LLOYDS BANKING GROUP

BECOMING THE BEST BANK FOR CUSTOMERS

Lloyds Banking Group
Annual Report and Accounts

2015

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About us

Lloyds Banking Group is a leading provider of financial services to individual and business customers in the UK.

Our main business activities are retail and commercial banking, general insurance, and long-term savings, protection and investment. We provide our services under a number of well recognised brands including Lloyds Bank, Halifax, Bank of Scotland and Scottish Widows and through a range of distribution channels including the largest branch network in the UK and a comprehensive digital proposition.

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.

Reporting

Just as we operate in an integrated way, we aim to report in an integrated way. We have taken further steps towards this goal this year. As well as reporting our financial results, we also report on our approach to operating responsibly and take into account relevant economic, political, social, regulatory and environmental factors. You can download our full reporting suite of documents online.

The 2015 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
Lord Blackwell
Chairman
Lloyds Banking Group
24 February 2016

This Annual Report and Accounts contains forward looking statements with respect to certain of the Group's plans and its current goals and expectations relating to its future financial condition, performance, results, strategic initiatives and objectives. For further details, reference should be made to the forward looking statements on page 292.

View our Annual Report and Accounts and other information about Lloyds Banking Group at www.lloydsbankinggroup.com

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

We are meeting our customers' needs by creating a simpler, more responsive organisation. We are investing in our digital capability and maintaining a comprehensive branch network.

OUR STRATEGIC PRIORITIES

Creating the best customer experience

Becoming simpler and more efficient

Delivering sustainable growth

Read more on page 20

The Group has pledged £5 million over five years to support more than 500 skilled apprentices at the Lloyds Banking Advanced Manufacturing Training Centre in Coventry. One of these apprentices is Kerry Smith, a young woman with aspirations to become a research engineer working in advanced automation and robotics.

Highlights and strategic priorities

HIGHLIGHTS

CONTINUED STRENGTH ACROSS THE WHOLE BUSINESS

Underlying profit up 5% to

£8.1bn

Supporting

1 in 5

of new business start-ups in the UK via our Retail Business Banking Segment

Celebrating

250 years

of helping the people, businesses and communities of Britain

Statutory profit before tax

£1.6bn

Statutory profit before tax of £1.6 billion, despite £4.0 billion of PPI charges

Strong balance sheet and liquidity position. Strong capital generation with pro forma CET1 ratio of

13.0%

Expanding our Environmental, Social and Governance (ESG) programme by issuing our second

ESG Bond

to finance SMEs, healthcare providers and renewable energy projects

Ordinary dividend per share

2.25p

with an additional special dividend of 0.5p per share

Read more on page 35
or visit www.lloydsbankinggroup.com

STRATEGIC PRIORITIES

GOOD START TO THE NEXT PHASE OF OUR STRATEGIC JOURNEY

Creating the best customer experience

We are improving customer experience with our multi-brand, multi-channel approach, combining digital capabilities with face-to-face services. We are transforming our digital presence, providing simpler, seamless interactions across online and mobile while sustaining extensive customer reach through our leading branch network.

Becoming simpler and more efficient

We are creating operational capability which is simpler and more efficient than today through further system enhancement and integration and are becoming more responsive to changing customer expectations while maintaining our cost leadership amongst UK high street banks. This cost leadership enables us to provide increased value to our customers and competitive differentiation.

Delivering sustainable growth

As the UK economy continues to recover, we are further developing Groupwide growth opportunities within our prudent risk appetite. We are maintaining market leadership in our main retail businesses, making the most of our multi-brand, multi-channel strategy whilst also focusing on areas where we can grow.

Read more on page 20
or visit www.lloydsbankinggroup.com

Divisional overview

We are a simple, low risk, customer focused bank operating through four divisions

Read more about our divisions on page 42
or visit www.lloydsbankinggroup.com

RETAIL

Our Retail division is a leading provider of current accounts, savings, loans and mortgages to personal and small business customers in the UK.

UNDERLYING PROFIT

£3,514m
(2014 £3,228m)

44%[1]

£280bn
Retail deposit balances

1 in 4
First-time buyers helped by us to buy their first home

Key brands

LLOYDS BANK
SCOTTISH WIDOWS
BANK OF SCOTLAND
HALIFAX

COMMERCIAL BANKING

Our Commercial Banking division has a rich heritage of supporting UK businesses from SMEs to large corporates and financial institutions.

UNDERLYING PROFIT

£2,431m
(2014 £2,206m)

31%[1]

5%
Growth in SME lending in 2015

17%
Our share of mid-market banking relationships

Key brands

LLOYDS BANK
AMC
BANK OF SCOTLAND
LDC
SCOTTISH WIDOWS

[1] Proportion of Group underlying profit.

CONSUMER FINANCE

Our Consumer Finance division provides motor finance solutions and credit cards to consumer and commercial customers.

UNDERLYING PROFIT

£1,005m
(2014 £1,010m)

13%[1]

15%
Our share of credit card balances

17%
Growth in our UK consumer finance lending in 2015

Key brands

LLOYDS BANK
blackhorse
BANK OF SCOTLAND
LEX AUTOLEASE
HALIFAX

[1] Proportion of Group underlying profit.

INSURANCE

Our Insurance division provides customers with long-term savings, investment and protection products and general insurance.

UNDERLYING PROFIT

£962m
(2014 £922m)

12%[1]

5.6m
Life and pension customers

15%
Our share of the home insurance market

Key brands

LLOYDS BANK
SCOTTISH WIDOWS
BANK OF SCOTLAND
HALIFAX

Chairman's statement

Lord Blackwell
Chairman

One of my primary roles as Chairman is to ensure we build a business which is commercially successful, helps our customers with their financial needs and plays a valued role in Britain's long-term economic success.

Overview

2015 was another year of significant progress in our drive to restore the Group's financial strength and deliver our goal of becoming the best bank for customers – and a year in which I felt a renewed sense of pride across the organisation for what we do and what we stand for. While legacy issues still impact on our results, we have increased underlying profit, further strengthened our balance sheet, continued to improve the efficiency of the business and enabled the government to substantially reduce its remaining stake in the Group at a profit. We have taken further steps to reinforce a customer focused culture and our staff surveys show continued strong engagement and commitment.

As a result of our business performance and strong capital position, I am pleased to announce that the Board has recommended a final ordinary dividend of 1.5 pence per share. The total ordinary dividend per share for 2015 of 2.25 pence has increased from 0.75 pence in 2014. In addition, the Board has recommended a capital distribution in the form of a special dividend of 0.5 pence per share. This is in line with the Group's policy that aims to provide a progressive and sustainable dividend whilst distributing surplus capital when appropriate to do so.

Strategic development

We remain committed to our clear strategy of building Lloyds Banking Group as a highly focused, low risk and low cost UK retail and commercial bank. In an uncertain world we are reinforced in our belief that this focus provides the best opportunity to build a strong and successful organisation that can deliver sustainable shareholder value based on outstanding customer service. At the same time we recognise that technology is transforming banking and the way our customers interact with us, and our core processes and our competitive landscape are being substantially reshaped. In addressing these challenges we believe that our customer focus and simple business model will continue to provide opportunities for competitive advantage.

2.25p

ordinary dividend per share

Helping Britain prosper

2015 was also a milestone year for the Group as we marked the 250th anniversary of Lloyds Bank, the 200th anniversary of Scottish Widows and the 30th anniversary of the Lloyds Charitable Foundations. Our celebrations reinforced our commitment to sustain the traditional values of customer service and community support, the foundations on which the Group has been built.

The strength of our Group comes from our rich and diverse heritage, our iconic brands, and a strong commitment to our core purpose of helping Britain prosper. We believe we are in a unique position to use our scale, reach and influence to help improve the economic and social issues facing people, businesses and communities through our Helping Britain Prosper Plan.

Corporate culture, operating responsibly

One of my goals as Chairman is to ensure we build a business which everyone feels proud of. Not only should we be a commercially successful business, but we should also be seen as having a noble purpose in helping our millions of customers manage their financial needs whilst playing a core and highly valued role in funding enterprise and supporting Britain's long-term economic growth.

In achieving this the Board and senior management have a vital role to play in shaping and embedding a healthy corporate culture, and this has been a major focus for the Board's attention over the last year. The values and standards of behaviour we set are an important influence and there are strong links between governance and establishing a culture that supports long-term success. These values and standards also provide the foundation on which we are seeking to build sustainable success as a responsible business, supporting the communities in which we operate and serve.

Communities

Our commitment to invest in the long-term economic future of the UK is highlighted, not just through our lending to customers such as first-time buyers and SMEs, but also through the many community programmes we run and through our four charitable Foundations.

Our shared goal for our milestone year was to make it our greatest ever year for supporting local communities. In response our colleagues completed more volunteering hours than ever and, in our first year of partnership with BBC Children in Need, we raised £5 million, more than double our original target of £2 million.

Our Foundations are at the heart of our purpose to help Britain prosper and to bring communities closer together. In 2015, we provided £17 million to the Foundations and since their establishment, they have distributed almost £600 million to charities and projects tackling disadvantage in communities across the UK.

£5m

raised for our charity of the year

Regulation

The regulatory landscape in which we operate continues to evolve. Competition, conduct and capital remain central to reform and the regulators are continuing to undertake reviews into products and markets. We are however now starting to see greater clarity on a number of key areas. In particular, the Bank of England has provided more certainty on industry capital levels, the FCA announced a consultation on PPI time barring and we continue to make progress towards a final plan on ring-fencing and resolution. With regards to the ongoing Competition and Markets Authority (CMA) review, while believing there is already strong competition in UK markets, we welcome any proposals that help competition provide better choice and more transparency for customers and are committed to working with the CMA to ensure better account comparability and easier switching.

There are a number of regulatory developments where the impact on us is still unclear including the Fair and Effective Markets Review, the Senior Managers and Certification Regime and changes to the individual and corporate pensions market; but overall, we believe our simple, low risk, UK focused strategy puts us in a strong position to adapt to these regulatory changes.

COMMITTED TO GOOD GOVERNANCE

One of the principal tasks of the Board is to develop a strategy which can achieve long-term success and generate sustainable returns for shareholders. This needs to be underpinned by the high standards of corporate governance which are critical to the success of any business today and should be driven by the Board (led by the Chairman) and embedded in the thinking and processes of the business. We are confident we have a proven, strong and skilled management team, a well balanced, experienced Board and a commitment to good governance, enabling us to build a business that we believe will deliver sustainable success in the future.

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.

Areas of focus

Corporate Governance Framework

In late 2014, we undertook an end-to-end review of the Group's governance arrangements from a fresh perspective. The review was informed by the 2014 annual review of Board Effectiveness as well as the work which is being carried out in the Group in preparation for the Senior Managers and Certification Regime. The review was completed in 2015 and the findings and the Board's response are set out on page 68.

Viability statement

The Board fulfilled its obligation to assess the Group's longer term viability during the year. Our viability statement can be found on page 108.

Strategy and customer focus

In 2015, the Board reviewed progress in implementing the Group's customer focused strategy whilst ensuring conduct, culture and values were at the forefront of how the business is run. You can read more in the strategic report.

IT resilience and digital transformation

There is an ever increasing understanding of the criticality of technology in delivering customer service. During the year, the Board spent considerable time reviewing the delivery of the three-year IT resilience investment and digital transformation programmes. You can read more on page 65.

Read more on governance in the corporate governance report or online at www.lloydsbankinggroup.com

Chairman's statement continued

Directors

We have recently appointed two new Independent Non-Executive Directors to the Board. Deborah McWhinney joined in December and brings an extensive executive background from North America in managing technology, operations and new digital innovations in banking, payments and institutional investment. Stuart Sinclair joined in January and brings experience in retail banking, consumer and asset finance and insurance.

These appointments will help ensure the Board is well placed to address future technology and market risks across the full range of business areas in which we operate.

Non-Executive Director Carolyn Fairbairn retired from the Board in October to take up the position of Director-General of the Confederation of British Industry. Meanwhile, in December, Dyfrig John announced his intention to retire after our AGM in 2016. We are very grateful to both of them for their significant contribution to the Group.

2015 also saw a number of changes to the Board's structure and composition, including the establishment of a Responsible Business Committee which underlines our commitment to being a responsible business.

More information on these changes as well as an overview of our approach to culture and values can be found in our corporate governance report on page 60.

ESTABLISHMENT OF A NEW RESPONSIBLE BUSINESS COMMITTEE

In 2015, an important new Board Committee was established to focus on responsible business. The Committee provides oversight of Group strategy and plans for delivering our aspirations to be a leader in responsible business.

The Committee also provides oversight and challenge to executive management on those activities which impact on our reputation as a trusted, responsible business.

In terms of responsibilities, the Committee oversees:

- the expression, measurement, communication and maintenance of our culture and values;
- the design and development of the Responsible Business Plan and the Helping Britain Prosper Plan, the measurement of performance against such plans and their internal and external communication;
- the development of policies relating to the responsible treatment of customers and their implementation, including measurement of trust, customer satisfaction and advocacy. This includes policies for access and inclusion and responsible lending including our customer vulnerability agenda;
- our engagement with communities and charitable and philanthropic activities;
- our approach to the control of our environmental impact, including measurement and internal and external reporting;
- the policies relating to the responsible treatment of employees and their implementation, including inclusion and diversity, and our codes of responsibility; and
- the engagement of employees in relation to the Group's Responsible Business Plan.

Read more on page 81
or visit www.lloydsbankinggroup.com

Remuneration

Our approach to reward is intended to provide a clear link between remuneration and delivery of the Group's key strategic objectives, supporting the aim of becoming the best bank for customers and, through that, for shareholders. We believe in offering fair reward. We are embedding a performance-driven and meritocratic culture where colleagues are rewarded for behaviours aligned to the long-term sustainable success of the business, our commitment to rebuilding trust and to changing the culture of the Group.

We want to ensure colleagues are empowered, inspired and incentivised to do the right thing for customers. Colleagues are rewarded in a way that recognises the very highest of expectations in respect of conduct and customer treatment, and when behaviour falls below acceptable standards, it is important that accountability is taken collectively as well as individually. This is particularly the case when dealing with, and learning from, mistakes of the past.

The Group has had a successful year, with a number of strategic milestones achieved. Nevertheless, despite better underlying results in 2015, the Group's total bonus outcome has reduced year-on-year to £353.7 million. This includes a 26 per cent collective performance adjustment being applied to the total bonus outcome to reflect the additional conduct-related provisions which impacted negatively on profitability and shareholder returns. As a percentage of pre-bonus underlying profit, the total bonus outcome has decreased to 4.2 per cent in 2015. Cash bonuses are capped at £2,000 with additional amounts paid in shares and subject to deferral and performance adjustment. Average bonus awards across all our colleagues are approximately £4,600.

More information on how we ensure our approach to remuneration supports our strategy can be found in the Directors' remuneration report on page 82.

Outlook

One of my primary roles as Chairman is to ensure we build a business which is commercially successful, helps our customers with their financial needs and plays a valued role in Britain's long-term economic success. Despite our progress we cannot be complacent. As I have described, we have to be increasingly focused on the scope and pace of change – in particular the speed of the digital revolution and the impact of new markets and technologies – if we are to remain well placed to serve customer needs in years to come. Managing that pace of change carefully is a major priority.

At the same time I believe we must also continue to focus on rebuilding the trust of our customers, regulators and politicians. Businesses are increasingly – and rightly – judged on how they demonstrate and communicate their broader value to society. Securing that position of trust, where we are doing the right things for our customers, the economy and society at large, is essential to a successful and sustainable future.

I would like to thank all my colleagues across the Group for their hard work and commitment in addressing these challenges and helping secure that future success.

Lord Blackwell
Chairman

Group Chief Executive's review

António Horta-Osório
Group Chief Executive

In our milestone year we have made a strong start to the next phase of our strategy and delivered a robust financial performance.

Highlights

2015 was a milestone year for Lloyds Banking Group. In a year in which we celebrated the 250th anniversary of Lloyds Bank and the 200th anniversary of Scottish Widows, we also continued to make strong progress in the next phase of our strategy to become the best bank for customers and shareholders. We improved customer experience, increased net lending in key customer segments, and delivered on key targets within the Helping Britain Prosper Plan. At the same time our financial performance has continued to improve, with an increase in underlying profitability and returns as well as a further strengthening of our already strong capital position, in spite of additional PPI provisions reflecting the Financial Conduct Authority's (FCA) consultation on time barring. This delivery has, in turn, enabled us to increase the ordinary dividend and to return surplus capital through a special dividend. As a result of our ongoing progress, the UK government has made further substantial progress in returning the Group to full private ownership.

The economic and regulatory environment

As a UK retail and commercial bank, we are well placed to continue to support and benefit from the sustainable recovery in the UK economy. While the current prolonged period of low interest rates and increasing competition have created challenges for profitability across the UK banking sector, we are well positioned, given our cost leadership position and low risk business model. The underlying health of the UK economy, to which we are inextricably linked, also remains resilient. This is reflected in strong employment levels, reduced levels of household and corporate indebtedness, and increased house prices, amongst other things, which provide a positive backdrop and underpin the Group's future prospects. In the face of current market volatility and uncertainties, including the forthcoming EU referendum, our strong balance sheet and low risk approach positions us well, while our differentiated business model continues to provide competitive advantage.

We remain well positioned in a regulatory environment that continues to evolve. 2015 brought greater clarity on a number of issues that are significant for the Group and the wider banking sector. We support the aims of the Competition and Markets Authority (CMA) in ensuring that small business customers and consumers have effective choice and are adequately protected, and we welcome the publication of its notice of possible remedies to ensure these objectives are achieved. Our simple, UK focused business model positions us well for ring-fencing and the Minimum Requirements for own funds and Eligible Liabilities (MREL).

In line with its broader aim of creating a safer and more stable UK banking sector, in December the Financial Policy Committee clarified its views on the future capital requirements for the industry. Importantly, these views for the industry as a whole are broadly consistent with the amount of capital we wish to retain to grow the business, meet regulatory requirements and cover uncertainties. This, in turn, supports the Group's expectation to be able to distribute a significant proportion of the capital it generates going forward. Finally, we welcome the decision of the FCA to consult on a deadline for PPI complaints and the certainty that this will bring for both customers and shareholders.

Group Chief Executive's review continued

Financial performance and balance sheet strength

The Group has delivered another robust financial performance in the year, with underlying profit increasing by 5 per cent to £8,112 million, or by 10 per cent excluding TSB, leading to an improvement in our underlying return on required equity to 15.0 per cent. This improvement was driven by net interest income, reflecting the strengthening of our net interest margin, lower operating costs and a significant reduction in impairment charges, which more than offset the more subdued outturn for other income. Statutory profit before tax was 7 per cent lower at £1,644 million, after additional charges that we have taken for PPI.

In 2015, we strengthened our provision for PPI by £4.0 billion, with a £2.1 billion increase taken in the fourth quarter primarily reflecting our interpretation of the FCA's consultation on a proposed time bar as well as the Plevin case. We also charged £745 million in relation to the disposal of TSB, bringing the total cost of delivering this commitment to the EU, which is now complete, to £2.4 billion over the past five years.

During the year, we have continued to strengthen our balance sheet, with our strong capital generation enabling us to increase our common equity tier 1 (CET1) ratio to 13.0 per cent, after increased dividend payments. This and our other capital and leverage ratios remain among the strongest of our major banking peers worldwide, in turn positioning us well for evolving regulatory capital requirements. In addition, the Group's liquidity position remains strong, with our total wholesale funding of £120 billion at the end of 2015 more than covered by our liquid assets of £123 billion.

The progress we have made in successfully executing our differentiated, simple and low risk business model is now being increasingly recognised, with the major credit rating agencies of Fitch, Moody's and Standard & Poor's having all either strengthened or reaffirmed the Bank's credit ratings during the course of the year. The transformation of the Group's risk profile has also been reflected in our credit default swap spread, which remains the lowest of our major UK banking peers. This and our cost:income ratio, which, at 49.3 per cent, is also the lowest of our major UK peers, remain ongoing sources of competitive advantage in line with the strategic plan presented to the market in June 2011.

Strategic progress

In 2015, we have made good progress in the three strategic objectives that we outlined at our strategic update in October 2014: creating the best customer experience; becoming simpler and more efficient; and delivering sustainable growth.

Creating the best customer experience

As a customer-focused business, we are committed to meeting our customers' evolving needs and preferences effectively through our multi-brand and multi-channel approach. In an environment where the pace of digital adoption is accelerating, we now have the largest digital bank, with our online customer base amounting to over 11.5 million customers and our mobile banking customer base of 6.6 million customers able to access the UK's no.1 rated banking app. Our strategic commitments for digital also remain on track, with c.55 per cent of customer needs being met digitally in 2015. We remain focused, however, on our integrated, multi-channel approach that our clients value and have continued to enhance and optimise the branch network to ensure that it meets our customers' evolving needs. In particular, we have now introduced Wi-fi connectivity and automated solutions for more simple customer transactions in nearly 70 per cent of branches. In addition, we have now launched our remote advice proposition, enabling customers to interact with us from the comfort of their own homes. In 2015 we also enhanced a number of customer processes, having launched an online feature which enables customers to obtain a mortgage agreement in principle in real time, and piloted a new process which has halved the time to open a new business bank account. Our progress in creating the best customer experience has been reflected in our net promoter score across the Group, which has continued to improve in 2015 and is now over 50 per cent higher than at the end of 2011. Group reportable banking complaints (excluding PPI) also remain significantly lower than the average of our major banking peers.

Becoming simpler and more efficient

Our cost leadership position remains a key source of competitive advantage and strategic priority for the Group. We continue to invest significantly in IT with a focus on ensuring that our systems and processes are both efficient and resilient and that our customers' experiences are improved through the end-to-end automation of key customer journeys. In addition, we achieved over £150 million of run-rate savings in third party spend in the year by managing demand more efficiently and negotiating better rates with our suppliers. Through these and other efficiency initiatives, we have to date delivered total run rate savings of £373 million in the second phase of our Simplification programme, and we remain ahead of target in achieving total run-rate savings of £1 billion by the end of 2017. In addition, we are actively responding to prolonged lower interest rates and have accelerated our cost savings delivery while also targeting further efficiency initiatives. The combination of this absolute focus on cost management and the resilience of our income generation has enabled us to improve our market-leading cost:income ratio to 49.3 per cent from 49.8 per cent in 2014.

c.55%

customer needs met digitally

Delivering sustainable growth

The Group aims to deliver growth across its key customer segments that is sustainable and consistent with its low risk business model. In 2015 we continued to make good progress in growing above the market in areas where we are underrepresented. Net lending to our SME customers increased by over £1 billion or 5 per cent in the year, continuing the trend of the last five years of significantly outperforming the market overall. Our Consumer Finance business is also generating strong growth with an ahead of plan 17 per cent year-on-year increase in UK lending, with motor finance continuing to deliver double digit growth and our credit card balances growing by approximately 4 per cent compared with the market growth rate of less than 2 per cent. We continue to support first-time buyers and remain the largest lender to this important customer group, providing 1 in 4 first-time buyer mortgages in 2015. We have taken the conscious decision, however, to balance margin considerations with volume growth in the mortgage business, growing our open book by around 1 per cent versus a market that grew by around 2.5 per cent. We believe this is the right approach as the leader in what is, at the moment, a low growth market where growth is predominantly coming from Buy-to-let.

Government stake and TSB sale

The combination of the significant progress we have made towards our strategic objectives and our robust financial performance has also enabled the UK government to make further substantial progress in returning the Group to full private ownership during the course of 2015. The government has now reduced its stake from 43 per cent to around 9 per cent, returning approximately £16 billion to the UK taxpayer above their 'in price', on top of the dividends paid in 2015. We will continue to support the proposed retail offer, but following the government's announcement on 28 January 2016, this has been deferred until it determines that the market conditions are appropriate. Separately, the completion of the sale of our interest in TSB to Banco Sabadell in June 2015 represents the continued delivery of our commitment to the European Commission under the terms of the state aid agreement.

Dividend

In line with our progressive and sustainable ordinary dividend policy, the Board has recommended a final ordinary dividend of 1.5 pence, taking the total ordinary dividend declared for the year to 2.25 pence per ordinary share.

In addition, the Board has recommended a special dividend of 0.5 pence per share, representing the distribution of surplus capital over and above the Board's view of the current level of capital required to grow the business, meet regulatory requirements and cover uncertainties.

Helping Britain Prosper and delivering growth in our key customer segments

As a customer-focused UK centric bank, our prospects are inextricably linked to the strength of the UK economy, which we continue to support through our strategic net lending targets in our key customer segments and the targets we have set through our Helping Britain Prosper Plan.

In our Retail division we continue to be a lead supporter of the UK government's Help to Buy scheme and have exceeded our lending target to small businesses within the Helping Britain Prosper Plan by supporting over 1 in 5 new business start-ups. In Commercial Banking we continue to play a lead role in supporting the UK economy and remain the largest net lender to SMEs in the UK government's Funding for Lending scheme.

Our Consumer Finance business also continues to deliver strong growth within our low risk appetite, increasing its market share, with the division also making a number of improvements to our customer propositions across motor finance and credit cards. In Insurance, following the completion of our first bulk annuity transaction with the Scottish Widows With-Profits fund in the first half, we have also successfully completed our first open market transaction in the fourth quarter and will continue to participate in this attractive market.

We continue to successfully deliver against our Helping Britain Prosper Plan targets to people, businesses and communities across the UK. Amongst these targets, in 2015 we donated £17 million to the Banks' four independent charitable foundations to tackle disadvantage, while also providing more than £1 million of additional funding to support credit unions and more than 320,000 colleague volunteering hours to support community projects.

Building the best team

We recognise the strategic importance of colleague engagement and the role that this plays in ensuring the continued delivery of our strategic priorities. The latest colleague survey results show that colleague engagement has continued to improve to the highest level to date and that our performance excellence score is above the UK 'high performance norm'. We have also made good progress with our target for gender diversity in senior management, with women now representing 31 per cent of senior managers, up from 28 per cent two years ago. These encouraging results demonstrate the Group's success in embedding a customer-focused culture and that our colleagues are committed to our aim of creating the best experience for our customers.

Outlook

Our strong strategic progress and good financial performance position the Group well for future success, with our business model allowing us to respond effectively to the challenges of the lower for longer interest rate environment and the current market volatility. We remain committed to our financial targets for return on required equity and cost:income ratio, although in light of the implementation of the corporation tax surcharge for banks and the lower for longer interest rate environment, we now expect to deliver a return on required equity of 13.5 to 15.0 per cent in 2018 and a cost:income ratio of around 45 per cent as we exit 2019, with improvements every year. Our capital generation will remain strong and we are increasing our guidance for annual pre dividend CET1 capital generation to around 2 per cent. In 2016, we expect an increased net interest margin of around 2.70 per cent and, in light of our low risk approach, a full year asset quality ratio of around 20 basis points, significantly lower than our medium-term guidance.

Summary

In our milestone year we made a strong start to the next phase of our strategy and have delivered a robust financial performance. The combination of this strategic and financial performance with our simple, low risk business model positions us well in the face of uncertainties regarding the global economic, political, competitive and regulatory environment and underpins our confidence in the Group's future prospects. From these firm foundations, we believe we are well placed to support the UK economy and become the best bank for customers, while delivering superior and sustainable returns for our shareholders.

António Horta-Osório
Group Chief Executive

Key performance indicators

Delivering for customers and shareholders

Our key performance indicators have been considered by the Board and identify the most effective output measures for assessing financial performance and progress towards becoming the best bank for customers. KPIs for balance sheet reduction and strategic investment are no longer included as they were directly related to our previous strategic priorities which have now been superseded.

As a result of strategic progress in 2015, we have reported improvements in underlying profits, strengthened our capital position despite conduct charges and announced increased dividend payments.

Customer relationships are key to our strategy and we specifically measure customer satisfaction and complaint levels. We also track our performance against the targets of our Helping Britain Prosper Plan, about which you can read more on page 13.

UNDERLYING PROFIT BEFORE TAX

£m

Underlying profit continued to increase in 2015, up 5 per cent.

STATUTORY PROFIT BEFORE TAX

£m

Pre-tax statutory profit was £1,644 million in 2015 compared to £1,762 million in 2014 with the reduction driven by increased PPI charges.

ORDINARY DIVIDEND

p

An increased ordinary dividend of 2.25 pence per share, in line with our progressive and sustainable dividend policy. In addition, the Board has recommended a special dividend of 0.5 pence per share.

UNDERLYING RETURN ON REQUIRED EQUITY

%

The underlying return on required equity improved in 2015, reflecting the growth in underlying profit.

EARNINGS PER SHARE

p

Earnings per share reduced in the year, largely due to additional provisions for PPI.

Remuneration aligned 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 across five areas (customer, people, risk, building the business, financial) which are reviewed on a regular basis.

Executive management are also eligible to participate in a long-term incentive plan (LTIP), 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.

COMMON EQUITY TIER 1 RATIO

%

Our common equity tier 1 ratio continued to improve in 2015 despite increased dividends; this is a strong position in absolute and relative terms compared to our major UK banking peers.

1 Pro forma.

COST:INCOME RATIO

%

Our cost:income ratio further improved to 49.3 per cent and remains the lowest of our major UK banking peers.

ASSET QUALITY RATIO

bp

Our asset quality ratio continued to improve, reflecting our low risk position and the current interest rate environment.

1 Excluding TSB.

TOTAL SHAREHOLDER RETURN (TSR)

%

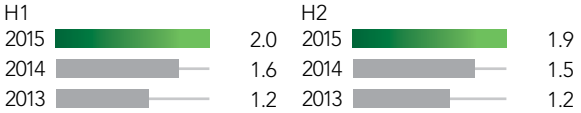
Our share price fell by 4 per cent in 2015, broadly in line with the FTSE100 but was better than the UK banking sector, with TSR also reflecting the benefit of our return to dividends. Share price performance and TSR in the last three years remain significantly ahead of the sector and the market.

Read more about our financial performance on page 35
or online at www.lloydsbankinggroup.com

CUSTOMER SATISFACTION
(Net promoter score)

Our net promoter score is the measure of customer service at key touch points and the likelihood of customers recommending us. It has continued to improve in the year.

CUSTOMER COMPLAINTS
(FCA reportable complaints per 1,000 accounts[1,2])



Although customer complaints have increased in the year, levels remain significantly below most of our key competitors.

1 Excluding PPI.
2 The metric has changed from banking complaints to reportable complaints to reflect performance management measures.

BEST BANK FOR CUSTOMERS INDEX % favourable

Our score increased by 6 points in 2015. The index is the outcome of a survey of more than 68,000 of our employees which shows how strongly they believe we are committed to becoming the best bank for customers.

DIGITAL ACTIVE CUSTOMER BASE m

Reflecting the pace of digital adoption, our number of active digital customers increased in the year, from 10.4 million to 11.5 million.

Helping Britain Prosper Plan 2015

This is the second year we have tracked and reported performance against all our Prosper Plan metrics and targets.

		NUMBER OF METRICS	ACHIEVED	NOT ACHIEVED
1	We'll help more customers get on the housing ladder – and more customers climb up it	3	●	
2	We'll help our customers plan and save for later life	1		●
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	4	●	
4	We'll help UK business to start up, scale up, and trade internationally to support the long term strength of the UK economy	6	●	
5	We'll help businesses and individuals to succeed with expert mentoring and training	5	●	
6	We'll be the banking Group that brings communities closer together to help them thrive	4	●	
7	We'll better represent the diversity of our customer base and our communities at all levels of the Group	5	●	

Our performance in 2015

Overall, in 2015 the Group performed well against the 28 metrics in the Plan and achieved 96 per cent of the targets we set for the year.

Particular highlights include providing 1 in 4 first-time buyer mortgages, supporting 1 in 5 start-up businesses, delivering 320,000 hours of colleague volunteering and achieving 31 per cent ✓ of senior roles held by women. Full details of our performance are available online.

We missed our target to help 100,000 customers plan and save for later life through company pension schemes. During 2015, 145,000 new customers started contributing to a corporate pension scheme managed by Scottish Widows. However, 139,000 customers stopped contributions with their existing employer, mainly because they started a new job with a new employer. Consequently, net growth in customer numbers was only 6,000.

We've therefore developed a new metric for 2016 to help consumers plan for later life through our retirement planning website. This reflects rapidly changing market conditions and our goal of helping more customers save for the long-term.

✓ Indicator is subject to limited ISAE 3000 (Revised) assurance by Deloitte LLP for the 2015 Annual Responsible Business Reporting. Deloitte LLP's 2015 assurance statement and the 2015 Reporting Criteria are available online at www.lloydsbankinggroup.com/RBdownloads

Read more about our 2015 performance and our new 2016 Prosper Plan targets at www.lloydsbankinggroup.com/ProsperPlan

Our strategic approach

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

Our strategy

We are a leading financial services group focused on becoming the best bank for customers whilst delivering superior and sustainable returns for shareholders through a simple, low risk, UK focused, retail and commercial banking business model.

In 2011, we outlined our strategy to be the best bank for customers and over the following three years the business was transformed with a reshaped, low risk portfolio, a strengthened balance sheet and a more efficient cost base. This firm foundation enabled us to launch the next phase of our strategy in 2014 which was focused on delivering value and high quality experiences for customers alongside superior and sustainable financial performance within a prudent risk and control framework.

We need to adapt to the changes in financial services brought about by technology, changing customer behaviour and increasing regulatory requirements at a time when traditional competitors' strategies converge and new entrants compete for customers. This change is being achieved through three strategic priorities which run to 2017. These priorities are:

– Creating the best customer experience

– Becoming simpler and more efficient

– Delivering sustainable growth

The achievement of our strategy could not happen without the support of our colleagues. We are therefore committed to 'building the best team' to create a high performance organisation.

You can read more about each of these priorities and the progress we made during 2015 on pages 20-21.

Operating responsibly

A sustainable and responsible approach to doing business is integral to everything we do. It underpins our aim to become the best bank for customers and our purpose to help Britain prosper. It is central to our strategy and business model. Our Helping Britain Prosper Plan sets out our public targets to help Britain's people, businesses and communities today, over and above our core business activities.

Doing business responsibly starts with our colleagues. We must continue to build a culture in which they are empowered, inspired and rewarded to do the right thing for customers. Our three Group Values: putting customers first, keeping it simple and making a difference together, provide inspiration and guidance. To help us live up to these values, as individuals, as a business or as suppliers, we operate in line with our Codes of Responsibility.

We have an effective top-to-bottom governance structure, providing an environment in which colleagues are encouraged and supported to do the right thing and to work responsibly. This governance structure includes our Group Board and Board-level Responsible Business Committee and cascades to every part of our business, through our Group Executive Committee and Group Customer First Committee.

Our focus on doing business responsibly is recognised by our continued presence in the FTSE4Good index, our position in the CDP (Carbon Disclosure Project) and Euronext Vigeo UK 20 Index, as well as our ranking in the Business in the Community CR Index.

OUR PURPOSE

HELPING BRITAIN PROSPER 15

OUR AIM

TO BECOME THE BEST BANK FOR CUSTOMERS WHILST DELIVERING SUPERIOR AND SUSTAINABLE RETURNS FOR SHAREHOLDERS

OUR BUSINESS MODEL

SIMPLE, LOW RISK, UK FOCUSED, RETAIL AND COMMERCIAL BANK 18

OUR RESPONSIBLE APPROACH TO BUSINESS 22

OUR STRATEGIC PRIORITIES

Creating the best customer experience

Becoming simpler and more efficient

Delivering sustainable growth

SUPPORTED BY OUR COLLEAGUES

Building the best team

Read more about our strategic priorities on page 20.

Our purpose

Helping Britain prosper

People, businesses and communities are facing some challenging issues. We are using our scale, reach and influence to help address these, through our Helping Britain Prosper Plan

We have always understood that when people, businesses and communities across Britain prosper, so do we. We help Britain prosper through our core products and services, but over and above these, through our Helping Britain Prosper Plan, which we launched in March 2014 and refreshed in 2015. The Plan was created in consultation with our stakeholders and external experts to ensure it is relevant and focused. It sets out clear targets to address social and economic issues prioritised by stakeholders which, as a bank, we are well placed to help address. These include: the shortage of affordable homes; supporting small businesses and the UK's manufacturing base; helping people and organisations acquire the digital skills and capability they need; and tackling disadvantage in local communities in order that more people can share in the UK's economic growth.

Evolving the Prosper Plan

We're continually evolving the Plan to reflect changing social and economic needs. A wide range of different stakeholders – including customers, colleagues, community partners, our charitable Foundations and opinion formers – have directly or indirectly contributed to this evolution. As a result, the Plan is simpler, more focused, more ambitious and increasingly measured in terms of the positive outcomes it achieves, not on its reach. Our ambition is to measure and audit the whole Plan on this basis, by 2017.

2016 Prosper Plan

The 2016 Plan is focused on helping people, businesses and communities to prosper, and has 24 metrics. It includes four new targets:

- Number of high value manufacturing apprenticeships as a result of our £1 million per year funding
- Number of customers helped to plan for later life through our retirement planning website
- Amount raised by colleagues and communities for our Charity of the Year
- Arrange and provide new funding support for social housing

We recognise that a major challenge for the UK economy is the relatively low level of productivity. Accordingly, in 2016 we are reviewing how we can help Britain become more productive and more globally competitive.

Britain doesn't stand still and our Plan needs to evolve to stay relevant. Consequently, we are refocusing our goals, targeting where we can make the biggest positive difference and setting even more stretching and measurable targets.

Sara Weller
Chairman, Responsible Business Committee

Building digital skills

Part of our vision is to help Britain prosper by giving everyone the chance to develop and improve their digital skills. In 2015 we supported the UK's digital skills charity Go ON UK's launch of the Digital Inclusion Heatmap. This was developed in conjunction with a number of partners to help ensure everyone in the UK has the basic digital skills they need. The Heatmap displays a measure of digital exclusion at a local level, providing policymakers and those working in the digital skills and inclusion sector with the insight to help drive engagement, action and funding where it is most needed.

>11,000 colleagues helping people and businesses improve their digital skills in 2015. We are on track to achieve our target of 20,000 by the end of 2017

Supporting small building firms

Lloyds Banking Group and the UK government launched the Housing Growth Partnership in 2015 to diversify house building. As a result, small house building firms are benefiting from a £100 million cash boost, recognising and supporting their key role in keeping the UK building. We have pledged £50 million of the fund to provide smaller building firms with capital to allow them to recruit and train skilled workers and become more competitive. We have also pledged £1 million over four years to support the development of construction skills in London.

Market overview

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

UK economic trends

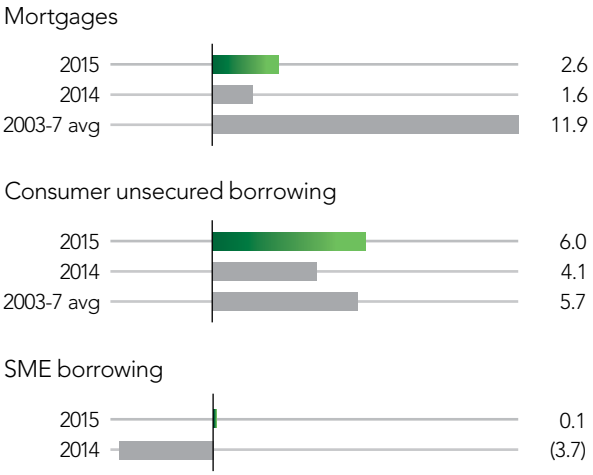
Resilience in the face of a fragile global economy

Initial estimates indicate that the UK economy grew by 2.2 per cent in 2015, close to its 25-year average, at a time when global growth slowed. UK economic growth was the second strongest of the G7 countries, only marginally behind the US. Eurozone growth improved during 2015, back to its 25-year average, but at 1.5 per cent it remains significantly slower than the UK.

Leadership of global growth is shifting back to developed economies as they emerge from a period of private sector debt reduction, government cuts and tax increases. The slowdown in emerging markets as their credit cycle turns is pushing inflation down across the world as their currencies and commodity prices fall. UK inflation has hovered close to zero throughout 2015, and as a result, consumers' inflation-adjusted incomes have increased, ending a seven year period in which they had been broadly flat. That has boosted consumer spending growth to an eight year high in 2015, and helped push unemployment down to pre-crisis levels.

Low inflation and risks from the slowdown in emerging markets are complicating central banks' setting of interest rates. The US increased rates in December 2015 for the first time since 2006, much later than had been expected at the start of the year. And the UK hasn't yet raised rates, contrary to consensus expectations at the start of 2015 of two increases during that year. Low interest rates, along with limited supply, have boosted property prices with UK house prices up 10 per cent during 2015, surpassing their 2007 peak, and commercial property prices up 7.8 per cent.

GROWTH IN OUR MARKETS
(yearly % change in UK market balances)



Market growth

Growth in the markets in which we operate has improved but in aggregate remains much weaker than pre-crisis. Mortgage volumes for house purchases rose 4.7 per cent to a post-crisis high, and their value rose by 10.7 per cent, pushing growth in balances up from 1.6 per cent in 2014 to 2.6 per cent in 2015, its strongest since 2008. Growth in consumer unsecured borrowing balances rose from 4.1 per cent in 2014 to 6.0 per cent in 2015, the strongest since 2005. Small and medium-sized companies (SMEs) have started to increase borrowing from banks again in 2015 for the first time since 2008, while companies' deposits continued to grow rapidly, up 11.5 per cent in 2015 after an average of 9.3 per cent across 2013-14. Consumer deposit growth fell back slightly from 4.3 per cent in 2014 to 3.8 per cent in 2015, but this was mainly due to the government's launch of pensioner bonds.

Margin pressure

Competition and the delay in Bank Rate increases are keeping banks' margins under pressure. The spread between average lending and deposit rates has held fairly flat in 2015 close to its pre-crisis level, having improved from the very low level of 2011-12 when wholesale funding costs were exceptionally high. Lending rates have fallen to a record low in 2015, and whilst deposit rates have fallen during the year they are still higher than short term financial-market rates, opposite to pre-crisis. Mortgage pricing has been particularly aggressive in 2015, with spreads on new loans over market funding costs falling around 50 basis points through the year.

Low level impairment

Improving indebtedness, along with the continued low interest rate environment, is continuing to reduce impairments which are below expected through-the-cycle levels. The share of highly indebted consumers has fallen further in 2015, and consumers' concerns over their level of debt and mortgage payments are back to pre-crisis lows. Personal and corporate insolvency rates are low, both around half their 2009-10 peaks. Rising property prices have also sharply reduced potential losses from defaults on property lending.

Outlook for 2016

Despite challenges from slowing emerging markets and rising US interest rates, the most likely outlook for the UK in 2016 is another year similar to 2015. Consensus expectations are for gdp growth of 2.2 per cent, CPI inflation rising to 1.1 per cent by the end of the year, house prices up 5 per cent, and another year without a rise in Bank Rate. As the recovery matures, borrowing is rising and domestic consumption will be the primary driver of economic growth. Lending has been subdued for five years and corporate and household balance sheets have strengthened, so that credit has room to grow without threatening macroeconomic stability. Low inflation will keep real household incomes growing, sustaining economic growth despite headwinds from the elevated level of sterling, weak manufacturing activity, tightening benefit payments and uncertainty over the future of the UK's membership of the EU.

There are, however, risks to those expectations, stemming from the deflationary impact of the slowdown in emerging markets, the associated recent volatility in financial markets that might weaken consumer and business confidence; and the referendum on UK membership of the EU which, if the vote is to leave, may create a period of uncertainty and impact companies' investment plans. Crystallisation of any of these risks could impact the UK economy, which in turn would have a negative impact on the Group's income, funding costs and impairment charges.

Regulation

The regulatory landscape in which we operate continues to evolve with the key areas of focus now protecting consumers and small business customers, ensuring competitive markets and strengthening the prudential framework.

Competition and conduct remain core elements of regulatory reform and regulators continue to undertake reviews into certain products and markets. For small business and personal current account customers, the Competition and Markets Authority (CMA) initiated a review in 2014 and has released a notice of possible remedies to improve transparency and the ease of switching having provisionally rejected structural remedies. Other competition reviews progressing include the FCA's review into the credit card market, whilst in the Insurance business we have seen the introduction of a cap on corporate pensions. The Payment Systems Regulator is separately reviewing indirect access and infrastructure provision. From a conduct perspective, the most significant development for us was the FCA decision to consult on a deadline for PPI complaints, with the results expected in the first half of 2016. We continue to work to ensure we provide appropriate and fair products with clear, simple and relevant terms.

