital	31,256	27,041	32,083
Pro forma total tier 1 capital[2]	32,027	27,925	32,967
Exposure measure			
Total statutory balance sheet assets	847,030	847,030	847,030
Adjustment for insurance assets	(84,302)	(83,401)	(83,401)
Removal of accounting value for derivatives and securities financing transactions	(61,686)	(61,686)	(61,686)
Exposure value for derivatives	24,598	24,598	24,598
Exposure value for securities and financing transactions	6,700	6,700	6,700
Off-balance sheet items	79,927	79,927	79,927
Other regulatory adjustments	(10,308)	(10,437)	(10,437)
Total exposures	801,959	802,731	802,731
Pro forma total exposure[2]	809,090	813,055	813,055
Leverage ratio	3.9%	3.4%	4.0%
Pro forma leverage ratio[2]	4.0%	3.4%	4.1%
Leverage ratio at 31 December 2012[3]	4.4%	3.1%	3.8%
Basel III December 2010 rules:[4]			
Leverage ratio		3.3%	3.9%
Pro forma leverage ratio[2]		3.4%	4.0%
Basel III January 2014 rules:[5]			
Leverage ratio		3.7%	4.4%
Pro forma leverage ratio[2]		3.8%	4.5%

[1] Includes the full value of tier 1 instruments reported under the prevailing rules as at 31 December 2013. These instruments will become ineligible for inclusion in tier 1 capital over the transitional period.

[2] Includes the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.

[3] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

[4] Exposure measure determined in accordance with the original December 2010 Basel III leverage ratio framework as interpreted through the July 2012 Basel III Quantitative Impact Study instructions and related guidance and as required by the PRA.

[5] Exposure measure estimated in accordance with the January 2014 revised Basel III leverage ratio framework.

In order to ensure that the capital and exposure components of the ratio are measured consistently CRD IV requires the assets of the Insurance entities included in the Group's statutory consolidated balance sheet to be excluded from the exposure measure in proportion to the element of the investment in the Group's Insurance businesses that is excluded from tier 1 capital. Under the January 2014 revised Basel III leverage ratio framework only the proportion of the investment in the Group's Insurance businesses not deducted from tier 1 capital is included in the exposure measure.

Leverage ratio exposure values for derivatives and securities financing transactions have been calculated in accordance with the methodologies prescribed by the relevant rules applied.

Off-balance sheet items primarily consist of undrawn credit facilities, including facilities that may be cancelled unconditionally at any time without notice. The leverage ratio exposure value for off-balance sheet items is determined by applying set credit conversion factors to the nominal values of the items, based on the classification of the item. On a CRD IV basis a credit conversion factor of 10 per cent is applied to unconditionally cancellable items, with remaining off-balance sheet items predominantly attracting a 100 per cent credit conversion factor. Under the January 2014 revised Basel III leverage ratio framework, the credit conversion factors applied to off-balance sheet items follow those prescribed by Standardised credit risk rules, subject to a floor of 10 per cent.

Other regulatory adjustments consist of other balance sheet assets that are required under CRD IV to be deducted from tier 1 capital. The removal of these assets from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio.

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Life insurance businesses

The business transacted by the life insurance companies within the Group comprises unit-linked business, non-profit business and with-profits business. Several companies transact either unit-linked and/or non-profit business, but Scottish Widows plc (Scottish Widows) and Clerical Medical Investment Group Limited (Clerical Medical) hold the only With-Profit Funds managed by the 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 PRA.

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. If the market is not active, the Group establishes a fair value by using valuation techniques. 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 PRA 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.

Regulatory capital requirements

Each life insurance company must retain sufficient capital to meet the regulatory capital requirements mandated by the PRA; 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 Resilience Capital Requirement). The regulatory capital requirement is deducted from the available capital resources to give statutory excess capital.

For Scottish Widows and Clerical Medical, no Resilience Capital Requirement is required. However, a further test is required in respect of the With-Profit Funds. This involves comparing the statutory basis of assessment with a realistic basis of assessment as described below.

Realistic basis: The PRA 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 fact that assumptions are best-estimate as opposed to prudent. This realistic valuation is an assessment of the financial position of a With-Profit Fund calculated under a methodology prescribed by the PRA.

The valuation of with-profits assets in a With-Profit Fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profit business written therein, it includes the present value of the anticipated future release of the prudent margins for adverse deviation. In addition, the realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above. The realistic valuation of liabilities differs from the statutory basis in including an allowance for future bonuses whilst the value of options and guarantees are assessed using a stochastic simulation model which values these liabilities on a basis consistent with tradable market option contracts (a market-consistent basis). In calculating the realistic liabilities, the model also 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 191.

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 Risk Capital Margin). In circumstances where the realistic excess capital position is less than the statutory excess capital, the company is required to hold additional capital to cover the shortfall. Any additional capital requirement under this test is referred to as the With-Profits Insurance Capital Component.

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 may include charges on policies where the associated costs are borne by the Non-Profit Fund.

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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 PRA.

Table 1.48: **Capital resources (audited)**

	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
At 31 December 2013 (statutory basis)						
Shareholders' funds:						
Held outside the long-term funds	–	–	–	2,362	4	2,366
Held within the long-term funds	–	–	6,139	–	181	6,320
Total shareholders' funds	–	–	6,139	2,362	185	8,686
Adjustments onto a regulatory basis:						
Unallocated surplus within insurance business	336	55	–	–	–	391
Value of in-force business	–	–	(4,117)	–	(80)	(4,197)
Other differences between IFRS and regulatory valuation of assets and liabilities	–	–	(430)	(2,659)	(23)	(3,112)
Estimated share of realistic liabilities consistent with the PRA reporting treatment	(389)	(55)	–	–	–	(444)
Qualifying loan capital	–	–	–	2,611	–	2,611
Support arrangement assets	210	–	(210)	–	–	–
Available capital resources	157	–	1,382	2,314	82	3,935
At 31 December 2012 (statutory basis)						
Shareholders' funds:						
Held outside the long-term funds			6	1,791	562	2,359
Held within the long-term funds	–	–	6,259	–	225	6,484
Total shareholders' funds	–	–	6,265	1,791	787	8,843
Adjustments onto a regulatory basis:						
Unallocated surplus within insurance business	205	62	–	–	–	267
Value of in-force business	–	–	(5,056)	–	(718)	(5,774)
Other differences between IFRS and regulatory valuation of assets and liabilities	–	–	101	(175)	152	78
Estimated share of realistic liabilities consistent with the PRA reporting treatment	(305)	(62)	–	–	–	(367)
Qualifying loan capital	–	–	–	2,238	–	2,238
Support arrangement assets	190	–	(190)	–	–	–
Available capital resources	90	–	1,120	3,854	221	5,285

Available capital resources for With-Profit Funds are presented in the table on a realistic basis as this is more onerous than on a regulatory basis.

Formal intra group capital arrangements

Scottish Widows has also provided subordinated loans to its fellow group undertaking Scottish Widows Bank plc. No such arrangement exists for Clerical Medical.

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-Profits 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. The requirements of the Scheme sit alongside Scottish Widows' published Principles and Practices of Financial Management of With-Profit business.

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. Under the Scheme 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 PRA 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 (subject to the Non-Participating Fund being able to cover this amount by its surplus admissible assets) in assessing the realistic value of assets available to the With-Profit Fund. At 31 December 2013 the estimated value of surplus admissible assets in the Non-Participating Fund was £1,902 million (2012: £1,430 million) and the estimated value of the Support Account was £nil (2012: £nil). However, at 31 December 2013, the excess of realistic liabilities of with-profits business written before demutualisation over the relevant assets was £54 million (2012: £62 million) which, in accordance with the PRA's permission, has been used to assess the estimated value of realistic assets available to the With-Profit Fund (and has therefore reduced the value of the Non-Participating Fund's surplus admissible assets by that amount).

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 2013, the estimated net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £6,784 million (2012: £5,647 million) and the estimated combined value of the Support Account and Further Support Account was £2,070 million (2012: £2,171 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 2013 is £156 million (2012: £128 million). Scottish Widows has obtained from the PRA 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 according 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 on traditional with-profits business. 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. In extreme circumstances capital within the Clerical Medical Non-Profit Fund may be made available to support the With-Profit Fund.

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.

RISK MANAGEMENT

Movements in regulatory capital

The movements in the Group's available capital resources in the life business can be analysed as follows:

Table 1.49: **Movements in available capital resources**

	Scottish Widows With-Profit Fund £m	Clerical Medical With-Profit Fund £m	UK Non-Profit Fund £m	UK Life Shareholder Fund £m	Overseas Life Business £m	Total Life Business £m
At 31 December 2012	90	–	1,120	3,854	221	5,285
Changes in estimations and in demographic assumptions used to measure life assurance liabilities	2	6	101	–	11	120
Dividends and capital transactions	–	–	(394)	(1,280)	(23)	(1,697)
Change in support arrangements	20	–	(20)	–	–	–
New business and other factors	45	(6)	732	(240)	60	591
Disposal of business	–	–	(157)	(20)	(187)	(364)
At 31 December 2013	157	–	1,382	2,314	82	3,935

With-Profit Funds

Available capital in the Scottish Widows With-Profit Fund has increased from £90 million at 31 December 2012 to an estimated £157 million at 31 December 2013 mainly due to a decrease in the liabilities of the non-transferred business (caused by model changes and positive investment returns). Available capital in the Clerical Medical With-Profit Fund is estimated to be zero at 31 December 2013 (no change from 31 December 2012). This is because the fund is in the process of distributing the free estate and all surplus will ultimately be distributed to policyholders.

UK Non-Profit Funds

Available capital in the UK Non-Profit Funds has increased from £1,120 million at 31 December 2012 to an estimated £1,382 million at 31 December 2013. This is mainly due to income on existing business offset by the impact of writing new business, positive investment returns, one-off transfers and an increase in provisions.

UK Life Shareholder Funds

Available capital in the UK Life Shareholder Funds has decreased from £3,854 million at 31 December 2012 to an estimated £2,314 million at 31 December 2013. The decrease mainly reflects the funding used to pay the dividend from Scottish Widows Group to Lloyds Bank.

Overseas life business

Available capital has decreased during 2013 due to a dividend payment which was partially offset by profits emerging on new and in force business.

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 1.50: **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
At 31 December 2013					
With-Profit Fund liabilities	13,539	7,427	–	–	20,966
Unit-linked business (excluding that accounted for as non-participating investment contracts)	–	–	45,310	4,064	49,374
Other life insurance business	–	–	11,702	–	11,702
Insurance and participating investment contract liabilities	13,539	7,427	57,012	4,064	82,042
Non-participating investment contract liabilities	–	–	26,722	868	27,590
Total policyholder liabilities	13,539	7,427	83,734	4,932	109,632
At 31 December 2012					
With-Profit Fund liabilities	13,779	8,248	2	–	22,029
Unit-linked business (excluding that accounted for as non-participating investment contracts)	–	–	38,756	8,429	47,185
Other life insurance business	–	–	12,923	2	12,925
Insurance and participating investment contract liabilities	13,779	8,248	51,681	8,431	82,139
Non-participating investment contract liabilities	–	–	49,929	4,443	54,372
Total policyholder liabilities	13,779	8,248	101,610	12,874	136,511

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Capital sensitivities

Shareholders' funds

Shareholders' funds outside the long-term business fund are invested in readily tradable assets (e.g. equities and fixed interest securities), cash and a range of less liquid fixed interest instruments, at levels consistent with the liquidity risk appetite of the Insurance business.

With-Profit Funds

The with-profits 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. Various hedging strategies are used to manage these exposures.

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). Assumptions relating to future expenses are also significant with increases in the expected level of future costs leading to increases in the value of the liabilities and consequently leading to a reduction in available capital. Reinsurance arrangements are in place to reduce the Group's exposure to deteriorating mortality rates in respect of non-annuity life insurance contracts such that assured life mortality is a less significant assumption. For Clerical Medical, assumptions relating to the provision in relation to German insurance business litigation are also significant.

Assets held in excess of those backing reserves are invested in readily tradable assets (e.g. equities and fixed interest securities), cash and a range of less liquid fixed interest instruments, at levels consistent with the risk appetite of the Insurance business.

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 2013 of £2.2 billion (2012: £2.1 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 PRA, the liabilities of both the Clerical Medical and Scottish Widows 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 swap yield curves.
– 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, at 31 December 2013, the 10 year equity-implied at-the-money assumption was set at 22.1 per cent (2012: 26.3 per cent). The assumption for property volatility was 15 per cent (2012: 15 per cent). The volatility of interest rates has been calibrated to the implied volatility of swaptions which was broadly 17 per cent (2012: 18 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

A number of typical guarantees are provided outside the With-Profit Funds such as guaranteed payments on death (e.g. term assurance) or guaranteed income for life (e.g. annuities). In addition, 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 £63 million (2012: £56 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 approximately £1 million. If yields were 0.5 per cent lower than assumed, the liability would increase by approximately £9 million.

RISK MANAGEMENT

Regulatory risk

Definition

Regulatory risk is defined as the risk that the Group is exposed to fines, censure, or legal or enforcement action due to failing to comply with applicable laws, regulations, codes of conduct or legal obligations.

Risk appetite

The Group has zero risk appetite for material regulatory breaches. This appetite is reviewed and approved annually by the Board. To achieve this, the Group has policies, processes and standards which provide the framework for businesses and colleagues to operate in accordance with the laws, regulations and voluntary codes which apply to the Group and its activities.

Exposures

The Group periodically experiences material regulatory breaches outside its risk appetite. Regulatory exposure is also driven by the significant volume of current legislation and regulation within the UK and overseas with which the Group has to comply, along with new or proposed legislation and regulation which needs to be interpreted, implemented and embedded into day-to-day operational and business practices across the Group. This is particularly the case currently: the industry still continues to witness increased levels of government and regulatory intervention in the banking sector with an increasing number of regulatory rules from both the UK and overseas affecting the Group's operations. It is clear that regulatory challenges remain, including the area of conduct where the Group accepted the findings of the FCA investigation into its historic Bancassurance incentive schemes, and agreed to pay a fine of £28 million in 2013. The Group has made significant changes to its incentive schemes since the period relating to the fine.

Measurement

Regulatory risks are measured against a set of risk appetite metrics, with appropriate thresholds, which have been approved by the Board and which are regularly reviewed and monitored. Metrics include assessments of control and material regulatory rule breaches.

Mitigation

Mitigation is undertaken across the Group and comprises the following key components:

– Risks are assessed by the business and controls put in place to mitigate them;
– Enhanced regulatory reporting;
– Regulatory horizon scanning;
– Oversight and assurance of the regulatory risks within the business;
– Quality assurance theme reviews to assess compliance with rules, regulations and policies;
– Continued investment in the Group's IT systems is enabling the Group to meet its regulatory commitments;
– Senior business leaders monitor the progress of these assessments and mitigations;
– Material risks and issues are escalated to Group-level bodies which challenge the business on its management of risks and issues; and
– Mandated policies and processes require minimum control frameworks, management information and standards to be implemented.

Monitoring

Business unit risk exposure is reported to Risk Division where it is aggregated at Group level and a report prepared. The report forms the basis of challenge to the business at the monthly Group Compliance and Conduct Risk Committee. This committee may escalate matters to the Chief Risk Officer, or higher committees. The report also forms the basis of the regulatory sections in the Group's consolidated risk reporting.

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Insurance risk

Definition

Insurance risk is defined as the risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions in earnings and/or value.

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 Group's risk preferences. Insurance risk appetite in the Insurance business is set by the Insurance Board and includes maximum earnings exposures to longevity and persistency risk in defined stresses. Insurance risk appetite for longevity in the defined benefit pension schemes is set by the Board using two key metrics: a one year increase to life expectancy and a combined market and longevity stress.

Exposures

The major sources of insurance risk within the Group are the Insurance business and the Group's defined benefit pension schemes. The nature of Insurance business involves the accepting of insurance risks which relate primarily to mortality, longevity, morbidity, persistency and expenses for the life and pension business, and property and unemployment for the general insurance business. The prime insurance risk of the Group's defined benefit pension schemes is related to longevity. As with any business, the Group is exposed to a number of insurance events, some of which are covered by bespoke corporate insurance policies.

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 on a range of stresses including risk measures based on 1-in-200 year stresses for Insurance's Individual Capital Assessment (Group defined benefit pension schemes utilise 1-in-20 year stresses) and other supporting measures where appropriate, including those set out in notes 36 and 37 to the financial statements.

Mitigation

A key element of the control framework is the consideration of insurance risk by an appropriate combination of high level committees and Boards. For the Insurance business the ultimate control body is the Insurance Board but significant risks from Insurance and the defined benefit pension schemes are reviewed by the Group Executive and Group Risk Committees and/or Board. Governance of the Group's defined benefit pension schemes also includes two specialist pension committees (one Group Executive sub committee and a supporting management committee).

Insurance risk is mitigated through pooling and through diversification across large numbers of individuals, geographical areas, and different types of risk exposure. A number of processes are used to control insurance risk including: 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 and management; policy wording; reinsurance and cost controls and efficiencies.

In addition, exposure limits by risk type are assessed through the business planning process and used as a control mechanism to ensure risks are taken within risk appetite.

The most significant insurance risks within the Insurance business are longevity risk, persistency risk and expenses. The merits of longevity risk transfer and hedging solutions are regularly reviewed. It is not possible to hedge persistency risk. 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 the Group's chosen reinsurers. The most significant insurance risk in the defined benefit pension schemes is longevity risk. The merits of longevity risk transfer and hedging solutions are regularly reviewed.

The Group's exposure to accumulations of risk and events (including possible catastrophes) is mitigated by insurance arrangements spread over different insurers. Detailed analysis, including that of the potential losses under various catastrophe scenarios, supports the choice of insurance arrangements.

Monitoring

Ongoing monitoring is in place to track the progression of insurance risks. In respect of the Insurance business this involves monitoring relevant experiences against expectations (for example claims experience, persistency experience, expenses and non-disclosure at the point of sale) as well as tracking the progression of insurance risk capital against limits and the sensitivity of profit before tax to the most significant insurance risks persistency and longevity. The effectiveness of controls put in place to manage insurance risk is evaluated and significant divergences from experience or movements in risk exposures are investigated and remedial action taken. Progress against risk appetite metrics in respect of longevity risk in the Group's defined benefit pension schemes is regularly reported and reviewed by the relevant committees.

RISK MANAGEMENT

People risk

Definition

People risk is defined as the risk that the Group fails to lead, manage and enable colleagues to deliver to customers, shareholders and regulators leading to reductions in earnings and/or value.

Risk appetite

The Group's people risk appetite and corresponding measures are reviewed and approved annually by the Board to enable the Group to lead responsibly and proficiently, manage people resource effectively, support and develop colleague talent, and meet legal and regulatory obligations related to its people.

To achieve this, the Group has developed and implemented policies and processes that provide a framework where the Group's businesses and colleagues can operate in accordance with the laws, regulations and voluntary codes that apply to the Group and its activities.

Exposures

The Group's management of material people risks is critical to its capacity to deliver against its strategic objectives and to be the best bank for customers. Over the coming year the Group anticipates the following key people risk exposures:

– Retention of colleague talent within key populations in the context of a more active employment market;
– The Group's reward scheme compliance and talent attraction may be impacted by regulatory changes to remuneration governance and the Approved Persons regime; and
– Colleague engagement may be challenged by ongoing media attention on banking sector culture, sales practices and ethical conduct.

Measurement

People risk is measured through a series of quantitative and qualitative indicators, aligned to key sources of people risk for the Group. In addition to risk appetite measures, people risks and controls are monitored across individual Divisions and business units. Divisional metrics are calibrated against the Group's risk appetite and monitored on a monthly basis via the Group's risk reporting structure.

Mitigation

The Group takes many mitigating actions with respect to people risk. Key areas of focus include:

– Strengthening the risk and customer focused culture amongst colleagues by developing and delivering initiatives that reinforce behaviours to generate the best possible long-term outcomes for customers and colleagues;
– Embedding the Group's Codes of Personal and Business Responsibility across the Group;
– Reviewing and developing incentives to ensure they promote colleagues behaviours that meet customer needs and regulatory expectations;
– Focusing on leadership and colleague engagement, through delivery of strategies to attract, retain and develop high calibre people together with implementation of rigorous succession planning;
– Maintaining focus on people risk management across the Group; and
– Ensuring compliance with legal and regulatory requirements related to Approved Persons and the Remuneration Code, and embedding compliant and appropriate colleague behaviours in line with Group policies, values and its people risk priorities.

Monitoring

People risks from across the Group are reported through the first line of defence. Key people risks are then escalated to the relevant operational or regulatory oversight committees. Key people risks are assessed in the context of the Group's wider risk profile, and tracked to remediation.

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Financial reporting risk

Definition

Financial reporting risk is defined as the risk that the Group suffers reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial reporting, failure to manage the associated risks of changes in taxation rates, law, ownership or corporate structure and the failure to disclose accurate and timely information.

Risk appetite

The risk appetite is set by the Board and reviewed on an annual basis or more frequently. It includes complying with statutory and regulatory reporting requirements and compliance with tax legislation in the jurisdictions in which the Group operates.

Exposure

Exposure represents the sufficiency of the Group's policies and procedures to maintain adequate systems, processes and controls to support statutory, prudential regulatory and tax reporting, to prevent and detect financial reporting fraud, to manage the Group's tax position and to support market disclosures.

Measurement

Financial reporting risk is measured by the adequacy of and compliance with a number of key controls. Identification of potential financial reporting risk also forms a part of the Group's Operational Risk management framework.

Mitigation

The Group maintains a system of internal controls, which is designed to:

- ensure that accounting policies are consistently applied, transactions are recorded and undertaken in accordance with delegated authorities, that assets are safeguarded and liabilities are properly recorded;
- enable the calculation, preparation and reporting of financial, prudential regulatory and tax outcomes in accordance with applicable International Financial Reporting Standards, statutory and regulatory requirements; and
- ensure that disclosures are made on a timely basis in accordance with statutory and regulatory requirements and as far as possible are consistent with best practice and in compliance with the British Bankers' Association Code for Financial Reporting Disclosure.

Monitoring

Financial reporting risk is actively monitored at business unit and Group levels. There are specific programmes of work undertaken across the Group to support:

- annual assessments of (1) the effectiveness of internal controls over financial reporting; and (2) the effectiveness of the Group's disclosure controls and procedures, both in accordance with the requirements of the US Sarbanes Oxley Act;
- annual certifications by the Senior Accounting Officer with respect to the maintenance of appropriate tax accounting arrangements, in accordance with the requirements of the 2009 Finance Act.

The Group also has in place an assurance process to support its prudential regulatory reporting and monitoring activities designed to identify and review tax exposures on a regular basis. There is ongoing monitoring to assess the impact of emerging regulation and legislation on financial, prudential regulatory and tax reporting.

The Group has a Disclosure Committee which assists the Group Chief Executive and Chief Financial Officer in fulfilling their disclosure responsibilities under relevant listing and other regulatory and legal requirements. In addition, the Audit Committee reviews the quality and acceptability of the Group's financial disclosures. For further information on the Audit Committee's responsibilities relating to financial reporting see pages 91 to 92.

RISK MANAGEMENT

Governance risk

Definition

Governance risk is defined as the risk that the Group's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively.

Risk appetite

Governance risk appetite is defined and embedded through the Group's Governance Principle and Policy which are reviewed and approved by the Board on an annual basis. The Group has governance arrangements that support the effective long-term operation of the business, maximise shareholder value and meet regulatory and social expectations.

Exposure

The internal governance arrangements of major financial institutions continue to be subject to a high level of regulatory and public scrutiny. The Group's exposure to governance risk is also reflective of the significant volume of existing and proposed legislation and regulation within the UK and overseas with which it must comply. Risk governance and risk culture are mutually reinforcing.

Measurement

The Group's governance arrangements are assessed against new or proposed legislation and regulation and best practice among peer organisations in order to identify any areas of enhancement required.

Mitigation

The Group's Risk Management Framework establishes robust arrangements for risk governance, in particular by:

- defining individual and collective accountabilities for risk management, risk oversight and risk assurance through a Three Lines of Defence model which supports the discharge of responsibilities to customers, shareholders and regulators;
- outlining governance arrangements which articulate the enterprise-wide approach to risk management; and
- supporting a consistent approach to Group-wide behaviour and risk decision making through a Group Policy Framework which helps everyone understand their responsibilities by clearly articulating and communicating rules, boundaries and risk appetite measures which can be controlled, enforced and monitored.

The Ethics and Responsible Business Policy and supporting Codes of Personal Responsibility and Business Responsibility embody the Group's values and reflect its commitment to operating responsibly and ethically both at a business and an individual level. All colleagues are required to adhere to the Codes in all aspects of their roles.

Driving adherence to the Group's Risk Management framework goes 'hand in glove' with its approach to risk culture which is embedded in the Group's approach to recruitment, selection, training, performance management and reward.

Monitoring

A review of the Group's Risk Management Framework, which includes the status of the Group's Principles and Policy Framework, and the design and operational effectiveness of key governance committees, is undertaken on an annual basis and the findings are reported to the Group Risk Committee, Board Risk Committee and the Board.

In addition, in 2013 the Group undertook a review of the findings of the Barclays Salz Review to ensure the Salz recommendations were factored into the Group's current approach to governance and ongoing initiatives. A further review will be undertaken in 2014.

For further information on Corporate Governance see pages 78 to 99.

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INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

Report on the financial statements

Our opinion

In our opinion:

– the financial statements, defined below, give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2013 and of the Group's loss and of the Group's and Parent Company's cash flows for the year then ended;

– the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;

– the Parent Company financial statements 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

– the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have audited

The Group financial statements and Parent Company financial statements (the 'financial statements'), which are prepared by Lloyds Banking Group plc (the 'Parent Company'), comprise:

– the Consolidated and Parent Company balance sheets as at 31 December 2013;

– the Consolidated income statement and the Consolidated statement of comprehensive income for the year then ended;

– the Consolidated and Parent Company statements of changes in equity and cash flow statements for the year then ended; and

– the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company, as applied in accordance with the provisions of the Companies Act 2006.

Certain disclosures required by the financial reporting framework have been presented elsewhere in the Annual Report and Accounts ('Annual Report'), rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

What an audit of financial statements involves

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

– whether the accounting policies are appropriate to the Group's and 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.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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Overview of our audit approach

Materiality

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the Group financial statements as a whole to be £265 million. In arriving at this judgement we have had regard to interest and other income rather than profitability given the variability in performance in recent periods.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £10 million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Overview of the scope of our audit

The Group is structured into four divisions being Retail Banking, Commercial Banking, Insurance, and Wealth, Asset Finance and International, as well as the Group's centralised functions (Group Operations and Central Items). Each of the divisions and the centralised functions comprises a number of business reporting units. The Group financial statements are a consolidation of these business reporting units.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group engagement team, or component auditors within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

For the Group's individually financially significant reporting units a full scope audit was performed over their complete financial information. Other reporting units were selected so that we obtained appropriate coverage across all account balances and performed audit work to cover the areas of focus we identified, and which are set out below. The level of coverage obtained was determined by our risk assessment for each account balance. For the other reporting units selected, either a full scope audit of their financial information or specified procedures over individual account balances were performed.

Areas of particular audit focus

In preparing the financial statements, the directors made a number of subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks or areas of focus identified by our audit. We discussed these areas of focus with the Audit Committee. Their report on those matters that they considered to be significant issues in relation to the financial statements is set out on page 92.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

Area of focus	How the scope of our audit addressed the area of focus
Loan loss impairment We focused on the determination of whether loans and advances were impaired and the measurement of impairment, in particular, the assessment of whether historic losses are indicative of incurred losses in the portfolios and the valuation of collateral for secured lending.	We tested the design and operating effectiveness of controls for loan loss impairment, including governance processes. We critically assessed the criteria for determining whether an impairment event had occurred and therefore whether a loan loss had been incurred. We specifically tested a sample of performing loans to challenge whether impairment events had been properly identified. Where impairment is calculated collectively for portfolios of loans in Retail Banking, Commercial Banking, and Wealth, Asset Finance and International, we understood and assessed the provisioning models and underlying assumptions used. In examining the models and assumptions, we considered whether all relevant risks were reflected in the modelled provision, and where not, whether model overlays appropriately reflected those risks. Where modelling assumptions were based on historic data, we assessed whether historic experience was reflective of the losses incurred in the portfolios based upon the current economic environment and the current circumstances of the borrowers. We also tested the extraction of historic data from underlying systems to the impairment models. For larger loan exposures (predominantly in Commercial Banking) where impairment is individually calculated, we understood the latest developments at the borrower and the basis of measuring the impairment provisions held, which is particularly significant in the Non-core portfolio where management are pursuing an exit strategy. We assessed the expected future cashflows and the valuation of collateral held, and challenged management as to whether valuations were up to date, consistent with the strategy being followed and appropriate for the purpose.
Conduct risk and related provisions The Group has to make redress payments for products and business mis-sold to customers in the past. The Group also has exposure to associated operational costs and regulatory fines. We focused on identifying products and businesses with exposures and assessing whether a provision was necessary. Where provisions were made, we focused on the measurement of the provision and in particular, the assumptions underlying the calculation of the provision. We focused the majority of our work on the provisions in relation to PPI, SME derivatives and also in respect of the mis-selling of insurance products in the German branch of Clerical Medical.	We tested the design and operating effectiveness of controls around management's processes for identifying exposures in relation to conduct risk areas and assessing whether provisions were necessary. We also assessed potential exposures based upon our own knowledge and experience of emerging industry issues and the regulatory environment. For all provisions made, we understood and critically assessed the provisioning models and underlying assumptions used. For those underlying assumptions based on historic experience, we assessed whether this was appropriate and where it was not deemed to be appropriate, the basis for and appropriateness of changes made was assessed. Given the judgemental nature of all of these provisions, we assessed critically the disclosures made in the financial statements. We particularly focused on assessing whether the disclosures made sufficiently clear the significant uncertainties that exist around determining the provisions and the sensitivity of the provisions to changes in the underlying assumptions.
Valuation of liabilities and assets arising from insurance contracts The value the Group places on insurance contracts is dependent on a number of subjective assumptions about future experience. We focused on the judgements aspects of setting economic and non-economic actuarial assumptions, in particular longevity, persistency, expenses, credit risk and illiquidity premium for which small changes can result in material impacts to the valuation of those liabilities and the value of in-force ('VIF') asset.	We assessed critically the specified actuarial assumptions, including consideration of management's rationale for the judgements applied and, where applicable, verifying back to underlying policyholder and industry benchmark data. We also tested controls over the experience and expense analysis. For longevity, persistency and expenses we considered recent experience and the appropriateness of the judgements on how future experience will evolve. For credit risk and illiquidity premium we have assessed the appropriateness of the methodology and any modifications made. We assessed the underlying assumptions with reference to wider market practice and prevailing economic conditions.

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Area of focus	How the scope of our audit addressed the area of focus
Uncertain tax positions The Group has a number of open tax matters, in respect of which management is required to make certain judgements as to the likely outturn for the purposes of calculating its tax position.	We examined the analysis performed by management setting out the basis for their judgement in respect of the material exposures identified, together with relevant supporting evidence such as correspondence with tax authorities and legal opinions obtained. We made our own assessment of the likelihood of the tax exposures occurring and the consequential accounting and disclosure treatments. In making our assessment we considered the interpretation of tax legislation in the relevant jurisdiction. We assessed the calculation of the exposures. We read and assessed the appropriateness of the disclosure made, in particular, in respect of contingent liabilities.
Management override of controls ISAs (UK & Ireland) state that the risk of management override of controls is a significant risk on all audit engagements.	For judgemental balances, which could include management bias, we considered the risk in planning our audit approach and reflected this in the audit work we performed, specifically in respect of impairment, conduct provisions, insurance liabilities and financial instruments held at fair value. We assessed and tested the effectiveness of company-wide controls, and performed our own analytical and substantive procedures on balances in the consolidated income statement and balance sheet. We also tested controls and performed substantive procedures over the new consolidation system. We identified higher risk journal entries in the general ledger and assessed their appropriateness through substantiation to relevant supporting evidence.
Revenue recognition ISAs (UK & Ireland) state that there is a rebuttable assumption that the auditor will treat revenue recognition as a significant risk.	We tested the design and operating effectiveness of controls and performed substantive testing over revenue recognition (including using computer-assisted audit techniques), particularly in relation to judgemental aspects such as determining effective interest rates on loans and deposits and recognition of fee income.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

Going concern

Under the Listing Rules we are required to review the directors' statement, set out on page 74, in relation to going concern. We have nothing to report having performed our review.

As noted in the directors' statement, the directors have concluded that it is appropriate to prepare the Group's and Parent Company's financial statements using the going concern basis of accounting. The going concern basis presumes that the Group and Parent Company have adequate resources to remain in operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed. In drawing this conclusion, the directors have considered:

– the regulatory capital position of the Group which is critical to the market maintaining confidence in the Group's ability to absorb losses that it may occur in a market stress; and

– the funding and liquidity position of the Group to be able to meet its liabilities as they fall due, including in a market stress.

This is an area of focus of our audit and we have concluded that the directors' use of the going concern basis is appropriate. However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and the Parent Company's ability to continue as a going concern. In drawing our conclusion, we critically assessed the going concern assessment undertaken by management and approved by the Board or Directors. As part of our assessment we have:

– critically assessed and challenged the appropriateness of the stress scenarios used and their impact on the Group's capital and liquidity position;

– understood and assessed key economic and other assumptions used in both the capital and liquidity plan and the Group's five year operating plan; and

– substantiated the Group's unencumbered collateral position and potential to access central bank liquidity facilities.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion:

– the information given in the Strategic Report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

– the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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

– we have not received all the information and explanations we require for our audit; or

– adequate accounting records have not been kept 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.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made, and under the Listing Rules we are required to review certain elements of the report to shareholders by the Board on directors' remuneration. We have no exceptions to report arising from these responsibilities.

Corporate Governance Statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the Parent Company's compliance with nine provisions of the UK Corporate Governance Code ('the Code'). We have nothing to report having performed our review.

On page 77 of the Annual Report, as required by the Code Provision C.1.1, the directors state that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy. On page 92, as required by C.3.8 of the Code, the Audit Committee has set out the significant issues that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

– the statement given by the directors is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit; or

– the section of the Annual Report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have no exceptions to report arising from this responsibility.

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Other information in the Annual Report

Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

– materially inconsistent with the information in the audited financial statements; or

– apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Parent Company acquired in the course of performing our audit; or

– is otherwise misleading.

We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of directors' responsibilities set out on page 77, the directors are responsible for the preparation of the Group and Parent Company financial statements and for being satisfied that they give a true and fair view.

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

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

Philip Rivett (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
5 March 2014

(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

	Note	2013 £ million	2012[1] £ million	2011[1] £ million
Interest and similar income		21,163	23,548	26,316
Interest and similar expense		(13,825)	(15,830)	(13,618)
Net interest income	5	7,338	7,718	12,698
Fee and commission income		4,119	4,650	4,935
Fee and commission expense		(1,385)	(1,444)	(1,391)
Net fee and commission income	6	2,734	3,206	3,544
Net trading income	7	16,467	15,005	(368)
Insurance premium income	8	8,197	8,284	8,170
Other operating income	9	3,249	4,700	2,799
Other income		30,647	31,195	14,145
Total income		37,985	38,913	26,843
Insurance claims	10	(19,507)	(18,396)	(6,041)
Total income, net of insurance claims		18,478	20,517	20,802
Regulatory provisions		(3,455)	(4,175)	(3,375)
Other operating expenses		(11,867)	(11,799)	(13,084)
Total operating expenses	11	(15,322)	(15,974)	(16,459)
Trading surplus		3,156	4,543	4,343
Impairment	12	(2,741)	(5,149)	(8,094)
Profit (loss) before tax		415	(606)	(3,751)
Taxation	14	(1,217)	(781)	861
Loss for the year		(802)	(1,387)	(2,890)
Profit attributable to non-controlling interests		36	84	73
Loss attributable to equity shareholders		(838)	(1,471)	(2,963)
Loss for the year		(802)	(1,387)	(2,890)
Basic loss per share	15	(1.2)p	(2.1)p	(4.3)p
Diluted loss per share	15	(1.2)p	(2.1)p	(4.3)p

[1] Restated – see note 1.

The accompanying notes are an integral part of the consolidated financial statements.

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December

	2013 £ million	2012[1] £ million	2011[1] £ million
Loss for the year	**(802)**	(1,387)	(2,890)
Other comprehensive income			
Items that will not subsequently be reclassified to profit or loss:			
Post-retirement defined benefit scheme remeasurements:			
Remeasurements before taxation	**(136)**	(2,136)	624
Taxation	**28**	491	(155)
	(108)	(1,645)	469
Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Adjustment on transfers from held-to-maturity portfolio	**–**	1,168	–
Change in fair value	**(680)**	900	2,527
Income statement transfers in respect of disposals	**(629)**	(3,547)	(343)
Income statement transfers in respect of impairment	**18**	42	80
Other income statement transfers	**–**	169	(79)
Taxation	**277**	339	(575)
	(1,014)	(929)	1,610
Movement in cash flow hedging reserve:			
Effective portion of changes in fair value taken to other comprehensive income	**(1,229)**	116	916
Net income statement transfers	**(550)**	(92)	70
Taxation	**374**	1	(270)
	(1,405)	25	716
Currency translation differences (tax: nil)	**(6)**	(14)	(84)
Other comprehensive income for the year, net of tax	**(2,533)**	(2,563)	2,711
Total comprehensive income for the year	**(3,335)**	(3,950)	(179)
Total comprehensive income attributable to non-controlling interests	**36**	82	72
Total comprehensive income attributable to equity shareholders	**(3,371)**	(4,032)	(251)
Total comprehensive income for the year	**(3,335)**	(3,950)	(179)

[1] Restated – see note 1.

CONSOLIDATED BALANCE SHEET

at 31 December

	Note	2013 £ million	2012[1] £ million	1 January 2012[1] £ million
Assets				
Cash and balances at central banks		**49,915**	80,298	60,722
Items in the course of collection from banks		**1,007**	1,256	1,408
Trading and other financial assets at fair value through profit or loss	17	**142,683**	160,620	148,614
Derivative financial instruments	18	**33,125**	56,557	66,073
Loans and receivables:				
Loans and advances to banks	19	**25,365**	32,757	32,877
Loans and advances to customers	20	**495,281**	517,225	565,638
Debt securities	23	**1,355**	5,273	12,470
		522,001	555,255	610,985
Available-for-sale financial assets	25	**43,976**	31,374	37,406
Held-to-maturity investments		**–**	–	8,098
Investment properties	26	**4,864**	5,405	6,122
Goodwill	27	**2,016**	2,016	2,016
Value of in-force business	28	**5,335**	6,800	6,638
Other intangible assets	29	**2,279**	2,792	3,196
Tangible fixed assets	30	**7,570**	7,342	7,673
Current tax recoverable		**31**	354	434
Deferred tax assets	42	**5,104**	4,913	4,635
Retirement benefit assets	41	**98**	741	1,262
Other assets	31	**27,026**	18,498	14,966
Total assets		**847,030**	934,221	980,248

[1] Restated – see note 1.

The accompanying notes are an integral part of the consolidated financial statements.

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Equity and liabilities	Note	2013 £ million	2012[1] £ million	1 January 2012[1] £ million
Liabilities				
Deposits from banks	32	**13,982**	38,405	39,810
Customer deposits	33	**441,311**	426,912	413,906
Items in course of transmission to banks		**774**	996	844
Trading and other financial liabilities at fair value through profit or loss	34	**43,625**	33,392	22,357
Derivative financial instruments	18	**30,464**	48,676	58,265
Notes in circulation		**1,176**	1,198	1,145
Debt securities in issue	35	**87,102**	117,253	184,964
Liabilities arising from insurance contracts and participating investment contracts	36	**82,777**	82,953	78,991
Liabilities arising from non-participating investment contracts	38	**27,590**	54,372	49,636
Unallocated surplus within insurance businesses	39	**391**	267	300
Other liabilities	40	**40,607**	46,793	44,320
Retirement benefit obligations	41	**1,096**	1,905	858
Current tax liabilities		**147**	138	103
Deferred tax liabilities	42	**3**	327	314
Other provisions	43	**4,337**	3,961	3,166
Subordinated liabilities	44	**32,312**	34,092	35,089
Total liabilities		**807,694**	891,640	934,068
Equity				
Share capital	45	**7,145**	7,042	6,881
Share premium account	46	**17,279**	16,872	16,541
Other reserves	47	**10,477**	12,902	13,818
Retained profits	48	**4,088**	5,080	8,266
Shareholders' equity		**38,989**	41,896	45,506
Non-controlling interests		**347**	685	674
Total equity		**39,336**	42,581	46,180
Total equity and liabilities		**847,030**	934,221	980,248

[1] Restated – see note 1.

The accompanying notes are an integral part of the consolidated financial statements.

The directors approved the consolidated financial statements on 5 March 2014.

Sir Winfried Bischoff
Chairman

António Horta-Osório
Group Chief Executive

George Culmer
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2013						
As previously reported	23,914	12,902	7,183	43,999	685	44,684
Restatement (notes 1 and 56)	–	–	(2,103)	(2,103)	–	(2,103)
Restated	23,914	12,902	5,080	41,896	685	42,581
Comprehensive income						
(Loss) profit for the year	–	–	(838)	(838)	36	(802)
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of taxation	–	–	(108)	(108)	–	(108)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(1,014)	–	(1,014)	–	(1,014)
Movements in cash flow hedging reserve, net of tax	–	(1,405)	–	(1,405)	–	(1,405)
Currency translation differences (tax: £nil)	–	(6)	–	(6)	–	(6)
Total other comprehensive income	–	(2,425)	(108)	(2,533)	–	(2,533)
Total comprehensive income	–	(2,425)	(946)	(3,371)	36	(3,335)
Transactions with owners						
Dividends	–	–	–	–	(25)	(25)
Issue of ordinary shares	510	–	–	510	–	510
Movement in treasury shares	–	–	(480)	(480)	–	(480)
Value of employee services:						
Share option schemes	–	–	142	142	–	142
Other employee award schemes	–	–	292	292	–	292
Change in non-controlling interests	–	–	–	–	(349)	(349)
Total transactions with owners	510	–	(46)	464	(374)	90
Balance at 31 December 2013	24,424	10,477	4,088	38,989	347	39,336

Further details of movements in the Group's share capital and reserves are provided in notes 45, 46, 47 and 48.

The accompanying notes are an integral part of the consolidated financial statements.

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	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2012						
As previously reported	23,422	13,818	8,680	45,920	674	46,594
Restatement (notes 1 and 56)	–	–	(414)	(414)	–	(414)
Restated	23,422	13,818	8,266	45,506	674	46,180
Comprehensive income						
(Loss) profit for the year	–	–	(1,471)	(1,471)	84	(1,387)
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of taxation	–	–	(1,645)	(1,645)	–	(1,645)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(927)	–	(927)	(2)	(929)
Movements in cash flow hedging reserve, net of tax	–	25	–	25	–	25
Currency translation differences (tax: £nil)	–	(14)	–	(14)	–	(14)
Total other comprehensive income	–	(916)	(1,645)	(2,561)	(2)	(2,563)
Total comprehensive income	–	(916)	(3,116)	(4,032)	82	(3,950)
Transactions with owners						
Dividends	–	–	–	–	(56)	(56)
Issue of ordinary shares	492	–	–	492	–	492
Movement in treasury shares	–	–	(407)	(407)	–	(407)
Value of employee services:						
Share option schemes	–	–	81	81	–	81
Other employee award schemes	–	–	256	256	–	256
Change in non-controlling interests	–	–	–	–	(15)	(15)
Total transactions with owners	492	–	(70)	422	(71)	351
Balance at 31 December 2012[1]	23,914	12,902	5,080	41,896	685	42,581

[1] Restated – see note 1.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2011						
As previously reported	23,106	11,575	11,380	46,061	841	46,902
Restatement (notes 1 and 56)	–	–	(707)	(707)	–	(707)
Restated	23,106	11,575	10,673	45,354	841	46,195
Comprehensive income						
(Loss) profit for the year	–	–	(2,963)	(2,963)	73	(2,890)
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of taxation	–	–	469	469	–	469
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	1,611	–	1,611	(1)	1,610
Movements in cash flow hedging reserve, net of tax	–	716	–	716	–	716
Currency translation differences (tax: nil)	–	(84)	–	(84)	–	(84)
Total other comprehensive income	–	2,243	469	2,712	(1)	2,711
Total comprehensive income	–	2,243	(2,494)	(251)	72	(179)
Transactions with owners						
Dividends	–	–	–	–	(50)	(50)
Issue of ordinary shares	316	–	–	316	–	316
Movement in treasury shares	–	–	(276)	(276)	–	(276)
Value of employee services:						
Share option schemes	–	–	125	125	–	125
Other employee award schemes	–	–	238	238	–	238
Change in non-controlling interests	–	–	–	–	(189)	(189)
Total transactions with owners	316	–	87	403	(239)	164
Balance at 31 December 2011[1]	23,422	13,818	8,266	45,506	674	46,180

[1] Restated – see note 1.

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CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December

	Note	2013 £ million	2012[1] £ million	2011[1] £ million
Profit (loss) before tax		**415**	(606)	(3,751)
Adjustments for:				
Change in operating assets	55(A)	**17,117**	47,805	44,097
Change in operating liabilities	55(B)	**(44,270)**	(46,153)	(19,187)
Non-cash and other items	55(C)	**11,231**	2,081	(1,130)
Tax paid		**(24)**	(78)	(136)
Net cash (used in) provided by operating activities		**(15,531)**	3,049	19,893
Cash flows from investing activities				
Purchase of financial assets		**(36,959)**	(22,050)	(28,995)
Proceeds from sale and maturity of financial assets		**21,552**	37,664	36,523
Purchase of fixed assets		**(2,982)**	(3,003)	(3,095)
Proceeds from sale of fixed assets		**2,090**	2,595	2,214
Acquisition of businesses, net of cash acquired	55(E)	**(6)**	(11)	(13)
Disposal of businesses, net of cash disposed	55(F)	**696**	37	298
Net cash (used in) provided by investing activities		**(15,609)**	15,232	6,932
Cash flows from financing activities				
Dividends paid to non-controlling interests		**(25)**	(56)	(50)
Interest paid on subordinated liabilities		**(2,451)**	(2,577)	(2,126)
Proceeds from issue of subordinated liabilities		**1,500**	–	–
Proceeds from issue of ordinary shares		**350**	170	–
Repayment of subordinated liabilities		**(2,442)**	(664)	(1,074)
Change in non-controlling interests		**–**	23	8
Net cash (used in) provided by financing activities		**(3,068)**	(3,104)	(3,242)
Effects of exchange rate changes on cash and cash equivalents		**(53)**	(8)	6
Change in cash and cash equivalents		**(34,261)**	15,169	23,589
Cash and cash equivalents at beginning of year		**101,058**	85,889	62,300
Cash and cash equivalents at end of year	55(D)	**66,797**	101,058	85,889

[1] Restated – see note 1.

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of preparation

The consolidated financial statements of Lloyds Banking Group plc have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the 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 74, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

The Group has adopted the following new standards and amendments to standards which became effective for financial years beginning on or after 1 January 2013:

Changes in accounting policy

(i) IFRS 10 *Consolidated Financial Statements*

IFRS 10 supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* and establishes the principles for when the Group controls another entity and is therefore required to consolidate the other entity in the Group's financial statements. Under IFRS 10, the Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through the exercise of power. As a result, the Group consolidates certain entities that were not previously consolidated and no longer consolidates certain entities which were previously consolidated, principally in relation to Open Ended Investment Companies. The Group has applied IFRS 10 retrospectively and restated its comparatives in accordance with the transitional provisions included in the standard. These provisions require the Group to re-assess its control conclusions as at 1 January 2013 and restate its comparative information, applying the revised assessment in 2012 to the extent that the relevant investments were held in that year. Details of the impact of these restatements are provided in note 56 to the financial statements.

(ii) Revised IAS 19 *Employee Benefits* (IAS 19R)

IAS 19R prescribes the accounting and disclosure by employers for employee benefits. Actuarial gains and losses (remeasurements) arising from the valuation of defined benefit pension schemes are no longer permitted to be deferred using the corridor approach and must be recognised immediately in other comprehensive income. In addition, IAS 19R also replaces interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability (asset). IAS 19R has been applied retrospectively and comparative figures restated accordingly. Details of the impact of these restatements are provided in note 56 to the financial statements.

The impact of the implementation of IAS 19R on the Group's results for the year ended 31 December 2013 has been to decrease other operating expenses by £28 million and increase profit before tax by the same amount. The impact on the balance sheet at 31 December 2013 has been to increase the net retirement benefit liability by £2,817 million, to increase deferred tax assets by £648 million and to reduce shareholders' equity by £2,169 million.

(iii) IFRS 13 *Fair Value Measurement*

IFRS 13 has been applied with effect from 1 January 2013. IFRS 13 defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. IFRS 13 requires that the fair value of a non-financial asset is determined based on the highest and best use of the asset, and that the fair value of a liability reflects its non-performance risk. These changes had no significant impact on the measurement of the Group's assets and liabilities. The IFRS 13 disclosures are given in notes 53 (financial instruments), 26 (investment properties) and 16 (disposal groups, in respect of assets held for sale measured at fair value) to the financial statements.