Alongside its December 2015 Financial Stability Report, the Bank of England issued its new capital framework, finalising its view on capital requirements for UK banks. This framework sets out the minimum requirements as well as the approach for setting capital buffers and the levels of debt required for resolution purposes. The framework will be implemented on a transitional basis, reaching an end-state by 2019. Also in December 2015, the Bank of England approved Scottish Widows Group's internal model for calculating its capital requirements under the Solvency II regime. We remain comfortably in excess of minimum requirements on our key capital ratios and are well positioned for implementation. The resilience of our capital position was demonstrated again in 2015 when we comfortably exceeded the threshold for the latest PRA stress test. In addition, from October 2015 the Liquidity Coverage Ratio (LCR) became the key ratio for the amount of cash and liquid assets a bank must hold, with the bank comfortably meeting its requirements.

Ring-fencing and resolution regulation continues to be relevant for all European banks under the EU Bank Recovery and Resolution Directive and additionally for UK banks under the Financial Services (Banking Reform) Act. Final legislation and near-final rules have now been issued, enabling us to better plan for implementation. Given our UK retail and commercial focused business model, we continue to expect ring-fencing to be less onerous for us to implement than many of our UK peers as we anticipate the vast majority of our business will sit within the ring-fence.

There are a number of other regulatory changes that have been implemented or developed through 2015, several of which are relevant to our business, including the Fair and Effective Markets Review, the Senior Managers and Certification Regime (SM&CR) and changes to the individual and corporate pensions market.

Overall however, we believe our simple, low risk, UK focused strategy puts us in a strong position to adapt to the evolving regulatory landscape.

Customer drivers and competition

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 and via a range of channels. The proportion of the UK population with access to the internet has increased significantly over the past few years, as has the proportion of people accessing the internet via their mobile phone. This has changed customer behaviours and expectations in terms of how they shop for goods and undertake banking and these trends are expected to accelerate.

Our customers require different products and services at different stages of their lives, with younger people requiring help with planning and providing for retirement, while the older generation is becoming increasingly interested in accessing their equity to support their retirement.

Many customers are motivated by their desire to achieve better value for money, not least in the current low interest rate environment, but security and reputation remain important factors. Customers want clear and transparent products delivered with good service and access to relevant, expert advice when they need it.

We have seen an influx of new entrants to the market, with a variety of business models. Many of these new entrants have expertise and experience in digital product offerings, with strong funding positions, credible brands, and in some cases pre existing customer bases and branch networks. In addition, non banks such as technology firms and supermarkets are disrupting the banking industry.

As outlined above, 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.

Our strategy, which focuses on our multi-brand, multi-channel distribution model, simpler processes, customer-driven product range and expertise across insurance and banking, puts us in a unique position to respond to these market conditions and meet the needs of individual and corporate 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. Read more about our strategic priorities on pages 20-21.

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 few years means we are better positioned to benefit from the UK economic recovery.
- Customer needs: our differentiated customer focused strategy along with our comprehensive multi-channel distribution network, and in particular our evolving digital capability, mean we are well positioned to address changing customer needs.
- Regulatory environment: greater clarity emerging on regulatory requirements and our simple, low risk, UK focused strategy places us in a strong position.
- Low cost position: this enables us to provide competitive differentiation for the benefit of customers and shareholders.

Key challenges

- Economic environment: increased concerns on the global growth outlook, the impact of continued low interest rates and the impact of the EU referendum.
- Regulatory environment: the level of regulatory change remains high with continued focus on ring-fencing, resolution and conduct. The SM&CR could potentially have significant impact on the business.
- Competition: an increasingly competitive market for lending and deposits could further impact margins and require us to innovate and evolve more quickly.
- Digital transformation: the pace of change is significant and we will need to continue to invest to meet evolving customer needs.

Our business model

We have a differentiated, UK focused, retail and commercial banking business model

By putting customers at the heart of everything we do, operating sustainably and responsibly and continuing to invest in our business strengths, we believe we will help Britain prosper and create value for our shareholders

EXTERNAL ENVIRONMENT

Our business model is influenced by external factors which continue to evolve, in particular:

Customer needs
We are adapting to changing customer behaviour such as the increased adoption of digital product offerings.

Economic and political environment
Our focus on the UK means our future is inextricably linked to the health of the UK economy, which has continued to perform resiliently.

Regulatory environment
Although we are now seeing more clarity, the level of regulation – whether it be focused on consumer protection, conduct, competition, capital or ring-fencing and resolution – remains high.

Competitive environment
The UK financial services market is one of the most competitive worldwide and in such a dynamic market, we continue to differentiate ourselves accordingly.

COMPETITIVE STRENGTHS THAT DIFFERENTIATE LLOYDS BANKING GROUP

We have a number of strengths and capabilities that provide significant advantage and differentiation, driving value creation. Maintaining this through continued investment is key to future success.

UK focus: Operating primarily in the UK means we are focused on a single developed market that we truly understand. It also means we avoid the complexities and costs of multi-jurisdictional operations.

Simple, low cost operating model: Our simpler operating model and focus on operational efficiency already provides a cost advantage which benefits both customers and shareholders and will continue to be a key focus for the Group.

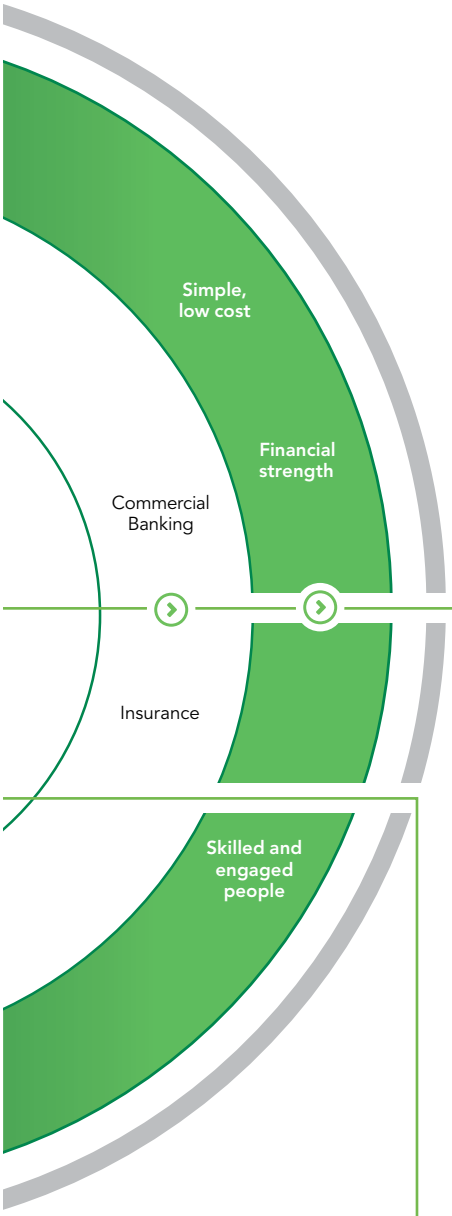
Low risk business: Being a low risk bank is central to our business model and to reducing earnings volatility. Our low risk appetite is reflected through the low level of non-performing loans and non-core assets and our credit default swap spread, which is amongst the best in the banking sector worldwide.

Financial strength: Our balance sheet and funding position have both been transformed in recent years and they are amongst the strongest within the banking sector worldwide.

Multi-brand proposition: Offering our services through a number of recognised brands enables us to address the needs of different customer segments more effectively.

Multi-channel approach: Operating in an integrated way through a range of distribution channels, including the largest branch network in the UK and a comprehensive digital proposition, ensures our customers can interact with us when they want and how they want.

Skilled and engaged people: Our colleagues provide real advantage. We continue to build a responsible culture where it is clear what is expected of them. Our Group Values of putting customers first, keeping it simple and making a difference together provide this clarity. We invest in skills and training while ensuring alignment to our customer focused strategy and commitment to build the best team.



PRODUCTS

Our product range is driven by the needs of our retail and commercial customers and informed through comprehensive customer analysis and insight.

Lending
mortgages, credit cards, personal and business loans

Deposit taking
current accounts, savings accounts

Insurance
home insurance, motor insurance, protection

Investment
pensions and investment products

Commercial financing
term lending, debt capital markets, private equity

Risk management
interest rate hedging, currency, liquidity

CREATING VALUE

Outcomes for our stakeholders

Customers:
Best bank for customers

Doing the right thing for our customers by meeting their financial needs, helping them succeed, improving our service proposition and creating value for them, is fundamental to our business model and the long-term sustainability of the business.

Shareholders:
Superior and sustainable returns

The successful delivery of our business model and strategy should enable delivery of superior and sustainable returns for our shareholders.

Society:
Helping Britain prosper

As the largest retail and commercial bank in the UK, helping Britain prosper is our central purpose. We have a number of public targets in areas where we can make the biggest difference for people, businesses and communities which are outlined in our Helping Britain Prosper Plan.

STRATEGIC PRIORITIES

We are adapting to the changes brought about by technology, changing customer behaviour and increasing regulatory requirements in a competitive market environment. To achieve this, we are focusing on three strategic priorities whilst building the best team.

Creating the best customer experience

Becoming simpler and more efficient

Delivering sustainable growth

SUPPORTED BY OUR COLLEAGUES

Building the best team

Read more on page 20 or visit www.lloydsbankinggroup.com

Our strategic priorities

Creating the best customer experience

We are improving customer experience with our multi-brand, multi-channel approach, combining digital capabilities with face-to-face services. We are transforming our digital presence, providing simpler, seamless interactions across online and mobile while sustaining extensive customer reach through our leading branch network.

Initiatives

- Seamless multi-channel distribution across branch, online, mobile and telephony
- Tailor product propositions to meet customer needs more effectively
- Commitment to conduct and investment in service

Expected outcomes

- Improved customer experience through enhanced digital offering
- Retain convenience and reach of the leading branch network
- Improvement in customer satisfaction and lower complaints

Progress in 2015

21%

digital market share[1]

- Largest digital bank:
  - 11.5 million online users/6.6 million mobile users
  - Increasing market share
- Enhanced digital offering:
  - UK's no 1 rated banking app
  - Direct to consumer car financing proposition
- Further investment in market leading branch network, rolling out Wi-fi and automated solutions to the majority of branches
- Net promoter score >50 per cent higher than at the end of 2011
- Customer complaints (excluding PPI) remain lower than our peers

1 Retail and Home Insurance H2 digital market share of new business flows.

Becoming simpler and more efficient

We are creating operational capability which is simpler and more efficient than today through further system enhancement and integration. We are becoming more responsive to changing customer expectations while maintaining our cost leadership amongst UK high street banks. This cost leadership enables us to provide increased value to our customers and competitive differentiation.

Initiatives

- Re-engineer and simplify processes to deliver efficiency in a digital world
- Reduce third party spend
- Increase investment in IT efficiency and resilience

Expected outcomes

- Increased automation of end-to-end customer journeys
- More efficient change capability
- Resilient systems and processes
- Continuation of Simplification programme
- Maintain cost leadership position

Progress in 2015

49.3%

cost:income ratio

- Cost leadership with continued reductions in cost:income ratio to 49.3 per cent
- Actively responding to lower rates through accelerated cost delivery and targeting further efficiency savings
- Ahead of target in delivery of £1 billion Simplification savings: £0.4 billion achieved to date
- Increased automation of key end-to-end customer journeys

Delivering sustainable growth

As the UK economy continues to recover, we are further developing Groupwide growth opportunities within our prudent risk appetite. We are maintaining market leadership in our main retail businesses, making the most of our multi-brand, multi-channel strategy whilst also focusing on areas where we can grow.

Initiatives

– Maintain market leading position in key retail business lines
– Leverage Group strengths to capture growth in underrepresented areas

Expected outcomes

– Net lending growth of >£1 billion annually in both SME and Mid Markets
– Consumer Finance to increase UK customer assets by over £6 billion from 2015 to 2017
– Support our customers in retirement planning, increasing customer assets by over £10 billion

Progress in 2015

5%

SME lending growth

– Growth in targeted areas:
  - SME lending growth of 5 per cent in a flat market
  - Consumer Finance customer asset growth of £3.2 billion
  - Execution of first external bulk annuity transaction
– Maintain market leadership in key retail business lines:
  - Market leadership retained in current accounts and deposits
  - Mortgage growth below market due to focus on protecting margins

Building the best team

Our colleagues are fundamental to the achievement of our strategy. We are committed to building a business our colleagues are proud to work for by creating the best environment for them to succeed, providing them with the right skills and tools and giving them the opportunity to share their views.

Initiatives

– Create a great place to work that is focused on the customer
– Build a high performance organisation
– Build an inclusive workplace with a diverse workforce
– Ensure reward structures are fair, transparent and understandable for colleagues

Expected outcomes

– Engaged colleagues who actively share their views
– Collaborative working environment that enables colleagues to work together better for the benefit of customers
– Line managers have the talent and capabilities to lead their teams and deliver our strategy
– An environment which supports agile working, a customer-centric mind-set and a culture of coaching and development
– Enhanced benefits package with simplified pay ranges

Progress in 2015

↑11 points

employee engagement index

– Best bank for customers index up 6 points highlighting increased customer focus in the business
– Employee engagement up 11 points
– 31 per cent of senior roles now held by women
– Top private sector company for lesbian, gay, bisexual and transgender people in the Stonewall Top 100
– Agile working programme launched
– Over 9,800 managers enrolled on new Line Manager Academy
– Enhanced reward proposition including simplified pay ranges

Operating responsibly

HOW WE RUN A RESPONSIBLE BUSINESS

Operating responsibly requires running our business in ways that meet all relevant legal and regulatory requirements. In addition, we have a number of internal policies and procedures related to doing business responsibly. These include our Ethics, Speak Up and Anti-Bribery policies.

As recent signatories to the UN Global Compact, we operate in line with its ten principles and support the UN's wider development agenda, including the Guiding Principles and Sustainable Development Goals. We welcome the Modern Slavery Act and will issue our first statement in 2017.

We assess and manage social, ethical and environmental risk in our lending activity and the Group is a signatory to the Equator Principles which provide a framework for determining, assessing and managing environmental and social risk in project finance transactions. We recognise the need to address climate change, protect biodiversity, support local communities and ensure human rights are protected.

Our Code of Business Responsibility affirms that we do not finance any activities prohibited by international conventions supported by the UK government, such as the Oslo Convention on Cluster Munitions and the Ottawa Treaty on Anti-Personnel Landmines. Consequently, we will not enter into credit or investment relationships with businesses believed to be in breach of these conventions.

Read more about our approach to managing risk and the Equator principles online at www.lloydsbankinggroup.com/RB

Focusing on what matters most

To guide our corporate reporting, we conducted a comprehensive materiality survey to identify and prioritise the issues that matter most to our stakeholders, including colleagues and opinion formers. This process was informed by a survey of more than 2,000 adults in the UK[1].

The five issues that most concerned our stakeholders in 2015:

- **Building trust in our business**
- **Running our business even more responsibly**
- **Improving customer experience**
- **Making our products and services clearer**
- **Explaining our wider economic contribution**

Doing business responsibly, sustainably and ethically, is the way to rebuild trust with people, businesses and communities across Britain, whilst also strengthening colleagues' pride in our Group.

Sara Weller
Chairman, Responsible Business Committee

1 Total sample size was 2,030 adults, of which 1,950 have a bank account. Fieldwork was undertaken by YouGov Plc between 8-9 October 2015. The survey was carried out online. The figures were weighted to be representative of all GB adults (aged 18+).

Read more about our Codes, Policies and our full Materiality Report at www.lloydsbankinggroup.com/RBDownloads

Building trust in our business

We can only achieve sustainable growth if we earn and retain the trust of our customers and other stakeholders. Trust is not a nice to have, it is a must have.

Greater transparency

We are committed to conducting our business responsibly and dealing transparently and fairly with any queries or concerns our stakeholders may have about our business or our strategy. We know that in order to become the best bank for customers we must be clear, open and visible about these key issues.

A clear purpose and strong values

We have set out our corporate purpose, to help Britain prosper and our ambition to do so as the best bank for customers. In 2012, we launched our three Group Values: putting customers first, keeping it simple, and making a difference together. These values and our Codes of Responsibility are embedded across the business, from recruitment through to performance management and training and development. The results of our colleague engagement surveys suggest that colleagues are increasingly guided and inspired by our Values.

97% of colleagues have completed training on our Codes of Responsibility and culture

Building a responsible culture

To become the best bank for customers we must continue to put the customer at the heart of everything we do. This year we created a new Group Customer First Committee, attended by senior leaders from across the business including the Chief Executive's Chief of Staff. The Committee is driving the development of a new Culture Framework. We will use this Framework to create a culture dashboard, to enable us to monitor our progress.

In building a culture in which colleagues are empowered, inspired and incentivised to do the right thing for customers, we assess our progress, along with colleagues' pride in our Group through our 'Best Bank for Customers' and 'Building the Best Team' surveys. In 2015, 85 per cent of colleagues responded to the latter. A new statement was included in 2015 – 'I understand how my team is supporting the Group's purpose to Helping Britain Prosper' where 81 per cent of colleagues agreed. This regular dialogue with colleagues provides rich data and a clear picture of how they're feeling. Further information on engaging colleagues, which is incorporated by reference into the strategic report, is on page 109 of the Directors' Report.

Read more information about building a responsible culture at www.lloydsbankinggroup.com/RB

Running our business even more responsibly

Stakeholders require reassurance that we run our business responsibly, complying with laws and regulations, managing risk effectively, and targeting growth in a sustainable and ethical manner.

A clearly defined business model and strategy

We are a simple, low risk, UK focused retail and commercial bank. A responsible approach is integral to our business model and our approach to value creation. You can read about this on page 18.

Strong risk management and governance

We need to manage risk effectively and make the right decisions for our customers, shareholders and the Group. We have a Board approved Group Risk Management Framework in place which you can read about on page 29.

Tackling bribery and corruption

We have established policies and procedures to ensure the Group complies with all applicable laws and regulations wherever it operates. Our Anti-Bribery Policy and principles apply to all Directors, colleagues, and anyone else acting on our behalf. The Policy prohibits the payment, offer, acceptance or request of any benefit (including cash) which could be construed as a bribe. All colleagues, including contractors, complete annual anti-bribery training and are encouraged to confidentially report any instances of suspected bribery via the Speak Up service or their line manager. Our suppliers are required to ensure that their employees are provided with appropriate training and awareness on a regular basis. Since 2014, the Group has been a member of Transparency International UK's Business Integrity Forum, a network of major international companies committed to anti-corruption and high ethical standards in business practices.

Paying and collecting UK tax

We continue to be one of the highest payers of UK tax; rated as second highest in the latest 100 Group PwC Total Tax Contribution Survey. We do not interpret tax laws in ways that we believe are contrary to their intention and we do not promote tax avoidance to our customers. We comply with the HMRC Code of Practice on Taxation for Banks and the Confederation of British Industry's Statement of Tax Principles. We are also a major tax collector, gathering £2.2 billion on behalf of HMRC in 2015.

£1.8bn of tax paid in 2015 (2014: £1.7bn)

Read more about stakeholder engagement at www.lloydsbankinggroup.com/RB

Improving customer experience

We want to be the best bank for customers, doing the right thing for them by providing products and services that they can afford, understand and trust to achieve the outcomes they want.

Improving customer experience

Over the past two years we have made significant improvements, designed to enhance outcomes for customers. They include improvements to our product governance processes, making our motor finance customer credit checks more rigorous, simplifying the terms and conditions information we publish and redesigning the way we support customers who have suffered recent bereavement. We aim to lead our industry in the way we treat these and other customers in vulnerable circumstances.

Measuring customer satisfaction

We measure customer satisfaction using the industry standard Net Promoter Score. We also use internal customer dashboards, which provide monthly information about customers' experience and views relating to our products and services. These data are discussed at the Group Executive Committee and the Board.

Dealing with customer complaints

We continue to take all complaints seriously. Improvements to our products and services and understanding the root causes of customer dissatisfaction underpins our efforts to reduce complaints. Where things do go wrong, we aim to put them right as quickly as possible, operating a 24-hour, 7-days a week service. To help ensure customers are dealt with as efficiently as possible, front line colleagues can use a 'phone-a-friend' escalation service to talk to specialists about a complaint whilst with a customer. In our drive to continuously improve of our complaints handling service, we encourage and support colleagues to study for an externally accredited complaint handling qualification. This type of commitment and investment has helped us to resolve in excess of four out of five of our general complaints either on the day they are received or by the end of the following day.

Read more about customer experience at www.lloydsbankinggroup.com/RB

Operating responsibly continued

Responsible marketing and communications

As a responsible business we must ensure that the way that we market our brands, products and services is fair, accurate, not misleading and ultimately easy for consumers to understand. The Group complies with voluntary and mandatory advertising and marketing standards. We are working to better understand customer behaviour and have used behavioural economic techniques to assess their preferences and improve our marketing materials as a result. This has made them more concise and clear. For example, we've simplified a savings maturity letter by introducing summary boxes and bullet points to highlight key information. This simple change has contributed to a reduction in complaints about the product maturity process by 80 per cent.

Protecting customers' privacy and data

Our customers, including 11.5 million who actively bank digitally, of which 6.6 million who use their mobile to bank with us, trust us with their money and personal details. To protect these assets, we consistently invest in security technologies, processes and training for colleagues. Since 2011 we have invested £157 million to improve security and provide protection for our customers. We also provide our customers with useful information about how they can improve their own money and data security behaviour.

We closed down more than 2,353 fraudulent websites in 2015 and we are a strategic partner of Get Safe Online, a joint initiative between the government, the National Crime Agency, and public and private sector supporters from the technology, communication, retail and finance sectors. We monitor unusual activity on customer accounts and use state-of-the-art technology to detect potential criminal activity. If we spot anything suspicious we take immediate and appropriate action.

26m credit and debit card transactions monitored for potential fraud every month

Tackling money laundering and terrorist financing

We take steps to make sure our products are not used for criminal purposes, such as money laundering and terrorist financing, working closely with legislators and regulators to combat this. We complete appropriate and proportionate customer due diligence throughout the duration of the customer relationship, and we monitor unusual activity on all customer accounts and use advanced technology to detect potential criminal activity. If we spot anything suspicious we take immediate and appropriate action. In 2015 we made further revisions to our Anti-Money Laundering and Counter Terrorist Policy and launched specialist training across the Group to help colleagues understand what is required from them.

Reporting concerns

Our whistleblowing policy, known as 'Speak Up', explains how colleagues can raise concerns confidentially without fear of reprisal. During 2015, 153 allegations received through our Speak Up line were investigated. Of the investigations concluded at year end, 63 per cent were upheld with appropriate remedial action taken where necessary. The majority of Speak Up allegations come from our Retail and Group Operations divisions, which given the scale of these business areas remains proportionate. We continue to educate and empower colleagues to do the right thing for our customers by challenging wrong behaviours if they witness them.

Download more information about our Codes and Policies at www.lloydsbankinggroup.com/RBDownloads

Making our products and services clearer

We serve an increasingly diverse customer base of individuals and businesses. To deliver sustainable growth we need to serve them all equally well.

Responsible lending

We understand the need to lend responsibly, in line with our own low-risk business model and customers' ability to meet their repayments. The support we offer all customers and the credit worthiness processes we use, reflect our responsible approach.

Serving vulnerable customers

Ensuring our products and services are accessible and suitable to the individual needs of all our customers is at the heart of everything we do; consistently offering the best experience for all of our customers, providing products and services when our customers need our support. This includes improving our processes when customers are bereaved and reviewing our websites and mobile banking services to ensure they are accessible to all our disabled customers.

Help for homebuyers

Buying a property is the biggest financial commitment many people ever make. We want to help more people get onto and move up the housing ladder. We made a public target to provide 1 in 4 of all new first-time buyers' mortgage loans completed in the UK in 2015, and we have fulfilled that commitment. Across all our customer brands, our gross new mortgage lending totalled £39 billion in 2015, and our support for home-buyers represented over 60 per cent of this lending.

We are a leading supporter of the UK government's Help to Buy scheme. We have advanced £3.5 billion of new lending to customers under the mortgage guarantee element of the scheme, since it was launched in the second half of 2013 up to the end of 2015.

>£11bn of new mortgage lending to more than 79,000 first-time buyers in 2015

Help for businesses

Our year-on-year net growth in lending to SMEs increased by 5 per cent in 2015. Our lending to SMEs has grown 25 per cent net since 2011, while it declined 13 per cent across the industry as a whole during the same period.

As part of our Helping Britain Prosper Plan we have a target to increase the amount of net lending to SMEs and Mid Market companies by £53 billion by 2017. We met our 2015 Prosper Plan target to increase net lending to these segments by at least £2 billion.

We support our business customers through our extensive network of customer facing staff. More than half a million business and commercial clients now bank digitally with us. We work with the Tinder Foundation and other partners such as the Government to improve digital skills for individuals, small businesses and charities.

Widening financial inclusion

We want to do more to help customers who are financially excluded or at risk of becoming so. Our financial inclusion strategy, launched in 2014, focuses on four strategic themes: providing accessible products and services that meet customers' needs; improving awareness and understanding of the impacts of financial exclusion across the bank; working in partnership with and signposting to other organisations that might be better suited to meet customer needs; and continuing to invest in financial education.

Opening a basic bank account can be the first step towards financial inclusion for many customers. In 2015, we provided over 300,000 new basic bank accounts and also helped 55,000 customers upgrade from basic to more mainstream products.

Digital technology offers an important opportunity to make financial services more accessible. Today, almost 6 million adults in the UK have never used the internet and over 50 per cent of charities and more than 1 million small and medium-sized businesses lack basic digital skills. Increasing digital capability is one of the most important factors that will drive financial inclusion over the coming years, so we aim to use our expertise and reach to promote wider understanding and access, as shown in our Lloyds Bank Consumer Digital Index.

Financial support and education

The credit union sector provides an essential service to many people across Britain. We believe that it can become an even more powerful choice for consumers to turn to, which is why we've been working in partnership with the Association of British Credit Unions Limited and the Credit Union Foundation, to provide a £4 million fund over four years which is invested in the core funding of credit unions to help them become more sustainable. In 2015, 69 credit unions applied for awards and 21 secured a large grant or seed funding.

We can help our current and future customers to avoid financial difficulties by providing them with a better understanding of money matters. We have invested £10 million in our Money for Life programme for young people since it launched in 2009. We are reviewing this programme in 2016 following the launch of the UK Financial Capability Strategy published by the Money Advice Service and our own experience of delivering community based financial education. We are considering additional ways to support customers and colleagues with money management.

£1m additional funding provided to support credit unions in 2015

Read more about our Helping Britain Prosper Plan at www.lloydsbankinggroup.com/ProsperPlan

Explaining our wider economic contribution

We contribute to the UK economy through our products and services, and through our commitments in our Helping Britain Prosper Plan. We also make a positive economic impact as a major employer and purchaser.

Creating new jobs

We employ more than 75,000 colleagues. We offer them all competitive rewards and benefits, including incentivisation schemes based on customer outcomes. We are helping to create additional jobs and bring talented people into our business through our Apprenticeship Scheme. This year we created over 1,000 new apprenticeship roles, bringing the total to over 3,200 since we launched the scheme in October 2012. We have committed, as part of our Helping Britain Prosper Plan, to create 8,000 new apprenticeships by 2020.

Supporting UK trade and manufacturing

Providing support to UK businesses so that they can export and attract international investment is essential to long term economic growth. In 2015, Lloyds Bank Commercial Banking became the first UK bank to enter into a strategic partnership with UK Trade and Investment to support UK businesses to export and to attract inward investment into the UK.

We are committed to supporting the manufacturing sector in the UK. In 2015, we announced a £5 million investment over five years to support over 500 skilled apprentices at the Lloyds Bank Advanced Manufacturing Training Centre in Coventry. This will help address the skills gap in the sector and help improve productivity and innovation in the sector.

£1.4bn of new funding support provided to UK manufacturing companies in 2015

Purchasing goods and services

We are working together with our suppliers and others in our supply chain to ensure we source goods and services in ways that are responsible, sustainable and mutually beneficial. They must also provide best value for our customers and shareholders. In 2015, we spent around £5.8 billion on a diverse range of goods and services, with over 4,000 different suppliers. We continue to honour our commitment to pay our suppliers on time and are signatories to the Prompt Payment Code. In our Helping Britain Prosper Plan, we set a 2015 target to pay 96 per cent of our supplier invoices within 30 days and we exceeded this target.

Read more about our business model and wider value creation on page 18.

Operating responsibly continued

RESPONSIBLE BUSINESS PERFORMANCE

In addition to the issues highlighted as most material by our stakeholders, we also report annually on other aspects of responsible business, which we regard as integral to our operations.

Colleagues

We want to ensure that every colleague feels valued and empowered to thrive in a truly inclusive business. We maintain regular dialogue with colleagues to assess their views and keep them informed about our performance and the issues we face. We have recognition agreements with two trade unions, Accord and Unite, which collectively negotiate and consult on behalf of around 95 per cent of our colleagues. You can read more about initiatives and progress on building the best team on page 21.

Learning and development

Investing in learning and development is critical in supporting colleagues to carry out their roles to the best of their ability. In 2015 we launched our Line Manager Academy, a brand new programme aimed at increasing the capability of our line manager population, reinforcing how they apply our values and Codes of Responsibility in their day-to-day roles. Overall, Colleagues logged onto our online learning system, Discover Learning, more than 10 million times and more than 96 per cent of our colleagues undertook formal learning.

Colleague well-being

We aim to make Lloyds Banking Group a great place to work for all colleagues, with their health and well-being as top priorities. We provide comprehensive online tools to support common health topics, such as fitness, smoking, diet and mental health. We issue monthly colleague newsletters on relevant issues. Working in partnership with external, market leading specialists, we provide colleagues with access to an Occupational Health Service, an Employee Assistance Programme, and to private medical cover. In 2015, we extended the company paid private medical provision to include all permanent colleagues.

Agile working

In 2015 we launched our Agile Working programme initiative, evolving our working approach to meet the ever-changing needs of our colleagues and customers. All colleagues can apply to work flexibly to support their preferred work-life balance, whether they're parents, carers, or have other priorities. In addition, they can buy extra holiday time and purchase other family benefits through our Flexible Benefits scheme. The Group was named a Top Ten Employer for Working Families in 2015.

Inclusion and diversity

We recognise that everyone is different. We value the unique differences that each of our colleagues bring to work every day. Together, they make Lloyds Banking Group stronger, and the best bank for customers. We're working hard to build an inclusive bank that reflects the diversity of modern Britain. All line managers completed inclusion and diversity capability training in 2015 and an additional 200 colleagues were trained to deliver disability awareness sessions with customers. Our 2015 'Words Count' campaign encouraged all colleagues to challenge non-inclusive language and behaviours, and over 20,000 colleagues are members our four diversity networks, which are open to everyone. The Group retained its leading position as the top private sector company for LGBT people in the Stonewall Top 100 and was named in The Times Top 50 Employers for Women. In addition we retained our Gold Standard in the Business Disability Forum Benchmark in recognition of the work done through the Group Disability Programme. More information on support for disabled colleagues, which is incorporated by reference into the strategic report, in the Directors' report on page 109.

		2015	2014
GENDER			
Board members	Male	**10**	10
	Female	**3**	3
Senior managers[1]	Male	**5,561**	5,644
	Female	**2,405**	2,204
Colleagues[1]	Male	**34,602**	35,255
	Female	**46,920**	47,728

	2015	2014[2]
ETHNICITY		
Percentages of colleagues from an ethnic minority	**6.8%**	6.6%
Ethnic minority managers	**6.4%**	6.0%
Ethnic minority senior managers	**3.7%**	3.3%

GENDER DIVERSITY[2,3] %

Colleagues (female)

Managers (female)

Senior managers (female)

DISABILITY %

Colleagues who disclose a disability

SEXUAL ORIENTATION %

Colleagues who disclose they are lesbian, gay, bisexual or transgender

1 Colleague scope of reporting: UK payroll headcount includes established and fixed term contract colleagues. Excludes parental leavers, Non-Executive Directors, contractors, temp, agency and internationals.

2 2014 figures restated due to a change in HR system, and also to include International colleagues within the gender information, to be on a comparable basis with 2015 figures.

3 Diversity scope of reporting: UK & International payroll headcount includes parental leavers and excludes contractors. Gender information includes International colleagues. All other diversity information is UK payroll only.

Seniors Managers: Grades F+
Managers: Grade D-E
Data source: HR system (HR Online). Apart from gender data, all diversity information is based on colleagues' voluntary self-declaration. As a result this data is not 100 percent representative; our systems do not record diversity data for the proportion of colleagues who have not declared this information.

✓ Indicator is subject to limited ISAE 3000 (Revised) assurance by Deloitte LLP for the 2015 Annual Responsible Business Reporting. Deloitte LLP's 2015 assurance statement and the 2015 Reporting Criteria are available online at www.lloydsbankinggroup.com/RBdownloads

Environment

Our ability to help Britain prosper 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.

We are committed to managing our direct environmental impact and reducing our greenhouse gas emissions. We do this through our Environmental Action Plan, which focuses on reducing risk and creating value through improved efficiency. More detail is included in our Environmental Statement, available online.

Greenhouse gas emissions

This year our overall carbon emissions, measured in CO_2 equivalent tonnes (CO_2e), have decreased by 9.85 per cent year-on-year and by 29.6 per cent against our 2009 baseline. The majority of this reduction is attributable to the reduction in consumption of gas and electricity, which make up the largest proportion of our emissions. This reduction was mainly due to energy management activity, for example continued optimisation of building management systems to ensure that heating and ventilation plant and lighting run times are matched to actual building operations and occupancy.

For more on emissions reporting and methodology, see the Directors' report, page 109.

CO_2e emissions (tonnes)

	Oct 2014 – Sept 2015	Oct 2013 – Sept 2014
Total CO_2e	398,191 ✓	441,703
Total scope 1	57,761 ✓	60,019
Total scope 2	241,008 ✓	264,252
Total scope 3	99,422 ✓	117,432

Restated 2013/2014 emissions data to improve the accuracy of reporting, using actual data to replace estimations and our re-categorisation of the emissions from our owned vehicles.

Emissions in tonnes CO_2e in line with the GHG Protocol Corporate Standard revised issue (2004).

Criteria used to measure and report Scope 1, 2, 3 emissions is provided in the Lloyds Banking Group criteria statement available online at www.lloydsbankinggroup.com/ResponsibleBusiness

✓ Indicator is subject to limited ISAE 3000 (Revised) assurance by Deloitte LLP for the 2015 Annual Responsible Business Reporting. Deloitte LLP's 2015 assurance statement and the 2015 Reporting Criteria are available online at www.lloydsbankinggroup.com/RBdownloads

32% reduction in energy use compared to our 2009 target baseline

Support for the low carbon economy

We provide finance to green industries and support for SMEs seeking to become more carbon and resource efficient.

In 2015, our UK based team was responsible for financing renewable projects with a combined capacity of more than 2.35GW. Globally, our investments in renewable energy are in excess of 9GW in capacity and cover solar, offshore and onshore wind, waste to energy and biomass.

Following the success of the Group's first Environmental, Social and Governance (ESG) bond in 2014, and in response to increased investor demand, it launched another £250 million bond in 2015. Lloyds Bank became the first UK bank to develop an ESG deposit scheme in response to client demand to invest in products that create positive impacts.

Read more on emissions reporting and methodology in the Directors' report 109

Communities

We are an integral part of communities across Britain, and we believe we can use our unique position to help them prosper. This year we raised £5 million (including matched giving) for our Charity of the Year, BBC Children in Need through various fundraising activity. In 2015, colleagues gave 320,000 paid volunteering hours to support community-based organisations. We are doing more to encourage skills-based volunteering.

The Foundations

We want to do more to help even more people through our four independent charitable Foundations. Our England and Wales Foundation is the UK's largest corporate foundation.

Since 1985, we have given almost £600 million to tackle disadvantage in communities across the UK.

£17m donated to our charitable Foundations in 2015

Stakeholders

We identify and engage with many different groups and individuals to understand their needs and views, to ensure our approach remains relevant.

Investors and ratings agencies

We held more than 1,000 meetings with investors in 2015. We regularly engage SRI/ESG investors as well as mainstream investors and investment analysts to provide them with information on our performance, strategic plans and how we do business responsibly. In 2015 we held a number of responsible business webinars and roadshows with investors and analysts. We also briefed ratings agencies about our performance against our Conduct Risk Appetite Metrics.

Independent Stakeholder Advisory Panel

Our Independent Panel is in place to provide an external viewpoint on elements of our Responsible Business strategy. In 2015, they discussed broad topics including our Helping Britain Prosper Plan and Financial Inclusion Strategy and fed back their recommendations to the Responsible Business Committee. You can read more about the Panel online at www.lloydsbankinggroup.com/RB

Read more about our community programmes at www.lloydsbankinggroup.com/RBCommunities

Risk overview

Effective risk management, governance and control

How we manage risk is a fundamental part of our strategy. We operate as a simple, low risk, UK focused, retail and commercial bank with a culture founded on a prudent through the cycle 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. Risk appetite, defined as the amount and type of risk that we are prepared to seek, accept or tolerate, 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

Group strategy and risk appetite are developed together to ensure one informs the other and creates 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 29). The principal risks we face, which could significantly impact the delivery of our strategy, are discussed on pages 30 to 33.

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

Sustainable growth

Embedding a risk culture that ensures proactive support and constructive challenge takes place across the business in order to deliver sustainable growth.

Prudent approach to risk

Implementing a prudent approach to risk appetite across the Group, aligned to the embedding of a strong risk culture, driven both from the top and across the wider business, ensures we operate within risk appetite.

Strong control framework

The Group's Risk Management Framework (RMF) acts as the foundation for the delivery of effective risk control and ensures that the Group risk appetite is adhered to.

Effective risk analysis, management and reporting

Close monitoring and stringent reporting to all levels of management and the Board ensures appetite limits are maintained and are subject to stressed analysis at a risk type and portfolio level.

Business focus and accountability

Effective risk management is a key focus and is included in key performance measures against which individual business units are assessed. The business areas in the first line are accountable for risk but with oversight from a strong and importantly, independent, Second Line Risk Division.

Achievements in 2015

We have continued our strategic journey and created a foundation to deliver our objectives, through reacting to changing customer behaviour, maintaining our strong capital position and increasing dividend payments, whilst continuing to adapt to the ever changing regulatory environment. Close and collaborative working across the Group within risk culture and appetite has supported key risk-related deliverables in the year. These included:

Conduct

Deploying a consistent and relentless approach under the Group conduct strategy to ensure we deliver customer needs with an open and transparent culture.

Credit rating

In recognition of the delivery of the Group's strategy, the three main credit rating agencies have either reaffirmed or upgraded our credit rating in the year.

State aid commitments

We have satisfied all material structural and behavioural commitments following the successful carve-out and disposal of TSB with respect to the State Aid commitments agreed with the European Commission under the State Aid regime in 2009. We are therefore no longer subject to restrictive behavioural commitments including the constraint on acquisitions, but continue to be bound by two remaining limited ancillary commitments which means that we remain subject to supervision by the European Commission with respect to these commitments until they cease to have effect on or before June 2017. Our strong risk management has assisted in the government's continued sell-down of shares to a holding which is approximately 9 per cent.

Capital strength

We have maintained our strong capital position through a combination of increased underlying profit and lower risk-weighted assets, partially offset by PPI and other conduct charges, which enabled the Group to pay both an interim dividend at half year and to recommend the payment of both a full year ordinary dividend and a special dividend whilst maintaining strong capital ratios. In 2015 the Group participated in the UK-wide concurrent stress testing run by the Bank of England, comfortably exceeding both the capital and leverage minimum thresholds set.

Impairments

Through effective risk management our impairment charge has fallen to £568 million, while the impairment ratio fell to 0.14 per cent. Reduction in run-off assets and the sustained improvement in asset quality across the Group reflects our robust risk management framework which is ingrained across the entire business, as detailed on page 29.

Risk governance

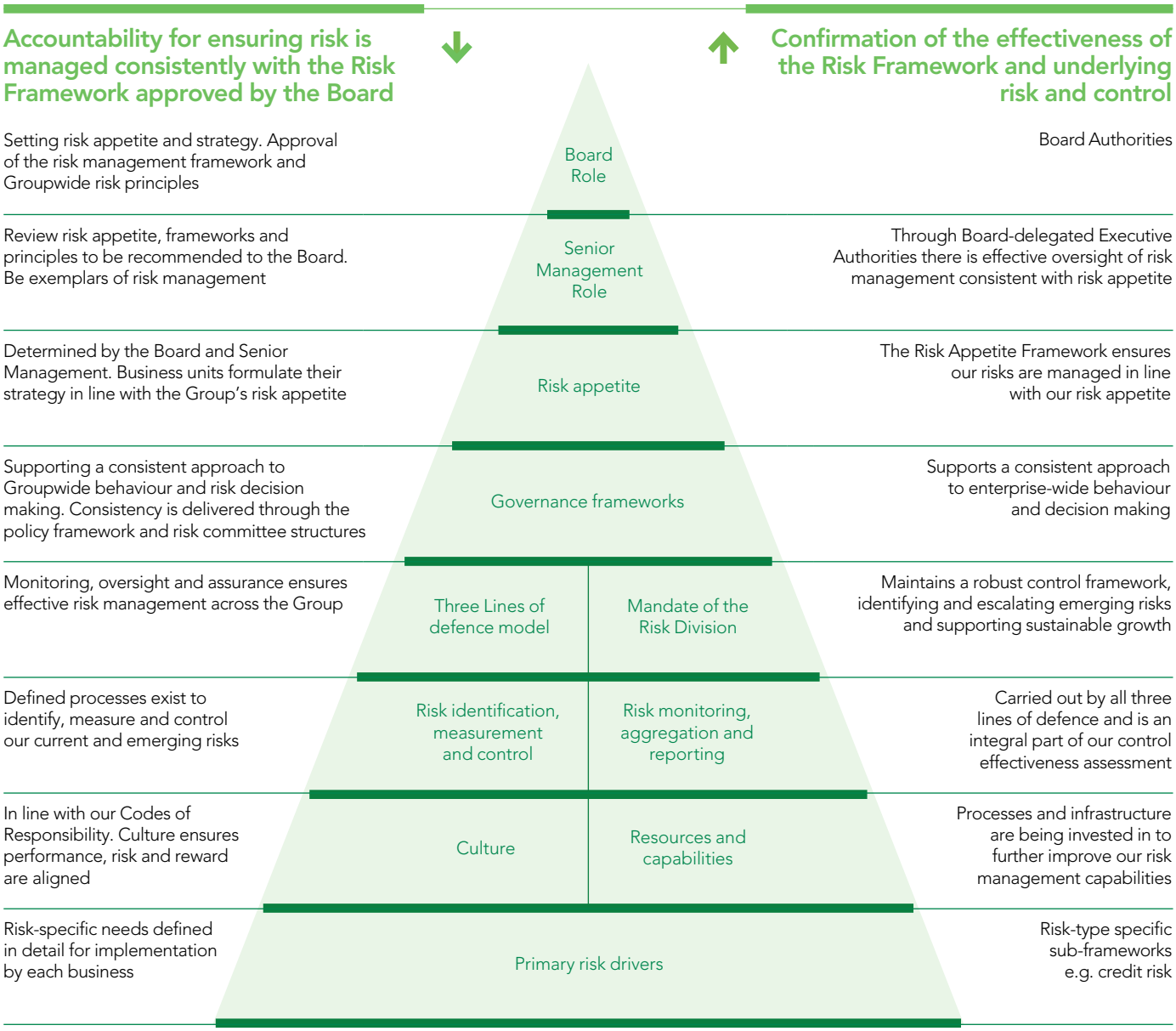
The Board approves the Group's overall RMF and sets risk appetite, both of which are designed to ensure that we manage our risks in the right way to achieve our agreed strategic objectives. It has a dedicated risk committee of non-executive directors who keep the design and performance of the Group's RMF under close and regular scrutiny, and interact closely with the executive risk management committee operating at Group Executive Committee level. The Board and senior management encourage a culture of transparency and openness to ensure that issues are escalated promptly to them where required.

The Board approved RMF and risk appetite are put into effect using an enterprise-wide framework which applies to every area of the business and covers all types of risk. The framework is designed to ensure we follow a consistent approach to risk management and reporting throughout the Group, so that all risks are fully understood and managed in relation to our agreed risk appetite. It includes our policies, procedures, controls and reporting.

A high level structure is shown in the diagram below.

The framework is periodically reviewed, updated and approved by the Board to reflect any changes in the nature of our business and external regulations, law, corporate governance and industry best practice. This helps us to ensure we continue to meet our responsibilities to our customers, shareholders and regulators. Our risk appetite and the policy framework define clear parameters within which our business units must operate in order to deliver the best outcome for customers and stakeholders.

The Board delegates authorities for risk management through the Group Chief Executive and the management hierarchy to individuals, an approach which is consistent with the focus of the Senior Managers and Certification Regime (SM&CR) on the principle of individual accountability. At a senior level, executives are supported in their decision-making by a committee-based governance structure. The concept of individual accountability for risk management is embedded in the RMF and culture at every level, and guides the way all employees approach their work, behave and make decisions. An important element of the framework is the maintenance of strong internal controls which are owned and operated by individual business areas. The Group's risk governance arrangements will support the effective implementation of the requirements of the SM&CR which comes into force in 2016.



Risk overview continued

The most significant risks we face which could impact the delivery of our strategy, together with key mitigating actions, are outlined below.

This year we have added two new principal risks:
- Insurance risk, reflecting that we are increasing our exposure to longevity risk, following our entry into the bulk annuity market in 2015; and
- Governance risk, given increasing societal and regulatory focus on governance arrangements.

All risks have the potential to impact our strategic priorities and the summary below illustrates the most predominant strategic priority impacted by the principal risks and uncertainties detailed.

PRINCIPAL RISKS	KEY MITIGATING ACTIONS
Credit risk The risk that customers to whom we have lent money or other counterparties with whom we have contracted, fail to meet their financial obligations, resulting in loss to the Group. Adverse changes in the economic and market environment we operate in or the credit quality and/or behaviour of our customers and counterparties could reduce the value of our assets and potentially increase our write downs and allowances for impairment losses, adversely impacting profitability. **Example:** – Whilst we have a deep understanding of credit risks across our commercial, mortgage and other portfolios; a changing economic environment, e.g. interest rate rises, can impact on customer affordability and therefore our performance.	– Credit policy, incorporating prudent lending criteria, aligned with Board approved risk appetite, to effectively manage risk. – Robust risk assessment and credit sanctioning, with clearly defined levels of authority to ensure we lend appropriately and responsibly. – Extensive and thorough credit processes and controls to ensure effective risk identification, management and oversight. – Effective, well-established governance process supported by independent credit risk assurance. – Early identification of signs of stress leading to prompt action in engaging the customer.
Regulatory and legal risk The risks of changing legislation, regulation, policies, voluntary codes of practice and their interpretation in the markets in which we operate can have a significant impact on the Group's operations, business prospects, structure, costs and/or capital requirements and ability to enforce contractual obligations. **Examples:** – Increased regulatory oversight and Prudential regulatory requirements. – Increased legislative requirements, such as ring-fencing legislation.	– The Legal, Regulatory and Mandatory Change Committee ensures we develop plans for delivery of all legal and regulatory changes and tracks their progress. Groupwide projects implemented to address significant impacts. – Continued investment in people, processes, training and IT to assess impact and help meet our legal and regulatory commitments. – Engage with regulatory authorities and relevant industry bodies on forthcoming regulatory changes, market reviews and Competition and Markets Authority investigations.
Conduct risk Conduct risk can arise from a number of areas 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. **Example:** – The most significant conduct cost in recent years has been PPI mis-selling.	– 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. – Clear customer accountabilities for colleagues, with rewards driven by customer-centric metrics. – Learning from past mistakes through root cause analysis of crystallised issues.
Operational risk We face significant operational risks which may result in financial loss, disruption or damage to our reputation. These include the availability, resilience and security of our core IT systems and the potential for failings in our customer processes. **Examples:** – A resilient IT environment is critical to providing reliable services to customers and enabling sustainable growth. – The dynamic threat posed by cyber risk and the potential for external attacks on the integrity of electronic data or the availability of systems.	– Continual review of our IT environment to ensure that systems and processes can effectively support the delivery of services to customers. – Addressing the observations and associated resilience risks raised in the Independent IT Resilience Review (2013), with independent verification of progress on an annual basis. – Investing in enhanced cyber controls to protect against external threats to the confidentiality or integrity of electronic data, or the availability of systems. Responding to findings from third party industry testing.
People risk Key people risks include the risk that we fail to lead responsibly in an increasing competitive marketplace, particularly with the introduction of the SM&CR in 2016. This may dissuade capable individuals from taking up senior positions within the industry. **Example:** – Lack of colleague capacity and capability could impact the achievement of business objectives. Additional colleague stretch (including increased dependency on key staff) could result in a loss of expertise.	– Focused action on strategy to attract, retain and develop high calibre people. – Maintain compliance with legal and regulatory requirements relating to the SM&CR, embedding compliant and appropriate colleague behaviours. – Continued focus on our culture, delivering initiatives which reinforce behaviours to generate the best long-term outcomes for customers and colleagues. – Maintain organisational people capability and capacity levels in response to increasing volumes of organisational and external market changes.

KEY RISK INDICATORS

ALIGNMENT TO STRATEGIC PRIORITIES AND FUTURE FOCUS

Impairment charge

2015	£568m
2014	£1,102m

Impaired assets

2015	£9,590m
2014	£14,308m

Delivering sustainable growth

We have a UK customer focused, low risk, conservative and well balanced credit portfolio, managed through the economic cycle and supported by strong credit portfolio management.

Credit risk decisions are consistent, fair and responsible, taking account of customers' circumstances.

We support sustainable growth and meet our targets in the Helping Britain Prosper Plan while staying within prudent risk appetite.

Impairments remain below long term levels and are expected to normalise over time. Emerging credit risks that have the potential to increase impairment include the global and UK economic environment as it can impact customer and counterparties' affordability.

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Legal, regulatory and mandatory investment spend

2015	£454m
2014	£406m

Delivering sustainable growth

We are committed to operating sustainably and responsibly, and commit significant resource and expense to ensure we meet our legal and regulatory obligations.

We respond as appropriate to impending legislation and regulation and associated consultations and participate in industry bodies. We continue to be subject to significant ongoing and new legislation, regulation and court proceedings, with numerous developments in each of these areas.

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

2015	1.9
2014	1.5

1 This key risk indicator is also a key performance indicator (KPI).

Creating the best customer experience

As we transform and simplify our business, minimising conduct risk is critical to achieving our strategic goals and meeting market and regulatory standards. Our customer focused conduct strategy forms the foundation of our vision to be the best bank for customers, allowing us to create the best customer experience through learning from past mistakes.

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Availability of core systems

2015	99.97%
2014	99.96%

Creating the best customer experience

We recognise the role that resilient technology plays in enabling us to create the best customer experience, and in maintaining banking services and trust across the wider industry. As such, the availability, resilience and security of our IT systems remains a key focus.

Our Cyber Programme continues to focus on improving the Groupwide cyber security controls and we regularly assess our cyber control environment, through both internal and third party testing.

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Best bank for customers index

2015	78%
2014	72%

Creating the best customer experience

We continue to focus on developing colleagues, their capabilities and skills in order to create the best customer experience and to respond quickly to the rapidly evolving change in customers' decision making.

The current regulatory regime presents some far reaching people implications in terms of personal accountability and remuneration arrangements. This coincides with the ongoing challenge of maintaining colleague capacity and capability to deliver our change agenda.

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Risk overview continued

PRINCIPAL RISKS	KEY MITIGATING ACTIONS
Insurance risk Key insurance risks within the Insurance business are longevity, persistency and property insurance. Longevity risk is expected to increase with the 2015 entry into the bulk annuity market. Longevity is also the key insurance risk in the Group's Defined Benefit Pension Schemes. **Examples:** – Increases in life expectancy (longevity) beyond current assumptions will increase the cost of annuities and pension scheme benefits. – Uncertain property insurance claims impact Insurance earnings and capital, e.g. extreme weather conditions, such as flooding, can result in high property damage claims.	– Insurance processes on underwriting, claims management, pricing and product design seek to control exposure to these risks. A team of longevity and bulk pricing experts has been built to support the new bulk annuity proposition. – The merits of longevity risk transfer and hedging solutions are regularly reviewed for both the Insurance business and the Group's Defined Benefit Pension Schemes. – Property insurance exposure to accumulations of risk and possible catastrophes is mitigated by a broad reinsurance programme.
Capital risk The risk that we have a sub-optimal amount or quality of capital or that capital is inefficiently deployed across the Group. **Example:** – A worsening macroeconomic environment could lead to adverse financial performance, which could deplete capital resources and/or increase capital requirements due to a deterioration in customers' creditworthiness.	– A comprehensive capital management framework that sets and monitors capital risk appetite using a number of key metrics. – Close monitoring of capital and leverage ratios to ensure we meet current and future regulatory requirements. – Comprehensive stress testing analysis to evidence sufficient levels of capital adequacy under various adverse scenarios. – Accumulation of retained profits and managing dividend policy appropriately.
Funding and liquidity risk The risk that we have insufficient financial resources to meet our commitments as they fall due, or can only secure them at excessive cost. **Example:** – Our funding and liquidity position is supported by a significant and stable customer deposit base. A deterioration in either the Group's or the UK's credit rating, or a sudden and significant withdrawal of customer deposits, would adversely impact our funding and liquidity position.	– Holding a large portfolio of unencumbered LCR eligible liquid assets to meet cash and collateral outflows and regulatory requirements and maintaining a further large pool of secondary assets that can be used to access central bank liquidity facilities. – Undertaking daily monitoring against a number of market and Group-specific early warning indicators and regular stress tests. – Maintaining a contingency funding plan detailing management actions and strategies available in stressed conditions.
Governance risk Against a background of increased regulatory focus on governance and risk management, the most significant challenges arise from the SM&CR in force from March 2016 and the requirement to improve the resolvability of the Group and to ring-fence core UK financial services and activities from January 2019. **Example:** – Non-compliance with or breaches of ring-fencing, resolution and SM&CR requirements will result in legal and regulatory consequences.	– Our response to the SM&CR is managed through a programme with work streams addressing each of the major components. – A programme is in place to address the requirements of ring-fencing and resolution and we are in close and regular contact with regulators to develop plans for our anticipated operating and legal structures. – Our aim is to ensure that evolving risk and governance arrangements continue to be appropriate across the range of business in the Group in order to comply with regulatory objectives.
Market risk The risk that our capital or earnings profile is affected by adverse market rates, in particular interest rates and credit spreads in the Banking business and equity and credit spreads in the Insurance business and the Group's Defined Benefit Pension Schemes. **Examples:** – Earnings are impacted by our ability to forecast and model customer behaviour accurately and establish appropriate hedging strategies. – The Insurance business is exposed indirectly to equity and credit markets through the value of future management charges on policyholder funds. Credit spread risk within the Insurance business primarily arises from bonds and loans used to back annuities. Credit spreads affect the value of the Group's Defined Benefit Pension Schemes' liabilities.	– Structural hedge programmes have been implemented to manage liability margins and margin compression, and the Group's exposure to Bank Base Rate. – Equity and credit spread risks are inherent within Insurance products and are closely monitored to ensure they remain within risk appetite. Where appropriate, asset liability matching is undertaken to mitigate risk. – The allocation to credit assets has been increased and equity holdings reduced within the Group's Defined Benefit Pension Schemes. A hedging programme is also in place to minimise exposure to nominal rates/inflation. – Stress and scenario testing of Group risk exposures.

KEY RISK INDICATORS

ALIGNMENT TO STRATEGIC PRIORITIES AND FUTURE FOCUS

Insurance (Life and Pensions) present value of new business premiums

2015	£9,460m
2014	£8,601m

Insurance (General Insurance) gross written premiums

2015	£1,148m
2014	£1,197m

Creating the best customer experience

We are committed to meeting the changing needs of customers by working to provide a range of insurance products via multiple channels. The focus is on creating the best customer experience by helping customers protect themselves today whilst preparing for a secure financial future.

Strategic growth initiatives within Insurance are developed and managed in line with a defined risk appetite, aligned to the Group risk appetite and strategy.

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Common equity tier 1 ratio[1]

2015[2]	13.0%
2014	12.8%

Leverage ratio

2015[2]	4.8%
2014	4.9%

1 This key risk indicator is also a key performance indicator (KPI).

Delivering sustainable growth

Ensuring we hold an appropriate level of capital to maintain financial resilience and market confidence, underpins our strategic objectives of supporting the UK economy and delivering sustainable growth.

Looking ahead, the Basel Committee is continuing to review aspects of the regulatory capital framework, and the Bank of England has consulted on its approach for setting minimum requirements for own funds and eligible liabilities. There is a risk that these could lead to higher capital requirements than we have anticipated in our strategic plans.

2 Ratios are post interim and recommended full year dividends and pro forma, reflecting dividend paid by Insurance in February 2016 in respect of 2015 earnings.

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Regulatory liquidity

2015	£123.4bn
2014[3]	£109.3bn

Loan to deposit ratio

2015	109%
2014	107%

3 Individual liquidity adequacy standards eligible primary liquid assets.

Delivering sustainable growth

We maintain a strong funding position in line with our low risk strategy. Our funding position has been significantly strengthened in recent years and our loan to deposit ratio remains within the target range.

Liquid assets are broadly equivalent to our total wholesale funding and thus provide a substantial buffer in the event of continued market dislocation.

There is a risk that our options to fund our balance sheet are reduced in future, or that the cost of funding may increase which could impact our performance versus our strategic plans.

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N/A

Becoming simpler and more efficient

Ring-fencing requirements ensure we become simpler and continue to create the best customer experience, through providing further protection to core Retail and SME deposits, provide transparency on our operations and facilitate the options available in resolution.

Resolution requirements are aimed at reducing the probability of failure and its impact on customers should we fail through continuity of critical banking services, helping rebuild trust in the financial services sector.

We already have a strong culture of ownership and accountability, and compliance with the SM&CR will enable us to further strengthen our ability to clearly demonstrate the responsibilities of Senior Managers and how these are discharged.

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Pension surplus

2015	£736m
2014	£890m

Delivering sustainable growth

We manage our exposure to movements in market rates throughout the year, leading us to promote low volatility earnings and offer a comprehensive customer proposition with market risk hedging strategies to support strategic aims, including delivering sustainable growth.

Mitigating actions are implemented to reduce the impact of market movements, resulting in a stable capital position. This allows us to more efficiently utilise available capital resources to deliver sustainable growth.

By reducing the volatility in the Group's Defined Benefit Pension Schemes through hedging in 2014, we have taken a conservative approach to risk in line with our strategy.

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FINANCIAL RESULTS

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Summary of Group results

Overview: robust financial performance with increased underlying profits and returns; strong balance sheet

The Group's underlying profit increased by 5 per cent in the year to £8,112 million, driven by a 1 per cent increase in total income, lower operating costs despite increased investment in the business and a 48 per cent improvement in impairments. Statutory profit before tax was £1,644 million (2014: £1,762 million) after provisions for PPI of £4,000 million (2014: £2,200 million) including an additional £2,100 million charged in the fourth quarter. Statutory profit after tax was £956 million compared to £1,499 million in 2014.

Total loans and advances to customers were £455 billion compared with £456 billion (excluding TSB) at 31 December 2014, with growth in the key customer segments offset by further reductions in run-off and portfolios closed to new business. Customer deposits were £418 billion compared with £423 billion (excluding TSB), a reduction of £5 billion, or 1 per cent, compared with 31 December 2014, largely due to a planned reduction in tactical deposits.

The combination of good underlying profitability and continued reduction in risk-weighted assets resulted in an improvement in the Group's common equity tier 1 ratio on a pro forma basis to 13.9 per cent before taking account of dividends in respect of 2015 and 13.0 per cent after dividends (31 December 2014: 12.8 per cent). The pro forma leverage ratio was 4.8 per cent (31 December 2014: 4.9 per cent).

Total income

	2015 £ million	2014 £ million	Change %
Net interest income	**11,482**	10,975	5
Other income	**6,155**	6,467	(5)
Total income	**17,637**	17,442	1
Banking net interest margin	**2.63%**	2.40%	23bp
Average interest-earning banking assets	**£441.9bn**	£461.1bn	(4)
Average interest-earning banking assets excluding run-off	**£427.5bn**	£431.2bn	(1)

Further detail on net interest income and other income is included on page 52.

Total income of £17,637 million was 1 per cent higher than 2014, with growth in net interest income partly offset by lower other income.

Net interest income increased 5 per cent to £11,482 million, reflecting the improved net interest margin. Net interest margin of 2.63 per cent was up 23 basis points, driven by a combination of lower deposit and wholesale funding costs, partly offset by continued pressure on asset prices. Average interest-earning banking assets fell by £19 billion, or 4 per cent, to £442 billion, largely as a result of the reduction of £15.6 billion in run-off assets. Excluding run-off, average interest-earning banking assets were 1 per cent lower with lending growth in key customer segments offset by reductions in portfolios closed to new business.

The Group expects the net interest margin for the 2016 full year will be around 2.70 per cent, despite continued low base rates, benefiting from further improvements in deposit and wholesale funding costs, including the impact of the ECN exchange, partly offset by continued pressure on asset prices.

Other income was 5 per cent lower at £6,155 million largely as a result of the reduction in run-off business. Excluding run-off, other income was in line with 2014. Fees and commissions were lower than 2014 mainly due to a reduction in current account and credit card transaction related net income, and the impact of changes in the regulatory environment. This was partly offset by income generated by the Insurance business from its entry into the bulk annuity market and the increase in operating lease income. As expected, other income recovered in the fourth quarter, and at £1,528 million, was 11 per cent ahead of the third quarter and 1 per cent higher than in the same period last year, despite insurance claims as a result of December's floods and storms of £58 million.

Costs

	2015 £ million	2014 £ million	Change %
Operating costs	**8,311**	8,322	–
Cost:income ratio	**49.3%**	49.8%	(0.5)pp
Simplification savings annual run-rate[1]	**£373m**		

1 Run-rate savings achieved from phase II of the Simplification programme.

Operating costs of £8,311 million were lower than in 2014 despite now including costs relating to the next phase of Simplification, with a £466 million increase in investment (including strategic initiatives and Simplification), and £143 million for pay, inflation and other costs, offset by £491 million of incremental savings from the Simplification programmes and £129 million of reductions from business disposals.

Phase II of the Simplification programme has delivered £373 million of annual run-rate savings to date and we are ahead of target in achieving £1 billion of Simplification savings by the end of 2017. The Group has a proven track record in cost management and given the lower interest rate environment, is responding through the accelerated delivery of cost initiatives and targeting further efficiency savings.

The cost:income ratio improved to 49.3 per cent from 49.8 per cent in 2014 and remains one of the lowest of our major UK banking peers. We remain committed to achieving annual improvements in the cost:income ratio with a target ratio of around 45 per cent and based on current interest rate assumptions we now expect to achieve this target as we exit 2019.

Operating lease depreciation increased 6 per cent to £764 million driven by the continued growth in the Lex Autolease business.

Summary of Group results continued

Impairment

	2015 £ million	2014 £ million	Change %
Continuing business impairment charge	560	899	38
Run-off impairment charge	8	203	96
Total impairment charge	568	1,102	48
Asset quality ratio	0.14%	0.23%	(9)bp
Impaired loans as a % of closing advances	2.1%	2.9%	(0.8)pp
Provisions as a % of impaired loans	46.1%	56.4%	(10.3)pp
Provisions as a % of impaired loans excluding run-off	43.0%	44.6%	(1.6)pp

The impairment charge was £568 million, 48 per cent lower than in 2014 as a result of the significant reduction in run-off business and improvements in all divisions. The charge is net of significant provision releases and write-backs, although at lower levels than seen in 2014. The asset quality ratio improved to 14 basis points from 23 basis points in 2014.

Impaired loans as a percentage of closing advances reduced to 2.1 per cent from 2.9 per cent at the end of December 2014, driven by reductions within both the continuing and the run-off portfolios including the impact of the sale of Irish commercial loans in the third quarter. Provisions as a percentage of impaired loans reduced from 56.4 per cent to 46.1 per cent reflecting the disposal of highly covered run-off assets during the year. The continuing business coverage ratio reduced slightly to 43.0 per cent (31 December 2014: 44.6 per cent) but remains strong.

In 2016, the Group expects to benefit from its continued disciplined approach to the management of credit and the resilient UK economy. The asset quality ratio for the 2016 full year is expected to be around 20 basis points, comprising a marginally lower level of gross impairments at around 25 basis points, compared with 28 basis points in 2015 and a much reduced level of write-backs and provision releases.

Statutory profit

	2015 £ million	2014 £ million	Change %
Underlying profit	8,112	7,756	5
Asset sales and other items:			
Asset sales and volatility	(182)	(1,190)	
Fair value unwind	(192)	(529)	
Other items	(342)	374	
	(716)	(1,345)	
Simplification costs	(170)	(966)	
TSB costs	(745)	(558)	
Payment protection insurance provision	(4,000)	(2,200)	
Other conduct provisions	(837)	(925)	
Profit before tax – statutory	1,644	1,762	(7)
Taxation	(688)	(263)	
Profit for the year	956	1,499	(36)
Underlying return on required equity	15.0%	13.6%	1.4pp
Statutory return on required equity	1.5%	3.0%	(1.5)pp

Statutory profit before tax was £1,644 million, down 7 per cent compared to 2014.

Asset sales and other items

Asset sales and volatility of £182 million included a charge of £101 million for the reduction in the value of the equity conversion feature embedded in the Group's Enhanced Capital Notes (ECNs) and negative insurance volatility of £105 million offset by a number of other items including own debt and banking volatility. The charge in 2014 of £1,190 million included a net loss of £988 million relating to the Group's ECN exchange offers and changes in value of the equity conversion feature, and negative insurance volatility of £228 million.

The fair value unwind arises as a result of acquisition related adjustments made at the time of the HBOS transaction in 2009. The reduction in the unwind in 2015 to £192 million relates to a lower charge relating to the HBOS subordinated debt of £363 million (2014: £497 million) and a credit for the accelerated amortisation of a fair value adjustment which was recognised in the first half of the year.

Other items of £342 million related to the amortisation of intangible assets. The credit of £374 million in 2014 included a gain of £710 million relating to changes made to the Group's defined benefit pension schemes.

Simplification

Simplification costs in 2015 were £170 million and relate to redundancy costs incurred to deliver phase II of the Simplification programme. The costs of £966 million in 2014 primarily related to redundancy, IT and other business costs of implementation relating to phase I.

TSB

The Group's results in 2015 include TSB for the first quarter only, following the agreement in March to sell our remaining stake in the business to Banco Sabadell. The charge of £745 million includes £660 million relating to the sale of TSB which covers the net costs of the Transitional Service Agreement between the Group and TSB and the contribution to be provided by the Group to TSB in migrating to an alternative IT platform, partially offset by the gain on sale.

PPI

The Group increased the provision for PPI costs by a further £4.0 billion in 2015, bringing the total amount provided to £16.0 billion. This included an additional £2.1 billion in the fourth quarter, largely to reflect the impact of our interpretation of the proposals contained within the Financial Conduct Authority's (FCA) consultation paper regarding a potential time bar and the Plevin case. As at 31 December 2015, £3.5 billion or 22 per cent of the total provision remained unutilised with approximately £3.0 billion relating to reactive complaints and associated administration costs.

The volume of reactive PPI complaints has continued to fall, with an 8 per cent reduction in 2015 compared with 2014, to approximately 8,000 complaints per week. Whilst direct customer complaint levels fell 30 per cent year-on-year, those from Claims Management Companies (CMCs) have remained broadly stable and as a result, CMCs now account for over 70 per cent of complaints.

Assuming current FCA proposals are implemented and an average of approximately 10,000 complaints per week, including those related to Plevin, the outstanding provision should be sufficient to cover all future PPI related complaints and associated administration costs through to mid-2018.

Weekly complaint trends could vary significantly throughout this period, given they are likely to be impacted by a number of factors including the potential impact of the FCA's proposed communication campaign as well as changes in the regulation of CMCs.

Other conduct provisions

In 2015, the Group incurred a charge of £837 million, of which £302 million was recognised in the fourth quarter relating to a number of non-material items including packaged bank accounts and a number of other product rectifications primarily in Retail, Insurance and Commercial Banking. Within the full year charge, £720 million of provisions related to potential claims and remediation in respect of products sold through the branch network and continuing investigation of matters highlighted through industry wide regulatory reviews, as well as legacy product sales and historical systems and controls such as those governing legacy incentive schemes. This includes a full year charge of £225 million in respect of complaints relating to packaged bank accounts. The full year charge also included the previously announced settlement of £117 million that the Group reached with the FCA with regard to aspects of its PPI complaint handling process during the period March 2012 to May 2013.

Taxation

The tax charge for the year to 31 December 2015 was £688 million (2014: £263 million), representing an effective tax rate of 42 per cent (2014: 15 per cent).

The effective tax rate was higher than the UK corporation tax rate largely due to the introduction in 2015 of restrictions on the deductibility of conduct related provisions which resulted in an additional tax charge of £459 million. Adjusting for this charge, the effective tax rate would have been 14 per cent reflecting a number of positive one-off items including non-taxable and relieved gains and a small prior year adjustment. Going forward we do not expect these positive one-off items to continue and now expect a medium-term effective tax rate of around 27 per cent, including the forthcoming 8 per cent surcharge on banking profits. This is lower than our previous guidance of around 30 per cent, reflecting actions on PPI.

Return on required equity[1]

	At 31 Dec 2015	At 31 Dec 2014	Change %
Underlying return on required equity	**15.0%**	13.6%	1.4pp
Statutory return on required equity	**1.5%**	3.0%	(1.5)pp

1 For basis of calculation see page 53.

Underlying return on required equity has improved in the year reflecting the improvement in underlying profit together with a reduction in the required equity which has been driven by the fall in risk-weighted assets. The statutory return was lower, largely as a result of higher conduct related provisions and the restriction on their tax deductibility.

At the time of the strategic update in October 2014, we anticipated achieving a sustainable return on required equity, of around 13.5 to 15.0 per cent by the end of 2017. Since this time, the expected level of interest rates over the plan period has reduced significantly, required equity has increased to 12 per cent and the new bank tax surcharge of 8 per cent will come into effect from 1 January 2016. We continue to target 13.5 to 15.0 per cent but, based on current interest rate assumptions, we now expect to deliver this in 2018.

Summary of Group results continued

Balance sheet

	At 31 Dec 2015	At 31 Dec 2014	Change %
Loans and advances to customers[1]	**£455bn**	£456bn	–
Customer deposits[1]	**£418bn**	£423bn	(1)
Wholesale funding	**£120bn**	£116bn	3
Wholesale funding <1 year maturity	**£38bn**	£41bn	(8)
Of which money-market funding <1 year maturity[2]	**£22bn**	£19bn	13
Loan to deposit ratio[1]	**109%**	108%	1pp
Liquidity coverage ratio – eligible assets	**£123bn**		

1 Comparatives restated to exclude TSB. As at 31 December 2014, loans and advances to customers including TSB were £478 billion, customer deposits including TSB were £447 billion and the loan to deposit ratio was 107 per cent.

2 Excludes balances relating to margins of £2.5 billion (31 December 2014: £2.8 billion) and settlement accounts of £1.4 billion (31 December 2014: £1.4 billion).

Total loans and advances to customers were £455 billion compared with £456 billion (excluding TSB) at 31 December 2014. Mortgage lending increased by 1 per cent, slightly below market growth of 2.5 per cent, reflecting our focus on protecting margin in a highly competitive low growth environment. UK loan growth in Consumer Finance was strong at 17 per cent and SME lending growth was 5 per cent, both outperforming the market. This growth was offset by further reductions in run-off and other lending portfolios which are closed to new business.

Total deposits were £418 billion compared with £423 billion (excluding TSB) at 31 December 2014, largely due to a planned reduction in tactical deposits.

Wholesale funding was £120 billion, of which £38 billion, or 32 per cent, had a maturity of less than one year (31 December 2014: £41 billion, representing 35 per cent).

The Group's liquidity position remains strong, with liquidity coverage ratio (LCR) eligible assets of £123 billion. LCR eligible assets represent almost 5.7 times the Group's money-market funding with a maturity of less than one year and were in excess of total wholesale funding at 31 December 2015 thus providing a substantial buffer in the event of market dislocation. The Group's LCR ratio already exceeds regulatory requirements and is greater than 100 per cent.

Capital ratios and risk-weighted assets

	At 31 Dec 2015	At 31 Dec 2014	Change %
Pro forma common equity tier 1 ratio[1,2]	**13.0%**	12.8%	0.2pp
Common equity tier 1 ratio[1]	**12.8%**	12.8%	–
Transitional tier 1 capital ratio	**16.4%**	16.5%	(0.1)pp
Transitional total capital ratio	**21.5%**	22.0%	(0.5)pp
Pro forma leverage ratio[2]	**4.8%**	4.9%	(0.1)pp
Risk-weighted assets[1]	**£223bn**	£240bn	(7)
Shareholders' equity	**£41bn**	£43bn	(5)

1 There is minimal difference between the common equity tier 1 ratios and risk-weighted assets under both the fully loaded and transitional bases.

2 Including Insurance dividend relating to 2015, paid in 2016. Excluding the Insurance dividend the leverage ratio was the same at 4.8 per cent.

The Group further strengthened its capital position in 2015, with the pro forma CET1 ratio increasing to 13.9 per cent before taking account of dividends in respect of 2015 and 13.0 per cent after dividends. The pro forma ratio recognises the 2015 Insurance dividend paid in February 2016 following the implementation of Solvency II. The improvement in the pro forma CET1 ratio was driven by a combination of underlying profit and lower risk-weighted assets offset by charges relating to PPI and other conduct issues.

The Group continues to be strongly capital generative, generating, on a pro forma basis, 300 basis points of capital before dividends and PPI in 2015. This has benefited from a significant reduction in risk-weighted assets, which is unlikely to be repeated. Going forward, we now expect to generate around 200 basis points of capital annually pre dividends. This will enable us to support sustainable growth in the business and help Britain prosper whilst delivering sustainable returns for shareholders.

In addition to the internal stress testing activity undertaken in 2015, the Group participated in the UK-wide concurrent stress testing run by the Bank of England, comfortably exceeding both the capital and leverage minimum thresholds.

The remaining issued Enhanced Capital Notes (ECNs) were not taken into account for the purposes of core capital in the PRA stress tests and the Group has determined that a Capital Disqualification Event (CDE), as defined in the conditions of the ECNs, has occurred. This determination was confirmed by a unanimous decision by the Court of Appeal on 10 December 2015 and on 29 January 2016 the Group announced the redemption of certain series of ECNs using the Regulatory Call Right. The Group also launched Tender Offers for the remaining series of ECNs on 29 January 2016 and subsequent to completion of such offers, the Group has announced that it will redeem those ECNs not validly tendered using the Regulatory Call Right. The Tender Offers and process for redemption of the ECNs not validly tendered by the noteholders will be completed before the end of the first quarter with an estimated cost of £0.7 billion.

The Group is aware that the Trustee has been granted leave by the Supreme Court to appeal the Court of Appeal decision. In the event that the Supreme Court were to determine that a CDE had not occurred, the Group would compensate fairly the holders of the ECNs whose securities are redeemed using the Regulatory Call Right for losses suffered as a result of early redemption.

Risk-weighted assets reduced by 7 per cent, or £17 billion to £223 billion (31 December 2014: £240 billion), primarily driven by the sale of TSB, other disposals in the run-off business and continued improvements in credit quality, partly offset by targeted lending growth.

The Group's pro forma leverage ratio, after taking account of dividends relating to 2015, reduced to 4.8 per cent (31 December 2014: 4.9 per cent) reflecting the reduction in tier 1 capital offset by the reduction in balance sheet assets arising, in part, from the sale of TSB.

Dividend

The Board has recommended a final ordinary dividend of 1.5 pence per share, together with a capital distribution in the form of a special dividend of 0.5 pence per share. This is in addition to the interim ordinary dividend of 0.75 pence per share (2014: nil) that was announced at our 2015 half-year results.

The total ordinary dividend per share for 2015 of 2.25 pence has increased from 0.75 pence in 2014, in line with our progressive and sustainable dividend policy, and we continue to expect ordinary dividends to increase over the medium term with a dividend payout ratio of at least 50 per cent of sustainable earnings.

The special dividend of 0.5 pence per share represents the distribution of surplus capital over and above the Board's view of the current level of capital required to grow the business, meet regulatory requirements and cover uncertainties. This level is consistent with our capital requirement guidance of around 12 per cent plus an amount broadly equivalent to a further year's ordinary dividend.

The amount of capital we believe is appropriate to hold is likely to vary from time to time depending on circumstances and the Board will give due consideration, subject to the situation at the time, to the distribution of any surplus capital through the use of special dividends or share buy backs. By its nature, there can be no guarantee that this level of special dividend or any surplus capital distribution will be appropriate in future years.

Conclusion

The Group has delivered a robust underlying performance in 2015, driven by higher income, lower operating costs and reduced impairment and further improved underlying returns. Statutory profit before tax of £1.6 billion was lower, due to the impact of PPI, where an additional charge of £2.1 billion was taken in the fourth quarter largely to reflect our interpretation of the impact of the proposals contained within the FCA consultation paper regarding a potential time bar and the Plevin case.

As a result of the strategic and financial progress, the Board has recommended the payment of an increased ordinary dividend and a special dividend and we are enhancing our guidance for the 2016 net interest margin and annual capital generation. Although the delivery of the cost:income ratio and return on required equity guidance has been deferred, we remain confident in the Group's prospects and its ability to generate capital and believe the Group is well positioned to deliver sustainable growth and superior returns.

George Culmer
Chief Financial Officer

Summary of Group results continued

Underlying basis – segmental analysis

2015	Retail £m	Commercial Banking £m	Consumer Finance £m	Insurance £m	Run-off and Central items £m	Group £m
Net interest income	7,397	2,510	1,287	(163)	451	11,482
Other income	1,122	2,066	1,358	1,827	(218)	6,155
Total income	8,519	4,576	2,645	1,664	233	17,637
Operating costs	(4,573)	(2,137)	(768)	(702)	(131)	(8,311)
Operating lease depreciation	–	(30)	(720)	–	(14)	(764)
Total costs	(4,573)	(2,167)	(1,488)	(702)	(145)	(9,075)
Impairment	(432)	22	(152)	–	(6)	(568)
Underlying profit excl. TSB	3,514	2,431	1,005	962	82	7,994
TSB						118
Underlying profit						8,112
Banking net interest margin	2.40%	2.93%	5.94%			2.63%
Average interest-earning banking assets	£315.8bn	£89.3bn	£22.4bn		£14.4bn	£441.9bn
Asset quality ratio	0.14%	0.01%	0.68%			0.14%
Return on risk-weighted assets	5.30%	2.33%	4.81%			3.53%
Return on assets	1.11%	1.16%	3.73%			0.98%

2014	Retail £m	Commercial Banking £m	Consumer Finance £m	Insurance £m	Run-off and Central items £m	Group £m
Net interest income	7,079	2,480	1,290	(131)	257	10,975
Other income	1,212	1,956	1,364	1,725	210	6,467
Total income	8,291	4,436	2,654	1,594	467	17,442
Operating costs	(4,464)	(2,123)	(762)	(672)	(301)	(8,322)
Operating lease depreciation	–	(24)	(667)	–	(29)	(720)
Total costs	(4,464)	(2,147)	(1,429)	(672)	(330)	(9,042)
Impairment	(599)	(83)	(215)	–	(205)	(1,102)
Underlying profit (loss) excl. TSB	3,228	2,206	1,010	922	(68)	7,298
TSB						458
Underlying profit						7,756
Banking net interest margin	2.29%	2.67%	6.49%			2.40%
Average interest-earning banking assets	£317.6bn	£93.2bn	£20.5bn		£29.8bn	£461.1bn
Asset quality ratio	0.19%	0.08%	1.05%			0.23%
Return on risk-weighted assets	4.60%	1.92%	4.87%			3.02%
Return on assets	1.02%	0.94%	4.02%			0.92%

Underlying basis

In order to present a more meaningful view of business performance, the results are presented on an underlying basis excluding items that in management's view would distort the comparison of performance between periods. Based on this principle the following items are excluded from underlying profit asset sales and other items, which includes the effects of certain asset sales, the impact of liability management actions, the volatility relating to the Group's own debt and hedging arrangements as well as that arising in the insurance businesses, insurance gross up, the amortisation of purchased intangible assets and the unwind of acquisition-related fair value adjustments, and certain past service pensions credits or charges in respect of the Group's defined benefit pension arrangements; Simplification costs, which for 2015 are limited to redundancy costs relating to the programme announced in October 2014. Costs in 2014 include severance, IT and business costs relating to the programme started in 2011; TSB build and dual running costs and the loss relating to the TSB sale; and payment protection insurance and other conduct provisions.

Consolidated income statement – underlying basis

	2015 £ million	2014 £ million	Change %
Net interest income	11,482	10,975	5
Other income	6,155	6,467	(5)
Total income	17,637	17,442	1
Operating costs	(8,311)	(8,322)	–
Operating lease depreciation	(764)	(720)	(6)
Total costs	(9,075)	(9,042)	–
Impairment	(568)	(1,102)	48
Underlying profit excluding TSB	7,994	7,298	10
TSB	118	458	
Underlying profit	8,112	7,756	5
Asset sales and other items	(716)	(1,345)	
Simplification costs	(170)	(966)	
TSB costs	(745)	(558)	
Payment protection insurance provision	(4,000)	(2,200)	
Other conduct provisions	(837)	(925)	
Profit before tax – statutory	1,644	1,762	(7)
Taxation	(688)	(263)	
Profit for the year	956	1,499	(36)
Underlying earnings per share	8.5p	8.1p	0.4p
Earnings per share	0.8p	1.7p	(0.9)p
Dividends per share – ordinary	2.25p	0.75p	
– special	0.5p	–	
Total	2.75p	0.75p	
Banking net interest margin[1]	2.63%	2.40%	23bp
Average interest-earning banking assets[1]	£442bn	£461bn	(4)
Cost:income ratio[1]	49.3%	49.8%	(0.5)pp
Asset quality ratio[1]	0.14%	0.23%	(9)bp
Return on risk-weighted assets	3.53%	3.02%	51bp
Return on assets	0.98%	0.92%	6bp
Underlying return on required equity	15.0%	13.6%	1.4pp
Statutory return on required equity	1.5%	3.0%	(1.5)pp

Balance sheet and key ratios

	At 31 Dec 2015	At 31 Dec 2014	Change %
Loans and advances to customers[2,3]	£455bn	£456bn	–
Customer deposits[3]	£418bn	£423bn	(1)
Loan to deposit ratio[3]	109%	108%	1pp
Pro forma common equity tier 1 ratio[4]	13.0%	12.8%	0.2pp
Common equity tier 1 ratio	12.8%	12.8%	–
Transitional total capital ratio	21.5%	22.0%	(0.5)pp
Risk-weighted assets	£223bn	£240bn	(7)
Pro forma leverage ratio[4]	4.8%	4.9%	(0.1)pp
Tangible net assets per share	52.3p	54.9p	(2.6)p

1 Excluding TSB.

2 Excludes reverse repos of £nil (31 December 2014: £5.1 billion).

3 Comparatives restated to exclude TSB.

4 Including Insurance dividend relating to 2015, paid in 2016. Excluding the Insurance dividend the leverage ratio was the same at 4.8 per cent.

Divisional results – Retail

Retail offers a broad range of financial service products, including current accounts, savings and mortgages, to UK personal customers, including Wealth and small business customers. It is also a distributor of insurance, and a range of long-term savings and investment products. Our aim is to be the best bank for customers in the UK, by building deep and enduring relationships that deliver value to customers, and by providing them with greater choice and flexibility. We will maintain our multi-brand and multi-channel strategy, and continue to simplify the business and provide more transparent products, helping to improve service levels and reduce conduct risks.

Progress against strategic initiatives

– Continued development of our digital capability. Our online user base has increased to over 11.5 million customers, with over 6.6 million active users on mobile and 2.9 million on tablets.
– Enhanced proposition for investment customers, becoming one of the first UK banks to offer investment advice through video conferencing and screen sharing.
– Invested in the branch network with 230 refurbishments in 2015, 70 per cent of branches are now Wi-fi enabled with an additional 470 self-service devices, giving customers flexibility to choose how they do their banking.
– Continued to attract new customers through positive switching activity, particularly through the Halifax challenger brand which has attracted more than 1 in 5 customers switching in 2015.
– Continued product developments including improvements to the Club Lloyds proposition and consolidation of savings products reducing portfolio complexity and aligning rates and features to create a simpler, more transparent product range for customers.
– Leading the way on the government's drive for improved financial inclusion by providing over 1 in 4 basic bank accounts to disadvantaged and low income customers in 2015.
– Provided 1 in 4 mortgages to first-time buyers. Retail continues to be a leading supporter of the UK government's Help to Buy scheme, with lending of £3.5 billion under the mortgage guarantee element of the scheme since launch and the launch of a market-leading 'Help to Buy ISA' in December.
– Supported more than 1 in 5 new business start-ups. Improved our proposition to small business customers, launching a range of new to market products and services.

Financial performance

– Underlying profit increased 9 per cent to £3,514 million.
– Net interest income increased 4 per cent. Margin has increased 11 basis points to 2.40 per cent, driven by improved deposit margin and mix, more than offsetting reduced lending rates.
– Other income down 7 per cent driven by current account transaction related income and regulatory changes, in particular, impacting the Wealth business.
– Total costs increased 2 per cent to £4,573 million, reflecting continued business investment and simplification to improve customer experiences and enable staff numbers to be reduced by 7 per cent in 2015.
– Impairment reduced 28 per cent to £432 million, reflecting continued low risk underwriting discipline, strong portfolio management and a favourable credit environment.
– Return on risk-weighted assets increased 70 basis points driven by the 9 per cent increase to underlying profit and a 3 per cent decrease in risk-weighted assets.
– Loans and advances to customers were £314.1 billion (31 December 2014: £315.2 billion) with the open mortgage book (excluding specialist mortgage book and Intelligent Finance) increasing 1 per cent slightly below market growth, reflecting actions to protect the net interest margin in a highly competitive, low growth environment. This is offset by a reduction in the portfolios closed to new business.
– Customer deposits decreased 2 per cent to £279.5 billion, with more expensive tactical balances down 20 per cent to £30.2 billion, reflecting actions to protect interest margins.
– Risk-weighted assets decreased by £1.8 billion to £65.9 billion, driven by an improvement in the credit quality of assets and a modest contraction to lending balances, partly offset by an increased allocation of operational risk risk-weighted assets.

Performance summary

	2015 £m	2014 £m	Change %
Net interest income	7,397	7,079	4
Other income	1,122	1,212	(7)
Total income	8,519	8,291	3
Operating costs	(4,573)	(4,464)	(2)
Operating lease depreciation	–	–	
Total costs	(4,573)	(4,464)	(2)
Impairment	(432)	(599)	28
Underlying profit	3,514	3,228	9
Banking net interest margin	2.40%	2.29%	11bp
Average interest-earning banking assets	£315.8bn	£317.6bn	(1)
Asset quality ratio	0.14%	0.19%	(5)bp
Return on risk-weighted assets	5.30%	4.60%	70bp
Return on assets	1.11%	1.02%	9bp

Key balance sheet items	At 31 Dec 2015 £bn	At 31 Dec 2014 £bn	Change %
Loans and advances excluding closed portfolios	286.8	284.7	1
Closed portfolios	27.3	30.5	(10)
Loans and advances to customers	314.1	315.2	–
Relationship balances	249.3	247.9	1
Tactical balances	30.2	37.6	(20)
Customer deposits	279.5	285.5	(2)
Total customer balances	593.6	600.7	(1)
Risk-weighted assets	65.9	67.7	(3)

Divisional results – Commercial Banking

Commercial Banking has been supporting British business for 250 years. It has a client-led, low risk, capital efficient strategy, helping UK-based clients and international clients with a link to the UK. Through our four customer facing divisions – SME, Mid Markets, Global Corporates and Financial Institutions – we provide clients with a range of products and services such as lending, transactional banking, working capital management, risk management, debt capital markets services, as well as access to private equity through Lloyds Development Capital.

Progress against strategic initiatives

– Continued to support the UK economy and Help Britain Prosper globally.

– Increased lending to SMEs by 5 per cent year-on-year, outperforming the market; remain the largest net lender to SMEs under the Funding for Lending Scheme (FLS), with over £6 billion of gross lending in 2015.

– Raised £540 million to date through our Environmental, Social and Governance (ESG) programmes to finance SMEs, healthcare providers and renewable energy projects in the most economically disadvantaged areas of the UK.

– Exceeded our funding commitment by providing £1.4 billion of support to UK manufacturing and opened the Advanced Manufacturing Training Centre as part of a five year programme to help increase manufacturing skills in the UK.

– Continued to attract new Mid Markets clients, increasing client advocacy and investing in relationship manager capability; supported British universities and housing associations in accessing £1 billion of bond financing.

– Strong income growth in Global Corporates with continued discipline in capital management; ranked first in Sterling capital markets financing for UK corporates in 2015. Enhanced our proposition to UK linked International clients doing business globally with strong growth in our UK linked US client franchise and the opening of a regional office in Singapore.