Other presentation and disclosure changes

In addition to the accounting policy changes discussed above, on 1 January 2013 the Group adopted the following new standards and amendments to standards which impact the presentation and disclosures in these financial statements; none of these standards has had a material impact on the primary financial statements.

– Amendments to IAS 1 *Presentation of Financial Statements – 'Presentation of Items of Other Comprehensive Income'*
  The amendments to IAS 1 require entities to group items presented in other comprehensive income on the basis of whether they may potentially be reclassified to profit or loss subsequently. The statement of other comprehensive income in these financial statements has been revised to reflect the new requirements.

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Note 1: Basis of preparation (continued)

– Amendments to IFRS 7 *Financial Instruments: Disclosures – 'Disclosures - Offsetting Financial Assets and Financial Liabilities'*
The amendments to IFRS 7 require entities to disclose information to enable users of the financial statements to evaluate the effect or potential effect of netting arrangements on the balance sheet. These disclosures are given in note 53 to the financial statements.

– IFRS 12 *Disclosure of Interests in Other Entities*
IFRS 12 requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. These disclosures are made in the notes to these financial statements.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2013 and which have not been applied in preparing these financial statements are given in note 57.

Note 2: Accounting policies

The Group's accounting policies are set out below. These accounting policies have been applied consistently.

(A) Consolidation

The assets, liabilities and results of Group undertakings (including structured 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 are entities controlled by the Group. The Group controls an entity when it has power over the entity, is exposed to, or has rights to, variable returns from its involvement with the entity, and has the ability to affect those returns through the exercise of its power. This 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. The Group reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to any of the above elements. 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.

The Group consolidates collective investment vehicles if its beneficial ownership interests give it substantive rights to remove the external fund manager over the investment activities of the fund. Where a subsidiary of the Group is the fund manager of a collective investment vehicle, the Group considers a number of factors in determining whether it acts as principal and therefore controls the collective investment vehicle including: an assessment of the scope of the Group's decision making authority over the investment vehicle; the rights held by other parties including substantive removal rights without cause over the Group acting as fund manager; the remuneration to which the Group is entitled in its capacity as decision maker; and the Group's exposure to variable returns from the beneficial interest it holds in the investment vehicle. Consolidation may be appropriate in circumstances where the Group has less than a majority beneficial interest. Where a collective investment vehicle is consolidated the interests of parties other than the Group are reported in other liabilities.

Structured entities are entities that are designed so that their activities are not governed by way of voting rights. In assessing whether the Group has power over such entities in which it has an interest, the Group considers factors such as the purpose and design of the entity; its practical ability to direct the relevant activities of the entity; the nature of the relationship with the entity; and the size of its exposure to the variability of returns of the entity.

The treatment of transactions with non-controlling interests depends on whether, as a result of the transaction, the Group loses control of the subsidiary. Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions; any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent entity. Where the group loses control of the subsidiary, at the date when control is lost the amount of any non-controlling interest in that former subsidiary is derecognised and any investment retained in the former subsidiary is remeasured to its fair value; the gain or loss that is recognised in profit or loss on the partial disposal of the subsidiary includes the gain or loss on the remeasurement of the retained interest.

Intercompany transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

The acquisition method of accounting is used to account for business combinations by the Group. The consideration for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred except those relating to the issuance of debt instruments (see (E)(5) below) or share capital (see (R)(1) below). Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

(2) Joint ventures and associates

Joint ventures are joint arrangements over which the Group has joint control with other parties and has rights to the net assets of the arrangements. Associates are entities over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the entity, but is not control or joint control of those policies, and is generally 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 2: Accounting policies (continued)

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.

(C) Other intangible assets

Other intangible assets include brands, core deposit intangible, purchased credit card relationships, customer-related intangibles and both internally and externally generated 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 7 years
Brands (which have been assessed as having finite lives)	10-15 years
Customer-related intangibles	up to 10 years
Core deposit intangible	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 using the effective interest method, except for those classified at fair value through profit or loss. 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 (H) below).

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 (O) below); those relating to leases are set out in (K)(2) below.

(E) Financial assets and liabilities

On initial recognition, financial assets are classified into fair value through profit or loss, available-for-sale financial assets, held-to-maturity investments 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. The Group initially recognises loans

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Note 2: Accounting policies (continued)

and receivables, deposits, debt securities in issue and subordinated liabilities when the Group becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of securities and other financial assets and trading liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

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 of 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.

(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 (F) below).

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.

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 (A)(2) above 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: Fair value of financial instruments) and note 53 (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; or

– 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, held-to-maturity investments 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 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. Reclassification of a

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 2: Accounting policies (continued)

financial asset from the available-for-sale category to the held-to-maturity category is permitted when the Group has the ability and intent to hold that financial asset to maturity.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable. Effective interest rates for financial assets reclassified to the loans and receivables and held-to-maturity categories are determined at the reclassification date. Any previous gain or loss on a transferred asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest method or until the asset becomes impaired. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest method.

When an impairment loss is recognised in respect of available-for-sale assets transferred, the unamortised balance of any available-for-sale reserve that remains in equity is transferred to the income statement and recorded as part of the impairment loss.

(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 (D) above) less provision for impairment (see (H) below).

The Group has entered into securitisation and similar transactions to finance certain loans and advances to customers. In cases where the securitisation vehicles are funded by the issue of debt, on terms whereby the majority of the risks and rewards of the portfolio of securitised lending are retained by the Group, these loans and advances continue to be recognised by the Group, together with a corresponding liability for the funding.

(4) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity other than:

– those that the Group designates upon initial recognition as at fair value through profit or loss;

– those that the Group designates as available-for-sale; and

– those that meet the definition of loans and receivables.

These are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method, less any provision for impairment.

A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments to available-for-sale financial assets.

(5) 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.

(6) Sale and repurchase agreements (including securities lending and borrowing)

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 borrowing and lending transactions are typically secured; collateral takes the form of securities or cash advanced or received. Securities lent to counterparties are retained on the balance sheet. Securities borrowed are not recognised on the balance sheet, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability. Cash collateral given or received is treated as a loan and receivable or customer deposit.

(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

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Note 2: Accounting policies (continued)

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: Fair value 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 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 such instruments. 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:

(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 used in net investment 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 of the financial asset and prior to the balance sheet date, there is objective evidence that a financial asset or group of financial assets has become impaired.

Where such an event has had an impact on the estimated future cash flows of the financial asset or group of financial assets, an impairment allowance is recognised. The amount of impairment allowance is the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. If the asset has a variable rate of interest, the discount rate used for measuring the impairment allowance is the current effective interest rate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 2: Accounting policies (continued)

Subsequent to the recognition of an impairment loss on a financial asset or a group of financial assets, interest income continues to be recognised on an effective interest rate basis, on the asset's carrying value net of impairment provisions. 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.

Impairment allowances are assessed individually for financial assets that are individually significant. Such individual assessment is used primarily for the Group's wholesale lending portfolios in the Commercial Banking and Wealth, Asset Finance and International divisions. Impairment allowances for portfolios of smaller balance homogenous loans such as most residential mortgages, personal loans and credit card balances in the Group's retail portfolios in both the Retail and Wealth, Asset Finance and International divisions 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.

Individual assessment

In respect of individually significant financial assets in the Group's wholesale lending portfolios, assets are reviewed on a regular basis and those showing potential or actual vulnerability are placed on a watchlist where greater monitoring is undertaken and any adverse or potentially adverse impact on ability to repay is used in assessing whether an asset should be transferred to a dedicated Business Support Unit. Specific examples of trigger events that would lead to the initial recognition of impairment allowances against lending to corporate borrowers (or the recognition of additional impairment allowances) include (i) trading losses, loss of business or major customer of a borrower; (ii) material breaches of the terms and conditions of a loan facility, including non-payment of interest or principal, or a fall in the value of security such that it is no longer considered adequate; (iii) disappearance of an active market because of financial difficulties; or (iv) restructuring a facility with preferential terms to aid recovery of the lending (such as a debt for equity swap).

For such individually identified financial assets, a review is undertaken of the expected future cash flows which requires significant management judgement as to the amount and timing of such cash flows. Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of costs to realise, whether or not foreclosure or realisation of the collateral is probable.

For impaired debt instruments which are held at amortised cost, 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.

Collective assessment

Impairment is assessed on a collective basis for (1) homogenous groups of loans that are not considered individually impaired; and (2) to cover losses which have been incurred but have not yet been identified on loans subject to individual impairment.

Homogenous groups of loans

In respect of portfolios of smaller balance, homogenous loans, the asset is included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. Segmentation takes into account factors such as the type of asset, industry sector, 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.

Generally, the impairment trigger used within the impairment calculation for a loan, or group of loans, is when they reach a pre-defined level of delinquency or where the customer is bankrupt. Loans where the Group provides arrangements that forgive a portion of interest or principal are also deemed to be impaired and loans that are originated to refinance currently impaired assets are also defined as impaired.

In respect of the Group's secured mortgage portfolios, the impairment allowance is calculated based on a definition of impaired loans which are those six months or more in arrears (or certain cases where the borrower is bankrupt or is in possession). The estimated cash flows are calculated based on historical experience and are dependent on estimates of the expected value of collateral which takes into account expected future movements in house prices, less costs to sell.

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics set out above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of cohorts of similar portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the cohort and historical loss experience for similar assets. Historical loss experience is adjusted on the basis of current observable data about economic and credit conditions (including unemployment rates and borrowers' behaviour) 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.

Incurred but not yet identified impairment

The collective provision also includes provision for inherent losses, that is losses that have been incurred but have not been separately identified at the balance sheet date. The loans that are not currently recognised as impaired are grouped into homogenous portfolios by key risk drivers. Risk drivers for secured retail lending include the current indexed loan-to-value, previous mortgage arrears, internal cross-product delinquency data and external credit bureau data; for unsecured retail lending they include whether the account is up-to-date and, if not, the number of payments that have been missed; and for wholesale lending they include factors such as observed default rates and loss given default. An assessment is made of the likelihood of each account becoming recognised as impaired within the loss emergence period, with the economic loss that each

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Note 2: Accounting policies (continued)

portfolio is likely to generate were it to become impaired. The loss emergence period is determined by local management for each portfolio and the Group has a range of loss emergence periods which are dependent upon the characteristics of the portfolios. Loss emergence periods are reviewed regularly and updated when appropriate. In general the periods used across the Group vary between one month and twelve months based on historical experience. Unsecured portfolios tend to have shorter loss emergence periods than secured portfolios.

Loan renegotiations and forbearance

In certain circumstances, the Group will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. Where the renegotiated payments of interest and principal will not recover the original carrying value of the asset, the asset continues to be reported as past due and is considered impaired. Where the renegotiated payments of interest and principal will recover the original carrying value of the asset, the loan is no longer reported as past due or impaired provided that payments are made in accordance with the revised terms. Renegotiation may lead to the loan and associated provision being derecognised and a new loan being recognised initially at fair value.

Write offs

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 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. For both secured and unsecured retail balances, the write-off takes place only once an extensive set of collections processes has been completed, or the status of the account reaches a point where policy dictates that forbearance is no longer appropriate. For wholesale lending, a write-off occurs if the loan facility with the customer is restructured, the asset is under administration and the only monies that can be received are the amounts estimated by the administrator, the underlying assets are disposed and a decision is made that no further settlement monies will be received, or external evidence (for example, third party valuations) is available that there has been an irreversible decline in expected cash flows.

Debt for equity exchanges

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, held as available-for-sale. 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 (A) above). 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.

(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 and the remaining period of the lease.

– Leasehold improvements: shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 2: Accounting policies (continued)

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.

(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) Employee benefits

Short-term employee benefits, such as salaries, paid absences, performance-based cash awards and social security costs are recognised over the period in which the employees provide the related services.

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. 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. 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, past service costs, net interest expense (income), and plan administration costs that are not deducted from the return on plan assets. Past service costs, which represents the change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment, are recognised when the plan amendment or curtailment occurs. Net interest expense (income) is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or asset.

Remeasurements, comprising actuarial gains and losses, the return on plan assets (excluding amounts included in net interest expense (income) and net of the cost of managing the plan assets), and the effect of changes to the asset ceiling (if applicable) are reflected immediately in the balance sheet with a charge or credit recognised in other comprehensive income in the period in which they occur. Remeasurements recognised in other comprehensive income are reflected immediately in retained profits and will not subsequently be reclassified to profit or loss.

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. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The costs of the Group's defined contribution plans are charged to the income statement in the period in which they fall due.

The accounting for share-based compensation is set out in (M) below.

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Note 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 or a Monte Carlo simulation. 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, 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 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.

(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 shareholders' 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 substantively 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 and current 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 tax is subsequently transferred to the income statement together with the 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. Insurance and participating investment contracts are accounted for under IFRS 4 *Insurance Contracts*, which permits (with certain exceptions) the continuation of accounting practices for measuring insurance and participating investment contracts that applied prior to the adoption of IFRS. The Group, therefore, continues to account for these products using UK GAAP, including FRS 27 *Life Assurance*, and UK established practice.

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 gives the holder the right 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, within the constraints of the terms and conditions of the instrument 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 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 Prudential Regulation Authority's realistic capital regime, except that projected transfers out of the funds into other Group funds are recorded in the unallocated surplus (see below). Further details on the realistic capital regime are given on page 187. Changes in the value of these liabilities are recognised in the income statement 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 returns (including movements in fair value and investment income) allocated to those contracts are recognised in the income statement through 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 are 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.

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Note 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 benefits payable on one or more contracts issued by the Group are recognised as assets arising from reinsurance contracts held. Where the underlying contracts issued by the Group are classified as insurance contracts and the reinsurance contract transfers significant insurance risk on those contracts to the reinsurer, the assets arising from reinsurance contracts held are classified as insurance contracts. Where the underlying contracts issued by the Group are classified as non-participating investment contracts and the reinsurance contract transfers financial risk on those contracts to the reinsurer, the assets arising from reinsurance contracts held are classified as non-participating investment contracts.

Assets arising from reinsurance contracts held – Classified as insurance 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.

Assets arising from reinsurance contracts held – Classified as non-participating investment contracts

These contracts are accounted for as financial assets whose value is contractually linked to the fair values of financial assets within the reinsurers' investment funds. Investment returns (including movements in fair value and investment income) allocated to these contracts are recognised 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 assets arising from reinsurance contracts held.

(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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 2: Accounting policies (continued)

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 (F)(3) above). 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.

(Q) Provisions and contingent liabilities

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.

Provision is made for irrevocable undrawn loan commitments if it is probable that the facility will be drawn and result in the recognition of an asset at an amount less than the amount advanced.

(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.

Note 3: Critical accounting estimates and judgements

The preparation of the Group's financial statements in accordance with IFRS 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 as follows.

Allowance for impairment losses on loans and receivables

At 31 December 2013 gross loans and receivables totalled £534,092 million (2012: £570,714 million) against which impairment allowances of £12,091 million (2012: £15,459 million) had been made (see note 24). The Group's accounting policy for losses arising on financial assets classified as loans and receivables is described in note 2 (H)(1); this note also provides an overview of the methodologies applied.

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 made up of two components, those determined individually and those determined collectively.

Individual impairment allowances are generally established against the Group's wholesale lending portfolios. The determination of individual impairment allowances requires the exercise of considerable judgement by management involving matters such as local economic conditions

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Note 3: Critical accounting estimates and judgements (continued)

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 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.

Collective impairment allowances are generally established for smaller balance homogenous portfolios such as the retail portfolios. The collective impairment allowance is also subject to estimation uncertainty and in particular 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 mortgage portfolio, a key variable is 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 were ten per cent lower than those estimated at 31 December 2013, the impairment charge would increase by approximately £310 million in respect of UK mortgages and a further £36 million in respect of Irish mortgages.

In addition, a collective unimpaired provision is made for loan losses that have been incurred but have not been separately identified at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Commercial Banking division, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unimpaired provisions would result in an increase in the collective unimpaired provision of approximately £105 million (at 31 December 2012, a one month increase in the loss emergence period would have increased the collective unimpaired provision by an estimated £130 million).

Recoverability of deferred tax assets

At 31 December 2013 the Group carried deferred tax assets on its balance sheet of £5,104 million (2012: £4,913 million) and deferred tax liabilities of £3 million (2012: £327 million) (note 42). This 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 presents the Group's deferred tax assets and liabilities by type. The largest category of deferred tax asset relates to tax losses carried forward.

The recoverability of the Group's deferred tax assets in respect of carry forward losses is based on an assessment of future levels of taxable profit expected to arise that can be offset against these losses. The Group's expectations as to the level of future taxable profits take into account the Group's long-term financial and strategic plans, and anticipated future tax adjusting items.

In making this assessment account is taken of business plans, the five year board approved operating plan and the following future risk factors:

– The expected future economic outlook as set out in the Group Chief Executive's Review and Market Overview;

– The retail banking business disposal as required by the European Commission; and

– Future regulatory change.

The Group's total deferred tax asset includes £6,338 million (2012: £7,034 million) in respect of trading losses carried forward. The tax losses have arisen in individual legal entities and will be used as future taxable profits arise in those legal entities, though substantially all of the unused tax losses for which a deferred tax asset has been recognised arise in Bank of Scotland plc and Lloyds Bank plc.

The deferred tax asset is expected to be utilised over different time periods in each of the entities in which the losses arise. Under current UK tax law there is no expiry date for unused tax losses. The losses are still expected to be fully utilised by 2019.

As disclosed in note 42, deferred tax assets totalling £802 million (2012: £1,311 million) have not been recognised in respect of certain capital losses carried forward, trading losses carried forward and unrelieved foreign tax credits as there are no predicted future capital or taxable profits against which these losses can be recognised.

Retirement benefit obligations

The net liability recognised in the balance sheet at 31 December 2013 in respect of the Group's retirement benefit obligations was £998 million (comprising an asset of £98 million and a liability of £1,096 million) (2012: a net liability of £1,164 million comprising an asset of £741 million and a liability of £1,905 million) related to post-retirement defined benefit schemes. The defined benefit pension schemes' net accounting deficit totalled £787 million (2012: deficit of £957 million) representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

The value of the Group's defined benefit pension schemes' liabilities requires management to make a number of assumptions. The key areas of estimation uncertainty are the discount rate applied to future cash flows and the expected lifetime of the schemes' members. The accounting surplus or deficit is sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variation. 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 and extrapolate the improving trend, however given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience.

The effect on the net accounting surplus or deficit and on the pension charge in the Group's income statement of changes to the principal actuarial assumptions is set out in note 41.

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Note 3: Critical accounting estimates and judgements (continued)

Valuation of assets and liabilities arising from life insurance business

At 31 December 2013, the Group recognised a value of in-force business asset of £4,874 million (2012: £5,488 million) and an acquired value of in-force business asset of £461 million (2012: £1,312 million). The value of in-force business asset represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. The acquired value of in-force business asset represents the 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 28. The valuation or recoverability of these assets requires assumptions to be made about future economic and operating conditions which are inherently uncertain and changes could significantly affect the value attributed to these assets. The key assumptions that have been made in determining the carrying value of the value of in-force business assets at 31 December 2013 are set out in note 28.

At 31 December 2013, the Group carried total liabilities arising from insurance contracts and participating investment contracts of £82,777 million (2012: £82,953 million). The methodology used to value these liabilities is described in note 36. Elements of the liability valuations require assumptions to be made about future investment returns, future mortality rates and future policyholder behaviour and are subject to significant management judgement and estimation uncertainty. The key assumptions that have been made in determining the carrying value of these liabilities are set out in note 36.

The effect on the Group's profit before tax and shareholders' equity of changes in key assumptions used in determining the life insurance assets and liabilities is set out in note 37.

Payment protection insurance and other regulatory provisions

At 31 December 2013, the Group carried provisions of £3,815 million (2012: £3,366 million) against the cost of making redress payments to customers and the related administration costs in connection with historical regulatory breaches, principally the misselling of payment protection insurance. Determining the amount of the provisions, which represent management's best estimate of the cost of settling these issues, requires the exercise of significant judgement. It will often be necessary to form a view on matters which are inherently uncertain, such as the number of future complaints, the extent to which they will be upheld and the average cost of redress. Consequently the continued appropriateness of the underlying assumptions is reviewed on a regular basis against actual experience and other relevant evidence and adjustments made to the provisions where appropriate.

Note 43 contains more detail on the nature of the assumptions that have been made and key sensitivities.

Fair value of financial instruments

In accordance with IFRS 13 *Fair Value Measurement*, the Group categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as level 1 are valued using quoted market prices and therefore there is minimal judgement applied in determining fair value. However, the fair value of financial instruments categorised as level 2 and, in particular, level 3 is determined using valuation techniques including discounted cash flow analysis and valuation models. These valuation techniques involve management judgement and estimates the extent of which depends on the complexity of the instrument and the availability of market observable information.

Valuation techniques for level 2 financial instruments use inputs that are based on observable market data. Level 3 financial instruments 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. Determining the appropriate assumptions to be used for level 3 financial instruments requires significant management judgement.

At 31 December 2013, the Group classified £7,700 million of financial assets and £1,075 million of financial liabilities as level 3. Further details of the Group's level 3 financial instruments and the sensitivity of their valuation including the effect of applying reasonably possible alternative assumptions in determining their fair value are set out in note 53. Details about sensitivities to market risk arising from trading assets and other treasury positions can be found in the Risk Management section on page 166.

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Note 4: Segmental analysis

Lloyds Banking Group provides 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.

The segmental results and comparatives are presented on an underlying basis, the basis reviewed by the chief operating decision maker.

The Group's activities are organised into four financial reporting segments: Retail; Commercial Banking; Wealth, Asset Finance and International; and Insurance.

Retail offers a broad range of retail financial service products in the UK, including current accounts, savings, personal loans, credit cards and mortgages. It is also a major general insurance and bancassurance distributor, selling a wide range of long-term savings, investment and general insurance products.

Commercial Banking provides banking and related services for all UK and multinational business clients, from small and medium-sized enterprises to major corporate and financial institutions.

Wealth, Asset Finance and International gives increased focus and momentum to the Group's private banking and asset management activities, closely co-ordinates the management of its international businesses and also encompasses the Asset Finance business. Wealth comprises the Group's private banking, wealth and asset management businesses in the UK and overseas. International comprises retail businesses, principally in Continental Europe.

Insurance provides long-term savings, protection and investment products distributed through the bancassurance, intermediary and direct channels in the UK. It is also a distributor of home insurance in the UK with products sold through the retail branch network, direct channels and strategic corporate partners. The business consists of Life, Pensions and Investments UK; Life, Pensions and Investments Europe; and General Insurance.

Other includes the costs of managing the Group's technology platforms, branch and head office property estate, operations (including payments, banking operations and collections) and sourcing, the costs of which are predominantly recharged to the other divisions. It also reflects other items not recharged to the divisions, including hedge ineffectiveness, UK bank levy, Financial Services Compensation Scheme costs, gains on liability management, volatile items such as hedge accounting volatility managed centrally, and other gains from the structural hedging of interest rate risk.

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 the majority of those derivative contracts entered into by business units for risk management purposes, the business unit recognises the net interest income or expense on an accrual accounting basis and transfers the remainder of the movement in the fair value of the derivative to the central group segment where the resulting accounting volatility is managed where possible through 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 leads to accounting volatility in the central group segment where it is managed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 4: Segmental analysis (continued)

	Retail £m	Commercial Banking £m	Wealth, Asset Finance and International £m	Insurance £m	Other £m	Underlying basis total £m
Year ended 31 December 2013						
Net interest income	7,536	2,426	870	(103)	156	10,885
Other income (net of insurance claims)	1,410	2,708	1,809	1,880	113	7,920
Total underlying income, net of insurance claims	8,946	5,134	2,679	1,777	269	18,805
Total costs	(4,096)	(2,392)	(1,991)	(687)	(469)	(9,635)
Impairment	(1,101)	(1,167)	(730)	–	(6)	(3,004)
Underlying profit (loss)	3,749	1,575	(42)	1,090	(206)	6,166
External revenue	10,478	4,410	2,451	2,459	(993)	18,805
Inter-segment revenue	(1,532)	724	228	(682)	1,262	–
Segment revenue	8,946	5,134	2,679	1,777	269	18,805
Segment external assets	345,037	255,459	30,987	155,656	59,891	847,030
Segment customer deposits	268,974	126,534	45,772	–	31	441,311
Segment external liabilities	287,610	225,985	47,879	149,757	96,463	807,694
Other segment items reflected in income statement above:						
Depreciation and amortisation	302	191	818	136	98	1,545
(Decrease) increase in value of in-force business	–	–	(9)	425	–	416
Defined benefit scheme charges	108	47	33	12	199	399
Other segment items:						
Additions to tangible fixed assets	484	178	1,429	373	518	2,982
Investments in joint ventures and associates at end of year	24	62	11	–	4	101

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Note 4: Segmental analysis (continued)[1]

	Retail £m	Commercial Banking £m	Wealth, Asset Finance and International £m	Insurance £m	Other £m	Underlying basis total £m
Year ended 31 December 2012[1]						
Net interest income	7,195	2,206	799	(78)	213	10,335
Other income (net of insurance claims)	1,462	2,932	2,043	1,929	(315)	8,051
Total underlying income, net of insurance claims	8,657	5,138	2,842	1,851	(102)	18,386
Total costs	(4,199)	(2,516)	(2,291)	(744)	(374)	(10,124)
Impairment	(1,270)	(2,946)	(1,480)	–	(1)	(5,697)
Underlying profit (loss)	3,188	(324)	(929)	1,107	(477)	2,565
External revenue	10,951	4,070	2,835	2,497	(1,967)	18,386
Inter-segment revenue	(2,294)	1,068	7	(646)	1,865	–
Segment revenue	8,657	5,138	2,842	1,851	(102)	18,386
Segment external assets	346,030	314,090	77,884	152,583	43,634	934,221
Segment customer deposits	260,838	114,115	51,885	–	74	426,912
Segment external liabilities	287,631	249,097	92,686	143,695	118,531	891,640
Other segment items reflected in income statement above:						
Depreciation and amortisation	345	219	815	95	90	1,564
(Decrease) increase in value of in-force business	–	–	(4)	273	–	269
Defined benefit scheme charges	103	54	36	23	(106)	110
Other segment items:						
Additions to tangible fixed assets	143	67	1,732	378	683	3,003
Investments in joint ventures and associates at end of year	185	113	6	–	9	313

[1] Restated – see note 1.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 4: Segmental analysis (continued)

	Retail £m	Commercial Banking £m	Wealth, Asset Finance and International £m	Insurance £m	Other £m	Underlying basis total £m
Year ended 31 December 2011[1]						
Net interest income	7,497	3,192	1,003	(67)	585	12,210
Other income (net of insurance claims)	1,660	2,806	2,230	2,344	(204)	8,836
Total underlying income, net of insurance claims	9,157	5,998	3,233	2,277	381	21,046
Total costs	(4,438)	(2,600)	(2,414)	(812)	(566)	(10,830)
Impairment	(1,970)	(4,210)	(3,604)	–	(3)	(9,787)
Underlying profit (loss)	2,749	(812)	(2,785)	1,465	(188)	429
External revenue	12,230	3,889	3,863	2,910	(1,846)	21,046
Inter-segment revenue	(3,073)	2,109	(630)	(633)	2,227	–
Segment revenue	9,157	5,998	3,233	2,277	381	21,046
Segment external assets	356,295	350,711	73,345	140,754	49,441	970,546
Segment customer deposits	247,088	123,822	41,661	–	1,335	413,906
Segment external liabilities	279,162	294,088	73,635	129,350	147,717	923,952
Other segment items reflected in income statement above:						
Depreciation and amortisation	364	244	836	91	67	1,602
Increase (decrease) in value of in-force business	–	–	3	(625)	–	(622)
Defined benefit scheme charges	121	54	37	23	173	408
Other segment items:						
Additions to tangible fixed assets	189	197	1,452	451	806	3,095
Investments in joint ventures and associates at end of year	147	155	29	–	3	334

[1] Restated – see note 1.

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Note 4: Segmental analysis (continued)

Reconciliation of underlying basis to statutory results

The underlying 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 underlying basis.

		Removal of:					
	Lloyds Banking Group statutory £m	Acquisition related and other items[1] £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Regulatory provisions[2] £m	Fair value unwind £m	Underlying basis £m
Year ended 31 December 2013							
Net interest income	7,338	(14)	–	2,930	–	631	10,885
Other income, net of insurance claims	11,140	460	(668)	(3,074)	–	62	7,920
Total underlying income, net of insurance claims	18,478	446	(668)	(144)	–	693	18,805
Operating expenses	(15,322)	2,041	–	144	3,455	47	(9,635)
Impairment	(2,741)	249	–	–	–	(512)	(3,004)
Underlying (loss) profit	415	2,736	(668)	–	3,455	228	6,166

[1] Comprises the effects of asset sales (gain of £100 million), volatile items (loss of £678 million), liability management (loss of £142 million), Simplification costs related to severance, IT and business costs of implementation (£830 million), EC mandated retail business disposal costs (£687 million), the amortisation of purchased intangibles (£395 million) and the past service pensions charge (£104 million, see note 11).

[2] Comprises the payment protection insurance provision (£3,050 million) and other regulatory provisions (£405 million).

		Removal of:					
	Lloyds Banking Group statutory £m	Acquisition related and other items[2] £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Regulatory provisions[3] £m	Fair value unwind £m	Underlying basis £m
Year ended 31 December 2012[1]							
Net interest income	7,718	(199)	(8)	2,587	–	237	10,335
Other income, net of insurance claims	12,799	(1,691)	(304)	(2,760)	50	(43)	8,051
Total underlying income, net of insurance claims	20,517	(1,890)	(312)	(173)	50	194	18,386
Operating expenses	(15,974)	1,478	–	173	4,175	24	(10,124)
Impairment	(5,149)	320	–	–	–	(868)	(5,697)
Underlying (loss) profit	(606)	(92)	(312)	–	4,225	(650)	2,565

[1] Restated – see note 1.

[2] Comprises the effects of asset sales (gain of £2,547 million), volatile items (loss of £748 million), liability management (loss of £229 million), Simplification costs related to severance, IT and business costs of implementation (£676 million), EC mandated retail business disposal costs (£570 million), the amortisation of purchased intangibles (£482 million) and the past service pensions credit (£250 million, see note 11).

[3] Comprises the payment protection insurance provision (£3,575 million) and other regulatory provisions (£650 million).

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Note 4: Segmental analysis (continued)

		Removal of:					
	Lloyds Banking Group statutory £m	Acquisition related and other items[2] £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Regulatory provisions[3] £m	Fair value unwind £m	Underlying basis £m
Year ended 31 December 2011[1]							
Net interest income	12,698	(843)	(19)	(336)	–	710	12,210
Other income, net of insurance claims	8,104	2	857	168	–	(295)	8,836
Total underlying income, net of insurance claims	20,802	(841)	838	(168)	–	415	21,046
Operating expenses	(16,459)	2,014	–	168	3,375	72	(10,830)
Impairment	(8,094)	–	–	–	–	(1,693)	(9,787)
Underlying (loss) profit	(3,751)	1,173	838	–	3,375	(1,206)	429

[1] Restated – see note 1.

[2] Comprises the effects of asset sales (gain of £284 million), volatile items (loss of £738 million), liability management (gain of £1,295 million), integration and Simplification costs related to severance, IT and business costs of implementation (£1,282 million), EC mandated retail business disposal costs (£170 million) and the amortisation of purchased intangibles (£562 million).

[3] Comprises the payment protection insurance provision (£3,200 million) and other regulatory provisions (£175 million).

Geographical areas

Following the continuing reduction in the Group's non-UK activities, an analysis between UK and non-UK activities is no longer provided.

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Note 5: Net interest income

	Weighted average effective interest rate					
	2013 %	2012[1] %	2011 %	2013 £m	2012[1] £m	2011 £m
Interest and similar income:						
Loans and advances to customers	3.83	3.94	4.03	19,928	21,600	23,950
Loans and advances to banks	0.45	0.54	0.78	457	603	628
Debt securities held as loans and receivables	1.52	4.77	3.17	32	433	590
Interest receivable on loans and receivables	3.27	3.38	3.63	20,417	22,636	25,168
Available-for-sale financial assets	1.92	1.99	2.58	746	624	886
Held-to-maturity investments	–	2.80	3.29	–	288	262
Total interest and similar income	3.19	3.31	3.58	21,163	23,548	26,316
Interest and similar expense:						
Deposits from banks, excluding liabilities under sale and repurchase transactions	0.65	1.14	0.80	(129)	(324)	(222)
Customer deposits, excluding liabilities under sale and repurchase transactions	1.53	1.69	1.66	(6,119)	(6,637)	(6,080)
Debt securities in issue	1.30	2.04	2.22	(1,451)	(3,043)	(5,045)
Subordinated liabilities	8.57	7.41	6.35	(2,956)	(2,783)	(2,155)
Liabilities under sale and repurchase agreements	1.21	1.47	1.39	(79)	(245)	(335)
Interest payable on liabilities held at amortised cost	1.88	2.08	2.04	(10,734)	(13,032)	(13,837)
Other	12.08	8.90	(1.14)	(3,091)	(2,798)	219
Total interest and similar expense	2.32	2.41	1.95	(13,825)	(15,830)	(13,618)
Net interest income				7,338	7,718	12,698

[1] Restated – see note 1.

Included within interest and similar income is £901 million (2012: £1,133 million; 2011: £1,405 million) in respect of impaired financial assets. Net interest income also includes a credit of £550 million (2012: credit of £92 million; 2011: charge of £70 million) transferred from the cash flow hedging reserve (see note 47).

During February 2012, the Group completed the exchange of certain subordinated debt securities issued by the HBOS group for new subordinated debt securities issued by Lloyds Bank plc (formerly Lloyds TSB Bank plc). As part of the exchange, the Group announced that all decisions to exercise calls on those original securities that remained outstanding following the exchange offer would be made with reference to the prevailing regulatory, economic and market conditions at the time. The Group adjusted the carrying amount of these securities to reflect the revised estimated cash flows and recognised a credit of £109 million in interest expense in the year ended 31 December 2012 (in 2011 there was a gain following a similar adjustment to carrying value of £570 million).

In December 2011, the Group decided to defer payment of non-mandatory coupons on certain securities and, instead, settle them using an Alternative Coupon Satisfaction Mechanism on their contractual terms. This change in expected cash flows resulted in a gain of £126 million in net interest income in the year ended 31 December 2011 from the recalculation of the carrying value of these securities.

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Note 6: Net fee and commission income

	2013 £m	2012[1] £m	2011 £m
Fee and commission income:			
Current accounts	**973**	1,008	1,053
Credit and debit card fees	**984**	941	877
Other	**2,162**	2,701	3,005
Total fee and commission income	**4,119**	4,650	4,935
Fee and commission expense	**(1,385)**	(1,444)	(1,391)
Net fee and commission income	**2,734**	3,206	3,544

[1] Restated – see note 1.

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.

Note 7: Net trading income

	2013 £m	2012[1] £m	2011 £m
Foreign exchange translation gains (losses)	**162**	(167)	317
Gains on foreign exchange trading transactions	**238**	502	341
Total foreign exchange	**400**	335	658
Investment property gains (losses) (note 26)	**156**	(264)	(107)
Securities and other gains (losses) (see below)	**15,911**	14,934	(919)
Net trading income (expense)	**16,467**	15,005	(368)

[1] Restated – see note 1.

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:

	2013 £m	2012[1] £m	2011 £m
Net income (expense) arising on assets held at fair value through profit or loss:			
Debt securities, loans and advances	**55**	4,042	5,293
Equity shares	**15,813**	10,847	(4,917)
Total net income arising on assets held at fair value through profit or loss	**15,868**	14,889	376
Net expense arising on liabilities held at fair value through profit or loss – debt securities in issue	**(93)**	(576)	(230)
Total net gains arising on assets and liabilities held at fair value through profit or loss	**15,775**	14,313	146
Net gains (losses) on financial instruments held for trading	**136**	621	(1,065)
Securities and other gains (losses)	**15,911**	14,934	(919)

[1] Restated – see note 1.

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Note 8: Insurance premium income

	2013 £m	2012 £m	2011 £m
Life insurance			
Gross premiums	**7,382**	7,391	7,276
Ceded reinsurance premiums	**(182)**	(222)	(322)
Net earned premiums	**7,200**	7,169	6,954
Non-life insurance			
Gross written premiums	**972**	1,081	1,198
Ceded reinsurance premiums	**(18)**	(31)	(52)
Net written premiums	**954**	1,050	1,146
Change in provision for unearned premiums (note 36(2))	**49**	72	70
Change in provision for ceded unearned premiums (note 36(2))	**(6)**	(7)	–
Net earned premiums	**997**	1,115	1,216
Total net earned premiums	**8,197**	8,284	8,170

Life insurance gross premiums can be further analysed as follows:

	2013 £m	2012 £m	2011 £m
Life and pensions	**6,823**	6,755	6,737
Annuities	**549**	630	529
Other	**10**	6	10
Gross premiums	**7,382**	7,391	7,276

Non-life insurance gross written premiums can be further analysed as follows:

	2013 £m	2012 £m	2011 £m
Credit protection	**141**	173	231
Home	**828**	904	963
Health	**3**	4	4
Gross written premiums	**972**	1,081	1,198

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 9: Other operating income

	2013 £m	2012 £m	2011 £m
Operating lease rental income	**1,120**	1,145	1,268
Rental income from investment properties (note 26)	**308**	389	388
Gains less losses on disposal of available-for-sale financial assets (note 47)	**629**	3,547	343
Movement in value of in-force business (note 28)	**416**	269	(622)
Liability management (see below)	**(142)**	(338)	599
Share of results of joint ventures and associates (note 13)	**43**	28	31
Other (see below)	**875**	(340)	792
Total other operating income	**3,249**	4,700	2,799

Liability management

Losses of £142 million arose in 2013 on transactions undertaken as part of the Group's management of wholesale funding and capital.

During February 2012, the Group completed the exchange of certain subordinated debt securities issued by the HBOS group for new subordinated debt securities issued by Lloyds Bank plc (formerly Lloyds TSB Bank plc). This exchange resulted in a gain on the extinguishment of the existing securities of £59 million being the difference between the carrying amount of the securities extinguished and the fair value of the new securities issued together with related fees and costs. Additionally, during the second half of 2012 losses totalling £397 million arose on the buy-back of other debt securities.

During December 2011, the Group completed the exchange of certain subordinated debt securities which resulted in a gain on extinguishment of the existing securities of £599 million.

Other

During 2013 the Group completed a number of disposals of assets and businesses, including:

- On 15 March 2013 the Group completed the sale of 102 million shares in St James's Place plc, reducing the Group's holding in that company to approximately 37 per cent. As a result of that reduction in holding the Group ceased to consolidate St James's Place plc in its accounts, instead accounting for the residual investment as an associate. The Group realised a gain of £394 million on the sale of those shares and the fair valuation of the Group's residual stake. Subsequently, on 29 May 2013 the Group completed the sale of a further 77 million shares, generating a profit of £39 million and on 13 December 2013 completed the sale of the remainder of its holding, generating a profit of £107 million.
- On 31 May 2013, the Group sold a portfolio of US RMBS (residential mortgage backed securities) for a cash consideration of £3.3 billion, realising a profit of £538 million.
- On 30 June 2013 the Group disposed of its Spanish retail banking operations, including Lloyds Bank International S.A.U and Lloyds Investment España SGIIC S.A.U, to Banco Sabadell, S.A. realising a loss of £256 million.
- On 31 December 2013, the Group completed the sale of its Australian operations (which principally comprise Capital Finance Australia Limited, a provider of motor and equipment asset finance, and BOS International (Australia) Limited, a corporate lending business) generating a profit on sale of £49 million.
- On 21 August 2013 the Group announced the sale of its German life insurance business, Heidelberger Lebensversicherung AG (Heidelberger Leben), with the sale expected to complete in the first quarter of 2014; an impairment of £382 million has been recognised in the year ended 31 December 2013.

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Note 10: Insurance claims

Insurance claims comprise:

	2013 £m	2012 £m	2011 £m
Life insurance and participating investment contracts			
Claims and surrenders:			
Gross	(8,495)	(8,719)	(8,622)
Reinsurers' share	108	185	230
	(8,387)	(8,534)	(8,392)
Change in insurance and participating investment contracts (note 36(1)):			
Change in gross liabilities	(5,184)	(4,284)	1,383
Change in assets arising from reinsurance contracts held	(48)	(186)	451
	(5,232)	(4,470)	1,834
Change in non-participating investment contracts:			
Change in gross liabilities	(5,409)	(5,058)	520
Change in assets arising from reinsurance contracts held	–	–	–
	(5,409)	(5,058)	520
Change in unallocated surplus (note 39)	(123)	31	340
Total life insurance and participating investment contracts	(19,151)	(18,031)	(5,698)
Non-life insurance			
Claims and claims paid:			
Gross	(388)	(439)	(521)
Reinsurers' share	–	1	4
	(388)	(438)	(517)
Change in liabilities (note 36(2)):			
Gross	33	74	186
Reinsurers' share	(1)	(1)	(12)
	32	73	174
Total non-life insurance	(356)	(365)	(343)
Total insurance claims	(19,507)	(18,396)	(6,041)
Life insurance and participating investment contracts gross claims can also be analysed as follows:			
Deaths	(611)	(618)	(625)
Maturities	(2,240)	(2,238)	(1,861)
Surrenders	(4,489)	(4,795)	(5,041)
Annuities	(860)	(789)	(764)
Other	(295)	(279)	(331)
Total life insurance gross claims	(8,495)	(8,719)	(8,622)

A non-life insurance claims development table is included in note 36.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 11: Operating expenses

	2013 £m	2012[1] £m	2011[1] £m
Staff costs:			
Salaries	3,331	3,411	3,784
Performance-based compensation	473	395	361
Social security costs	385	383	432
Pensions and other post-retirement benefit schemes (note 41):			
Past service charges (credits)[2]	104	(250)	–
Other	654	589	610
	758	339	610
Restructuring costs	111	217	124
Other staff costs	783	746	1,064
	5,841	5,491	6,375
Premises and equipment:			
Rent and rates	467	488	547
Hire of equipment	15	17	22
Repairs and maintenance	178	174	188
Other	310	270	294
	970	949	1,051
Other expenses:			
Communications and data processing	1,169	1,082	954
Advertising and promotion	313	314	398
Professional fees	425	550	576
UK bank levy	238	179	189
Other	971	1,108	1,301
	3,116	3,233	3,418
Depreciation and amortisation:			
Depreciation of tangible fixed assets (note 30)	1,374	1,431	1,434
Amortisation of acquired value of in-force non-participating investment contracts (note 28)	54	79	78
Amortisation of other intangible assets (note 29)	512	616	663
	1,940	2,126	2,175
Impairment of tangible fixed assets	–	–	65
Total operating expenses, excluding regulatory provisions	11,867	11,799	13,084
Regulatory provisions:			
Payment protection insurance provision (note 43)	3,050	3,575	3,200
Other regulatory provisions (note 43)[3,4]	405	600	175
	3,455	4,175	3,375
Total operating expenses	15,322	15,974	16,459

[1] Restated – see note 1.

[2] The Group has agreed certain changes to early retirement and commutation factors in two of its principal defined benefit pension schemes, resulting in a cost of £104 million recognised in the Group's income statement in the year ended 31 December 2013.

During 2012, following a review of policy in respect of discretionary pension increases in relation to the Group's defined benefit pension schemes, increases in certain schemes are now linked to the Consumer Price Index rather than the Retail Price Index. The impact of this change was a reduction in the Group's defined benefit obligation of £258 million, recognised in the Group's income statement in 2012, net of a charge of £8 million resulting from a change to the commutation factors in one of the Group's smaller schemes.

[3] Other regulatory provisions in 2013 include a fine of £28 million levied on the Group by the Financial Conduct Authority in relation to failings in control over sales incentive schemes in the Group's branch network.

[4] Regulatory provisions of £50 million were charged against income in 2012.

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Note 11: Operating expenses (continued)

Performance-based compensation

The table below analyses the Group's performance-based compensation costs (excluding branch-based sales incentives) between those relating to the current performance year and those relating to earlier years.

	2013 £m	2012 £m	2011 £m
Performance-based compensation expense comprises:			
Awards made in respect of the year ended 31 December	**394**	362	363
Awards made in respect of earlier years	**79**	33	(2)
	473	395	361
Performance-based compensation expense deferred until later years comprises:			
Awards made in respect of the year ended 31 December	**47**	37	43
Awards made in respect of earlier years	**30**	15	29
	77	52	72

Performance-based awards expensed in 2013 include cash awards amounting to £126 million (2012: £128 million; 2011: £160 million).

Average headcount

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2013	2012	2011
UK	**96,001**	110,295	116,371
Overseas	**1,868**	3,322	4,078
Total	**97,869**	113,617	120,449

Fees payable to the auditors

Fees payable to the Company's auditors by the Group are as follows:

	2013 £m	2012 £m	2011 £m
Fees payable for the audit of the Company's current year annual report	**1.5**	1.6	1.7
Fees payable for other services:			
Audit of the Company's subsidiaries pursuant to legislation	**15.1**	15.7	16.9
Other services supplied pursuant to legislation	**4.4**	4.5	4.8
Total audit fees	**21.0**	21.8	23.4
Other services – audit related fees	**5.0**	1.7	2.9
Total audit and audit related fees	**26.0**	23.5	26.3
Services relating to taxation:			
Taxation compliance services	**0.3**	0.2	0.2
All other taxation advisory services	**0.3**	0.6	0.9
	0.6	0.8	1.1
Other non-audit fees:			
Services relating to corporate finance transactions	**0.3**	0.5	6.3
Other services	**5.6**	2.2	2.6
Total other non-audit fees	**5.9**	2.7	8.9
Total fees payable to the Company's auditors by the Group	**32.5**	27.0	36.3

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 11: Operating expenses (continued)

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 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.

During the year, the auditors also earned fees payable by entities outside the consolidated Lloyds Banking Group in respect of the following:

	2013 £m	2012 £m	2011 £m
Audits of Group pension schemes	**0.3**	0.4	0.4
Audits of the unconsolidated Open Ended Investment Companies managed by the Group	**0.5**	0.8	0.6
Reviews of the financial position of corporate and other borrowers	**6.5**	5.4	11.0
Acquisition due diligence and other work performed in respect of potential venture capital investments	**2.1**	0.7	1.0

Note 12: Impairment

	2013 £m	2012 £m	2011 £m
Impairment losses on loans and receivables:			
Loans and advances to customers	**2,725**	5,125	8,020
Debt securities classified as loans and receivables	**1**	(4)	49
Total impairment losses on loans and receivables (note 24)	**2,726**	5,121	8,069
Impairment of available-for-sale financial assets	**15**	37	80
Other credit risk provisions	**–**	(9)	(55)
Total impairment charged to the income statement	**2,741**	5,149	8,094

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Note 13: Investments in joint ventures and associates

The Group's share of results of and investments in equity accounted joint ventures and associates comprises:

	Joint ventures			Associates			Total		
	2013 £m	2012 £m	2011 £m	**2013 £m**	2012 £m	2011 £m	**2013 £m**	2012 £m	2011 £m
Share of income statement amounts:									
Income	**65**	278	316	**151**	63	160	**216**	341	476
Expenses	**(32)**	(229)	(261)	**(116)**	(68)	(161)	**(148)**	(297)	(422)
Impairment	**(22)**	(6)	(20)	**–**	(1)	1	**(22)**	(7)	(19)
Profit (loss) before tax	**11**	43	35	**35**	(6)	–	**46**	37	35
Tax	**(4)**	(9)	(4)	**1**	–	–	**(3)**	(9)	(4)
Share of post-tax results	**7**	34	31	**36**	(6)	–	**43**	28	31
Share of other comprehensive income	**–**	6	(6)	**–**	–	–	–	6	(6)
Share of total comprehensive income	**7**	40	25	**36**	(6)	–	**43**	34	25
Share of balance sheet amounts:									
Current assets	**519**	3,103	3,346	**115**	127	246	**634**	3,230	3,592
Non-current assets	**1,163**	1,596	2,148	**508**	581	976	**1,671**	2,177	3,124
Current liabilities	**(448)**	(729)	(714)	**(249)**	(128)	(293)	**(697)**	(857)	(1,007)
Non-current liabilities	**(1,139)**	(3,672)	(4,471)	**(368)**	(565)	(904)	**(1,507)**	(4,237)	(5,375)
Share of net assets at 31 December	**95**	298	309	**6**	15	25	**101**	313	334
Movement in investments over the year:									
At 1 January	**298**	309	326	**15**	25	103	**313**	334	429
Exchange and other adjustments	**(10)**	2	(3)	**–**	1	(1)	**(10)**	3	(4)
Additional investments	**4**	10	7	**957**	1	3	**961**	11	10
Disposals	**(197)**	(44)	(47)	**(983)**	(6)	(79)	**(1,180)**	(50)	(126)
Share of post-tax results	**7**	34	31	**36**	(6)	–	**43**	28	31
Dividends paid	**(7)**	(13)	(5)	**(19)**	–	(1)	**(26)**	(13)	(6)
Share of net assets at 31 December	**95**	298	309	**6**	15	25	**101**	313	334

The Group's unrecognised share of losses of associates for the year was £4 million (2012: recognised net loss of £10 million; 2011: recognised net loss of £8 million) and of joint ventures was £94 million in 2013 (2012: £126 million; 2011: £85 million). 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 £36 million (2012: £31 million; 2011: £56 million) and of joint ventures is £358 million (2012: £330 million; 2011: £299 million).