– Facilitated £11.3 billion of financing to support UK infrastructure projects, including the Thames Tideway Tunnel that is expected to create c.9,000 new jobs and Galloper Wind Farm that will provide clean energy to c.336,000 homes.

– Strong growth in our Financial Institution franchise benefiting from London as the world's leading financial centre and supporting the Financial Services industry in the UK. In 2015 we have helped our clients raise over £60 billion of funding.

– Continued to invest in next generation digital capabilities to transform clients' experiences, with the pilot underway on the new 'CB Online' transaction banking platform.

– Increased return on risk-weighted assets to 2.33 per cent, exceeding our 2013 strategic commitment of returns of greater than 2 per cent and on track to exceed 2.40 per cent by the end of 2017. This reflected income growth and cost management in challenging markets, with disciplined capital and credit management as recognised by the award of Credit Portfolio Manager of the Year by Risk Awards.

– Awarded Business Bank of the Year at the FD's excellence Awards for the 11th consecutive year.

Financial performance

– Underlying profit up 10 per cent to £2,431 million with broad based Core Client Franchise income growth with strong increases in Lending, Capital Markets and Financial Markets helped by substantial impairment reductions and disciplined cost management resulting in positive jaws.

– Net interest margin increased by 26 basis points due to higher lending margins and controlled deposit pricing.

– Other income increase driven by refinancing support provided to Global Corporate clients and increases in Mid Markets.

– Impairments release of £22 million reflects lower gross charges and a number of write-backs and releases.

– Increased lending to SME and Mid Markets companies reflecting the strength of our locally based relationship managers.

– Deposits up 5 per cent with growth in SME, Mid Markets and Global Corporates transactional deposits underpinned by continued investment in the transaction banking platform and the improved credit rating of Lloyds Bank, offset by the optimisation of Financial Institutions deposits.

– 3 per cent decrease in risk-weighted assets despite increased lending to SMEs and Mid Market clients, driven by continued optimisation initiatives, improved credit quality and reduced operational risk risk-weighted assets.

Performance summary

	2015 £m	2014 £m	Change %
Net interest income	2,510	2,480	1
Other income	2,066	1,956	6
Total income	4,576	4,436	3
Operating costs	(2,137)	(2,123)	(1)
Operating lease depreciation	(30)	(24)	(25)
Total costs	(2,167)	(2,147)	(1)
Impairment release/(charge)	22	(83)	
Underlying profit	2,431	2,206	10
Banking net interest margin	2.93%	2.67%	26bp
Average interest-earning banking assets	£89.3bn	£93.2bn	(4)
Asset quality ratio	0.01%	0.08%	(7)bp
Return on risk-weighted assets	2.33%	1.92%	41bp
Return on assets	1.16%	0.94%	22bp

Key balance sheet items	At 31 Dec 2015 £bn	At 31 Dec 2014 £bn	Change %
SME	29.2	27.9	5
Other	72.1	73.0	(1)
Loans and advances to customers	101.3	100.9	–
Customer deposits	126.1	119.9	5
Total customer balances	227.4	220.8	3
Risk-weighted assets	102.5	106.2	(3)

Divisional results – Consumer Finance

Consumer Finance provides a range of products including motor finance, credit cards, and European mortgages and deposit taking, aiming to deliver sustainable growth within risk appetite. Motor Finance seeks to achieve this through improving customer service by building digital capability and continuing to create innovative propositions. Credit Cards aims to attract customers through better use of Group customer relationships and insight, underpinned by improvements to customer experience.

Progress against strategic initiatives

Investing in growth:

– Exceeded UK customer assets growth targets, whilst improving portfolio credit quality.
– Developed a broader and more competitive Cards product range, investing in digital reach and core capabilities to deliver new business and customer service improvements.
– Implemented enhanced application processes in Black Horse for motor dealers, leading to more efficient customer service; launched a new direct to consumer online secured car finance proposition to serve the needs of internet banking customers; and implemented further capabilities in the light commercial vehicle sector to improve the offering to Lex Autolease customers.

Focus on new business in a competitive market:

– Leading issuer of new credit cards in 2015, with a 22 per cent increase in average advances to new customers and a 20 per cent increase in the number of existing customers transferring balances in from competitors.
– Black Horse grew its market share through an 18 per cent increase in new lending, through improved dealer motor finance penetration and the Jaguar Land Rover (JLR) partnership.
– Lex Autolease fleet size up 7 per cent with leads from existing bank relationships up 13 per cent.

Growing balances in under-represented markets:

– Credit Cards balances increased 4 per cent compared with market growth of less than 2 per cent.
– Black Horse loans up 34 per cent outperforming a strong market and benefiting from the continued strength of the JLR relationship, while leading the industry in embedding significant Consumer Credit regulatory change.
– Lex Autolease operating lease assets grew 13 per cent driven by new SME customer activity.

Financial performance

– Underlying profit of £1,005 million with growth in better quality but lower margin lending, resulting in broadly flat income but lower impairments. This was offset by increased cost of investment in growth initiatives.
– Net interest income in line with prior year at £1,287 million (2014: £1,290 million) with 9 per cent growth in average interest-earning banking assets offset by a lower net interest margin down 55 basis points to 5.94 per cent.
– Net interest margin was down due to the acquisition of lower risk but lower margin new business, an increased proportion of Cards interest free balance transfer balances as we grow the business and the impact of the planned reduction in deposits in line with Group's balance sheet funding strategy. Despite this, return on risk-weighted assets was down only 6 basis points reflecting the portfolio quality.
– Other income of £1,358 million (2014: £1,364 million) with higher income from Lex Autolease fleet growth offset by the impact of lower interchange income in Credit Cards as a result of the recent EU ruling.
– Operating costs increased by 1 per cent, to £768 million as efficiency savings were more than offset by continued investment spend. Operating lease depreciation increased 8 per cent driven by Lex Autolease fleet growth.
– Impairment charges reduced by 29 per cent to £152 million, driven by the continued improvement in portfolio quality, supported by the sale of Credit Card recoveries assets; asset quality ratio improved by 37 basis points to 0.68 per cent.
– Net lending increased by 13 per cent driven by Black Horse and Credit Cards. UK Consumer Finance lending growth of 17 per cent year-on-year.
– Customer deposits reduced by 26 per cent, of which 4 per cent was due to foreign exchange movements, to £11.1 billion driven by the Group's funding strategy.
– Risk-weighted assets down 4 per cent despite a 13 per cent increase in customer assets reflecting the continued improvement in portfolio quality and a reduced allocation of operational risk risk-weighted assets.

Performance summary

	2015 £m	2014 £m	Change %
Net interest income	1,287	1,290	–
Other income	1,358	1,364	–
Total income	2,645	2,654	–
Operating costs	(768)	(762)	(1)
Operating lease depreciation	(720)	(667)	(8)
Total costs	(1,488)	(1,429)	(4)
Impairment	(152)	(215)	29
Underlying profit	1,005	1,010	–
Banking net interest margin	5.94%	6.49%	(55)bp
Average interest-earning banking assets	£22.4bn	£20.5bn	9
Asset quality ratio	0.68%	1.05%	(37)bp
Impaired loans as % of closing advances	2.3%	3.4%	(1.1)pp
Return on risk-weighted assets	4.81%	4.87%	(6)bp
Return on assets	3.73%	4.02%	(29)bp

Key balance sheet items	At 31 Dec 2015 £bn	At 31 Dec 2014 £bn	Change %
Loans and advances to customers	23.7	20.9	13
Of which UK	18.7	16.0	17
Operating lease assets	3.5	3.1	13
Total customer assets	27.2	24.0	13
Of which UK	22.2	19.1	16
Customer deposits	11.1	15.0	(26)
Total customer balances	38.3	39.0	(2)
Risk-weighted assets	20.1	20.9	(4)

Divisional results – Insurance

The Insurance division is committed to providing a range of trusted and value for money products to meet the needs of our customers. Scottish Widows, in its 200th year, is helping almost six million customers protect what they value most and plan financially for the future. In addition, the general insurance business is protecting the homes, belongings, cars and businesses of over three million customers.

Progress against strategic initiatives

Against a backdrop of continued regulatory change, Insurance has made good progress against its strategic initiatives.

– Increased Corporate Pensions funds under management by £1.4 billion to £28.4 billion through supporting a further 1,600 employers and 30,000 employees into auto-enrolment.
– Helped 215,000 customers to understand their additional retirement choices introduced by Pensions Freedoms in April through our dedicated retirement planning website and customer hub. Around 27,000 of these customers benefited from a personalised appointment.
– Launched a new non-advised pension drawdown product to support customers through the additional retirement choices introduced by Pensions Freedoms in April.
– Successfully delivered our first external bulk annuity transaction with a £0.4 billion deal in the fourth quarter, building on the £2.4 billion Scottish Widows With-Profits deal earlier in the year.
– Secured a further £1.4 billion of high yielding long-dated assets to improve investment returns for assets backing annuity liabilities, with over £5 billion acquired in the past four years through collaboration with the Commercial Banking Division.
– Launched a protection proposition into the Independent Financial Adviser (IFA) channel, complementing the protection offering to customers of the Bank, which is now available online through a quick and easy digital journey.
– Continued to grow Home Insurance sales through online channels, whilst developing an enhanced, more flexible, digitally enabled product expected to launch in the first half of 2016.
– Helped more than 5,000 customers who were impacted by the floods and storms in December 2015.
– Received approval from the PRA for our Solvency II internal model, on which ongoing capital requirements will be based.
– Completed, through a Part VII transfer, the consolidation of eight UK Life companies into a single combined entity, significantly simplifying the business.

Financial performance

– Underlying profit increased by 4 per cent to £962 million, driven by increased new business from bulk annuity deals as well as the net benefit from a number of assumption updates. These have been partially offset by increased costs reflecting significant investment spend, adverse economics and reduced general insurance income.
– Building on the £1 billion of dividends remitted in 2014, the division paid a further £0.5 billion of dividends to the Group in February 2016.
– Operating cash generation reduced by £61 million, primarily reflecting reduced general insurance income and increased new business strain following our entry into the attractive bulk annuities market, partially offset by increased cash generation from the long-term investments strategy.
– LP&I sales (PVNBP) increased by 10 per cent in the year, boosted by £2,783 million from bulk annuity deals. Excluding this, PVNBP fell by 22 per cent, driven by significant regulatory and market change including increased auto enrolment driven sales in 2014.
– General Insurance Gross Written Premiums (GWP) decreased 4 per cent, reflecting the competitive market environment and the run-off of products closed to new customers.

Capital

– Our internal model for Solvency II was successfully implemented on 1 January 2016 with the capital position remaining robust. The estimated solvency ratio for the insurance business at 1 January 2016 was 148 per cent before allowing for dividends.

Performance summary

	2015 £m	2014 £m	Change %
Net interest income	(163)	(131)	(24)
Other income	1,827	1,725	6
Total income	1,664	1,594	4
Total costs	(702)	(672)	(4)
Underlying profit	962	922	4
Operating cash generation	676	737	(8)
UK LP&I sales (PVNBP)[1]	9,460	8,601	10
General Insurance total GWP[2]	1,148	1,197	(4)
General Insurance combined ratio	83%	76%	7pp

1 Present value of new business premiums.

2 Gross written premiums.

Profit by product group

	2015						2014
	Pensions & investments £m	Protection & retirement £m	Bulk annuities £m	General Insurance £m	Other[1] £m	Total £m	Total £m
New business income	168	33	125	–	–	326	268
Existing business income	630	122	–	–	28	780	882
Long-term investment strategy	–	73	102	–	–	175	160
Assumption changes and experience variances	(208)	240	30	–	(2)	60	(134)
General Insurance income net of claims	–	–	–	323	–	323	418
Total income	590	468	257	323	26	1,664	1,594
Total costs	(414)	(133)	(10)	(145)	–	(702)	(672)
Underlying profit 2015	176	335	247	178	26	962	922
Underlying profit 2014[2]	236	344	–	274	68	922	

1 'Other' is primarily income from return on free assets, interest expense plus certain provisions.

2 To aid comparability, 2014 profit by product group has been restated to align with the revised product offerings and how the Insurance business supports customers. Full 2014 comparator tables for the profit and cash disclosures can be found on the Lloyds Banking Group investor site.

New business income increased by £58 million, with the primary driver being the new bulk annuity business. This was offset by a reduction in Protection income, following the removal of face-to-face advice in branch standalone protection sales and reduced annuity income following the introduction of Pensions Freedoms in 2015. Corporate pension income remained robust despite lower sales following the auto enrolment driven increases in 2014.

The fall in existing business income reflects a reduction in the expected rate of return used to calculate life and pensions income. The rate of return is largely set by reference to an average 15 year swap rate (2.57 per cent in 2015 and 3.48 per cent in 2014).

Long-term investment strategy includes the benefit from the successful acquisition of a further £1.4 billion of higher yielding assets to match the long duration annuity liabilities.

Divisional results – Insurance continued

Assumption changes and experience variances include an adverse impact of £208 million in pensions and investments as a result of the strengthening of lapse assumptions on the pensions book to allow for the impact of the recent pension reforms. This was more than offset by the £240 million of benefit recognised within Protection and Retirement, primarily as a result of changes to assumptions on longevity. These longevity changes reflect both experience in the annuity portfolio and the adoption of a new industry model reflecting an updated view of future life expectancy.

General Insurance income net of claims has fallen by £95 million. This reflects the run-off of products closed to new customers, the impact of becoming a sole underwriter of the home insurance business (which has resulted in a short term reduction from the loss of commission recognised upfront) and the impact of adverse weather. The anticipated launch in early 2016 of a more flexible Home product is expected to lead to an improvement in general insurance sales going forward.

Costs are £30 million higher, reflecting significant investment spend as part of an ongoing programme of growth and simplification initiatives. In 2015 this included the launch of Protection to IFAs and our bulk annuities business alongside the Part VII transfer as well as a significant regulatory change agenda in particular to support pensions freedoms and transition to Solvency II. Excluding investment related expenditure, underlying costs fell by 3 per cent during 2015 reflecting ongoing operational efficiencies.

Operating cash generation

	2015						2014
	Pensions & investments £m	Protection & retirement £m	Bulk annuities £m	General Insurance £m	Other £m	Total £m	Total £m
Cash invested in new business	(178)	(30)	(129)	–	–	(337)	(288)
Cash generated from existing business	531	166	110	–	28	835	751
Cash generated from General Insurance	–	–	–	178	–	178	274
Operating cash generation[1]	353	136	(19)	178	28	676	737
Intangibles and other adjustments[2]	(177)	199	266	–	(2)	286	185
Underlying profit	176	335	247	178	26	962	922
Operating cash generation 2014[3]	230	139	–	274	94	737	

1 Derived from underlying profit by removing the effect of movements in intangible (non-cash) items and assumption changes. For 2015 reporting this measure has been refined to include the cash benefits from the 'long-term investments strategy'.

2 Intangible items include the value of in-force life business, deferred acquisition costs and deferred income reserves.

3 Restated to align with the revised product offerings and how the Insurance business supports customers.

The Insurance business generated £676 million of operating cash in 2015, £61 million lower than the prior year. The initial cash strain from writing new bulk annuity business, reduced volumes within General Insurance and a reduction in the expected rate of return used to calculate life and pensions income, drove the reduction in cash generated in the year. These impacts have been partly offset by £185 million of cash benefits recognised in respect of the acquisition of attractive higher yielding assets to match long duration annuity liabilities and a £48 million benefit from the sale of a reinsurance asset.

Divisional results – Run-off and Central items

Run-off

	2015 £m	2014 £m
Net interest income	(88)	(116)
Other income	145	451
Total income	57	335
Operating costs	(150)	(279)
Operating lease depreciation	(14)	(29)
Total costs	(164)	(308)
Impairment	(8)	(203)
Underlying loss	(115)	(176)

	2015 £bn	2014 £bn
Loans and advances to customers	10.3	14.4
Total assets	12.2	16.9
Risk-weighted assets	10.2	16.8

– The reduction in income and costs largely reflects the impact of disposals made in 2014 including the sale of Scottish Widows Investment Partnership.
– The reduction in the impairment charge reflects the continued success in managing down the run-off portfolios.
– Run-off now represents 2 per cent of total loans and advances to customers and less than 5 per cent of the Group's risk-weighted assets.

Central items

	2015 £m	2014 £m
Total income	176	132
Total costs	19	(22)
Impairment release (charge)	2	(2)
Underlying profit	197	108

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

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:

	2015 £m	2014 £m
Banking net interest income – underlying basis	11,630	11,058
Insurance division	(163)	(131)
Other net interest income (including trading activity)	15	48
Group net interest income – underlying basis	11,482	10,975
Asset sales and other items	(318)	(619)
TSB	192	786
Insurance gross up	(38)	(482)
Group net interest income – statutory	11,318	10,660

Average interest-earning banking assets are gross of impairment allowances and comprise solely of customer and product balances in the banking businesses on which interest is earned or paid. Non-banking assets largely relate to fee based loans and advances within Commercial Banking and loans sold by Commercial Banking and Retail to Insurance to back annuitant liabilities. Other non-banking includes pooling arrangements where interest is received from or paid to customers based on the net of their lending and deposit balances but these balances cannot be netted on the Group balance sheet.

	Quarter ended 31 Dec 2015 £bn	Quarter ended 30 Sept 2015 £bn	Quarter ended 30 Jun 2015 £bn	Quarter ended 31 Mar 2015 £bn
Net loans and advances to customers	455.2	455.0	452.3	455.1
Impairment provision and fair value adjustments	4.4	4.9	7.0	7.4
Non-banking items:				
Fee based loans and advances	(10.1)	(8.0)	(7.2)	(6.4)
Sale of assets to Insurance	(5.7)	(5.3)	(5.2)	(4.7)
Other non-banking	(5.6)	(6.2)	(5.5)	(6.6)
Gross loans and advances (banking)	438.2	440.4	441.4	444.8
Averaging	1.0	(1.7)	1.8	1.7
Average interest-earning banking assets	439.2	438.7	443.2	446.5
Continuing businesses	427.8	425.5	427.4	429.5
Run-off	11.4	13.2	15.8	17.0
	439.2	438.7	443.2	446.5
Average interest-earning banking assets (year to date)	441.9	442.8	444.8	446.5

Other operating income

	2015 £ million	2014 £ million	Change %
Fees and commissions:			
Retail	876	998	(12)
Commercial Banking	1,562	1,605	(3)
Consumer Finance	247	308	(20)
Central items	(81)	(132)	39
Insurance income[1]:	2,604	2,779	(6)
Life and pensions	1,367	1,368	–
Bulk annuities	257	–	
General insurance	462	576	(20)
	2,086	1,944	7
Operating lease income	1,130	1,071	6
Other	190	222	(14)
Other income excluding run-off	6,010	6,016	–
Run-off	145	451	(68)
Other income	6,155	6,467	(5)

1 Includes insurance income reported by Retail and Consumer Finance.

Volatility arising in insurance businesses

The Group's statutory result before tax included negative volatility totalling £105 million compared to negative volatility of £228 million in 2014.

Volatility comprises the following:

	2015 £m	2014 £m
Insurance volatility	(303)	(219)
Policyholder interests volatility	87	17
Total volatility	(216)	(202)
Insurance hedging arrangements	111	(26)
Total	(105)	(228)

Insurance volatility

The Group's insurance business has policyholder liabilities that are supported by substantial holdings of investments. IFRS requires that the changes in both the value of the liabilities and investments are reflected within the income statement. The value of the liabilities does not move exactly in line with changes in the value of the investments. As the investments are substantial, 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 impact of the actual return on these investments differing from the expected return is included within insurance volatility.

The expected gross investment returns used to determine the underlying profit of the business are based on prevailing market rates and published research into historical investment return differentials for the range of assets held. Where appropriate, rates are updated throughout the year to reflect changing market conditions and changes in the asset mix. In 2015 the basis for calculating these expected returns has been enhanced to reflect an average of the 15 year swap rate over the preceding 12 months and rates were updated throughout the year to reflect changing market conditions. The negative insurance volatility during 2015 of £303 million primarily reflects lower equity returns than expected, widening credit spreads and low returns on cash investments.

Policyholder interests volatility

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 expected 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 2015, the statutory results before tax included a credit to other income which relates to policyholder interests volatility totalling £87 million (2014: £17 million) reflecting offsetting movements in equity, bond and gilt returns.

Insurance hedging arrangements

The Group purchased put option contracts in 2015 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. These were financed by selling some upside potential from equity market movements. On a mark-to-market basis a gain of £111 million was recognised in relation to these contracts in 2015.

Return on required equity

Underlying return on required equity is the underlying profit after tax at the standard UK corporation tax rate less the post-tax profit attributable to other equity holders divided by the average required equity for the period. Required equity comprises shareholders' equity and non-controlling interests and is the amount required to achieve a common equity tier 1 ratio of 12.0 per cent after allowing for regulatory adjustments and deductions. An adjustment is also made to reflect the notional earnings on any excess or shortfall in equity.

Statutory return on required equity is the statutory profit after tax less the post-tax profit attributable to other equity holders divided by the average required equity for the period. An adjustment is also made to reflect the notional earnings on any excess or shortfall in equity.

Five year financial summary

The financial statements (statutory basis) for each of the years presented have been audited by PricewaterhouseCoopers LLP, independent auditors.

	2015	2014	2013	2012[1]	2011[1]
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**17,421**	16,399	18,478	20,517	20,802
Operating expenses	**(15,387)**	(13,885)	(15,322)	(15,974)	(16,459)
Trading surplus	**2,034**	2,514	3,156	4,543	4,343
Impairment	**(390)**	(752)	(2,741)	(5,149)	(8,094)
Profit (loss) before tax	**1,644**	1,762	415	(606)	(3,751)
Profit (loss) for the year	**956**	1,499	(802)	(1,387)	(2,890)
Profit (loss) for the year attributable to ordinary shareholders	**466**	1,125	(838)	(1,471)	(2,963)

	31 December 2015	31 December 2014	31 December 2013	31 December 2012[1]	31 December 2011[1]
Balance sheet data (£m)					
Share capital	**7,146**	7,146	7,145	7,042	6,881
Shareholders' equity	**41,234**	43,335	38,989	41,896	45,506
Other equity instruments	**5,355**	5,355	–	–	–
Net asset value per ordinary share	**57.9p**	60.7p	54.6p	59.5p	66.1p
Customer deposits	**418,326**	447,067	439,467	426,216	413,906
Subordinated liabilities	**23,312**	26,042	32,312	34,092	35,089
Loans and advances to customers	**455,175**	482,704	492,952	516,764	565,638
Total assets	**806,688**	854,896	842,380	933,064	970,609

	2015	2014	2013	2012[1]	2011[1]
Share information					
Basic earnings (loss) per ordinary share	**0.8p**	1.7p	(1.2)p	(2.1)p	(4.3)p
Diluted earnings (loss) per ordinary share	**0.8p**	1.6p	(1.2)p	(2.1)p	(4.3)p
Dividends per ordinary share[2,3]	**2.75p**	0.75p	–	–	–
Market price (year end)	**73.1p**	75.8p	78.9p	47.9p	25.9p
Number of shareholders (thousands)	**2,563**	2,626	2,681	2,733	2,770
Number of ordinary shares in issue (millions)[4]	**71,374**	71,374	71,368	70,343	68,727

	2015	2014	2013	2012[1]	2011[1]
Financial ratios (%)[5]					
Dividend payout ratio[6]	**359.3**	45.1	–	–	–
Post-tax return on average shareholders' equity	**1.3**	2.9	(2.0)	(3.3)	(6.7)
Post-tax return on average assets	**0.11**	0.17	(0.09)	(0.14)	(0.06)
Cost:income ratio[7]	**88.3**	84.7	82.9	77.9	79.1

	31 December 2015	31 December 2014	31 December 2013	31 December 2012	31 December 2011
Capital ratios (%)[8, 9]					
Total capital	**21.5**	22.0	20.8	17.3	15.6
Tier 1 capital	**16.4**	16.5	14.5	13.8	12.5
Common equity tier 1 capital/Core tier 1 capital	**12.8**	12.8	14.0	12.0	10.8

1 Restated in 2013 for IAS 19 (Revised) and IFRS 10.

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 Dividends per ordinary share in 2015 includes a recommended special dividend of 0.5 pence.

4 This figure excludes the limited voting ordinary shares owed by the Lloyds Bank Foundations.

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

6 Total dividend for the year divided by earnings attributable to ordinary shareholders adjusted for tax relief on distributions to other equity holders.

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

8 Capital ratios for 2014 reflected CRD IV transitional rules as implemented by the PRA on 1 January 2014. Capital ratios for 2013 and earlier years have not been restated to reflect the implementation of CRD IV.

9 Capital ratios for 2012 and 2011 were not restated to reflect the adoption of IAS 19 (Revised).

GOVERNANCE

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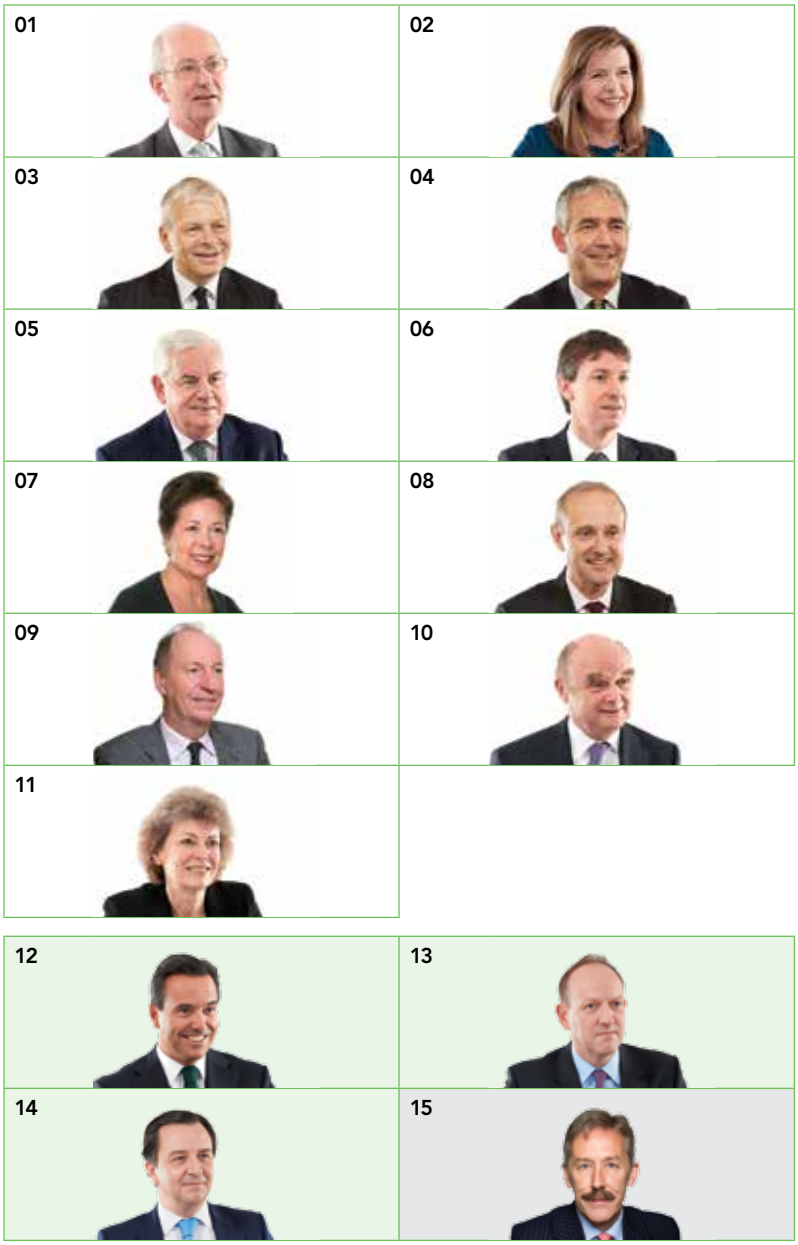
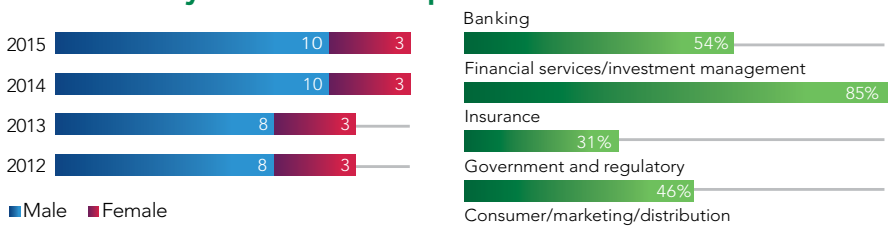
Board of Directors



KEY

Member of Nomination & Governance Committee	NG	Member of Remuneration Committee	Re
Member of Audit Committee	A	Member of Responsible Business Committee	RB
Member of Risk Committee	Ri	Committee Chairman	●

Board diversity: members and experience



This information is provided as at 31 December 2015.

NON-EXECUTIVE DIRECTORS

01 Lord Blackwell
Chairman NG Ri Re RB

Appointed: June 2012 (Board), April 2014 (Chairman)

Skills and experience: Lord Blackwell has deep financial services knowledge as well as extensive insurance, banking, regulatory and public policy experience gained from senior positions in a wide range of industries. His breadth of experience, credibility with key stakeholders and strong leadership qualities make him an effective Chairman. He was previously the Chairman of Scottish Widows Group, a former Senior Independent Director of Standard Life and also chaired their UK Life and Pensions Board. His other former Non-Executive Directorships have included Halma plc, Dixons Group and SEGRO. He was also a member of the Board of the Centre for Policy Studies, a Non-Executive Board Member of Ofcom and of the Office of Fair Trading, a Partner of McKinsey & Co. and a Director of Group Development at NatWest Group. He was Head of the Prime Minister's Policy Unit from 1995 to 1997 and was appointed a Life Peer in 1997.
External appointments: Chairman of Interserve plc (until 29 February 2016).

02 Anita Frew
Deputy Chairman and Independent Director NG A Ri Re RB

Appointed: December 2010 (Board), May 2014 (Deputy Chairman)

Skills and experience: Anita has significant board, financial and general management experience across a range of sectors, including banking, asset management, manufacturing and utilities. Her extensive board level experience makes her an effective Deputy Chairman. Anita was Chairman of Victrex plc, having previously been its Senior Independent Director. She was also the Senior Independent Director of Aberdeen Asset Management and IMI plc, 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.
External appointments: Chairman of Croda International Plc and a Non-Executive Director of BHP Billiton.

03 Alan Dickinson
Independent Director NG A Ri Re

Appointed: September 2014

Skills and experience: Alan is a highly regarded retail and commercial banker having spent 37 years with the Royal Bank of Scotland, most notably as Chief Executive of RBS UK. Alan's strategic focus and core banking experience complements the balance of skills on our Board. More recently, he was Chairman of Brown, Shipley & Co. Limited, a Non-Executive Director of Nationwide Building Society and Chairman of its Risk Committee and a Non-Executive Director of Carpetright plc.
External appointments: Non-Executive Director of Willis Limited and Chairman of its Risk Committee, Senior Independent Director of Urban & Civic plc and a Governor of Motability.

04 Simon Henry
Independent Director A Ri

Appointed: June 2014

Skills and experience: Simon has deep international experience in board level strategy and execution. His extensive knowledge of financial markets, treasury and risk management and his qualification as an Audit Committee Financial Expert is of particular value in our Board Risk and Audit Committees.
He was previously Shell's Chief Financial Officer for Exploration & Production and prior to that Head

of Group Investor Relations.
External appointments: Chief Financial Officer and an Executive Director of Royal Dutch Shell plc with responsibility for Shell's Finance, IT, Strategy and Planning functions. Chair of the European Round Table CFO Taskforce, Member of the Main Committee of the 100 Group of UK FTSE CFOs, the Advisory Panel of CIMA and of the Advisory Board of the Centre for European Reform.

05 Dyfrig John CBE
Independent Director (Ri) (Re)
Appointed: January 2014

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 Remuneration Committee and Risk Committee. He was formerly Chairman of Principality Building Society and a Board member of the Wales Millennium Centre.
External appointments: Member of the Welsh Rugby Union's Audit Committee.

06 Nick Luff
Independent Director (NG) (A) (Ri)
Appointed: March 2013

Skills and experience: Nick 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 was previously the Group Finance Director of Centrica plc, Finance Director of The Peninsular & Oriental Steam Navigation Company and Chief Financial Officer of P&O Princess Cruises plc. He previously served as a Non-Executive Director and was the Audit Committee Chair of QinetiQ Group plc.
External appointments: Executive Director and Chief Financial Officer of RELX Group.

07 Deborah McWhinney
Independent Director (A) (Ri)
Appointed: December 2015

Skills and experience: Deborah has an extensive executive background in managing technology, operations and new digital innovations across banking, payments and institutional investment. She broadens the Board's diversity from a global market perspective. Deborah is a former Chief Executive Officer, Global Enterprise Payments and President, Personal Banking and Wealth Management at Citibank. She was previously President of Institutional Services at Charles Schwab Corporation and held executive roles at Engage Media Services Group, Visa International and Bank of America, where she held senior roles in Consumer Banking.
External appointments: Independent Director of Fluor Corporation and IHS Corporation, a Trustee of the California Institute of Technology and of the Institute for Defense Analyses.

08 Nick Prettejohn
Independent Director and Chairman of Scottish Widows Group (A) (Ri)
Appointed: June 2014

Skills and experience: Nick has significant financial services experience, particularly in insurance where he has served as Chief Executive of Lloyd's of London and Prudential UK and Europe as well as Chairman of Brit Insurance. 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. He is a former Non-Executive Director of the Prudential Regulation Authority and of Legal and General Plc as well as Chairman of the Financial Services Practitioner Panel.
External appointments: Member of the BBC Trust, Chairman of the Britten-Pears Foundation and of the Royal Northern College of Music.

09 Stuart Sinclair
Independent Director (Ri) (Re)
Appointed: January 2016

Skills and experience: Stuart has extensive experience in retail banking and insurance and also brings to the Board wider experience in consumer finance and asset finance. He is a former Non-Executive Director of TSB Banking Group plc and TSB Bank plc. Stuart was previously a Non-Executive Director of LV Group, President and Chief Operating Officer of Aspen Insurance, held Chief Executive Officer roles at GE Capital's Consumer Finance division both in the UK and China, and Director of UK Retail Banking then Chief Executive Officer of Tesco Personal Finance at Royal Bank of Scotland. He was also a Council Member of The Royal Institute for International Affairs. His early career included Managing Consultant at Braxton Associates and Partner at Mercer Managing Consultant (now Oliver Wyman).
External appointments: Non-Executive Director and Chair of the Risk Committees at Provident Financial Plc, Vitality Life and Vitality Health. Senior Independent Director at QBE Insurance (Europe) Limited and Swinton Group Limited.

10 Anthony Watson CBE
Senior Independent Director (NG) (A) (Ri) (Re)
Appointed: April 2009 (Board), May 2012 (Senior Independent Director)

Skills and experience: Tony is our Senior Independent Director and with over 40 years of experience in the investment management industry and related sectors, he is well placed to carry out this role. His former positions include Chief Executive of Hermes Pensions Management and Chairman of the Asian Infrastructure Fund, MEPC, the Marks & Spencer Pension Trustees and of the Strategic Investment Board (Northern Ireland). He is also a former Member of the Financial Reporting Council, a Senior Independent Director of Hammerson and a Non-Executive Director of the Shareholder Executive and Vodafone Group.
External appointments: Senior Independent Director of Witan Investment Trust, Chairman of the Lincoln's Inn Investment Committee and a member of the Norges Bank Investment Management Corporate Governance Advisory Board.

11 Sara Weller CBE
Independent Director (Ri) (Re) (RB)
Appointed: February 2012

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. Her previous appointments include Managing Director of Argos, various senior positions at J Sainsbury including Deputy Managing Director, Lead Non-Executive Director at the Department of Communities and Local Government, a Non-Executive Director of Mitchells & Butler as well as a number of senior management roles for Abbey National and Mars Confectionery.
External appointments: Non-Executive Director of United Utilities Group and Chair of their Remuneration Committee, a Governing Council Member of Cambridge University, Chairman of the Planning Inspectorate and Board member at the Higher Education Funding Council.

EXECUTIVE DIRECTORS

12 António Horta-Osório
Executive Director and Group Chief Executive
Appointed: January 2011 (Board), March 2011 (Group Chief Executive)

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. Previously he worked for Goldman Sachs, Citibank and held various senior management positions at Grupo Santander before becoming its Executive Vice President. He was a Non-Executive Director of Santander UK and subsequently Chief Executive. He is also former Non-Executive Director of the Court of the Bank of England and Governor of the London Business School.
External appointments: Non-Executive Director of EXOR S.p.A., Fundação Champalimaud and Sociedade Francisco Manuel dos Santos in Portugal, a member of the Board of Stichting INPAR and Chairman of the Wallace Collection.

13 George Culmer
Executive Director and Chief Financial Officer
Appointed: May 2012 (Board)

Skills and experience: George is a chartered accountant with extensive 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. George was an Executive Director and Chief Financial Officer of RSA Insurance Group, the former Head of Capital Management of Zurich Financial Services and Chief Financial Officer of its UK operations as well as holding various senior management positions at Prudential. He is a Non-Executive Director of Scottish Widows.
External appointments: None.

14 Juan Colombás
Executive Director and Chief Risk Officer
Appointed: January 2011 (Chief Risk Officer), November 2013 (Board)

Skills and experience: Juan has significant banking and risk management experience, having spent 30 years working in these fields both internationally and in the UK. 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. He was previously the Chief Risk Officer and Executive Director 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. He has served as the Group's Chief Risk Officer and as a member of the Group Executive Committee since January 2011.
External appointments: Vice Chairman of the International Financial Risk Institute.

15 Malcolm Wood
Company Secretary
Appointed: November 2014

Skills and experience: Previously General Counsel and Company Secretary of Standard Life after a career as a corporate lawyer in private practice in London and Edinburgh. He has a wealth of experience in governance, policy and regulation. He is a Fellow of the Institute of Chartered Secretaries and Administrators and a Member of the Chartered Institute for Securities and Investment and the GC100.

Group Executive Committee

Delivering our vision and managing a more agile organisation

The depth of diverse experience and complementary skills within our management team strengthens our ability to adjust to changing market environments and to deliver our strategy to become the best bank for customers.

Biographies of the Group Executive Committee (GEC) members, and in the case of the Group Audit Director, GEC attendee, are provided opposite.

BOARD MEMBERS

António Horta-Osório
Executive Director and Group Chief Executive

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

Full biography on page 57.

George Culmer
Executive Director and Chief Financial Officer

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

Full biography on page 57.

Juan Colombás
Executive Director and 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.

Full biography on page 57.

NON-BOARD MEMBERS

01

02

03

04

05

06

07

08

09

01 Andrew Bester
Chief Executive Officer, Commercial Banking

Andrew joined the Group in 2012 from Standard Chartered Bank where he held a variety of senior roles including Global COO and, later, Chief Financial Officer of Consumer Banking. Previously, Andrew worked at Xchanging Plc and Deutsche Bank. He trained as a Chartered Accountant.

Andrew sits on the Board of the Global Financial Markets Association and the Advisory Board of the University of Cambridge Programme for Sustainability Leadership and is a member of The Prince of Wales's UK Corporate Leaders' Group. Andrew is Executive Sponsor for Inclusion & Diversity and the Group's Ambassador's programme.

02 Karin Cook
Group Director, Operations

Karin joined the Group in 2013 as Chief Operating Officer, Commercial Banking and became Group Director, Operations in 2015. Karin joined from HSBC where she was Global Chief Operating Officer for Private Banking from 2010 to 2013 and Global Head of OTC Derivative Operations for HSBC from 2004 to 2010. Prior to HSBC, Karin spent nine years at Morgan Stanley in London where she led a combined Finance and Operations team for Equity Derivatives after beginning her career at Goldman Sachs in Paris in 1990, where she worked in Futures Operations.

Karin is a Non-Executive Director of Scottish Widows Ltd. She is also the Group's Executive Sponsor for Sexual Orientation and Gender Identity.

03 Simon Davies
Chief People, Legal and Strategy Officer

Simon joined the Group in 2016 from Linklaters LLP where he was Firmwide Managing Partner, a position he held from January 2008. Prior to this, Simon spent 12 years in Asia, specialising in M&A and securities advice, serving terms in each of Hong Kong and Tokyo and was Managing Partner for Asia from 2003-2007. He is a Solicitor of the High Court of the Hong Kong Special Administrative Region, as well as a Solicitor of the Senior Courts of England and Wales.

Simon joined Linklaters in London in 1990, having studied at Emmanuel College, Cambridge. He is a trustee of the National Youth Theatre of Great Britain and a member of TheCityUK China Market Advisory Group.

04 Mary Hall
Group Audit Director (GEC attendee)

Mary joined the Group in 2014 from KPMG Canada where she was a senior Financial Services Audit Partner having previously held various senior roles including Canadian Industry Leader for Financial Services, Canadian National Banking Sector Leader and Chair of KPMG's Global New Banking Entrants Committee. Mary is a Chartered Accountant with over 25 years in the financial services industry.

Since her appointment, Mary has defined a transformational vision for Group Audit, providing independent and fresh perspectives. Mary has a primary reporting line to the Chairman of the Audit Committee and a secondary reporting line to the Group Chief Executive. Mary sits on the advisory Board of the Forward Institute in the UK.

05 Vim Maru
Group Director, Customer Products and Marketing

Vim joined the Group in 2011. He has responsibility for Retail Customer Products and Group Marketing. Previously, Vim worked at Santander UK and Abbey National. He was appointed to our Group Executive Committee in 2013 and is a Non-Executive Director of Scottish Widows and a VISA Europe Board Director.

Vim holds an Economics degree from the London School of Economics and is a member of the Institute of Chartered Accountants.

06 Miguel-Ángel Rodríguez-Sola
Group Director, Digital

Miguel joined the Group in 2011 before which he held a variety of executive positions in the UK, USA and Spain for Santander. Prior to this, Miguel was a Partner at McKinsey where he worked for over 12 years. He assumed his current role in September 2013 having previously held the position of Group Strategy Director and Commercial Director of the Retail Division.

Miguel holds a 'Cum Laude' degree in Business Administration from the University of Barcelona and an MBA from IESE Business School. He is a Board member of Go ON UK.

07 Antonio Lorenzo
Interim Chief Executive, Scottish Widows and Interim Group Director, Insurance

Antonio joined the Group in 2011 as head of the Wealth and International division and Group Corporate Development, leading the Group's strategic review and subsequent programme of reducing non-core assets and exiting international locations. From 2013, he assumed the role of Group Director, Consumer Finance & Group Corporate Development, leading the division's growth strategy whilst completing the sale of TSB. In October 2015 he was appointed Interim Chief Executive, Scottish Widows and Group Director, Insurance. Antonio is also Group Executive Sponsor for Emerging Talent.

Antonio joined the Group from Santander, where he had worked in a number of different leadership roles and jurisdictions since 1998. He was part of the management team that completed the take-over of Abbey National and Bradford & Bingley; and was Chief Financial Officer of Santander UK. Before Santander, Antonio spent over nine years at Arthur Andersen.

08 David Oldfield
Group Director, Retail and Consumer Finance

David was appointed in June 2015 as Group Director for the Retail Division responsible for the largest retail banking network in the UK, serving around 30 million customers. Additionally, in February 2016, David assumed responsibility for the Consumer Finance Division.

David started his career with Lloyds Bank 31 years ago on the graduate entrant programme and has held a number of key leadership roles across all Divisions of the Group since that time. Immediately prior to this role he was appointed to Group Executive Committee in May 2014 as Group Director, Operations.

David is a Non-Executive Director for Motability Operations Plc and a Fellow of the Chartered Institute of Bankers. He is also Group Executive Sponsor for Disability.

09 Matthew Young
Group Corporate Affairs Director

Matt joined the Group as Corporate Affairs Director in 2011 as part of a new management team brought in to bring the bank back to health following the financial crisis and return it private ownership. Prior to Lloyds, he was Communications Director at Santander during a period when the bank made a successful entry into the UK market following the acquisition and subsequent rebranding of Abbey National, Alliance & Leicester, and Bradford & Bingley. Matt joined Santander from NatWest in 1999 where he held a number of senior communications roles.

Matt has a degree in Political Science and a postgraduate certificate in Education. He is a Board member of the British Bankers Association, a member of the PR Guild, and a former trustee of the Prince of Wales sponsored charity, In Kind Direct.

Corporate governance report

Dear Shareholders

As Chairman of the Board I believe that the highest standards of corporate governance are critical to the success of our business today. Good governance underpins the delivery of our strategy to become the best bank for customers and generate sustainable returns for shareholders. Our Board is committed to ensuring good governance is embedded in the thinking and processes of the business.