In March 2013 the Group sold a tranche of shares in St James's Place plc, reducing the Group's holding in that company to approximately 37 per cent and from that point commenced accounting for the residual investment as an associate. The Group sold its remaining shareholding in May and December 2013 so that the entire investment had been disposed of by the end of the year.

The Group's principal joint venture investment at 31 December 2013 was in Sainsbury's Bank plc; the Group owns 50 per cent of the ordinary share capital of Sainsbury's Bank plc, whose business is banking and principal area of operation is the UK. Sainsbury's Bank plc is incorporated in the UK and the Group's interest is held by a subsidiary. In May 2013 the Group reached agreement to sell its interest in Sainsbury's Bank plc to J Sainsbury plc; this transaction completed on 31 January 2014 and the Group's investment at 31 December 2013 is included in disposal group assets (see note 16).

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 14: Taxation

(A) Analysis of tax (charge) credit for the year

	2013 £m	2012[1] £m	2011[1] £m
UK corporation tax:			
Current tax on profit for the year	(226)	(181)	(93)
Adjustments in respect of prior years	(205)	58	(146)
	(431)	(123)	(239)
Foreign tax:			
Current tax on profit for the year	(60)	(86)	(90)
Adjustments in respect of prior years	26	(8)	36
	(34)	(94)	(54)
Current tax (charge) credit	(465)	(217)	(293)
Deferred tax (note 42):			
Origination and reversal of temporary differences	(434)	(329)	1,673
Reduction in UK corporation tax rate	(594)	(320)	(423)
Adjustments in respect of prior years	276	85	(96)
	(752)	(564)	1,154
Tax charge	**(1,217)**	(781)	861

[1] Restated – see note 1.

The charge for tax on the profit for 2013 is based on a UK corporation tax rate of 23.25 per cent (2012: 24.5 per cent; 2011: 26.5 per cent).

The income tax charge is made up as follows:

	2013 £m	2012[1] £m	2011[1] £m
Tax (charge) credit attributable to policyholders	(328)	(950)	72
Shareholder tax (charge) credit	(889)	169	789
Tax (charge) credit	**(1,217)**	(781)	861

[1] Restated – see note 1.

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Note 14 Taxation (continued)

(B) Factors affecting the tax (charge) credit for the year

A reconciliation of the credit (charge) that would result from applying the standard UK corporation tax rate to the profit (loss) before tax to the actual tax (charge) credit for the year is given below:

	2013 £m	2012[1] £m	2011[1] £m
Profit (loss) before tax	415	(606)	(3,751)
Tax (charge) credit thereon at UK corporation tax rate of 23.25 per cent (2012: 24.5 per cent; 2011: 26.5 per cent)	(96)	148	994
Factors affecting (charge) credit:			
UK corporation tax rate change	(594)	(320)	(423)
Disallowed items	(167)	(186)	(121)
Non-taxable items	132	240	398
Overseas tax rate differences	(116)	75	17
Gains exempted or covered by capital losses	57	36	106
Policyholder tax	(251)	(144)	160
Further factors affecting the life business[2]:			
Derecognition of deferred tax on policyholder tax credit	–	(583)	(146)
Taxation of certain insurance assets arising on transition to new tax regime	–	(221)	–
Changes to the taxation of pension business:			
Policyholder tax cost	–	(182)	–
Shareholder tax benefit	–	206	–
Deferred tax on losses no longer recognised following sale of Australian operations	(348)	–	–
Tax losses where no deferred tax recognised	–	(25)	(261)
Deferred tax on Australian tax losses not previously recognised	60	12	–
Tax losses not previously recognised	–	–	332
Adjustments in respect of previous years	97	135	(206)
Effect of results of joint ventures and associates	9	23	8
Other items	–	5	3
Tax (charge) credit on (loss) profit on ordinary activities	(1,217)	(781)	861

[1] Restated – see note 1.

[2] The Finance Act 2012 introduced a new UK tax regime for the taxation of life insurance companies which takes effect from 1 January 2013. The new regime, combined with current economic forecasts, had a number of impacts on the tax charge in 2012.

The Finance Act 2013 (the Act) was substantively enacted on 2 July 2013. The Act further reduced the main rate of corporation tax to 21 per cent with effect from 1 April 2014 and 20 per cent with effect from 1 April 2015. The change in the main rate of corporation tax from 23 per cent to 20 per cent has resulted in a reduction in the Group's net deferred tax asset at 31 December 2013 of £636 million, comprising the £594 million charge included in the income statement and a £42 million charge included in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 15: Earnings per share

	2013 £m	2012[1] £m	2011[1] £m
Loss attributable to equity shareholders – basic and diluted	(838)	(1,471)	(2,963)
	2013 million	2012 million	2011 million
Weighted average number of ordinary shares in issue – basic	71,009	69,841	68,470
Adjustment for share options and awards	–	–	–
Weighted average number of ordinary shares in issue – diluted	71,009	69,841	68,470
Basic loss per share	(1.2)p	(2.1)p	(4.3)p
Diluted loss per share	(1.2)p	(2.1)p	(4.3)p

[1] Restated – see note 1.

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 18 million (2012: 13 million; 2011: 10 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

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, if any, that arise 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.

The weighted-average number of anti-dilutive share options and awards excluded from the calculation of diluted earnings per share was 28 million at 31 December 2013 (2012: 37 million; 2011: 619 million).

Note 16: Disposal groups

Disposal groups are classified as held for sale if the Group will recover the carrying amount principally through a sale transaction rather than through continuing use and a sale is considered highly probable. The Group completed the sale of its joint venture interest in Sainsbury's Bank on 31 January 2014 and expects to complete the announced sales of its international private banking operations in Monaco and Gibraltar, its German insurance business and Scottish Widows Investment Partnership, its asset management business, in the next 12 months. The assets and liabilities associated with these operations are therefore classified as held-for-sale disposal groups at 31 December 2013 and included within other assets and other liabilities respectively.

	2013 £m	2012 £m
Other assets		
Assets of disposal groups classified as held for sale	7,988	194
Other liabilities		
Liabilities of disposal groups classified as held for sale	7,302	214

Disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. The Group has recognised an impairment of £382 million within other income relating to disposal groups classified as held for sale during 2013.

At 31 December 2012, the Group's Uruguayan branch business, its branch remittance business in Japan and its portfolio management business in Luxembourg were classified as held-for-sale; these sales completed in 2013.

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Note 16: Disposal groups (continued)

The major classes of assets and liabilities of the disposal groups, which are principally in the Insurance segment, are as follows:

	2013 £m	2012 £m
Assets[1]		
Cash and balances at central banks	–	82
Trading and other financial assets at fair value through profit or loss	5,040	–
Loans and advances to banks	101	7
Loans and advances to customers	244	84
Available-for-sale financial assets	–	27
Value of in-force business	1,017	–
Other	1,968	20
Provision for impairment of the disposal groups	(382)	(26)
	7,988	194
Liabilities		
Customer deposits	307	185
Liabilities arising from insurance contracts and participating investment contracts	4,901	–
Deferred tax liabilities	282	–
Other	1,812	29
	7,302	214

[1] Disposal groups measured at fair value less costs to sell of £247 million (2012: liability of £20 million), which are non-recurring fair value measurements, are based on prices offered by third parties under binding sale and purchase agreements and are therefore classified within level 3 of the fair value hierarchy.

Note 17: Trading and other financial assets at fair value through profit or loss

These assets are comprised as follows:

	2013			2012[1]		
	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	21,083	27	21,110	13,598	34	13,632
Loans and advances to banks	8,333	–	8,333	919	–	919
Debt securities:						
Government securities	4,259	16,430	20,689	3,965	17,380	21,345
Other public sector securities	14	2,183	2,197	–	1,056	1,056
Bank and building society certificates of deposit	1,491	–	1,491	3,166	228	3,394
Asset-backed securities:						
Mortgage-backed securities	5	793	798	130	795	925
Other asset-backed securities	171	756	927	21	1,892	1,913
Corporate and other debt securities	1,929	18,691	20,620	1,172	26,387	27,559
	7,869	38,853	46,722	8,454	47,738	56,192
Equity shares	4	66,399	66,403	–	89,447	89,447
Treasury and other bills	61	54	115	374	56	430
Total	37,350	105,333	142,683	23,345	137,275	160,620

[1] Restated – see note 1.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 17: Trading and other financial assets at fair value through profit or loss (continued)

Other financial assets at fair value through profit or loss include the following assets designated into that category:

(i) financial assets backing insurance contracts and investment contracts of £101,185 million (2012: £134,537 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. Included within these assets are investments in unconsolidated structured entities of £24,552 million, see note 22;

(ii) loans and advances to customers of £27 million (2012: £34 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 £2,632 million (2012: £2,110 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 2013 of the loans and advances to banks and customers designated at fair value through profit or loss was £27 million (2012: £34 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.

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £29,288 million (2012: £14,433 million). Collateral is held with a fair value of £32,434 million (2012: £19,629 million), all of which the Group is able to repledge. At 31 December 2013, £8,195 million had been repledged (2012: £15,640 million).

For amounts included above which are subject to repurchase agreements see note 54.

Note 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 and cash flow hedge approaches as described in note 54; and
– Derivatives held in policyholder 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 IAS 39. 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, £828 million (2012: £2,829 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.

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Note 18: Derivative financial instruments (continued)

The fair values and notional amounts of derivative instruments are set out in the following table:

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
At 31 December 2013			
Trading and other			
Exchange rate contracts:			
Spot, forwards and futures	38,213	699	639
Currency swaps	291,667	3,207	4,196
Options purchased	33,061	780	–
Options written	33,445	–	836
	396,386	4,686	5,671
Interest rate contracts:			
Interest rate swaps	1,892,322	15,065	15,388
Forward rate agreements	1,991,371	17	13
Options purchased	107,374	3,395	–
Options written	101,136	–	3,194
Futures	141,669	2	12
	4,233,872	18,479	18,607
Credit derivatives	6,507	208	190
Embedded equity conversion feature	–	1,212	–
Equity and other contracts	18,780	1,753	1,478
Total derivative assets/liabilities – trading and other	4,655,545	26,338	25,946
Hedging			
Derivatives designated as fair value hedges:			
Currency swaps	35,651	383	453
Interest rate swaps	154,657	4,707	1,044
Options purchased	522	10	–
	190,830	5,100	1,497
Derivatives designated as cash flow hedges:			
Interest rate swaps	559,690	1,670	3,017
Futures	92,692	5	–
Currency swaps	1,135	12	4
	653,517	1,687	3,021
Total derivative assets/liabilities – hedging	844,347	6,787	4,518
Total recognised derivative assets/liabilities	5,499,892	33,125	30,464

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 Credit risk.

The embedded equity conversion feature of £1,212 million (2012: £1,421 million) reflects the value of the equity conversion feature contained in the Enhanced Capital Notes issued by the Group in 2009; the loss of £209 million arising from the change in fair value over 2013 (2012: gain of £249 million; 2011: loss of £5 million) is included within net gains on financial instruments held for trading within net trading income (note 7).

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Note 18: Derivative financial instruments (continued)

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
At 31 December 2012[1]			
Trading and other			
Exchange rate contracts:			
Spot, forwards and futures	203,484	1,432	1,599
Currency swaps	107,217	1,689	1,683
Options purchased	42,140	591	–
Options written	21,757	–	605
	374,598	3,712	3,887
Interest rate contracts:			
Interest rate swaps	2,071,103	32,826	31,891
Forward rate agreements	1,836,186	494	593
Options purchased	105,245	4,463	–
Options written	115,516	–	4,051
Futures	53,529	2	2
	4,181,579	37,785	36,537
Credit derivatives	6,167	94	343
Embedded equity conversion feature	–	1,421	–
Equity and other contracts	23,714	1,974	1,311
Total derivative assets/liabilities – trading and other	4,586,058	44,986	42,078
Hedging			
Derivatives designated as fair value hedges:			
Currency swaps	56,188	817	356
Interest rate swaps	135,516	6,018	1,772
Options written	68	68	–
	191,772	6,903	2,128
Derivatives designated as cash flow hedges:			
Interest rate swaps	86,190	4,653	4,438
Futures	49,527	1	–
Currency swaps	2,395	14	32
	138,112	4,668	4,470
Total derivative assets/liabilities – hedging	329,884	11,571	6,598
Total recognised derivative assets/liabilities	4,915,942	56,557	48,676

[1] Restated – see note 1.

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Note 18: Derivative financial instruments (continued)

Hedged cash flows

For designated cash flow hedges the following table shows when the Group's hedged cash flows are expected to occur and when they will affect income.

2013	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	354	762	1,247	1,356	1,418	5,443	3,097	424	14,101
Forecast payable cash flows	(46)	(41)	(57)	(75)	(75)	(429)	(503)	(143)	(1,369)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	575	999	1,275	1,382	1,429	5,143	2,894	404	14,101
Forecast payable cash flows	(51)	(48)	(63)	(70)	(75)	(432)	(491)	(139)	(1,369)

2012	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	214	241	271	139	67	163	37	33	1,165
Forecast payable cash flows	(168)	(126)	(36)	(40)	(148)	(960)	(1,682)	(442)	(3,602)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	254	287	256	95	51	157	32	33	1,165
Forecast payable cash flows	(190)	(120)	(41)	(42)	(154)	(963)	(1,694)	(398)	(3,602)

There were no transactions for which cash flow hedge accounting had to be ceased in 2013 or 2012 as a result of the highly probable cash flows no longer being expected to occur.

Note 19: Loans and advances to banks

	2013 £m	2012[1] £m
Lending to banks	2,168	591
Money market placements with banks	23,197	32,169
Total loans and advances to banks before allowance for impairment losses	25,365	32,760
Allowance for impairment losses (note 24)	–	(3)
Total loans and advances to banks	**25,365**	32,757

[1] Restated – see note 1.

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £183 million (2012: £662 million). Collateral is held with a fair value of £183 million (2012: £662 million), all of which the Group is able to repledge.

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Note 20: Loans and advances to customers

	2013 £m	2012 £m
Agriculture, forestry and fishing	**6,051**	5,531
Energy and water supply	**4,414**	3,321
Manufacturing	**7,650**	8,530
Construction	**7,024**	7,526
Transport, distribution and hotels	**22,294**	26,568
Postal and telecommunications	**2,364**	1,397
Property companies	**44,277**	52,388
Financial, business and other services	**44,807**	49,190
Personal:		
Mortgages	**335,611**	337,879
Other	**23,230**	28,334
Lease financing	**4,435**	6,477
Hire purchase	**5,090**	5,334
Total loans and advances to customers before allowance for impairment losses	**507,247**	532,475
Allowance for impairment losses (note 24)	**(11,966)**	(15,250)
Total loans and advances to customers	**495,281**	517,225

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £120 million (2012: £5,087 million). Collateral is held with a fair value of £112 million (2012: £4,916 million), all of which the Group is able to repledge. Included within this are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £49 million (2012: £2 million).

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

	2013 £m	2012 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**557**	1,271
Later than 1 year and not later than 5 years	**1,736**	2,049
Later than 5 years	**4,542**	6,232
	6,835	9,552
Unearned future finance income on finance leases	**(2,330)**	(3,027)
Rentals received in advance	**(70)**	(30)
Commitments for expenditure in respect of equipment to be leased	**–**	(18)
Net investment in finance leases	**4,435**	6,477

The net investment in finance leases represents amounts recoverable as follows:

	2013 £m	2012 £m
Not later than 1 year	**277**	835
Later than 1 year and not later than 5 years	**1,140**	1,491
Later than 5 years	**3,018**	4,151
Net investment in finance leases	**4,435**	6,477

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 2013 and 2012 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 £6 million (2012: £33 million).

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Note 20: Loans and advances to customers (continued)

The unguaranteed residual values included in finance lease receivables were as follows:

	2013 £m	2012 £m
Not later than 1 year	31	49
Later than 1 year and not later than 5 years	20	126
Later than 5 years	–	14
Total unguaranteed residual values	**51**	189

Note 21: Securitisations and covered bonds

Securitisation programmes

Loans and advances to customers and debt securities classified as loans and receivables include loans securitised under the Group's securitisation programmes, the majority of which have been sold by subsidiary companies to bankruptcy remote structured entities. As the structured entities are funded by the issue of debt on terms whereby the majority of the risks and rewards of the portfolio are retained by the subsidiary, the structured entities are consolidated fully and all of these loans are retained on the Group's balance sheet, with the related notes in issue included within debt securities in issue. In addition to the structured entities described below, the Group sponsors three conduit programmes, Argento, Cancara and Grampian.

Covered bond programmes

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of covered bonds by the Group. The Group retains all of the risks and rewards associated with these loans and the partnerships are consolidated fully with the loans retained on the Group's balance sheet and the related covered bonds in issue included within debt securities in issue.

The Group's principal securitisation and covered bond programmes, together with the balances of the advances subject to these arrangements and the carrying value of the notes in issue at 31 December, are listed below. The notes in issue are reported in note 35.

	2013		2012	
	Loans and advances securitised £m	Notes in issue £m	Loans and advances securitised £m	Notes in issue £m
Securitisation programmes[1]				
UK residential mortgages	55,998	36,286	80,125	57,285
US residential mortgage-backed securities	–	–	185	221
Commercial loans	10,931	11,259	15,024	14,110
Irish residential mortgages	–	–	5,189	3,509
Credit card receivables	6,314	3,992	6,974	3,794
Dutch residential mortgages	4,381	4,508	4,547	4,682
Personal loans	2,729	750	4,412	2,000
PFI/PPP and project finance loans	525	106	688	104
Motor vehicle loans	–	–	1,039	1,086
	80,878	56,901	118,183	86,791
Less held by the Group		(38,288)		(58,732)
Total securitisation programmes (note 35)		18,613		28,059
Covered bond programmes				
Residential mortgage-backed	59,576	36,473	91,420	64,593
Social housing loan-backed	2,536	1,800	2,927	2,400
	62,112	38,273	94,347	66,993
Less held by the Group		(7,606)		(26,320)
Total covered bond programmes (note 35)		30,667		40,673
Total securitisation and covered bond programmes		49,280		68,732

[1] Includes securitisations utilising a combination of external funding and credit default swaps.

Cash deposits of £13,500 million (2012: £19,691 million) held by the Group are restricted in use to repayment of the debt securities issued by the structured entities, the term advances relating to covered bonds and other legal obligations. Additionally, the Group had certain contractual

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Note 21: Securitisations and covered bonds (continued)

arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2013 these obligations had not been triggered and the maximum exposure under these facilities was £402 million (2012: £497 million).

The Group has a number of covered bond programmes, for which Limited Liability Partnerships have been established to ring-fence asset pools and guarantee the covered bonds issued by the Group. At the reporting date the Group had over-collateralised these programmes as set out in the table above to meet the terms of the programmes, to secure the rating of the covered bonds and to provide operational flexibility. From time-to-time, the obligations of the Group to provide collateral may increase due to the formal requirements of the programmes. The Group may also voluntarily contribute collateral to support the ratings of the covered bonds.

The Group recognises the full liabilities associated with its securitisation and covered bond programmes within debt securities in issue, although the obligations of the Group are limited to the cashflows generated from the underlying assets. The Group could be required to provide additional support to a number of the securitisation programmes to support the credit ratings of the debt securities issued, in the form of increased cash reserves and the holding of subordinated notes. Further, certain programmes contain contractual obligations that require the Group to repurchase assets should they become credit impaired.

The Group has not voluntarily offered to repurchase assets from any of its public securitisation programmes during 2013 (2012: £471 million was voluntarily repurchased). Such repurchases are made in order to ensure that the expected maturity dates of the notes issued from these programmes are met.

Note 22: Structured entities

The Group's interests in structured entities are both consolidated and unconsolidated. Detail of the Group's interests in consolidated structured entities are set out in: note 21 for securitisations and covered bond vehicles, note 41 for structured entities associated with the Group's pension schemes, and below in part (A) and (B). Details of the Group's interests in unconsolidated structured entities are included below in part (C).

(A) Asset-backed conduits

In addition to the structured entities discussed in note 21, which are used for securitisation and covered bond programmes, the Group sponsors three asset-backed conduits, Argento, Cancara and Grampian, which invest in debt securities and client receivables. All the external assets in these conduits are consolidated in the Group's financial statements. The total consolidated exposures in these conduits are set out in the table below:

	Argento £m	Cancara £m	Grampian £m	Total £m
At 31 December 2013				
Loans and advances	**161**	**4,781**	**9**	**4,951**
Debt securities classified as loans and receivables:				
Asset-backed securities	**299**	**300**	**–**	**599**
Debt securities classified as available-for-sale financial assets:				
Asset-backed securities	**356**	**–**	**–**	**356**
Total assets	**816**	**5,081**	**9**	**5,906**
At 31 December 2012				
Loans and advances	140	4,342	58	4,540
Debt securities classified as loans and receivables:				
Asset-backed securities	603	367	358	1,328
Debt securities classified as available-for-sale financial assets:				
Asset-backed securities	396	–	143	539
Total assets	1,139	4,709	559	6,407

All debt securities and lending assets held by the Group in Cancara are restricted in use, as they are held by the collateral agent for the benefit of the commercial paper investors and the liquidity providers only. The Group provides liquidity facilities to Cancara under terms that are usual and customary for standard lending activities in the normal course of the Group's banking activities. The Group could be asked to provide support under the contractual terms of these arrangements if Cancara experienced a shortfall in external funding, which may occur in the event of market disruption. As at 31 December 2013 and 2012 these obligations had not been triggered.

Argento and Grampian have no Commercial Paper in issue and no external liquidity providers. Any restriction on the use of the assets included in the table above by the Group is due to their use in repurchase transactions see note 20 and note 53.

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Note 22: Structured entities (continued)

(B) Consolidated collective investment vehicles

The assets and liabilities of the Insurance business held in consolidated collective investment vehicles, such as Open-Ended Investment Companies and limited partnerships, are not directly available for use by the Group. However, the Group's investment in the majority of these collective investment vehicles is readily realisable. As at 31 December 2013, the total carrying value of these consolidated collective investment vehicle assets and liabilities held by the Group was £55,934 million (2012: £68,644million).

The Group has no contractual arrangements (such as liquidity facilities) that would require it to provide financial or other support to the consolidated collective investment vehicles; the Group has not previously provided such support and has no current intentions to provide such support.

(C) Unconsolidated collective investment vehicles and limited partnerships

The Group's direct interests in unconsolidated structured entities comprise investments in collective investment vehicles, such as Open-Ended Investment Companies and limited partnerships with a total carrying value of £24,552 million at 31 December 2013, included within financial assets designated at fair value through profit and loss (see note 17). At 31 December 2013, the total asset value of these unconsolidated structured entities, including the portion in which the Group has no interest, was £543 billion.

The Group's maximum exposure to loss is equal to the carrying value of the investment. However, the Group's investments in collective investment vehicles are primarily held to match policyholder liabilities in the Insurance division and the majority of the risk from a change in the value of the Group's investment is matched by a change in policyholder liabilities. The collective investment vehicles are primarily financed by investments from investors in the vehicles.

During the year the Group has not provided any non-contractual financial or other support to these unconsolidated collective investment vehicles.

The Group considers itself the sponsor of a structured entity where it is primarily involved in the design and establishment of the structured entity; and further where the Group transfers assets to the structured entity; market products associated with the structured entity in its own name and/or provide guarantees regarding the structured entity's performance.

The Group's asset management businesses sponsor a range of diverse investment funds and limited partnerships where it acts as the fund manager or equivalent decision maker and markets the funds under one of the Group's brands.

The Group earns fees from managing the investments of these funds. The investment management fees that the Group earned from unconsolidated collective investment vehicles, including those in which the Group held no interest at 31 December 2013, are reported in note 51.

Note 23: Debt securities classified as loans and receivables

Debt securities accounted for as loans and receivables comprise:

	2013 £m	2012 £m
Asset-backed securities:		
Mortgage-backed securities	**333**	3,927
Other asset-backed securities	**740**	1,150
Corporate and other debt securities	**407**	402
Total debt securities classified as loans and receivables before allowance for impairment losses	**1,480**	5,479
Allowance for impairment losses (note 24)	**(125)**	(206)
Total debt securities classified as loans and receivables	**1,355**	5,273

For amounts included above which are subject to repurchase agreements see note 54.

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Note 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
At 1 January 2012	18,732	14	276	19,022
Exchange and other adjustments	(379)	(1)	(8)	(388)
Advances written off	(8,697)	(10)	(73)	(8,780)
Recoveries of advances written off in previous years	843	–	15	858
Unwinding of discount	(374)	–	–	(374)
Charge (release) to the income statement (note 12)	5,125	–	(4)	5,121
At 31 December 2012	15,250	3	206	15,459
Exchange and other adjustments	**291**	**–**	**–**	**291**
Disposal of businesses	**(176)**	**–**	**–**	**(176)**
Advances written off	**(6,229)**	**(3)**	**(82)**	**(6,314)**
Recoveries of advances written off in previous years	**456**	**–**	**–**	**456**
Unwinding of discount	**(351)**	**–**	**–**	**(351)**
Charge to the income statement (note 12)	**2,725**	**–**	**1**	**2,726**
At 31 December 2013	**11,966**	**–**	**125**	**12,091**

Of the total allowance in respect of loans and advances to customers, £10,217 million (2012: £13,936 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date.

Of the total allowance in respect of loans and advances to customers, £2,217 million (2012: £3,309 million) was assessed on a collective basis.

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Note 25: Available-for-sale financial assets

	2013			2012		
	Conduits £m	Other £m	Total £m	Conduits £m	Other £m	Total £m
Debt securities:						
Government securities	–	38,290	38,290	–	25,555	25,555
Bank and building society certificates of deposit	–	208	208	–	188	188
Asset-backed securities:						
Mortgage-backed securities	139	1,124	1,263	277	1,247	1,524
Other asset-backed securities	217	698	915	262	498	760
Corporate and other debt securities	–	1,855	1,855	–	1,848	1,848
	356	42,175	42,531	539	29,336	29,875
Equity shares	–	570	570	–	528	528
Treasury and other bills	–	875	875	–	971	971
Total available-for-sale financial assets	356	43,620	43,976	539	30,835	31,374

Details of the Group's asset-backed conduits shown in the table above are included in note 22.

For amounts included above which are subject to repurchase agreements see note 54.

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).

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Note 26: Investment properties

	2013 £m	2012 £m
At 1 January	5,405	6,122
Exchange and other adjustments	11	22
Additions:		
Acquisitions of new properties	270	428
Consolidation of new subsidiary undertakings	805	411
Additional expenditure on existing properties	39	89
Total additions	1,114	928
Disposals	(1,240)	(1,403)
Changes in fair value (note 7)	156	(264)
Disposal of businesses	(582)	–
At 31 December	4,864	5,405

In addition, the following amounts have been recognised in the income statement:

	2013 £m	2012 £m
Rental income (note 9)	308	389
Direct operating expenses arising from investment properties that generate rental income	59	42

Capital expenditure in respect of investment properties:

	2013 £m	2012 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	2	24

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.

The fair value of investment properties is measured using the market approach and incorporates the income approach where appropriate. The fair value of investment property is generally measured using observable inputs. Whether investment properties are categorised as level 2 or 3 (see note 53 (4) for details of levels in the fair value hierarchy) depends on the extent of the adjustments made to observable inputs and this depends on the investment property concerned. Investment property is compared to property for which there is observable market data about its realisable value on disposal. Adjustments to this observable data are applied, if necessary, for specific characteristics of the property, such as the nature, location or condition of the specific asset. If such information is not available, alternative valuation methods using unobservable inputs, such as discounted cash flow analysis or recent prices in less active markets are used. For investment property under construction, the value on disposal is considered to be at the point at which the property is fully constructed. Adjustments are made for the costs and risks associated with construction. Investment property under construction for which fair value is not yet reliably measurable is valued at cost, until the fair value can be reliably measured.

The table above analyses movements in investment properties, all of which are categorised as level 3.

Note 27: Goodwill

	2013 £m	2012 £m
At 1 January and 31 December	2,016	2,016
Cost[1]	2,362	2,362
Accumulated impairment losses	(346)	(346)
At 31 December	2,016	2,016

[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 (2012: £2,016 million), £1,836 million, or 91 per cent of the total (2012: £1,836 million, 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 (2012: £170 million, 8 per cent of the total) to Asset Finance in the Group's Wealth, Asset Finance and International division.

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Note 27: Goodwill (continued)

The recoverable amount of Scottish Widows has been based on a value-in-use calculation. The calculation uses pre-tax 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. 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 above would not cause the recoverable amount of Scottish Widows to fall below its balance sheet carrying value.

The recoverable amount of Asset Finance has also been based on a value-in-use calculation using pre-tax cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 14 per cent. 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. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of Asset Finance to fall below the balance sheet carrying value.

Note 28: Value of in-force business

The gross value of in-force business asset in the consolidated balance sheet is as follows:

	2013 £m	2012 £m
Acquired value of in-force non-participating investment contracts	**461**	1,312
Value of in-force insurance and participating investment contracts	**4,874**	5,488
Total value of in-force business	**5,335**	6,800

The movement in the acquired value of in-force non-participating investment contracts over the year is as follows:

	2013 £m	2012 £m
At 1 January	**1,312**	1,391
Amortisation taken to income statement (note 11)	**(54)**	(79)
Disposal of businesses	**(797)**	–
At 31 December	**461**	1,312

The acquired value of in-force non-participating investment contracts includes £277 million (2012: £303 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:

	2013 £m	2012 £m
At 1 January	**5,488**	5,247
Exchange and other adjustments	**21**	(28)
Movements in the year:		
New business	**595**	570
Existing business:		
Expected return	**(432)**	(471)
Experience variances	**(246)**	52
Assumption changes	**37**	(90)
Economic variance	**462**	208
Movement in the value of in-force business taken to income statement (note 9)	**416**	269
Disposal of businesses	**(1,051)**	–
At 31 December	**4,874**	5,488

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. This will also contain changes in the other assets and liabilities, including the effects of changes in assumptions used to value the liabilities, of the relevant businesses. 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.

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:

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Note 28: Value of in-force business (continued)

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. The certainty equivalent approach covers all investment assets relating to insurance and participating investment contracts, other than the annuity business (where an illiquidity premium is included, see below).

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. Further information on options and guarantees can be found on page 191.

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 and, since late 2012, illiquid loan assets. 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 corporate bond holdings and relevant illiquid loan assets. The determination of the market premium for illiquidity reflects actual asset allocation and relevant observable market data, and has been checked for consistency with the capital markets. The illiquidity premium is estimated to be 91 basis points at 31 December 2013 (2012: 73 basis points). Moving to the actual asset allocation in the calculation of the market premium for illiquidity combined with a change to the assumed level of illiquidity within the illiquid loan assets, has been to increase the value of in-force business by £118 million at 31 December 2013. This is included as an assumption change in the table above. The effect of this change on profit before tax, after also including the impacts of movements in liabilities, is given in note 36.

The risk-free rate is derived from the relevant swap curve less a deduction for credit risk. Prior to 2013, the risk-free rate for the valuation of financial options and guarantees was defined as the spot yield derived from the relevant government bond yield curve. The risk-free rate for the non-annuity business was defined as the 15 year government bond. For annuity business, the risk-free rate was based on the UK Government bond yield curve (plus an allowance for an illiquidity premium).

The effect of deriving risk-free rates from swap curves instead of government bond yields has been to increase the value of in-force business by £132 million at 31 December 2013. This is included as an assumption change in the table above. The effect of this change on profit before tax, after including the impacts of movements in liabilities, is given in note 36.

The table below shows the resulting range of yields and other key assumptions at 31 December for UK business:

	2013[1] %	2012 %
Risk-free rate (value of in-force non-annuity business)	**0.00 to 4.04**	2.32
Risk-free rate (value of in-force annuity business)	**0.64 to 5.06**	3.25
Risk-free rate (financial options and guarantees)	**0.21 to 3.45**	0.22 to 3.56
Retail price inflation	**3.59**	3.13
Expense inflation	**4.25**	3.61

[1] All risk-free rates at 31 December 2013 are quoted as the range of rates implied by the relevant swap curve.

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, reinsurer default 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, expenses, 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.

Mortality and morbidity

The mortality and morbidity assumptions, including allowances for improvements in longevity, are set with regard to the Group's actual experience where this provides a reliable basis and relevant industry data otherwise. For German business, appropriate industry tables have been considered.

Lapse (persistency) and paid-up rates

Lapse and paid up rates assumptions are reviewed each year. The most recent experience is considered along with the results of previous analyses and management's views on future experience. 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 and any known or expected trends in underlying data. The pensions lapse assumptions have been strengthened due to persistency experience and to make allowance for the impact of the Office of Fair Trading review on fairness of legacy pension charges. The impact of these changes has been to decrease the value of in-force business by £158 million.

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. 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.

These assumptions are intended to represent a best estimate of future experience, and further information about the effect of changes in key assumptions is given in note 37.

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Note 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 2012	596	2,770	300	881	959	5,506
Exchange and other adjustments	–	–	–	–	27	27
Additions	–	–	–	–	236	236
Disposals	–	–	–	–	(89)	(89)
At 31 December 2012	596	2,770	300	881	1,133	5,680
Exchange and other adjustments	–	–	–	–	22	22
Additions	–	–	15	–	274	289
Disposals	–	–	–	–	(92)	(92)
Disposal of businesses	–	–	–	(343)	(17)	(360)
At 31 December 2013	**596**	**2,770**	**315**	**538**	**1,320**	**5,539**
Accumulated amortisation:						
At 1 January 2012	65	1,192	178	486	389	2,310
Exchange and other adjustments	–	–	–	–	25	25
Charge for the year	21	368	60	40	127	616
Disposals	–	–	–	–	(63)	(63)
At 31 December 2012	86	1,560	238	526	478	2,888
Exchange and other adjustments	–	–	–	–	9	9
Charge for the year	21	300	62	20	109	512
Disposals	–	–	–	–	(45)	(45)
Disposal of businesses	–	–	–	(104)	–	(104)
At 31 December 2013	**107**	**1,860**	**300**	**442**	**551**	**3,260**
Balance sheet amount at 31 December 2013	**489**	**910**	**15**	**96**	**769**	**2,279**
Balance sheet amount at 31 December 2012	510	1,210	62	355	655	2,792

Included within brands above are assets of £380 million (31 December 2012: £380 million) 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 have an indefinite useful life.

The core deposit intangible is the benefit derived from a large stable deposit base that has low interest rates, and the balance sheet amount at 31 December 2013 shown above will be amortised, in accordance with the Group's accounting policy, on a straight line basis over its remaining useful life of four years.

The purchased credit card relationships represent the benefit of recurring income generated from the portfolio of credit cards purchased.

The customer-related intangibles include customer lists and the benefits of customer relationships that generate recurring income.

Capitalised software enhancements principally comprise identifiable and directly associated internal staff and other costs.

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Note 30: Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m	Total tangible fixed assets £m
Cost:				
At 1 January 2012	2,454	4,792	5,519	12,765
Exchange and other adjustments	2	(82)	(11)	(91)
Additions	225	711	1,314	2,250
Disposals	(65)	(306)	(1,924)	(2,295)
Write-offs	–	(1,562)	–	(1,562)
At 31 December 2012	2,616	3,553	4,898	11,067
Exchange and other adjustments	–	83	(17)	66
Additions	300	758	1,326	2,384
Disposals	(48)	(406)	(1,460)	(1,914)
Disposal of businesses	(2)	(94)	(80)	(176)
At 31 December 2013	**2,866**	**3,894**	**4,667**	**11,427**
Accumulated depreciation and impairment:				
At 1 January 2012	1,097	2,983	1,012	5,092
Exchange and other adjustments	(8)	(77)	52	(33)
Depreciation charge for the year	130	432	869	1,431
Disposals	(28)	(266)	(909)	(1,203)
Write-offs	–	(1,562)	–	(1,562)
At 31 December 2012	1,191	1,510	1,024	3,725
Exchange and other adjustments	4	18	(10)	12
Depreciation charge for the year	145	418	811	1,374
Disposals	(41)	(305)	(808)	(1,154)
Disposal of businesses	–	(68)	(32)	(100)
At 31 December 2013	**1,299**	**1,573**	**985**	**3,857**
Balance sheet amount at 31 December 2013	**1,567**	**2,321**	**3,682**	**7,570**
Balance sheet amount at 31 December 2012	1,425	2,043	3,874	7,342

At 31 December the future minimum rentals receivable under non-cancellable operating leases were as follows:

	2013 £m	2012 £m
Receivable within 1 year	1,053	1,039
1 to 5 years	1,165	1,291
Over 5 years	356	435
Total future minimum rentals receivable	**2,574**	2,765

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2013 and 2012 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £19 million at 31 December 2013 (£30 million at 31 December 2012) is expected to be received under non-cancellable sub-leases of the Group's premises.

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Note 31: Other assets

	2013 £m	2012[1] £m
Assets arising from reinsurance contracts held (note 36 and note 38)	732	2,320
Deferred acquisition and origination costs (see below)	130	774
Settlement balances	2,904	1,332
Corporate pension asset	9,984	6,353
Investments in joint ventures and associates (note 13)	101	313
Assets of disposal groups (note 16)	7,988	194
Other assets and prepayments	5,187	7,212
Total other assets	**27,026**	18,498

[1] Restated – see note 1.

Deferred acquisition and origination costs:

	2013 £m	2012 £m
At 1 January	774	693
Costs deferred, net of amounts amortised to the income statement	(19)	80
Exchange and other adjustments	–	1
Disposal of businesses	(625)	–
At 31 December	**130**	774

Note 32: Deposits from banks

	2013 £m	2012 £m
Liabilities in respect of securities sold under repurchase agreements	1,874	23,368
Other deposits from banks	12,108	15,037
Deposits from banks	**13,982**	38,405

Included in the amounts reported above are deposits held as collateral for facilities granted, with a carrying value of £1,874 million (2012: £23,078 million) and a fair value of £2,112 million (2012: £25,682 million).

Included in the amounts reported above are collateral balances in the form of cash provided in respect of repurchase agreements amounting to £nil (2012: £4 million).

Note 33: Customer deposits

	2013 £m	2012 £m
Non-interest bearing current accounts	40,802	36,909
Interest bearing current accounts	77,789	65,202
Savings and investment accounts	265,422	261,573
Liabilities in respect of securities sold under repurchase agreements	2,978	4,433
Other customer deposits	54,320	58,795
Customer deposits	**441,311**	426,912

Included in the amounts reported above are deposits held as collateral for facilities granted, with a carrying value of £2,978 million (2012: £4,429 million) and a fair value of £3,114 million (2012: £4,552 million).

Included in the amounts reported above are collateral balances in the form of cash provided in respect of repurchase agreements amounting to £416 million (2012: £192 million).

Included in the amounts reported above are deposits of £258,384 million (2012: £246,965 million) which are protected under the UK Financial Services Compensation Scheme.

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Note 34: Trading and other financial liabilities at fair value through profit or loss

	2013 £m	2012[1] £m
Liabilities held at fair value through profit or loss	5,306	5,700
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	28,902	24,553
Short positions in securities	6,890	2,200
Other	2,527	939
	38,319	27,692
Trading and other financial liabilities at fair value through profit or loss	**43,625**	33,392

[1] Restated – see note 1.

Liabilities designated at fair value through profit or loss primarily 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.

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2013 was £6,625 million, which was £1,358 million higher than the balance sheet carrying value (2012: £6,553 million, which was £853 million higher than the balance sheet carrying value). At 31 December 2013 there was a cumulative £214 million increase 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 Bank plc, the issuing entity within the Group. Of the cumulative amount a decrease of £40 million arose in 2013 and an increase of £437 million arose in 2012.

Note 35: Debt securities in issue

	2013 £m	2012[1] £m
Medium-term notes issued	23,921	29,537
Covered bonds (note 21)	30,667	40,673
Certificates of deposit issued	8,866	11,087
Securitisation notes (note 21)	18,613	28,059
Commercial paper	5,035	7,897
Total debt securities in issue	**87,102**	117,253

[1] Restated – see note 1.

Note 36: Liabilities arising from insurance contracts and participating investment contracts

Insurance contract and participating investment contract liabilities are comprised as follows:

	2013			2012		
	Gross £m	Reinsurance[1] £m	Net £m	Gross £m	Reinsurance[1] £m	Net £m
Life insurance (see (1) below):						
Insurance contracts	67,626	(675)	66,951	65,650	(2,257)	63,393
Participating investment contracts	14,416	–	14,416	16,489	–	16,489
	82,042	(675)	81,367	82,139	(2,257)	79,882
Non-life insurance contracts (see (2) below):						
Unearned premiums	442	(10)	432	494	(16)	478
Claims outstanding	293	–	293	320	(1)	319
	735	(10)	725	814	(17)	797
Total	82,777	(685)	82,092	82,953	(2,274)	80,679

[1] Reinsurance balances are reported within other assets (note 31).

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Note 36: Liabilities arising from insurance contracts and participating investment contracts (continued)

(1) Life insurance

The movement in life insurance contract and participating investment contract liabilities over the year can be analysed as follows:

	Insurance contracts £m	Participating investment contracts £m	Gross £m	Reinsurance £m	Net £m
At 1 January 2012	62,399	15,631	78,030	(2,452)	75,578
New business	2,757	65	2,822	(67)	2,755
Changes in existing business	668	794	1,462	253	1,715
Change in liabilities charged to the income statement (note 10)	3,425	859	4,284	186	4,470
Exchange and other adjustments	(174)	(1)	(175)	9	(166)
At 31 December 2012	65,650	16,489	82,139	(2,257)	79,882
New business	**4,008**	**295**	**4,303**	**(28)**	**4,275**
Changes in existing business	**3,230**	**(2,349)**	**881**	**76**	**957**
Change in liabilities charged to the income statement (note 10)	**7,238**	**(2,054)**	**5,184**	**48**	**5,232**
Exchange and other adjustments	**(2)**	**(11)**	**(13)**	**(7)**	**(20)**
Disposal of businesses	**(5,260)**	**(8)**	**(5,268)**	**1,541**	**(3,727)**
At 31 December 2013	**67,626**	**14,416**	**82,042**	**(675)**	**81,367**

Liabilities for insurance contracts and participating investment contracts can be split into with-profit fund liabilities, accounted for using the PRA's realistic capital regime (realistic liabilities) and non-profit fund liabilities, accounted for using a prospective actuarial discounted cash flow methodology, as follows:

	2013			2012		
	With-profit fund £m	Non-profit fund £m	Total £m	With-profit fund £m	Non-profit fund £m	Total £m
Insurance contracts	**11,739**	**55,887**	**67,626**	12,383	53,267	65,650
Participating investment contracts	**9,227**	**5,189**	**14,416**	9,646	6,843	16,489
Total	**20,966**	**61,076**	**82,042**	22,029	60,110	82,139

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 smoothed investment vehicle to policyholders, protecting them against short-term market fluctuations. Payouts may be subject to a guaranteed minimum payout if certain policy conditions are met. With-profit policyholders are entitled to at least 90 per cent of the distributed profits, with the shareholders receiving the balance. The policyholders are also usually insured against death and the policy may carry a guaranteed annuity option at retirement.

(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 (including guaranteed annuity options);
– Deductions levied against asset shares;
– Planned enhancements to with-profits benefits reserve; 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 36: Liabilities arising from insurance contracts and participating investment contracts (continued)

(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 swap curve, adjusted for credit risk. Further information on significant options and guarantees is given on page 191.

Guaranteed annuity option take-up rates
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.

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 business is written through the Group's 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:

– Traditional and unit linked endowment or pensions business; and

– Life insurance business.

In August 2013 the Group announced the sale of Heidelberger Leben, which is expected to complete in the first quarter of 2014.

(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.

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Note 36: Liabilities arising from insurance contracts and participating investment contracts (continued)

(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 2013 resulted in the following key impacts on profit before tax:

– Change in persistency assumptions (£210 million decrease).

– Change in the assumption in respect of current and future mortality rates (£114 million increase).

– Change in expenses assumptions (£34 million increase).

– Move to swap curves to derive risk-free rates (£174 million increase).

– Determination of illiquidity premium for annuity business based on actual asset allocation and change to assumed level of illiquidity within illiquid loan assets (£118 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.

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Note 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:

	2013 £m	2012 £m
Credit protection	60	94
Home	673	718
Health	2	2
Total gross non-life insurance contract liabilities	**735**	814

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 2012	566	(23)	543
Increase in the year	1,081	(31)	1,050
Release in the year	(1,153)	38	(1,115)
Change in provision for unearned premiums charged to income statement (note 8)	(72)	7	(65)
At 31 December 2012	494	(16)	478
Increase in the year	972	(18)	954
Release in the year	(1,021)	24	(997)
Change in provision for unearned premiums charged to income statement (note 8)	(49)	6	(43)
Exchange translation	(3)	–	(3)
At 31 December 2013	**442**	**(10)**	**432**

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Note 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 outstanding			
Notified claims	313	(1)	312
Incurred but not reported	82	(1)	81
At 1 January 2012	395	(2)	393
Cash paid for claims settled in the year	(455)	1	(454)
Increase (decrease) in liabilities:			
Arising from current year claims	492	–	492
Arising from prior year claims	(111)	–	(111)
Change in liabilities charged to income statement (note 10)	(74)	1	(73)
Exchange and over adjustments	(1)	–	(1)
At 31 December 2012	320	(1)	319
Cash paid for claims settled in the year	**(385)**	**–**	**(385)**
Increase (decrease) in liabilities:			
Arising from current year claims	**379**	**–**	**379**
Arising from prior year claims	**(27)**	**1**	**(26)**
Change in liabilities charged to income statement (note 10)	**(33)**	**1**	**(32)**
Exchange and other adjustments	**6**	**–**	**6**
At 31 December 2013	**293**	**–**	**293**
Notified claims	**263**	**–**	**263**
Incurred but not reported	**30**	**–**	**30**
At 31 December 2013	**293**	**–**	**293**
Notified claims	280	–	280
Incurred but not reported	40	(1)	39
At 31 December 2012	320	(1)	319

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Note 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 shown 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

	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	**2013 £m**	**Total £m**
Accident year								
Estimate of ultimate claims costs:								
At end of accident year	317	205	639	609	446	421	**349**	**2,986**
One year later	311	199	539	517	366	382		
Two years later	299	195	494	497	353			
Three years later	292	187	487	493				
Four years later	285	186	483					
Five years later	286	186						
Six years later	286							
Current estimate in respect of above claims	286	186	483	493	353	382	**349**	**2,532**
Current estimate of claims relating to general insurance business acquired in 2009	388	256	–	–	–	–	**–**	**644**
Current estimate of cumulative claims	674	442	483	493	353	382	**349**	**3,176**
Cumulative payments to date	(671)	(436)	(475)	(475)	(332)	(344)	**(165)**	**(2,898)**
Liability recognised in the balance sheet	3	6	8	18	21	38	**184**	**278**
Liability in respect of earlier years								**–**
Total liability included in the balance sheet								**278**

The liability of £278 million shown in the above table excludes £10 million of unallocated claims handling expenses and £5 million of unexpired risk reserve.

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Note 37: Life insurance sensitivity analysis

The following table demonstrates the effect of reasonably possible 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
At 31 December 2013			
Non-annuitant mortality and morbidity[1]	**5% reduction**	**39**	**31**
Annuitant mortality[2]	**5% reduction**	**(151)**	**(121)**
Lapse rates[3]	**10% reduction**	**132**	**106**
Future maintenance and investment expenses[4]	**10% reduction**	**194**	**155**
Risk-free rate[5]	**0.25% reduction**	**50**	**40**
Guaranteed annuity option take up[6]	**5% addition**	**–**	**–**
Equity investment volatility[7]	**1% addition**	**(8)**	**(6)**
Widening of credit default spreads on corporate bonds[8]	**0.25% addition**	**(238)**	**(191)**
Increase in illiquidity premia[9]	**0.10% addition**	**82**	**66**

	Change in variable	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m
At 31 December 2012			
Non-annuitant mortality and morbidity[1]	5% reduction	43	33
Annuitant mortality[2]	5% reduction	(170)	(131)
Lapse rates[3]	10% reduction	117	90
Future maintenance and investment expenses[4]	10% reduction	199	153
Risk-free rate[5]	0.25% reduction	26	20
Guaranteed annuity option take up[6]	5% addition	(9)	(7)
Equity investment volatility[7]	1% addition	(7)	(5)
Widening of credit default spreads on corporate bonds[8]	0.25% addition	(239)	(184)
Increase in illiquidity premia[9]	0.10% addition	93	72

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. Swap curves, 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 spreads on assets are unchanged and hence market values are unchanged. Swap curves and the non-annuity risk-free rate are both assumed to be unchanged. The increased illiquidity premium increases the annuity risk-free rate.