This report sets out our approach to governance in practice, the work of the Board during 2015 and includes reports from the Nomination & Governance Committee, the newly established Responsible Business Committee, the Audit Committee and the Board Risk Committee. Information about the work of the Remuneration Committee is included in the Directors' remuneration report on pages 82 to 106.

I recognise that governance must be dynamic and evolve to meet current and future demands. Therefore, in late 2014, I commissioned our newly appointed Company Secretary to undertake an end-to-end review of our governance arrangements from a fresh perspective.

I am responsible for leading the Board and ensuring its effectiveness. I am pleased to report that further to the actions identified by the Company Secretary in his review and in the 2014 Board Effectiveness Review, changes were introduced and actions implemented which have led to improvements in a number of areas. Details of the 2015 Board Effectiveness Review, together with information about our progress against the 2014 review actions are on pages 67 and 68.

During 2015, succession planning and the composition of the Board and its Committees remained a key focus. I am pleased to welcome Deborah McWhinney and Stuart Sinclair as independent Non-Executive Directors in December 2015 and January 2016 respectively. They bring deep banking and wider financial services experience, helping ensure the Board is well placed to address future technology and market risks across the full range of business areas in which we operate. Carolyn Fairbairn, an independent Non-Executive Director, retired from the Board in October 2015 to take up the position of Director-General of the Confederation of British Industry in November 2015. Dyfrig John, an independent Non-Executive Director, has notified the Board that he wishes to reduce his workload and therefore does not intend to seek re-election at the 2016 annual general meeting (AGM). Both Carolyn and Dyfrig leave with our thanks and best wishes for the future.

2015 has also seen a number of changes to our Committee structure and composition, including the establishment of a Responsible Business Committee, underlining the Group's commitment to being a responsible business. Rebuilding trust and delivering our vision of being the best bank for customers are integral to our strategy. Full details of all Committee changes during the year are on page 62.

Your Board remains focused on how the Group delivers solutions that continue to put the customer at the heart of everything we do. There is an ever increasing understanding of the criticality of technology in delivering customer service. During the year, the Board spent considerable time reviewing the delivery of our investment in IT resilience and digital transformation programmes.

2015, our milestone year, was a year of continued delivery for the Group and included the reinstatement of dividends. The decision to resume dividends bears testament to the successful transformation and improved risk profile of the business. Read more on page 63.

Looking forward to 2016, our corporate governance priorities will be continuing to deliver and oversee the implementation of the Group's strategy, implementing the actions from the 2015 Board Effectiveness Review and the introduction of the Senior Managers and Certification Regime (SM&CR).

Lord Blackwell
Chairman

2015 GOVERNANCE IN FOCUS

Corporate Governance Framework

Our Corporate Governance Framework is reviewed at least annually by the Board to ensure it remains effective. This year the framework was subject to an additional end-to-end review by the Company Secretary.

Read more on page 69

Succession planning

Our approach to succession planning ensures the desired mix of skills and experience of Board members, now and in the future. Just as importantly, talent needs to be recognised and nurtured within executive and management levels and across the Group as a whole.

Read more on page 73

Responsible business

Our approach to culture and values is led by the Board. The creation of a board-level Responsible Business Committee during the year underlines the Group's commitment to being a responsible business.

Read more on page 81

Remuneration

The Board ensures that there is a clear link between remuneration and the delivery of the Group's business strategy.

Read more in the Directors' remuneration report on pages 82 to 106

Risk management and viability statement

The Board is responsible for the Group's risk management and internal controls systems and for reviewing their effectiveness. The Board is also responsible for assessing the going concern and longer term viability of the Company and the Group.

Read more on pages 70 and 108

IT resilience and digital transformation

There is an ever increasing understanding of the criticality of technology in delivering customer service. During the year, the Board spent considerable time reviewing the delivery of the three-year IT resilience investment and digital transformation programmes.

Read more on page 65

This report explains how the Group applies the highest principles of corporate governance, in particular those laid down in the 2014 edition of the Financial Reporting Council (FRC)'s UK Corporate Governance Code (Code). The Code can be accessed at www.frc.org.uk

LEADERSHIP

The Board

The Group is led by an effective, committed and unitary Board, which is collectively responsible for the long-term success of the Company. The Board comprises a Chairman (who was independent on appointment), independent Non-Executive Directors and Executive Directors. The names and biographies of current Directors are set out on pages 56 and 57.

There is a clear division of responsibility at the head of the Company, which is documented in the Group's Corporate Governance Framework. The Chairman has overall responsibility for the leadership of the Board and for ensuring its effectiveness while the Group Chief Executive manages and leads the business.

The Corporate Governance Framework sets out a number of key decisions and matters that are reserved for the Board's approval. The Board sets the strategy, oversees its delivery and establishes the culture, values and standards of the Group. The Board ensures that the Group manages risk effectively, monitors financial performance and reporting and ensures that appropriate and effective succession planning arrangements and remuneration policies are in place. It provides and encourages entrepreneurial leadership across the Group within this framework.

Board Committees

The Board is supported by its Committees which make recommendations on matters delegated to them under the Corporate Governance Framework, 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 Chairmen report to the Board on the activities of the Committee at each Board meeting. A structure chart of the Board Committees can be found on page 62.

A full schedule of all matters reserved to the Board and Terms of Reference for each of the Board Committees can be found at www.lloydsbankinggroup.com/our-group/corporate-governance

Group Chief Executive

Responsibility for day-to-day management of the business is delegated to the Group Chief Executive. The Group Chief Executive delegates aspects of his own authority, as permitted under the Corporate Governance Framework, to members of the Group Executive Committee (GEC). The names and biographies of current GEC members and GEC attendee, the Group Audit Director, are set out on pages 58 and 59. The GEC meets weekly to scrutinise the Group's business. The Group Audit Director, the Group HR Director (until October 2015) and the Company Secretary attend the weekly GEC meetings to ensure that there is appropriate internal audit oversight, that employee interests and people strategy matters are considered and that the highest standards of corporate governance are maintained, including the escalation of matters to the Board and its Committees. In January 2016, a new role of Chief People, Legal and Strategy Officer was created to lead the HR, Legal and Strategy functions. The Chief People, Legal and Strategy Officer is a member of the GEC and reports to the Group Chief Executive.

Company Secretary

All Directors, including Non-Executive Directors, have access to the services of the Company Secretary in relation to the discharge of their duties. Both the appointment and removal of the Company Secretary is a matter for the Board as a whole.

KEY ROLES AND RESPONSIBILITIES

Chairman – Lord Blackwell

- Leads the Board
- Promotes the highest standards of corporate governance
- Sets the Board's agenda
- Builds an effective and complementary Board
- Leads Board succession planning
- Ensures effective communication with shareholders

Deputy Chairman – Anita Frew

- Ensures continuity of Chairmanship during any change of chairmanship
- Supports the Chairman in representing the Board and acting as a spokesperson
- Deputises for the Chairman
- Available to the Board for consultation and advice
- Represents the Group's interests to official enquiries and review bodies

Senior Independent Director – Anthony Watson

- Sounding board for the Chairman and Group Chief Executive
- Acts as a conduit for the views of other Non-Executive Directors
- Conducts the Chairman's annual performance appraisal
- Helps resolve shareholders' concerns
- Attends meetings with major shareholders and financial analysts to understand issues and concerns

Non-Executive Directors

- Challenge constructively
- Help develop and set the Group's strategy
- Actively participate in Board decision making
- Scrutinise management performance
- Satisfy themselves on the integrity of financial information
- Review the Group's risk exposures and controls
- Determine the remuneration of Executive Directors

The Non-Executive Directors are listed on pages 56 and 57.

Group Chief Executive – António Horta-Osório

- Manages the Group on a day-to-day basis
- Makes decisions on matters affecting the operation, performance and strategy of the Group's business
- Provides leadership and direction to senior management
- 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

Executive Directors

- Under the leadership of the Group Chief Executive, make and implement decisions in all matters affecting the operations, performance and strategy of the Group's business
- Provide specialist knowledge and experience to the Board
- Responsible for the successful leadership and management of the Risk and Finance divisions
- Design, develop and implement strategic plans
- Deal with day-to-day operations of the Group

The Executive Directors are listed on page 57.

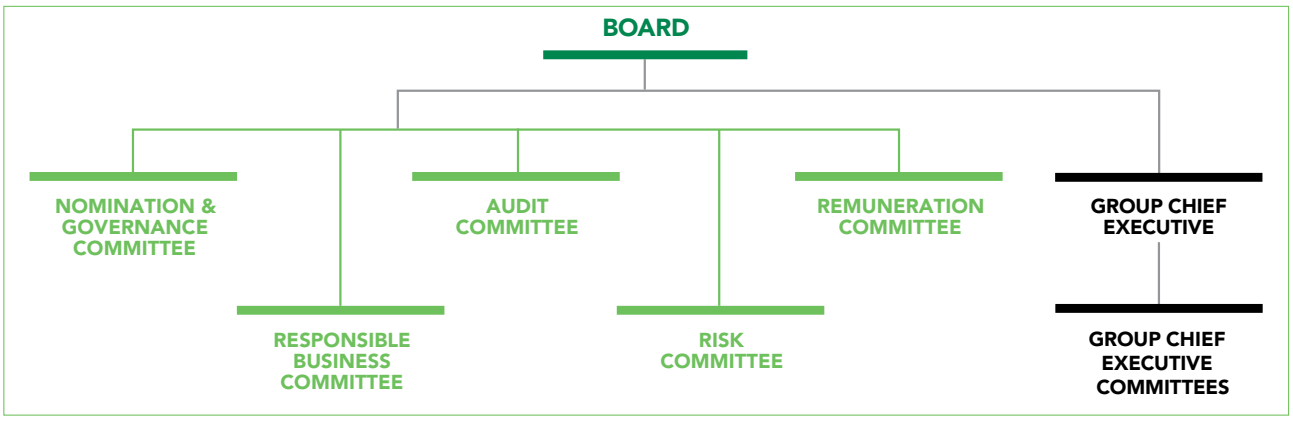
Company Secretary – Malcolm Wood

- Advises the Board
- Ensures good information flows and comprehensive practical support are provided to Directors
- Maintains the Group's corporate governance framework
- Organises Directors' induction and training
- Communicates with shareholders as appropriate and ensures due regard is paid to their interests

Corporate governance report continued

LEADERSHIP continued

Board and governance structure



Reports from the Nomination & Governance Committee, the Audit Committee, the Board Risk Committee and the Responsible Business Committee can be found on pages 72 to 81. Information about the work of the Remuneration Committee is included in the Directors' remuneration report on pages 82 to 106. Please see pages 118 to 119 for a list of the Group Chief Executive Committees and their purpose.

Subsidiary governance

The Boards of the four main companies, Lloyds Banking Group plc, Lloyds Bank plc, HBOS plc and Bank of Scotland plc, comprise the same Directors, with Board meetings for these companies being held concurrently. The agenda is split between the companies, allowing decisions to be taken and scrutinised by the appropriate Board.

The Board of the Group's insurance subsidiary, Scottish Widows Group Limited, which also sits as the Board of its 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.

The Group continues to conduct the majority of its business through a number of subsidiary entities. A certification process, at individual entity level, of compliance with the minimum governance standards set out in the Corporate Governance Framework enhances management of any legal, regulatory and reputational risks associated with the Group's subsidiary entities.

The process provides GEC members with additional oversight of subsidiary entities within their respective business area, including an escalation process for any matters of non-compliance. In addition, the process provides continued focus on simplification of the Group's legal entity structure through consideration of the lifecycle of each entity.

Changes in Board Committees

During 2015, the Nomination & Governance Committee continued to keep under review succession planning and the effectiveness of the Board and its Committees. To ensure the Group's corporate governance is consistent with best practice, in addition to the annual Board Effectiveness Review, a Corporate Governance Review was carried out by the Company Secretary during the year. The following changes to Committees were made:

- The Group established a Responsible Business Committee (RBC) of the Board. The RBC is chaired by Sara Weller CBE and includes as members Lord Blackwell, Chairman, and Anita Frew, Deputy Chairman. The RBC oversees the measurement and communication of the Group's customer-centric culture and values, as well as the development of the Helping Britain Prosper Plan. The creation of a board-level RBC underlines the Group's commitment to being a responsible business. A report on the activities of the RBC can be found on page 81;
- Anita Frew, Deputy Chairman, succeeded Anthony Watson, Senior Independent Director, as Chairman of the Remuneration Committee, effective 1 October 2015. The change reflected best governance on the separation of the role of the Senior Independent Director and the Chairman of the Remuneration Committee. Mr Watson served as Chairman of the Remuneration Committee since May 2010 and remains a member of the Remuneration Committee;
- Alan Dickinson, an independent Non-Executive Director and Chairman of the Board Risk Committee, was appointed as a member of the Remuneration and Nomination & Governance Committees, effective 17 July 2015;
- Carolyn Fairbairn, an independent Non-Executive Director, retired from the Board and as a member of the Audit and Remuneration Committees on 31 October 2015;
- Deborah McWhinney joined the Board as an independent Non-Executive Director on 1 December 2015 and was appointed as a member of the Audit and Risk Committees; and
- Stuart Sinclair joined the Board as an independent Non-Executive Director on 4 January 2016 and was appointed as a member of the Risk and Remuneration Committees.

Dyfrig John, an independent Non-Executive Director, has notified the Board that he does not intend to seek re-election at the 2016 AGM. Mr John is currently a member of the Risk and Remuneration Committees.

The Board in 2015

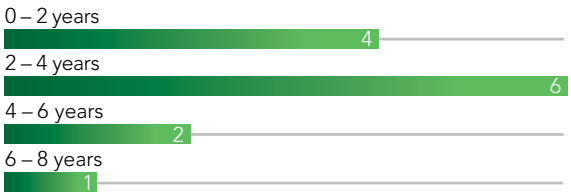
The Directors who served during the year and their attendance at Board meetings is set out in the table below. The attendance of Directors at Committee meetings is displayed within the individual Committee reports found on pages 72 to 81 and for the Remuneration Committee on page 91. Whilst all Non-Executive Directors are, where appropriate, invited to and regularly attend other Committee meetings, only their attendance at Committees of which they are members is recorded.

A number of other Board Committee meetings were held during the year, including meetings in relation to the disposal of the Group's remaining interest in TSB Bank, the regulatory par call of Enhanced Capital Notes, stress testing results and PPI complaint handling.

	Board meetings[1]	
	Eligible to attend	Attended
Directors who served during 2015		
António Horta-Osório	10	10
Lord Blackwell	10	10
Juan Colombás	10	10
George Culmer	10	10
Alan Dickinson	10	10
Anita Frew	10	10
Simon Henry	10	9[2]
Dyfrig John	10	10
Nick Luff	10	10
Deborah McWhinney[3]	1	1
Nick Prettejohn	10	10
Anthony Watson	10	10
Sara Weller	10	10
Former directors who served during 2015		
Carolyn Fairbairn[4]	8	8

1 The number of Board meetings includes two ad hoc meetings, one held in October in relation to the Group's preparation for the SM&CR and one in December to provide updates on the Court of Appeal decision on the regulatory par call of Enhanced Capital Notes and the 2015 PRA stress test result.
2 Mr Henry was unable to join the July Board meeting due to the third quarter 2015 results announcement for Royal Dutch Shell plc, of which he is Chief Financial Officer, being presented on the same day.
3 Joined the Board on 1 December 2015.
4 Retired on 31 October 2015.

Board tenure (as at 31 December 2015)



Setting the Board agenda and Board paper content

There is a comprehensive and continuous process in place for ensuring the Board has the right information at the right time and in the right format to enable the Directors to make the right decisions. The Chairman sets 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 and material issues.

The process of escalating issues and agenda setting was a key focus of the 2014 Board Effectiveness Review and the Company Secretary's end-to-end Corporate Governance Review. Accordingly a number of enhancements were made to the process during the year. A key recommendation was the introduction of quarterly reviews of topics for Board presentations and 'deep dives' as described on pages 68 and 69.

Draft Board papers are reviewed at the appropriate Group Chief Executive Committee meeting held prior to the Board meeting, along with the draft Board agenda, and there is time allocated at each GEC meeting to consider whether any matters require escalation to the Board. The Group Chief Executive also held separate Board paper review meetings to review individual papers in more detail or those not considered at one of the meetings referred to above. These meetings were held with the Chief Financial Officer, the Chief Risk Officer, the Company Secretary and authors of the main papers, as required.

Prior to each Board meeting the Chairman, Company Secretary and the Chief of Staff, who assists the Group Chief Executive and runs his executive office, review the agenda, the arrangements for the Board meeting and the time allocation for individual agenda items. A similar comprehensive process is in place for each of the Board Committees.

How Board meetings are run

The Chairman ensures Board meetings are structured to facilitate open discussion, debate and challenge. Through his opening remarks, the Chairman sets the focus of each meeting.

In the rare event of a Director being unable to attend a meeting, the Chairman discusses the matters proposed with the Director concerned, seeking their support and or feedback accordingly. The Chairman subsequently represents those views at the meeting.

Directors are sent papers for the Board meeting up to seven days in advance of the meeting in order that they may have the time to consider the proposals put forward and seek clarification or further information as required. The Board makes full use of technology such as video conferencing, teleconferencing, a Board portal and tablets in its meeting arrangements. This leads to greater flexibility, security and efficiency in Board paper distribution.

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 ahead of the meeting. Some of these pre meetings are for Non-Executive Directors only, some also include the Group Chief Executive and others the full Board. At least once a year, a meeting is held without the Chairman in attendance. Additionally, 'deep dive' sessions into specific topics are delivered either at the end of Board meetings or at additional sessions held between Board meetings.

Access to advice

The Group provides access, at its expense, to the services of independent professional advisers in order to assist Directors in their role. Board Committees are also provided with sufficient resources to undertake their duties.

Dividends

The Board met on several occasions during 2015 to consider the appropriate level of dividend payment and to set the dividend policy. The Group's dividend policy aims to provide a progressive and sustainable dividend whilst distributing surplus capital when appropriate to do so. In reaching the decision to pay a dividend, the Board has to take into account a number of legal, financial and capital constraints. Further information on capital management and the Group's dividend policy can be found on pages 161 and 162.

Corporate governance report continued

LEADERSHIP continued

BOARD FOCUS IN 2015

FINANCIAL
- Budget for 2015 and Group operating plan
- Draft results and presentation to analysts
- Approval of dividends
- Approval of large transactions
- Disposal of TSB Bank

STRATEGY AND CUSTOMER FOCUS
- Review of progress in implementing the Group's 2015-17 strategy
- Continuing development and monitoring of key metrics of customer dashboard
- Conduct, culture and values
- IT resilience and digital transformation

REGULATORY
- Ring-fencing and resolution
- SM&CR updates
- Banking Standards Board updates
- Regulatory changes

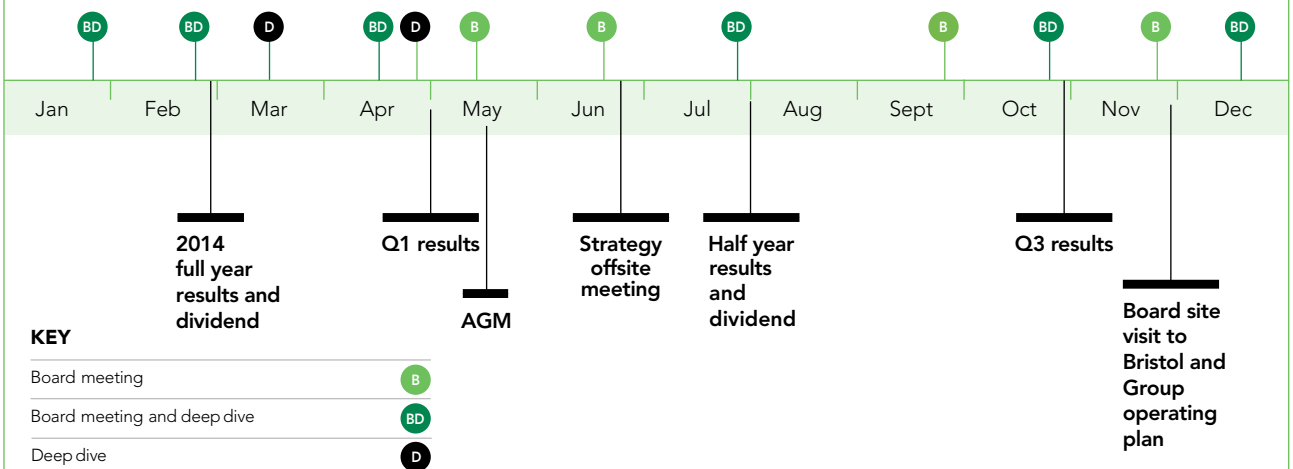
REGULAR AGENDA ITEMS
- Group performance report from the Group Chief Executive
- Report on financial performance, including budgets, forecasts and capital position from the Chief Financial Officer
- Risk report from the Chief Risk Officer
- Chairman's activities report
- Reports from Committee Chairmen

GOVERNANCE
- Board effectiveness and Chairman's performance reviews
- Board and Committee structure, size and composition
- Responsible Business review and creation of the Responsible Business Committee
- Review of Corporate Governance Framework
- Company Secretary's Corporate Governance Review

SHAREHOLDERS
- Investor Relations updates
- AGM briefing
- Dividend reinvestment programme
- Proposed public offering of shares in the Company by HM Treasury

RISK MANAGEMENT
- Approval of Group risk appetite and Risk Management Framework
- Review of internal control systems
- Investigations into PPI and LIBOR issues
- Investigations into packaged bank account complaints
- Review and approval of PRA stress testing results
- CMA investigation into retail banking

BOARD MEETINGS AND ACTIVITY IN 2015



KEY

Board meeting	B
Board meeting and deep dive	BD
Deep dive	D

The deep dive sessions, strategy offsite meeting and site visit to Bristol are described on page 65.

The Board in action

The Non-Executive Directors see attendance at Board and Committee meetings as only one part of their role. The Non-Executive Directors regularly meet with senior management and spend time increasing their understanding of the business through formal briefing sessions or more informal events such as breakfast briefings, dinners and site visits.

The Non-Executive Directors also receive regular updates from the Group Chief Executive's office including a weekly email which gives context to current issues. In-depth and background materials are regularly provided via a reading room on the Board portal.

In addition to the annual schedule of Board and Committee meetings, the Board held eight 'deep dives', a two-day strategy offsite meeting and a strategy meeting at the Group's Bristol site reviewing the operating plan. Further details are given opposite.

The Board meets annually prior to the AGM in Scotland followed by a joint discussion with the Board of Scottish Widows Group Limited allowing in-depth focus on insurance matters.

Non-Executive Directors' office

The Non-Executive Directors frequently visit the Group's offices on Group business and to meet with senior management outside of Board and Committee meetings. To support the Non-Executive Directors in fulfilling their role, the Group provides an office, with administrative support, and a meeting room for the Non-Executive Directors' use.

Chairman's office

The Chairman maintains an office with support to help manage his programme of activities, obtain briefings and deal with external contacts.

Chairman's activities

The Chairman undertakes an extensive engagement programme each year representing the Group at industry events, acting as a spokesperson for the Group and meeting with clients, regulators, investors, the media, our Foundations and their beneficiaries. The programme includes visits to regional offices, branches, IT and operations centres, where the Chairman meets local management and colleagues through meetings, floor walks, team talks and Town Hall sessions. The Town Hall sessions are an opportunity for colleagues to hear from the Chairman on the Group's performance and strategic direction, and importantly, to ask questions. These events are very popular and are always well attended.

Deep dives

During the year the Board held eight 'deep dives' which provided the opportunity for presentations from senior management and an in-depth review of key areas of focus including:

– Customer experience
– Group Digital (two updates)
– IT transformation update and outlook
– Group Operations, including IT strategy
– Retail performance and products
– Commercial Banking
– The changing UK payments landscape

Strategy offsite

During the year the Board spent two days offsite focusing on:

– Culture and colleague engagement
– Group strategy implementation
– Retail strategy

The agenda was structured to allow plenty of opportunity for discussion and concluded with a group discussion on strategy, culture and rebuilding trust.

Site visit to Bristol

In November 2015, the Board held an offsite meeting in Bristol, attended by GEC members, at which it reviewed the Group operating plan in detail. The November Committee meetings also took place at the Group's Bristol offices. During the visit, Board and GEC members took the opportunity to meet colleagues based in Bristol and the South West over dinner and at an informal breakfast hosted by the Chairman and Non-Executive Directors. Some Board members also visited the Bristol City Centre branch to meet the local director and branch based colleagues.

Chairman's Town Hall sessions

In October 2015, as part of his engagement programme, the Chairman visited two of the Group's IT sites near Manchester, where he was joined by 275 colleagues.

The Chairman spoke to colleagues on the progress the Group is making with the next stage of its strategy to become the best bank for customers, how it had strengthened its balance sheet, and the importance of continuing to restore the trust and confidence of customers and other key stakeholders. The visit included a question and answer session, where colleagues asked questions on such topics as how the Group is remediating risk, the impact of new challenger banks and emerging new technologies on the landscape.

Board oversight: IT resilience and digital transformation

The Board remains focused on how the Group delivers solutions that continue to put the customer at the heart of everything it does. The Group's multi-channel service reflects customers' changing preferences in how they choose to do business with the Group, providing seamless access through a secure and resilient digital infrastructure.

The Board spends considerable time reviewing the delivery of the three-year IT resilience investment and digital transformation programmes. IT resilience and cyber security are regularly monitored through the risk dashboard in the reports from the Group Chief Executive and Group Risk Officer and through the work of the Board Risk Committee of which all Non-Executive Directors are members. Additionally, the Board received a detailed progress update at its strategy offsite meeting in November and presentations from senior management on the delivery of the programmes at 'deep dive' sessions held during the year.

Also, the Board's approach to succession planning, led by the Chairman, helps ensure the Board is well placed to address future technology and market risks across the full range of business areas in which the Group operates. Read more on succession planning and Board appointments on page 73.

Information on the progress being made on the delivery of digital capability can be found in the strategic report and on IT resilience and cyber security in the report from the Board Risk Committee.

Corporate governance report continued

EFFECTIVENESS

Board size and composition

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, ten 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 the composition of the Board and independence of the Non-Executive Directors are provided in the Nomination & Governance Committee report.

Board changes

In June 2015, Carolyn Fairbairn, an independent Non-Executive Director, informed the Board of her intention to retire from the Board on 31 October 2015 to take up the position of Director-General of the Confederation of British Industry in November 2015. Ms Fairbairn had been a member of the Board since June 2012. Dyfrig John, an independent Non-Executive Director, has notified the Board that he wishes to reduce his workload and therefore does not intend to seek re-election at the 2016 AGM. Mr John has been a member of the Board since January 2014.

Deborah McWhinney and Stuart Sinclair joined the Board as independent Non-Executive Directors on 1 December 2015 and 4 January 2016 respectively. The Board is not looking actively to appoint any further Non-Executive Directors at this stage.

More about the appointment of new Directors and the Group's approach to succession planning can be found in the Nomination & Governance Committee report. Changes to Board Committee memberships are set out on page 62.

Directors' biographies can be found at www.lloydsbankinggroup.com/our-group/directors

Diversity policy

The Board places great emphasis on ensuring that its membership reflects diversity in the broadest sense. The combination of personalities and experience on the Board provides a comprehensive range of perspectives and challenge and improves the quality of decision making. Information on Board diversity by gender and experience can be found on page 56.

The Board has adopted, and was close to achieving, the recommendations of Lord Davies of 25 per cent female representation by 2015. As at 31 December 2015, female representation on the Board remained at 23 per cent (based on three female directors and 10 male directors). During the period between the appointment of Stuart Sinclair on 4 January 2016 and Dyfrig John's retirement at the 2016 AGM, female representation on the Board will drop to 21.4 per cent, when there will be male directors with the number of women on the Board remaining at three.

A table providing details of the number of women employed at various levels of seniority within the Group as at 31 December 2014 and 2015 can be found on page 26.

Developing diversity

The Board recognises that senior management is a group from which future directors may be selected. To promote diversity the Group has a variety of colleague networks which include: Breakthrough, a women's network; the Group Ethnic Minority network; the Access network which aims to provide support for colleagues with disabilities; and Rainbow, an inclusive Groupwide network for lesbian, gay, bisexual and transgender colleagues.

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 provided in the Responsible Business section of our website at www.lloydsbankinggroup.com/our-group/responsible-business

Board induction

The Group appreciates the importance of a well-focused induction plan to help a new Director get up to speed as quickly as possible and enable them to contribute fully to Board deliberations.

The Chairman personally ensures that on appointment each Director receives a full, formal and tailored induction. The emphasis is on ensuring the induction brings the business and its issues alive for the new Director, taking account of the specific role they have been appointed to fulfil and the skills/experience of the Director to date.

The plan is informed by the recruitment and resourcing process, with input from other key internal stakeholders and from the Directors themselves. At its core is a comprehensive programme of one-to-one briefings with key senior executives across the Group. Committee Chairmen receive additional dedicated training from relevant business executives to support them in their role and the Chairman of Scottish Widows Group Limited receives further briefings on the insurance business.

Non-Executive Directors are encouraged to identify any further information needs and to request any additional meetings or visits to help familiarise themselves with the business. In practice, some of the areas covered by the induction plan are likely to have been covered as part of the Director's own research prior to taking on the role. However, the plan aims to provide a more in-depth review of the issues and, facilitated by the Company Secretary, is delivered as soon as possible after the date of appointment. Directors who take on or change roles during the year attend induction meetings in respect of those new roles.

Induction plan – Deborah McWhinney and Stuart Sinclair

Core programme

– Strategic and corporate induction
– Governance and Director responsibilities
– Responsibilities of an FCA approved person
– Senior Managers and Certification Regime
– Detailed risk induction programme
– Detailed briefings on each of the Group's business divisions
– Opportunity to meet with major shareholders as requested

One-to-one briefings

– Chairman
– Company Secretary
– Executive Directors
– GEC members
– Group Audit Director
– Senior executives from across the Group

Bespoke programme

The Chairman personally ensures a new Director receives a tailored induction. In the case of Ms McWhinney, she requested that the risk induction include an overview of the UK regulatory landscape, reflective of her career having been spent in the United States to date.

Branch and site visits form part of the induction and in the case of Mr Sinclair, he requested a visit to the Group's insurance business, Scottish Widows.

Both Ms McWhinney and Mr Sinclair also received specific briefings on the Committees on which they will serve.

Briefing and reading materials

Briefing and reading materials are made available on the Board portal.

Professional development and training

Continuing professional development is an important aspect of every professional's working life, including Directors. Skills and knowledge need to be kept up-to-date to ensure the efficiency of the Board as a whole and the ability of every single Director to contribute to the highest standards.

The Chairman leads the learning and development of Directors and the Board generally and regularly reviews and agrees with each Director their training and development needs.

The Company provides ample opportunities, support and resources for learning. A comprehensive programme, under the leadership of the Chairman, is in place throughout the year and comprises both formal and informal training and information sessions. 'Deep dive' sessions into specific topics play an important role and are delivered either at the end of Board meetings or at additional sessions held between Board meetings. The 'deep dive' sessions delivered in 2015 are described on page 65.

Site visits and conversations at Board dinners are also recognised as effective ways of learning, since they give Directors an opportunity to consider business areas and experiences outside their direct areas of expertise. Site visits in particular provide 'shop floor' experiences and reconnect Directors and senior management alike with the business and with customer service as it is performed throughout the branches. This provides insights into what customers want and need from the Group.

The Board also receives regular refresher training and information sessions throughout the year to address current business or emerging issues such as the SM&CR, ring-fencing and resolution and stress testing.

Management meetings and one-to-one meetings with key executives from across the Group's operations complete the picture. The Company Secretary maintains a training and development log for each Director.

Development and training programme at a glance

During the year a comprehensive programme, under the leadership of the Chairman, was in place comprising both formal and informal training and information sessions. These included:

- 'Deep dive' sessions detailed on page 65
- Site visits, Board dinners and breakfast meetings
- Training and information sessions on the SM&CR, ring-fencing and resolution and stress testing
- Management meetings and one-to-one meetings with key executives from across the Group's operations
- Briefing material on the Board portal

Board effectiveness

The Chairman of the Board leads the rolling review of the Board's effectiveness and that of its Committees and individual Directors with the support of the Nomination & Governance Committee, which he also chairs. The annual evaluation, which is facilitated externally at least once every three years, provides an opportunity to consider ways of identifying greater efficiencies, maximising strengths and highlighting areas for further development.

Corporate Governance Review

In late 2014 the Chairman commissioned the newly appointed Company Secretary to undertake an end-to-end review of the Group's governance arrangements from a fresh perspective. The Company Secretary's review was informed by, amongst other matters, the 2014 annual review of Board Effectiveness as well as the work which is being carried out in the Group in preparation for the SM&CR. The Company Secretary completed his review in 2015 and his findings and the Board's response are set out on page 69.

2014 evaluation of the Board's performance

The 2014 evaluation was conducted internally between December 2014 and January 2015 by the Company Secretary, and was overseen by the Nomination & Governance Committee. Following the review, a number of changes were introduced and actions implemented which led to improvements in a number of areas including the timeliness and content of papers and the process for escalation of issues to the Board and its Committees. These enhancements have been reflected in improved scores from the 2015 evaluation. A summary of the Board's progress against the actions arising from the 2014 effectiveness review are set out on page 68.

2015 evaluation of the Board's performance

In accordance with the three year cycle, the 2015 evaluation was facilitated externally by JCA Group between October 2015 and January 2016. The review was commissioned by the Chairman, assisted by the Company Secretary and overseen by the Nomination & Governance Committee. JCA Group has provided certain Board and senior management level recruitment services to the Group from time to time but not in relation to the searches for the Group Board Non-Executive Directors during 2015. Otherwise, JCA Group has no other connection with the Group.

The 2015 review considered broadly the same areas as the 2014 review for comparability including: strategy; risk and control; planning and performance; Board composition and size; culture and dynamics; balance of skills and experience; diversity; relationships between management and independent directors; governance; the Board's calendar and agenda; the quality and timeliness of information; and support for Directors and Committees.

2015 review process

- Meeting between JCA Group and the Senior Independent Director
- Questionnaire completed by each Director broadly in the same format as for the 2014 review for comparability
- Individual meetings between each Director and a representative from JCA Group
- Presentation by JCA Group of the highlights to the Nomination & Governance Committee in November 2015
- Presentation by JCA Group to the Board in January 2016

At the time of the 2016 AGM, Anthony Watson will have been on the Board for more than seven years. Therefore, in compliance with the Code, his review was particularly rigorous.

Anthony Watson, the Senior Independent Director, carried out the evaluation of the Chairman's performance using a questionnaire and individual meetings with Directors other than the Chairman.

Deborah McWhinney and Stuart Sinclair, who joined the Board in December 2015 and January 2016 respectively, did not participate in the review but attended the presentation by JCA Group to the Board in January 2016.

Corporate governance report continued

EFFECTIVENESS continued

Outcome of 2015 Board Effectiveness Review

The outcome of the effectiveness review has been discussed by the Board and each of the Committees. The outcome of the evaluation of the Chairman's performance was discussed by the Directors in the absence of the Chairman.

The reviews concluded that the performance of the Board, its Committees, the Chairman and each of the Directors continues to be effective. All Directors demonstrated commitment to their roles. Overall, the Board was considered collegiate, inclusive and hard-working, with shared values of integrity and respect. The Chairman was widely respected and had strong working relationships with the Chief Executive Officer, Executive Directors and Non-Executive Directors and had performed his role to a high standard. The Board had high regard for the Chief Executive Officer and the transformation of the business he had led. The increasing depth of debate at meetings was welcomed but the review identified a number of actions that will continue to maintain and improve the Board's effectiveness and ensure the effort and time given by the Board translates into creating real impact for the business, shareholders and customers. The review recommendations are summarised below.

If Directors have concerns about the Company or a proposed action which cannot be resolved, it is recorded in the Board minutes. Also on resignation, Non-Executive Directors are encouraged to provide a written statement of any concerns to the Chairman, for circulation to the Board. No such concerns were raised in 2015 and up to the date of this report.

2014 Board Effectiveness Review (internal)

Recommendations	Actions taken/progress
The timeliness and content of Board and Committee papers	– New Board template and guidelines rolled out – Further targeted training for authors to ensure papers are delivered in a timely manner, present a balanced view of all issues and are concise – Improved 2015 effectiveness review scores
The process for escalation of matters to the Board and its Committees	– Corporate Governance Framework amended to impose clear responsibility on GEC members to escalate matters – Time allocated at each GEC meeting to consider whether any matters require escalation – Briefings to other senior executives on the obligation to escalate matters – Quarterly reviews of topics for Board presentations and deep dives introduced involving the Chairman, the Company Secretary, the Chief Risk Officer and the Group Chief Executive or his Chief of Staff, who assists the Group Chief Executive and runs his executive office. The quarterly reviews are also attended by the Group Audit Director and the Group Director, Conduct, Compliance and Operational Risk – Improved 2015 effectiveness review scores
The creation of a new Board Committee to provide oversight of the strategy and plans for delivering the Group's aspirations to be a leader in responsible business, as part of the Group's objective of helping Britain prosper	– Board-level Responsible Business Committee established

Recommendations from the 2015 Board Effectiveness Review (external)

Strategy

– Continue to focus on strategy, with particular attention to the longer term horizon and the impact of the changing technology and competitive landscape

Succession planning

– Maintain a proactive approach to succession planning for Executive and Non-Executive Directors and for senior management

Board information

– Continue the progress made in 2015 in ensuring that information provided to the Board and its Committees is clear, concise, relevant and focused

– Review and continue to evolve metrics used to assess business performance to ensure that they provide an appropriate level of detail and insight for the Board

Service contracts and letters of appointment

The Executive Directors have service contracts which may be terminated on 12 months' notice by the Company or six months' notice by the Executive Director. The Chairman has a letter of appointment which may be terminated on six months' notice by either the Company or the Chairman. The Non-Executive Directors all have letters of appointment and are appointed for an initial term of three years after which their appointment may continue subject to an annual review. Non-Executive Directors may have their appointment terminated, in accordance with statute and the articles of association, at any time with immediate effect and without compensation. All Directors are subject to annual re-election by shareholders.

The terms and conditions of appointment of the Chairman, Non-Executive Directors and Executive Director are available for inspection at the registered office address.

Election and re-election

All Directors appointed to the Board since the AGM in 2015 will stand for election at the 2016 AGM. All other Directors will retire and those wishing to serve again will submit themselves for re-election at the AGM. Dyfrig John, an independent Non-Executive Director, has notified the Board that he does not intend to seek re-election at the 2016 AGM. Biographies of current Directors are set out on pages 56 and 57. Details of the Directors seeking election or re-election at the AGM are set out in the Notice of Meeting.

Directors' and Officers' liability insurance

Throughout 2015 the Group had appropriate insurance cover in place to protect Directors, including the former Director 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 107. No Director or former Director sought to recover costs or expenses under their indemnity in 2015.

Time commitments

Non-Executive Directors are required to devote such time as is necessary for the effective discharge of their duties. The estimated minimum time commitment set out in the terms of appointment is 35-40 days per annum including attendance at Committee meetings. For Committee Chairmen and the Senior Independent Director, this increases to a minimum of 45 to 50 days. The time devoted on the Group's business by the Non-Executive Directors is in reality considerably more than the minimum requirements. As described elsewhere, the Non-Executive Directors see preparation for and attendance at Board and Committee meetings as only one part of their role. Outside of formal meetings, they meet regularly with senior management and attend briefing sessions and more informal events.

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 no more than one non-executive director role in a FTSE 100 company nor the chairmanship of such a 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 will step down as Chairman of Interserve plc on 29 February 2016. The Chairman's biography can be found on page 56.

Corporate Governance Review

In November 2014, the Chairman commissioned the Company Secretary to examine the corporate governance of the Group.

The purpose of the review was to provide the Board with an assessment of the Group's corporate governance together with recommendations on steps to improve it. The Nomination & Governance Committee considered the review in April 2015 prior to the Chairman and the Company Secretary reporting on the conclusions to the Board.

The review focused on the operation of the Board and its Committees and in particular: agenda setting and the process of escalating issues; the timing and content of information received by the Board and its Committees; how the Board and the Committees used their time; and Secretariat support.

The review found the governance of the Group by the Board and its Committees to be generally effective and the Secretariat and the Insurance Secretariat to be generally effective in supporting the governance of the Group. Recommendations included:

- quarterly reviews of topics for Board presentations and deep dives involving the Chairman, the Company Secretary, the Chief Risk Officer and the Group Chief Executive or his Chief of Staff, who assists the Group Chief Executive and runs his executive office. The quarterly reviews are also attended by the Group Audit Director and the Group Director, Conduct, Compliance and Operational Risk;
- Board and Committee papers to be standardised using the adoption of a new Board template;
- the Board calendar should avoid more than two Board Committee meetings taking place on the same day;
- Chairmen should maintain an appropriate balance between presentations and time allocated to discussion; and
- Secretariat should recruit additional senior capability in order to take a more pro-active role in maintaining high governance standards throughout the Group.

Recruitment for the Secretariat is ongoing. All other recommendations from the governance review have been implemented in full.

Senior Managers and Certification Regime (SM&CR)

The Company Secretary carried out a further review of the Corporate Governance Framework in preparation for the introduction in March 2016 of the SM&CR and, as relevant to the Scottish Widows Group, the Senior Insurance Managers Regime (SIMR).

The review found that the framework was generally aligned with the requirements of the SM&CR and, as relevant to the Scottish Widows Group, the SIMR, but a number of changes were recommended. These included amendments to the statements of responsibilities of the Directors and members of the GEC and minor amendments to the terms of reference of a number of Board and Group Chief Executive Committees.

The Nomination & Governance Committee considered the review in January 2016 prior to a report on the conclusions to the Board. The Board reviewed and approved the proposed changes, which were part of a wider range of initiatives undertaken to prepare the Group for the introduction of SM&CR and SIMR.

Corporate governance report continued

EFFECTIVENESS continued

Conflicts of interest

All Directors of the Company 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 role.

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.

Stuart Sinclair is a Non-Executive Director of Provident Financial Plc, a supplier of personal credit products to the non-standard lending market, and Senior Independent Director at both QBE Insurance (Europe) Limited, a general insurance and reinsurance company, and Swinton Group Limited, an insurance broker for home and motor insurance. The Board has recognised that potential conflicts may arise in relation to his position at QBE Insurance and in relation to Swinton Group. The Board has authorised the potential conflicts and requires Mr Sinclair to recuse himself from discussions, should the need arise.

Prior to Carolyn Fairbairn's retirement from the Board, she was also a Non-Executive Director of the Competition and Markets Authority (CMA). During the period she served on the Board, she recused herself from all discussions at the CMA on their investigation into banking competition.

INTERNAL CONTROL

Board responsibility

The Board is responsible for the Group's risk management and internal control systems, which are designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. The Directors and senior management are committed to maintaining a robust control framework as the foundation for the delivery of effective risk management. The Directors acknowledge their responsibilities in relation to the Group's risk management and internal control systems and for reviewing their effectiveness.

In establishing and reviewing during the year the systems of risk management and internal control, the Directors confirm that they carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity, the likelihood of a risk event occurring and the costs of control. The process for identification, evaluation and management of the principal risks faced by the Group 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, evaluation and management 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. Information regarding the main features of the risk management and internal control systems in relation to the financial reporting process is provided within the risk management report on pages 112 to 169.

Control effectiveness review

An annual control effectiveness review (CER) is undertaken to evaluate the effectiveness of the Group's control framework with regard to its material risks, and to ensure management actions are in place to address key gaps or weaknesses in the control framework. 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.

Reviews by the Board

The effectiveness of the risk management and internal control systems is reviewed regularly by the Board and the Audit Committee, including an annual review. The Audit Committee 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.

The Group's risk management and internal control systems are regularly reviewed by the Board and are consistent with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting issued by the Financial Reporting Council and compliant with the requirements of the Capital Requirements Directive IV (CRD IV). They have been in place for the year under review and up to the date of the approval of the annual report. The Group has determined material compliance with BCBS 239 risk data aggregation and risk reporting requirements and continues to actively manage enhancements.

Conclusion

The Group has enhanced the control environment during the last year in a number of key respects, such as IT, cyber security and Anti-Money Laundering (AML) controls. This is reflected in the 2015 CER assessment which provides reasonable assurance that the Group's controls are effective or that where control weaknesses are identified, they are subject to management oversight and action plans. This conclusion is consistent with the delivery of previously initiated action plans and an improvement in the operational risk profile of the Group. The Audit Committee, in conjunction with the Board Risk Committee, concluded that the Group's risk management and internal control systems were effective and adequate having regard to the Group's risk profile and strategy, and recommended that the Board approve them accordingly.

REMUNERATION

The statement by the Chairman of the Remuneration committee, the Directors' Remuneration policy and the Directors' Remuneration Implementation Report are set out on pages 82 to 106.

SHAREHOLDER RELATIONSHIPS

The Board recognises and values greatly the need to deliver a programme of engagement that offers all shareholders the opportunity to receive company communication and to share their views with the Board. Accordingly, the Group has dedicated teams with responsibility for engaging with institutional investors, retail shareholders and the market using a comprehensive communication programme. This includes investor meetings in the UK and overseas, analyst briefings, market announcements and the AGM. The Group's website is a key tool in ensuring shareholders can access communications and documents as soon as they are published, including a live webcast of the AGM. Recordings of webcasts and other analyst presentations are also available.

Key facts at 31 December 2015

- The Group has 2.6 million shareholders, the largest number of ordinary shareholders in the UK. Retail shareholders represent approximately 99.1 per cent of the total number of shareholders.
- Institutional shareholders hold approximately 95.6 per cent of the issued share capital on the share register including approximately 7 per cent held on behalf of retail shareholders in private nominee arrangements.

Relationships with institutional investors

Investor Relations has primary responsibility for managing and developing the Group's external relationships with existing and potential institutional equity investors. Supported by the Group Chief Executive, Chief Financial Officer, other members of the senior management team and Non-Executive Board members where appropriate, 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.

Investor Relations ensures that the Group's Board and Executive Committee are informed of key messages, market developments and the perception of the Group in the market. The primary responsibility for managing and developing relationships with existing and potential debt investors rests with the Group Corporate Treasury team with support from Investor Relations.

During 2015, Investor Relations held over 1,250 meetings with and gave presentations to institutional debt and equity investors. Discussions included the Group's financial and operational performance, the dividend payment and associated policy, the Group's capital management policy and progress in the Group's strategy to be the best bank for customers.

Investor Relations is also responsible for delivering the Group's financial results which includes presentations to the market and publication of formal results and announcements, as well as hosting regular national and international roadshows and meetings for current and potential institutional equity and debt investors in the Company.

Governance and executive remuneration

Lord Blackwell (Chairman), Anthony Watson (Senior Independent Director) and Anita Frew (Deputy Chairman and Chairman of the Remuneration Committee), have participated in numerous meetings and discussions with investors and other stakeholders, including the Group's regulators, regarding governance and the strategic direction of the Group. They also engaged extensively with proxy advisors, regulators and larger shareholders on issues relating specifically to executive remuneration.

At the Group's AGM in May 2015, shareholders gave an advisory 'for' vote of 97.68 per cent in favour of the implementation during 2014 of the Directors' Remuneration Policy. Shareholders will be asked to provide an advisory vote on the Directors' Remuneration Implementation Report for the financial year ended 31 December 2015 at the AGM in 2016, and in 2017 when shareholders will also be asked to consider and approve a new Directors Remuneration Policy.

Relationships with retail shareholders

The Company Secretary has a team dedicated to engage with retail shareholders who, with support from our registrar Equiniti Limited, deliver the Group's shareholder service strategy, including the AGM.

Shareholders are engaged using a rolling programme of communications. By way of example, when the Group resumed dividend payments in February 2015 a mailing was sent to shareholders informing them of the choices available based on existing payment instructions held.

The Group's retail shareholders are well informed and knowledgeable and this is demonstrated through much of the correspondence received. Enquiries from retail shareholders range from discussing technical accounting matters and strategy implementation, through to their experiences as customers.

Group Secretariat provides feedback to the Board and appropriate committees to ensure the views of retail shareholders are received and considered.

The Group is committed to helping Britain prosper and since 2012 Group Secretariat has engaged with ProSearch, a tracing agency, to find lost shareholders and reunite them with unclaimed dividends. To date, shareholders have been reunited with over £32 million, with a further £900,000 being donated to charitable causes.

The Annual General Meeting

The AGM is an opportunity for shareholders to engage directly with the Board. All Board members attended the Group's AGM in 2015. The AGM in 2016 will again be held in Scotland in accordance with the articles of association. At the AGM in 2015, over 70 per cent of total voting rights were voted by shareholders. The lowest vote 'in favour' across all resolutions was 93.26 per cent. All resolutions are voted on by way of a poll.

STATEMENT OF COMPLIANCE

UK Corporate Governance Code

The UK Corporate Governance Code 2014 (Code) applied to the 2015 financial year. The Group confirms that it applied the main principles and complied with all provisions of the Code throughout the year. The Code is publicly available at www.frc.org.uk

The British Bankers' Association Code for Financial Reporting Disclosure

The Group has adopted the British Bankers' Association's Code for Financial Reporting Disclosure and its 2015 financial statements have been prepared in compliance with its principles.

Corporate governance report continued

NOMINATION & GOVERNANCE COMMITTEE REPORT

Good succession planning contributes to the delivery of the Group's strategy by ensuring the desired mix of skills and experience of Board members now and in the future.

	Committee meetings	
	Eligible to attend	Attended
Committee Chairman		
Lord Blackwell	7	7
Committee members who served during 2015		
Alan Dickinson[1]	3	3
Anita Frew	7	7
Nick Luff	7	7
Deborah McWhinney[2]	–	–
Anthony Watson	7	6[3]

[1] Joined the Committee on 17 July 2015.
[2] Joined the Committee on 1 December 2015. No Committee meeting was held in December.
[3] Mr Watson was unable to attend the July Committee meeting due to a prior commitment.

Dear Shareholders

During 2015, succession planning and the composition of the Board and its Committees remained a key focus for the Nomination & Governance Committee. On the Committee's recommendation, the Board appointed Deborah McWhinney and Stuart Sinclair as independent Non-Executive Directors in December 2015 and January 2016 respectively.

Details of all Board changes during the year are set out on page 66. More about the appointment of Deborah and Stuart and the Group's approach to succession planning can be found on the next page.

A number of changes to our Committee structure and composition were recommended to the Board, including the establishment of a Responsible Business Committee, underlining the Group's commitment to being a responsible business. Full details of all Committee changes during the year are set out on page 62.

Our Corporate Governance Framework is reviewed at least annually by the Board to ensure it remains effective. The review is overseen by the Committee and this year the framework was subject to an additional end-to-end review by the Company Secretary and a further review in preparation for the Senior Managers and Certification Regime (SM&CR). Full details of the Company Secretary's findings and the Board's response are set out on page 69.

The Committee considered progress against the actions from the 2014 Board Effectiveness Review and I am pleased to report that the changes introduced and actions arising from the review have led to concrete improvements in a number of areas. Details of our progress against the 2014 review actions and the findings and recommendations from the externally facilitated 2015 review can be found on page 68. I and the other Board members find the annual review process valuable and insightful.

Lord Blackwell
Chairman, Nomination & Governance Committee

Committee purpose and responsibilities

The purpose of the 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 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 Committee's terms of reference can be found at www.lloydsbankinggroup.com/our-group/corporate-governance

Diversity policy

The Board places great emphasis on ensuring that its membership reflects diversity in the broadest sense. For information on the diversity policy, please refer to page 66.

Committee composition, skills and experience

To ensure a broad representation of experienced and independent Directors, membership of the Committee comprises the Chairman, the Deputy Chairman, the Senior Independent Director, the Chairman of the Audit Committee, the Chairman of the Remuneration Committee and, from 17 July 2015, the Chairman of the Risk Committee. The Group Chief Executive attends meetings as appropriate.

During the year, the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

How Committee meetings are run

The management of the Committee is in keeping with the basis on which meetings of the Board are managed, as detailed on page 63, with a structure which facilitates open discussion and debate, with steps taken to ensure adequate time for members of the Committee to consider proposals which are put forward.

Matters considered by the Committee

During the year the Committee considered a number of issues relating to the Group's governance arrangements, both internal and external. It assisted the Chairman in keeping the composition of the Board and its Committees under review and to lead the appointment process for nominations to the Board. These issues are summarised on the next page.

SUCCESSION PLANNING – A STRATEGIC APPROACH

Approach

The Committee recognises that good succession planning contributes to the delivery of the Group's strategy by ensuring the desired mix of skills and experience of Board members now and in the future.

Just as importantly, talent needs to be recognised and nurtured within executive and management levels and across the Group as a whole. The Group's Annual Talent Review allows the Group to identify talent and have the right succession plans and development programmes in place to ensure the Group creates opportunities for current and future leaders.

Process

The Committee supports the Chairman in keeping the composition of the Board and its Committees under regular review and in leading the appointment process for nominations to the Board.

At the core of the process is an on-going audit led by the Chairman of the collective Board's technical and governance skill set. This exercise allows the creation of a matrix which the Chairman uses to track the Board's strengths and identify gaps in the desired collective skills profile of Board members taking into account the Group's future strategic direction.

Gaps may also be identified through the annual Board evaluation process, where Board composition is a key focus. Underpinning this process is consideration of the personal characteristics that an individual is expected to bring to the Board.

The Committee considers the adequacy of succession arrangements for Executive Directors, members of the GEC and their direct reports. 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.

The Board is kept informed of senior executive succession planning with the leadership approach visible to all Non-Executive Directors.

Succession planning in practice

JUNE 2015

- Search commenced for two Non-Executive Directors
- Executive search firm Russell Reynolds, who have no other connection with the Group, appointed to support the search
- Role specification drawn up, taking into account the Board skills audit and current and future Board requirements and to give due weight to diversity objectives
- Search focused on candidates who would bring a combination of core retail and/or commercial banking experience and in technology/operations
- Candidates considered from North America and other overseas locations as well as the UK

SEPT -OCT 2015

- Long list of candidates considered
- Short list of potential candidates selected and approached by Russell Reynolds to gauge interest
- Potential candidates invited to meet the Chairman, Group Chief Executive and individual Committee members

NOV 2015

- Recommended to the Board the appointment of two candidates, Deborah McWhinney and Stuart Sinclair, who had stood out in the recruitment process as having the skills, experience, values and personal characteristics to be strong contributors to the Board and to address the Board's skills requirements

DEC 2015-JAN 2016

- Deborah McWhinney joined the Board on 1 December 2015 and brings an extensive executive background in managing technology, operations and new digital innovations across banking, payments and institutional investment. She also broadens Board diversity with a global market perspective
- Stuart Sinclair joined the Board on 4 January 2016 and in addition to his retail banking experience, also brings wider experience of consumer and asset finance as well as insurance

Board well placed to address future technology and market risks across the full range of business areas in which the Group operates

How the Nomination & Governance Committee spent its time in 2015

Effectiveness

During 2015, the Committee oversaw the annual evaluations of the performance of the Board and its Committees. In January 2015, the Committee reviewed the findings of the 2014 Board Effectiveness Review and recommended actions to the Board to address the areas identified for improvement. Progress against the plan was reviewed during the year. For the 2015 Board Effectiveness Review, the Committee made recommendations to the Board on the process and timing of the review including the appointment of an external facilitator. Full details of the 2015 Board Effectiveness Review together with details of the progress against the 2014 review actions are set out on pages 67 and 68.

Corporate governance

The Committee continued its role of overseeing the Board's governance arrangements to ensure that they paid due regard to best practice principles and remain appropriate. In 2015, in addition to the annual review of the Corporate Governance Framework, the Committee oversaw an additional end-to-end review by the Company Secretary and a further review in preparation for the SM&CR. The Company Secretary's findings and the Board's response are set out on page 69.

During 2015, the Committee received regular corporate governance updates from the Company Secretary, considered the impact of emerging regulation on the Board and its corporate governance practices, received a report from the Chairman on communications from shareholders and approved the appointment of Trustees to the Bank's Foundations.

Independence and time commitments

The independence of Non-Executive Directors, the election or re-election of Directors and their suitability to continue in office were reviewed. 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. 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 2015, the Committee is satisfied that, throughout the year, all Non-Executive Directors remained independent as to both character and judgement.

The Committee reviewed 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 and found them to be appropriate.

Corporate governance report continued

AUDIT COMMITTEE REPORT

The quality of external and internal audit services continues to be of central importance to the Group, and the Committee has played a key role in safeguarding these essential assurance activities.

	Committee meetings	
	Eligible to attend	Attended
Committee Chairman		
Nick Luff	7	7
Committee members who served during 2015		
Alan Dickinson	7	7
Anita Frew	7	7
Simon Henry	7	5[1]
Deborah McWhinney[2]	1	1
Nick Prettejohn	7	7
Anthony Watson	7	7
Former Committee members who served during 2015		
Carolyn Fairbairn[3]	6	6

[1] Mr Henry was unable to attend both January and July Audit Committee meetings due to prior executive commitments.
[2] Joined the Committee on 1 December 2015.
[3] Retired on 31 October 2015.

Dear Shareholders

It has been another busy year for the Committee. We have continued to focus on the issues relevant to the Group's financial reporting, considering key accounting judgments and ensuring ongoing quality in related disclosures. We have also spent a significant proportion of our time considering other key areas, including monitoring of the Group's internal control framework, where we continue to work to ensure it remains strong and fit for purpose.

Assessing the appropriate provisioning for the costs of redress relating to Payment Protection Insurance (PPI) remains the most significant area of judgment in the Group's financial reporting. There have been major developments in this area during 2015, including the consultation by the FCA on a potential time bar for claims.

The Committee has reviewed and challenged management's assessment of the remaining costs relating to PPI claims and is satisfied that the accounting, and related disclosures, are appropriate. Further detail on PPI and other key financial reporting issues are set out in the report below.

The Committee has overseen continued transformation of the internal audit function under the leadership of the Group Audit Director, Mary Hall, following her appointment in the second half of 2014. Audit planning, supported by the development of an audit risk universe, has been enhanced, and greater rigour has been introduced to the audit methodology. Carefully directed use of external expertise is being used to ensure that appropriate skills are deployed in audits of technical areas, and good progress is being made in developing the skills and experience of the internal audit team.

Ensuring the continued effectiveness of the external audit has also been a focus for the Committee. We reviewed the plan for the external audit, considered the reports from the external auditor on accounting and control matters, and engaged with them on key judgments. We are working with the auditors to ensure a smooth transition to a new lead audit partner for the 2016 audit.

Nick Luff
Chairman, Audit Committee

Committee purpose and responsibilities

The purpose of the Committee is to monitor and review the Group's financial and narrative reporting arrangements, the effectiveness of the internal controls over financial reporting and the risk management framework, whistleblowing arrangements and each of 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. A full list of responsibilities is detailed in the Committee's terms of reference, which can be found at www.lloydsbankinggroup.com/our-group/corporate-governance

Committee composition, skills and experience

The Committee acts independently of the executive to ensure that the interests of the shareholders are properly protected in relation to financial reporting and internal control.

All members of the Committee are independent Non-Executive Directors, the majority with recent and relevant experience in finance and/or banking. Nick Luff is a chartered accountant and has significant financial experience in the UK listed environment enabling him to fulfill the role of Audit Committee Chair, and for SEC purposes the role of Audit Committee Financial Expert. In addition, Simon Henry is a certified accountant and has extensive knowledge of financial markets, treasury and risk management, and also qualifies as an Audit Committee Financial Expert under SEC rules.

How Committee meetings are run

The management of the Committee is in keeping with the basis on which meetings of the Board are managed, as detailed on page 63, with a structure which facilitates open discussion and debate, with steps taken to ensure adequate time for members of the Committee to consider proposals which are put forward.

During the course of the year, the Committee held separate sessions with the internal and external audit teams, without members of the executive management present. During

the year, the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review. Based on the outcomes of the annual board effectiveness review further efforts are being made to build upon improvements made in the previous year on the timeliness and quality of Committee papers, and additional opportunities for training for Committee members are being introduced.

Whilst the Committee's membership comprises the Non-Executive Directors noted above, all Non-Executive Directors may attend meetings as agreed with the Chairman. The Group Audit Director, the external auditor, the Group Chief Executive, the Chief Financial Officer and the Chief Risk Officer also attend meetings of the Committee as appropriate.

Matters considered by the Committee

During the year the Committee considered a number of issues relating to the Group's financial reporting, these issues are summarised below, including discussion of the conclusions the Committee reached, and the key factors considered by the Committee in reaching its conclusions.

In addition, the Committee considered a number of other significant issues not related directly to financial reporting, including internal controls, internal audit and external audit. These issues are also discussed in detail in the next section, including insight into the key factors considered by the Committee in reaching its conclusion.

How the Audit Committee spent its time in 2015

Financial reporting

During the year, the Committee considered the following significant financial issues in relation to the Group's financial statements and disclosures, with input from management, Group Audit and the external auditor:

KEY ISSUES	COMMITTEE REVIEW AND CONCLUSION
Payment Protection Insurance (PPI) Determining the adequacy of the provision for redress payments and administration costs in connection with the mis-selling of PPI is highly judgmental. The Group makes a number of assumptions about the number of future complaints that will be received including uphold rates for complaints received; average redress payments; and related administrative costs. In the 2015 full year results, an additional provision of £4,000 million was made for expected PPI costs. To 31 December 2015, the Group has provided a total of £16,025 million in respect of PPI mis-selling redress and administration costs.	– The Committee continued to challenge the assumptions made by management to determine the provision for PPI redress and administration costs. It also reviewed management's assessment of (i) the scope of the reviews required by the regulator; (ii) claims management company activity; and (iii) the potential impact of a consultation paper by the Financial Conduct Authority on setting a deadline by which consumers would need to make their PPI complaints and on the potential impact of Plevin, all of which have significant impact on redress and administration costs. – The Committee oversaw continued use of sensitivities reflecting the uncertainty that remains around the ultimate cost of PPI. – Group Audit has reviewed the process used by management to calculate the PPI provision and has provided assurance to the Committee that the process uses reasonable, consistent and supportable assumptions and inputs. – The Committee concluded that the processes followed by management in determining the provision for PPI redress continued to be appropriate and that the provisions and the Group's external disclosures were appropriate. – The disclosures relating to PPI are set out in note 39: 'Other provisions' on page 234 of the financial statements.
Other conduct provisions During 2015 the Group has made provisions for a number of other conduct related matters, including potential redress in respect of Packaged Bank Accounts which required assumptions to be made, based on management judgement.	– For Packaged Bank Accounts, the Committee understood the basis for determining expected complaints levels, the range of potential redress payments and the adequacy of provisions made for operational costs for the expected duration of the programme. – Group Audit has undertaken a review of the process that has been established and maintained by management to calculate the extent of conduct related provisions; and has provided assurance to the Committee that the process uses reasonable, consistent, supportable assumptions and inputs. – The Committee was satisfied that the provisions for other conduct matters were appropriate. The disclosures relating to other conduct provisions are set out in note 39: 'Other provisions' on page 234 of the financial statements.
Allowance for impairment losses on loans and receivables Determining the appropriateness of impairment losses is judgemental and requires the Group to make assumptions.	– The Committee challenged the level of provisions made and the assumptions used to calculate the impairment provisions held by the Group. – Group Audit has assessed the effectiveness of impairment governance processes and reported their findings to the Committee. – The Committee was satisfied that the impairment provisions were appropriate. The disclosures relating to impairment provisions are set out in note 53: 'Financial risk management' on page 265 of the financial statements.
Recoverability of the deferred tax asset A deferred tax asset can be recognised only to the extent that it is recoverable. Where a deferred tax asset arises from carry forward losses, the future levels of taxable profit in the Group must be assessed.	– The Committee considered the recognition of deferred tax assets, in particular legal entity forecast taxable profits based on the Group's operating plan and the Group's long-term financial and strategic plans. – The Committee considered the impact on deferred tax assets of changes in tax legislation and the removal of the ability to offset customer redress costs against taxable profits. – The 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 197 and note 38: 'Deferred tax' on page 232 of the financial statements.

Corporate governance report continued

KEY ISSUES	COMMITTEE REVIEW AND CONCLUSION
Uncertain tax positions The Group has open tax matters which require it to make judgements about the most likely outcome for the purposes of calculating its tax position.	– The uncertain tax positions of the Group were considered taking into account the respective views of management and the views of the relevant tax authorities. The Committee also understood the external advice obtained by management to support the views taken. – The Committee was satisfied that the provisions and disclosures made in respect of uncertain tax positions were appropriate. The relevant disclosures are set out in note 49: 'Contingent liabilities and commitments' on page 246 of the financial statements.
Retirement benefit obligations The Group must make both financial and demographic assumptions of a judgemental nature to determine the value of the defined benefit obligation.	– As in previous years, the Committee considered the assumptions underlying the calculation of the defined benefit liabilities, in particular the discount rate and mortality assumptions which, following the completion of the triennial funding valuation, have been updated to reflect recent experience. – The Committee was also satisfied that the Group's quantitative and qualitative disclosures made in respect of retirement benefit obligations are appropriate. The relevant disclosures are set out in note 37: 'Retirement benefit obligations' on page 226 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 economic and non-economic actuarial assumptions.	– The Committee challenged the economic and non-economic actuarial assumptions made by management and reviewed the movements in the key assumptions since 31 December 2014. – The Committee was satisfied that the value of the VIF asset and insurance liabilities were appropriate. The disclosures are set out in note 25 on page 218 and note 33 on page 222 of the financial statements.
Adjustment to derivative valuations Determining the credit, debit and funding valuation adjustments for uncollateralised derivative transactions requires management to make appropriate judgements on matters such as the creditworthiness of the derivative counterparty.	– The Committee reviewed the methodologies for the Group's derivative valuation adjustments, including management's proposal to base future funding valuation adjustments on executed trades, rather than average interbank rates, and to include the adjustment in the valuation of all of the Group's uncollateralised derivatives. – The Committee is satisfied that the proposed change and the disclosures set out in note 50 to the financial statements on page 249 are appropriate.
Sale of interests in businesses Determining the appropriate accounting for the sale of shares in TSB Banking Group (TSB) required management to make judgements when assessing the facts and circumstances specific to each tranche of the transaction. Following the offer made by Visa Inc to purchase Visa Europe Limited, management judgement was required to determine an appropriate carrying value of the Group's interest in Visa Europe.	– Judgement was required to assess when the Group ceased to control TSB, at which point its results and balance sheet were no longer consolidated in the Group's accounts, and the loss on disposal recognised. – The Committee was satisfied with the accounting treatment of the various tranches of TSB shares sold. – The interest in Visa Europe is carried as an available-for-sale financial asset. The Committee reviewed management's assessment of its valuation having regard for the terms of the offer made by Visa Inc and concurred with the view taken by management.
Viability statement A new requirement in 2015 requires the directors to confirm whether they have a reasonable expectation that the Company and the Group will be able to continue to operate and meet their liabilities as they fall due for a specified period. The disclosure must set out the basis for directors' conclusions and explain why the period chosen is appropriate.	– The Committee sought management's input to its assessment of the viability of the Company and the Group. The assessment, which was based on the Group's operating, capital and funding plans, also included consideration of the principal and emerging risks which could impact the performance of the Group, and the liquidity and capital projections over the period. – The Committee was satisfied that the viability statement be provided and agreed that three years was a suitable period of review.
Hedge accounting Determining the appropriateness of hedge accounting adjustments is a complex process requiring the identification and on-going monitoring of a large number of accounting hedge relationships.	– The Committee received periodic reports on the Group's hedge accounting strategies, and challenged management on the reasons for any proposed change to existing practices and the appropriateness of any new strategy. – The Committee was satisfied that the changes proposed by management to the Group's hedging strategies were appropriate.

Other significant issues

The following matters were also considered by the Committee:

Risk management and internal control systems

Full details of the internal control and risk management systems in relation to the financial reporting process are given within the risk management report on pages 111 to 169. Specific matters that the Committee considered during the year included:

- the effectiveness of systems for internal control, financial reporting and risk management;
- the extent of the work undertaken by the Finance teams across the Group and consideration of the resources to ensure that the control environment continued to operate effectively;
- the major findings of internal investigations into control weaknesses, fraud or misconduct and management's response along with any control deficiencies identified through the assessment of the effectiveness of the internal controls over financial reporting under the US Sarbanes-Oxley Act; and
- Three Lines of Defence, where Group Audit led an assessment of the effectiveness of such arrangements during the first half of the year, and reported regularly to the Committee on progress made by management against actions raised as part of this assessment.

The Committee was satisfied that internal controls over financial reporting were appropriately designed and operating effectively.

Group Audit

In monitoring the activity, role and effectiveness of the internal audit function and their audit programme the Committee:

- monitored the effectiveness of Group Audit and their audit programme through quarterly reports on the activities undertaken and a report from the Quality Assurance function within Group Audit;
- approved the annual audit plan and budget and reviewed progress against the plan through the year;
- considered the major findings of significant internal audits, and management's response; and
- reviewed thematic audits completed during the period which included topics on customer outcomes, operational resilience and embedding of the Risk Management Framework.

Speak Up (the Group's whistleblowing service)

The Committee received and considered reports from management on the Group's whistleblowing arrangements including summaries of cases and ongoing reviews of the Whistleblowing Governance Structure. On consideration of the reports submitted, the Committee was satisfied with the actions which had been taken, the reports first having been considered and approved by the Board's Whistleblowing Champion, Anita Frew.

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.

In some cases, PwC are selected over another service provider due to their detailed knowledge and understanding of the business. Any allowable non-audit service with a value above a defined fee limit requires prior approval from the Committee Chairman. The total amount of fees paid to the auditor for both audit and non audit related services in 2015 is disclosed in note 11 to the financial statements on page 206. The decrease against the prior year largely relates to fees incurred in 2014 in respect of assurance services provided by PwC ahead of the Initial Public Offering of TSB in June 2014.

External auditor

The Committee oversees the relationship with the external auditor. During the year, the Committee considered the auditors' terms of engagement (including remuneration), their independence and objectivity and approved the audit plan (including methodology and risk identification processes).

The Committee also considered the effectiveness and performance of the auditor and the audit process. These assessments considered data and information from a number of sources including:

- the results of an internal effectiveness survey; and
- the Financial Reporting Council's (FRC) 2015 Audit Quality Inspection Report (AQIR) on PwC published in May 2015.

The Committee concluded that it was satisfied with the auditor's performance and recommended to the Board a proposal for the reappointment of the auditor, to be approved at the Company's AGM.

Statutory Audit Services compliance

The company and the Group confirms its compliance with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 for the year to 31 December 2015.

PwC have been auditor to the company and the Group since 1995, having previously been auditor to certain of the Group's constituent companies. PwC were re-appointed as auditor with effect from 1 January 2016 as part of a tendering process conducted during 2014.

Corporate governance report continued

BOARD RISK COMMITTEE REPORT

The Committee continues to set the tone from the top on risk management and embedding risk culture.

	Committee meetings	
	Eligible to attend	Attended
Committee Chairman		
Alan Dickinson	8	8
Committee members who served during 2015		
Lord Blackwell	8	8
Anita Frew	8	8
Simon Henry	8	7[1]
Deborah McWhinney[2]	–	–
Dyfrig John	8	8
Nick Luff	8	8
Nick Prettejohn	8	7[3]
Anthony Watson	8	8
Sara Weller	8	8

[1] Mr Henry was unable to attend the May Risk Committee meeting due to prior executive commitments.
[2] Joined the Committee on 1 December 2015. No Committee meeting was held in December.
[3] Mr Prettejohn was unable to attend the May Risk Committee meeting due to prior executive commitments.

Dear Shareholders

I am pleased to have this first opportunity to write to you as Chairman of the Board Risk Committee, with our report on how the Committee discharged its responsibilities in 2015.

We have continued to take a dynamic approach to the review of existing and emerging risks, balancing our agenda to include standing areas of risk management, whilst ensuring key risks which have emerged during the course of year are escalated for the Committee's consideration. Considerable time has been spent by the Committee in making sure that satisfactory action is taken in the management of risk arising from the Group's material lending portfolios, notably our Mortgage and Commercial lending. Good progress has been made during the year in further understanding the underlying risks and enhancing risk management.

I would also like to highlight the Committee's work in helping to achieve the core aim of operating as a safe, low risk bank, where we consider the Group has made good progress. We have seen deeper embedding of a strong risk culture helping to deliver further reduction in overall risk levels compared to 2014.

Considerable time has also been spent in the review of risks relating to the resilience of IT systems and cyber security, an area of major importance to the Group. Management has taken material action to address these issues, a position the Committee will continue to monitor closely in 2016.

As in previous years, the Committee has regularly considered in detail the Consolidated Risk Report, discussed further on page 80, which provides a comprehensive overview of the various categories of risk management, including an assessment of adherence to risk appetite limits set by the Board.

The Committee has concluded that the Group continues to have strong discipline in the management of both emerging and existing risks and has taken further positive steps towards achieving the objective of operating a safe, low risk bank. The environment in which the Group operates continues to change rapidly and the Committee will continue to review emerging and inherent risks with that objective very much in mind.

Alan Dickinson
Chairman, Board Risk Committee

Committee purpose and responsibilities

The purpose of the Board Risk Committee is to review the risk culture of the Group, setting the tone from the top in respect of risk management. The Committee is also responsible for ensuring the risk culture is fully embedded and supports at all times the Group's agreed risk appetite, covering the extent and categories of risk which the Board considers as acceptable for the Company.

In seeking to achieve this, the Committee assumes responsibility for monitoring the Group's Risk Management Framework, which embraces risk principles, policies, methodologies, systems, processes, procedures and people. It also includes the review of new, or material amendments to risk principles and polices, and overseeing any action resulting from material breaches of such policy.

More details on the Group's wider approach to risk management can be found in the Risk Management section on pages 111 to 169. Full details of the Committee's responsibilities are set out in its terms of reference, which can be found at www.lloydsbankinggroup.com/our-group/corporate-governance

Committee composition, skills and experience

Alan Dickinson became Chair of the Board Risk Committee on 1 January 2015, taking over responsibility from Anita Frew. Alan is a highly regarded Retail and Commercial banker, having spent 37 years with the Royal Bank of Scotland, most notably as Chief Executive of RBS UK, overseeing the group's Retail and Commercial operations in the UK. The Committee is composed of independent Non-Executive Directors, who provide core banking and risk knowledge, together with breadth of experience which brings knowledge from other sectors, and a clear awareness of the importance of putting the customer at the centre of all that the Group does.

Whilst the Committee is made up of the Non-Executive Directors noted above, the Non-Executive Directors who were

not members of the Committee routinely attended meetings during 2015. Stuart Sinclair was appointed as an independent Non-Executive Director and a member of the Committee on 4 January 2016, and from January 2016, all Non-Executive Directors are members of the Board Risk Committee. The Chief Risk Officer has full access to the Committee and attends all meetings, the Group Audit Director and members of the Executive also attend meetings as appropriate.

During the year the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

How Committee meetings are run

The management of the Committee is in keeping with the basis on which meetings of the Board are managed, as detailed on page 63, with a structure which facilitates open discussion and debate. Steps are taken to ensure adequate time for members to consider proposals which are put forward.

As the most senior risk forum in the Group, the Committee interacts with other related risk forums, including the Executive Group Risk Committee. Such interaction assists with the agenda planning process, where in addition to annual agenda planning, matters considered by the Group Risk Committee are reviewed to ensure escalation of all relevant matters to the Board Risk Committee.

Matters considered by the Committee

Over the course of the year the Committee considered a wide range of risks facing the Group, both standing and emerging, across all key areas of risk management, in addition to risk culture and risk appetite, as noted above.

As part of this review, certain risks were identified which required further detailed consideration. Set out below is a summary of these risks, with an outline of the material factors considered by the Committee, and the conclusions which were ultimately reached.

How the Board Risk Committee spent its time in 2015

KEY RISKS	COMMITTEE REVIEW AND CONCLUSION
Conduct risk The Committee continues to focus closely on the Group's approach to conduct risk.	As highlighted in several of the individual sections below, the Committee seeks to ensure that conduct risk is considered and reviewed to ensure the highest standards are applied. For further detail see the sections on Low Risk Bank, Consolidated Risk Report and Divisional Risk Profiles. In addition the Committee considered reports on complaints, rectifications, conduct risk appetite metrics and product governance. Conclusion: Whilst a great deal has been achieved as a result of the Group's conduct strategy initiatives, which continue to transition into business as usual management, improving the Group's conduct risk profile remains a priority for the Group in 2016 and will continue to be a subject of focus for the Committee.
Material lending portfolios Review was undertaken of the risks associated with the Group's material lending portfolios, including the key Retail mortgage portfolio and the Commercial portfolio.	In reviewing the material lending portfolios, consideration was given to the quality and size of the lending books, with additional review of the quality of new lending, potential levels of impairments and overall levels of sector concentration. The performance of these portfolios in 'stressed' situations was also considered, in order to determine their resilience in a wide range of adverse conditions. Conclusion: Management continues to take satisfactory action in addressing the risks arising from these key lending portfolios, and the Committee will continue to review these core aspects of the Group's business during the course of 2016.
Low risk bank Considerable time was devoted to reviewing progress with the Group's stated aim of operating as a simple, low risk, customer focused bank, generating stable and sustainable earnings.	In assessing progress during the year in achieving this important objective, a number of factors were considered, including financial, operational and credit risk metrics, with particular attention given to assessing progress in delivering the Group's conduct strategy. Review of the Group's progress and risk profile in these areas was also considered relative to its financial services peer group. Delivering greater customer focus is a core requirement of the low risk strategy, and was a further important consideration in the Committee's assessment of the steps taken during the year. Conclusion: The Group continues to move further towards achieving its stated aim of operating as a low risk bank, and compares favourably in most related areas of assessment with its peer group, with particularly good progress in lowering levels of risk in respect of conduct, capital management and credit quality. As further management initiatives to deliver the Group's low risk aims are implemented, the Committee will continue to review progress made during the course of the coming year.
IT resilience and cyber security The risks posed in respect of cyber security and the overall resilience of the IT systems has been a central area of focus for the Committee, acknowledging the increased threat posed to the Group's business by online crime.	The adequacy of arrangements for IT operational resilience were considered in detail, including the levels of complexity and automation in the Group's IT systems, with emphasis on processes which underpinned services critical to day to day operations, in particular those with immediate customer impact. In respect of cyber security, consideration was given to areas including possibilities for malicious access and removal of information from systems, and the ability of the Group to detect such attacks. A variety of exercises were undertaken to test the resilience of IT and cyber security arrangements, with considerable time spent reviewing the results of these exercises and considering the recommendations of management to provide enhancements to these arrangements. In particular the delivery of the Group's related Cyber Security and IT Resilience programmes was reviewed. Consideration was also given to the Group's position in the context of its wider banking sector peers. Conclusion: Whilst much has been achieved in respect of IT resilience and cyber security initiatives, including enhancements delivered to increase resilience to cyber threats, and evidence of a more unified approach to IT resilience, work in respect IT resilience and cyber security will remain an important area for the Group in 2016, and will continue to be reviewed by the Committee.

Corporate governance report continued

KEY RISKS	COMMITTEE REVIEW AND CONCLUSION
Stress testing The review of stress testing exercises and their results was a key area of focus during the year.	The stress testing scenarios considered by the Committee were diverse, including internally modelled scenarios involving factors such as material economic downturns and large scale cyber-attack, with further consideration of stress testing against a number of external scenarios, including those set by the PRA. Assessment was made of the impacts in these scenarios on a range of metrics relating to resilience in adverse conditions, including amongst others impacts on the Group's capital and liquidity positions, in particular the impact on the tier one common capital ratio. Comparison in each scenario of the Group's position relative to its competitors was also undertaken, with detailed review of the mitigating actions proposed by management in each scenario. Conclusion: The Group's capital and liquidity positions remained above required minimums in testing against both internal and external scenarios, with outcomes in most scenarios remaining above the wider risk appetite targets set by the Board. The implementation and assessment of robust and well managed stress testing arrangements will remain a key area of focus for the Committee in the coming year.
Consolidated risk report Review was undertaken on a regular basis of a consolidated report on key aspects of risk management across the business, both existing and emerging risks, including assessment of adherence to risk appetite limits set by the Board.	The Consolidated Risk Report enables review of all core areas of risk management, including Capital, Credit, Operational, Regulatory and Conduct risk amongst others, providing further analysis of key component areas of risk management under each of these headings. Consideration was given not only to the risk management position on a 'point in time' basis, but also on a 'look forward' basis, with rolling 12 month forecasts , including review of proposed management action to address key risks as they develop. Conclusion: The Consolidated Risk Report has assisted the Committee in its assessment of the Group's management of both existing and emerging risks, with ongoing progress being made to embed policies and practice required to mitigate common areas of risk, and sufficient levels of agility within the organisation to address emerging risks as the Group's operating plan continues to develop.
Divisional risk profiles In addition to the Consolidated Risk Report, detailed summaries of risk management across each of the Group's main operating divisions were also considered.	Focus was given to unique areas of risk management within each division, in addition to review of divisional performance in areas of risk management common across the business, including conduct risk management, portfolio concentrations, market conditions, and the overall quality of both new and existing business. Detailed comparisons of the approach to the management of risk within each division were also considered, including any significant differences in approach, and any instances of potential best practice which could be implemented across the Group. Common and emerging trends were also highlighted. Conclusion: Key risks continue to be well managed within each of the Group's main operating divisions, with action taken within each business to address risks which are specific to that division. Such action is aided by the unified approach taken in addressing risks which are common across all areas of the Group, including improving management of conduct risks.
Emerging risks Achieving the Group's 'low risk' ambitions requires review of the material risks emerging, in particular in relation to the Group's operating plan, assessing their likely impact and agreeing appropriate mitigants.	The constantly evolving regulatory and economic landscapes in which the Group operates, both within the UK and overseas, have been important factors in assessing emerging risk, and agreeing mitigating actions where material change is anticipated. Areas of focus have included the opportunities and risks emerging from developments in technology, in particular in relation to the Group's ambition of improving its digital and technological capabilities in delivering for customers. Risks arising from the implementation of banking sector ring-fencing legislation have also been an important consideration, ensuring adequate forward planning is undertaken to address anticipated risks as requirements in this area continue to emerge. Conclusion: The Group has a good understanding and oversight of its emerging risk position, and takes steps to mitigate the impacts of new risks as they appear, ensuring close alignment in its assessment of emerging risks with developments in both the Group's business model and its external regulatory and economic environment.
Banking reform Review was undertaken of the Group's implementation of Banking Reform, including Senior Managers and Certification Regime and Ring Fenced Banking.	A number of initiatives are in course across the organisation to implement the provisions of the Financial Services (Banking Reform) Act (the 'Act'), including projects to enable the implementation of the Senior Managers and Certification Regime, and also the requirements of ring-fenced banking. Conclusion: As part of its review of these arrangements the Committee concluded there continues to be action needed to fully implement the requirements of the Act, as detailed provisions continue to emerge, however the Group is well placed to respond to the ongoing requirements and future developments.
Pensions risk Risks arising from the Group's various pension arrangements were reviewed, in light of ongoing changes in actuarial profiles.	Factors considered by the Committee in the assessment of pensions risk included levels of risk appetite in relation to overall pension provision, with particular consideration of projected future asset performance in changing economic conditions. The risks posed in respect of certain market events were also assessed, including potential interest rate and inflation changes, and also the impact on Group pension schemes of ongoing improvements in life expectancy. Conclusion: Despite the impact of wider macro-economic uncertainty, and the potential impact on underlying investments, the levels of risk in relation to the Group's pension schemes continue to be well managed and remain within risk appetite for the Group.

RESPONSIBLE BUSINESS COMMITTEE REPORT

The establishment of a Board Committee to oversee our responsible business activities demonstrates our commitment to doing business in the right way as we work to help Britain prosper.

	Committee meetings	
	Eligible to attend	Attended
Committee Chairman		
Sara Weller	3	3
Committee members who served during 2015		
Lord Blackwell	3	3
Anita Frew	3	3

Dear Shareholders

I am delighted to present the first report from the Responsible Business Committee, formed in July 2015, to provide oversight, challenge and guidance on the Group's approach to becoming a more responsible business.

The Committee's remit includes:
- the establishment, measurement and review of plans to strengthen the Group's culture and values;
- the Group's approach to: building trust with customers; communities; environment; employees; ethical business; stakeholder engagement and reputation;
- the design and development of the Responsible Business plan and Helping Britain Prosper Plan (HBPP) and the measurement of performance against these plans.

An update on our responsible business activities forms part of the strategic report on page 22. The HBPP, on page 15, provides an overview of what the Group is doing to help Britain's communities, businesses and individuals address current social and economic issues. The Committee has overseen the development of both plans, as they evolve in response to progress we have already made and challenges that lie ahead.

The Committee has made progress in establishing its working patterns and reporting arrangements since its first meeting in July 2015. We look forward to continuing our work in 2016 when our focus will be on: the evolution of the HBPP and stakeholder reaction to it; tracing the Group's reputation and trust amongst a wide range of stakeholder groups; measuring our progress on building a culture that puts customers at the heart of what we do; and supporting work to embed responsible business activities with all our colleagues across the business.

Sara Weller
Chairman, Responsible Business Committee

Establishment of the Committee

An executive level Committee to oversee the Group's responsible business activities was established in 2013, chaired by a Non-Executive Director, with membership drawn from senior leaders across the Group. The Committee played a key role in the development of the initial HBPP and the Group's focus on operating as a responsible business.

A recommendation to establish the Board level Responsible Business Committee (RBC) was accepted by the Board in April 2015. The Company Secretary worked with colleagues to ensure the RBC's remit met current good practice standards that aligned with, but did not overlap, the responsibilities of the executive level Group Customer First Committee (see page 119).

The Committee's activities in 2015

During 2015, the Committee has:
- received updates on the development of a framework for assessing and measuring stakeholder trust, including customers and shareholders;
- worked with the executive team to develop the HBPP with a focused suite of metrics;
- considered reports from the Chairman of the Group Customer First Committee (see update on page 22) and GEC members on the development of the Group's culture framework; and
- discussed responsible business activities in the Group with colleagues in business areas, including Group Sourcing.

Responsible Business Committee and external stakeholders

The members of the Committee have an ongoing dialogue with key stakeholders with an interest in the Committee's activities. During 2015, the Committee invited a representative of the Group's Stakeholder Advisory Panel to provide feedback on the 2015 HBPP and recommendations for areas of focus in the 2016 Plan. Representatives of the Financial Conduct Authority were invited to attend a meeting to observe the Committee at work. In 2016, the Committee will be inviting representatives of the Banking Standards Board and the Competition and Markets Authority, amongst others, to join a meeting to discuss their respective work programmes.

Directors' remuneration report

STATEMENT BY THE CHAIRMAN OF THE REMUNERATION COMMITTEE

In the context of improving financial performance and a return to dividend payments, the Committee continues to ensure clear alignment between remuneration and delivery of the Group's strategic objectives.

Dear Shareholders

Introduction

On behalf of the Board and as Chair of the Group's Remuneration Committee, I am pleased to present the Directors' remuneration report for the year ended 31 December 2015. I am extremely grateful for the overall strong support and positive feedback received from shareholders during 2015. I look forward to working together during 2016.

This report is split into three parts:

- Remuneration at a glance - a summary of the key aspects of remuneration outcomes for 2015.
- Directors' remuneration policy
- Annual report on remuneration - how the policy was implemented in 2015 and is intended to apply in 2016.

A summary of the remuneration policy approved at the 2014 Annual General Meeting (AGM) is included for information only. No changes have been made to the policy this year. My introductory statement and the annual report on remuneration will be subject to an advisory vote at the 2016 AGM.

I took over as Chair of the Remuneration Committee from Tony Watson in October 2015. On behalf of the Group, I would like to take the opportunity to thank Tony for the significant contribution he has made in his chairmanship of the Committee since 2011, a period that has seen profound change both for the Group and the wider UK economy.

Alignment to strategy

The Committee continues to place great importance on ensuring there is a clear link between remuneration and delivery of the Group's key strategic objectives. For 2015, the Group's priorities have been creating the best customer experience, becoming simpler and more efficient and delivering sustainable growth. These support our continued aim of becoming the best bank for customers and our 'helping Britain prosper' plan.

Underpinning the Group's strategic focus is the 'building the best team' agenda, a key component of which is the Group's desire to offer fair reward to all colleagues. In considering employee reward, the Committee seeks to balance the importance of dealing with legacy conduct-related matters, investment for our customers, returning value to shareholders and providing support to the communities in which we operate. The Committee has placed a great deal of emphasis on ensuring that reward outcomes are aligned to the long term sustainable success of the business, the Group's commitment to rebuilding trust and changing our culture to ensure that colleagues are empowered, inspired and incentivised to do the right thing for customers, particularly when it comes to dealing with, and learning from, mistakes of the past.

Remuneration outcomes for 2015

As set out in detail in the annual report on remuneration, both the financial and strategic measures set by the Committee for the 2015 bonus were exceeded, with underlying profit of £8,112 million and dividends in respect of 2015 of £1.6 billion and a total capital distribution of £2.0 billion, demonstrating the Group's return to financial health. In addition, the Group has completed the sale of the remaining holding in TSB (at a premium of around £200 million), whilst the strong financial performance has enabled the Government to make further substantial progress in returning the Group to full private ownership and has resulted in rating agency upgrades and improved feedback from the regulators.