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Note 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 2012	49,636	(57)	49,579
New business	4,236	(1)	4,235
Changes in existing business	526	12	538
Exchange and other adjustments	(26)	–	(26)
At 31 December 2012	54,372	(46)	54,326
New business	**1,294**	**(1)**	**1,293**
Changes in existing business	**1,899**	**–**	**1,899**
Disposal of business	**(29,953)**	**–**	**(29,953)**
Exchange and other adjustments	**(22)**	**–**	**(22)**
At 31 December 2013	**27,590**	**(47)**	**27,543**

Note 39: Unallocated surplus within insurance businesses

The movement in the unallocated surplus within long-term insurance businesses over the year can be analysed as follows:

	2013 £m	2012 £m
At 1 January	**267**	300
Change in unallocated surplus recognised in the income statement (note 10)	**123**	(31)
Exchange and other adjustments	**1**	(2)
At 31 December	**391**	267

Note 40: Other liabilities

	2013 £m	2012[1] £m
Settlement balances	**3,358**	2,040
Unitholders' interest in Open Ended Investment Companies	**22,219**	33,651
Liabilities of disposal groups (note 16)	**7,302**	214
Other creditors and accruals	**7,728**	10,888
Total other liabilities	**40,607**	46,793

[1] Restated – see note 1.

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Note 41: Retirement benefit obligations

	2013 £m	2012[1] £m	2011[1] £m
Charge to the income statement			
Past service charges (credits)[2]	**104**	(250)	–
Other	**392**	349	395
Defined benefit pension schemes	**496**	99	395
Other post-retirement benefit schemes	**7**	11	13
Total defined benefit schemes	**503**	110	408
Defined contribution pension schemes	**255**	229	202
Total charge to the income statement	**758**	339	610

[1] Restated – see note 1.

[2] The Group has agreed certain changes to early retirement and commutation factors in two of its principal defined benefit pension schemes, resulting in a cost of £104 million recognised in the Group's income statement in the year ended 31 December 2013. In 2012, there was a net credit of £250 million following a decision to link discretionary pension increases in certain schemes to the Consumer Price Index (note 11).

	2013 £m	2012[1] £m
Amounts recognised in the balance sheet		
Retirement benefit assets	**98**	741
Retirement benefit obligations	**(1,096)**	(1,905)
Total amounts recognised in the balance sheet	**(998)**	(1,164)

The total amount recognised in the balance sheet relates to:

	2013 £m	2012[1] £m
Defined benefit pension schemes	**(787)**	(957)
Other post-retirement benefit schemes	**(211)**	(207)
Total amounts recognised in the balance sheet	**(998)**	(1,164)

[1] Restated – see note 1.

Pension schemes

Defined benefit schemes

(i) Characteristics of and risks associated with the Group's schemes

The Group has established a number of defined benefit pension schemes in the UK and overseas. All significant schemes are based in the UK, with the three most significant being the defined benefit sections of the Lloyds Bank Pension Schemes No's 1 and 2 and the HBOS Final Salary Pension Scheme. These schemes provide retirement benefits calculated as a percentage of final pensionable salary depending upon the length of service; the minimum retirement age under the rules of the schemes at 31 December 2013 was generally 55 although certain categories of member are deemed to have a contractual right to retire at 50.

The Group operates a number of funded and unfunded pension arrangements, the majority, including the three most significant schemes, are funded schemes in the UK. All schemes are operated as separate legal entities under trust law by the trustees. All UK schemes are funded in compliance with the Pensions Act 2004. A valuation exercise is carried out for each scheme at least every three years, whereby scheme assets are measured at market value and liabilities ('Technical Provisions') are measured using prudent assumptions, if a deficit is identified a recovery plan is agreed and sent to the Pensions Regulator for review. The outcome of this valuation process, including agreement of any recovery plans, is agreed between the Group and the scheme Trustee. The Group's overseas defined benefit pension schemes are subject to local regulatory arrangements.

The latest full valuations of the three main schemes were carried out as at 30 June 2011; the results have been updated to 31 December 2013 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 2013 by qualified independent actuaries.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 41: Retirement benefit obligations (continued)

During 2009, the Group made one-off contributions to the Lloyds Bank Pension Scheme No 1 and Lloyds Bank 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 contained assets of approximately £5.4 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. At 31 December 2013, the limited liability partnerships held assets of approximately £5.4 billion and cash payments of £215 million were made to the pension schemes during the year (2012: £215 million). The limited liability partnerships are consolidated fully in the Group's balance sheet (see note 22).

The Group has also established two private limited companies which hold assets to provide security for the Group's obligations to the HBOS Final Salary Pension Scheme and a section of the Lloyds Bank Pension Scheme No 1. At 31 December 2013 these held assets of approximately £2.6 billion in aggregate; they do not make any distributions to the pension schemes. The private limited companies are consolidated fully in the Group's balance sheet.

The terms of these arrangements require the Group to maintain assets in these vehicles to agreed minimum values in order to secure obligations owed to the relevant Group pension schemes. The Group has satisfied this requirement during 2013.

The Group currently expects to pay contributions of approximately £525 million to its defined benefit schemes in 2014.

The responsibility for the governance of the Group's funded defined benefit pension schemes lies with the Pension Trustees. Each of the Group's funded UK defined benefit pension schemes are managed by a Trustee Board (the Trustee) whose role is to ensure that their Scheme is administered in accordance with the Scheme rules and relevant legislation, and to safeguard the assets in the best interests of all members and beneficiaries. The Trustee is solely responsible for setting investment policy and for agreeing funding requirements with the employer through the triennial valuation process. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the Scheme's regulations.

(ii) Amounts in the financial statements

	2013 £m	2012 £m
Amount included in the balance sheet		
Present value of funded obligations	**(33,355)**	(31,324)
Fair value of scheme assets	**32,568**	30,367
Net amount recognised in the balance sheet	**(787)**	(957)

	2013 £m	2012 £m
Net amount recognised in the balance sheet		
At 1 January	**(957)**	592
Net defined benefit pension expense	**(496)**	(99)
Actuarial losses on defined benefit obligation	**(1,265)**	(2,607)
Return on plan assets	**1,133**	484
Employer contributions	**804**	669
Exchange and other adjustments	**(6)**	4
At 31 December	**(787)**	(957)

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Note 41: Retirement benefit obligations (continued)

	2013 £m	2012 £m
Movements in the defined benefit obligation		
At 1 January	**(31,324)**	(28,236)
Current service cost	**(351)**	(360)
Interest expense	**(1,414)**	(1,373)
Remeasurements:		
Actuarial (losses) gains – experience	**184**	(495)
Actuarial (losses) gains – demographic assumptions	**15**	(233)
Actuarial (losses) gains – financial assumptions	**(1,464)**	(1,879)
Benefits paid	**1,061**	995
Past service cost	**(5)**	(16)
Employee contributions	**(3)**	(3)
Curtailments	**(104)**	250
Settlements	**62**	12
Exchange and other adjustments	**(12)**	14
At 31 December	**(33,355)**	(31,324)
The total defined benefit obligation comprises:		
Amounts owing to active members	**(8,647)**	(8,004)
Amounts owing to deferred members	**(9,927)**	(8,927)
Amounts owing to pensioners	**(13,547)**	(13,207)
Amounts owing to dependents	**(1,234)**	(1,186)
Total defined benefit obligation at 31 December	**(33,355)**	(31,324)

	2013 £m	2012 £m
Changes in the fair value of scheme assets		
At 1 January	**30,367**	28,828
Return on plan assets excluding amounts included in interest income	**1,133**	484
Interest income	**1,392**	1,433
Employer contributions	**804**	669
Employee contributions	**3**	3
Benefits paid	**(1,061)**	(995)
Settlements	**(55)**	(16)
Administrative costs paid	**(21)**	(29)
Exchange and other adjustments	**6**	(10)
At 31 December	**32,568**	30,367

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 41: Retirement benefit obligations (continued)

Composition of scheme assets:

	2013			2012		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equity instruments	1,276	–	1,276	2,016	–	2,016
Debt instruments	12,845	–	12,845	10,704	–	10,704
Property	–	1,062	1,062	–	1,100	1,100
Pooled investment vehicles	4,684	10,671	15,355	4,337	10,975	15,312
Money market instruments, cash, derivatives and other assets and liabilities	506	1,524	2,030	522	713	1,235
At 31 December	19,311	13,257	32,568	17,579	12,788	30,367

The assets of all the funded plans are held independently of the Group's assets in separate trustee administered funds.

An analysis by credit rating of the pension schemes' debt securities is provided below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2013							
Fixed interest government bonds	877	884	143	218	80	–	2,202
Index linked government bonds	6,955	–	–	–	–	–	6,955
Corporate and other debt securities	127	442	1,305	1,206	482	75	3,637
Asset-backed securities	–	–	–	–	–	51	51
Total debt securities	7,959	1,326	1,448	1,424	562	126	12,845
At 31 December 2012							
Fixed interest government bonds	772	97	29	94	–	–	992
Index linked government bonds	6,288	–	–	–	–	–	6,288
Corporate and other debt securities	153	478	1,289	835	243	85	3,083
Asset-backed securities	–	–	27	208	57	49	341
Total debt securities	7,213	575	1,345	1,137	300	134	10,704

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Note 41: Retirement benefit obligations (continued)

The pension schemes' pooled investment vehicles comprise:

	2013 £m	2012 £m
UK equity investment funds	**457**	2,996
Non-UK equity investment funds	**2,177**	2,265
Fixed interest and index linked government bond funds	**277**	331
Corporate bond funds	**469**	466
Private equity	**963**	902
Infrastructure funds	**690**	635
Property partnerships and unit trusts	**383**	427
Hedge and mutual funds	**2,382**	1,846
Reinsurance (OEICs) vehicles	**654**	315
Mezzanine debt funds	**108**	111
Long-term equity funds	**84**	114
Emerging market equity funds	**1,018**	1,051
Emerging market debt funds	**1,142**	705
Multi strategy alternative credit funds	**749**	–
Asset-backed pension contribution schemes	**214**	429
Liquidity funds	**3,588**	2,719
At 31 December	**15,355**	15,312

The expense recognised in the income statement for the year ended 31 December comprises:

	2013 £m	2012 £m	2011 £m
Current service cost	**351**	360	380
Net interest amount	**22**	(60)	(20)
Past service credits and curtailments (see below)	**104**	(250)	(25)
Settlements	**(7)**	4	8
Past service cost – plan amendments	**5**	16	20
Plan administration costs incurred during the year	**21**	29	32
Total defined benefit pension expense	**496**	99	395

The Group has agreed certain changes to early retirement and commutation factors in two of its principal defined benefit pension schemes, resulting in a cost of £104 million recognised in the Group's income statement in the year ended 31 December 2013. In 2012, there was a net credit of £250 million following a decision to link discretionary pension increases in certain schemes to the Consumer Price Index (note 11).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 41: Retirement benefit obligations (continued)

Assumptions

The principal actuarial and financial assumptions used in valuations of the defined benefit pension schemes were as follows:

	2013 %	2012 %
Discount rate	**4.60**	4.60
Rate of inflation:		
Retail Prices Index	**3.30**	2.90
Consumer Price Index	**2.30**	2.00
Rate of salary increases	**2.00**	2.00
Rate of increase for pensions in payment	**2.80**	2.70
	2013 Years	2012 Years
Life expectancy for member aged 60, on the valuation date:		
Men	**27.4**	27.4
Women	**29.7**	29.7
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**28.6**	28.5
Women	**31.0**	30.9

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 at 31 December 2013 is assumed to live for, on average, 27.4 years for a male and 29.7 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.

(iii) Amount timing and uncertainty of future cash flows

Risk exposure of the defined benefit schemes

Whilst the Group is not exposed to any unusual, entity specific or scheme specific risks in its defined benefit pension schemes, it is exposed to a number of significant risks, detailed below:

Inflation rate risk: the majority of the plans' benefit obligations are linked to inflation both in deferment and once in payment. Higher inflation will lead to higher liabilities although this will be partially offset by holdings of inflation-linked gilts and, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation.

Interest rate risk: The defined benefit obligation is determined using a discount rate derived from yields on AA-rated corporate bonds. A decrease in corporate bond yields will increase plan liabilities although this will be partially offset by an increase in the value of bond holdings.

Longevity risk: The majority of the schemes obligations are to provide benefits for the life of the members so increases in life expectancy will result in an increase in the plans' liabilities.

Investment risk: Scheme assets are invested in a diversified portfolio of debt securities, equities and other return-seeking assets. If the assets underperform the discount rate used to calculate the defined benefit obligation, it will reduce the surplus or increase the deficit. Volatility in asset values and the discount rate will lead to volatility in the net pension liability on the Group's balance sheet and in other comprehensive income. To a lesser extent this will also lead to volatility in the pension expense in the Group's income statement.

The ultimate cost of the defined benefit obligations to the Group will depend upon actual future events rather than the assumptions made. The assumptions made are unlikely to be borne out in practice and as such the cost may be higher or lower than expected.

Note 41: Retirement benefit obligations (continued)

Sensitivity analysis

The effect of reasonably possible changes in key assumptions on the value of scheme liabilities and the resulting pension charge in the Group's income statement and on the net defined benefit pension scheme liability, for the Group's three most significant schemes, is set out below. The sensitivities provided assume that all other assumptions and the value of the schemes' assets remain unchanged, and are not intended to represent changes that are at the extremes of possibility. The calculations are approximate in nature and full detailed calculations could lead to a different result. It is unlikely that isolated changes to individual assumptions will be experienced in practice. Due to the correlation of assumptions, aggregating the effects of these isolated changes may not be a reasonable estimate of the actual effect of simultaneous changes in multiple assumptions.

	Effect of reasonably possible alternative assumptions			
	Increase (decrease) in the income statement charge		Increase (decrease) in the net defined benefit pension scheme liability	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Inflation (including pension increases):[1]				
Increase of 0.5 per cent	**108**	137	**1,833**	2,362
Decrease of 0.5 per cent	**(93)**	(110)	**(1,706)**	(1,888)
Discount rate:[2]				
Increase of 0.5 per cent	**(166)**	(152)	**(2,638)**	(2,396)
Decrease of 0.5 per cent	**155**	151	**2,890**	2,740
Expected life expectancy of members:				
Increase of one year	**38**	40	**686**	675
Decrease of one year	**(36)**	(39)	**(676)**	(664)

[1] At 31 December 2013, the assumed rate of RPI inflation is 3.3 per cent and CPI inflation 2.3 per cent (2012: RPI 2.90 per cent and CPI 2.00 per cent).

[2] At 31 December 2013, the assumed discount rate is 4.6 per cent (2012: 4.60 per cent).

Sensitivity analysis method and assumptions

The sensitivity analysis above reflects the impact on the Group's three most significant schemes which account for over 90 per cent of the Group's defined benefit obligations. Whilst differences in the underlying liability profiles for the remainder of the Group's pension arrangements mean they may exhibit slightly different sensitivities to variations in these assumptions, the sensitivities provided above are indicative of the impact across the Group as a whole.

The inflation assumption sensitivity applies to both the assumed rate of increase in the Consumer Prices Index (CPI) and the Retail Prices Index (RPI), and include the impact on the rate of increases to pensions, both before and after retirement. These pension increases are linked to inflation (either CPI or RPI) subject to certain minimum and maximum limits.

The sensitivity analysis (including the inflation sensitivity) does not include the impact of any possible change in the rate of salary increases. These increases are capped at a maximum of 2 per cent per annum, and have been assumed to increase at this maximum rate in both 2012 and 2013, therefore there is no sensitivity to an increase in this assumption. The Group is currently in formal consultation with the members of its defined benefit pension schemes regarding proposed changes to the way pensionable pay is calculated, which if introduced would reduce the rate of salary increases to zero. If implemented these changes would have the effect of decreasing both the Group's income statement charge and net defined benefit scheme liability.

The life expectancy assumption has been applied by allowing for an increase/decrease in life expectation from age 60 of one year, based upon the approximate weighted average age for each scheme. Whilst this is an approximate approach and will not give the same result as a one year increase in life expectancy at every age, it provides an appropriate indication of the potential impact on the schemes from changes in life expectancy.

There was no change in the methods and assumptions used in preparing the sensitivity analysis from the re-stated prior year.

Asset-liability matching strategies

The main schemes' assets are invested in a diversified portfolio, consisting primarily of debt securities and equities. The investment strategy is not static and will evolve to reflect the structure of liabilities within the schemes. Specific asset-liability matching strategies for each pension plan are independently determined by the responsible governance body for each scheme and in consultation with the employer.

A significant goal of the asset-liability matching strategies adopted by Group schemes is to reduce volatility caused by changes in market expectations of interest rates and inflation. In the main, this is achieved by investing scheme assets in bonds, primarily fixed interest gilts and index linked gilts, and by entering into interest rate and inflation swap arrangements. These investments are structured to take into account the profile of scheme liabilities, and actively managed to reflect both changing market conditions and changes to the liability profile.

The current asset-liability matching strategy has the objective of mitigating approximately 54 per cent (2012: 45 per cent) of the interest rate volatility and 71 per cent (2012: 54 per cent) of the inflation rate volatility of the liabilities.

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Note 41: Retirement benefit obligations (continued)

Maturity profile of defined benefit obligation

The following table provides information on the weighted average duration of the defined benefit pension obligations and the distribution and timing of benefit payments:

	2013 Years	2012 Years
Duration of the defined benefit obligation	**19**	19
	2013 £m	2012 £m
Maturity analysis of benefits expected to be paid		
Benefits expected to be paid within 12 months	**1,067**	999
Benefits expected to be paid between 1 and 2 years	**1,009**	970
Benefits expected to be paid between 2 and 5 years	**3,420**	3,210
Benefits expected to be paid between 5 and 10 years	**7,207**	6,739
Benefits expected to be paid between 10 and 15 years	**8,945**	8,446
Benefits expected to be paid between 15 and 25 years	**21,102**	20,072
Benefits expected to be paid between 25 and 35 years	**20,851**	19,767
Benefits expected to be paid between 35 and 45 years	**16,374**	15,508
Benefits expected to be paid in more than 45 years	**11,403**	11,096

Maturity analysis method and assumptions

The projected benefit payments are based on the assumptions underlying the assessment of the obligations, including allowance for expected future inflation. They are shown in their undiscounted form and therefore appear large relative to the discounted assessment of the defined benefit obligations recognised in the Group's balance sheet. They are in respect of benefits that have been accrued prior to the respective year-end date only and make no allowance for any benefits that may have been accrued subsequently.

Defined contribution schemes

The Group operates a number of defined contribution pension schemes in the UK and overseas, principally Your Tomorrow and the defined contribution sections of the Lloyds Bank Pension Scheme No. 1.

During the year ended 31 December 2013 the charge to the income statement in respect of defined contribution schemes was £255 million (2012: £229 million; 2011: £202 million), representing the contributions payable by the employer in accordance with each scheme's rules.

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 2013 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 6.90 per cent (2012: 6.50 per cent).

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Note 41: Retirement benefit obligations (continued)

Movements in the other post-retirement benefits obligation:

	2013 £m	2012 £m
At 1 January	(207)	(188)
Exchange and other adjustments	–	(3)
Actuarial loss	(4)	(13)
Insurance premiums paid	7	8
Charge for the year	(7)	(11)
At 31 December	(211)	(207)

Note 42: Deferred tax

The movement in the net deferred tax balance is as follows:

	2013 £m	2012 £m
Asset at 1 January		
As previously reported		4,182
Restatement (notes 1 and 56)		139
Restated	4,586	4,321
Exchange and other adjustments	7	(14)
Disposals	558	–
Income statement (charge) credit (note 14):		
Due to change in UK corporation tax rate	(594)	(320)
Other	(158)	(244)
	(752)	(564)
Amount credited (charged) to equity:		
Post-retirement defined benefit scheme remeasurements	28	491
Available-for-sale financial assets (note 47)	274	344
Cash flow hedges (note 47)	374	1
Share-based compensation	26	7
	702	843
Asset at 31 December	5,101	4,586

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	2013 £m	2012 £m	Tax disclosure	2013 £m	2012 £m
Deferred tax assets	5,104	4,913	Deferred tax assets	8,097	8,997
Deferred tax liabilities	(3)	(327)	Deferred tax liabilities	(2,996)	(4,411)
Asset at 31 December	5,101	4,586	**Asset at 31 December**	5,101	4,586

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Note 42: Deferred tax (continued)

The deferred tax (charge) credit in the income statement comprises the following temporary differences:

	2013 £m	2012 £m	2011 £m
Accelerated capital allowances	482	410	319
Pensions and other post-retirement benefits	(14)	(237)	(120)
Long-term assurance business	86	(869)	596
Allowances for impairment losses	(86)	(332)	(56)
Tax losses carried forward	(1,049)	974	(55)
Tax on fair value of acquired assets	322	28	(107)
Other temporary differences	(493)	(538)	577
Deferred tax (charge) credit in the income statement	(752)	(564)	1,154

Deferred tax assets and liabilities are comprised as follows:

	2013 £m	2012 £m
Deferred tax assets:		
Pensions and other post-retirement benefits	288	271
Accelerated capital allowances	649	167
Allowances for impairment losses	22	227
Other provisions	45	109
Available-for-sale asset revaluation	–	286
Tax losses carried forward	6,338	7,034
Other temporary differences	755	903
Total deferred tax assets	8,097	8,997
	2013 £m	**2012 £m**
Deferred tax liabilities:		
Accelerated capital allowances	–	–
Long-term assurance business	(1,195)	(1,849)
Available-for-sale asset revaluation	(30)	–
Tax on fair value of acquired assets	(1,236)	(1,741)
Effective interest rates	(19)	(34)
Derivatives	(190)	(333)
Other temporary differences	(326)	(454)
Total deferred tax liabilities	(2,996)	(4,411)

The Finance Act 2013 (the Act) was substantively enacted on 2 July 2013. The Act further reduced the main rate of corporation tax to 21 per cent with effect from 1 April 2014 and 20 per cent with effect from 1 April 2015. The change in the main rate of corporation tax from 23 per cent to 20 per cent has resulted in a reduction in the Group's net deferred tax asset at 31 December 2013 of £636 million, comprising the £594 million charge included in the income statement and a £42 million charge included in equity.

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 £6,338 million (2012: £7,034 million) in relation to trading 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 (see note 3).

Deferred tax assets of £168 million (2012: £330 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 £593 million (2012: £939 million) have not been recognised in respect of trading losses carried forward, mainly in certain overseas companies and in respect of other temporary differences in the insurance businesses. Trading losses can be carried forward indefinitely, except for losses in the USA which expire after 20 years.

In addition, deferred tax assets have not been recognised in respect of unrelieved foreign tax carried forward at 31 December 2013 of £41 million (2012: £42 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.

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Note 43: Other provisions

	Provisions for commitments £m	Payment protection insurance £m	Other regulatory provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2013	66	2,431	935	73	456	3,961
Exchange and other adjustments	(40)	–	12	19	(32)	(41)
Provisions applied	–	(2,674)	(360)	(28)	(10)	(3,072)
Charge for the year	–	3,050	421	5	13	3,489
At 31 December 2013	26	2,807	1,008	69	427	4,337

Provisions for 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.

Payment protection insurance

Following the unsuccessful legal challenge by the BBA against the Financial Services Authority (FSA) and the Financial Ombudsman Service (FOS), the Group made provisions totalling £6,775 million in 2011 and 2012 against the costs of paying redress to customers in respect of past sales of PPI policies, including the related administrative expenses.

During 2013 average monthly customer initiated complaints have continued to fall. Good progress has also been made in the planned proactive mailings. There have been some adverse trends (as detailed below), and a further £3,050 million has been added to the provision, of which £500 million was at the half year, £750 million in the third quarter and £1,800 million at the year end. This brings the total amount provided to £9,825 million, of which approximately £2,090 million relates to anticipated administrative expenses. As at 31 December 2013, £2,807 million of the provision remained unutilised (29 per cent of total provision) relative to an average monthly spend including administration costs in the last six months of £230 million. The increase of £3,050 million in 2013, and the overall provision, is underpinned by the following drivers:

– **Volumes of customer initiated complaints (after excluding complaints from customers where no PPI policy was held)** – at 31 December 2012, the provision assumed a total of 2.3 million complaints would be received. Average monthly volumes in 2013 decreased by 54 per cent compared to 2012, and fourth quarter volumes fell in line with the Group's revised end third quarter expectations. However, following further statistical modelling and the results of a customer survey, the Group is now forecasting a slower decline in future volumes than previously expected. A further provision of £870 million was therefore made during the year to reflect this. Approximately 2.5 million complaints have been received to date, with the provision assuming approximately 550,000 in the future compared to an average run-rate of approximately 37,000 per month in the last three months. The table below details the historical complaint trends.

Average monthly complaint volumes – reactive							
Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013
109,893	130,752	110,807	84,751	61,259	54,086	49,555	37,457

– **Proactive Mailing resulting from Past Business Reviews (PBR)** – the Group is proactively mailing customers where it has been identified that there was a risk of potential mis-sale. During the year, further groups of customers have been added to the proactive mailing exercise increasing the scope to 2.8 million policies, including approximately 300,000 additional policies in the second half. This, combined with higher than expected response rates from customers covered by the proactive mailing, resulted in a further provision of £470 million for the full year to reflect the additional cost incurred to date and in relation to future mailings.

– **Uphold rates** – average uphold rates per policy have increased from 61 per cent during the first half to 80 per cent for the last six months, with an average of 81 per cent in the fourth quarter. This reflects the impact of changes to the complaint handling policy, in part following consultation with the Financial Conduct Authority (FCA) and feedback from the FOS. In addition to this, there was a greater proportion of proactive mailing complaints received during the period for which uphold rates are higher. The provision assumes a slightly higher uphold rate going forward to allow for further embedding of complaint handling policy changes. The impact of higher uphold rates has resulted in a £335 million increase to the provision.

– **Average redress** – the average redress paid per policy has been relatively stable, but remains higher than expected by approximately £160 per policy due to the product and age mix of the complaints. This has resulted in an additional provision of £135 million.

– **Re-review of previously handled cases** – previously reviewed complaints are being assessed to ensure consistency with the current complaint handling policy. At 31 December 2012 the expected level of re-review was minimal. During 2013, and most notably in the fourth quarter, this has increased to approximately 590,000 cases at an estimated cost of £460 million.

– **Expenses** – given the update to volume related assumptions, the Group has also increased its estimate for administrative expenses which comprise complaint handling costs and costs arising from cases subsequently referred to the FOS, by £780 million.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 43: Other provisions (continued)

An Enforcement Team of the FCA is investigating the Group's governance of third party suppliers and potential failings in the PPI complaint handling process. A provision of £50 million has been made in respect of the likely administration costs of responding to the FCA's inquiries. It is not possible at this stage to make any assessment of what, if any, additional liability may result from the investigation.

Since the commencement of the PPI redress programme in 2011 the Group estimates that it has contacted, settled or provided for approximately 40 per cent of the policies sold since 2000, covering both customer-initiated complaints and actual and expected proactive mailings undertaken by the Group. The total amount provided for PPI represents the Group's best estimate of the likely future costs, albeit a number of risks and uncertainties remain, in particular complaint volumes, uphold rates, average redress paid, the scope and cost of proactive mailings and remediation, and the outcome of the FCA Enforcement Team investigation. The cost of these factors could differ materially from the Group's estimates and the assumptions underpinning them and could result in a further provision being required.

Key metrics and sensitivities are highlighted in the table below:

Sensitivities[1]	To date unless noted	Future	Sensitivity
Customer initiated complaints since origination (m)	2.5	0.5	0.1 = £200m
Proactive Mailing: – number of policies (m)[2]	1.66	1.19	0.1 = £45m
– response rate[3]	37%	31%	1% = £20m
Average uphold rate per policy[4]	80%	83%	1% = £15m
Average redress paid per upheld policy[5]	£1,600	£1,600	£100 = £110m
Remediation cases (k)	21	569	1 Case = £770
Administrative expenses (£m)	1,410	680	1 Case = £500
FOS Referral Rate[6]	35%	36%	1%= £4m
FOS Overturn Rate[7]	49%	33%	1%= £2m

[1] All sensitivities exclude claims where no PPI policy was held.

[2] To date volume includes customer initiated complaints.

[3] Metric has been adjusted to include mature mailings only, and exclude expected customer initiated complaints. Future response rates are expected to be lower than experienced to date as mailings to higher risk customers have been prioritised.

[4] The percentage of complaints where the Group finds in favour of the customer. This is a blend of proactive and customer initiated complaints. The 80 per cent uphold rate is based on the latest six months to December 2013.

[5] The amount that is paid in redress in relation to a policy found to have been mis-sold, comprising, where applicable, the refund of premium, compound interest charged and interest at 8 per cent per annum. Actuals are based on six months to December 2013. The accumulation of interest on future redress is expected to be offset by the mix shifting away from more expensive cases.

[6] The percentage of cases reviewed by the Group that are subsequently referred to the FOS by the customer. A complaint is considered mature when six months have elapsed since initial decision. Actuals are based on decision made by the Group during January to June 2013 and subsequently referred to the FOS.

[7] The percentage of complaints referred where the FOS arrive at a different decision to the Group. Actuals are based on six months to December 2013. The future overturn rate is expected to be lower due to changes in the case review process implemented during 2013 which has resulted in a higher uphold rate as noted above. In turn this reduces the number / percentage of cases likely to be overturned by the FOS.

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Note 43: Other provisions (continued)

Other regulatory provisions

Litigation in relation to insurance branch business in Germany

Clerical Medical Investment Group Limited (CMIG) has received a number of claims in the German courts, relating to policies issued by CMIG but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. Following decisions in July 2012 from the Federal Court of Justice (FCJ) in Germany the Group recognised a further provision of £150 million in its accounts for the year ended 31 December 2012 bringing the total amount provided to £325 million. During the half-year to 30 June 2013 the Group has charged a further £75 million with respect to this litigation increasing the total provision to £400 million. The remaining unutilised provision as at 31 December 2013 is £246 million.

However, there are still a number of uncertainties as to the full impact of the FCJ's decisions, and the validity of any of the claims facing CMIG will turn upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once there is further clarity with respect to a range of legal issues and factual determinations involved in these claims and/or all relevant claims have been resolved.

Interest rate hedging products

In June 2012, a number of banks, including the Group, reached agreement with the FSA (now FCA) to carry out a review of sales made since 1 December 2001 of interest rate hedging products (IRHP) to certain small and medium-sized businesses. As at 31 December 2013 the Group had identified 1,771 sales of IRHPs to customers within scope of the agreement with the FCA which are being reviewed and, where appropriate, redressed. The Group agreed that on conclusion of this review it would provide redress to any in-scope customers where appropriate.

The Group provided £400 million in its accounts for the year ended 31 December 2012 for the estimated cost of redress and related administration costs, based on a pilot review that had been conducted at the time. In the final quarter of 2013, a significant number of additional cases were reviewed, providing a larger and more representative sample from which to estimate the total cost of the review. As a result, an additional provision of £130 million has been recognised. During the same period, the Group confirmed it would pay any redress due to in-scope customers before any consequential loss claims had been outlined and agreed with them. At 31 December 2013, the total amount provided for the cost of redress and related administration costs is £530 million of which £162 million had been utilised. No provision has been recognised in relation to claims from customers which are not covered by the agreement with the FCA, or incremental claims from customers within the scope of the review. These will be monitored and future provisions will be recognised to the extent an obligation resulting in a probable outflow is identified.

Other regulatory matters

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and governmental authorities in relation to a range of matters; a provision is held against the costs expected to be incurred as a result of the conclusions reached. In 2013 the provision was increased by a further £200 million, in respect of matters affecting the Retail, Commercial, and Wealth and Asset Finance businesses, bringing the total amount charged to £300 million of which £75 million had been utilised at 31 December 2013. This increase reflects the Group's assessment of a limited number of matters under discussion, none of which currently is individually considered financially material in the context of the Group.

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 biannual basis and will normally run off over the period of under-recovery of the leases concerned, currently averaging three years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

Other

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.

Other provisions include those arising out of the insolvency of a third party insurer, which remains exposed to asbestos and pollution claims in the US. The ultimate cost and timing of payments are uncertain. The provision held of £37 million at 31 December 2013 represents management's current best estimate of the cost after having regard to actuarial estimates of future losses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 44: Subordinated liabilities

	2013 £m	2012 £m
Preference shares	876	1,385
Preferred securities	4,301	4,394
Undated subordinated liabilities	1,916	1,927
Enhanced Capital Notes	8,938	8,947
Dated subordinated liabilities	16,281	17,439
Total subordinated liabilities	32,312	34,092

These securities 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 preference shares and preferred 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 dated Enhanced Capital Notes (ECNs) 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 (2012: 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 Prudential Regulatory Authority.

The movement in subordinated liabilities during the year was as follows:

	2013 £m	2012 £m
At 1 January	34,092	35,089
Issued during the year	1,500	128
Repurchases and redemptions during the year	(2,442)	(857)
Foreign exchange and other movements	(838)	(268)
At 31 December	32,312	34,092

	Note	2013 £m	2012 £m
Preference shares			
6% Non-cumulative Redeemable Preference Shares	a	–	–
7.875% Non-cumulative Preference Shares callable 2013 (US$1,250 million)		–	259
7.875% Non-cumulative Preference Shares callable 2013 (€500 million)		–	149
6.0884% Non-cumulative Fixed to Floating Rate Preference Shares callable 2015 (£745 million)		10	10
5.92% Non-cumulative Fixed to Floating Rate Preference Shares callable 2015 (US$750 million)		127	125
6.267% Non-cumulative Fixed to Floating Rate Preference Shares callable 2016 (US$1,000 million)		274	280
6.3673% Non-cumulative Fixed to Floating Rate Preference Shares callable 2019 (£335 million)		2	2
6.475% Non-cumulative Preference Shares callable 2024 (£186 million)		39	39
6.413% Non-cumulative Fixed to Floating Rate Preference Shares callable 2035 (US$750 million)		51	104
6.657% Non-cumulative Fixed to Floating Rate Preference Shares callable 2037 (US$750 million)		16	14
9.25% Non-cumulative Irredeemable Preference Shares (£300 million)		304	350
9.75% Non-cumulative Irredeemable Preference Shares (£100 million)		53	53
Total preference shares		876	1,385

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.

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Note 44: Subordinated liabilities (continued)

	Note	2013 £m	2012 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)	a	**209**	214
6.85% Non-cumulative Perpetual Preferred Securities (US$1,000 million)	a	**121**	238
8.117% Non-cumulative Perpetual Preferred Securities (Class A) (£250 million)	a, b	**256**	262
7.627% Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities (€415 million)	a, c, e	**66**	50
6.35% Step-up Perpetual Capital Securities (€500 million)	a, d	**212**	226
6.071% Non-cumulative Perpetual Preferred Securities (US$750 million)		**423**	382
7.834% Sterling Step-up Non-voting Non-cumulative Preferred Securities callable 2015 (£250 million)		**5**	5
4.939% Non-voting Non-cumulative Perpetual Preferred Securities (€750 million)		**26**	23
7.286% Perpetual Regulatory Tier One Securities (Series A) (£150 million)		**132**	128
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)		**89**	83
6.461% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities (£600 million)		**455**	439
13% Step-up Perpetual Capital Securities callable 2019 (£785 million)		**8**	8
13% Step-up Perpetual Capital Securities callable 2019 (€532 million)		**50**	48
7.754% Non-cumulative Perpetual Preferred Securities (Class B) (£150 million)		**101**	98
12% Fixed to Floating Rate Perpetual Tier 1 Capital Securities callable 2024 (US$2,000 million)		**1,211**	1,239
7.281% Perpetual Regulatory Tier One Securities (Series B) (£150 million)		**90**	95
13% Step-up Perpetual Capital Securities callable 2029 (£700 million)		**660**	629
7.881% Guaranteed Non-voting Non-cumulative Preferred Securities (£245 million)		**187**	227
Total preferred securities		**4,301**	4,394

a These securities have passed their first call date, and are callable at specific dates as per the terms of the securities at the option of the issuer and with approval from the PRA.

b The fixed rate on this security was reset from 8.117 per cent to 6.059 per cent with effect from 31 May 2010.

c The fixed rate on this security was reset from 7.627 per cent to 3 month Euribor plus 2.875 per cent with effect from 9 December 2011.

d The fixed rate on this security was reset from 6.35 per cent to 3 month Euribor plus 2.50 per cent with effect from 25 February 2013.

e Following an exchange in February 2012, certain holders elected to exchange some notes into a new series of dated subordinated securities issued by Lloyds Bank plc.

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Note 44: Subordinated liabilities (continued)

	Note	2013 £m	2012 £m
Undated subordinated liabilities			
6.625% Undated Subordinated Step-up Notes (£410 million)	a, b	6	6
Floating Rate Undated Subordinated Step-up Notes (€300 million)	a	16	13
6.05% Fixed to Floating Rate Undated Subordinated Notes (€500 million)	a, c	8	5
5.375% Undated Fixed to Floating Rate Subordinated Notes (US$1,000 million)		–	9
8.625% Perpetual Subordinated Notes (£200 million)		–	22
4.875% Undated Subordinated Fixed to Floating Rate Instruments (€750 million)		79	70
Floating Rate Undated Subordinated Notes (€500 million)		49	44
4.25% Perpetual Fixed to Floating Rate Reset Subordinated Guaranteed Notes (€750 million) (Clerical Medical Finance plc)		283	261
10.25% Subordinated Undated Instruments (£100 million)		1	1
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million) (Scottish Widows plc)		533	556
5.125% Undated Subordinated Fixed to Floating Notes (€750 million)		49	45
7.5% Undated Subordinated Step-up Notes (£300 million)		5	4
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)		2	2
6.5% Undated Subordinated Step-up Notes callable 2019 (£270 million)		1	1
7.375% Undated Subordinated Guaranteed Bonds (£200 million) (Clerical Medical Finance plc)		44	37
5.625% Cumulative Callable Fixed to Floating Rate Undated Subordinated Notes callable 2019 (£500 million)		5	1
12% Perpetual Subordinated Bonds (£100 million)		20	21
5.75% Undated Subordinated Step-up Notes (£600 million)		3	3
8.75% Perpetual Subordinated Bonds (£100 million)		5	5
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)		–	–
9.375% Perpetual Subordinated Bonds (£50 million)		14	14
5.75% Undated Subordinated Step-up Notes (£500 million)		4	4
6.5% Undated Subordinated Step-up Notes callable 2029 (£450 million)		–	–
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)		10	10
Floating Rate Primary Capital Notes (US$250 million)	a	109	111
Primary Capital Undated Floating Rate Notes:			
Series 1 (US$750 million)	a	162	165
Series 2 (US$500 million)	a	169	173
Series 3 (US$600 million)	a	218	223
13.625% Perpetual Subordinated Bonds (£75 million)		19	19
11.75% Perpetual Subordinated Bonds (£100 million)		102	102
Total undated subordinated liabilities		**1,916**	1,927

a These securities have passed their first call date, and are callable at specific dates as per the terms of the securities at the option of the issuer and with approval from the PRA.

b The fixed rate on this security was reset from 6.625 per cent to 4.64821 per cent with effect from 15 July 2010.

c The fixed rate on this security was reset from 6.05 per cent to 3 month Euribor plus 2.25 per cent with effect from 23 November 2011.

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Note 44: Subordinated liabilities (continued)

With the exception of the two series identified in footnote b below, the ECNs were issued in lower tier 2 format and are convertible into ordinary shares on the breach of a defined trigger. The trigger is if the published core tier 1 ratio of the Group (as defined by the Financial Services Authority in May 2009) falls below 5 per cent.

	Note	2013 £m	2012 £m
Enhanced Capital Notes			
7.625% Enhanced Capital Notes due 2019 (£151 million)		**145**	144
8.125% Enhanced Capital Notes due 2019 (£4 million)		**4**	4
9% Enhanced Capital Notes due 2019 (£97 million)		**102**	98
7.8673% Enhanced Capital Notes due 2019 (£331 million)		**333**	332
15% Enhanced Capital Notes due 2019 (£775 million)		**1,064**	1,093
15% Enhanced Capital Notes due 2019 (€487 million)		**567**	571
8.875% Enhanced Capital Notes due 2020 (€125 million)		**116**	113
9.334% Enhanced Capital Notes due 2020 (£208 million)		**231**	230
7.375% Enhanced Capital Notes due 2020 (€95 million)		**80**	78
Floating Rate Enhanced Capital Notes due 2020 (€53 million)	a	**37**	37
7.875% Enhanced Capital Notes due 2020 (US$408 million)		**258**	267
11.04% Enhanced Capital Notes due 2020 (£736 million)		**824**	847
7.5884% Enhanced Capital Notes due 2020 (£732 million)		**706**	703
6.385% Enhanced Capital Notes due 2020 (€662 million)		**524**	493
6.439% Enhanced Capital Notes due 2020 (€711 million)		**563**	542
8% Fixed to Floating Rate Undated Enhanced Capital Notes callable 2020 (US$1,259 million)	b	**662**	662
9.125% Enhanced Capital Notes due 2020 (£148 million)		**157**	157
12.75% Enhanced Capital Notes due 2020 (£57 million)		**71**	73
7.869% Enhanced Capital Notes due 2020 (£597 million)		**593**	591
7.625% Enhanced Capital Notes due 2020 (€226 million)		**185**	181
7.875% Enhanced Capital Notes due 2020 (US$986 million)		**595**	608
11.125% Enhanced Capital Notes due 2020 (£39 million)		**44**	44
8.5% Undated Enhanced Capital Notes callable 2021 (US$277 million)	b	**146**	147
14.5% Enhanced Capital Notes due 2022 (£79 million)		**110**	113
9.875% Enhanced Capital Notes due 2023 (£57 million)		**66**	66
11.25% Enhanced Capital Notes due 2023 (£95 million)		**115**	113
10.5% Enhanced Capital Notes due 2023 (£69 million)		**78**	76
11.875% Enhanced Capital Notes due 2024 (£35 million)		**44**	45
7.975% Enhanced Capital Notes due 2024 (£102 million)		**99**	99
16.125% Enhanced Capital Notes due 2024 (£61 million)		**94**	95
15% Enhanced Capital Notes due 2029 (£68 million)		**108**	108
9% Enhanced Capital Notes due 2029 (£107 million)		**112**	112
8.5% Enhanced Capital Notes due 2032 (£104 million)		**105**	105
Total Enhanced Capital Notes		**8,938**	8,947

a Interest is payable quarterly in arrears at a rate of 3 month Euribor plus 3.1 per cent per annum.

b Issued in upper tier 2 format.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 44: Subordinated liabilities (continued)

	Note	2013 £m	2012 £m
Dated subordinated liabilities			
Subordinated Step-up Floating Rate Notes 2016 (€500 million)	a	172	172
Subordinated Step-up Floating Rate Notes 2016 (£300 million)	a	183	184
Callable Floating Rate Subordinated Notes 2016 (€500 million)	a	109	96
Callable Floating Rate Subordinated Notes 2016 (€500 million)	a	156	137
Subordinated Callable Notes 2016 (US$750 million)	a	218	198
Subordinated Callable Notes 2017 (€1,000 million)	a	276	243
6.75% Subordinated Callable Fixed to Floating Rate Instruments 2017 (Aus$200 million)	a, b	5	6
Subordinated Callable Floating Rate Instruments 2017 (Aus$400 million)	a	33	38
5.109% Callable Fixed to Floating Rate Notes 2017 (Can$500 million)	a, c	10	8
Subordinated Callable Notes 2017 (US$1,000 million)	a	211	198
6.305% Subordinated Callable Fixed to Floating Rate Notes 2017 (£500 million)	a, d	23	21
6.125% Notes 2013 (€325 million)		–	280
5.625% Subordinated Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)		–	858
4.25% Subordinated Guaranteed Notes 2013 (US$1,000 million)		–	619
6.45% Fixed to Floating Subordinated Guaranteed Bonds 2023 (€400 million) (Clerical Medical Finance plc)		–	181
11% Subordinated Bonds 2014 (£250 million)		275	284
5.875% Subordinated Notes 2014 (£150 million)		155	157
5.875% Subordinated Guaranteed Bonds 2014 (€750 million)		658	669
4.375% Callable Fixed to Floating Rate Subordinated Notes 2019 (€750 million)		621	604
4.875% Subordinated Notes 2015 (€1,000 million)		862	844
6.625% Subordinated Notes 2015 (£350 million)		371	375
6.9625% Callable Subordinated Fixed to Floating Rate Notes 2020 callable 2015 (£750 million)		701	716
11.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (€1,147 million)		975	977
10.75% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (£466 million)		458	477
9.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (US$568 million)		349	360
10.125% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (Can$387 million)		223	240
13% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (Aus$417 million)		234	280
10.5% Subordinated Bonds 2018 (£150 million)		174	177
6.75% Subordinated Fixed Rate Notes 2018 (US$2,000 million)		1,102	1,146
10.375% Subordinated Fixed to Fixed Rate Notes 2024 callable 2019 (€154 million)		141	143
6.375% Subordinated Instruments 2019 (£250 million)		256	281
6.5% Dated Subordinated Notes 2020 (€1,500 million)		1,433	1,458
7.375% Dated Subordinated Notes 2020		3	4
5.75% Subordinated Fixed to Floating Rate Notes 2025 callable 2020 (£350 million)		331	371
6.5% Subordinated Fixed Rate Notes 2020 (US$2,000 million)		1,231	1,345
Subordinated Floating Rate Notes 2020 (€100 million)		85	83
9.375% Subordinated Bonds 2021 (£500 million)		617	727
5.374% Subordinated Fixed Rate Notes 2021 (€160 million)		147	152
9.625% Subordinated Bonds 2023 (£300 million)		341	376
7.07% Subordinated Fixed Rate Notes 2023 (€175 million)		175	183
5.50% Subordinated Notes 2023 (£850 million) (Scottish Widows plc)		794	–
4.50% Fixed Rate Step-up Subordinated Notes due 2030 (€750 million)		445	457
7.625% Dated Subordinated Notes 2025 (£750 million)		822	915
6% Subordinated Notes 2033 (US$750 million)		313	399
7.00% Subordinated Notes 2043 (£650 million) (Scottish Widows plc)		593	–
Total dated subordinated liabilities		**16,281**	17,439

a These securities have passed their first call dates, and are callable at specific dates as per the terms of the securities at the option of the issuer and with approval of the PRA.

b The interest rate payable on this security was reset from 6.75 per cent fixed to Bank Bill Swap Rate plus 0.76 per cent with effect from 1 May 2012.

c The interest rate payable on this security was reset from 5.109 per cent fixed to Canadian Dealer Offered Rate plus 0.65 per cent with effect from 21 June 2012.

d The interest rate payable on this security was reset from 6.305 per cent fixed to 3-month Libor plus 1.2 per cent with effect from 18 October 2012.

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Note 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

	2013 Number of shares	2012 Number of shares	2011 Number of shares	2013 £m	2012 £m	2011 £m
Ordinary shares of 10p (formerly 25p) each						
At 1 January	**70,342,844,289**	68,726,627,112	68,074,129,454	**7,034**	6,873	6,807
Issued in relation to the payment of coupons on certain hybrid capital securities	**712,973,022**	479,297,215	–	**71**	47	–
Issued under employee share schemes	**312,618,630**	1,136,919,962	652,497,658	**32**	114	66
At 31 December	**71,368,435,941**	70,342,844,289	68,726,627,112	**7,137**	7,034	6,873
Limited voting ordinary shares of 10p (formerly 25p) each						
At 1 January and 31 December	**80,921,051**	80,921,051	80,921,051	**8**	8	8
Total issued share capital				**7,145**	7,042	6,881

Share issuances

In 2013 the Group issued 713 million new ordinary shares (2012: 479 million shares; 2011: nil) in relation to payment of coupons in the year on certain hybrid capital securities that are non-cumulative; the remaining 312 million shares issued in 2013 were in respect of employee share schemes (2012: 1,137 million shares; 2011: 652 million shares).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 45: Share capital (continued)

(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 75.

The directors have authority to allot and issue ordinary and preference shares and to make market purchases of ordinary and preference shares as granted at the annual general meeting on 16 May 2013. The authority to issue shares and the authority to make market purchases of shares will expire at the next 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 99.9 per cent of the total ordinary share capital at 31 December 2013, 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 on a winding up may share in the assets of the Company.

Limited voting ordinary shares

The limited voting ordinary shares are held by the Lloyds Bank Foundations (the Foundations). The holders of the limited voting ordinary shares, who held 0.1 per cent of the total ordinary share capital at 31 December 2013, 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.

The Company has entered into deeds of covenant with the Foundations under the terms of which the Company makes annual donations. The deeds of covenant can be cancelled by the Company at nine years notice, at which point the limited voting ordinary share capital would convert into ordinary shares. Such notice has been given to the Lloyds Bank Foundation for Scotland.

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.

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Note 46: Share premium account

	2013 £m	2012 £m	2011 £m
At 1 January	**16,872**	16,541	16,291
Issued in relation to the settlement of coupons on certain hybrid capital securities[1]	**279**	123	–
Issued under employee share schemes	**128**	208	250
At 31 December	**17,279**	16,872	16,541

[1] During 2013 the Group issued new ordinary shares for a consideration of £350 million (2012: £170 million; 2011: £nil) in relation to payment of coupons on certain hybrid capital securities that are non-cumulative.

Note 47: Other reserves

	2013 £m	2012 £m	2011 £m
Other reserves comprise:			
Merger reserve	**8,107**	8,107	8,107
Capital redemption reserve	**4,115**	4,115	4,115
Revaluation reserve in respect of available-for-sale financial assets	**(615)**	399	1,326
Cash flow hedging reserve	**(1,055)**	350	325
Foreign currency translation reserve	**(75)**	(69)	(55)
At 31 December	**10,477**	12,902	13,818

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 and amounts transferred from share capital following the cancellation of the deferred shares.

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; in the case of available-for-sale financial assets obtained on acquisitions of businesses, since the date of acquisition; and in the case of transferred assets that were previously held at amortised cost, by reference to that amortised cost.

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:

	2013 £m	2012 £m	2011 £m
Merger reserve			
At 1 January and 31 December	**8,107**	8,107	8,107

	2013 £m	2012 £m	2011 £m
Capital redemption reserve			
At 1 January and 31 December	**4,115**	4,115	4,115

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 47: Other reserves (continued)

	2013 £m	2012 £m	2011 £m
Revaluation reserve in respect of available-for-sale financial assets			
At 1 January	399	1,326	(285)
Adjustment on transfer from held-to-maturity portfolio	–	1,168	–
Change in fair value of available-for-sale financial assets	(680)	900	2,527
Deferred tax	86	(516)	(657)
Current tax	3	(3)	–
	(591)	1,549	1,870
Income statement transfers:			
Disposals (note 9)	(629)	(3,547)	(343)
Deferred tax	191	848	30
	(438)	(2,699)	(313)
Impairment	18	42	80
Deferred tax	(3)	12	29
	15	54	109
Other transfers	–	169	(79)
Deferred tax	–	–	24
	–	169	(55)
At 31 December	(615)	399	1,326

	2013 £m	2012 £m	2011 £m
Cash flow hedging reserve			
At 1 January	350	325	(391)
Change in fair value of hedging derivatives	(1,229)	116	916
Deferred tax	320	(17)	(257)
Current tax	–	–	–
	(909)	99	659
Income statement transfers (note 5)	(550)	(92)	70
Deferred tax	54	18	(13)
	(496)	(74)	57
At 31 December	(1,055)	350	325

	2013 £m	2012 £m	2011 £m
Foreign currency translation reserve			
At 1 January	(69)	(55)	29
Currency translation differences arising in the year	(155)	(69)	(58)
Foreign currency gains (losses) on net investment hedges (tax: £nil)	149	55	(26)
At 31 December	(75)	(69)	(55)

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Note 48: Retained profits

	2013 £m	2012 £m	2011 £m
At 1 January			
As previously reported			11,380
Restatement (notes 1 and 56)			(707)
Restated	5,080	8,266	10,673
Profit (loss) for the year	(838)	(1,471)	(2,963)
Post-retirement defined benefit scheme remeasurements	(108)	(1,645)	469
Movement in treasury shares	(480)	(407)	(276)
Value of employee services:			
Share option schemes	142	81	125
Other employee award schemes	292	256	238
At 31 December	**4,088**	5,080	8,266

Retained profits are stated after deducting £480 million (2012: £158 million; 2011: £33 million) representing 578 million (2012: 301 million; 2011: 58 million) treasury shares held.

Note 49: Ordinary dividends

No dividends were paid on ordinary shares during 2011, 2012 or 2013 and the directors do not propose to pay a final dividend in respect of 2013.

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 have chosen to waive their entitlement to the dividends on those shares as indicated: the Lloyds Banking Group Share Incentive Plan (holding at 31 December 2013: 16,857,069 shares, 31 December 2012: 12,040,715 shares, waived rights to all dividends), the Lloyds TSB Group Employee Share Ownership Trust (holding at 31 December 2013: 52,150,441 shares, 31 December 2012: 73,007,743 shares, on which it waived rights to all dividends), Lloyds Group Holdings (Jersey) Limited (holding at 31 December 2013: 42,846 shares, 31 December 2012: 42,846 shares, waived rights to all but a nominal amount of one penny in total) and the Lloyds TSB Qualifying Employee Share Ownership Trust (holding at 31 December 2013: 1,398 shares, 31 December 2012: 1,398 shares, waived rights to all but a nominal amount of one penny in total).

Note 50: Share-based payments

Charge to the income statement

The charge to the income statement is set out below:

	2013 £m	2012 £m	2011 £m
Deferred bonus plan	276	248	221
Executive and SAYE plans:			
Options granted in the year	42	12	13
Options granted in prior years	74	65	130
	116	77	143
Share plans:			
Shares granted in the year	3	3	3
Shares granted in prior years	4	5	9
	7	8	12
Total charge to the income statement	399	333	376

During the year ended 31 December 2013 the Group operated the following share-based payment schemes, all of which are equity settled.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 50: Share-based payments (continued)

Deferred bonus plans

Bonuses in respect of the performance in 2013 of employees within certain of the Group's bonus plans have been recognised in these financial statements in full. The amounts to be settled in shares are included within the total charge to the income statement detailed above.

Lloyds Banking Group executive share option 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 March 2004 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.

Performance conditions for executive options

For options granted in 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 was 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 in 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.

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Note 50: Share-based payments (continued)

Movements in the number of share options outstanding under the executive share option schemes during 2012 and 2013 are set out below:

	2013		2012	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	8,044,896	224.95	10,174,869	225.15
Forfeited	(1,992,303)	227.70	(2,129,973)	225.92
Lapsed	–	–	–	–
Outstanding at 31 December	6,052,593	224.04	8,044,896	224.95
Exercisable at 31 December	6,052,593	224.03	8,044,896	224.95

No options were exercised during 2013 or 2012. The weighted average remaining contractual life of options outstanding at the end of the year was 0.8 years (2012: 1.9 years). The fair values of the executive share options have been determined using a standard Black-Scholes model.

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:

	2013		2012	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	314,572,023	48.01	453,019,032	49.74
Granted	510,414,399	40.62	–	–
Exercised	(294,905,606)	46.78	–	–
Forfeited	(7,715,717)	43.08	(8,427,262)	49.15
Cancelled	(10,761,588)	45.61	(88,340,810)	49.83
Expired	(10,633,894)	56.28	(41,678,937)	62.67
Outstanding at 31 December	500,969,617	41.16	314,572,023	48.01
Exercisable at 31 December	2,255,239	120.76	119,141	86.50

The weighted average share price at the time that the options were exercised during 2013 was £0.65. No options were exercised in 2012. The weighted average remaining contractual life of options outstanding at the end of the year was 2.9 years (2012: 0.8 years).

The weighted average fair value of SAYE options granted during 2013 was £0.24. No options were granted in 2012. The fair values of the SAYE options have been determined using a standard Black-Scholes model.

For the HBOS sharesave plan, no options were exercised during 2013 or 2012. The options outstanding at 31 December 2013 had an exercise price of £1.8066 (2012: £1.8066) and a weighted average remaining contractual life of 1.1 years (2012: 2.1 years).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 50: Share-based payments (continued)

Other share option plans

Lloyds Banking 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 under this plan have been granted specifically to facilitate recruitment and as such were not subject to any performance conditions. The Plan's usage 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.

Participants are not entitled to any dividends paid during the vesting period.

	2013		2012	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	45,614,150	Nil	53,000,069	Nil
Granted	9,284,956	Nil	34,345,366	Nil
Exercised	(16,079,222)	Nil	(41,290,412)	Nil
Forfeited	(1,290,720)	Nil	(440,873)	Nil
Lapsed	(174,185)	Nil	–	Nil
Outstanding at 31 December	37,354,979	Nil	45,614,150	Nil
Exercisable at 31 December	4,275,432	Nil	3,065,531	Nil

The weighted average fair value of options granted in the year was £0.56 (2012: £0.30). The fair values of options granted have been determined using a standard Black-Scholes model. The weighted average share price at the time that the options were exercised during 2013 was £0.55 (2012: £0.33). The weighted average remaining contractual life of options outstanding at the end of the year was 3.6 years (2012: 3.7 years).

Lloyds Banking Group Share Buy Out Awards

As part of arrangements to facilitate the recruitment of certain Executives, options have been granted by individual deed and, where appropriate, in accordance with the Listing Rules of the UK Listing Authority.

The awards were granted in recognition that the Executives' outstanding awards over shares in their previous employing company lapsed on accepting employment with the Group.

Movements in the number of options outstanding are set out below:

	2013		2012	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	21,321,237	Nil	21,321,237	Nil
Granted	–	–	–	–
Exercised	(5,953,810)	Nil	–	–
Forfeited	(4,194,827)	Nil	–	–
Outstanding at 31 December	11,172,600	Nil	21,321,237	Nil
Exercisable at 31 December	11,083,749	Nil	16,509,862	Nil

No options were granted in 2013 or 2012. The weighted average remaining contractual life of options outstanding at the end of the year was 7.5 years (2012: 8.6 years).

The weighted average share price at the time the options were exercised during 2013 was £0.75. No options were exercised in 2012.

Participants are entitled to any dividends paid during the vesting period. This amount will be paid in cash unless the Remuneration Committee decides it will be paid in shares.

The fair values of the majority of options granted have been determined using a standard Black-Scholes model. The fair values of the remaining options have been determined by Monte Carlo simulation.

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Note 50: Share-based payments (continued)

HBOS share option plans

The table below details the outstanding options for the HBOS Share Option Plan and the St James's Place Share Option Plan. 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 partners of St James's Place, which granted options in respect of Lloyds Banking Group plc shares. The final award under the St James's Place Share Option Plan was made in 2009. Movements in the number of share options outstanding under these schemes are set out below:

During 2013 the Group completed the sale of all of its holding in St James's Place plc, as set out in note 9. The participants of the St James's Place Share Option Plan remain entitled to the Lloyds Banking Group plc shares awarded under the terms of this Plan and these options are included in the table below.

Participants are not entitled to any dividends paid during the vesting period.

	2013		2012	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	19,857,692	363.76	22,058,552	394.30
Exercised	(2,609,272)	51.83	–	–
Forfeited	(240,349)	568.80	(319,134)	572.22
Lapsed	(2,144,026)	546.43	(1,881,726)	686.47
Cancelled	(1,744,461)	532.39	–	–
Outstanding at 31 December	13,119,584	369.76	19,857,692	363.76
Exercisable at 31 December	13,119,584	369.76	19,857,692	363.76

The weighted average share price at the time the options were exercised during 2013 was £0.72. No options were exercised in 2012.

The options outstanding under the HBOS Share Option Plan and St James's Place Share Option Plan at 31 December 2013 had exercise prices in the range of £0.5183 to £5.80 (2012: £0.5183 to £5.80) and a weighted average remaining contractual life of 0.2 years (2012: 1.1 years).

Other share plans

Lloyds Banking Group 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.

Participants may be entitled to any dividends paid during the vesting period if the performance conditions are met. An amount equal in value to any dividends paid between the award date and the date the Remuneration Committee determine that the performance conditions were met may be paid, based on the number of shares that vest. The Remuneration Committee will determine if any dividends are to be paid in cash or in shares.

The performance conditions for awards made in March and August 2010 were as follows:

(i) **EPS:** relevant to 50 per cent of the award. Performance was measured based on EPS growth over a three year period from the baseline EPS of 2009.

If the absolute improvement in adjusted EPS reached 158 per cent, 25 per cent of this element of the award, being the threshold, would vest. If absolute improvement in adjusted EPS reached 180 per cent, 100 per cent of this element would vest.

Vesting between threshold and maximum would be on a straight line basis.

(ii) **EP:** relevant to 50 per cent of the award. Performance was measured based on the compound annual growth rate of adjusted EP over the three financial years starting on 1 January 2010 relative to an adjusted 2009 EP base.

If the compounded annual growth rate of adjusted EP reached 57 per cent per annum, 25 per cent of this element of the award, being the threshold, would vest. If the compounded annual growth rate of adjusted EP reached 77 per cent per annum, 100 per cent of this element would vest.

Vesting between threshold and maximum would be on a straight line basis.

For awards made to Executive Directors, a third performance condition was set, relating to Absolute Share Price, relevant to 28 per cent of the award. Performance was measured based on the Absolute Share Price on 26 March 2013, being the third anniversary of the award date. If the share price at the end of the performance period was 75 pence or less, none of this element of the award would vest. If the share price was 114 pence or higher, 100 per cent of this element would vest. Vesting between threshold and maximum would be on a straight line basis, provided that shares comprised in the Absolute Share Price element may only be released if both the EPS and EP performance measures had been satisfied at the threshold level or above. The EPS and EP performance conditions each relate to 36 per cent of the total award.

At the end of the performance period for the EPS and EP measures, it was assessed that neither of the performance conditions had been met and the awards did not vest.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 50: Share-based payments (continued)

The performance conditions for awards made in March and September 2011 are as follows:

(i) **EPS:** relevant to 50 per cent of the award. The performance target is based on 2013 adjusted EPS outcome.

If the adjusted EPS reaches 6.4p, 25 per cent of this element of the award, being the threshold, will vest.

If adjusted EPS reaches 7.8p, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(ii) **EP:** relevant to 50 per cent of the award. The performance target is based on 2013 adjusted EP outcome.

If the adjusted EP reaches £567 million, 25 per cent of this element of the award, being the threshold, will vest. If the adjusted EP reaches £1,534 million, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

For awards made to Executive Directors, a third performance condition was set, relating to Absolute Total Shareholder Return, relevant to one third of the award. Performance will be measured based on the annualised Absolute Total Shareholder Return over the three year performance period. If the annualised Absolute Total Shareholder Return at the end of the performance period is less than 8 per cent, none of this element of the award will vest. If the Absolute Total Shareholder Return is 8 per cent, 25 per cent of this element of the award, being the threshold, will vest. If the Absolute Total Shareholder Return is 14 per cent or higher, 100 per cent of this element will vest. Vesting between threshold and maximum will be on a straight line basis. The EPS and EP performance conditions will each relate to 33.3 per cent of the total award.

At the end of the performance period for the EPS and EP measures, the targets had not been fully met and therefore these awards will vest in 2014 at a rate of 68 per cent (54 per cent for members of the Group Executive Committee, including Executive Directors).

The performance conditions for awards made in March and September 2012 are as follows:

(i) **EP:** relevant to 30 per cent of the award. The performance target is based on 2014 adjusted EP outcome.

If the adjusted EP reaches £225 million, 25 per cent of this element of the award, being the threshold, will vest.

If the adjusted EP reaches £2,330 million, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(ii) **Absolute Total Shareholder Return (ATSR):** relevant to 30 per cent of the award. Performance will be measured against the annualised return over the three year period ending 31 December 2014.

If the ATSR reaches 12 per cent per annum, 25 per cent of this element of the award, being the threshold, will vest.

If the ATSR reaches 30 per cent per annum, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(iii) **Short-term funding as a percentage of total funding:** relevant to 10 per cent of the award. Performance will be measured relative to 2014 targets.

If the average percentage reaches 20 per cent, 25 per cent of this element of the award, being the threshold, will vest.

If the average percentage reaches 15 per cent, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(iv) **Non-core assets at the end of 2014:** relevant to 10 per cent of the award. Performance will be measured by reference to balance sheet non-core assets at 31 December 2014.

If non-core assets amount to £95 billion or less, 25 per cent of this element of the award, being the threshold, will vest.

If non-core assets amount to £80 billion or less, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(v) **Net Simplification benefits:** relevant to 10 per cent of the award. Performance will be measured by reference to the run rate achieved by the end of 2014.

If a run rate of net Simplification benefits of £1.5 billion is achieved, 25 per cent of this element of the award, being the threshold, will vest.

If a run rate of net Simplification benefits of £1.8 billion is achieved, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(vi) **Customer satisfaction:** relevant to 10 per cent of the award. Performance will be measured by reference to the total number of FSA reportable complaints per 1,000 customers over the three year period to 31 December 2014.

If complaints per 1,000 customers average 1.5 per annum or less over three years, 25 per cent of this element of the award, being the threshold, will vest.

If complaints per 1,000 customers average 1.3 per annum or less over three years, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

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Note 50: Share-based payments (continued)

The performance conditions for awards made in March and October 2013 are as follows:

(i) **EP:** relevant to 35 per cent of the award. The performance target is based on 2015 adjusted EP outcome.

If the adjusted EP reaches £1,254 million, 25 per cent of this element of the award, being the threshold, will vest.

If the adjusted EP reaches £1,881 million, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(ii) **Absolute Total Shareholder Return (ATSR):** relevant to 30 per cent of the award. Performance will be measured against the annualised return over the three year period ending 31 December 2015.

If the ATSR reaches 8 per cent per annum, 25 per cent of this element of the award, being the threshold, will vest.

If the ATSR reaches 16 per cent per annum, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(iii) **Adjusted total costs:** relevant to 10 per cent of the award. The performance target is based on 2015 adjusted total costs.

If adjusted total costs are £9,323 million or less, 25 per cent of this element of the award, being the threshold, will vest.

If adjusted total costs are £8,973 million or less, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(iv) **Non-core assets excluding UK Retail at the end of 2015:** relevant to 10 per cent of the award. Performance will be measured by reference to balance sheet non-core assets at 31 December 2015.

If non-core assets amount to £37 billion or less, 25 per cent of this element of the award, being the threshold, will vest.

If non-core assets amount to £28 billion or less, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(v) **Customer satisfaction:** relevant to 10 per cent of the award. Performance will be measured by reference to the total number of FCA reportable complaints per 1,000 customers over the three year period to 31 December 2015.

If complaints per 1,000 customers average 1.05 per annum or less over three years, 25 per cent of this element of the award, being the threshold, will vest.

If complaints per 1,000 customers average 0.95 per annum or less over three years, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(vi) **SME lending:** relevant to 5 per cent of the award. Performance will be measured by reference to the movement in lending to SMEs relative to the market as reported by the Bank of England over the three year period ending 31 December 2015.

If the movement in SME lending equates to this market movement, 25 per cent of this element of the award, being the threshold, will vest.

If the movement in SME lending is 4 per cent or more greater than the market movement, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

In addition, short-term funding must remain within that stated in the Group's Risk Appetite throughout the three year period to 31 December 2015.

	2013 Number of shares	2012 Number of shares
Outstanding at 1 January	**515,951,517**	543,738,186
Granted	**186,360,995**	265,011,679
Vested	**–**	(71,591,014)
Forfeited	**(153,426,617)**	(221,207,334)
Outstanding at 31 December	**548,885,895**	515,951,517

The weighted average fair value of the share awards granted in 2013 was £0.34 (2012: £0.24). The fair values of the majority of share awards granted have been determined using a standard Black-Scholes model. The fair values of the remaining share awards have been determined by Monte Carlo simulation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 50: Share-based payments (continued)

Scottish Widows Investment Partnership Long-Term Incentive Plan

The Scottish Widows Investment Partnership (SWIP) Long-Term Incentive Plan applicable to senior executives and employees of SWIP, which had previously been a cash-only scheme, was amended in May 2012 for awards granted on or after that date. The amendment introduced the receipt of shares in Lloyds Banking Group plc as an element of the total award. For awards made in June 2012, the other element continued to be cash-based, with the split between cash-based and share-based determined by the Remuneration Committee. Awards made in June 2013 were fully share-based. The amendment is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of SWIP over a three year period. Awards are made within limits set by the rules of the Plan, with the maximum limits for combined cash and shares awarded equating to 3.5 times annual salary. In exceptional circumstances this may increase to four times annual salary.

The performance conditions for share-based awards made in June 2012 are as follows:

(i) **Profitability:** relevant to 40 per cent of the award. The performance target is based on a cumulative three year profit before tax. If cumulative profit before tax reaches a specified target level, 100 per cent of this element will vest. If cumulative profit before tax reaches 90 per cent of the target level, 25 per cent of this element of the award, being the threshold, will vest. If cumulative profit before tax reaches 110 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

(ii) **Investment performance:** relevant to 40 per cent of the award. The performance target is based on the percentage of SWIP funds achieving at or above benchmark performance (on a competitor median or index basis) over the three year period. If 50 per cent of funds exceed benchmark performance, 25 per cent of this element of the award, being the threshold, will vest. If 55 per cent of funds exceed benchmark performance, 100 per cent of this element, being the target, will vest. If 70 per cent of funds exceed benchmark performance, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

(iii) **Funds under management (FUM) growth:** relevant to 20 per cent of the award. The performance target is based on growth in the value of third party assets managed by SWIP by the end of the three year period. If third party FUM reaches a specified target level, 100 per cent of this element of the award will vest. If third party FUM reaches 80 per cent of the target level, 25 per cent of this element, being the threshold, will vest. If third party FUM reaches 120 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

For awards made to SWIP's Code Staff (as defined by FSA), a fourth performance condition was set, relating to an internal measure of operational risk. This additional measure is relevant to 15 per cent of the award for these individuals, with a corresponding 5 per cent reduction in each of the weightings for the other three measures described above. As with the other measures, this performance condition has a target value at which 100 per cent of the award will vest, a maximum value at which 200 per cent of the award will vest, and a threshold value at which 25 per cent of the award will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

The relevant period commenced on 1 January 2012 and ends on 31 December 2014.

The performance conditions for share-based awards made in June 2013 are as follows:

(i) **Profitability:** relevant to 35 per cent of the award. The performance target is based on a cumulative three year profit before tax. If cumulative profit before tax reaches a specified target level, 100 per cent of this element will vest. If cumulative profit before tax reaches 80 per cent of the target level, 25 per cent of this element of the award, being the threshold, will vest. If cumulative profit before tax reaches 120 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

(ii) **Investment performance:** relevant to 35 per cent of the award. The performance target is based on the percentage of SWIP funds achieving at or above benchmark performance (on a competitor median or index basis) over the three year period. If 50 per cent of funds exceed benchmark performance, 25 per cent of this element of the award, being the threshold, will vest. If 55 per cent of funds exceed benchmark performance, 100 per cent of this element, being the target, will vest. If 70 per cent of funds exceed benchmark performance, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

(iii) **Funds under management (FUM) growth:** relevant to 15 per cent of the award. The performance target is based on growth in the value of third party assets managed by SWIP by the end of the three year period. If third party FUM reaches a specified target level, 100 per cent of this element of the award will vest. If third party FUM reaches 80 per cent of the target level, 25 per cent of this element, being the threshold, will vest. If third party FUM reaches 120 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

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Note 50: Share-based payments (continued)

(iv) **Risk:** relevant to 15 per cent of the award. The performance target is based on a cumulative three year risk score. If the cumulative risk score reaches a specified target level, 100 per cent of this element will vest. If the cumulative risk score reaches 120 per cent of the target level, 25 per cent of this element of the award, being the threshold, will vest. If the cumulative risk score is 80 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

The relevant period commenced on 1 January 2013 and ends on 31 December 2015.

	2013 Number of shares	2012 Number of shares
Outstanding at 1 January	**5,452,877**	–
Granted	**10,331,924**	5,452,877
Outstanding at 31 December	**15,784,801**	5,452,877

The fair value of the share awards granted in 2013 was £0.43. The fair values of share awards granted have been determined using a standard Black-Scholes model.

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**
At 31 December 2013									
Exercise price range									
£0 to £1	**–**	**–**	**–**	**40.63**	**2.91**	**499,088,383**	**5.25**	**4.1**	**51,528,728**
£1 to £2	**199.91**	**0.6**	**196,201**	**180.64**	**1.09**	**1,881,234**	**–**	**–**	**–**
£2 to £3	**224.85**	**0.8**	**5,856,392**	**–**	**–**	**–**	**–**	**–**	**–**
£5 to £6	**–**	**–**	**–**	**–**	**–**	**–**	**580.00**	**0.2**	**7,897,324**

	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
At 31 December 2012									
Exercise price range									
£0 to £1	–	–	–	46.79	0.8	311,648,405	5.43	4.9	74,766,919
£1 to £2	199.91	1.6	233,714	178.14	1.8	2,923,618	–	–	–
£2 to £3	225.69	1.9	7,811,182	–	–	–	–	–	–
£3 to £4	–	–	–	–	–	–	–	–	–
£5 to £6	–	–	–	–	–	–	566.89	0.9	12,026,160

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 50: Share-based payments (continued)

The fair value calculations at 31 December 2013 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	Save-As-You-Earn	Executive Share Plan 2003	LTIP	SWIP LTIP
Weighted average risk-free interest rate	0.33%	0.37%	0.31%	0.30%
Weighted average expected life	3.1 years	1.0 years	3.0 years	3.0 years
Weighted average expected volatility	45%	35%	45%	45%
Weighted average expected dividend yield	2.5%	2.5%	4.3%	4.4%
Weighted average share price	£0.51	£0.57	£0.49	£0.49
Weighted average exercise price	£0.41	Nil	Nil	Nil

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, during which period the employee is entitled to any dividends paid on such shares. 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.

The last award of free shares was made in 2008.

Matching shares

The Group undertakes to match shares purchased by employees up to the value of £30 per month; these matching shares are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. 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 2013 was 19,870,495 (2012: 36,158,343), with an average fair value of £0.63 (2012: £0.34), based on market prices at the date of award.

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Note 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 the 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:

	2013 £m	2012 £m	2011 £m
Compensation			
Salaries and other short-term benefits	15	12	12
Post-employment benefits	–	–	–
Share-based payments	21	13	11
Total compensation	36	25	23

Aggregate contributions in respect of key management personnel to defined contribution pension schemes were £0.2 million (2012: £0.1 million; 2011: £0.2 million).

	2013 million	2012 million	2011 million
Share option plans			
At 1 January	25	22	6
Granted, including certain adjustments[1] (includes entitlements of appointed key management personnel)	5	8	20
Exercised/lapsed (includes entitlements of former key management personnel)	(16)	(5)	(4)
At 31 December	14	25	22

[1] 2010 includes adjustments, using a standard HMRC formula, to negate the dilutionary impact of the Group's 2009 capital raising activities.

	2013 million	2012 million	2011 million
Share plans			
At 1 January	70	58	56
Granted, including certain adjustments[1] (includes entitlements of appointed key management personnel)	42	45	35
Exercised/lapsed (includes entitlements of former key management personnel)	(7)	(33)	(33)
At 31 December	105	70	58

[1] 2010 includes adjustments, using a standard HMRC formula, to negate the dilutionary impact of the Group's 2009 capital raising activities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 51: Related party transactions (continued)

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:

	2013 £m	2012 £m	2011 £m
Loans			
At 1 January	**2**	3	3
Advanced (includes loans of appointed key management personnel)	**2**	3	1
Repayments (includes loans of former key management personnel)	**(2)**	(4)	(1)
At 31 December	**2**	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 2.5 per cent and 23.9 per cent in 2013 (2012: 2.5 per cent and 29.95 per cent; 2011: 1.09 per cent and 27.5 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2012 and 2011: £nil).

	2013 £m	2012 £m	2011 £m
Deposits			
At 1 January	**10**	6	4
Placed (includes deposits of appointed key management personnel)	**29**	39	17
Withdrawn (includes deposits of former key management personnel)	**(26)**	(35)	(15)
At 31 December	**13**	10	6

Deposits placed by key management personnel attracted interest rates of up to 2.9 per cent (2012: 3.8 per cent; 2011: 5 per cent).

At 31 December 2013, the Group did not provide any guarantees in respect of key management personnel (2012 and 2011: none).

At 31 December 2013, 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 £1 million with six directors and five connected persons (2012: £1 million with five directors and three connected persons; 2011: £3 million with four directors and three connected persons).

Subsidiaries

Details of the principal subsidiaries are given in note 9 to the parent company financial statements. In accordance with IFRS 10 *Consolidated financial statements*, transactions and balances with subsidiaries have been eliminated on consolidation.

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Note 51: Related party transactions (continued)

UK Government

In January 2009, the UK Government through HM Treasury became a related party of the Company following its subscription for ordinary shares issued under a placing and open offer. At 31 December 2013, HM Treasury held a 32.7 per cent interest in the Company's ordinary share capital and consequently HM Treasury remained a related party of the Company during the year ended 31 December 2013; this percentage holding has reduced from 39.2 per cent at 31 December 2012 following the UK Government's sale of 4,282 million shares on 17 September 2013 and the impact of issues of ordinary shares.

From 1 January 2011, in accordance with IAS 24, UK Government-controlled entities became related parties of the Group. The Group regards the Bank of England and entities controlled by the UK Government, including The Royal Bank of Scotland Group plc, Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

Since 31 December 2011, the Group has had the following significant transactions with the UK Government or UK Government-related entities:

During the year ended 31 December 2013, the Group participated in a number of schemes operated by the UK Government and central banks and made available to eligible banks and building societies.

National Loan Guarantee Scheme

The Group has participated in the UK Government's National Loan Guarantee Scheme, which was launched on 20 March 2012. Through the scheme, the Group is providing eligible UK businesses with discounted funding, subject to continuation of the scheme and its financial benefits, and based on the Group's existing lending criteria. Eligible businesses who have taken up the funding benefit from a 1 per cent discount on their funding rate for a certain period of time.

Business Growth Fund

In May 2011 the Group agreed, together with The Royal Bank of Scotland plc (and three other non-related parties), to commit up to £300 million of equity investment by subscribing for shares in the Business Growth Fund plc which is the company created to fulfil the role of the Business Growth Fund as set out in the British Bankers' Association's Business Taskforce Report of October 2010. At 31 December 2013, the Group had invested £64 million (31 December 2012: £50 million) in the Business Growth Fund and carried the investment at a fair value of £52 million (31 December 2012: £44 million).

Big Society Capital

In January 2012 the Group agreed, together with The Royal Bank of Scotland plc (and two other non-related parties), to commit up to £50 million each of equity investment into the Big Society Capital Fund. The Fund, which was created as part of the Project Merlin arrangements, is a UK social investment fund. The Fund was officially launched on 3 April 2012 and the Group had invested £12 million in the Fund by 31 December 2012 and invested a further £11 million during the year ended 31 December 2013.

Funding for Lending

In August 2012, the Group announced its support for the UK Government's Funding for Lending Scheme and confirmed its intention to participate in the scheme. The Funding for Lending Scheme represents a further source of cost effective secured term funding available to the Group. The initiative supports a broad range of UK based customers, providing householders with more affordable housing finance and businesses with cheaper finance to invest and grow. In November 2013, the Group entered into extension letters with the Bank of England to take part in the extension of the Funding for Lending Scheme until the end of January 2015. The extension of the Funding for Lending Scheme focuses on providing businesses with cheaper finance to invest and grow. At 31 December 2013, the Group had drawn down £8.0 billion under the Funding for Lending Scheme. A further £2.2 billion was drawn in January 2014, which under the Funding for Lending rules counts as funding from the 2013 scheme capacity. This figure includes £0.2 billion drawn by Sainsbury's Bank plc. As a result of the Group's holding in the joint venture, Sainsbury's Bank plc was part of the Group for Funding for Lending purposes for the period to 31 January 2014.

Help to Buy

On 7 October 2013, Bank of Scotland plc entered into an agreement with The Commissioners of Her Majesty's Treasury by which it agreed that the Halifax Division of Bank of Scotland plc would participate in the Help to Buy Scheme with effect from 11 October 2013 and that Lloyds Bank plc would participate from 3 January 2014. The Help to Buy Scheme is a scheme promoted by the Government and is aimed to encourage participating lenders to make mortgage loans available to customers who require higher loan-to-value mortgages. Halifax and Lloyds are currently participating in the Scheme whereby customers borrow between 90 per cent and 95 per cent of the purchase price.

In return for the payment of a commercial fee, HM Treasury has agreed to provide a guarantee to the lender to cover a proportion of any loss made by the lender arising from a higher loan-to-value loan being made. By 31 December 2013, £79 million had been advanced under this scheme.

Central bank facilities

In the ordinary course of business, the Group may from time to time access market-wide facilities provided by central banks.

Other government-related entities

Other than the transactions referred to above, there were no other significant transactions with the UK Government and UK Government-controlled entities (including UK Government-controlled banks) during the period that were not made in the ordinary course of business or that were unusual in their nature or conditions.

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Note 51: Related party transactions (continued)

Other related party transactions

Sale of certain securitisation notes

During the year ended 31 December 2013, the Group sold at fair value certain securitisation notes to Lloyds Bank Pension Trust (No. 1) Limited for a consideration of approximately £340 million. Following the sale, the Group deconsolidated the relevant securitisation entities recognising a profit of £236 million.

Subsequently, the Group entered into a commercially negotiated agreement with Lloyds Bank Pension Trust (No.1) Limited to jointly sell a portfolio of US Residential Mortgage-Backed Securities with a book value of £3.5 billion. As a result of selling the portfolio together a price premium was achieved compared to selling the notes separately. Under the terms of the agreement the Group and Lloyds Bank Pension Trust (No.1) Limited agreed to share any price premium achieved above an agreed minimum threshold amount. The joint sale resulted in the Group realising a total pre-tax gain of approximately £538 million, of which £99 million related to the premium sharing agreement.

St. James's Place plc

In March 2013 the Group sold 102 million shares in St. James's Place plc; fees totalling some £5 million in relation to the sale were settled by St. James's Place plc.

Pension funds

The Group provides banking and some investment management services to certain of its pension funds. At 31 December 2013, customer deposits of £145 million (2012: £129 million) and investment and insurance contract liabilities of £4,728 million (2012: £4,569 million (restated)) related to the Group's pension funds.

Collective investment vehicles

The Group manages 210 (2012: 244) collective investment vehicles, such as Open Ended Investment Companies (OEICs) and of these 145 (2012: 136) are consolidated. The Group invested £2,472 million (2012: £1,563 million) and redeemed £2,189 million (2012: £1,690 million) in the unconsolidated collective investment vehicles during the year and had investments, at fair value, of £3,291 million (2012: £6,479 million) at 31 December. The Group earned fees of £277 million from the unconsolidated collective investment vehicles during 2013 (2012: £325 million).

Joint ventures and associates

The Group provides both administration and processing services to its principal joint venture, Sainsbury's Bank plc. The amounts receivable by the Group during the year were £35 million (2012: £32 million), of which £10 million was outstanding at 31 December 2013 (2012: £16 million). At 31 December 2013, Sainsbury's Bank plc also had balances with the Group that were included in loans and advances to banks of £806 million (2012: £1,299 million) and deposits by banks of £927 million (2012: £1,268 million).

At 31 December 2013 there were loans and advances to customers of £4,448 million (2012: £3,424 million) outstanding and balances within customer deposits of £70 million (2012: £45 million) 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 2013, these companies had total assets of approximately £6,913 million (2012: £10,759 million), total liabilities of approximately £7,084 million (2012: £10,956 million) and for the year ended 31 December 2013 had turnover of approximately £6,989 million (2012: £8,169 million) and made a net loss of approximately £16 million (2012: net loss of £488 million). In addition, the Group has provided £3,355 million (2012: £5,146 million) of financing to these companies on which it received £170 million (2012: £208 million) of interest income in the year.

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Note 52: Contingent liabilities and commitments

Interchange fees

On 24 May 2012, the General Court of the European Union (the General Court) upheld the European Commission's 2007 decision that an infringement of EU competition law had arisen from arrangements whereby MasterCard issuers charged a uniform fallback multilateral interchange fee (MIF) in respect of cross border transactions in relation to the use of a MasterCard or Maestro branded payment card.

MasterCard has appealed the General Court's judgment to the Court of Justice of the European Union. MasterCard is supported by several card issuers, including the Group. Judgment is not expected until the summer of 2014 or later.

In parallel:

– the European Commission is also considering further action, and has proposed legislation to regulate interchange fees, following its 2012 Green Paper (Towards an integrated European market for cards, internet and mobile payments) consultation;
– the European Commission has consulted on commitments proposed by VISA to settle an investigation into whether arrangements adopted by VISA for the levying of the MIF in respect of cross-border credit card payment transactions also infringe European Union competition laws. VISA has proposed inter alia to reduce the level of interchange fees on cross-border credit card transactions to the interim level (30 basis points) also agreed by MasterCard. VISA has previously reached an agreement (which expires in 2014) with the European Commission to reduce the level of interchange fees for cross-border debit card transactions to the interim levels agreed by MasterCard;
– the Office of Fair Trading (OFT) has placed on hold its examination of whether the levels of interchange fees paid by retailers in respect of MasterCard and VISA credit cards, debit cards and charge cards in the UK infringe competition law. The OFT has placed the investigation on hold pending the outcome of the MasterCard appeal to the Court of Justice of the European Union; and
– the UK Government held a consultation in 2013, Opening Up UK Payments. The consultation included a proposal to legislate to introduce a new economic regulator with responsibility for payment systems, including three and four party card schemes, and a role in setting or approving interchange fees.

The ultimate impact of the investigations and any regulatory or legislative developments on the Group can only be known at the conclusion of these investigations and any relevant appeal proceedings and once regulatory or legislative proposals are more certain.

Investigations and litigation relating to interbank offered rates, and other reference rates

A number of government agencies in the UK, US and elsewhere, including the UK Financial Conduct Authority, the Serious Fraud Office, the US Commodity Futures Trading Commission, the US Securities and Exchange Commission, the US Department of Justice and a number of State Attorneys General, as well as the European and Swiss Competition Commissions, are conducting investigations into submissions made by panel members to the bodies that set various interbank offered rates including the BBA London Interbank Offered Rates (LIBOR) and the European Banking Federation's Euribor, along with other reference rates. Certain Group companies were (at the relevant times) and remain members of various panels whose members make submissions to these bodies including the BBA LIBOR panels. No Group company is or was a member of the Euribor panel. Certain Group companies have received subpoenas and requests for information from certain government agencies and the Group is co-operating with their investigations.

Certain Group companies, together with other panel banks, have also been named as defendants in private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar LIBOR. The claims have been asserted by plaintiffs claiming to have had an interest in various types of financial instruments linked to US Dollar LIBOR. The allegations in these cases, the majority of which have been coordinated for pre-trial purposes in multi-district litigation proceedings (MDL) in the US District Court for the Southern District of New York (the 'District Court'), are substantially similar to each other. The lawsuits allege violations of the Sherman Antitrust Act, the Racketeer Influenced and Corrupt Organizations Act (RICO) and the Commodity Exchange Act (CEA), as well as various state statutes and common law doctrines. Certain of the plaintiffs' claims have been dismissed by the District Court, various motions directed to the sufficiency of their pleading of certain claims are still pending, and many of these cases have been stayed by order of the District Court.

The Group is also reviewing its activities in relation to the setting of certain foreign exchange daily benchmark rates, following the FCA's publicised initiation of an investigation into other financial institutions in relation to this activity. In addition, the Group, together with a number of other banks, has been named as a defendant in several actions in the District Court, in which the plaintiffs allege that the defendants manipulated WM/Reuters foreign exchange rates in violation of US antitrust laws. The time-frame for the Group and the other defendants to move to dismiss these claims has not yet been set.

It is currently not possible to predict the scope and ultimate outcome on the Group of the various regulatory investigations, private lawsuits or any related challenges to the interpretation or validity of any of the Group's contractual arrangements, including their timing and scale.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 52: Contingent liabilities and commitments (continued)

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is the UK's independent statutory compensation fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable or likely to be unable to pay claims against it. The FSCS is funded by levies on the authorised financial services industry. Each deposit-taking institution contributes towards the FSCS levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March.

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. Although the substantial majority of this loan, which totalled approximately £17 billion at 31 March 2013, will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants of the FSCS. In July 2013, the FSCS confirmed that it expects to raise compensation costs levies of approximately £1.1 billion on all deposit-taking participants over a three year measurement period from 2012 to 2014 to enable it to repay the balance of the HM Treasury loan which matures in 2016. The Group has provided for its share of the 2012 and 2013 element of the levy. The amount of future compensation costs levies payable by the Group depends on a number of factors including participation in the market at 31 December, the level of protected deposits and the population of deposit-taking participants.

Investigation into Bank of Scotland and report on HBOS

The FSA's enforcement investigation into Bank of Scotland plc's Corporate division between 2006 and 2008 concluded with the publication of a Final Notice on 9 March 2012. No financial penalty was imposed on the Group or Bank of Scotland plc. On 12 September 2012 the FSA confirmed it was starting work on a public interest report on HBOS. That report is currently expected to be published in 2014.

US shareholder litigation

In November 2011 the Group and two former members of the Group's Board of Directors were named as defendants in a purported securities class action filed in the United States District Court for the Southern District of New York. The complaint asserted claims under the Securities Exchange Act of 1934 in connection with alleged material omissions from statements made in 2008 in connection with the acquisition of HBOS. In October 2012 the court dismissed the complaint. The plaintiffs' appeal against this decision was dismissed on 19 September 2013 and the time limit for further appeals expired in December 2013.

US-Swiss tax programme

The US Department of Justice (the DOJ) and the Swiss Federal Department of Finance announced on 29 August 2013 a programme (the Programme) for Swiss banks to obtain resolution concerning their status in connection with ongoing investigations by the DOJ into individuals and entities that use foreign (i.e. non-U.S.) bank accounts to evade U.S. taxes and reporting requirements, and individuals and entities that facilitate or have facilitated the evasion of such taxes and reporting requirements. Swiss banks that choose to participate have to notify the DOJ of their election to categorise their relevant banking operations according to one of a number of defined categories under the Programme. The Group, which carried out private banking operations in Switzerland prior to disposing of these operations in November 2013, has notified the DOJ of its elected categorisation on the basis that while it believes it has operated in full compliance with all US federal tax laws, there remains the possibility that certain of its clients may not have declared their assets in compliance with such laws. The Group will continue to co-operate with the DOJ under the terms of the Programme. However, at this time, it is not possible to predict the ultimate outcome of the Group's participation in the Programme, including the timing and scale of any fine finally payable to the DOJ.

Tax authorities

The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where Her Majesty's Revenue and Customs ('HMRC') adopt a different interpretation and application of tax law which might lead to additional tax. The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In the second half of 2013 HMRC informed the Group that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities of approximately £600 million and a reduction in the Group's deferred tax asset of approximately £400 million. The Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

Other legal actions and regulatory matters

In addition, during the ordinary course of business the Group is subject to other threatened and actual legal proceedings (including class or group action claims brought on behalf of customers, shareholders or other third parties), and regulatory challenges, investigations and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers 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 properly to assess the merits of the case and no provisions are held against such matters. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

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Note 52: Contingent liabilities and commitments (continued)

	2013 £m	2012 £m
Contingent liabilities		
Acceptances and endorsements	**204**	107
Other:		
Other items serving as direct credit substitutes	**710**	523
Performance bonds and other transaction-related contingencies	**1,966**	2,266
	2,676	2,789
Total contingent liabilities	**2,880**	2,896

The contingent liabilities of the Group arise in the normal course of its banking business and it is not practicable to quantify their future financial effect.

	2013 £m	2012 £m
Commitments		
Documentary credits and other short-term trade-related transactions	**54**	11
Forward asset purchases and forward deposits placed	**440**	546
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	**9,559**	7,404
Other commitments	**55,002**	53,196
	64,561	60,600
1 year or over original maturity	**40,616**	40,794
Total commitments	**105,671**	101,951

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £56,292 million (2012: £52,733 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:

	2013 £m	2012 £m
Not later than 1 year	**292**	310
Later than 1 year and not later than 5 years	**928**	987
Later than 5 years	**1,166**	1,332
Total operating lease commitments	**2,386**	2,629

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 2013 amounted to £345 million (2012: £279 million). Of this amount, £344 million (2012: £276 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 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		Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
		Held for trading £m	Designated upon initial recognition £m					
At 31 December 2013								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	49,915	–	49,915
Items in the course of collection from banks	–	–	–	–	–	1,007	–	1,007
Trading and other financial assets at fair value through profit or loss	–	37,350	105,333	–	–	–	–	142,683
Derivative financial instruments	6,787	26,338	–	–	–	–	–	33,125
Loans and receivables:								
Loans and advances to banks	–	–	–	–	25,365	–	–	25,365
Loans and advances to customers	–	–	–	–	495,281	–	–	495,281
Debt securities	–	–	–	–	1,355	–	–	1,355
	–	–	–	–	522,001	–	–	522,001
Available-for-sale financial assets	–	–	–	43,976	–	–	–	43,976
Total financial assets	6,787	63,688	105,333	43,976	522,001	50,922	–	792,707
Financial liabilities								
Deposits from banks	–	–	–	–	–	13,982	–	13,982
Customer deposits	–	–	–	–	–	441,311	–	441,311
Items in course of transmission to banks	–	–	–	–	–	774	–	774
Trading and other financial liabilities at fair value through profit or loss	–	38,319	5,306	–	–	–	–	43,625
Derivative financial instruments	4,518	25,946	–	–	–	–	–	30,464
Notes in circulation	–	–	–	–	–	1,176	–	1,176
Debt securities in issue	–	–	–	–	–	87,102	–	87,102
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	82,777	82,777
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	27,590	27,590
Unallocated surplus within insurance businesses	–	–	–	–	–	–	391	391
Financial guarantees	–	–	50	–	–	–	–	50
Subordinated liabilities	–	–	–	–	–	32,312	–	32,312
Total financial liabilities	4,518	64,265	5,356	–	–	576,657	110,758	761,554

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Note 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
At 31 December 2012[1]								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	80,298	–	80,298
Items in the course of collection from banks	–	–	–	–	–	1,256	–	1,256
Trading and other financial assets at fair value through profit or loss	–	23,345	137,275	–	–	–	–	160,620
Derivative financial instruments	11,571	44,986	–	–	–	–	–	56,557
Loans and receivables:								
Loans and advances to banks	–	–	–	–	32,757	–	–	32,757
Loans and advances to customers	–	–	–	–	517,225	–	–	517,225
Debt securities	–	–	–	–	5,273	–	–	5,273
	–	–	–	–	555,255	–	–	555,255
Available-for-sale financial assets	–	–	–	31,374	–	–	–	31,374
Total financial assets	11,571	68,331	137,275	31,374	555,255	81,554	–	885,360
Financial liabilities								
Deposits from banks	–	–	–	–	–	38,405	–	38,405
Customer deposits	–	–	–	–	–	426,912	–	426,912
Items in course of transmission to banks	–	–	–	–	–	996	–	996
Trading and other financial liabilities at fair value through profit or loss	–	27,692	5,700	–	–	–	–	33,392
Derivative financial instruments	6,598	42,078	–	–	–	–	–	48,676
Notes in circulation	–	–	–	–	–	1,198	–	1,198
Debt securities in issue	–	–	–	–	–	117,253	–	117,253
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	82,953	82,953
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	54,372	54,372
Unallocated surplus within insurance businesses	–	–	–	–	–	–	267	267
Financial guarantees	–	–	48	–	–	–	–	48
Subordinated liabilities	–	–	–	–	–	34,092	–	34,092
Total financial liabilities	6,598	69,770	5,748	–	–	618,856	137,592	838,564

[1] Restated – see note 1.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 53: Financial instruments (continued)

(2) Reclassification of financial assets

No financial assets have been reclassified in 2013.

During 2012 the Group has reviewed its holding of government securities classified as held-to-maturity and in view of the fact that it was no longer the Group's intention to hold these to maturity, securities with a carrying amount of £10,811 million and a fair value of £11,979 million were reclassified as available-for-sale financial assets in December 2012.

No financial assets were reclassified in 2011.

In 2010, government securities with a fair value of £3,601 million were reclassified from available-for-sale financial assets to held-to-maturity investments reflecting the Group's then positive intent and ability to hold them until maturity.

In 2009, no financial assets were reclassified.

In 2008, in accordance with the amendment to IAS 39 that became applicable during that year, 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 financial assets 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.

Carrying value and fair value of reclassified assets

The table below sets out the carrying value and fair value of reclassified financial assets.

	2013		2012		2011		2010		2009		2008	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
From held for trading to loans and receivables	–	–	11	9	67	56	750	727	1,833	1,822	2,883	2,926
From available-for-sale financial assets to loans and receivables	–	–	162	203	217	219	313	340	394	422	454	402
From available-for-sale financial assets to held-to-maturity investments	–	–	–	–	3,624	3,846	3,455	3,539	–	–	–	–
From held-to-maturity investments to available-for-sale financial assets	1,117	1,117	4,998	4,998	–	–	–	–	–	–	–	–
Total carrying value and fair value	**1,117**	**1,117**	5,171	5,210	3,908	4,121	4,518	4,606	2,227	2,244	3,337	3,328

During the year ended 31 December 2013, the carrying value of assets reclassified to loans and receivables decreased by £173 million due to sales and maturities of £173 million.

No financial assets have been reclassified in accordance with paragraphs 50B, 50D or 50E of IAS 39 since 2008; the following disclosures relate to those assets which were so reclassified in 2008.

a) 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.

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
From held for trading to loans and receivables	**1**	1	(3)	(34)	208	(347)

The table below shows the additional gains (losses) that would have been recognised in other comprehensive income if the reclassifications had not occurred.

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
From available-for-sale financial assets to loans and receivables	**(56)**	24	(68)	69	161	(108)

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Note 53: Financial instruments (continued)

b) Actual amounts recognised in respect of reclassified assets

After reclassification the reclassified financial assets contributed the following amounts to the Group income statement.