The Group has continued to embed the revised methodology for calculating the risk-adjusted bonus outcome implemented in 2014. The Committee believes it is important that all colleagues are rewarded in a way that recognises the very highest of expectations in respect of conduct and customer treatment and the links between performance, risk management and reward are clear in the way that the Group sets expectations and communicates them with colleagues. When there are failures in risk management, or when material errors occur, it is equally important that accountability is taken collectively for those issues and, where appropriate, at an individual level as well. During 2015, a number of risk and conduct-related matters had an impact on both the Group's financial performance and its reputation with the public, shareholders and regulatory bodies, such as PPI, as well as the risk management failure which led to regulatory settlement on PPI complaint handling.

Taking into consideration all relevant factors, the Committee has applied collective adjustments of 26 percent to the Group's 2015 bonus outcome, reducing the total to £353.7 million. As a percentage of pre-bonus underlying profit, the bonus outcome is 4.2 per cent for 2015, down from 4.5 per cent in 2014.

The approach to determine bonus awards for the Executive Directors is consistent with other colleagues across the Group. The Committee determined that bonus awards of between 57 per cent and 63 per cent of maximum opportunity should be made to Executive Directors. In addition, we applied reductions to the 2012 and 2013 deferred bonus awards for each of the Executive Directors, in line with other senior managers, to reflect the Group's handling of PPI complaints.

The long-term incentive plan (LTIP) awards made in 2013 are proposed to vest at 94.18 per cent, reflecting performance in the period to 31 December 2015. This vesting outcome reflects the significant shareholder value created over the period. Awards were granted at 49.29 pence.

Overall, the total remuneration for the Executive Directors is down by around 20 per cent compared to 2014. Further details on the reward outcomes for Executive Directors are outlined in the annual report on remuneration.

Rewarding colleagues

During 2015, the Group has continued to invest in the broader remuneration package for colleagues, with improvements made to pay, benefits and colleague share plans. It also undertook a detailed review of the variable pay arrangements used to incentivise customer-facing colleagues, primarily in the Retail division. These arrangements do not contain sales output measures, so colleagues are incentivised purely by reference to customer service or Balanced Scorecard performance measures. In some parts of our business, variable pay arrangements have been removed and have either been replaced with fixed base salary or eligible colleagues have transitioned to the discretionary annual bonus plan. From 2016, a single variable pay arrangement will be introduced for all customer-facing colleagues in the Retail division, using a Balanced Scorecard approach with clearly identified performance descriptors, measuring whole job contribution.

Average discretionary bonus awards across all colleagues are approximately £4,600, with only 3 per cent of our colleagues receiving a bonus in excess of £25,000. In line with previous years, the first £2,000 of any bonus award is paid in cash with the balance being deferred in shares which are released periodically over subsequent months and years.

Executive salary awards for 2016

The Committee's continuing aim is to position Executive Director remuneration conservatively, but competitively, against the market. We are also very mindful of the average awards made to colleagues across the Group, which in 2016 will be 2 per cent. The Group is therefore proposing to increase the base salaries of the Executive Directors. For the Chief Financial Officer and Chief Risk Officer, it is proposed that base salaries will increase by 2 per cent, in line with colleagues across the Group.

For the first time since 2011, a base salary increase is also proposed for the Group Chief Executive. The Group Chief Executive was hired on the basis that upon the Government shareholding falling in the range of 15-20 per cent or less, the Committee would consider his remuneration being increased in line with market conditions. With the Government's shareholding now being around 9 per cent and given the recovery of the Group's financial strength, the Committee has decided it should now begin to adjust the Group Chief Executive's salary towards the Reference Salary. After discussion with shareholders, the Committee has decided to stage this adjustment over two years. For 2016, this will consist of an increase in base salary of 2 per cent, in line with the other Executive Directors, and an additional increase of 4 per cent to reflect the arrangements above, taking his total salary to £1,125,000. The Group Chief Executive has suggested, and the Board has approved, that for 2016 the 4 per cent increase be delivered in shares and held until the Government has sold its shareholding in the Group. After this increase, the Group Chief Executive's salary remains conservative compared to peers.

Impact of regulatory change

2015 has been another year in which significant regulatory change has dominated the remuneration agenda. This has included the publication of revised PRA and FCA rules on remuneration under CRD IV and a significant consultation on changes to the EBA Guidelines that overlay the UK rulebook.

In addition, during 2015, the remuneration requirements of the AIFMD Remuneration Code took effect. Alongside the specific remuneration rules, the Committee has also considered the impact of the introduction of the Senior Manager and Certification Regimes from March 2016 and other significant regulatory changes.

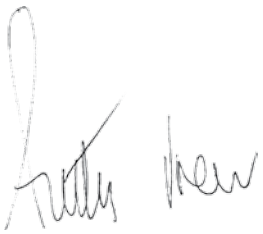
In particular, from 2016, there will be a regulatory requirement to extend deferral from three years to seven years. At least 60 per cent of total variable pay must be deferred. Currently the Group defers all bonuses awarded to the Executive Directors entirely in shares, an approach which is significantly more conservative than the market practice and current regulations require. In order to implement longer deferral of variable remuneration, the Group will make modest changes to the delivery of variable remuneration for the 2016 performance period. In addition to these changes for the 2016 performance period, the Committee is conducting a full review of the Group's approach to variable remuneration and is considering making changes to deliver a simpler and more efficient structure. Any changes would apply from the 2017 performance period and it is intended that the Group will consult on these changes during 2016.

Consideration of stakeholder views

The Group is committed to consulting key stakeholders to ensure their view is taken into consideration when determining remuneration. During 2015, the Group has consulted with major shareholders to gather their feedback and views on the Group's approach to remuneration, in particular the proposed changes to base salary for Executive Directors and the Group's forward-looking approach to variable remuneration in 2016. The Group has also met regularly with its main regulators, the PRA and FCA. The Group is grateful for the support and ongoing dialogue with key stakeholders.

The Committee reviews an annual report from the Group HR Director on the operation of the Group's remuneration policy and its effectiveness. In 2015, the report concluded that effective systems and controls are in place for all requirements of the Policy and that it continues to deliver outcomes in line with the Group's values, reward principles and the requirements of the PRA and FCA remuneration rules and guidance issued by the European Banking Authority.

The Board places great emphasis on ensuring that remuneration policy and practices align to the Group's strategy and the continued focus on delivering superior and sustainable shareholder returns. I hope you will support the resolutions relating to remuneration at the 2016 AGM.



Anita Frew
Chairman, Remuneration Committee

Directors' remuneration report continued

REMUNERATION AT A GLANCE

How Lloyds Banking Group performed

The Group has had a successful 2015 with a number of strategic milestones achieved, notably improved dividend returns, increase in underlying profit and completion of the sale of TSB at a premium to market value.

The Group's approach to reward is to provide a clear link between remuneration and delivery of the Group's strategy and the aim of becoming the best bank for customers.

The Group believes in offering fair reward. It is embedding a performance-driven and meritocratic culture where colleagues are rewarded for behaviours aligned to the long-term sustainable success of the business, the commitment to rebuilding trust and changing the culture of the Group.

Key performance measures

The table below illustrates outcomes against the Group's key performance measures relevant to remuneration. The annual bonus outcome is driven by a combination of Group underlying profit and Balanced Scorecard performance. The LTIP measures Group performance over a three year period, using a range of financial and strategic measures.

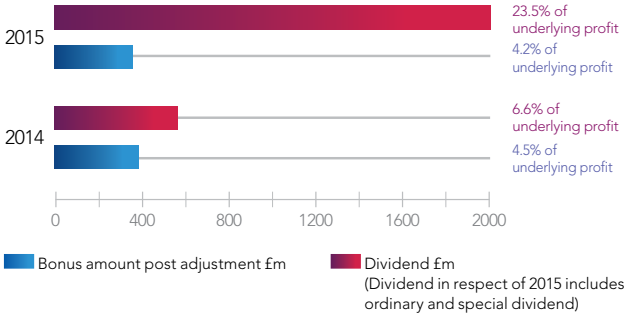
Measure	2015	2014
Underlying profit before tax	**£8,112m**[1]	£7,756m
Group Balanced Scorecard	**Strong**	Strong
Economic profit	**£2,233m**	£2,094m
Total Shareholder Return (TSR) *Per annum for the three years ended 31 December*	**16.6%**	30.2%
Cost:income ratio	**49.3%**	49.8%
Net promoter score	**59.3%**	59.2%
Digital active customer base	**11.5m**	10.4m
Colleague engagement score	**71%**	60%

[1] The underlying profit result used for remuneration purposes is £7,994 million (excluding TSB).

Annual bonus plan outcome

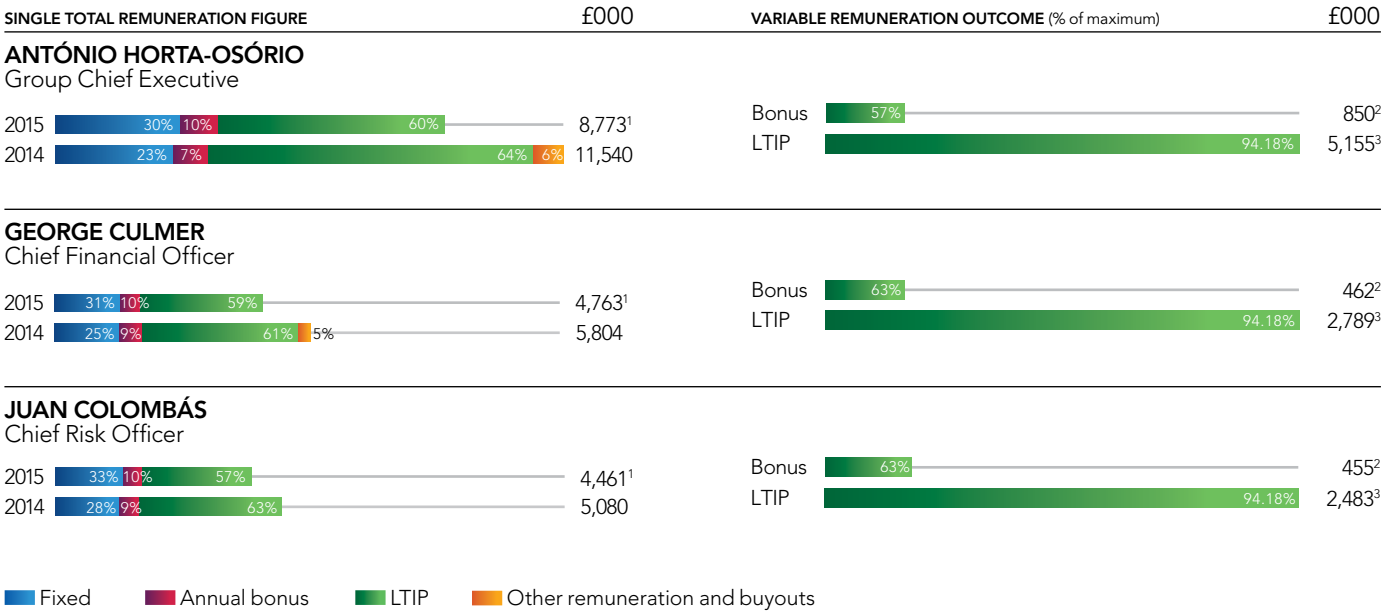
Despite the better results in 2015, the decision has been taken to reduce the Group's total bonus outcome by approximately 26 per cent. Material adjustments have been made to the outcome in 2015 (as in 2014) to reflect the impacts of legacy items.

Discretionary annual bonus awards of £353.7 million will be made for 2015 (4 per cent down from £369.5 million in 2014). The total bonus awards as a percentage of pre-bonus underlying profit before tax declined from 4.5 per cent in 2014 to 4.2 per cent in 2015. This compares favourably to shareholder return from dividend payments over the same period.



Executive Director remuneration outcomes

The charts below summarise the Executive Directors' remuneration for the years ended 31 December 2014 and 2015.



1 In June 2015, the Group reached a settlement with the Financial Conduct Authority (FCA) with regard to aspects of its Payment Protection Insurance (PPI) complaint handling process during the period March 2012 to May 2013. As a result, the Committee decided to make adjustments in respect of bonuses awarded in 2012 and 2013 to the Group Executive Committee and some other senior executives given their ultimate oversight of the PPI operations. The number of shares adjusted was 409,039 for the GCE, 109,464 for the CFO and 376,055 for the CRO.

2 2015 bonus, awarded in March 2016.

3 2013 LTIP vesting and dividend equivalents awarded in shares were confirmed by the Remuneration Committee at its meeting on 16 February 2016. The average share price between 1 October 2015 and 31 December 2015 (73.72 pence) has been used to calculate the value. The shares were awarded in 2013 based on a share price of 49.29 pence.

Directors' remuneration: policy implementation overview for 2016

The detailed policy implementation table containing all elements of remuneration can be found on page 103.

Base salary 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 Executive Directors and forms the basis of a competitive remuneration package.	Salaries will be as follows, effective date shown below: Group Chief Executive (GCE): £1,125,000 (1 January 2016) Chief Financial Officer (CFO): £749,088 (1 April 2016) Chief Risk Officer (CRO): £738,684 (1 January 2016)
Fixed share award 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 levels of award set for 2016 remain unchanged and are as follows: GCE: £900,000 CFO: £504,000 CRO: £497,000 Shares will be released in equal tranches over a five year period.
Annual bonus Incentivise and reward the achievement of the Group's annual financial and strategic targets.	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.
Long-term incentive plan 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.	The maximum annual long-term incentive award for Executive Directors is 300 per cent of salary. Awards in 2016, based on individual performance in 2015, are being 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 continued

DIRECTORS' REMUNERATION POLICY

The policy set out in the 2013 Directors' remuneration report was formally approved by shareholders at the AGM on 15 May 2014.

It is 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 sought. No changes are proposed for 2016, therefore shareholders will not be asked to vote on the remuneration policy at the AGM this year.

The remuneration policy tables for Executive and Non-Executive Directors are included below for ease of reference. They have been reproduced as approved in 2014 with minor changes due to regulatory requirements under the latest PRA Rulebook which take effect in 2016 and changes in the operation of the all-employee share plans in 2015. Information on how the Policy will be implemented in 2016 is included in the annual report on remuneration. The full policy is set out on pages 102 to 109 of the annual report and accounts for the year ended 31 December 2013 which is available at: www.lloydsbankinggroup.com/globalassets/documents/investors/2013/2013_lbg_annual_report.pdf

As outlined in the 2013 Directors' remuneration report, the Group's policy is intended to ensure that the remuneration proposition is both cost effective and enables the Group to attract and retain executives of the highest calibre. The 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, the requirements of the major stakeholders are balanced: 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 the strategic aim of becoming 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).

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 Executive 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. 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.
Performance measures	N/A

Pension

Purpose and link to strategy	The 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 allowance as cash in lieu of pension contribution.
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 annual report on remuneration. Core benefits include a company car or car allowance, private medical insurance, life insurance 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 Save As You Earn (SAYE) is £500. The maximum value of shares that may be purchased under the Share Incentive Plan (SIP) in any year is £1,800 with a two for one match. Currently a three for two match is operated up to a maximum employee investment of £30 per month. The maximum value of free shares that may be awarded in any year is £3,600.
Performance measures	N/A, following HMRC rules.

Directors' remuneration report continued

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. The Committee may adjust deferred 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. Bonus awards may be subject to clawback for a period of up to seven years after the date of award. This period may be extended to ten years where there is an ongoing internal or regulatory investigation.
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.
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 annual report on remuneration for the relevant year. At least 50 per cent of the awards are weighted towards financial measures, with the balance on strategic objectives. 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 or 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 annual report on remuneration for the relevant year unless this information is deemed to be commercially sensitive.

Long-term incentive plan (LTIP)

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. 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. LTIP awards may be subject to clawback for a period of up to seven years after the date of award. This period may be extended to ten years where there is an ongoing internal or regulatory investigation.
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 annual report on remuneration each year. At least 60 per cent of awards are weighted towards typical market (e.g. Total Shareholder Return) and/or financial measures (e.g. economic profit), with the balance on strategic measures. 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. For future awards, the Committee will disclose in the annual report on remuneration 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 holdings are shown in the annual report on remuneration.

Deferral of variable remuneration

Operation	The annual bonus and long-term incentive plans are both considered variable remuneration for the purpose of regulatory payment and deferral requirements. The payment of variable remuneration and deferral levels are determined at the time of award and in compliance with regulatory requirements (which currently require that at least 60 per cent of total variable remuneration is deferred and at least 50 per cent of total variable remuneration is paid in shares or other equity linked instruments). From 2016, deferred awards normally vest over a period of seven years with vesting between the third and seventh anniversary of award, on a pro-rata basis.

Directors' remuneration report continued

Remuneration policy table for Chairman and Non-Executive Directors

The table below sets out the remuneration policy that has been applied to Non-Executive Directors (NEDs) from the date of the AGM 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 insurance, 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. 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. 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	N/A

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 letter of appointment. His engagement may be terminated on six months' notice by either the Group or him.

ANNUAL REPORT ON REMUNERATION

Remuneration Committee

Committee purpose and responsibilites

The Remuneration Committee has responsibility for setting remuneration for all Executive Directors and the Chairman, including pension rights and any compensation payments. The Committee also recommends and monitors the level and structure of remuneration for senior management and material risk takers.

The Committee's purpose 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 Committee's Terms of Reference can be found on the Company's website at www.lloydsbankinggroup.com/our-group/corporate-governance

The Directors who served on the Committee during the year and their attendance at Committee meetings is set out in the table below.

	Remuneration Committee meetings[1]	
	Eligible to attend	Attended
Committee Chairman		
Anthony Watson (until 30 September 2015 and member thereafter)	11	11
Anita Frew (member to 30 September 2015 and Chairman thereafter)	11	10[2]
Committee members who served during 2015		
Lord Blackwell	11	11
Alan Dickinson[3]	2	2
Dyfrig John	11	11
Sara Weller	11	11
Former members who served during 2015		
Carolyn Fairbairn[4]	10	10

1 The number of meetings includes ad hoc meetings.
2 Ad hoc meeting arranged at short notice.
3 Appointed as member of the Committee on 17 July 2015.
4 Retired on 31 October 2015.

Committee composition, skills and experience

The Committee comprises Non-Executive Directors from a wide background to provide a balanced and independent view on remuneration matters. From 1 October 2015, Anita Frew succeeded Anthony Watson as Chairman, with Anthony Watson remaining as a member of the Committee. The change was made to bring about the separation of the roles of Senior Independent Director – also held by Anthony Watson – and Chairman of the Remuneration Committee in line with best practice. Carolyn Fairbairn retired as a Director of the Board and as a member of the Committee with effect from 31 October 2015. Dyfrig John has notified the Board that he wishes to reduce his workload and therefore does not intend to seek re-election at the 2016 Annual General Meeting. Stuart Sinclair was appointed as an independent Non-Executive Director and as a member of the Committee on 4 January 2016.

How Committee meetings are run

The management of the Committee is in keeping with the basis on which meetings of the Board are managed, as detailed on page 61, with a structure which facilitates open discussion and debate, with steps taken to ensure adequate time for members of the Committee to consider proposals which are put forward.

During 2015, the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review. Building on improvements made in the previous year, the review identified a number of actions relating to agenda planning, the timeliness and content of Committee papers and induction of new Committee members that will continue to maintain and improve the Committee's effectiveness.

Matters considered by the Committee

The Committee met 11 times during 2015, including four ad hoc meetings called at short notice, to consider the following principal matters:

– Review of remuneration arrangements for senior executives;
– Determination of bonus outcome based on divisional and functional performance and adjustment for risk;
– Review of the use of new balanced scorecards for the determination of bonuses in divisions and functions;
– Performance conditions for the long-term incentive plan (LTIP) and the deferred bonus plan, including a review of clawback provisions;
– Bonus and salary awards for Executive Directors and key senior managers;
– Performance adjustments in respect of staff, and in particular in relation to staff accountable for PPI or LIBOR infractions;
– Feedback from the Committee Chairman on his/her meetings respectively with the PRA and shareholders;
– Results of the Remuneration Committee effectiveness review and the suggestions for improvement;
– Approval of the 2014 and 2015 Directors' remuneration report for publication within the annual report and Form 20-F; and
– Remuneration governance in the light of regulatory changes.

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 as remuneration consultant by the Committee following a competitive tendering process. Deloitte has voluntarily signed up to the Remuneration Consultants' Code of Conduct. The Committee has evaluated Deloitte's performance during 2015. The process of the review consisted of a detailed questionnaire completed by members of the Committee. The results were discussed by the Committee and it was concluded that Deloitte were effective in providing objective and independent advice to the Committee. In particular, it was recognised that Deloitte had sufficient knowledge and experience of all appropriate remuneration-related areas to provide adequate contributions to enable the Committee to fulfil its responsibilities. Deloitte LLP is not connected with the Group.

Deloitte's fees for services to the Committee in 2015 were on a time and materials basis and amounted to £426,700. In addition, Deloitte LLP provided the Group with advice on taxation and other consulting services, and assurance services.

António Horta-Osório (Group Chief Executive), Rupert McNeil (Group HR Director until 16 October 2015), Paul Hucknall (HR Director, Performance & Reward), Chris Evans (Director, Performance and Variable Reward) and Matthew Elderfield (Group Director, Conduct, Compliance and Organisational Risk) 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.

Directors' remuneration report continued

The Committee is satisfied that its processes are robust and diligent and that the Group's remuneration and incentive plans conform to best practice standards.

Statement of voting at Annual General Meeting

The Group's remuneration policy was detailed within the Directors' remuneration report for 2013 and voted on at the 2014 AGM. The remuneration offered to the Executive Directors in 2015 was disclosed in last year's remuneration implementation report and was voted on at the 2015 AGM. The shareholder votes submitted at the meetings, either directly, by mail or by proxy, were as follows:

	Votes cast in favour		Votes cast against		Votes withheld
	Number of shares (millions)	Percentage of votes cast	Number of shares (millions)	Percentage of votes cast	Number of shares (millions)
Remuneration policy (2014 vote)	48,261	97.97%	999	2.03%	1,391
Remuneration implementation report (2015 vote)	51,131	97.67%	1,220	2.33%	410

Remuneration outcome for 2015

Executive directors (audited)

The following table summarises the total remuneration delivered during 2015 in relation to service as an Executive Director.

	António Horta-Osório		George Culmer		Juan Colombás[6]		Totals	
£000	2015	2014	2015	2014	2015	2014	2015	2014
Base salary	1,061	1,061	731	720	724	710	2,516	2,491
Fixed share award	900	900	504	504	497	497	1,901	1,901
Benefits	140	119	41	40	73	60	254	219
Pension allowance[1]	568	568	182	180	181	173	931	921
Other remuneration[2]	2	1	2	301	2	–	6	302
Annual bonus[3]	850	800	462	496	455	468	1,767	1,764
Long-term incentive[4]	5,252	7,379	2,841	3,563	2,529	3,172	10,622	14,114
Conditional pension buy-out[5]	–	712	–	–	–	–	–	712
Total remuneration	8,773	11,540	4,763	5,804	4,461	5,080	17,997	22,424
Less: Buy-out amounts	–	(712)	–	(300)	–	–	–	(1,012)
Less: performance adjustment[7]	(234)	–	(65)	–	(3)	–	(302)	–
Total remuneration less buy-outs and performance adjustment	8,539	10,828	4,698	5,504	4,458	5,080	17,695	21,412

– As disclosed last year, the 2014 annual bonus awarded to the Group Chief Executive (GCE) was subject to a discretionary adjustment to reflect the external environment. The 2014 mechanical bonus outcome, before any discretionary adjustment would have been £978,882, but was reduced by approximately 18 per cent to £800,000. This year the mechanical bonus outcome is £849,649.

– In June 2015, the Group reached a settlement with the Financial Conduct Authority (FCA) with regard to aspects of its Payment Protection Insurance (PPI) complaint handling process during the period March 2012 to May 2013. As a result, the Committee decided to make performance adjustments in respect of bonuses awarded in 2012 and 2013 to the Group Executive Committee and some other senior executives given their ultimate oversight of the PPI operations. The number of shares adjusted was 409,039 for the GCE, 109,464 for the Chief Financial Officer (CFO) and 376,055 for the Chief Risk Officer (CRO) (pro-rated in the above table to reflect his appointment to Executive Director).

1 Following changes to the amount of tax relief available on pension contributions in each year, Executive 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.

2 Other remuneration payments comprise contractual cash payments to George Culmer as part of the buyout of benefits from his previous employer and income from all employee share plans, which arises through employer matching or discounting of employee purchases.

3 In addition to deferral and performance adjustment, the GCE's bonus will only vest if the Group's share price remains above 75.5 pence on average for any 126 consecutive trading days in the five years following grant or the UK government sells 100 per cent of its shareholding in the Group at any time during the three years following grant. 50 per cent of the award will vest and be released, at the earliest, on the second anniversary of the award if either of the conditions has been met by that date, with the remaining 50 per cent vesting no less than six months later. If neither of the conditions has been met by the fifth anniversary of the award, the award will lapse entirely.

4 The LTIP vesting and dividend equivalents awarded in shares were confirmed by the Remuneration Committee at its meeting on 16 February 2016. The average share price between 1 October 2015 and 31 December 2015 (73.72 pence) has been used to indicate the value. The shares were awarded in 2013 based on a share price of 49.29 pence. LTIP figures for 2014 have been adjusted for the share price on the date of vesting (79.2 pence).

5 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 Group. It is an Employer-Financed Retirement Benefits Scheme (EFRBS). The EFRBS provides benefits on a defined benefit basis at a normal retirement age of 65. The EFRBS 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. Accrual at 31 December 2015 is a pension of 6 per cent of the reference salary or £73,200. No new pension entitlement was accrued in 2015.

There are no other Executive Directors with defined benefit pension commitments.

6 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.

7 Performance adjustment: the share price used for the valuation was the market price for a share in the Group at the award dates, 49.29 pence and 78.878 pence, respectively. For the CRO, the total number of shares (376,055) has been pro-rated to reflect his appointment to Executive Director on 29 November 2013.

Pension and benefits (audited)

Pension/Benefit £	António Horta-Osório	George Culmer	Juan Colombás
Employer contribution to pension scheme	10,670	18,076	20,774
Cash allowance in lieu of pension contribution	556,890	164,624	160,276
Car or car allowance	12,000	11,168	12,000
Flexible benefits payments	42,440	28,800	28,400
Private medical insurance	28,928	760	13,149
Tax preparation	24,829	–	15,766
Transportation	32,440	–	3,598

2013 LTIP vesting (audited)

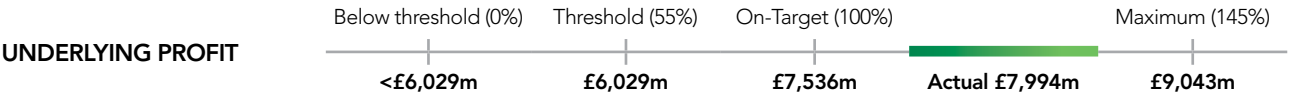
	Number of shares awarded	Vesting %	Number of shares vesting	Indicative share price at vesting	Indicative value of award at vesting	Indicative dividend equivalent	Indicative total value
António Horta-Osório	7,425,441	94.18%	6,993,280	73.72 pence	£5,155,446	£96,308	£5,251,754
George Culmer	4,017,041	94.18%	3,783.249	73.72 pence	£2,789,011	£52,100	£2,841,111
Juan Colombás	3,576,283	94.18%	3,368,143	73.72 pence	£2,482,995	£46,384	£2,529,379

Annual bonus (audited)

In line with 2014, the Group's total bonus outcome is the sum of the divisional and functional bonus outcomes. The bonus outcome for each division and function is driven by two performance indicators of equal weighting: Group underlying profit and division/function Balanced Scorecard (BSC) performance. Each performance indicator is used as a modifier to increase or decrease the target bonus outcome in the range of 0 per cent – 145 per cent, subject to an overall funding limit as outlined below.

The 2015 annual bonus outcome for the Group (excluding TSB) was determined by adjusting the Group's target bonus outcome (£415.4 million in 2015) according to:

– **Group underlying profit performance:** a target of £7,536 million was approved by the Board, with threshold and maximum set at 20 per cent above and below target. The outcome for 2015 was as follows:



This resulted in a modifier of 1.14.

– **Balanced Scorecard performance:** stretching objectives for each division were approved by the Committee around the start of the performance year. The objectives were aligned to the Group's strategy and split across five categories:
  – Customer
  – People
  – Risk
  – Building the business
  – Financial

BSC ratings are based on a scale ranging from 'Under' (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'.

For 2015, the Group adopted a new approach whereby each measure in the BSC is assigned targets aligned to the five-point rating scale. Performance against these targets has been subject to detailed review and calibration by Management and the Committee advisor (Deloitte LLP). This detailed review is intended to support the Committee in exercising judgement.

The Committee reviewed performance in depth to determine ratings for the Group and each division, including consideration of risk matters arising in 2015.

The ratings for each division and function are communicated to colleagues within the business area to ensure bonus outcomes are transparent. The ratings are considered commercially sensitive; however, as an indication of performance, the overall rating for the Group (as determined by the Committee) was Strong and the average modifier applied was 1.21.

Key performance factors considered by the Committee in arriving at the performance assessment for the Group included:

– Improvements in financial results – net interest income increased by 5 per cent to £11,482 million, underlying profit increased by 5 per cent in the year to £8,112 million and there was a 48 per cent improvement in impairments.

– The Group successfully completed the sale of TSB.

– Growth in the key customer segments – net lending to SMEs increased by 5 per cent and there has been continued development of the Group's digital capability.

– Low risk – the continued reduction in risk-weighted assets resulted in an improvement in the Group's common equity tier 1 ratio and the asset quality ratio continued to improve, demonstrating the Group's low risk position.

– Effective cost leadership – the ongoing Simplification programme has delivered £373 million of annual run-rate savings to date and is ahead of target in achieving £1 billion of savings by the end of 2017. The Group has increased investment in IT, with a focus on ensuring that systems and processes are both efficient and resilient.

Directors' remuneration report continued

– An increased ordinary dividend of 2.25 pence per share in 2015, in line with its progressive and sustainable dividend policy.
– The resilience of our capital position was demonstrated again in 2015 when we comfortably exceeded the threshold for the latest PRA stress test.
– Building the best team – employee engagement up 11 points and best bank for customers index up 6 points highlighting increased customer focus in the business.
– Delivering a consistent and relentless approach under the Group conduct strategy to ensure we deliver customer needs with an open and transparent culture.

BALANCED SCORECARD

– **Collective performance adjustment:** consideration was given to items not factored into the Group underlying profit or divisional balanced scorecards. These included the provisions for legacy conduct-related matters relevant to the year and regulatory settlements in relation to PPI handling. It also considered positive factors, such as the sale of the remaining holding in TSB (at a premium of c.£200 million). As a result of these items, the Committee approved an overall adjustment of approximately 26 per cent, resulting in a final bonus outcome of £353.7 million as shown in the table below.

Total bonus outcome

		2015 final position
On-target bonus		**£415.4m**
Group underlying profit modifier	1.14	
Divisional/functional performance modifier (weighted average of all divisions/functions)	1.21	
Modified total outcome		**£479.5m**
Collective performance adjustment (approx.)		**26%**
Total bonus outcome		**£353.7m**

To ensure fairness for the Group's shareholders, the total bonus outcome is subject to a limit of 10 per cent of pre-bonus underlying profit. For 2015, the bonus outcome of £353.7 million is significantly below the limit of £835 million.

Individual outcomes for Executive Directors

The individual bonus awards for Executive Directors are determined in the same way as for colleagues across the Group, with outcomes based on:

– Group underlying profit performance
– Balanced Scorecard performance
– Collective performance adjustment
– Individual performance
– On-target award

Awards are approved by the Committee, which has discretion to adjust outcomes for any reason.

António Horta-Osório

The Group Chief Executive's (GCE) individual performance assessment for 2015, as confirmed by the Committee, reflected a number of considerations including:

– Underlying profit increased by 5 per cent to £8,112 million, leading to an improvement in underlying return on required equity to 15 per cent.
– Improved financial strength with the pro forma common equity tier 1 (CET1) ratio at 13.0 per cent after dividend payments and improved credit rating.
– Strong performance on 2015 stress tests, comfortably exceeding the PRA capital threshold.
– Continued support for 'helping Britain prosper' plan, maintaining record of above market growth in SME lending.
– Continued growth in digital channels and service capabilities for personal customers.
– Further improvement in employee engagement survey results.
– Successful completion of the TSB sale.
– Gained shareholder support for credible and sustainable dividend policy. 2015 ordinary dividends 2.25 pence per share, with an additional special dividend of 0.5 pence per share recommended.
– Maintained conditions that allowed UKFI to effect a significant reduction in the government shareholding. The UKFI shareholding is now around 9 per cent compared to around 25 per cent before the trading plan commenced in December 2014.

Based on a full assessment of performance, the Committee agreed an individual rating for 2015 of Strong for the GCE.

Expected outcomes are based on individual performance before taking into account a modifier based on underlying profit and the Group BSC, as follows:

Rating	Under	Developing	Good	Strong	Top
Expected outcome as % of salary	0%	0%	42%	91%	140%

Following the Committee's assessment of performance against the underlying profit target and Group BSC objectives, and taking into account the collective performance adjustment of 26 per cent and the individual rating of Strong, the Committee determined a 2015 bonus award to the GCE of £849,649 (57 per cent of maximum). As disclosed previously, the mechanical bonus outcome for the GCE's bonus in 2014 was £978,882. This award was reduced to £800,000 to reflect the external environment at the time. The GCE's 2015 bonus of £849,649 is 13 per cent lower than the 2014 mechanical bonus outcome.

George Culmer

The Chief Financial Officer's (CFO) personal performance assessment for 2015, as confirmed by the Committee, reflected a number of considerations including:

– Maintaining a sound performance of the Finance Division, continuing to improve key risk metrics in liquidity, funding and capital.
– Playing a key role in the continued improvement in the Group's common equity tier 1 ratio (13 per cent compared to 12.8 per cent for 2014), whilst increasing ordinary dividend payments to 2.25 pence per share, with an additional special dividend of 0.5 pence per share.
– Cost leadership, with continued reductions in cost:income ratio to 49.3 per cent.
– Rating upgrade from a median of A to A+ following positive engagement with the Credit Risk Agencies (CRAs).
– Stress testing within appetite.
– Delivering the completion of the TSB sale.
– Well managed relationships with key risk external stakeholders, e.g. investors, regulators and CRAs.

Based on a full assessment of performance, the Committee agreed an individual rating for 2015 of Strong Plus for the CFO.

Expected outcomes are based on individual performance before taking into account a modifier based on underlying profit and the Finance division's BSC, as follows:

Rating	Under	Developing	Good	Strong	Top
Expected outcome as % of salary	0%	0%	30%	65%	100%

Following the Committee's assessment of performance against the underlying profit target and the Finance division's BSC objectives, and taking into account the collective performance adjustment of 26 per cent and the individual rating of Strong Plus, the Committee determined a 2015 bonus award to the CFO of £461,846 (63 per cent of maximum).

Juan Colombás

The Chief Risk Officer's (CRO) personal performance assessment for 2015, as confirmed by the Committee, reflected a number of considerations including:

– Significant progress in the Group's Risk Management, delivering important steps forward in the governance of the business.
– Prudent lending criteria, leading to improved credit quality across all portfolios.
– Effective risk management leading to a reduction in the impairment charge to £568 million.
– Further improved RWA/Capital management and further reductions in the run-off portfolio.
– Continued good progress in conduct strategy.
– Continued strengthening and enhancement of the Group's policy, standards and control framework.

Based on a full assessment of performance, the Committee agreed an individual rating for 2015 of Strong Plus for the CRO.

Expected outcomes are based on individual performance, before taking into account a modifier based on underlying profit and the Risk division's BSC, as follows:

Rating	Under	Developing	Good	Strong	Top
Expected outcome as % of salary	0%	0%	30%	65%	100%

Following the Committee's assessment of performance against the underlying profit target and the Risk division's BSC objectives, and taking into account the collective performance adjustment of 26 per cent and the individual rating of Strong Plus, the Committee determined a 2015 bonus award to the CRO of £455,431 (63 per cent of maximum).

Deferral

Consistent with the aim of ensuring that short-term financial results are only rewarded if they promote sustainable growth, the 2015 bonus awards for all Executive Directors are deferred into shares until at least March 2018 and subject to malus, clawback and a further holding period following vesting. They are also subject to remaining in the Group's employment.

The Group Chief Executive's 2015 bonus award is subject to an additional condition that the share price must remain above 75.5 pence on average for any 126 consecutive trading days in the five years following grant or the UK government sells 100 per cent of its shareholding during the three years following grant. 50 per cent of the award will vest and be released, at the earliest, on the second anniversary of the award if either of the conditions has been met by that date, with the remaining 50 per cent vesting no less than six months later. If neither of the conditions has been met by the fifth anniversary of the award, the award will lapse entirely.

The Group has implemented clawback, covering all material risk takers, in line with PRA requirements. Vested variable remuneration can be recovered from employees for a period of up to seven years after the date of award in the case of a material or severe risk event. The Committee reserves the right to exercise its discretion in reducing any payment that otherwise would have been earned, if it deems appropriate.

Directors' remuneration report continued

Long-term awards made in March 2013 vesting for the period ended on 31 December 2015 (audited)

The Group has performed strongly over the performance period of the 2013 Long Term Incentive Plan (LTIP) awards, continuing to transform the business for the benefit of its shareholders. During the performance period of the plan (from 1 January 2013 to 31 December 2015), the Group's share price increased by 47 per cent from 49.69 pence to 73.07 pence.

At the end of the performance period, it has been assessed that awards will vest at 94.18 per cent of maximum.

	Threshold	Maximum	Vesting at threshold	Vesting at maximum	Actual performance	Vesting % of maximum
Economic profit 35% of award	£1,254m	£1,881m	25%	100%	**£2,233m**	**35%**
Absolute total shareholder return 30% of award	8% per annum	16% per annum	25%	100%	**16.6%**	**30%**
Customer satisfaction (FCA reportable complaints per 1,000 accounts over 3 years)[1] 10% of award	1.05	0.95	25%	100%	**1.02**	**4.18%**
Total costs 10% of award	<=£9,323m	<=£8,973m	25%	100%	**£8,691m**	**10%**
Non-core assets at end of 2015 (excluding UK Retail) 10% of award	£37.2bn	£28.4bn	25%	100%	**£10.3bn**	**10%**
SME lending 5% of award	at market	4%	25%	100%	**8.1%**	**5%**

1 Excluding CMC-led complaints and PPI complaints.

Percentage change in remuneration of the Group Chief Executive versus the wider employee population

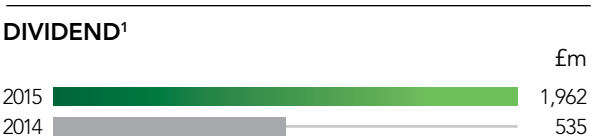
Figures for 'All Employees' are calculated using figures for UK-based colleagues subject to the Group Annual Bonus Plan. This population is considered to be the most appropriate group of employees for these purposes because its remuneration structure is consistent with that of the GCE. For 2015, 46,474 colleagues were included in this category.

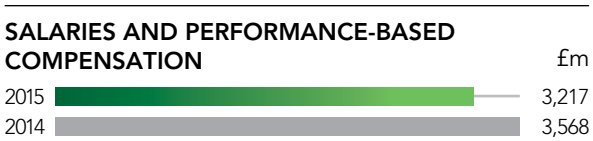
	% change in base salary (2014 – 2015)	% change in bonus (2014 – 2015)	% change in benefits (2014 – 2015)
GCE	6%	6%	18%
All employees	2%[1]	(14.1)%[1]	2%[1]

1 Adjusted for movements in staff numbers and other impacts to ensure a like-for-like comparison.

Relative spend on pay (£m)

The graph below illustrates the relative importance of spend on pay (total remuneration of all Group employees) compared with distributions to shareholders. Distributions to shareholders are ordinary and special dividends.





1 2015: Ordinary and special dividend in respect of the financial year ended 31 December 2015, partly paid in 2015 and partly to be paid in 2016. 2014: ordinary dividend in respect of the financial year ended 31 December 2014, paid in 2015.

Payments within the reporting year to past directors (audited)

As part of arrangements on leaving the Group, a deferred bonus was released to Tim Tookey (£68,713).

Loss of office payments (audited)

There were no payments for the loss of office made to former Directors during 2015.

External appointments held by the Executive Directors

António Horta-Osório – During the year ended 31 December 2015, the Group Chief Executive served as a Non-Executive Director of Exor, Fundação Champalimaud, Stichting INPAR and Sociedade Francisco Manuel dos Santos for which he received fees of £216,054 in total.

Chairman and Non-Executive Directors (audited)

	Fees £000		Taxable benefits £000		Total £000	
	2015	2014	2015	2014	2015	2014
Current Non-Executive Directors						
Lord Blackwell	700	580[1]	12[2]	9[2]	712	589
Alan Dickinson	144	33[3]	–	–	144	33
Anita Frew	236	202[3]	–	–	236	202
Simon Henry	105	53[3]	–	–	105	53
Dyfrig John	105	105	–	–	105	105
Nick Luff	135	135	–	–	135	135
Deborah McWhinney	9	–	–	–	9	–
Nick Prettejohn	350	182[3]	–	–	350	182
Anthony Watson	209	215	–	–	209	215
Sara Weller	135	123	–	–	135	123
Former Non-Executive Directors						
Sir Winfried Bischoff (retired April 2014)	–	183	–	10[4]	–	193
Carolyn Fairbairn (retired October 2015)	88	105	–	–	88	105
David Roberts (retired May 2014)	–	95	–	–	–	95
Total	2,216	2,011	12	19	2,228	2,030

1 Fees reflect the period of service prior to becoming Chairman of the Board.

2 Car allowance (£8,909 and £12,000).

3 Fees reflect the period in role on a pro-rata basis.

4 2014 taxable benefits are made up of car allowance of £3,136, private medical benefit of £608, and transportation of £6,693.

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	2015 Total
Alan Dickinson	65			20	9	50			144
Carolyn Fairbairn	54			17	17				88
Anita Frew	65	100		20	27	20		4[2]	236
Simon Henry	65			20		20			105
Dyfrig John	65			20	20				105
Nick Luff	65			50		20			135
Deborah McWhinney	5			2		2			9
Nick Prettejohn	65			20		20	245		350
Anthony Watson	65		60	20	43	20		1[2]	209
Sara Weller	65				20	20		30[2]	135

1 Scottish Widows Group Ltd.

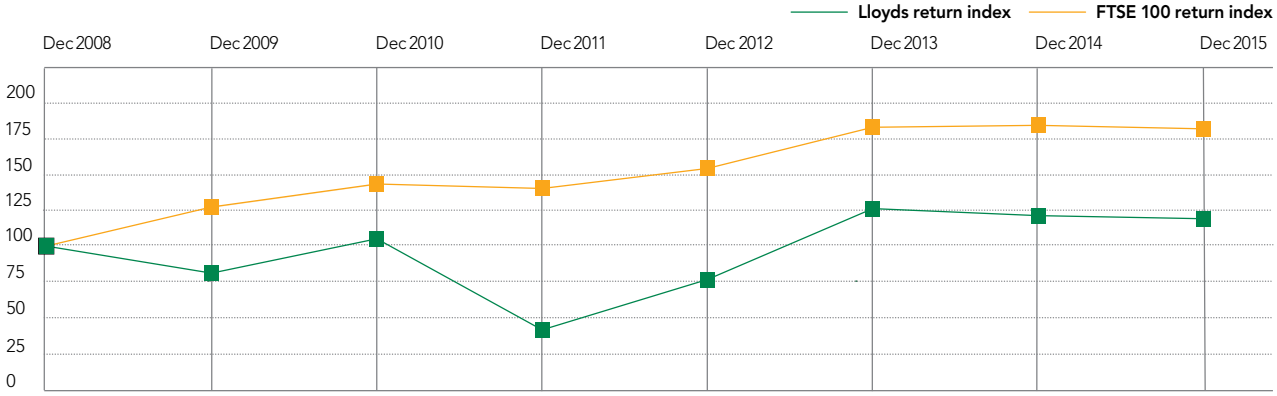
2 Fees for membership of Nomination Committee.