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
From held for trading to loans and receivables:						
Net interest income	–	–	1	24	55	31
Impairment losses	–	–	–	(6)	(49)	(158)
Total amounts recognised	–	–	1	18	6	(127)

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
From available-for-sale financial assets to loans and receivables:						
Net interest income	1	1	2	1	34	3
Impairment credit (losses)	–	5	(8)	(2)	(56)	(23)
Gains (losses) on disposal	(5)	–	–	–	–	–
Total amounts recognised	(4)	6	(6)	(1)	(22)	(20)

(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.

	2013		2012[1]	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	142,683	142,683	160,620	160,620
Derivative financial instruments	33,125	33,125	56,557	56,557
Loans and receivables:				
Loans and advances to banks	25,365	25,296	32,757	32,746
Loans and advances to customers: unimpaired	473,239	464,453	484,868	474,061
Loans and advances to customers: impaired	22,042	22,042	32,357	32,357
Debt securities	1,355	1,251	5,273	5,402
Available-for-sale financial assets	43,976	43,976	31,374	31,374
Financial liabilities				
Deposits from banks	13,982	14,101	38,405	38,738
Customer deposits	441,311	441,855	426,912	428,749
Trading and other financial liabilities at fair value through profit or loss	43,625	43,625	33,392	33,392
Derivative financial instruments	30,464	30,464	48,676	48,676
Debt securities in issue	87,102	90,803	117,253	122,847
Liabilities arising from non-participating investment contracts	27,590	27,590	54,372	54,372
Financial guarantees	50	50	48	48
Subordinated liabilities	32,312	34,449	34,092	36,382

[1] Restated – see note 1.

The carrying amount of the following financial instruments is a reasonable approximation of fair value: cash and balances at central banks, items in the course of collection from banks, items in course of transmission to banks and notes in circulation.

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Note 53: Financial instruments (continued)

(4) Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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 are not financial instruments or for other assets and liabilities which are not carried at fair value in the Group's consolidated balance sheet. 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.

Valuation control framework

The key elements of the control framework for the valuation of financial instruments include model validation, product implementation review and independent price verification. These functions are carried out by appropriately skilled risk and finance teams, independent of the business area responsible for the products.

Model validation covers both qualitative and quantitative elements relating to new models. In respect of new products, a product implementation review is conducted pre- and post-trading. Pre-trade testing ensures that the new model is integrated into the Group's systems and that the profit and loss and risk reporting are consistent throughout the trade life cycle. Post-trade testing examines the explanatory power of the implemented model, actively monitoring model parameters and comparing in-house pricing to external sources. Independent price verification procedures cover financial instruments carried at fair value. The frequency of the review is matched to the availability of independent data, monthly being the minimum. Valuation differences in breach of established thresholds are escalated to senior management. The results from independent pricing and valuation reserves are reviewed monthly by senior management.

Formal committees, consisting of senior risk, finance and business management, meet at least quarterly to discuss and approve valuations in more judgemental areas, in particular for unquoted equities, structured credit, over-the-counter options and the Credit Valuation Adjustment (CVA) reserve.

Valuation of financial assets and liabilities

Assets and liabilities carried at fair value or for which fair values are disclosed have been classified into three levels according to the quality and reliability of information used to determine the fair values.

Level 1

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 equity shares, treasury bills and other government securities.

Level 2

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. 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

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.

Unless otherwise noted, the following disclosures are provided separately for assets and liabilities carried at fair value and those carried at amortised cost.

The Group manages valuation adjustments for its derivative exposures on a net basis; the Group determines their fair values on the basis of their net exposures. In all other cases, fair values of financial assets and liabilities measured at fair value are determined on the basis of their gross exposures.

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Note 53: Financial instruments (continued)

Financial assets and liabilities carried at fair value

Valuation hierarchy

The table below analyses the financial assets and liabilities of the Group which are carried at fair value. They are categorised into levels 1 to 3 based on the degree to which their fair value is observable. The fair value measurement approach is recurring in nature.

Valuation hierarchy

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2013				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	21,110	–	21,110
Loans and advances to banks	–	8,333	–	8,333
Debt securities:				
Government securities	20,191	498	–	20,689
Other public sector securities	–	1,312	885	2,197
Bank and building society certificates of deposit	–	1,491	–	1,491
Asset-backed securities:				
Mortgage-backed securities	30	768	–	798
Other asset-backed securities	171	756	–	927
Corporate and other debt securities	244	18,689	1,687	20,620
	20,636	23,514	2,572	46,722
Equity shares	64,690	53	1,660	66,403
Treasury and other bills	7	108	–	115
Total trading and other financial assets at fair value through profit or loss	85,333	53,118	4,232	142,683
Available-for-sale financial assets				
Debt securities:				
Government securities	38,262	28	–	38,290
Bank and building society certificates of deposit	–	208	–	208
Asset-backed securities:				
Mortgage-backed securities	–	1,263	–	1,263
Other asset-backed securities	–	841	74	915
Corporate and other debt securities	56	1,799	–	1,855
	38,318	4,139	74	42,531
Equity shares	48	147	375	570
Treasury and other bills	852	23	–	875
Total available-for-sale financial assets	39,218	4,309	449	43,976
Derivative financial instruments	235	29,871	3,019	33,125
Total financial assets carried at fair value	124,786	87,298	7,700	219,784
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	–	5,267	39	5,306
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	28,902	–	28,902
Short positions in securities	6,473	417	–	6,890
Other	–	2,527	–	2,527
	6,473	31,846	–	38,319
Total trading and other financial liabilities at fair value through profit or loss	6,473	37,113	39	43,625
Derivative financial instruments	119	29,359	986	30,464
Financial guarantees	–	–	50	50
Total financial liabilities carried at fair value	6,592	66,472	1,075	74,139

There were no significant transfers between level 1 and level 2 during the year.

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Note 53: Financial instruments (continued)

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2012				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	13,632	–	13,632
Loans and advances to banks	–	919	–	919
Debt securities:				
Government securities	19,138	2,207	–	21,345
Other public sector securities	–	1,056	–	1,056
Bank and building society certificates of deposit	68	3,326	–	3,394
Asset-backed securities:				
Mortgage-backed securities	232	693	–	925
Other asset-backed securities	348	1,565	–	1,913
Corporate and other debt securities	8,346	17,694	1,519	27,559
	28,132	26,541	1,519	56,192
Equity shares	87,566	94	1,787	89,447
Treasury and other bills	430	–	–	430
Total trading and other financial assets at fair value through profit or loss	116,128	41,186	3,306	160,620
Available-for-sale financial assets				
Debt securities:				
Government securities	25,555	–	–	25,555
Bank and building society certificates of deposit	42	146	–	188
Asset-backed securities:				
Mortgage-backed securities	–	1,524	–	1,524
Other asset-backed securities	–	687	73	760
Corporate and other debt securities	22	1,826	–	1,848
	25,619	4,183	73	29,875
Equity shares	21	99	408	528
Treasury and other bills	869	16	86	971
Total available-for-sale financial assets	26,509	4,298	567	31,374
Derivative financial instruments	76	54,123	2,358	56,557
Total financial assets carried at fair value	142,713	99,607	6,231	248,551
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	–	5,700	–	5,700
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	24,553	–	24,553
Short positions in securities	1,850	350	–	2,200
Other	15	924	–	939
	1,865	25,827	–	27,692
Total trading and other financial liabilities at fair value through profit or loss	1,865	31,527	–	33,392
Derivative financial instruments	36	48,097	543	48,676
Financial guarantees	–	–	48	48
Total financial liabilities carried at fair value	1,901	79,624	591	82,116

There were no significant transfers between level 1 and level 2 during the year.

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Note 53: Financial instruments (continued)

Valuation methodology

Loans and advances and debt securities

Loans and advances and debt securities measured at fair value and classified as level 2 are valued by discounting expected cash flows using an observable credit spread applicable to the particular instrument.

Where there is limited trading activity in debt securities, the Group uses valuation models, consensus pricing information from third party pricing services and broker or lead manager quotes to determine an appropriate valuation. Debt securities are classified as level 3 if there is a significant valuation input that cannot be corroborated through market sources or where there are materially inconsistent values for an input. Asset classes classified as level 3 mainly comprise certain collateralised loan obligations and collateralised debt obligations.

Equity investments

Unlisted equity and fund investments are valued using different techniques in accordance with the Group's valuation policy and International Private Equity and Venture Capital Guidelines.

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.

– 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.
– 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. Recent transactions involving the sale of similar businesses may sometimes be used as a frame of reference in deriving an appropriate multiple.
– 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.

Unlisted equity investments and investments in property partnerships held in the life assurance funds are valued using third party valuations. 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 which 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 which are priced using rates available from publicly quoted sources.
– Credit derivatives which are valued using standard models with observable inputs, except for the items classified as level 3, which are valued using publicly available yield and credit default swap (CDS) curves.
– Less complex interest rate and foreign exchange option products which 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.

Complex interest rate and foreign exchange products where there is significant dispersion of consensus pricing or where implied funding costs are material and unobservable are classified as level 3.

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 asset-backed security and the resulting derivative assets or liabilities have been classified as either level 2 or level 3 according to the classification of the underlying asset-backed security.

The Group's level 3 derivative assets include £1,212 million (2012: £1,421 million) in respect of the value of the embedded equity conversion feature of the Enhanced Capital Notes issued in December 2009. The embedded equity conversion feature is valued by comparing the market price of the Enhanced Capital Notes with the market price of similar bonds without the conversion feature. The latter is calculated by discounting the expected Enhanced Capital Note 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 Enhanced Capital Notes was calculated with reference to multiple broker quotes.

Liabilities held at fair value through profit or loss

These principally comprise debt securities in issue which are classified as level 2 and their fair value is determined using techniques whose inputs are based on observable market data.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 53: Financial instruments (continued)

Movements in Level 3 portfolio

The table below analyses movements in level 3 financial assets carried at fair value (recurring measurement).

	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Derivative assets £m	Total level 3 assets carried at fair value (recurring basis) £m
At 1 January 2012	2,941	2,056	2,649	7,646
Exchange and other adjustments	10	(60)	12	(38)
Gains recognised in the income statement within other income	166	(356)	(335)	(525)
Losses recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	–	(58)	–	(58)
Purchases	513	218	45	776
Sales	(570)	(1,358)	(13)	(1,941)
Transfers into the level 3 portfolio	337	138	–	475
Transfers out of the level 3 portfolio	(91)	(13)	–	(104)
At 31 December 2012	3,306	567	2,358	6,231
Exchange and other adjustments	**21**	**15**	**2**	**38**
Gains recognised in the income statement within other income	**296**	**–**	**144**	**440**
Gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	**–**	**40**	**–**	**40**
Purchases	**582**	**43**	**271**	**896**
Sales	**(631)**	**(224)**	**(102)**	**(957)**
Transfers into the level 3 portfolio	**995**	**12**	**354**	**1,361**
Transfers out of the level 3 portfolio	**(337)**	**(4)**	**(8)**	**(349)**
At 31 December 2013	**4,232**	**449**	**3,019**	**7,700**
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December 2013	**70**	**5**	**159**	**234**
Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December 2012	85	(33)	(335)	(283)

The table below analyses movements in the Level 3 financial liabilities portfolio.

	Trading and other financial liabilities at fair value through profit or loss £m	Derivative liabilities £m	Financial guarantees £m	Total level 3 financial liabilities carried at fair value £m
At 1 January 2012	–	741	49	790
Exchange and other adjustments	–	10	–	10
Gains recognised in the income statement within other income	–	(227)	(3)	(230)
Additions	–	28	2	30
Redemptions	–	(25)	–	(25)
Transfers into the level 3 portfolio	–	16	–	16
At 31 December 2012	–	543	48	591
Exchange and other adjustments	**–**	**8**	**–**	**8**
Losses (gains) recognised in the income statement within other income	**10**	**(30)**	**3**	**(17)**
Additions	**29**	**262**	**–**	**291**
Redemptions	**–**	**(29)**	**(1)**	**(30)**
Transfers into the level 3 portfolio	**–**	**233**	**–**	**233**
Transfers out of the level 3 portfolio	**–**	**(1)**	**–**	**(1)**
At 31 December 2013	**39**	**986**	**50**	**1,075**
(Losses) gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December 2013	**(10)**	**20**	**(3)**	**7**
Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December 2012	–	223	3	226

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Note 53: Financial instruments (continued)

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.

Sensitivity of level 3 valuations

			At 31 December 2013			At 31 December 2012[5]		
				Effect of reasonably possible alternative assumptions[2]			Effect of reasonably possible alternative assumptions[2]	
	Valuation techniques	Significant unobservable inputs[1]	Carrying value £m	Favourable changes £m	Unfavourable changes £m	Carrying value £m	Favourable changes £m	Unfavourable changes £m
Trading and other financial assets at fair value through profit or loss								
Debt securities	Discounted cash flows	Credit spreads (bps) n/a[3]	18	5	(2)	–	–	–
Equity and venture capital investments	Market approach	Earnings multiple (0.2/14.6)	2,132	70	(70)	1,854	51	(51)
	Underlying asset/ net asset value (incl. property prices)[4]	n/a	130	–	–	227	–	–
Unlisted equities and property partnerships in the life funds	Underlying asset/ net asset value (incl. property prices)[4]	n/a	1,952	–	–	1,225	–	–
			4,232			3,306		
Available-for-sale financial assets								
Asset-backed securities	Lead manager or broker quote/ consensus pricing	n/a	74	–	–	73	–	–
Equity and venture capital investments	Underlying asset/ net asset value (incl. property prices)[4]	n/a	375	28	(19)	494	36	(11)
			449			567		
Derivative financial assets								
Embedded equity conversion feature	Lead manager or broker quote	Equity conversion feature spread (199 bps/420 bps)	1,212	59	(58)	1,421	63	–
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (62 bps/192 bps)	1,461	66	(39)	899	69	(48)
	Option pricing model	Interest rate volatility (3%/112%)	346	6	(7)	38	2	(21)
			3,019			2,358		
Level 3 financial assets carried at fair value			7,700			6,231		
Trading and other financial liabilities at fair value through profit or loss			39	1	(1)	–	–	–
Derivative financial liabilities								
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (62 bps/192 bps)	754	–	–	475	–	–
	Option pricing model	Interest rate volatility (3%/112%)	232	–	–	68	–	–
			986			543		
Financial guarantees			50			48		
Level 3 financial liabilities carried at fair value			1,075			591		

[1] Ranges are shown where appropriate and represent the highest and lowest inputs used in the level 3 valuations.

[2] Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

[3] A single pricing source is used.

[4] Underlying asset/net asset values represent fair value.

[5] Comparatives are provided only where disclosures were required in 2012.

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Note 53: Financial instruments (continued)

Unobservable inputs

Significant unobservable inputs affecting the valuation of debt securities, unlisted equity investments and derivatives are as follows:

– Interest rates and inflation rates are referenced in some derivatives where the payoff that the holder of the derivative receives depends on the behaviour of those underlying references through time.

– Credit spreads represent the premium above the benchmark reference instrument required to compensate for lower credit quality; higher spreads lead to a lower fair value.

– Volatility parameters represent key attributes of option behaviour; higher volatilities typically denote a wider range of possible outcomes.

– Earnings multiples are used to value certain unlisted equity investments; a higher earnings multiple will result in a higher fair value.

Reasonably possible alternative assumptions

Valuation techniques applied to many of the Group's level 3 instruments often involve the use of two or more inputs whose relationship is interdependent. The calculation of the effect of reasonably possible alternative assumptions included in the table above reflects such relationships.

Debt securities

Reasonably possible alternative assumptions have been determined in respect of the Group's structured credit investment by flexing credit spreads.

Derivatives

Reasonably possible alternative assumptions have been determined in respect of the Group's derivative portfolios as follows:

– In respect of the embedded equity conversion feature of the Enhanced Capital Notes, the sensitivity was based on the absolute difference between the actual price of the enhanced capital note and the closest, alternative broker quote available plus the impact of applying a 10 bps increase/decrease in the market yield used to derive a market price for similar bonds without the conversion feature. The effect of interdependency of the assumptions is not material to the effect of applying reasonably possible alternative assumptions to the valuations of derivative financial instruments.

– Uncollateralised inflation swaps are valued using appropriate discount spreads for such transactions. These spreads are not generally observable for longer maturities. The reasonably possible alternative valuations reflect flexing of the spreads for the differing maturities to alternative values of between 62 bps and 192 bps (2012: 51 bps and 260 bps).

– Swaptions are priced using industry standard option pricing models. Such models require interest rate volatilities which may be unobservable at longer maturities. To derive reasonably possible alternative valuations these volatilities have been flexed within a range of 3 per cent to 112 per cent (2012: 31 per cent and 79 per cent).

Unlisted equity, venture capital investments and investments in property partnerships

The valuation techniques used for unlisted equity and venture capital investments vary depending on the nature of the investment. Reasonably possible alternative valuations for these investments have been calculated by reference to the approach taken, as appropriate to the business sector and investment circumstances and as such the following inputs have been considered:

– for valuations derived from earnings multiples, consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple;

– the discount rates used in discounted cash flow valuations; and

– in line with International Private Equity and Venture Capital Guidelines, the values of underlying investments in fund investments portfolios.

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Note 53: Financial instruments (continued)

Financial assets and liabilities carried at amortised cost

Valuation hierarchy

The table below analyses the fair values of the financial assets and liabilities of the Group which are carried at amortised cost. They are categorised into levels 1 to 3 based on the degree to which their fair value is observable.

At 31 December 2013	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Loans and receivables:				
Loans and advances to customers	–	–	486,495	486,495
Loans and advances to banks	–	–	25,296	25,296
Debt securities	157	42	1,052	1,251
Financial liabilities				
Deposits from banks	–	13,957	144	14,101
Customer deposits	–	423,122	18,733	441,855
Debt securities in issue	–	90,628	175	90,803
Subordinated liabilities	–	34,449	–	34,449

Note: Comparatives not provided as disclosure not required in 2012.

Valuation methodology

Financial assets

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 taking into account expected credit losses, prevailing market interest rates and expected future cash flows. For retail exposures, 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. 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 value of wholesale 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.

The fair values of debt securities, which were previously within assets held for trading and were reclassified to loans and receivables, 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.

Financial liabilities

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.

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 discounted cash flow techniques at a rate which reflects market rates of interest and the Group's own credit spread.

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Note 53: Financial instruments (continued)

Derivative valuation adjustments

Derivative financial instruments which are carried in the balance sheet at fair value are adjusted where appropriate to reflect credit risk, market liquidity and other risks.

(i) Uncollateralised derivative valuation adjustments, excluding monoline counterparties

The following table summarises the movement on this valuation adjustment account during 2013 and 2012:

	2013 £m	2012 £m
At 1 January	**897**	1,226
Income statement credit	**(241)**	(209)
Transfers	**(158)**	(120)
At 31 December	**498**	897

Represented by:

	2013 £m	2012 £m
Credit Valuation Adjustment	**485**	928
Debit Valuation Adjustment	**(122)**	(174)
Funding Valuation Adjustment	**135**	143
	498	897

Credit and Debit Valuation Adjustments (CVA and DVA) are applied to the Group's over-the-counter derivative exposures with counterparties that are not subject to standard interbank collateral arrangements. These exposures largely relate to the provision of risk management solutions for corporate customers within the Commercial Banking division.

A CVA is taken where the Group has a positive future uncollateralised exposure (asset). A DVA is taken where the Group has a negative future uncollateralised exposure (liability). These adjustments reflect interest rates and expectations of counterparty creditworthiness and the Group's own credit spread respectively.

The CVA is sensitive to:

– the current size of the mark-to-market position on the uncollateralised asset;

– expectations of future market volatility of the underlying asset; and

– expectations of counterparty creditworthiness.

In circumstances where exposures to a counterparty become impaired, any associated derivative valuation adjustment is transferred and assessed for specific loss alongside other non-derivative assets and liabilities that the counterparty may have with the Group.

Market Credit Default Swap (CDS) spreads are used to develop the probability of default for quoted counterparties. For unquoted counterparties, internal credit ratings and market sector CDS curves and recovery rates are used. The Loss Given Default (LGD) is based on market recovery rates and internal credit assessments.

The combination of a one notch deterioration in the credit rating of derivative counterparties and a ten per cent increase in LGD increases the CVA by £67 million. Current market value is used to estimate the projected exposure for products not supported by the model, which are principally complex interest rate options that are traded in very low volumes. For these, the CVA is calculated on an add-on basis (in total contributing £5 million of the overall CVA balance at 31 December 2013).

The DVA is sensitive to:

– the current size of the mark-to-market position on the uncollateralised liability;

– expectations of future market volatility of the underlying liability; and

– the Group's own CDS spread.

A one per cent rise in the CDS spread would lead to an increase in the DVA of £89 million to £211 million.

The risk exposures that are used for the CVA and DVA calculations are strongly influenced by interest rates. Due to the nature of the Group's business the CVA/DVA exposures tend to be on average the same way around such that the valuation adjustments fall when interest rates rise. A one per cent rise in interest rates would lead to a £187 million fall in the overall valuation adjustment to £177 million. The CVA model used by the Group does not assume any correlation between the level of interest rates and default rates.

The Group has also recognised a Funding Valuation Adjustment to adjust for the net cost of funding certain uncollateralised derivative positions where the Group considers that this cost is included in market pricing. This adjustment is calculated on the expected future exposure discounted at a suitable cost of funds. A ten basis points increase in the cost of funds will increase the funding valuation adjustment by approximately £9 million.

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Note 53: Financial instruments (continued)

(ii) Uncollateralised derivative valuation adjustments – monoline counterparties
The Group has no significant derivative exposures remaining against monoline counterparties.

(iii) Market liquidity
The Group includes mid to bid-offer valuation adjustments against the expected cost of closing out the net market risk in the Group's trading positions within a timeframe that is consistent with historical trading activity and spreads that the trading desks have accessed historically during the ordinary course of business in normal market conditions.

At 31 December 2013, the Group's derivative trading business held mid to bid-offer valuation adjustments of £70 million (2012: £103 million).

(iv) LIBOR/Overnight Index Swap basis
The Group's derivative trading business applies £50 million (31 December 2012: £74 million) of valuation adjustments against the changing market approach to valuing derivatives that are subject to daily collateral margin, where standard market practice is to pay interest on an Overnight Index Swap basis rather than a LIBOR rate.

No credit valuation adjustment is taken on collateralised swaps.

Own credit adjustments
The carrying amount of issued notes that are designated at fair value through profit or loss is adjusted to reflect the effect of changes in own credit spreads. The resulting gain or loss is recognised in the income statement.

At 31 December 2013, the own credit adjustment arising from the fair valuation of £5,267 million (2012: £5,700 million) of the Group's debt securities in issue designated at fair value through profit or loss resulted in a gain of £40 million (2012: loss of £437 million).

(5) Transfers of financial assets

A. Transferred financial assets that continue to be recognised in full

The Group enters into repurchase and securities lending transactions in the normal course of business that do not result in derecognition of the financial assets covered as substantially all of the risks and rewards, including credit, interest rate, prepayment and other price risks are retained by the Group. In all cases, the transferee has the right to sell or repledge the assets concerned.

As set out in note 21, included within loans and receivables are loans transferred under the Group's securitisation and covered bond programmes. As the Group retains all of a majority of the risks and rewards associated with these loans, including credit, interest rate, prepayment and liquidity risk, they remain on the Group's balance sheet. Assets transferred into the Group's securitisation and covered bond programmes are not available to be used by the Group whilst the assets are within the programmes. However, the Group retains the right to remove loans from the covered bond programmes where they are in excess of the programme's requirements. In addition, where the Group has retained some of the notes issued by securitisation and covered bond programmes, the Group has the ability to sell or pledge these retained notes.

The table below sets out the carrying values of the transferred assets and the associated liabilities. For repurchase and securities lending transactions, the associated liabilities represent the Group's obligation to repurchase the transferred assets. For securitisation programmes, the associated liabilities represent the external notes in issue (note 35). Except as otherwise noted below, none of the liabilities shown in the table below have recourse only to the transferred assets.

At 31 December 2013	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
Repurchase and securities lending transactions		
Trading and other financial assets at fair value through profit or loss	10,832	927
Available-for-sale financial assets	6,093	3,726
Loans and receivables:		
Loans and advances to customers	19,074	3,936
Debt securities classified as loans and receivables	88	–
Securitisation programmes		
Loans and receivables:		
Loans and advances to customers	80,878	18,613[1]

[1] Excludes securitisation notes held by the Group (£38,288 million).

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Note 53: Financial instruments (continued)

At 31 December 2012	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
Repurchase and securities lending transactions		
Trading and other financial assets at fair value through profit or loss	10,612	620
Available-for-sale financial assets	8,967	4,693
Loans and receivables:		
Loans and advances to customers	19,015	6,662
Debt securities classified as loans and receivables	498	346
Securitisation programmes		
Loans and receivables:		
Loans and advances to customers[1]	118,183	28,059[2]

[1] Includes US residential mortgage-backed securities and associated liabilities whose carrying values were £185 million and £221 million respectively; the associated liabilities have recourse only to the securities transferred and, at 31 December 2012, the fair values of the securities and the associated liabilities were £244 million and £311 million respectively, a difference of £67 million.

[2] Excludes securitisation notes held by the Group (£58,732 million).

B. Transferred financial assets derecognised in their entirety with ongoing exposure

The following information by type of ongoing exposure relates to assets and liabilities arising from contractual rights or obligations retained or obtained in connection with financial assets that have been derecognised in their entirety.

	Carrying amount of ongoing exposure in balance sheet			
		At fair value through profit or loss		
At 31 December 2013	**Loans and receivables £m**	**Designated upon initial recognition £m**	**Fair value of ongoing exposure £m**	**Maximum exposure to loss £m**
Debt securities	**78**	**–**	**76**	**78**[1]

	Carrying amount of ongoing exposure in balance sheet			
		At fair value through profit or loss		
At 31 December 2012	Loans and receivables £m	Designated upon initial recognition £m	Fair value of ongoing exposure £m	Maximum exposure to loss £m
Debt securities	119	–	102	119[1]
Fund investments	–	70	70	100[2]
Total	119	70	172	219

[1] Amount represents the carrying amount of the asset.

[2] Amount represents the carrying amount of the asset plus undrawn commitments of £30 million.

Debt securities shown in the table above are notes held in non-controlled securitisation vehicles representing the Group's ongoing involvement in financial assets transferred into those securitisation vehicles in prior years. The debt securities, which benefit from significant credit enhancement, are classified as available-for-sale financial assets and are managed on a similar basis to the Group's other non-traded asset-backed securities.

Fund investments shown in the table above are equity and debt interests in an investment fund representing the Group's ongoing involvement in financial assets transferred into the fund in a prior year. The fund investments were designated at fair value through profit or loss and are managed on a similar basis to the Group's trading assets.

The Group has no obligation or option to repurchase any of the assets transferred.

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Note 53: Financial instruments (continued)

Amounts recognised in the income statement

In respect of debt securities shown above, an amount of £1 million was recognised during the year (2012: £2 million; £6 million cumulatively since derecognition) within net interest income.

In respect of fund investments shown above, an amount of £nil million was recognised during the year (2012: £3 million; £55 million cumulatively since derecognition) within net trading income.

(6) Financial instruments subject to offsetting, enforceable master netting agreements and similar arrangements

The following information relates to financial assets and liabilities which have been set off in the balance sheet and those which have not been set off but for which the Group has enforceable master netting agreements in place with counterparties.

At 31 December 2013	Gross amounts of assets/liabilities £m	Amounts set off in the balance sheet[3] £m	Net amounts presented in the balance sheet £m
Financial assets			
Trading and other financial assets at fair value through profit or loss[1]	113,395	–	113,395
Derivative financial instruments	50,285	(17,160)	33,125
Loans and receivables:			
Loans and advances to banks[1]	25,182	–	25,182
Loans and advances to customers[1]	495,161	–	495,161
Debt securities	1,355	–	1,355
Reverse repurchase agreements	34,028	(4,437)	29,591
Available-for-sale financial assets	43,976	–	43,976
Financial liabilities			
Deposits from banks[2]	12,108	–	12,108
Customer deposits[2]	438,333	–	438,333
Trading and after financial liabilities at fair value through profit or loss[2]	14,723	–	14,723
Repurchase agreements	38,191	(4,437)	33,754
Derivative financial instruments	47,624	(17,160)	30,464

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Note 53: Financial instruments (continued)

At 31 December 2013	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[4]		Potential net amounts if offset of related amounts permitted £m
		Financial instruments £m	Cash collateral received/ pledged £m	
Financial assets				
Trading and other financial assets at fair value through profit or loss[1]	113,395	(903)	–	112,492
Derivative financial instruments	33,125	(19,479)	(3,188)	10,458
Loans and receivables:				
Loans and advances to banks[1]	25,182	–	–	25,182
Loans and advances to customers[1]	495,161	(10,958)	(49)	484,154
Debt securities	1,355	–	–	1,355
Reverse repurchase agreements	29,591	(4,160)	(416)	25,015
Available-for-sale financial assets	43,976	(3,782)	–	40,194
Financial liabilities				
Deposits from banks[2]	12,108	–	(2,798)	9,310
Customer deposits[2]	438,333	(6,811)	(806)	430,716
Trading and after financial liabilities at fair value through profit or loss[2]	14,723	–	–	14,723
Repurchase agreements	33,754	(12,992)	(49)	20,713
Derivative financial instruments	30,464	(19,479)	–	10,985

At 31 December 2012	Gross amounts of assets/liabilities £m	Amounts set off in the balance sheet[3] £m	Net amounts presented in the balance sheet £m
Financial assets			
Trading and other financial assets at fair value through profit or loss[1]	146,187	–	146,187
Derivative financial instruments	72,192	(15,635)	56,557
Loans and receivables:			
Loans and advances to banks[1]	32,095	–	32,095
Loans and advances to customers[1]	512,138	–	512,138
Debt securities	5,273	–	5,273
Reverse repurchase agreements	25,476	(5,294)	20,182
Available-for-sale financial assets	31,374	–	31,374
Financial liabilities			
Deposits from banks[2]	15,037	–	15,037
Customer deposits[2]	422,479	–	422,479
Trading and after financial liabilities at fair value through profit or loss[2]	8,839	–	8,839
Repurchase agreements	57,648	(5,294)	52,354
Derivative financial instruments	64,311	(15,635)	48,676

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Note 53: Financial instruments (continued)

At 31 December 2012	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[4] Financial instruments £m	Cash collateral received/pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets				
Trading and other financial assets at fair value through profit or loss[1]	146,187	(612)	–	145,575
Derivative financial instruments	56,557	(38,158)	(5,429)	12,970
Loans and receivables:				
Loans and advances to banks[1]	32,095	–	(135)	31,960
Loans and advances to customers[1]	512,138	(13,140)	(2)	498,996
Debt securities	5,273	(344)	–	4,929
Reverse repurchase agreements	20,182	(8,863)	(196)	11,123
Available-or-sale financial assets	31,374	(4,716)	–	26,658
Financial liabilities				
Deposits from banks[2]	15,037	–	(5,259)	9,778
Customer deposits[2]	422,479	(5,728)	(367)	416,384
Trading and after financial liabilities at fair value through profit or loss[2]	8,839	–	–	8,839
Repurchase agreements	52,354	(21,498)	(1)	30,855
Derivative financial instruments	48,676	(38,158)	(135)	10,383

[1] Excluding reverse repurchase agreements.

[2] Excluding repurchase agreements.

[3] The amounts set off in the balance sheet as shown above represent derivatives and repurchase agreements with central clearing houses which meet the criteria for offsetting under IAS 32.

[4] The Group enters into derivatives and repurchase and reverse repurchase agreements with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in respective of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

The effects of over collateralisation have not been taken into account in the above table.

Note 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; liquidity risk; capital risk; and insurance risk. Information about the Group's exposure to each of the above risks and capital can be found on pages 123 to 196. 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.

Market risk

The Group uses various market risk measures for risk reporting and setting risk appetite limits and triggers. These measures include Value at Risk and Stress Scenarios.

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 many 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.

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Note 54: Financial risk management (continued)

At 31 December 2013 the aggregate notional principal of interest rate swaps designated as fair value hedges was £154,657 million (2012: £135,516 million) with a net fair value asset of £3,663 million (2012: asset of £4,246 million) (note 18). The losses on the hedging instruments were £933 million (2012: gains of £572 million). The gains on the hedged items attributable to the hedged risk were £872 million (2012: losses of £560 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. Note 18 shows when the hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2013 was £559,690 million (2012: £86,190 million) with a net fair value liability of £1,347 million (2012: asset of £215 million) (note 18). In 2013, ineffectiveness recognised in the income statement that arises from cash flow hedges was a loss of £60 million (2012: gain of £6 million).

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 are disclosed on page 166.

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 currency borrowings. At 31 December 2013 the aggregate principal of these currency borrowings was £1,695 million (2012: £2,489 million). In 2013, an ineffectiveness gain of £16 million before tax and £12 million after tax (2012: ineffectiveness loss of £1 million before and 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

	2013 £m	2012 £m
Euro:		
Gross exposure	567	919
Net investment hedge	(464)	(842)
	103	77
US dollar:		
Gross exposure	379	316
Net investment hedge	(341)	(542)
	38	(226)
Swiss franc:		
Gross exposure	(7)	6
Net investment hedge	–	(9)
	(7)	(3)
Australian dollar:		
Gross exposure	853	1,104
Net investment hedge	(866)	(1,077)
	(13)	27
Japanese yen:		
Gross exposure	(1)	19
Net investment hedge	(1)	(19)
	(2)	–
Other non-sterling	106	106
Total structural foreign currency exposures, after net investment hedges	225	(19)

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Note 54: Financial risk management (continued)

Credit risk

The Group's credit risk exposure arises in respect of the instruments below and predominantly in the United Kingdom, the European Union and the United States. Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, which include the use of various credit risk rating systems as inputs and measure the credit risk of loans and advances to customers and banks at a counterparty level using three components: (i) the probability of default by the counterparty on its contractual obligations; (ii) the 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 uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral, using master netting agreements and other credit risk transfers, such as asset sales and credit derivative based transactions.

A. Maximum credit exposure

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, which includes amounts held to cover unit-linked and With Profits funds liabilities, is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

	2013 £m	2012[1] £m
Loans and receivables:		
Loans and advances to banks, net[2]	**25,365**	32,757
Loans and advances to customers, net[2]	**495,281**	517,225
Debt securities, net[2]	**1,355**	5,273
Deposit amounts available for offset[3]	**(6,811)**	(5,728)
	515,190	549,527
Available-for-sale financial assets (excluding equity shares)	**43,406**	30,846
Trading and other financial assets at fair value through profit or loss (excluding equity shares)[4]:		
Loans and advances	**29,443**	14,551
Debt securities, treasury and other bills	**46,837**	56,622
	76,280	71,173
Derivative assets:		
Derivative assets, before offsetting under master netting arrangements	**33,125**	56,557
Amounts available for offset under master netting arrangements[3]	**(19,479)**	(38,158)
	13,646	18,399
Assets arising from reinsurance contracts held	**732**	2,320
Financial guarantees	**8,591**	9,520
Irrevocable loan commitments and other credit-related contingencies[5]	**59,172**	55,629
Maximum credit risk exposure	**717,017**	737,414
Maximum credit risk exposure before offset items	**743,307**	781,300

[1] Restated – see note 1.

[2] Amounts shown net of related impairment allowances.

[3] 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.

[4] Includes assets within the Group's unit-linked funds for which credit risk is borne by the policyholders and assets within the Group's With-Profits funds for which credit risk is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for such assets which back related contract liabilities.

[5] See note 52 – Contingent liabilities and commitments for further information.

B. Credit quality of assets

Loans and receivables

The disclosures in the table below and those on pages 330 and 331 are produced under the underlying basis used for the Group's segmental reporting. The Group believes that, for reporting periods following a significant acquisition such as the acquisition of HBOS in 2009, this underlying basis, which includes the allowance for loan losses at the acquisition date on a gross basis, more fairly reflects the underlying provisioning status of the loans. The remaining acquisition-related fair value adjustments in respect of this lending are therefore identified separately in this table.

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.

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Note 54: Financial risk management (continued)

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	
At 31 December 2013						
Neither past due nor impaired	25,219	318,668	36,789	110,093	465,550	29,443
Past due but not impaired	146	12,329	580	786	13,695	–
Impaired – no provision required	–	637	1,284	1,824	3,745	–
– provision held	–	6,229	1,456	20,829	28,514	–
Gross	25,365	337,863	40,109	133,532	511,504	29,443
Allowance for impairment losses	–	(2,194)	(1,044)	(12,469)	(15,707)	–
Fair value adjustments	–				(516)	–
Net balance sheet carrying value	25,365				495,281	29,443
At 31 December 2012[1]						
Neither past due nor impaired	32,726	319,613	41,223	117,613	478,449	14,551
Past due but not impaired	31	12,880	922	1,527	15,329	–
Impaired – no provision required	–	741	1,530	1,504	3,775	–
– provision held	3	7,391	2,124	33,003	42,518	–
Gross	32,760	340,625	45,799	153,647	540,071	14,551
Allowance for impairment losses	(3)	(2,845)	(1,326)	(17,601)	(21,772)	–
Fair value adjustments	–				(1,074)	–
Net balance sheet carrying value	32,757				517,225	14,551

[1] Restated – see note 1.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2(H). All impaired loans which exceed certain thresholds, principally within the Group's Commercial Banking 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 which are individually determined to be impaired with a gross amount before impairment allowances of £22,390 million (31 December 2012: £34,533 million).

The table below sets out the reconciliation of the allowance for impairment losses of £11,966 million (2012: £15,250 million) shown in note 24 to the allowance for impairment losses on an underlying basis of £15,707 million (2012: £21,772 million) shown above:

	2013 £m	2012 £m
Allowance for impairment losses on loans and advances to customers	11,966	15,250
HBOS allowance at 16 January 2009[1]	11,147	11,147
HBOS charge covered by fair value adjustments[2]	11,815	11,306
Amounts subsequently written off	(19,674)	(16,383)
	3,288	6,070
Foreign exchange and other movements	453	452
Allowance for impairment losses on loans and advances to customers on an underlying basis	15,707	21,772

[1] Comprises an allowance held at 31 December 2008 of £10,693 million and a charge for the period from 1 January 2009 to 16 January 2009 of £454 million.

[2] This represents the element of the charge on loans and advances to customers in HBOS's results that was included within the Group's fair value adjustments in respect of the acquisition of HBOS on 16 January 2009.

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Note 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
At 31 December 2013						
Good quality	25,044	314,749	29,129	68,674		29,432
Satisfactory quality	171	2,948	6,414	29,038		7
Lower quality	2	308	501	9,991		3
Below standard, but not impaired	2	663	745	2,390		1
Total loans and advances which are neither past due nor impaired	25,219	318,668	36,789	110,093	465,550	29,443
At 31 December 2012[1]						
Good quality	32,173	313,372	30,924	60,510		14,514
Satisfactory quality	174	4,532	8,579	33,477		28
Lower quality	10	552	862	18,153		6
Below standard, but not impaired	369	1,157	858	5,473		3
Total loans and advances which are neither past due nor impaired	32,726	319,613	41,223	117,613	478,449	14,551

[1] Restated – see note 1.

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. Further information about the Group's internal probabilities of default rating models can be found on page 134.

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
At 31 December 2013						
0-30 days	146	5,596	489	347	6,432	–
30-60 days	–	2,639	87	102	2,828	–
60-90 days	–	1,734	4	57	1,795	–
90-180 days	–	2,360	–	41	2,401	–
Over 180 days	–	–	–	239	239	–
Total loans and advances which are past due but not impaired	146	12,329	580	786	13,695	–
At 31 December 2012						
0-30 days	–	5,996	744	860	7,600	–
30-60 days	3	2,667	138	131	2,936	–
60-90 days	2	1,750	29	328	2,107	–
90-180 days	6	2,467	5	56	2,528	–
Over 180 days	20	–	6	152	158	–
Total loans and advances which are past due but not impaired	31	12,880	922	1,527	15,329	–

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 54: Financial risk management (continued)

Debt securities classified as loans and receivables

An analysis by credit rating of the Group's debt securities classified as loans and receivables is provided below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2013							
Asset-backed securities:							
Mortgage-backed securities	1	–	172	160	–	–	333
Other asset-backed securities	265	58	203	79	117	18	740
	266	58	375	239	117	18	1,073
Corporate and other debt securities	150	25	–	–	–	232	407
Gross exposure	416	83	375	239	117	250	1,480
Allowance for impairment losses							(125)
Total debt securities classified as loans and receivables							1,355
At 31 December 2012							
Asset-backed securities:							
Mortgage-backed securities	637	1,109	877	745	368	191	3,927
Other asset-backed securities	541	57	199	107	245	1	1,150
	1,178	1,166	1,076	852	613	192	5,077
Corporate and other debt securities	150	–	–	–	–	252	402
Gross exposure	1,328	1,166	1,076	852	613	444	5,479
Allowance for impairment losses							(206)
Total debt securities classified as loans and receivables							5,273

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Note 54: Financial risk management (continued)

Available-for-sale financial assets (excluding equity shares)

An analysis of the Group's available-for-sale financial assets is included in note 25. The credit quality of the Group's available-for-sale financial assets (excluding equity shares) is set out below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2013							
Debt securities:							
Government securities	31,623	6,667	–	–	–	–	38,290
Bank and building society certificates of deposit	–	163	45	–	–	–	208
Asset-backed securities:							
Mortgage-backed securities	911	115	25	130	82	–	1,263
Other asset-backed securities	557	226	107	–	25	–	915
	1,468	341	132	130	107	–	2,178
Corporate and other debt securities	1,083	174	191	351	37	19	1,855
Total debt securities	34,174	7,345	368	481	144	19	42,531
Treasury bills and other bills	15	852	8	–	–	–	875
Total held as available-for-sale financial assets	34,189	8,197	376	481	144	19	43,406
At 31 December 2012							
Debt securities:							
Government securities	18,227	7,328	–	–	–	–	25,555
Bank and building society certificates of deposit	–	75	71	42	–	–	188
Asset-backed securities:							
Mortgage-backed securities	976	212	50	120	166	–	1,524
Other asset-backed securities	336	241	116	–	67	–	760
	1,312	453	166	120	233	–	2,284
Corporate and other debt securities	293	281	567	600	85	22	1,848
Total debt securities	19,832	8,137	804	762	318	22	29,875
Treasury bills and other bills	866	–	16	89	–	–	971
Total held as available-for-sale financial assets	20,698	8,137	820	851	318	22	30,846

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Note 54: Financial risk management (continued)

Debt securities, treasury and other bills held at fair value through profit or loss

An analysis of the Group's trading and other financial assets at fair value through profit or loss is included in note 17. The credit quality of the Group's debt securities, treasury and other bills held at fair value through profit or loss is set out below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2013							
Debt securities, treasury and other bills held at fair value through profit or loss							
Trading assets:							
Government securities	3,985	274	–	–	–	–	4,259
Other public sector securities	14	–	–	–	–	–	14
Bank and building society certificates of deposit	–	787	704	–	–	–	1,491
Asset-backed securities:							
Mortgage-backed securities	–	–	–	–	5	–	5
Other asset-backed securities	87	31	23	17	13	–	171
	87	31	23	17	18	–	176
Corporate and other debt securities	489	168	843	386	29	14	1,929
Total debt securities held as trading assets	4,575	1,260	1,570	403	47	14	7,869
Treasury bills and other bills	6	55	–	–	–	–	61
Total held as trading assets	4,581	1,315	1,570	403	47	14	7,930
Other assets held at fair value through profit or loss:							
Government securities	5,572	10,284	382	177	1	14	16,430
Other public sector securities	1,962	195	26	–	–	–	2,183
Bank and building society certificates of deposit	–	–	–	–	–	–	–
Asset-backed securities:							
Mortgage-backed securities	99	176	331	187	–	–	793
Other asset-backed securities	240	188	224	103	1	–	756
	339	364	555	290	1	–	1,549
Corporate and other debt securities	383	2,619	7,462	5,886	617	1,724	18,691
Total debt securities held at fair value through profit or loss	8,256	13,462	8,425	6,353	619	1,738	38,853
Treasury bills and other bills	54	–	–	–	–	–	54
Total other assets held at fair value through profit or loss	8,310	13,462	8,425	6,353	619	1,738	38,907
Total held at fair value through profit or loss	12,891	14,777	9,995	6,756	666	1,752	46,837

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Note 54: Financial risk management (continued)

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2012[1]							
Debt securities, treasury and other bills held at fair value through profit or loss							
Trading assets:							
Government securities	3,688	277	–	–	–	–	3,965
Bank and building society certificates of deposit	–	2,182	907	77	–	–	3,166
Asset-backed securities:							
Mortgage-backed securities	42	10	78	–	–	–	130
Other asset-backed securities	2	14	4	1	–	–	21
	44	24	82	1	–	–	151
Corporate and other debt securities	385	148	330	278	30	1	1,172
Total debt securities held as trading assets	4,117	2,631	1,319	356	30	1	8,454
Treasury bills and other bills	370	4	–	–	–	–	374
Total held as trading assets	4,487	2,635	1,319	356	30	1	8,828
Other assets held at fair value through profit or loss:							
Government securities	15,213	1,588	204	362	1	12	17,380
Other public sector securities	694	205	131	6	–	20	1,056
Bank and building society certificates of deposit	–	94	134	–	–	–	228
Asset-backed securities:							
Mortgage-backed securities	236	95	309	125	22	8	795
Other asset-backed securities	251	394	792	386	22	47	1,892
	487	489	1,101	511	44	55	2,687
Corporate and other debt securities	3,198	2,836	8,021	7,647	2,866	1,819	26,387
Total debt securities held at fair value through profit or loss	19,592	5,212	9,591	8,526	2,911	1,906	47,738
Treasury bills and other bills	56	–	–	–	–	–	56
Total other assets held at fair value through profit or loss	19,648	5,212	9,591	8,526	2,911	1,906	47,794
Total held at fair value through profit or loss	24,135	7,847	10,910	8,882	2,941	1,907	56,622

[1] Restated – see note 1.

Credit risk in respect of trading and other financial assets at fair value through profit or loss held within the Group's unit-linked funds is borne by the policyholders and credit risk in respect of with-profits funds is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for such assets which back those contract liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 54: Financial risk management (continued)

Derivative assets

An analysis of derivative assets is given in note 18. The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £13,646 million (2012: £18,399 million), cash collateral of £3,188 million (2012: £5,429 million) was held and a further £2,372 million was due from OECD banks (2012: £1,387 million).

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2013							
Trading and other	**298**	**4,719**	**13,300**	**4,209**	**2,554**	**1,258**	**26,338**
Hedging	**–**	**2,936**	**3,687**	**127**	**32**	**5**	**6,787**
Total derivative financial instruments	**298**	**7,655**	**16,987**	**4,336**	**2,586**	**1,263**	**33,125**
At 31 December 2012							
Trading and other	226	13,507	18,137	5,046	6,439	1,631	44,986
Hedging	–	6,038	4,596	111	824	2	11,571
Total derivative financial instruments	226	19,545	22,733	5,157	7,263	1,633	56,557

Assets arising from reinsurance contracts held

Of the assets arising from reinsurance contracts held at 31 December 2013 of £732 million (2012: £2,320 million), £383 million (2012: £764 million) were due from insurers with a credit rating of AA or above.

Financial guarantees and irrevocable loan commitments

Financial guarantees 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.

C. Collateral held as security for financial assets

A general description of collateral held as security in respect of financial instruments is provided on page 136. The Group holds collateral against loans and receivables and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for trading and other financial assets at fair value through profit or loss and for derivative assets is also shown below.

Loans and receivables

The disclosures below are produced under the underlying basis used for the Group's segmental reporting. The Group believes that, for reporting periods following a significant acquisition, such as the acquisition of HBOS in 2009, this underlying basis, which includes the allowance for loan losses at the acquisition on a gross basis, more fairly reflects the underlying provisioning status of the loans.

The Group holds collateral in respect of loans and advances to banks and customers as set out below. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

Loans and advances to banks

The Group may require collateral before entering into a credit commitment with another bank, depending on the type of financial product and the counterparty involved, and netting arrangements are obtained whenever possible and to the extent that such agreements are legally enforceable. Collateral is held as part of reverse repurchase or securities borrowing transactions.

There were reverse repurchase agreements which are accounted for as collateralised loans within loans and advances to banks with a carrying value of £183 million (2012: £662 million), against which the Group held collateral with a fair value of £183 million (2012: £662 million), all of which the Group is able to repledge.

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Loans and advances to customers

The Group holds collateral against loans and advances to customers in the form of 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.

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Note 54: Financial risk management (continued)

Retail lending

Mortgages

An analysis by loan-to-value ratio of the Group's residential mortgage lending is provided below. The value of collateral used in determining the loan-to-value ratios 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.

	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
At 31 December 2013				
Less than 70 per cent	**161,105**	**4,294**	**1,743**	**167,142**
70 per cent to 80 per cent	**64,954**	**2,296**	**970**	**68,220**
80 per cent to 90 per cent	**46,581**	**2,224**	**1,080**	**49,885**
90 per cent to 100 per cent	**24,592**	**1,720**	**1,027**	**27,339**
Greater than 100 per cent	**21,436**	**1,795**	**2,046**	**25,277**
Total	**318,668**	**12,329**	**6,866**	**337,863**
At 31 December 2012				
Less than 70 per cent	131,277	3,283	1,470	136,030
70 per cent to 80 per cent	61,677	1,962	846	64,485
80 per cent to 90 per cent	52,651	2,314	1,114	56,079
90 per cent to 100 per cent	36,428	2,092	1,133	39,653
Greater than 100 per cent	37,580	3,229	3,569	44,378
Total	319,613	12,880	8,132	340,625

Other

No collateral is held in respect of retail credit cards or overdrafts, or unsecured personal loans. For non-mortgage retail lending to small businesses, collateral will often include second charges over residential property and the assignment of life cover.

The majority of non-mortgage retail lending is unsecured. At 31 December 2013, impaired non-mortgage lending amounted to £1,696 million, net of an impairment allowance of £1,044 million (2012: £2,328 million, net of an impairment allowance of £1,326 million). The fair value of the collateral held in respect of this lending was £144 million (2012: £48 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation and the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Unimpaired non-mortgage retail lending amounted to £36,081 million (2012: £42,145 million). Lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination and are thereafter monitored in accordance with business unit credit policy.

The Group credit risk disclosures for unimpaired non-mortgage retail lending report assets gross of collateral and therefore disclose the maximum loss exposure. The Group believes that this approach is appropriate. The value of collateral is reassessed if there is observable evidence of distress of the borrower. Unimpaired non-mortgage retail lending, including any associated collateral, is managed on a customer-by-customer basis rather than a portfolio basis. No aggregated collateral information for the entire unimpaired non-mortgage retail lending portfolio is provided to key management personnel.

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Note 54: Financial risk management (continued)

Wholesale lending

Reverse repurchase transactions

There were reverse repurchase agreements which are accounted for as collateralised loans with a carrying value of £120 million (2012: £5,087 million), against which the Group held collateral with a fair value of £112 million (2012: £4,916 million), all of which the Group is able to repledge. Included in these amounts are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £49 million (2012: £2 million). These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Impaired secured lending

The value of collateral is re-evaluated and its legal soundness re-assessed if there is observable evidence of distress of the borrower; this evaluation is used to determine potential loss allowances and management's strategy to try to either repair the business or recover the debt.

At 31 December 2013, impaired secured wholesale lending amounted to £9,845 million, net of an impairment allowance of £11,063 million (2012: £17,257 million, net of an impairment allowance of £15,193 million). The fair value of the collateral held in respect of impaired secured wholesale lending was £6,915 million (2012: £9,414 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation. For the purposes of determining the total collateral held by the Group in respect of impaired secured wholesale lending, the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Impaired secured wholesale lending and associated collateral relates to lending to property companies and to customers in the financial, business and other services; transport, distribution and hotels; and construction industries.

Unimpaired secured lending

Unimpaired secured wholesale lending amounted to £69,108 million (2012: £74,485 million). Wholesale lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination. The types of collateral taken and the frequency with which collateral is required at origination is dependent upon the size and structure of the borrower. For exposures to corporate customers and other large institutions, the Group will often require the collateral to include a first charge over land and buildings owned and occupied by the business, a mortgage debenture over the company's undertaking and one or more of its assets, and keyman insurance. The Group maintains policies setting out acceptable collateral, maximum loan-to-value ratios and other criteria to be considered when reviewing a loan application. The decision as to whether or not collateral is required will be based upon the nature of the transaction and the credit worthiness of the customer. Other than for project finance, object finance and income producing real estate where charges over the subject assets are a basic requirement, the provision of collateral will not determine the outcome of a credit application. The fundamental business proposition must evidence the ability of the business to generate funds from normal business sources to repay debt.

The extent to which collateral values are actively managed will depend on the credit quality and other circumstances of the obligor. Although lending decisions are predominantly based on expected cash flows, any collateral provided may impact the pricing and other terms of a loan or facility granted; this will have a financial impact on the amount of net interest income recognised and on internal loss-given-default estimates that contribute to the determination of asset quality.

For unimpaired secured wholesale lending, the Group reports assets gross of collateral and therefore discloses the maximum loss exposure. The Group believes that this approach is appropriate as collateral values at origination and during a period of good performance may not be representative of the value of collateral if the obligor enters a distressed state.

Unimpaired secured wholesale lending is predominantly managed on a cash flow basis. On occasion, it may include an assessment of underlying collateral, although, for impaired lending, this will not always involve assessing it on a fair value basis. No aggregated collateral information for the entire unimpaired secured wholesale lending portfolio is provided to key management personnel.

Trading and other financial assets at fair value through profit or loss (excluding equity shares)

In respect of trading and other financial assets at fair value through profit or loss, the fair value of collateral accepted under reverse repurchase transactions which are accounted for as collateralised loans that the Group is permitted by contract or custom to sell or repledge was £32,434 million (2012: £19,629 million). Of this, £8,195 million was sold or repledged (2012: £15,640 million).

In addition, securities held as collateral in the form of stock borrowed amounted to £46,552 million (2012: £38,040 million). Of this amount, £45,277 million (2012: £36,549 million) had been resold or repledged as collateral for the Group's own transactions.

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

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Note 54: Financial risk management (continued)

Derivative assets, after offsetting of amounts under master netting arrangements

The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the net derivative assets after offsetting of amounts under master netting arrangements of £13,646 million (2012: £18,399 million), cash collateral of £3,188 million (2012: £5,429 million) was held.

Irrevocable loan commitments and other credit-related contingencies

At 31 December 2013, the Group held irrevocable loan commitments and other credit-related contingencies of £59,172 million (2012: £55,629 million). Collateral is held as security, in the event that lending is drawn down, on £19,123 million (2012: £17,697 million) of these balances.

Lending decisions in respect of irrevocable loan commitments are based on the obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. For wholesale commitments, it is the Group's practice to request collateral whose value is commensurate with the nature of the commitment. For retail mortgage commitments, the majority are for mortgages with a loan-to-value ratio of less than 100 per cent. Aggregated collateral information covering the entire balance of irrevocable loan commitments over which security will be taken is not provided to key management personnel.

D. Collateral pledged as security

Repo and stock lending transactions

The Group pledges assets primarily for repurchase agreements and securities lending transactions which are generally conducted under terms that are usual and customary for standard securitised borrowing contracts.

The fair value of collateral pledged in respect of repurchase transactions, accounted for as secured borrowings, where the secured party is permitted by contract or custom to repledge was £37,999 million (2012: £48,077 million). In addition, the following financial assets on the balance sheet have been pledged as collateral as part of securities lending transactions:

Assets pledged

	2013 £m	2012 £m
Trading and other financial assets at fair value through profit or loss	**9,928**	10,000
Loans and advances to customers	**14,927**	11,603
Debt securities classified as loans and receivables	**89**	154
Available-for-sale financial assets	**2,311**	4,251
	27,255	26,008

In addition to the assets detailed above, the Group also holds assets that are encumbered through the Group's asset-backed conduits and its securitisation and covered bond programmes. Further details of these assets are provided in notes 21 and 22.

E. Collateral repossessed

	2013 £m	2012 £m
Residential property	**897**	936
Other	**5**	6
	902	942

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.

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Note 54: Financial risk management (continued)

F. Treatment of customers experiencing financial stress

The Group operates a number of schemes to assist borrowers who are experiencing financial stress. The material elements of these schemes are described in the Risk Management report on pages 137 and 138 and further details relating to those cases where the Group has granted a concession, whether temporarily or permanently, are set out below.

Retail customers

Forbearance activities

The Group classifies the treatments offered to retail customers who have experienced financial difficulty into the following categories:

- *Reduced contractual monthly payment:* a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payments, for example temporary interest only arrangements and short-term payment holidays granted in collections. Any arrears existing at the commencement of the arrangement are retained;
- *Reduced payment arrangements:* a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example short-term arrangements to pay;
- *Term extensions:* a permanent account change for customers in financial distress where the overall term of the mortgage is extended resulting in a lower contractual monthly payment; and
- *Repair:* a permanent account change used to repair a customer's position where they have emerged from financial difficulty, for example capitalisation of arrears.

Customers receiving support from UK Government sponsored programmes

The Group participates in a number of UK Government sponsored programmes designed to support households, which are described on page 137. Where these schemes provide borrowers with a state benefit that is used to service the loan, there is no change in the reported status of the loan which is managed and reported in accordance with its original terms.

The Group assesses whether a loan benefitting from a UK Government sponsored programme is impaired using the same accounting policies and practices as it does for loans not benefitting from such a programme. There is no direct impact on the impairment status of a loan benefitting from the Mortgage Rescue schemes, as these schemes involve the purchase, and eventual sale, of the property. The loans included within the Income Support for Mortgage Interest scheme may be impaired, in accordance with the normal definition of impairment.

The Income Support for Mortgage Interest scheme remains the most successful of the Government backed schemes. It is the longest-running, is the most widely known and provides both the customer and the Group with an assurance as to the maintenance of at least two years' worth of interest payments. The Group estimates that customers representing approximately £2.6 billion of its mortgage exposures are receiving this benefit. This includes those who are also receiving other treatments for financial difficulty.

Customers in financial difficulty receiving support under other schemes

The Group measures the success of a forbearance scheme based upon the proportion of customers maintaining or improving their arrears position over the 12 months following the exit from a forbearance treatment. For temporary treatments, 87 per cent of customers who have accepted temporary interest-only concessions and 75 per cent of customers accepting reduced payment arrangements have maintained or improved their arrears position. For permanent treatments, 77 per cent of customers who have accepted capitalisations of arrears and 40 per cent of customers who have accepted term extensions have maintained or improved their arrears position.

Forbearance identification and classification

The Group has applied revised forbearance definitions based upon principles developed through the British Bankers' Association. As a result of this, forbearance data for 2012 has been restated to reflect the new definitions. The restated data for 2012 shows overall forbearance balances to be higher than previous financial statements as the balances now include accounts which are no longer on a forbearance treatment, but where the exposure is known to be, or may still be, in financial difficulty.

The Group classifies a retail account as forborne at the time a customer in financial difficulty is granted a concession. Accounts are classified as forborne only for the period of time which the exposure is known to be, or may still be, in financial difficulty. Where temporary forbearance is granted, exit criteria are applied to include accounts until they are known to no longer be in financial difficulty. Details of the exit criteria are shown in the analysis below. Where the treatment involves a permanent change to the contractual basis of the customer's account such as a capitalisation of arrears or term extension, the Group classifies the balance as forborne for a period of 24 months, after which no distinction is made between these accounts and others where no change has been made.

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Note 54: Financial risk management (continued)

Secured retail lending – UK

At 31 December 2013, retail secured loans and advances currently or recently subject to forbearance were 2.0 per cent (31 December 2012: 2.9 per cent) of total retail secured loans and advances. The Group no longer offers temporary interest only as a forbearance treatment to secured lending customers in financial difficulty, which is the primary driver of the reduction in forbearance balances in 2013. Further analysis of the forborne loan balances is set out below:

	Total loans and advances which are currently or recently forborne		Total current and recent forborne loans and advances which are impaired[1]		Impairment provisions as % of loans and advances which are currently or recently forborne	
	2013 £m	2012[2] £m	2013 £m	2012[2] £m	2013 %	2012[2] %
At 31 December						
Temporary forbearance arrangements						
Reduced contractual monthly payment[3]	995	4,514	226	538	4.0	2.5
Reduced payment arrangements[4]	1,376	1,412	160	320	3.2	4.0
	2,371	5,926	386	858	3.5	2.8
Permanent treatments						
Repair and term extensions[5]	4,008	3,565	305	289	3.4	3.9
Total	6,379	9,491	691	1,147	3.4	3.2
Included in the total above:						
Temporary arrangements currently on treatment	1,100	3,103	179	516	3.4	3.7
Permanent treatments within last 12 months	2,187	1,913	78	90	3.1	4.3

[1] £5,688 million of current and recent forborne loans and advances were not impaired at 31 December 2013 (31 December 2012: £8,344 million).

[2] Restated to reflect the change in forbearance probation periods. Previously only temporary arrangements in place at the year end and permanent changes commenced during the year were shown.

[3] Includes temporary interest only arrangements and short-term payment holidays granted in collections where the customer is currently benefitting from the treatment and where the concession has ended within the previous six months (temporary interest only) and previous 12 months (short-term payment holidays).

[4] Includes customers who had an arrangement to pay less than the contractual amount at 31 December or where an arrangement ended within the previous three months.

[5] Includes capitalisation of arrears and term extensions which commenced during the previous 24 months and remaining as customers at the year end.

Collective impairment assessment of retail secured loans subject to forbearance

Loans which are forborne are grouped with other assets with similar risk characteristics and assessed collectively for impairment as described below. The loans are not considered as impaired loans unless they meet the Group's definition of an impaired asset.

The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the underlying loss risk of exposures. The Group uses sophisticated behavioural scoring to assess customers' credit risk. The underlying behavioural scorecards consider many different characteristics of customer behaviour, both static and dynamic, from internal sources and also from credit bureaux data, including characteristics that may identify when a customer has been in arrears on products held with other firms. Hence, these models take a range of potential indicators of customer financial distress into account.

The performance of such models is monitored and challenged on an ongoing basis, in line with the Group's model governance policies. The models are also regularly recalibrated to reflect up to date customer behaviour and market conditions. Specifically, regular detailed analysis of modelled provision outputs is undertaken to demonstrate that the risk of forbearance or other similar activities is recognised, that the outcome period adequately captures the risk and that the underlying risk is appropriately reflected. Where this is not the case, additional provisions are applied to capture the risk.

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Note 54: Financial risk management (continued)

Unsecured retail lending – UK

At 31 December 2013, UK retail unsecured loans and advances currently or recently subject to forbearance were 2.6 per cent (31 December 2012: 3.9 per cent) of total UK retail unsecured loans and advances of £21,566 million (31 December 2012: £22,698 million). Further analysis of the forborne loan balances is set out below:

	Total loans and advances which are currently or recently forborne		Total current and recent forborne loans and advances which are impaired[1]		Impairment provisions as % of loans and advances which are currently or recently forborne	
	2013 £m	2012[2] £m	2013 £m	2012[2] £m	2013 %	2012[2] %
Temporary forbearance arrangements						
Reduced contractual monthly payment[3]	260	339	230	324	39.2	48.8
Reduced payment arrangements[4]	104	194	86	150	51.7	49.3
	364	533	316	474	42.8	49.0
Permanent treatments						
Repair and term extensions[5]	201	350	79	176	9.9	10.4
Total	565	883	395	650	31.1	33.7
Included in the total above:						
Temporary arrangements currently on treatment	265	388	262	383	45.0	51.6
Permanent treatments within last 12 months	90	208	38	110	13.2	11.8

[1] £170 million of current and recent forborne loans and advances were not impaired at 31 December 2013 (31 December 2012: £233 million).

[2] Restated to reflect the change in forbearance probation periods. Previously only temporary arrangements in place at the year end and permanent changes commenced during the year were shown.

[3] Includes repayment plans and short-term payment holidays granted in collections where the customer is currently benefitting from the treatment and where the concession has ended within the previous six months.

[4] Includes customers who had an arrangement to pay less than the contractual amount at 31 December or where an arrangement ended within the previous six months.

[5] Includes capitalisation of arrears and term extensions which commenced during the previous 24 months and remaining as customers at the year end.

Collective impairment assessment of UK retail unsecured loans and advances subject to forbearance

Credit risk provisioning for the UK retail unsecured portfolio is undertaken on a purely collective basis. The approach used is based on segmented cash flow models, divided into two primary streams for loans judged to be impaired and those that are not. Accounts subject to repayment plans and collections refinance loans are among those considered to be impaired.

For exposures that are judged to be impaired, provisions are determined through modelling the expected cure rates, write-off propensity and cash flows with segments explicitly relating to repayment plans and refinance loans treatments. Payments of less than the monthly contractual amount are reflected in reduced cash flow forecasts when calculating the impairment allowance for these accounts.

The outputs of the models are monitored and challenged on an ongoing basis. The models are run monthly meaning that current market conditions and customer processes are reflected in the output. Where the risks identified are not captured in the underlying models, appropriate additional provisions are made.

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Note 54: Financial risk management (continued)

Secured retail lending – Ireland

At 31 December 2013, Irish secured loans and advances subject to current or recent forbearance were 12.2 per cent (31 December 2012: 12.3 per cent) of total Irish retail secured loans and advances. Further analysis of the forborne loan balances is set out below:

	Total loans and advances which are currently or recently forborne		Total current and recent forborne loans and advances which are impaired[1]		Impairment provisions as % of loans and advances which are currently or recently forborne	
	2013 £m	2012[2] £m	2013 £m	2012[2] £m	2013 %	2012[2] %
At 31 December						
Temporary forbearance arrangements						
Reduced contractual monthly payment	–	–	–	–	–	–
Reduced payment arrangements[3]	254	385	227	336	49.8	45.2
	254	385	227	336	49.8	45.2
Permanent treatments						
Repair and term extensions[4]	473	430	102	71	14.4	27.9
Total	727	815	329	407	26.7	36.1
Included in the total above:						
Temporary arrangements currently on treatment	224	300	43	32	13.9	30.1
Permanent treatments within last 12 months	196	272	174	232	50.0	44.5

[1] £398 million of current and recent forborne loans and advances were not impaired at 31 December 2013 (31 December 2012: £408 million).

[2] The 2012 numbers have been restated to reflect the change in forbearance probation periods. Previously only temporary arrangements in place at the year end and permanent changes commenced during the year were shown.

[3] Includes customers who had an arrangement to pay less than the contractual amount at 31 December or where an arrangement ended within the previous three months.

[4] Includes capitalisation of arrears and term extensions which commenced during the previous 24 months and remaining as customers at the year end.

Asset Finance retail lending

Asset Finance operates a number of retail portfolios including Black Horse Motor Finance as well as a number of portfolios closed to new business and currently in run-off. The reduction in the level of forborne loans in 2013 was driven by the continuing run-off and sale of non-core portfolios. The table below includes both the open and closed retail portfolios in the Asset Finance business. For temporary forbearance arrangements, it includes accounts that are currently on a forbearance treatment. For permanent forbearance treatments, it includes capitalisation of arrears which commenced during the previous 12 months.

	Total loans and advances which are forborne		Total forborne loans and advances which are impaired[1]		Impairment provisions as % of loans and advances which are forborne	
	2013 £m	2012 £m	2013 £m	2012 £m	2013 %	2012 %
At 31 December						
Reduced contractual monthly payment	209	328	192	301	62.8	58.0
Reduced payment arrangements	63	112	56	102	24.9	24.8
Repair	5	7	1	2	2.3	1.6
Total	277	447	249	405	53.2	48.8

[1] £28 million of forborne loans and advances were not impaired at 31 December 2013 (31 December 2012: £42 million).

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Note 54: Financial risk management (continued)

Commercial customers

Forbearance

A key factor in determining whether the Group treats a commercial customer as forborne is the granting of a concession to a borrower who is in financial difficulty.

Loans that have been renegotiated and/or restructured for solely commercial reasons, where there is no financial difficulty would not be treated as forborne. The Group does not believe the concept of forbearance attaches to the trading book where assets are marked to market daily.

The Group recognises that forbearance alone is not necessarily an indicator of impaired status but is a trigger for the review of the customer's credit profile. The Group grants forbearance when it believes that there is a realistic prospect of the customer continuing to be able to repay all facilities in full. If there is any concern over future cash flows and the Group incurring a loss, then forborne loans will be classified as impaired in accordance with the Group's impairment policy.

Recovery can sometimes be through improvement in market or economic conditions, or the customer may benefit from access to alternative sources of liquidity such as an equity injection. These can be especially relevant in real estate or other asset backed transactions where a fire sale of assets in a weak market may be unattractive.

Depending on circumstances and when operated within robust parameters and controls, the Group believes forbearance can help support the customer in the short to medium-term.

Therefore the Group expects to have unimpaired forborne assets within its portfolios, although as noted below, these are specifically controlled and managed. Unimpaired forborne assets are included in calculating the overall collective unimpaired provision, and which uses the historical observed default rate of the portfolio as a whole as part of its calculation.

Types of forbearance

Forbearance treatments may include changes to:

– Contractual payment terms (for example loan extensions, or changes to debt servicing terms), and
– Non-payment contractual terms (for example covenant amendments or waivers) where the modifications enable default to be avoided.

The four main types of forbearance concessions to commercial customers in financial difficulty are set out below:

– Covenants: This includes temporary and permanent waivers, amendment or resetting of non-payment contractual covenants (including LTV and interest cover). The granting of this type of concession in itself would not result in the loan being classified as impaired;
– Extensions/Alterations: This includes extension and/or alteration of repayment terms to a level outside of market or the Group's risk appetite due to the customer's inability to make existing contractual repayment terms; amendments to an interest rate to a level considered outside of market or the Group's risk appetite, or other amendments such as changes to debt servicing arrangements;
– Forgiveness: This includes debt for equity swaps or partial debt forgiveness. This type of forbearance will always give rise to impairment; and
– Multiple type of forbearance (a mixture of the above three). Where a concession is granted to a customer that is not in financial difficulty or the risk profile is considered within current risk appetite, the concession would not be considered to be an act of forbearance.

A number of options are available to the Group where a customer is facing financial difficulty, and each case is treated depending on its own specific circumstances.

The Group's strategy and offer of forbearance is largely dependent on the individual situation and early identification, control and monitoring are key in order to support the customer and protect the Group. Concessions are often provided to help the customer with their day to day liquidity and working capital.

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Note 54: Financial risk management (continued)

Forbearance identification and classification

The Group's policy is to treat all impaired assets in Commercial Banking as having been granted some form of forbearance. Impaired loans and advances exist only in Business Support; Global Non Core; and, for smaller SME customers, Customer Support. Unimpaired forborne loans and advances exist in the good book, in Business Support and in Global Non Core.

All non-retail loans and advances in Commercial Banking are reviewed at least annually by the independent Risk Division. As part of our long established Credit Risk Classification system, every loan and advance in the good book is categorised as either 'good' or 'watchlist'.

The watchlist is further categorised depending on the current and expected credit risk attaching to the customer and the transaction. All watchlist names are reviewed by the Business and Risk at least once a month, and the classification is updated if required.

Any concession granted to a customer is reviewed and must be approved by the independent Risk Division. If Risk Division determines that the customer is in financial difficulty, then any off-market concession granted is treated as forbearance and the loan reviewed monthly. Forbearance does not arise if the customer is not in financial difficulty or if the risk profile of the customer following the concession is within the Group's current risk appetite.

Any event that causes concern over future payments from the customer is likely to result in the asset being assessed for impairment and, if required, an impairment allowance recognised. If impairment is identified, the customer is immediately transferred to Business Support and the lending will be treated as an impaired asset. If no impairment is identified, the Risk Division will determine if the customer should remain in the good book (categorised as watchlist), or transfer to Business Support for more intensive monitoring.

All reviews performed in the good book, Business Support or Global Non Core include analysis of latest financial information, a consideration of the market and sector the customer operates in, performance against plan and revised terms and conditions granted as part of the forbearance concession.

Exit from forbearance classification

A customer where forbearance has been granted will remain treated and recorded as forborne until it evidences acceptable performance over a period of time. This period will depend on a number of factors such as whether the customer is trading in line with its revised plan, it is operating within the new terms and conditions (including observation to revised covenants and contractual payments), its financial performance is stable or improving, and there are no undue concerns over its future performance. As a minimum, this period is currently expected to be at least 12 months following a forbearance event (during 2014, the minimum cure period will be reviewed again in conjunction with regulatory requirements). However, notwithstanding this, the overriding requirement is that the financial difficulty previously seen has been removed, and the performance has stabilised.

Once a customer evidences acceptable performance over a period of time, the Group would expect that it could be returned to the mainstream good classification and they would no longer be considered forborne. It is important to note that such a decision can be made only by the independent Risk Division.

Currently, the exception to this 12 month minimum period is where a permanent structural cure is made (for example, this could be an injection of new collateral security or partial repayment of debt to restore an LTV back to within the covenant). In this case, the customer may be removed from the forbearance category once the permanent cure has been made.

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Note 54: Financial risk management (continued)

Further analysis of the forborne loan balance is set out below:

	Total loans and advances which are forborne		Impairment provisions as % of loans and advances which are forborne	
	2013 £m	2012 £m	2013 %	2012 %
Impaired	14,714	23,965	43.6	41.7
Unimpaired	6,221	9,027	–	–
Total	20,935	32,992	30.6	30.3

All impaired assets are considered forborne. At 31 December 2013, £6,221 million (31 December 2012: £9,027 million) of its unimpaired assets are also considered forborne as a result of proactive management of cases to help customers in financial difficulties. Of this figure, £3,789 million was classified as non-core, with the remaining £2,432 million classified as core.

The table below sets out the Group's largest unimpaired forborne loans and advances to commercial customers (exposures over £5 million) as at 31 December 2013 by type of forbearance, together with a breakdown on which exposures are classified as Direct Real Estate:

	Direct Real Estate £m	Other industry sector £m	Total £m
At 31 December 2013			
Type of unimpaired forbearance			
UK exposures[1] > £5 million			
Covenants	1,555	842	2,397
Extensions	200	343	543
Multiple	23	380	403
	1,778	1,565	3,343
Exposures < £5 million and other non-UK			2,878
Total			6,221

[1] Based on the location of the office recording the transaction.

Ireland wholesale (part of Wealth, Asset Finance and International division)

All loans and advances in Ireland wholesale (whether impaired or unimpaired) are treated as forborne and all assets are classified as non-core.

	Total loans and advances which are forborne		Impairment provisions as % of loans and advances which are forborne	
	2013 £m	2012 £m	2013 %	2012 %
Impaired	8,322	10,967	73.1	68.0
Unimpaired	1,108	1,908	–	–
Total	9,430	12,875	64.5	58.0

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Note 54: Financial risk management (continued)

Liquidity risk

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. The Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the PRA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

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. Certain balances, included in the table below on the basis of their residual maturity, are repayable on demand upon payment of a penalty.

Maturities of assets and liabilities

	Up to 1 month £m	1-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-2 years £m	2-5 years £m	Over 5 years £m	Total £m
At 31 December 2013									
Assets									
Cash and balances at central banks	49,823	5	78	–	–	–	–	9	49,915
Trading and other financial assets at fair value through profit or loss	15,874	6,966	5,868	3,892	2,630	5,601	2,989	98,863	142,683
Derivative financial instruments	567	1,022	858	780	582	2,420	6,938	19,958	33,125
Loans and advances to banks	11,853	5,980	3,310	553	1,038	344	1,827	460	25,365
Loans and advances to customers	35,006	6,720	9,699	10,269	11,886	25,191	56,156	340,354	495,281
Debt securities held as loans and receivables	–	150	10	–	–	41	66	1,088	1,355
Available-for-sale financial assets	139	642	26	390	142	1,933	2,932	37,772	43,976
Other assets	6,265	9,083	1,491	663	1,610	2,665	7,900	25,653	55,330
Total assets	119,527	30,568	21,340	16,547	17,888	38,195	78,808	524,157	847,030
Liabilities									
Deposits from banks	9,984	612	291	788	116	1,548	113	530	13,982
Customer deposits	337,130	16,034	18,659	13,562	11,224	26,749	16,592	1,361	441,311
Derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	19,321	12,458	3,974	2,165	1,414	5,029	9,182	20,546	74,089
Debt securities in issue	5,427	5,771	6,399	3,644	4,081	12,184	18,857	30,739	87,102
Liabilities arising from insurance and investment contracts	1,486	6,579	2,317	2,244	3,046	8,430	21,300	65,356	110,758
Other liabilities	7,679	6,043	1,230	374	1,045	1,146	1,814	28,809	48,140
Subordinated liabilities	363	238	800	718	645	2,710	5,813	21,025	32,312
Total liabilities	381,390	47,735	33,670	23,495	21,571	57,796	73,671	168,366	807,694
At 31 December 2012									
Assets									
Cash and balances at central banks	80,035	259	4	–	–	–	–	–	80,298
Trading and other financial assets at fair value through profit or loss	7,949	9,813	2,710	1,386	1,383	1,748	5,368	130,263	160,620
Derivative financial instruments	2,450	938	1,063	817	864	3,761	13,982	32,682	56,557
Loans and advances to banks	18,167	6,513	2,830	389	455	437	3,291	675	32,757
Loans and advances to customers	44,781	8,718	9,850	9,328	11,874	27,393	64,428	340,853	517,225
Debt securities held as loans and receivables	153	–	–	22	–	203	236	4,659	5,273
Available-for-sale financial assets	565	130	558	32	174	241	4,168	25,506	31,374
Other assets	5,394	463	1,008	564	485	159	360	41,684	50,117
Total assets	159,494	26,834	18,023	12,538	15,235	33,942	91,833	576,322	934,221
Liabilities									
Deposits from banks	14,131	3,212	9,682	297	1,317	2,981	5,454	1,331	38,405
Customer deposits	322,788	14,159	14,144	11,471	12,242	24,319	26,270	1,519	426,912
Derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	12,818	5,556	8,005	2,875	1,963	4,630	15,534	30,687	82,068
Debt securities in issue	13,912	10,505	4,242	3,422	4,503	16,130	30,244	34,295	117,253
Liabilities arising from insurance and investment contracts	27,230	1,469	1,789	1,707	1,774	5,983	14,693	82,947	137,592
Other liabilities	10,171	298	567	75	929	618	745	41,915	55,318
Subordinated liabilities	402	1,541	–	–	294	1,043	7,255	23,557	34,092
Total liabilities	401,452	36,740	38,429	19,847	23,022	55,704	100,195	216,251	891,640

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 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 this data to evaluate the Group's liquidity position. In particular, amounts in respect of customer deposits are usually contractually payable on demand or at short notice. However, in practice, these deposits are not usually withdrawn on their contractual maturity.

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
At 31 December 2013						
Deposits from banks	9,944	636	1,254	1,710	738	14,282
Customer deposits	322,931	15,576	38,689	43,011	34,510	454,717
Trading and other financial liabilities at fair value through profit or loss	18,811	9,906	4,416	7,382	3,616	44,131
Debt securities in issue	7,427	5,069	15,805	40,928	24,514	93,743
Liabilities arising from non-participating investment contracts	27,590	–	–	–	–	27,590
Subordinated liabilities	180	424	2,503	15,019	24,538	42,664
Total non-derivative financial liabilities	386,883	31,611	62,667	108,050	87,916	677,127
Derivative financial liabilities:						
Gross settled derivatives – outflows	4,880	81,612	35,369	56,857	33,767	212,485
Gross settled derivatives – inflows	(4,115)	(79,256)	(34,321)	(55,396)	(32,625)	(205,713)
Gross settled derivatives – net flows	765	2,356	1,048	1,461	1,142	6,772
Net settled derivatives liabilities	21,730	179	438	1,202	541	24,090
Total derivative financial liabilities	22,495	2,535	1,486	2,663	1,683	30,862
At 31 December 2012						
Deposits from banks	13,858	3,556	11,187	8,566	1,382	38,549
Customer deposits	323,925	14,928	39,298	51,043	1,579	430,773
Trading and other financial liabilities at fair value through profit or loss	11,622	4,720	7,874	6,931	3,764	34,911
Debt securities in issue	14,186	10,890	16,223	63,851	27,451	132,601
Liabilities arising from non-participating investment contracts	27,205	–	–	–	27,167	54,372
Subordinated liabilities	61	1,768	1,705	15,903	30,032	49,469
Total non-derivative financial liabilities	390,857	35,862	76,287	146,294	91,375	740,675
Derivative financial liabilities:						
Gross settled derivatives – outflows	2,331	3,243	7,097	51,424	33,678	97,773
Gross settled derivatives – inflows	(2,026)	(2,790)	(6,853)	(50,384)	(32,145)	(94,198)
Gross settled derivatives – net flows	305	453	244	1,040	1,533	3,575
Net settled derivatives liabilities	39,146	212	1,052	3,132	1,233	44,775
Total derivative financial liabilities	39,451	665	1,296	4,172	2,766	48,350

The Group's financial guarantee contracts are accounted for as financial instruments and measured at fair value on the balance sheet. The majority of the Group's financial guarantee contracts are callable on demand, were the guaranteed party to fail to meet its obligations. It is, however, expected that most guarantees will expire unused. The contractual nominal amounts of these guarantees totalled £8,591 million at 31 December 2013 (2012: £9,520 million) with £4,233 million expiring within one year; £837 million between one and three years; £2,039 million between three and five years; and £1,482 million over five years (2012: £4,865 million expiring within one year; £1,302 million between one and three years; £1,729 million between three and five years; and £1,624 million over five years).

The majority of the Group's non-participating investment contract liabilities are unit-linked. These unit-linked products are invested in accordance with unit fund mandates. Clauses are included in policyholder contracts to permit the deferral of sales, where necessary, so that linked assets can be realised without being a forced seller.

The principal amount for undated subordinated liabilities with no redemption option is included within the over five years column; interest of approximately £85 million (2012: £79 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 171 to 177.

Note 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
At 31 December 2013	**1,088**	**1,391**	**5,231**	**21,468**	**53,599**	**82,777**
At 31 December 2012	989	1,451	5,198	20,426	54,889	82,953

For insurance and participating investment contracts which are neither unit-linked nor in the Group's with-profit funds, in particular annuity liabilities, the aim is to invest in assets such that the cash flows on investments match those on the projected future liabilities.

The following tables set out the amounts and residual maturities of the Group's off balance sheet contingent liabilities and commitments.

	Up to 1 month £m	1-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
At 31 December 2013									
Acceptances and endorsements	**59**	**56**	**9**	**–**	**10**	**15**	**13**	**42**	**204**
Other contingent liabilities	**256**	**501**	**207**	**145**	**464**	**377**	**118**	**608**	**2,676**
Total contingent liabilities	**315**	**557**	**216**	**145**	**474**	**392**	**131**	**650**	**2,880**
Lending commitments	**30,918**	**11,857**	**15,452**	**4,632**	**7,519**	**14,886**	**17,064**	**2,849**	**105,177**
Other commitments	**–**	**–**	**–**	**–**	**494**	**–**	**–**	**–**	**494**
Total commitments	**30,918**	**11,857**	**15,452**	**4,632**	**8,013**	**14,886**	**17,064**	**2,849**	**105,671**
Total contingents and commitments	**31,233**	**12,414**	**15,668**	**4,777**	**8,487**	**15,278**	**17,195**	**3,499**	**108,551**
	Up to 1 month £m	1-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
At 31 December 2012									
Acceptances and endorsements	48	8	17	–	–	–	33	1	107
Other contingent liabilities	375	409	254	113	85	662	144	747	2,789
Total contingent liabilities	423	417	271	113	85	662	177	748	2,896
Lending commitments	44,332	1,288	10,518	3,969	5,632	14,493	17,486	3,676	101,394
Other commitments	–	–	170	153	234	–	–	–	557
Total commitments	44,332	1,288	10,688	4,122	5,856	14,493	17,486	3,676	101,951
Total contingents and commitments	44,755	1,705	10,959	4,235	5,951	15,155	17,663	4,424	104,847

Capital risk

Capital risk is defined as the risk that the Group has a sub-optimal amount or quality of capital or that capital is inefficiently deployed across the Group.

Capital risk appetite is set by the Board, reflecting the Group's strategic plans, regulatory capital constraints and market expectations. It includes a number of minimum capital ratios in normal and stressed conditions as well as a specific measure for the Insurance business, set by the Insurance Board, taking account of the need to maintain regulatory solvency including appropriate management buffers. The Board and the Group Chief Executive, assisted by the Group Asset and Liability Committee and the Group Risk Committee, regularly review performance against the risk appetite. A key metric is the Group's common equity tier 1 (CET1) capital ratio which the Group currently aims to maintain in excess of 10 per cent.

Additionally, a series of stress analyses is undertaken during the year to determine the adequacy of the Group's capital resources in adverse economic scenarios including those provided by the PRA.

Insurance risk

Insurance risk is the risk of reductions in earnings, capital 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.

The Group's appetite for solvency and earnings in insurance entities is reviewed and approved annually by the Board. Insurance risks are measured using a variety of techniques including stress and scenario testing, and, where appropriate, stochastic modelling. Ongoing monitoring is in place to track the progression of insurance risks. This normally involves monitoring relevant experiences against expectations, as well as evaluating the effectiveness of controls put in place to manage insurance risk.

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Note 55: Consolidated cash flow statement

(A) Change in operating assets

	2013 £m	2012[1] £m	2011 £m
Change in loans and receivables	**28,041**	50,773	39,361
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**(6,476)**	524	5,867
Change in other operating assets	**(4,448)**	(3,492)	(1,131)
Change in operating assets	**17,117**	47,805	44,097

(B) Change in operating liabilities

	2013 £m	2012[1] £m	2011 £m
Change in deposits from banks	**(25,529)**	(1,325)	(10,480)
Change in customer deposits	**16,747**	13,392	20,283
Change in debt securities in issue	**(29,032)**	(66,968)	(43,893)
Change in derivative financial instruments, trading and other liabilities at fair value through profit or loss	**(6,258)**	1,497	14,249
Change in investment contract liabilities	**3,171**	7,421	793
Change in other operating liabilities	**(3,369)**	(170)	(139)
Change in operating liabilities	**(44,270)**	(46,153)	(19,187)

[1] Restated – see note 1.

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Note 55: Consolidated cash flow statement (continued)

(C) Non-cash and other items

	2013 £m	2012[1] £m	2011[1] £m
Depreciation and amortisation	1,940	2,126	2,175
Impairment of tangible fixed assets	–	–	65
Revaluation of investment properties	(156)	264	107
Provision for impairment of disposal groups	382	26	–
Allowance for loan losses	2,726	5,121	8,069
Write-off of allowance for loan losses	(5,858)	(7,922)	(7,405)
Impairment of available-for-sale financial assets	15	37	80
Change in insurance contract liabilities	5,300	3,929	(2,081)
Payment protection insurance provision	3,050	3,575	3,200
Other regulatory provisions	405	650	175
Other provision movements	2	(101)	(294)
Net charge in respect of defined benefit schemes	503	110	408
Impact of consolidation and deconsolidation of OEICs[2]	6,303	(829)	(6,094)
Unwind of discount on impairment allowances	(351)	(374)	(226)
Foreign exchange impact on balance sheet[3]	89	(219)	302
Liability management losses (gains) within other income[4]	80	(59)	(599)
Interest expense on subordinated liabilities	2,956	2,783	2,155
(Profit) loss on disposal of businesses	(362)	7	21
Net gain on sale of available-for-sale financial assets	(629)	(3,547)	(343)
Hedging valuation adjustments on subordinated debt	(1,083)	225	1,091
Value of employee services	434	337	363
Issue of shares (non-cash)	160	322	316
Transactions in own shares	(480)	(407)	(276)
Accretion of discounts and amortisation of premiums and issue costs	286	12	151
Share of post-tax results of associates and joint ventures	(43)	(28)	(31)
Transfers to income statement from reserves	(550)	198	(85)
Profit on disposal of tangible fixed assets	(43)	(75)	(36)
Other non-cash items	(26)	(101)	36
Total non-cash items	15,050	6,060	1,244
Contributions to defined benefit schemes	(811)	(675)	(838)
Payments in respect of payment protection insurance provision	(2,674)	(3,299)	(1,045)
Payments in respect of other regulatory provisions	(360)	(20)	(497)
Other	26	15	6
Total other items	(3,819)	(3,979)	(2,374)
Non-cash and other items	11,231	2,081	(1,130)

[1] Restated – see note 1.

[2] These OEICs (Open-ended investment companies) are mutual funds which are consolidated if the Group manages the funds and also has a majority beneficial interest. The population of OEICs to be consolidated varies at each reporting date as external investors acquire and divest holdings in the various funds. The consolidation of these funds is effected by the inclusion of the fund investments and a matching liability to the unitholders; and changes in funds consolidated represent a non-cash movement on the balance sheet.

[3] When considering the movement on each line of the balance sheet, the impact of foreign exchange rate movements is removed in order to show the underlying cash impact.

[4] A number of capital transactions entered into by the Group in 2011 and 2012 involved the exchange of existing securities for new issues and as a result there was no related cash flow.

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Note 55: Consolidated cash flow statement (continued)

(D) Analysis of cash and cash equivalents as shown in the balance sheet

	2013 £m	2012[2] £m	2011[2] £m
Cash and balances at central banks	49,915	80,298	60,722
Less: mandatory reserve deposits[1]	(937)	(580)	(1,070)
	48,978	79,718	59,652
Loans and advances to banks	25,365	32,757	32,877
Less: amounts with a maturity of three months or more	(7,546)	(11,417)	(6,640)
	17,819	21,340	26,237
Total cash and cash equivalents	66,797	101,058	85,889

[1] 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.
[2] Restated – see note 1.

Included within cash and cash equivalents at 31 December 2013 is £14,058 million (2012: £17,889 million; 2011: £21,601 million) held within the Group's life funds, which is not immediately available for use in the business.

(E) Acquisition of group undertakings and businesses

	2013 £m	2012 £m	2011 £m
Net cash outflow arising from acquisitions of and additional investment in joint ventures in the year	(6)	(11)	(10)
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	–	–	(3)
Net cash outflow	(6)	(11)	(13)

(F) Disposal and closure of group undertakings and businesses

	2013 £m	2012 £m	2011 £m
Trading and other assets at fair value through profit or loss	35,159	–	134
Loans and advances to customers	2,612	15	24
Loans and advances to banks	1,701	16	–
Investment property	582	–	–
Value of in-force business	831	–	–
Other intangible assets	251	–	–
Tangible fixed assets	67	–	147
	41,203	31	305
Customer deposits	(1,923)	–	–
Debt securities in issue	(264)	–	–
Liabilities arising from insurance contracts and participating investment contracts	(451)	–	–
Liabilities arising from non-participating investment contracts	(29,953)	–	–
Non-controlling interests	(357)	(38)	(197)
Other net assets (liabilities)	(6,160)	51	211
	(39,108)	13	14
Net assets	2,095	44	319
Cash and cash equivalents disposed	(1,702)	–	–
Non-cash consideration received	(59)	–	–
Profit (loss) on sale	362	(7)	(21)
Net cash inflow (outflow)	696	37	298

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Note 56: Restatement of prior period information

As explained in note 1, the Group has adopted IFRS 10 *Consolidated Financial Statements* and Amendments to IAS 19 *Employee Benefits* (IAS 19R) on 1 January 2013.

The Group has restated information for the preceding comparative periods.

The following tables summarise the adjustments arising on the adoption of IAS 19R and IFRS 10 to the Group's:

– income statements, statements of comprehensive income and statements of cash flows for the year ended 31 December 2012 and the year ended 31 December 2011; and

– balance sheets at 31 December 2012, 31 December 2011 and 1 January 2011.

Consolidated income statement – year ended 31 December 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Interest and similar income	23,535	13	–	23,548
Interest and similar expense	(14,460)	(1,370)	–	(15,830)
Net interest income	9,075	(1,357)	–	7,718
Fee and commission income	4,731	(81)	–	4,650
Fee and commission expense	(1,438)	(6)	–	(1,444)
Net fee and commission income	3,293	(87)	–	3,206
Net trading income	13,554	1,451	–	15,005
Insurance premium income	8,284	–	–	8,284
Other operating income	4,700	–	–	4,700
Other income	29,831	1,364	–	31,195
Total income	38,906	7	–	38,913
Insurance claims	(18,396)	–	–	(18,396)
Total income, net of insurance claims	20,510	7	–	20,517
Regulatory provisions	(4,175)	–	–	(4,175)
Other operating expenses	(11,756)	(1)	(42)	(11,799)
Total operating expenses	(15,931)	(1)	(42)	(15,974)
Trading surplus	4,579	6	(42)	4,543
Impairment	(5,149)	–	–	(5,149)
(Loss) profit before tax	(570)	6	(42)	(606)
Taxation	(773)	(6)	(2)	(781)
Loss for the year	(1,343)	–	(44)	(1,387)
Profit attributable to non-controlling interests	84	–	–	84
Loss attributable to equity shareholders	(1,427)	–	(44)	(1,471)
Loss for the year	(1,343)	–	(44)	(1,387)
Basic loss per share	(2.0)p			(2.1)p
Diluted loss per share	(2.0)p			(2.1)p

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 56: Restatement of prior period information (continued)

Consolidated statement of comprehensive income – year ended 31 December 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Loss for the year	(1,343)	–	(44)	(1,387)
Other comprehensive income				
Items that will not subsequently be reclassified to profit or loss:				
Post-retirement defined benefit scheme remeasurements:				
Remeasurements before taxation	–	–	(2,136)	(2,136)
Taxation	–	–	491	491
	–	–	(1,645)	(1,645)
Items that may subsequently be reclassified to profit or loss:				
Movements in revaluation reserve in respect of available-for-sale financial assets:				
Adjustments on transfers from held-to-maturity portfolio	1,168	–	–	1,168
Change in fair value	900	–	–	900
Income statement transfers in respect of disposals	(3,547)	–	–	(3,547)
Income statement transfers in respect of impairment	42	–	–	42
Other income statement transfers	169	–	–	169
Taxation	339	–	–	339
	(929)	–	–	(929)
Movements in cash flow hedging reserve:				
Effective portion of changes in fair value	116	–	–	116
Net income statement transfers	(92)	–	–	(92)
Taxation	1	–	–	1
	25	–	–	25
Currency translation differences (tax: nil)	(14)	–	–	(14)
Other comprehensive income for the year, net of tax	(918)	–	(1,645)	(2,563)
Total comprehensive income for the year	(2,261)	–	(1,689)	(3,950)
Total comprehensive income attributable to non-controlling interests	82	–	–	82
Total comprehensive income attributable to equity shareholders	(2,343)	–	(1,689)	(4,032)
Total comprehensive income for the year	(2,261)	–	(1,689)	(3,950)

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Note 56: Restatement of prior period information (continued)

Consolidated cash flow statement – year ended 31 December 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
(Loss) profit before tax	(570)	6	(42)	(606)
Adjustments for:				
Change in operating assets	48,333	(528)	–	47,805
Change in operating liabilities	(46,681)	528	–	(46,153)
Non-cash and other items	2,045	(6)	42	2,081
Tax paid	(78)	–	–	(78)
Net cash provided by operating activities	3,049	–	–	3,049
Cash flows from investing activities				
Purchase of financial assets	(22,050)	–	–	(22,050)
Proceeds from sale and maturity of financial assets	37,664	–	–	37,664
Purchase of fixed assets	(3,003)	–	–	(3,003)
Proceeds from sale of fixed assets	2,595	–	–	2,595
Acquisition of businesses, net of cash acquired	(11)	–	–	(11)
Disposal of businesses, net of cash disposed	37	–	–	37
Net cash provided by investing activities	15,232	–	–	15,232
Cash flows from financing activities				
Dividends paid to non-controlling interests	(56)	–	–	(56)
Interest paid on subordinated liabilities	(2,577)	–	–	(2,577)
Proceeds from issue of ordinary shares	170	–	–	170
Repayment of subordinated liabilities	(664)	–	–	(664)
Change in non-controlling interests	23	–	–	23
Net cash used in financing activities	(3,104)	–	–	(3,104)
Effects of exchange rate changes on cash and cash equivalents	(8)	–	–	(8)
Change in cash and cash equivalents	15,169	–	–	15,169
Cash and cash equivalents at beginning of year	85,889	–	–	85,889
Cash and cash equivalents at end of year	101,058	–	–	101,058

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 56: Restatement of prior period information (continued)

Consolidated balance sheet at 31 December 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Assets				
Cash and balances at central banks	80,298	–	–	80,298
Items in course of collection from banks	1,256	–	–	1,256
Trading and other financial assets at fair value through profit or loss	153,990	6,630	–	160,620
Derivative financial instruments	56,550	7	–	56,557
Loans and receivables:				
Loans and advances to banks	29,417	3,340	–	32,757
Loans and advances to customers	517,225	–	–	517,225
Debt securities	5,273	–	–	5,273
	551,915	3,340	–	555,255
Available-for-sale financial assets	31,374	–	–	31,374
Investment properties	5,405	–	–	5,405
Goodwill	2,016	–	–	2,016
Value of in-force business	6,800	–	–	6,800
Other intangible assets	2,792	–	–	2,792
Tangible fixed assets	7,342	–	–	7,342
Current tax recoverable	354	–	–	354
Deferred tax assets	4,285	–	628	4,913
Retirement benefit assets	1,867	–	(1,126)	741
Other assets	18,308	190	–	18,498
Total assets	924,552	10,167	(498)	934,221

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Note 56: Restatement of prior period information (continued)

Consolidated balance sheet at 31 December 2012 (continued)

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Equity and liabilities				
Liabilities				
Deposits from banks	38,405	–	–	38,405
Customer deposits	426,912	–	–	426,912
Items in course of transmission to banks	996	–	–	996
Trading and other financial liabilities at fair value through profit or loss	35,972	(2,580)	–	33,392
Derivative financial instruments	48,665	11	–	48,676
Notes in circulation	1,198	–	–	1,198
Debt securities in issue	117,369	(116)	–	117,253
Liabilities arising from insurance contracts and participating investment contracts	82,953	–	–	82,953
Liabilities arising from non-participating investment contracts	54,372	–	–	54,372
Unallocated surplus within insurance businesses	267	–	–	267
Other liabilities	33,941	12,852	–	46,793
Retirement benefit obligations	300	–	1,605	1,905
Current tax liabilities	138	–	–	138
Deferred tax liabilities	327	–	–	327
Other provisions	3,961	–	–	3,961
Subordinated liabilities	34,092	–	–	34,092
Total liabilities	879,868	10,167	1,605	891,640
Equity				
Share capital	7,042	–	–	7,042
Share premium account	16,872	–	–	16,872
Other reserves	12,902	–	–	12,902
Retained profits	7,183	–	(2,103)	5,080
Shareholders' equity	43,999	–	(2,103)	41,896
Non-controlling interests	685	–	–	685
Total equity	44,684	–	(2,103)	42,581
Total equity and liabilities	924,552	10,167	(498)	934,221

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 56: Restatement of prior period information (continued)

Consolidated income statement – year ended 31 December 2011

	As previously reported £m	IAS 19 Revised £ m	Restated £m
Interest and similar income	26,316	–	26,316
Interest and similar expense	(13,618)	–	(13,618)
Net interest income	12,698	–	12,698
Fee and commission income	4,935	–	4,935
Fee and commission expense	(1,391)	–	(1,391)
Net fee and commission income	3,544	–	3,544
Net trading income	(368)	–	(368)
Insurance premium income	8,170	–	8,170
Other operating income	2,799	–	2,799
Other income	14,145	–	14,145
Total income	26,843	–	26,843
Insurance claims	(6,041)	–	(6,041)
Total income, net of insurance claims	20,802	–	20,802
Regulatory provisions	(3,375)	–	(3,375)
Other operating expenses	(12,875)	(209)	(13,084)
Total operating expenses	(16,250)	(209)	(16,459)
Trading surplus	4,552	(209)	4,343
Impairment	(8,094)	–	(8,094)
Profit (loss) before tax	(3,542)	(209)	(3,751)
Taxation	828	33	861
Profit (loss) for the year	(2,714)	(176)	(2,890)
Profit attributable to non-controlling interests	73	–	73
Profit (loss) attributable to equity shareholders	(2,787)	(176)	(2,963)
Profit (loss) for the year	(2,714)	(176)	(2,890)
Basic loss per share	(4.1)p		(4.3)p
Diluted loss per share	(4.1)p		(4.3)p

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Note 56: Restatement of prior period information (continued)

Consolidated statement of comprehensive income – year ended 31 December 2011

	As previously reported £m	IAS 19 Revised £m	Restated £m
Loss for the year	(2,714)	(176)	(2,890)
Other comprehensive income			
Items that will not subsequently be reclassified to profit or loss:			
Post-retirement defined benefit scheme remeasurements			
Remeasurement before taxation	–	624	624
Taxation	–	(155)	(155)
	–	469	469
Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	2,527	–	2,527
Income statement transfers in respect of disposals	(343)	–	(343)
Income statement transfers in respect of impairment	80	–	80
Other income statement transfers	(79)	–	(79)
Taxation	(575)	–	(575)
	1,610	–	1,610
Movements in cash flow hedging reserve:			
Effective portion of changes in fair value	916	–	916
Net income statement transfers	70	–	70
Taxation	(270)	–	(270)
	716	–	716
Currency translation differences (tax: nil)	(84)	–	(84)
Other comprehensive income for the year, net of tax	2,242	469	2,711
Total comprehensive income for the year	(472)	293	(179)
Total comprehensive income attributable to non-controlling interests	72	–	72
Total comprehensive income attributable to equity shareholders	(544)	293	(251)
Total comprehensive income for the year	(472)	293	(179)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 56: Restatement of prior period information (continued)

Consolidated cash flow statement – year ended 31 December 2011

	As previously reported £m	IAS 19 Revised £m	Restated £m
Profit (loss) before tax	(3,542)	(209)	(3,751)
Adjustments for:			
Change in operating assets	44,097	–	44,097
Change in operating liabilities	(19,187)	–	(19,187)
Non-cash and other items	(1,339)	209	(1,130)
Tax paid	(136)	–	(136)
Net cash provided by operating activities	19,893	–	19,893
Cash flows from investing activities			
Purchase of financial assets	(28,995)	–	(28,995)
Proceeds from sale and maturity of financial assets	36,523	–	36,523
Purchase of fixed assets	(3,095)	–	(3,095)
Proceeds from sale of fixed assets	2,214	–	2,214
Acquisition of businesses, net of cash acquired	(13)	–	(13)
Disposal of businesses, net of cash disposed	298	–	298
Net cash provided by (used in) investing activities	6,932	–	6,932
Cash flows from financing activities			
Dividends paid to non-controlling interests	(50)	–	(50)
Interest paid on subordinated liabilities	(2,126)	–	(2,126)
Proceeds from issue of ordinary shares	–	–	–
Repayment of subordinated liabilities	(1,074)	–	(1,074)
Change in non-controlling interests	8	–	8
Net cash used in financing activities	(3,242)	–	(3,242)
Effects of exchange rate changes on cash and cash equivalents	6	–	6
Change in cash and cash equivalents	23,589	–	23,589
Cash and cash equivalents at beginning of year	62,300	–	62,300
Cash and cash equivalents at end of year	85,889	–	85,889

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Note 56: Restatement of prior period information (continued)

Consolidated balance sheet at 1 January 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Assets				
Cash and balances at central banks	60,722	–	–	60,722
Items in course of collection from banks	1,408	–	–	1,408
Trading and other financial assets at fair value through profit or loss	139,510	9,104	–	148,614
Derivative financial instruments	66,013	60	–	66,073
Loans and receivables:				
Loans and advances to banks	32,606	271	–	32,877
Loans and advances to customers	565,638	–	–	565,638
Debt securities	12,470	–	–	12,470
	610,714	271	–	610,985
Available-for-sale financial assets	37,406	–	–	37,406
Held-to-maturity investments	8,098	–	–	8,098
Investment properties	6,122	–	–	6,122
Goodwill	2,016	–	–	2,016
Value of in-force business	6,638	–	–	6,638
Other intangible assets	3,196	–	–	3,196
Tangible fixed assets	7,673	–	–	7,673
Current tax recoverable	434	–	–	434
Deferred tax assets	4,496	–	139	4,635
Retirement benefit assets	1,338	–	(76)	1,262
Other assets	14,762	204	–	14,966
Total assets	970,546	9,639	63	980,248

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 56: Restatement of prior period information (continued)

Consolidated balance sheet at 1 January 2012 (continued)

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Equity and liabilities				
Liabilities				
Deposits from banks	39,810	–	–	39,810
Customer deposits	413,906	–	–	413,906
Items in course of transmission to banks	844	–	–	844
Trading and other financial liabilities at fair value through profit or loss	24,955	(2,598)	–	22,357
Derivative financial instruments	58,212	53	–	58,265
Notes in circulation	1,145	–	–	1,145
Debt securities in issue	185,059	(95)	–	184,964
Liabilities arising from insurance contracts and participating investment contracts	78,991	–	–	78,991
Liabilities arising from non-participating investment contracts	49,636	–	–	49,636
Unallocated surplus within insurance businesses	300	–	–	300
Other liabilities	32,041	12,279	–	44,320
Retirement benefit obligations	381	–	477	858
Current tax liabilities	103	–	–	103
Deferred tax liabilities	314	–	–	314
Other provisions	3,166	–	–	3,166
Subordinated liabilities	35,089	–	–	35,089
Total liabilities	923,952	9,639	477	934,068
Equity				
Share capital	6,881	–	–	6,881
Share premium account	16,541	–	–	16,541
Other reserves	13,818	–	–	13,818
Retained profits	8,680	–	(414)	8,266
Shareholders' equity	45,920	–	(414)	45,506
Non-controlling interests	674	–	–	674
Total equity	46,594	–	(414)	46,180
Total equity and liabilities	970,546	9,639	63	980,248

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Note 56: Restatement of prior period information (continued)

Consolidated balance sheet at 1 January 2011

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Assets				
Cash and balances at central banks	38,115	–	–	38,115
Items in course of collection from banks	1,368	–	–	1,368
Trading and other financial assets at fair value through profit or loss	156,191	–	–	156,191
Derivative financial instruments	50,777	–	–	50,777
Loans and receivables:		–	–	
Loans and advances to banks	30,272	–	–	30,272
Loans and advances to customers	592,597	–	–	592,597
Debt securities	25,735	–	–	25,735
	648,604	–	–	648,604
Available-for-sale financial assets	42,955	–	–	42,955
Held-to-maturity investments	7,905	–	–	7,905
Investment properties	5,997	–	–	5,997
Goodwill	2,016	–	–	2,016
Value of in-force business	7,367	–	–	7,367
Other intangible assets	3,496	–	–	3,496
Tangible fixed assets	8,190	–	–	8,190
Current tax recoverable	621	–	–	621
Deferred tax assets	4,164	–	261	4,425
Retirement benefit assets	736	–	(430)	306
Other assets	13,072	–	–	13,072
Total assets	991,574	–	(169)	991,405

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 56: Restatement of prior period information (continued)

Consolidated balance sheet at 1 January 2011 (continued)

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Equity and liabilities				
Liabilities				
Deposits from banks	50,363	–	–	50,363
Customer deposits	393,633	–	–	393,633
Items in course of transmission to banks	802	–	–	802
Trading and other financial liabilities at fair value through profit or loss	26,762	–	–	26,762
Derivative financial instruments	42,158	–	–	42,158
Notes in circulation	1,074	–	–	1,074
Debt securities in issue	228,866	–	–	228,866
Liabilities arising from insurance contracts and participating investment contracts	80,729	–	–	80,729
Liabilities arising from non-participating investment contracts	51,363	–	–	51,363
Unallocated surplus within insurance businesses	643	–	–	643
Other liabilities	29,696	–	–	29,696
Retirement benefit obligations	423	–	538	961
Current tax liabilities	149	–	–	149
Deferred tax liabilities	247	–	–	247
Other provisions	1,532	–	–	1,532
Subordinated liabilities	36,232	–	–	36,232
Total liabilities	944,672	–	538	945,210
Equity				
Share capital	6,815	–	–	6,815
Share premium account	16,291	–	–	16,291
Other reserves	11,575	–	–	11,575
Retained profits	11,380	–	(707)	10,673
Shareholders' equity	46,061	–	(707)	45,354
Non-controlling interests	841	–	–	841
Total equity	46,902	–	(707)	46,195
Total equity and liabilities	991,574	–	(169)	991,405

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Note 57: Future accounting developments

The following pronouncements may have a significant effect on the Group's financial statements but are not applicable for the year ending 31 December 2013 and have not been applied in preparing these financial statements. Save as disclosed below, the full impact of these accounting changes is being assessed by the Group.

Pronouncement	Nature of change	IASB effective date
Amendment to IAS 32 *Financial Instruments: Presentation – 'Offsetting Financial Assets and Financial Liabilities'*	Inserts application guidance to address inconsistencies identified in applying the offsetting criteria used in the standard. Some gross settlement systems may qualify for offsetting where they exhibit certain characteristics akin to net settlement. This amendment is not expected to have a significant impact on the Group.	Annual periods beginning on or after 1 January 2014.
Amendments to IAS 39 *Financial Instruments: Recognition and Measurement – 'Novation of Derivatives and Continuation of Hedge Accounting'*	Provides relief from discontinuing hedge accounting in circumstances where a derivative designated as a hedging instrument is novated to a central counterparty as a consequence or introduction of laws or regulations. These amendments are not expected to have a significant impact on the Group.	Annual periods beginning on or after 1 January 2014.
IFRIC 21 *Levies*[1]	Clarifies that the obligating event that gives rise to a liability to pay a government levy is the activity that triggers the payment of the levy as set out in the relevant legislation. An entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period. This interpretation is not expected to have a significant impact on the Group.	Annual periods beginning on or after 1 January 2014.
IFRS 9 *Financial Instruments*[1,2]	Replaces those parts of IAS 39 *Financial Instruments: Recognition and Measurement* relating to the classification, measurement and derecognition of financial assets and liabilities. IFRS 9 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 instruments and eliminates the available-for-sale financial asset and held-to-maturity investment categories in IAS 39. The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to the entity's own credit risk is recorded in other comprehensive income. The hedge accounting requirements are more closely aligned with risk management practices and follow a more principle-based approach.	Date yet to be determined.

[1] As at 5 March 2014, these pronouncements are awaiting EU endorsement.

[2] IFRS 9 is the standard which will replace IAS 39. Further changes to IFRS 9 are expected dealing with impairment of financial assets measured at amortised cost, which will be based on expected rather than incurred credit losses, and limited amendments to classification and measurement which include the introduction of a third measurement category, fair value through other comprehensive income. Until the standard is complete, it is not possible to determine the overall impact of the standard on the financial statements.

Note 58: Approval of financial statements

The consolidated financial statements were approved by the Directors of Lloyds Banking Group plc on 5 March 2014.

PARENT COMPANY BALANCE SHEET

	Note	2013 £ million	2012 £ million
Assets			
Non-current assets:			
Investment in subsidiaries	9	**40,933**	40,534
Loans to subsidiaries	9	**11,043**	8,123
Deferred tax asset	2	**4**	9
		51,980	48,666
Current assets:			
Derivative financial instruments		**1,452**	1,693
Other assets		**1,171**	974
Amounts due from subsidiaries	3	**67**	147
Cash and cash equivalents		**511**	2,231
Current tax recoverable		**19**	–
		3,220	5,045
Total assets		**55,200**	53,711
Equity and liabilities			
Capital and reserves:			
Share capital	4	**7,145**	7,042
Share premium account	4	**17,279**	16,872
Merger reserve	5	**7,764**	7,764
Capital redemption reserve	5	**4,115**	4,115
Retained profits	6	**1,414**	2,017
Total equity		**37,717**	37,810
Non-current liabilities:			
Debt securities in issue	8	**535**	545
Subordinated liabilities	7	**1,669**	4,349
		2,204	4,894
Current liabilities:			
Current tax liabilities		**–**	266
Other liabilities		**15,279**	10,741
		15,279	11,007
Total liabilities		**17,483**	15,901
Total equity and liabilities		**55,200**	53,711

The accompanying notes are an integral part of the parent company financial statements.

The directors approved the parent company financial statements on 5 March 2014.

Sir Winfried Bischoff
Chairman

António Horta-Osório
Group Chief Executive

George Culmer
Chief Financial Officer

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PARENT COMPANY STATEMENT OF CHANGES IN EQUITY

at 31 December

	Share capital and premium £ million	Merger reserve £ million	Capital redemption reserve £ million	Retained profits[1] £ million	Total £ million
Balance at 1 January 2011	23,106	7,764	4,115	2,276	37,261
Total comprehensive income[1]	–	–	–	(168)	(168)
Issue of ordinary shares	316	–	–	–	316
Cancellation of deferred shares					
Redemption of preference shares					
Movement in treasury shares	–	–	–	(291)	(291)
Value of employee services:					
Share option schemes	–	–	–	143	143
Other employee award schemes	–	–	–	238	238
Balance at 31 December 2011	23,422	7,764	4,115	2,198	37,499
Total comprehensive income[1]	–	–	–	(224)	(224)
Issue of ordinary shares	492	–	–	–	492
Movement in treasury shares	–	–	–	(282)	(282)
Value of employee services:					
Share option schemes	–	–	–	69	69
Other employee award schemes	–	–	–	256	256
Balance at 31 December 2012	23,914	7,764	4,115	2,017	37,810
Total comprehensive income[1]	–	–	–	(846)	(846)
Issue of ordinary shares	510	–	–	–	510
Movement in treasury shares	–	–	–	(165)	(165)
Value of employee services:					
Share option schemes	–	–	–	116	116
Other employee award schemes	–	–	–	292	292
Balance at 31 December 2013	**24,424**	**7,764**	**4,115**	**1,414**	**37,717**

[1] Total comprehensive income comprises only the profit (loss) for the year; no statement of comprehensive income has been shown for the parent company, as permitted by section 408 of the Companies Act 2006.

PARENT COMPANY CASH FLOW STATEMENT

	2013 £ million	2012 £ million	2011 £ million
Loss before tax	(1,090)	(259)	(202)
Fair value and exchange adjustments and other non-cash items	137	245	329
Change in other assets	124	14	255
Change in other liabilities and other items	4,699	750	2,576
Tax (paid) received	(35)	290	151
Net cash provided by (used in) operating activities	3,835	1,040	3,109
Cash flows from investing activities			
Capital injection into Lloyds Bank plc	–	–	(2,340)
Amounts advanced to subsidiaries	(3,082)	–	–
Redemption of loans to subsidiaries	197	209	–
Net cash (used in) provided by investing activities	(2,885)	209	(2,340)
Cash flows from financing activities			
Interest paid on subordinated liabilities	(253)	(293)	(39)
Repayment of subordinated liabilities	(2,767)	–	–
Proceeds from issue of ordinary shares	350	170	–
Net cash used in financing activities	(2,670)	(123)	(39)
Change in cash and cash equivalents	(1,720)	1,126	730
Cash and cash equivalents at beginning of year	2,231	1,105	375
Cash and cash equivalents at end of year	511	2,231	1,105

The accompanying notes are an integral part of the parent company financial statements.

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NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

Note 1: Accounting policies

The Company has applied International Financial Reporting Standards as adopted by the European Union in its financial statements for the year ended 31 December 2013. 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 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.

Note 2: Deferred tax asset

The movement in the net deferred tax asset is as follows:

	2013 £m	2012 £m
At 1 January	**9**	8
Income statement (charge) credit	**(5)**	1
At 31 December	**4**	9

The deferred tax asset relates to temporary differences.

Note 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.

Note 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.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

Note 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 and amounts transferred from share capital following the cancellation of the deferred shares.

Movements in other reserves were as follows:

	2013 £m	2012 £m	2011 £m
Merger reserve			
At 1 January and 31 December	**7,764**	7,764	7,764

	2013 £m	2012 £m	2011 £m
Capital redemption reserve			
At 1 January and 31 December	**4,115**	4,115	4,115

Note 6: Retained profits

	£m
At 1 January 2011	2,276
Loss for the year	(168)
Movement in treasury shares	(291)
Value of employee services:	
Share option schemes	143
Other employee award schemes	238
At 31 December 2011	2,198
Loss for the year	(224)
Movement in treasury shares	(282)
Value of employee services:	
Share option schemes	69
Other employee award schemes	256
At 31 December 2012	2,017
Loss for the year	**(846)**
Movement in treasury shares	**(165)**
Value of employee services:	
Share option schemes	**116**
Other employee award schemes	**292**
At 31 December 2013	**1,414**

Details of the Company's dividends are as set out in note 49 to the consolidated financial statements.

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Note 7: Subordinated liabilities

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 Prudential Regulatory Authority.

	Note	2013 £m	2012 £m
Preference shares			
6% Non-Cumulative Redeemable Preference Shares	a	–	–
7.875% Non-Cumulative Preference Shares callable 2013 (US$1,250 million)	a	–	204
7.875% Non-Cumulative Preference Shares callable 2013 (€500 million)	a	–	105
6.0884% Non-Cumulative Fixed to Floating Rate Preference Shares callable 2015 (£745 million)	a	10	10
5.92% Non-Cumulative Fixed to Floating Rate Preference Shares callable 2015 (US$750 million)	a	123	119
6.267% Non-Cumulative Fixed to Floating Rate Preference Shares callable 2016 (US$1,000 million)	a	274	284
6.3673% Non-Cumulative Fixed to Floating Rate Preference Shares callable 2019 (£335 million)	a	2	2
6.475% Non-Cumulative Preference Shares callable 2024 (£186 million)	a	39	39
6.413% Non-Cumulative Fixed to Floating Rate Preference Shares callable 2035 (US$750 million)	a	108	107
6.657% Non-Cumulative Fixed to Floating Rate Preference Shares callable 2037 (US$750 million)	a	125	125
9.25% Non-Cumulative Irredeemable Preference Shares (£300 million)	a	266	266
9.75% Non-Cumulative Irredeemable Preference Shares (£100 million)	a	54	54
Total preference shares		**1,001**	1,315
Undated subordinated liabilities			
6.0884% Undated Subordinated Notes callable 2015 (£732 million)		–	668
6.369% Undated Subordinated Notes callable 2015 (£597 million)		–	551
5.92% Undated Subordinated Notes callable 2015 (US$378 million)		–	200
6.267% Undated Subordinated Notes callable 2016 (US$466 million)		–	237
6.3673% Undated Subordinated Notes callable 2019 (£331 million)		–	296
6.475% Undated Subordinated Notes callable 2024 (£102 million)		–	88
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	b	10	10
6.413% Undated Subordinated Notes callable 2035 (US$375 million)		–	172
6.657% Undated Subordinated Notes callable 2037 (US$316 million)		–	143
Total undated subordinated liabilities		**10**	2,365
Dated subordinated liabilities			
5.875% Subordinated Guaranteed Bonds 2014 (€750 million)		658	669
Total dated subordinated liabilities		**658**	669
Total subordinated liabilities		**1,669**	4,349

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. Further information regarding this can be found in note 44 to the consolidated financial statements.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

Note 8: Debt securities in issue

These comprise US$862.5 million 7.75% Public Income Notes due 2050 issued by the Company in July 2010.

Note 9: Related party transactions

In January 2009 HM Treasury became a related party of the Company and has remained so during 2012 and 2013. From 1 January 2011, in accordance with IAS 24, UK Government-controlled entities also became related parties of the Group. Further information on the relationship and transactions with HM Treasury and UK Government-controlled entities is given in note 51 to the consolidated financial statements.

Key management personnel

The key management personnel of the Group and the Company are the same. The relevant disclosures are given in note 51 to the consolidated financial statements.

The Company has no employees (2012: nil).

As discussed in note 2 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

	2013 £m	2012 £m
At 1 January	**40,534**	40,534
Capital contribution	**399**	–
At 31 December	**40,933**	40,534

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:

	Share class	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Lloyds Bank plc (formerly Lloyds TSB Bank plc)	Ordinary	England	100%	Banking and financial services
Scottish Widows plc	Ordinary	Scotland	100%[1]	Life assurance
HBOS plc	Ordinary	Scotland	100%[1]	Holding company
Bank of Scotland plc	Ordinary	Scotland	100%[1]	Banking and financial services
TSB Bank plc (formerly Lloyds TSB Scotland plc)	Ordinary	Scotland	100%[1]	Banking and financial services
St. Andrew's Insurance plc	Ordinary	England	100%[1]	General insurance
Clerical Medical Investment Group Limited	Ordinary	England	100%[1]	Life assurance
Clerical Medical Managed Funds Limited	Ordinary	England	100%[1]	Life assurance

[1] Indirect interest.

The principal area of operation for each of the above subsidiaries is the United Kingdom.

A full list of subsidiaries will be included in the Company's next annual return, the Company having made use of the exemption in section 410 of the Companies Act 2006.

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Note 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's preference shares and preferred securities for the two year period from 31 January 2010 to 31 January 2012. The Group also 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 could have been 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 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

	2013 £m	2012 £m
At 1 January	**8,123**	8,286
Exchange and other adjustments	**35**	46
New issues	**3,082**	–
Redemptions	**(197)**	(209)
At 31 December	**11,043**	8,123

In addition the Company carries out banking activities through its subsidiary, Lloyds Bank plc. At 31 December 2013, the Company held deposits of £511 million with Lloyds Bank plc (2012: £2,231 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 £nil (2012: £2,355 million) and within other liabilities is £14,821 million (2012: £10,630 million) due to subsidiary undertakings. In addition, at 31 December 2013 the Company had interest rate and currency swaps with Lloyds Bank plc with an aggregate notional principal amount of £2,454 million and a net positive fair value of £1,452 million (2012: notional principal amount of £2,442 million and a net positive fair value of £1,693 million). Of this amount an aggregate notional principal amount of £1,854 million and a net positive fair value of £226 million (2012: notional principal amount of £1,842 million and a net positive fair value of £260 million) were designated as fair value hedges to manage the Company's issuance of subordinated liabilities and debt securities in issue.

A further notional principal amount of £600 million and a net positive fair value of £13 million (2012: notional principal amount of £600 million and a net positive fair value of £14 million) of this amount were designated as cash flow hedges.

Guarantees

The Company guarantees certain of its subsidiaries' liabilities to the Bank of England.

Other related party transactions

Related party information in respect of other related party transactions is given in note 51 to the consolidated financial statements.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

Note 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 Company's 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
At 31 December 2013					
Financial assets:					
Cash and cash equivalents	–	–	–	511	511
Derivative financial instruments	240	1,212	–	–	1,452
Loans to subsidiaries	–	–	11,043	–	11,043
Amounts due from subsidiaries	–	–	67	–	67
Total financial assets	240	1,212	11,110	511	13,073
Financial liabilities:					
Debt securities in issue	–	–	–	535	535
Subordinated liabilities	–	–	–	1,669	1,669
Total financial liabilities	–	–	–	2,204	2,204
At 31 December 2012					
Financial assets:					
Cash and cash equivalents	–	–	–	2,231	2,231
Derivative financial instruments	272	1,421	–	–	1,693
Loans to subsidiaries	–	–	8,123	–	8,123
Amounts due from subsidiaries	–	–	147	–	147
Total financial assets	272	1,421	8,270	2,231	12,194
Financial liabilities:					
Debt securities in issue	–	–	–	545	545
Subordinated liabilities	–	–	–	4,349	4,349
Total financial liabilities	–	–	–	4,894	4,894

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. The derivative assets classified as held for trading (not being designated as hedging instruments) shown above represent level 3 portfolios. The level 3 derivatives reflect the value 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.

The following reconciliation shows the movements in derivative financial instrument assets within level 3 portfolios:

	2013 £m	2012 £m
At 1 January	1,421	1,172
(Losses) gains recognised in the income statement	(209)	249
At 31 December	1,212	1,421

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 Bank plc, to manage these risks.

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Note 10: Financial instruments (continued)

Credit risk

The majority of the Company's credit risk arises from amounts due from its wholly owned subsidiary, Lloyds Bank plc, and subsidiaries of that company.

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
At 31 December 2013						
Debt securities in issue	10	–	30	562	–	602
Subordinated liabilities	–	2	128	697	1,509	2,336
Total financial instrument liabilities	10	2	158	1,259	1,509	2,938
At 31 December 2012						
Debt securities in issue	10	–	31	616	–	657
Subordinated liabilities	–	24	308	3,675	1,785	5,792
Total financial instrument liabilities	10	24	339	4,291	1,785	6,449

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £1 million (2012: £296 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.

	2013		2012	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets:				
Cash and cash equivalents	511	511	2,231	2,231
Derivative financial instruments	1,452	1,452	1,693	1,693
Loans to subsidiaries	11,043	10,988	8,123	8,318
Amounts due from subsidiaries	67	67	147	147
Financial liabilities:				
Debt securities in issue	535	535	545	545
Subordinated liabilities	1,669	1,959	4,349	4,711

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

Note 10: Financial instruments (continued)

Valuation hierarchy

The table below analyses the assets and liabilities of the Company. With the exception of derivatives all assets and liabilities are held at amortised cost. They are categorised into levels 1 to 3 based on the degree to which their fair value is observable.

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2013				
Cash and cash equivalents	–	–	511	511
Derivative financial instruments	–	240	1,212	1,452
Loans to subsidiaries	–	11,043	–	11,043
Amounts due from subsidiaries	–	67	–	67
Total financial assets	–	11,350	1,723	13,073
Debt securities in issue	–	535	–	535
Subordinated liabilities	–	1,669	–	1,669
Total financial liabilities	–	2,204	–	2,204

Comparatives have not been provided as this disclosure was not required in 2012.

There were no significant movements in level 3 assets carried at fair value in 2013 and 2012.

Sensitivity of level 3 valuations

	Valuation technique(s)	Significant unobservable inputs[1]	Carrying value £m	Effect of reasonably possible alternative assumptions[2] Favourable changes £m	Unfavourable changes £m
Financial assets carried at fair value at December 2013					
Derivative financial assets					
Embedded equity conversion feature	Lead manager or broker quote	Equity conversion feature spread (199 bps/420 bps)	1,212	59	(58)
			1,212		
Financial assets carried at fair value at December 2012					
Derivative financial assets					
Embedded equity conversion feature	Lead manager or broker quote	Equity conversion feature spread	1,421	63	–
			1,421		

[1] For the year ended 2013 ranges are shown where appropriate and represent the highest and lowest inputs used in the level 3 valuations. For the year ended 2012 ranges are not shown as these were not required in 2012.

[2] Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

Note 11: Approval of the financial statements and other information

The parent company financial statements were approved by the directors of Lloyds Banking Group plc on 5 March 2014.

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.

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SHAREHOLDER INFORMATION

Annual general meeting

The annual general meeting will be held at the Edinburgh International Conference Centre, The Exchange, Edinburgh EH3 8EE on Thursday 15 May 2014 at 11.00 am. Further details about the meeting, including the proposed resolutions, can be found in our notice of annual general meeting which will be available shortly on our website www.lloydsbankinggroup.com

Shareholder enquiries including the Lloyds Banking Group Shareholder Account

For queries about your shareholding or to tell us about changes to your circumstances, please contact Equiniti Limited using the details shown below. Equiniti Limited maintain shareholder records on our behalf and deal with shareholder enquiries either in writing or by telephone:

Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA

Telephone 0871 384 2990
Textphone 0871 384 2255
Overseas +44 (0)121 415 7066

Telephone lines are open 8.30 am to 5.30 pm, Monday to Friday. Calls to 0871 numbers are charged at 8p per minute plus network extras. Calls from outside the United Kingdom are charged at applicable international rates. The call prices quoted were correct at February 2014.

Reports and communications

The Group issues regulatory announcements through the Regulatory News Service (RNS); shareholders can subscribe for free via the 'Investors & Performance' section of our website www.lloydsbankinggroup.com where you can also find our statutory reports and shareholder communications. A summary of these are listed below:

		Available format			
Report/Communication	Month	Online	RNS	Paper	Email
Preliminary results	Feb	✔	✔		
Annual report and accounts, annual review or performance summary	Mar	✔		✔	✔
Pillar 3 Disclosures	Mar	✔			
Notice of annual general meeting and voting materials	Apr	✔		✔	✔
Country-by-country reporting[1]	Jun/Jul	✔			
Q1 interim management statement	May	✔	✔		
Interim results	Jul	✔	✔		
Group Chief Executive letter to shareholders	Mar/Aug	✔		✔	✔
Q3 interim management statement	Oct	✔	✔		

[1] To be published on the Group's website by 1 July 2014 in accordance with the Capital Requirements (country-by-country) Regulations 2013.

Digital communications – Shareview by Equiniti Limited

Shareview, the website provided by Equiniti, allows shareholders to sign up to receive email communications and also provides the opportunity to self-manage your shareholding online. Shareholders can also access frequently asked questions, useful fact sheets, guidance notes, downloadable forms and a secure messaging system.

See **www.shareview.co.uk** and **help.shareview.co.uk** for further details.

Share dealing facilities

We offer a choice of three share dealing services for our UK shareholders and customers. To see the full range of services available for each, please use the contact details below:

Service Provider	Telephone Dealing	Internet Dealing
Bank of Scotland Share Dealing	0845 606 1188	www.bankofscotlandsharedealing.co.uk
Halifax Share Dealing	08457 22 55 25	www.halifaxsharedealing.co.uk
Lloyds Bank Direct Investments	0845 60 60 560	www.lloydsbank.com/shares

Note:

All internet services are available 24/7. Telephone dealing services are available between 8.00 am and 9.15 pm, Monday to Friday and 9.00 am to 1.00 pm on Saturday. To open a share dealing account with any of these services, you must be 18 years of age or over and be resident in the UK, Jersey, Guernsey or the Isle of Man.

Share price information

Shareholders can access both the latest and historical share prices via our website www.lloydsbankinggroup.com as well as listings in most national newspapers. For a real time buying or selling price, you will need to contact a stockbroker, or you can contact the share dealing providers detailed on the previous page.

Individual Savings Accounts (ISAs)

There are a number of options for investing in Lloyds Banking Group shares through an ISA. For details of services and products provided by the Group please contact: Bank of Scotland Share Dealing, Halifax Share Dealing or Lloyds Bank Direct Investments using the contact details overleaf.

American Depositary Receipts (ADRs)

Our shares are traded in the USA through a New York Stock Exchange-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: BNY Mellon Depositary Receipts, PO Box 30170, College Station, TX 77842-3170. Telephone: 1-866-259-0336 (US toll free), international callers: +1 201-680-6825. Alternatively visit www.adrbnymellon.com or email shrrelations@cpushareownerservices.com

Analysis of shareholders

At 31 December 2013	Shareholders		Number of ordinary shares	
Size of shareholding	Number	%	Millions	%
1 – 999	2,178,728	81.27	664.0	0.93
1,000 – 9,999	438,757	16.37	1,155.4	1.62
10,000 – 99,999	59,765	2.23	1,410.4	1.97
100,000 – 999,999	2,471	0.09	589.5	0.83
1,000,000 – 4,999,999	509	0.02	1,230.7	1.72
5,000,000 – 9,999,999	177	0.01	1,239.7	1.74
10,000,000 – 49,999,999	262	0.01	5,913.6	8.29
50,000,000 – 99,999,999	55	0.00	3,924.4	5.50
100,000,000 – 499,999,999	62	0.00	12,382.3	17.35
500,000,000 – 999,999,999	11	0.00	7,696.3	10.78
1,000,000,000 and over	9	0.00	35,162.1	49.27
	2,680,806	100.00	71,368.4	100.00

Share sale fraud and scams

Shareholders should exercise caution when unsolicited callers offer the chance to buy or sell shares with promises of huge returns. If it sounds too good to be true, it usually is. Please take steps to protect yourself. We strongly recommend that you seek advice from an independent financial adviser authorised by the Financial Conduct Authority (FCA). If you are uncertain you can check if they are authorised via the Financial Services Register which is available at www.fca.org.uk.

If you are concerned that you may have been targeted by such a scheme, please contact the FCA Consumer Helpline on 0800 111 6768 or use the online 'Share Fraud Reporting Form' available from their website (see above). We would also recommend that you contact the Police through Action Fraud on 0300 123 2040 or see www.actionfraud.org.uk for further information.

FORWARD LOOKING STATEMENTS

This annual report contains certain forward looking statements with respect to the business, strategy and plans of the 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 the Lloyds Banking Group 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 or may 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 the Group or its management including in respect of certain synergy targets; statements about the future business and economic environments in the United Kingdom (UK) and elsewhere including, but not limited to, future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about 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 business, strategy, plans and/or results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient funding to meet the Group's liquidity needs; changes to the Group's credit ratings; the ability to derive cost savings and other benefits including, without limitation, as a result of the Group's Simplification Programme; changing demographic developments including mortality and changing customer behaviour including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; 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, accounting standards or practices; regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies and actions of governmental or regulatory authorities in the UK, the European Union (EU), the US or elsewhere; the implementation of the draft EU crisis management framework directive and banking reform, following the recommendations made by the Independent Commission on Banking; the ability to attract and retain senior management and other employees; requirements or limitations imposed on the Group as a result of HM Treasury's investment in the Group; the ability to complete satisfactorily the disposal of certain assets as part of the Group's EU State Aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; market related trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services and lending companies; and the success of the Group in managing the risks of the foregoing. Please refer to the latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of certain factors, together with examples of forward looking statements.

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.

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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. Such a customer is also said to be in a state of delinquency and the entire outstanding balance is delinquent.
Asset-Backed commercial paper	See **Commercial Paper**
Asset-Backed Securities (ABS)	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.
Asset Quality Ratio	The impairment charge for the year in respect of loans and advances to customers expressed as a percentage of average loans and advances to customers.
Bank levy	The levy that applies to certain UK banks, UK building societies and the UK operations of foreign banks from 1 January 2011. The levy is payable based on a percentage of the chargeable equity and liabilities of the bank as at the balance sheet date.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.
Basel III	The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010 and due to be phased in, through CRD IV, from 1 January 2014 onward.
Basis point	One hundredth of a per cent (0.01 per cent). 100 basis points is 1 per cent. Used in quoting movements in interest rates or yields on securities.
Buy-to-let mortgages	Buy-to-let mortgages are those mortgages offered to customers purchasing residential property as a rental investment.
Central Counterparty (CCP)	An institution mediating between the buyer and the seller in a financial transaction, such as a derivative contract or repurchase agreement (repo). Where a CCP is used, a single bilateral contract between the buyer and the seller is replaced with two contracts, one between the buyer and the CCP and one between the CCP seller.
Collateralised Debt Obligation (CDO)	A security issued by a third party which references ABSs or other assets purchased by the issuer. Lloyds Banking Group has invested in instruments issued by other banking groups, including Collateralised Loan Obligations and Commercial Real Estate CDOs.
Collateralised Loan Obligation (CLO)	A security backed by the repayments from a pool of commercial loans. CLOs are usually structured products with different tranches whereby senior classes of holder receive repayment before other tranches are repaid.
Collectively assessed loan impairment provision	A provision established following an impairment assessment on a collective basis for homogeneous groups of loans, such as credit card receivables and personal loans, that are not considered individually significant and for loan losses that have been incurred but not separately identified at the balance sheet date.
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 mortgage repayments of interest and principal.
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.
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.
Common equity tier 1 capital (CET1)	The highest quality form of regulatory capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
Conduits	A financial vehicle that holds asset-backed securities which are financed with short-term deposits (generally **commercial paper**) that use the asset-backed securities as collateral. The conduit will often have a liquidity line 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, Argento, Cancara and Grampian. 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.

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Core tier 1 capital	As defined by the PRA mainly comprising shareholders' equity and equity non-controlling interests after deducting goodwill, other intangible assets and other regulatory deductions. Further details are given in the Capital Risk section on page 178.
Core tier 1 ratio	Core tier 1 capital as a percentage of **risk-weighted assets**.
Cost:Income ratio	Operating expenses compared to total income net of insurance claims. The Group calculates this ratio using the 'underlying basis' which is the basis on which financial information is reported internally to management.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial instruments and may include derivative contracts and repo contracts.
Coverage ratio	Impairment provisions as a percentage of impaired loans.
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.
CRD IV	On 27 June 2013, the European Commission published, through the official journal of the European Union, its legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR), which form the CRD IV package. Amendments were subsequently made to the Regulation trough the corrigenda published on 30 November 2013. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are set to be implemented from 1 January 2014 onwards, with certain sections set to be phased in.
Credit default swap	A credit default swap is a type of 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. The entity selling protection 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 derivatives	A credit derivative is a financial instrument that derives its value from the credit rating of an underlying instrument carrying the credit risk of the issuing entity. The principal type of credit derivatives are **credit default swaps**, which are used by the Group as part of its trading activity and to manage its own exposure to credit risk.
Credit risk	The risk that parties with whom the Group has contracted fail to meet their obligations (both on and off-balance sheet).
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.
Credit valuation adjustments	These are adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty. Further details are given in note 53.
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.
Debt securities	Debt securities are assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Debt securities in issue	These are unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.
Delinquency	See **Arrears**.
Embedded equity conversion feature	An embedded equity conversion feature is a derivative contained within the terms and conditions of a debt instrument that enables or requires the instrument to be converted into equity under a particular set of circumstances. The Group's Enhanced Capital Notes (ECNs) contain such a feature whereby these notes convert to ordinary shares in the event that the consolidated core tier 1 ratio of the Group falls below 5 per cent.
Enhanced Capital Notes (ECNs)	The Group's ECNs are subordinated notes issued by the Group that contain an embedded equity conversion feature. Further details of these are given in note 44.

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Enterprise Risk Management	As defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Enterprise Risk Management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.
Expected loss	This is the amount of loss that can be expected by the Group calculated in accordance with PRA rules. In broad terms it is calculated by multiplying the Default Frequency by the **Loss Given Default** by the **Exposure at Default**.
Equity risk	The financial risk involved in holding equity in a particular investment.
Exposure at default	An estimate of the amount expected to be owed by a customer at the time of the customer's default.
Fair value adjustment	Fair value adjustments arise on acquisition when assets and liabilities are acquired at fair values that are different from the carrying values in the acquired company. In respect of the Group's acquisition of HBOS the principal adjustments were write-downs in respect of loans and advances to customers and debt issued.
Financial Services Compensation Scheme (FSCS)	The Financial Services Compensation Scheme (FSCS) is the UK's independent statutory compensation fund for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by management expenses levies and, where necessary, compensation levies on authorised firms.
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.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to an obligor's financial difficulties.
Full time equivalent	A full time employee is one that works a standard five day week. The hours or days worked by part time employees are measured against this standard and accumulated along with the number of full time employees and counted as full time equivalents. This is a more consistent measure of the amount of time worked than employee numbers which will fluctuate as the mix of part-time and full-time employees changes.
Funded/unfunded exposures	Exposures where the notional amount of the transaction is either funded or unfunded.
Funding risk	The risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient.
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.
Impairment losses	An impairment loss is the reduction in value that arises following an impairment review of an asset that determines that the asset's value is lower than it's carrying value. For impaired financial assets measured at amortised cost, impairment losses are the difference between the carrying value and the present value of estimated future cash flows, discounted at the asset's original effective interest rate. Impairment losses can be difficult to assess and the critical accounting estimates and judgements in note 3 detail the key assessments made when determining impairment losses.
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.
Individually assessed loan impairment provisions	Impairment loss provisions for individually significant impaired loans are assessed on a case-by-case basis, taking into account the financial condition of the counterparty, any guarantor and the realisable value of any collateral held.
Interest rate risk	Interest rate risk in arises from the different repricing characteristics of the Group's non-trading assets, liabilities and off-balance sheet positions of the Group. Interest rate risk arises predominantly from the mismatch between interest rate sensitive assets and liabilities, but also to the investment term of capital and reserves, and the need to minimise income volatility.

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Internal Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, based on Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events as they apply on a solo level and on a consolidated level.
Internal Ratings-Based approach ('IRB')	A methodology of estimating the credit risk within a portfolio by utilising internal risk parameters to calculate credit risk regulatory capital requirements. There are two approaches to IRB: Foundation IRB and Advanced IRB.
Investment grade	This refers to the highest range of credit ratings, from 'AAA' to 'BBB' as measured by external credit rating agencies.
ISDA (International Swaps and Derivatives Association) master agreement	A standardised contract developed by the ISDA which is used as an umbrella contract for bilateral derivative contracts.
Level 1 fair value measurements	Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2 fair value measurements	Level 2 fair value measurements 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 where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.
Level 3 fair value measurements	Level 3 fair value measurements 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.
Leverage finance	Funding provided for entities with higher than average indebtedness, which typically arises from sub-investment grade acquisitions or event-driven financing.
Leverage ratio	Tier 1 capital divided by the exposure measure. Basel III reforms introduced a leverage ratio framework designed to reinforce risk based capital requirements with a simple, transparent, non-risk based 'backstop' measure.
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 over collateralisation (in the case of **covered mortgage bonds**). Liquidity enhancement makes funds available if required, for other reasons than asset default, eg to ensure timely repayment of maturing commercial paper.
Liquidity Coverage Ratio (LCR)	The ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and ideally, be central bank eligible.
Liquidity risk	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.
Loan to deposit ratio	The ratio of loans and advances to customers net of allowance for impairment losses and excluding reverse repurchase agreements divided by customer deposits excluding repurchase agreements.
Loan-to-value ratio (LTV)	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.
Loss emergence period	The loss emergence period is the estimated period between impairment occurring and the loss being specifically identified and evidenced by the establishment of an appropriate impairment allowance.
Loss Given Default	The estimated loss that will arise if a customer defaults. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.
Market risk	The risk that unfavourable market moves (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and bond prices, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and/or value.
Master netting agreement	An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.
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.
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-backed securities	See Residential and Commercial Mortgage-Backed Securities.

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Mortgage related assets	Assets which are referenced to underlying mortgages.
Mortgage vintage	The year the mortgage was issued.
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**.
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 asset value per ordinary share	Shareholders' equity divided by the number of ordinary shares and limited voting ordinary shares in issue, adjusted to exclude shares held under certain employee share ownership plans.
Net Stable Funding Ratio (NSFR)	The ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. The ratio is required to be over 100% with effect from 2018. Available stable funding would include such items as equity capital, preferred stock with a maturity of over 1 year, or liabilities with a maturity of over 1 year.
Net interest income	The difference between interest received on assets and interest paid on liabilities.
Net interest margin	Net interest margin is net interest income as a percentage of average interest-earning assets. Details of the Group's banking net interest margin are given on page 66.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
Over-the-counter derivatives	Over-the-counter derivatives are derivatives for which the terms and conditions can be freely negotiated by the counterparties involved, unlike exchange traded derivatives which have standardised terms.
Prime mortgages	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.
Probability of default	The likelihood that a customer will default on their obligation within the next year.
Regulatory capital	The amount of capital that the Group holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies.
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.
Residential Mortgaged-Backed Securities (RMBS)	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).
Retail loans	Money loaned to individuals rather than institutions. These include both secured and unsecured loans such as mortgages and credit card balances.
Risk appetite	The amount and type of risk that the Group is prepared to seek, accept or tolerate.
Risk-weighted assets	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with the Basel Capital Accord as implemented by the PRA.
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 a 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** 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 by type with the amounts secured and associated funding raised is given in note 21.

GLOSSARY

Sovereign exposures	Exposures to central governments and central government departments, central banks and entities owned or guaranteed by the aforementioned.
Specialist mortgages	Specialist mortgages include those mortgage loans provided to customers who have self-certified their income (normally as a consequence of being self-employed) or who are otherwise regarded as a sub-prime credit risk. New mortgage lending of this type has not been offered by the Group since early 2009.
Standardised Approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings of obligors (where available) and supervisory risk weights. In relation to operational risk, a method of calculating the operational risk capital requirement by the application of a supervisory defined percentage charge to the gross income of specified business lines.
Stress testing	Stress and scenario testing is the term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the capital resources which are required to be held.
Structured entities (SEs)	SEs are entities that have been designed so that voting or similar rights are not the dominant factor in determining who controls the entity, such as when voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs often have specific restrictions around their ongoing activities and are created to accomplish a narrow and well-defined objective.
Sub-investment grade	This refers to credit ratings issued by external credit rating agencies that are below 'BBB' grade or its equivalent.
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.
Tier 1 capital	A measure of a bank's financial strength defined by the PRA. It captures core tier 1 capital plus other tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies. Further details are given in the Capital Risk section on page 178.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 capital	A component of regulatory capital defined by the PRA, mainly comprising qualifying subordinated loan capital, certain non-controlling interests and eligible collective impairment allowances. Further details are given in the Capital Risk section on page 178.
Trading book	Positions in financial instruments and commodities held for trading purposes or to hedge other elements of the trading book.
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. It is measured to specified level of confidence, often 95 per cent or 99 per cent.
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.

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ABBREVIATIONS

ABS	Asset-Backed Securities
ADRs	American Depositary Receipts
BoE	Bank of England
BSU	Business Support Unit
CDO	Collateralised Debt Obligation
CDS	Credit Default Swap
CET1	Common Equity Tier 1
CLO	Collateralised Loan Obligation
CMIG	Clerical Medical Investment Group Limited
CRA	Credit Reference Agency
CRD IV	Capital Requirements Directive IV
CVA	Credit Valuation Adjustment
DVA	Debit Valuation Adjustment
EC	European Commission
ECNs	Enhanced Capital Notes
EEI	Employee Engagement Index
EEV	European Embedded Value
EFG	Enterprise Finance Guarantee Scheme
EP	Economic Profit
EPS	Earnings Per Share
ERM	Enterprise Risk Management
EU	European Union
FCA	Financial Conduct Authority
FLS	Funding for Lending Scheme
FRC	Financial Reporting Council
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
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
IPO	Initial Public Offering
ISA	Individual Savings Account
KPIs	Key Performance Indicators
LCR	Liquidity Coverage Ratio
LDC	Lloyds Development Capital
LIBOR	London Inter-Bank Offered Rate
LMI	Line Manager Index
LP&I	Life, Pensions and Investments
LTIP	Long-Term Incentive Plan
LTV	Loan-to-value
MIF	Multilateral Interchange Fee
NPS	Net Promoter Score
NSFR	Net Stable Funding Ratio
OEICs	Open Ended Investment Companies
OFT	Office of Fair Trading
PEI	Performance Excellence Index
PFI	Private Finance Initiative
PPI	Payment Protection Insurance
PPP	Public Private Partnership
PRA	Prudential Regulation Authority
PVNBP	Present Value of New Business Premiums
RDR	Retail Distribution Review
SAYE	Save-As-You-Earn
SEC	Securities and Exchange Commission
SMEs	Small and Medium-sized enterprises
SWIP	Scottish Widows Investment Partnership
TSR	Total Shareholder Return
UK	United Kingdom of Great Britain and Northern Ireland
UKFI	UK Financial Investments Limited
US	United States of America
VaR	Value-at-Risk

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Disclosures arising from Enhanced Disclosure Task Force (EDTF) recommendations

The 32 recommendations listed below are made in the report 'Enhancing the Risk Disclosures of Banks' issued by the Enhanced Disclosure Task Force of the Financial Stability Board on 29 October 2012.

The Group's Pillar 3 disclosures can be found at www.lloydsbankinggroup.com

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