Directors' remuneration report continued

Historical total shareholder return (TSR) performance

The chart below shows the historical TSR of Lloyds Banking Group plc compared with the FTSE 100 as required by the regulations, rebased as at 31 December 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



Rebased to 100 on 31 December 2008.
Source: Deloitte

Historical Group Chief Executive (GCE) remuneration outcomes

	GCE	2009	2010	2011	2012	2013	2014	2015
GCE single figure of remuneration £000	J E Daniels	1,121	2,572	855	–	–	–	–
	António Horta-Osório	–	–	1,765	3,398	7,475	11,540	8,773
Annual bonus payout (% of maximum opportunity)	J E Daniels	Waived	62%	0%	–	–	–	–
	António Horta-Osório	–	–	Waived	62%	71%	54%	57%
Long-term incentive vesting (% of maximum opportunity)	J E Daniels	0%	0%	0%	–	–	–	–
	António Horta-Osório	–	–	0%	0%	54%	97%	94.18%

Notes: J E Daniels served as GCE until 28 February 2011; António Horta-Osório was appointed GCE from 1 March 2011. J E Daniels declined to take a bonus in 2009 and António Horta-Osório declined to take a bonus in 2011.

Outstanding share awards
Directors' interests (audited)

Shareholding guidelines

Executive Directors were required to build up a holding in Lloyds Banking Group plc shares of value equal to 150 per cent of base salary (200 per cent for the GCE) within three years from the later of 1 January 2012 or their date of joining the Board. With the introduction of the fixed share award in 2014, the gross annual value of this award was added to salary to determine the personal shareholding requirement. For the purposes of assessing the additional shareholding requirement, Executive Directors have up to three years from 1 January 2014 to build up the additional shareholding created by the addition of the fixed share award. As at 31 December 2015, all Executive Directors significantly exceeded the requirements.

Executive Directors are required to retain any shares vesting from 2013 LTIP awards onwards for a further two years post vesting (although vested shares would count towards the shareholding requirement).

	Number of shares			Number of options		Total shareholding[4]		Value
	Owned outright	Unvested subject to continued employment	Unvested subject to performance	Unvested subject to continued employment	Vested unexercised	Totals at 31 December 2015	Totals at 24 February 2016	Expected value at 31 December 2015 (£000s)[2]
Executive Directors								
António Horta-Osório[1]	11,761,072	5,759,844	16,644,524	37,151	–	34,202,591	34,203,204[3]	18,911
George Culmer	7,090,093	1,735,766	9,004,413	37,151	–	17,867,423	17,867,957[3]	9,766
Juan Colombás	3,145,458	1,801,742	8,253,825	29,990	535,231	13,766,246	13,766,780[3]	7,043
Non-Executive Directors								
Lord Blackwell	50,000	–	–	–	–	50,000	n/a	n/a
Alan Dickinson	100,000	–	–	–	–	100,000	n/a	n/a
Anita Frew	300,000	–	–	–	–	300,000	n/a	n/a
Simon Henry	100,000	–	–	–	–	100,000	n/a	n/a
Dyfrig John	27,385	–	–	–	–	27,385	n/a	n/a
Nick Luff	300,000	–	–	–	–	300,000	n/a	n/a
Deborah McWhinney[1]	200,000	–	–	–	–	200,000	n/a	n/a
Nick Prettejohn	–	–	–	–	–	–	n/a	n/a
Stuart Sinclair	–	–	–	–	–	–	n/a	n/a
Anthony Watson	476,357	–	–	–	–	476,357	n/a	n/a
Sara Weller	200,000	–	–	–	–	200,000	n/a	n/a

1 Shareholdings held by António Horta-Osório and Deborah McWhinney are either wholly or partially in the form of ADRs.

2 Awards subject to performance under the LTIP had an expected value of 50 per cent of face value at grant (using current accounting assumptions). Values are based on the 31 December 2015 closing price of 73.07 pence. Full face value of awards are £24,991,833 for António Horta-Osório, £13,055,725 for George Culmer and £10,058,995 for Juan Colombás.

3 The changes in beneficial interests for António Horta-Osório (613 shares), George Culmer (534 shares) and Juan Colombás (534 shares) relate to 'partnership' and 'matching' shares acquired under the Lloyds Banking Group Share Incentive Plan between 31 December 2015 and 24 February 2016. There have been no other changes up to 24 February 2016.

4 Including holdings of connected persons.

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 102.

As a result of the above shareholdings, the position for each Executive Director is as follows:

		Shareholding requirement		Current shareholding		
Executive Directors	Base salary plus fixed share award (£000s)	% of base salary plus fixed share award	Number of shares[1]	% of base salary plus fixed share award[1]	Number of shares as at 31/12/15[2]	Requirement met
António Horta-Osório	1,961	200%	5,155,439	456%	11,759,547	Yes
George Culmer	1,238	150%	2,441,801	435%	7,088,568	Yes
Juan Colombás	1,221	150%	2,407,887	214%	3,428,561	Yes

1 Number of shares required and current shareholding percentage of base salary plus fixed share award figures are calculated using the average share price for the period 1 April 2014 to 31 March 2015 (76.075 pence).

2 Includes shares owned outright reduced by forfeitable 'matching' shares under the Share Incentive Plan, plus the estimated net number of vested unexercised options.

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.

Directors' remuneration report continued

Breakdown of shares interests (audited)

Long-term incentive plan awarded in 2015

Awards (in the form of conditional rights to free shares) in 2015 were made over shares with a value of 300 per cent of reference salary for the GCE (4,579,006 shares with a face value of £3,660,000); 275 per cent for the CFO (2,477,167 shares with a face value of £1,980,000); and 275 per cent for the CRO (2,442,762 shares with a face value of £1,952,500). The share price used to calculate face value is the average price over the five days prior to grant (6 March to 11 March 2015), which was 79.93 pence. This was the average share price used to determine the number of shares awarded.

The performance conditions attached to these awards are set out in the table below. The performance period ends on 31 December 2017.

Category	Measure	Basis of payout range	Metric	Weighting
Delivering sustainable growth	Absolute TSR	Growth in share price including dividends over 3-year period	Threshold: 8% pa Maximum: 16% pa	30%
Becoming simpler and more efficient	Economic profit	Set relative to 2017 targets	Threshold: £2,870m Maximum: £3,587m	25%
	Cost:income ratio	Set relative to 2017 targets	Threshold: 45.6% Maximum: 44.5%	10%
Creating the best customer experience	Customer complaint handling (total FCA reportable complaints per 1,000 accounts)[1] and Financial Ombudsman Service (FOS) uphold rate	Average performance over 3-year period	Threshold: 1.15 complaints per 1,000 accounts and 32% FOS uphold rate Maximum: 1.05 complaints per 1,000 accounts and 28% FOS uphold rate	10%
	Net promoter score	Major Group average ranking over 2017	Threshold: 3rd Maximum: 1st	10%
	Digital active customer base	Set relative to 2017 targets	Threshold: 12.7m active users Maximum: 13.3m active users	7.5%
	Colleague engagement score	Set relative to 2017 targets	Threshold: 62% Maximum: 70%	7.5%

1 Measure excludes PPI complaints and any complaints received via Claims Management Companies (CMC), but includes Banking, Home Finance, General Insurance, Life, Pensions and Investment complaints. The Group's performance is heavily influenced by CMC volumes which are automatically reportable if defended. However, only 2 per cent of complaints received via CMCs are currently upheld by the Financial Ombudsman Service (FOS). Accordingly, the Committee has determined that complaints received via CMCs should be excluded from this measure.

The targets referred to in the table relate to the Group's strategic plan, as approved by the Board. Further details have not been provided for reasons of commercial sensitivity, but will be disclosed after vesting.

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.

Deferred bonus awarded in 2015

Bonus is deferred into shares. The face value of the share awards in respect of bonuses granted in March 2015 was £800,000 (1,000,875 shares) for the GCE; £496,000 (620,542 shares) for the CFO; and £467,892 (585,376 shares) for the CRO. The share price used to calculate the face value is the average price over the five days prior to grant (6 March to 11 March 2015), which was 79.93 pence.

Interests in share options (audited)

	At 1 January 2015	Granted during the year	Exercised during the year	Lapsed during the year	At 31 December 2015	Exercise price	Exercise periods From	Exercise periods To	Notes
António Horta-Osório	22,156	–	–	–	22,156	40.62p	1/6/2016	30/11/2016	1
	14,995		–	–	14,995	60.02p	1/1/2018	30/6/2018	1
George Culmer	2,216,187	–	2,216,187	–	–	–			2,3
	2,243,816	–	2,243,816	–	–	–			2,3
	22,156	–	–	–	22,156	40.62p	1/6/2016	30/11/2016	1
	14,995	–	–	–	14,995	60.02p	1/1/2018	30/6/2018	1
Juan Colombás	235,499	–	–	–	235,499	–	15/6/2011	30/3/2021	4
	299,732	–	–	–	299,732	–	15/6/2012	30/3/2021	4
	29,990	–	–	–	29,990	60.02p	1/1/2018	30/6/2018	1
Former Directors who served during 2015									
None									

1 Sharesave.

2 Executive share award granted on 6 August 2012 for the loss of deferred share awards forfeited on leaving RSA Insurance Group plc.

3 Options exercised on 31 March 2015. The closing market price of the Group's ordinary shares on that date was 78.28 pence.

4 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.

The aggregate amount of gains made by Directors on the exercise of share options was £3,491,290.

None of the other Directors at 31 December 2015 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 2015 and 31 December 2015 was 75.82 pence and 73.07 pence, respectively. The range of prices between 1 January 2015 and 31 December 2015 was 68.68 pence to 89.00 pence.

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 100 and 105.

	At 1 January 2015	Awarded during the year	Vested during the year	Lapsed during the year	At 31 December 2015	End of performance period	Expected value (£000s)	Notes
António Horta-Osório	9,644,684	–	9,316,764	327,920	–	31/12/2014	–	1
	7,425,441	–	–	–	7,425,441	31/12/2015	5,426	
	4,640,077		–	–	4,640,077	31/12/2016	3,391	
		4,579,006	–	–	4,579,006	31/12/2017	3,346	2
George Culmer	4,657,045	–	4,498,705	158,340	–	31/12/2014	–	1
	4,017,041	–	–	–	4,017,041	31/12/2015	2,935	
	2,510,205	-	–	–	2,510,205	31/12/2016	1,834	
		2,477,167			2,477,167	31/12/2017	1,810	2
Juan Colombás	4,146,064	–	4,005,097	140,967	–	31/12/2014	–	1
	3,576,283	–	–	–	3,576,283	31/12/2015	2,613	
	2,234,780	–	–		2,234,780	31/12/2016	1,633	
		2,442,762	–	–	2,442,762	31/12/2017	1,785	2

1 The shares awarded in March 2012 vested on 12 March 2015. The closing market price of the Group's ordinary shares on that date was 79.2 pence.

2 Award price 79.93 pence.

Values are based on the 31 December 2015 closing price of 73.07 pence.

Directors' remuneration report continued

Directors' interests – summary of awards vested, purchases and sales made by directors in 2015 (unaudited)

	Holding at 1 January 2015 (or appointment date)	Transactions during the year	Number of shares	Notes	Holding at 31 December 2015
Executive Directors					
António Horta-Osório	6,204,884	12/03/15	4,937,883	Release of 2012 LTIP	
		27/03/15	149,642	Fixed Share Award	
		19/05/15	56	Dividend reinvestment	
		25/06/15	136,880	Fixed Share Award	
		29/09/15	162,262	Fixed Share Award	
		21/12/15	166,993	Fixed Share Award	
		Monthly	2,472	Share Incentive Plan purchase and matching shares	**11,761,072**
George Culmer	1,232,436	12/03/15	2,384,313	Release of 2012 LTIP	
		27/03/15	83,799	Fixed Share Award	
		31/03/15	2,358,546	Exercise of Share Buy out Award	
		19/05/15	11,151	Dividend reinvestment	
		25/06/15	76,652	Fixed Share Award	
		25/06/15	357,526	Release of 2012 Deferred Bonus	
		02/09/15	357,526	Release of 2012 Deferred Bonus	
		28/09/15	41,358	Dividend reinvestment	
		29/09/15	90,867	Fixed Share Award	
		21/12/15	93,516	Fixed Share Award	
		Monthly	2,403	Share Incentive Plan purchase and matching shares	**7,090,093**
Juan Colombás	3,101,794	12/03/15	2,122,701	Release of 2012 LTIP	
		12/03/15	118,078	Release of 2011 Deferred Bonus	
		27/03/15	82,635	Fixed Share Award	
		20/05/15	3,647	Dividend reinvestment	
		12/06/15	(2,750,000)	Sale	
		25/06/15	75,588	Fixed Share Award	
		25/06/15	44,355	Release of 2012 Deferred Bonus	
		02/09/15	162,436	Release of 2011 and 2012 Deferred Bonus	
		29/09/15	89,604	Fixed Share Award	
		21/12/15	92,217	Fixed Share Award	
		Monthly	2,403	Share Incentive Plan purchase and matching shares	**3,145,458**
Non-Executive Directors					
Lord Blackwell	50,000				**50,000**
Alan Dickinson	50,000	30/10/2015	50,000	Purchase	**100,000**
Anita Frew	300,000				**300,000**
Simon Henry	–	30/06/2015	100,000	Purchase	**100,000**
Dyfrig John	27,385				**27,385**
Nick Luff	200,000	20/03/2015	100,000	Purchase	**300,000**
Deborah McWhinney[1]	200,000				**200,000**
Nick Prettejohn	–				**–**
Anthony Watson	476,357				**476,357**
Sara Weller	200,000				**200,000**

1 Held in 50,000 ADRs with one ADR being equivalent to four ordinary shares.

Implementation of the policy in 2016

It is proposed to operate the policy in the following way in 2016:

Base salary	In line with the policy, 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. The Group has applied a 2 per cent overall salary budget increase for the general population differentiated by performance and market position (with increases of around 5 per cent for strongly performing colleagues). Salary increases of 2 per cent are proposed for the Chief Financial Officer (CFO) and the Chief Risk Officer (CRO). When the Group Chief Executive Officer (GCE), António Horta-Osório, was appointed to the Board at the start of 2011 it was agreed that, reflecting the weak financial position of the Group at that time, his salary would initially be held at £1,061,000, a level below the prevailing market rate. To recognise this fact, the agreement with the GCE also contained a market related 'reference salary' of £1.22 million, to be used in setting long term remuneration such as pension and LTIP. Since 2011 the Group has achieved a successful transformation of its financial strength under his leadership and the government has reduced its shareholding from over 40 per cent to around 9 per cent. Until now, however, the GCE has received no increase in his base salary since joining the Board in January 2011, despite overall pay settlements in the Group, including the proposed 2 per cent for 2016, amounting to 13.8 per cent since 2011. For the first time since 2011, a base salary increase is proposed for the GCE. The GCE was hired on the basis that upon the Government shareholding falling in the range of 15-20 per cent or less, the Committee would consider his remuneration being increased in line with market conditions. With the Government's shareholding now being around 9 per cent and given the recovery of the Group's financial strength, the Committee has decided it should now begin to adjust the GCE's salary towards the reference salary. After discussion with shareholders, the Committee has decided to stage this adjustment over two years. For 2016, this will consist of an increase in base salary of 2 per cent, in line with the other Executive Directors, and an additional increase of 4 per cent to reflect the arrangements above, taking his total salary to £1,125,000. The GCE has suggested, and the Board has approved, that for 2016 the 4 per cent increase be delivered in shares and held until the Government has sold its shareholding in the Group. After this increase, the GCE's salary remains conservative compared to peers. Salaries will therefore be as follows, effective dates shown below: GCE: £1,125,000 (1 January 2016) CFO: £749,088 (1 April 2016) CRO: £738,684 (1 January 2016) There is no change to the GCE's reference salary of £1.22 million which is used to calculate certain elements of long-term remuneration and the pension allowance.
Fixed share award	Fixed share awards were introduced in 2014 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 2016 are as follows: GCE: £900,000 CFO: £504,000 CRO: £497,000 Shares will be released in equal tranches over a five year period.
Pension	In line with the remuneration policy, Executive Directors are entitled to a pension allowance which they may choose to take as cash in lieu of pension contributions. The level of allowances has not been increased for 2016. GCE: 50 per cent of reference salary less flexible benefits 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 Employer-Financed Retirement Benefits Scheme (EFRBS), subject to performance conditions, as described further in the annual report on remuneration.
Benefits	For 2016, the benefits provided to Executive Directors include a car allowance, transportation, private medical insurance, life assurance and other benefits selected through the flexible benefits allowance which is capped at 4 per cent of base salary.
All employee plans	Executive Directors are eligible to participate in the Group's Sharesave and Sharematch plans on the same basis as other employees.

Directors' remuneration report continued

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/or the individual is rated 'Developing performer' or below. The expected value of the bonus is 30 per cent of the maximum opportunity.
Deferral	For the 2016 performance year, the annual bonus will be awarded in a combination of cash (up to 50 per cent) and shares. 40 per cent of the annual bonus will be released immediately on award, 40 per cent will be released on the first anniversary of award and the remaining 20 per cent will be released on the second anniversary of award. These deferral arangements will apply to the GCE and the other Executive Directors.
Performance measures and targets	For 2016 the annual bonus will be based on: – Underlying profit – 50 per cent – Balanced scorecard (BSC) objectives comprising five categories (customer, people, control environment, building the business, finance) – 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 annual report on remuneration. The Committee applies its judgement to determine the payout level commensurate with business and/or individual performance in determining the final BSC rating. Performance adjustment is determined by the Remuneration Committee and Board Risk Committee and may result in a reduction of up to 100 per cent of the bonus opportunity. The Independent Performance Adjustment Committee (IPAC) reviews the BSC outcomes and submits a report to the Remuneration Committee and Board Risk Committee to assist in this process. The application of malus will generally be considered when: – there is reasonable evidence of employee misbehaviour, misconduct or material error or that they participated in conduct which resulted in losses for the Group or failed to meet appropriate standards of fitness and propriety; – there is material failure of risk management at a Group, business area, division and/or business unit level; – the financial results at a Group, division or business unit level are re-stated or consideration is given to restatement; – the Committee determines that the financial results for a given year do not support the level of variable remuneration awarded; and/or – any other circumstances where the Committee consider adjustments should be made. Individual performance adjustment is informed using a matrix-based approach taking into account the severity of the issue, the individual's proximity to the issue and the individual's behaviour in relation to the issue. In addition, the annual bonus may be subject to clawback for a period of up to seven years after the date of award. This period may be extended to ten years where there is an ongoing internal or regulatory investigation. The application of clawback will generally be considered when: – there is reasonable evidence of employee misbehaviour or material error; or – there is material failure of risk management at a Group, business area, division and/or business unit level.

Long-term incentive plan

Opportunity

The maximum annual long-term incentive award for Executive Directors is 300 per cent of salary. Awards in 2016 are being made as follows:

GCE: 300 per cent of reference salary

CFO: 275 per cent of base salary

CRO: 275 per cent of base salary

Performance measures and targets

2016 awards will be subject to a three-year performance period, and a two-year holding period following vesting.

During 2015 and early 2016, the Committee consulted widely with various shareholders on appropriate performance measures and, in particular, on how management can be incentivised through the LTIP to successfully deliver the objectives set out in the Group Strategic Review.

The awards made in 2016 will vest based on the Group's performance against the following key measures:

– Absolute Total Shareholder Return (30 per cent)

– Economic profit (25 per cent)

– Cost:income ratio (10 per cent)

– Strategic measures (35 per cent)

The following table provides a breakdown of these measures and the targets applicable.

The Committee believes these measures capture risk management and profit growth and appropriately align management and shareholder interests.

LTIP awards may be subject to clawback for a period of up to seven years after the date of award. This period may be extended to 10 years where there is an ongoing internal or regulatory investigation.

The Committee may consider the application of malus and clawback as outlined in the annual bonus section above.

Strategic focus	Measure	Basis of payout range	Metric	Weighting
Delivering sustainable growth	Absolute Total Shareholder Return (TSR)	Growth in share price including dividends over 3-year period	Threshold: 8% Maximum: 16%	30%
Becoming simpler and more efficient	Economic profit[1]	Set relative to 2018 targets	Threshold: £2,507m Maximum: £3,308m	25%
	Cost:income ratio	Set relative to 2018 targets	Threshold: 47.3% Maximum: 46.1%	10%
Creating the best customer experience	Total reportable complaints[2,3] and	Set relative to 2018 targets	See note 2 below	10%
	Financial Ombudsman Service (FOS) uphold rate[3]		=<35% =<25%	
	Net promoter score	Major Group average ranking over 2018	Threshold: 3rd Maximum: 1st	10%
	Digital active customer base	Set relative to 2018 targets	Threshold: 13.4m Maximum: 14m	7.5%
	Colleague engagement score	Set relative to 2018 targets	Threshold: 66% Maximum: 72%	7.5%

1 The reduction in economic profit compared to the 2015 LTIP (for 2017 performance) reflects the introduction of the corporation tax surcharge for banks of 8 per cent.

2 Measure excludes PPI complaints and any complaints received via Claims Management Companies, but includes Banking, Home Finance, General Insurance, Life, Pensions and Investment complaints. The FCA has issued guidance which applies from 2016. The threshold and maximum for total reportable complaints are subject to validation, based on experience in H1 2016 and will be disclosed to shareholders later in the year.

3 The Board will continue to review its risk appetite and to the extent that this results in changes to the acceptable level of uphold, consideration will be given to bringing the metric in line with revised appetite. The metric will be no easier to achieve.

Directors' remuneration report continued

Chairman and Non-Executive Director fees in 2016

The annual fee for the Chairman was increased by 2 per cent to £714,000, in line with the overall salary budget for the general colleague population.

The annual Non-Executive Director fees were reviewed in November 2015. As a result of this review and following consultation with shareholders, for the first time since 2008, the fees were increased, as follows, to reflect market practice in financial services groups of a similar size. These changes took effect from 1 January 2016.

	2016	2015
Basic fee	£75,000	£65,000
Deputy Chairman	£100,000	£100,000
Senior Independent Director	£60,000	£60,000
Audit Committee Chairmanship	£60,000	£50,000
Remuneration Committee Chairmanship	£60,000	£50,000
Board Risk Committee Chairmanship	£60,000	£50,000
Responsible Business Committee Chairmanship	£30,000	£30,000
Audit Committee membership	£30,000	£20,000
Remuneration Committee membership	£30,000	£20,000
Board Risk Committee membership	£30,000	£20,000
Responsible Business Committee members[1]	£10,000	N/A
Nomination & Governance Committee membership[2]	£5,000	£5,000

1 New members only.
2 Where individual is not already Chairman of another Committee.

Non-Executive Directors may receive more than one of the above fees.

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.

Additional disclosures

Emoluments of the eight highest paid senior executives[1]

The following table sets out the emoluments of the eight highest paid senior executives (excluding Executive Directors) in respect of the 2015 performance year.

	Executive							
	8 £000	7 £000	6 £000	5 £000	4 £000	3 £000	2 £000	1 £000
Fixed								
Cash based	585	406	330	420	580	508	711	682
Share based	410	280	740	650	406	350	490	467
Total fixed	995	686	1,070	1,070	986	858	1,201	1,149
Variable								
Upfront cash	2	2	2	2	2	2	2	2
Deferred cash	0	0	0	0	0	0	0	0
Upfront shares	135	67	298	238	90	177	137	238
Deferred shares	205	46	450	360	61	269	209	360
Long-term incentive plan	951	1,578	861	1,076	2,071	1,973	2,763	2,588
Total variable pay	1,293	1,693	1,611	1,676	2,224	2,421	3,111	3,188
Pension cost	146	101	66	84	145	127	178	169
Total remuneration	**2,434**	**2,480**	**2,747**	**2,830**	**3,355**	**3,406**	**4,490**	**4,506**

1 Includes members of the Group Executive Committee and Senior Executive level colleagues.

Variable remuneration in respect of performance year 2015. LTIP values shown reflect awards for which the performance period ended on 31 December 2015 and include dividend equivalents. Pension costs based on a percentage of salary according to level.

On behalf of the Board

Anita Frew
Chairman, Remuneration Committee

Directors' report

Corporate governance statement

The corporate governance report found on pages 56 to 81 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).

Profit and dividends

The consolidated income statement shows a statutory profit before tax for the year ended 31 December 2015 of £1,644 million (2014: £1,762 million).

The directors have recommended a final dividend, which is subject to approval by the shareholders at the Annual General Meeting, of 1.5 pence per share (2014: 0.75 pence per share) totalling £1,070 million (2014: £535 million). The directors have also recommended a special dividend of 0.5 pence per share (2014: nil) totalling £357 million (2014: £nil). The final and special dividend will be paid on 17 May 2016.

The dividend in respect of 2014 of 0.75 pence per ordinary share was paid to shareholders on 19 May 2015 and an interim dividend for 2015 of 0.75 pence per ordinary share was paid on 28 September 2015; these dividends totalled £1,070 million. Further information on dividend is shown in note 46 on page 241 and is incorporated by reference.

Appointment and retirement of Directors

The appointment and retirement 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.

Deborah McWhinney and Stuart Sinclair have been appointed to the Board since the 2015 AGM and will therefore stand for election at the forthcoming AGM. 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 wishing to serve again, will submit themselves for re-election at the forthcoming AGM. Dyfrig John, an independent Non-Executive Director, has notified the Board that he does not intend to seek re-election at the 2016 AGM.

Board composition changes

Changes to the composition of the Board since 1 January 2015 up to the date of this report are shown in the table below:

	Joined the Board	Retired from the Board
Carolyn Fairbairn		31 October 2015
Deborah McWhinney	1 December 2015	
Stuart Sinclair	4 January 2016	

Directors' indemnities

The Directors of the Company, including the former Director who retired during the year 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 Director appointed in 2015. In addition, the Group had appropriate Directors and Officers liability insurance cover in place throughout 2015. Revisions are being made to the existing Deeds of Indemnity to take account of the Senior Managers and Certification Regime. Deeds for existing Directors are available for inspection at the Company's registered office.

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.

Information incorporated by reference

The following additional information forms part of the Directors' Report, and is incorporated by reference.

	Content	Pages
Group results	Summary of Group results	35 to 41
Ordinary dividends	Ordinary dividends – note to the accounts	241
Directors' biographies	Directors and their biographical details	56 to 57
Directors in 2015	Directors who served in 2015	56 to 57
Directors' emoluments	Directors' emoluments and share interests	82 to 106
Internal control and financial risk management	Internal control and financial risk management systems in relation to financial reporting	168
	Financial risk management objectives and policies in relation to the use of financial instruments	112 to 169 and 249 to 261
Information included in the strategic report	Future developments	2 to 33
	Greenhouse gas emissions (additional information)	27
	Inclusion and diversity	26
	Engaging colleagues (additional information)	22
Disclosures required under Listing Rule 9.8.4R	Significant contracts	244 to 246
	Dividend waivers	241
Principal risks and uncertainties	Funding and liquidity	32 and 153 to 159
	Capital position	160 to 165
Share capital and control	Share capital and restrictions on the transfer of shares or voting rights – note to the accounts	237 to 238
	Special rights with regard to the control of the Company – note to the accounts	237 to 238
Post balance sheet events	Events since the balance sheet date - note to the accounts	279

Directors' report continued

Power of Directors in relation to shares

The Board manages the business of the Company under the powers set out in the articles of association, these powers include the Directors' ability to issue or buy back shares. The Directors were granted authorities to issue and allot shares and to buy back shares at the 2015 AGM. Shareholders will be asked to renew these authorities at the 2016 AGM.

The Company did not repurchase any of its shares during the year (2014: 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 2015, the Company had been notified by its substantial shareholders under Rule 5 of the DTR of the following interests in the Company's shares:

	Interest in shares	% of issued share capital with rights to vote in all circumstances at general meetings[1]
The Solicitor for the Affairs of Her Majesty's Treasury	7,057,718,792[2]	9.89%
BlackRock, Inc.	3,668,756,765[3]	5.14%

[1] Percentage provided was correct at the date of notification.
[2] A direct holding.
[3] The most recent notification provided by BlackRock, Inc. under Rule 5 of the DTR identifies (i) an indirect holding of 3,599,451,380 shares in the Company representing 5.04 per cent of the voting rights in the Company, and (ii) a holding of 69,305,385 in other financial instruments in respect of the Company representing 0.09 per cent of the voting rights of the Company. BlackRock, Inc.'s holding most recently notified to the Company under Rule 5 of the DTR varies from the holding disclosed in BlackRock, Inc.'s Schedule 13-G filing with the US Securities and Exchange Commission dated 9 February 2016, which identifies beneficial ownership of 4,847,496,882 shares in the Company representing 6.8 per cent of the issued share capital in the Company. This variance is attributable to different notification and disclosure requirements between these regulatory regimes.

No further notifications have been received under Rule 5 of the DTR as at the date of this report.

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 Foundations (the Foundations) which hold limited voting shares in the Company (the limited voting shares are further described in note 41 on pages 237 to 238). 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.

Branches

The Group provides a wide range of banking and financial services through branches and offices in the UK and overseas.

Research and development activities

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

Post balance sheet events

Other than as stated in note 56 (which is incorporated into this report by reference), there have been no other 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 32 and pages 153 to 159 and capital position on pages 160 to 165 and additionally have considered projections for the Group's capital and funding position. Accordingly, the Directors conclude that it is appropriate to continue to adopt the going concern basis in preparing the accounts over the next 12 months.

Viability statement

The Directors have an obligation under the UK Corporate Governance Code to state whether they believe the Company and the Group will be able to continue in operation and meet their liabilities as they fall due over a specified period determined by the Directors, taking account of the current financial position and the principal risks of the Company and the Group.

In making this assessment, the Directors have considered a wide range of information, including the principal and emerging risks which could impact the performance of the Group, and the Group's operating plan which comprises detailed customer, financial, capital and funding projections together with an assessment of relevant risk factors. In 2015, particular focus was given to the implications arising from the continuing interest rate environment, the impact of regulatory change requirements on investment plans, developing regulatory requirements and changes to tax legislation.

Group, divisional and business unit operating plans are produced and subject to regulatory and internal stress testing scenarios on an annual basis. The planning process takes account of the Group's business objectives, the risks taken to seek to meet those objectives and the controls in place to mitigate those risks to remain within the Group's overall risk appetite.

The Group's planning process comprises the following key stages:

- Each year, the Board revises the strategy, risk appetite and objectives of the Group in the context of the operating environment and external market commitments. This information is used to produce Group and divisional targets used by divisional teams to support development of their operating plans.
- The financial projections, expected market and business changes, and future expected legal, accounting and regulatory changes are subject to rigorous review and challenge from both divisional and Group executives. Risk Division provide an independent assessment to the Board on alignment of the plan with Group strategy and Board risk appetite, highlighting key risks to delivery of the plan.
- The planning process is also underpinned by a robust stress testing framework to assess compliance with the Group risk appetite. Further information on stress testing and reverse stress testing is provided on page 115. The stress testing scenarios are designed to be severe but plausible; and take full account of the availability and likely effectiveness of the mitigating actions that could be taken to avoid or reduce the impact or occurrence of the underlying risks. In considering the likely effectiveness of such actions, the conclusions of the Board's regular monitoring and review of risk and internal control systems, as discussed on page 70, is taken into account.

– The final operating plan, Risk Division assessment and the results of the stress testing are presented to the Board for approval. Once approved, the operating plan drives detailed divisional and Group targets for the following year.

The Directors have specifically assessed the prospects of the Company and the Group over the first three years of the current plan. This period presents the Board with a reasonable degree of confidence given there is greater certainty over expected events and macroeconomic assumptions during the earlier years of the plan, whilst still providing an appropriate longer-term outlook. It is also well within the period covered by the Group's future projections of profitability, cash flows, capital requirements and capital resources.

Information relevant to the assessment can be found in the following sections of the annual report and accounts:

– The Group's principal activities, business and operating models and strategic direction are described in the strategic report;
– Emerging risks are disclosed on page 114;
– The principal risks, including the Group's objectives, policies and processes for managing credit, capital, liquidity and funding, are provided in the Risk Management section on pages 112 to 169; and
– The Group's approach to stress testing and reverse stress testing, including both regulatory and internal stresses, is described on page 115.

Based upon this assessment, the Directors have a reasonable expectation that the Company and the Group will be able to continue in operation and meet its liabilities as they fall due over the next three years to 31 December 2018.

Greenhouse gas emissions

The Group has voluntarily reported greenhouse gas emissions and environmental performance since 2009, and since 2013 this has been in line with the requirements of the Companies Act 2006. The full emissions, in tonnes of CO2 equivalent, are reported in the strategic report on page 27.

Deloitte LLP has reviewed a selection of non-financial KPIs, indicated by providing limited assurance using the International Standard on Assurance Engagements (ISAE) 3000 (Revised). Their full, independent assurance statement is available online at www.lloydsbankinggroup.com/RBdownloads

Methodology

The Group follows the principles of the Greenhouse Gas (GHG) Protocol Corporate Accounting and Reporting Standard to calculate our Scope 1, 2 and 3 emissions from our worldwide operations.

The reporting period is 1 October 2014 to 30 September 2015, which is different to that of our Directors' report (January 2015 – December 2015). This is in line with Regulations in that the majority of the emissions reporting year falls within the period of the Directors' report. Emissions are reported based on an operational boundary. The scope of reporting is in line with the GHG Protocol and covers Scope 1, Scope 2 and Scope 3 emissions. Reported Scope 1 emissions cover emissions generated from gas and oil used in buildings, emissions from UK company-owned vehicles used for business travel and emissions from the use of air conditioning and chiller/refrigerant plant. Reported Scope 2 emissions cover emissions generated from the use of electricity. Reported Scope 3 emissions relate to business travel undertaken by colleagues and emissions associated with the extraction and distribution of each of our energy sources – electricity, gas and oil. A detailed definition of these emissions can be found in our 2015 Reporting Criteria online at www.lloydsbankinggroup.com/RBdownloads

Intensity ratio

An intensity ratio of GHG gases per £m of underlying income has been selected.

	Oct 2014 – Sept 2015	Oct 2013– Sep 2014
GHG emissions per unit of underlying income	**22.3**	24.0

Omissions

Emissions associated with joint ventures and investments are not included in this disclosure as they fall outside the scope of our operational boundary. The Group does not have any emissions associated with heat, steam or cooling and is not aware of any other material sources of omissions from our reporting.

Engaging colleagues

We provide colleagues with information on the Group's performance and matters that concern their role, for example changes in the economic or regulatory environment, management changes and reward and remuneration. Colleagues are regularly consulted and share their views twice a year through our 'best bank for customers' and 'building the best team' colleague surveys. More information on these is available on page 22. The results of these surveys were shared across the organisation, with over 4,000 line managers holding survey results conversations with their teams to agree actions to deliver our vision of becoming the best bank for customers. Colleagues are offered share schemes as part of wider incentive arrangements, and to encourage their financial involvement.

Inclusion and diversity

We aim to appoint the best person available into any role and to attract talented people from diverse backgrounds. We encourage and give full and fair consideration to job applications from people with a disability and are unbiased in the way we assess, select, appoint, train and promote people. We encourage job applications from those with a disability and continue to run a work experience programme with Remploy to support people with disabilities wanting to enter the workplace. All colleagues, including disabled colleagues, are provided with training and development opportunities so that they can carry out their role to the best of their ability. All line managers completed inclusion and diversity capability training in 2015, and an additional 200 colleagues were trained to deliver disability awareness sessions with customers.

Our award-winning workplace adjustment programme, which provides physical and non-physical adjustments to all colleagues including disabled colleagues, carried out more than 6,300 adjustments in 2015, bringing the total to 28,000 since the programme started in 2002. We retained our Gold Standard in the Business Disability Forum Benchmark with a score of 98. The Disability Standard establishes what best practice is across the business in terms of disability performance and recognises the adjustments the Group has made for employees, candidates and customers as part of the Group Disability Programme.

Directors' report continued

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 AGM.

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 at 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 56 and 57 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 position and performance, business model and strategy. The Directors have also separately reviewed and approved the strategic report.

On behalf of the Board

Malcolm Wood
Company Secretary
24 February 2016
Lloyds Banking Group plc
Registered in Scotland
Company number SC95000

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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Further information on risk management can be found:

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Note 53: Financial risk management	265
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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.

The risk overview (pages 28 to 33) provides a summary of risk management within the Group. It highlights the important role of risk as a strategic differentiator, risk achievements in 2015 and priorities for 2016 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 emerging risks, approach to stress testing, risk governance, committee structure, appetite for risk (pages 112 to 119) and a full analysis of the primary risk drivers (pages 120 to 169) – 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, exposures, measurement, mitigation and monitoring.

THE GROUP'S APPROACH TO RISK

The Group operates a prudent approach to risk with rigorous management controls to support sustainable business growth and minimise losses. Through a strong and independent risk function (Risk Division) a robust control framework is maintained to identify and escalate emerging risks to support sustainable business growth within risk appetite and through good risk reward decision making.

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.

As part of a conservative business model that embodies a risk culture founded on a prudent approach to managing risk, the Group refreshed its Codes of Business and Personal Responsibility in 2015 reinforcing its approach where colleagues are accountable for the risks they take and where the needs of customers are paramount.

The focus remains on building and sustaining long-term relationships with customers cognisant of the economic climate.

Risk appetite

- Defined 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 2015. This incorporated challenge and recommendations from the Board Risk Committee and is fully aligned with Group strategy.
- Risk appetite is embedded within principles, policies, authorities and limits across the Group and continues to evolve to reflect external market developments and composition of the Group.
- Performance is optimised by allowing business units to operate within approved risk appetite and limits.

Governance and control

- The Group's approach to risk is founded on a robust control framework and a strong risk management culture which are the foundation for the delivery of effective risk management and guide the way all employees approach their work, behave and make decisions.
- Governance is maintained through delegation of authority from the Board down to individuals through the management hierarchy. Senior executives are supported by a committee-based structure which is designed to ensure open challenge and support effective decision making.
- The Group's risk appetite, principles, policies, procedures, controls and reporting are regularly reviewed and updated where needed to ensure they remain fully in line with regulations, law, corporate governance and industry good-practice.
- 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.
- Board-level engagement, coupled with the direct involvement of senior management in Groupwide risk issues at Group Executive Committee level, ensures that escalated issues are promptly addressed and remediation plans are initiated where required.
- Line management is directly accountable for identifying and managing risks in their individual businesses, ensuring that business decisions strike an appropriate balance between risk and reward consistent with the Group's risk appetite.
- Clear responsibilities and accountabilities for risk are defined across the Group through a Three Lines of Defence model which ensures effective independent oversight and assurance in respect of key decisions.

Risk decision making and reporting

- Taking risks which are well understood, consistent with strategy and with appropriate return 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 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 as a member of the Board, has direct access to the Chairman and members of BRC.

Table 1.1: **Exposure to risk arising from the business activities of the Group**

The table below provides a high level guide to how the Group's business activities are reflected in its risk measures and balance sheet. Details of the business activities for each division are provided in the Divisional Results on pages 42 to 51.

	Lloyds Banking Group						
Division	Retail £bn	Commercial Banking £bn	Consumer Finance £bn	Run-off £bn	Central Items[1] £bn	Insurance[2] £bn	Total £bn
Risk-weighted assets (RWAs)							
– Credit risk[3]	48.8	83.4	17.6	10.0	12.7	–	172.5
– Counterparty credit risk[3]	–	9.1	–	–	0.6	–	9.7
– Operational risk	17.1	6.3	2.5	0.2	–	–	26.1
– Market risk	–	3.7	–	–	0.1	–	3.8
Total (excluding threshold)	65.9	102.5	20.1	10.2	13.4	–	212.1
– Threshold[4]	–	–	–	–	10.6	–	10.6
Total	**65.9**	**102.5**	**20.1**	**10.2**	**24.0**	**–**	**222.7**

1 Central items include assets held outside the main operating divisions, including exposures relating to Group Corporate Treasury which holds the Group's liquidity portfolio, and Group Operations.

2 As a separate regulated business, Insurance maintains its own regulatory solvency requirements, including appropriate management buffers, and reports directly to Insurance Board. Insurance does not hold any RWAs, as its assets are removed from the Banking Group's regulatory capital calculations. However, part of the Group's investment in Insurance is included in the calculation of Threshold RWAs, subject to the CRD IV rules, while the remainder is taken as a capital deduction.

3 Exposures relating to the default fund of a central counterparty and credit valuation adjustments are included in Credit Risk and Counterparty Credit Risk respectively for the purposes of this table.

4 Threshold is presented on a fully loaded CRD IV basis. Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of deducted from CET1 capital. Significant investments primarily arise from the investment in the Group's Insurance business.

Principal risks

The Group's principal risks are shown in the risk overview (pages 28 to 33). The Group's emerging risks are shown overleaf. Full analysis of the Group's risk drivers is on pages 120 to 169.

Risk management continued

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.

These risks are considered alongside the Group's operating plan.

Risk	Key mitigating actions
Regulatory and legal change: The pace and volume of regulatory and legal change and developments including: competition; pensions; capital requirements; payments; accounting standards changes; Senior Managers and Certification Regime (SM&CR); and consumer protection laws, all have the potential to impact the delivery of our strategic objectives.	– Continue to implement our conduct strategy ensuring the customer is at the heart of our business planning whilst working closely with regulatory authorities and industry bodies to ensure that the Group can identify and respond to the evolving regulatory landscape. – Programmes in place to deliver SM&CR by March 2016 implementation and ring-fencing and resolution by January 2019.
Low interest rate environment: Continuation of the present low interest rate environment has the potential to negatively impact the delivery of the Group's strategic and operational objectives. As a result there may be a requirement to review our cost and investment priorities.	– Regular reviews and updates to strategic milestones provide opportunity to reposition and reprioritise to minimise and negate potential impacts.
Response to market changes (agility): The dynamic nature of external influences has the potential to impact the delivery of the strategy and risk profile of the Group. As technology advances, the typical banking model is evolving, and as such, operational complexity has the potential to restrict the Group's speed of response.	– Organisational and behavioural effectiveness is reviewed through regular Group Strategic Reviews, ensuring the continued drive for simplicity and efficiency, and the building of new capabilities to support sustainable growth. – Sustained and continuing investment in digital capability and customer channels with our plans progressively updated to reflect market trends and customer behaviour.
Conduct risk: In a low growth environment we cannot compromise on our Conduct Strategy for revenue growth. Further provisions for legacy issues may be required if issues emerge which require remediation.	– Rigorous implementation of our conduct strategy with customer needs at the centre rather than a product driven model. – Programmes in place to deliver redress to customers with Groupwide rectification governance in place to enhance effectiveness.
Data integrity, IT and cyber: Cyber remains an evolving threat to the Group and its strategic objectives. Increased digital interconnectivity across the Group, its customers and suppliers has the potential to heighten our vulnerability to cyber-attacks, which could disrupt service for customers, and cause financial loss and reputational damage.	– Delivery of the Group cyber control framework, aligned to industry-recognised cyber security framework, and continued investment in the Group's Cyber Programme to ensure integrity of key systems and processes remains a priority. – Resilience programmes in place to protect the integrity and availability of the Group's systems and mitigate the impacts of cyber-attacks.
Market liquidity: Financial markets continue to exhibit signs of a lack of liquidity and potential impacts include the speed at which structural hedging can be undertaken and relevant asset portfolio liquidated.	– Market liquidity is reviewed on a regular basis through specific committees which approve funding plans, based on detailed analysis to ensure regulatory compliance and future liquidity requirements are satisfied.
Ring-fencing and resolution: UK ring-fencing legislation, regulation and rules impact the Group's business and operating model and could impact the ability to, and cost of, serving customers effectively to a greater extent than current assumptions, with potential changes in the competitive landscape and changes to customer and market behaviour.	– Engagement with relevant governmental and regulatory bodies and other agencies to deliver compliance by January 2019. – Business model design will optimise delivery of the full range of services to ring-fenced Bank customers through the provision of certain propositions from Group entities outside the ring-fence.
Leveraging data: Increasing regulatory scrutiny under EU Data Protection Regulation may limit the extent to which customer data can be used to support the Group in achieving its strategic objectives.	– Assessment of the possible impacts of legislation is ongoing and the Group expects to deliver enhanced systems to fulfil related regulatory requirements. – Chief Data Officer reviewing Groupwide operating model and aligning the Group's appetite appropriately.
UK political uncertainty: An EU in-out referendum has been called for the 23 June 2016. In the event that the referendum outcome determines an exit from the EU, there may be an impact on UK trade, the domestic economy and inward investment and, in the short term, the potential for market volatility.	– The Group will monitor and assess the potential impacts on an on-going basis, manage exposures according to its current risk appetite and continue to review our existing contingency plans for market volatility before and after the referendum.
Geopolitical shocks: Current uncertainties could further impede the global economic recovery and adjustment from a period of ultra-accommodative monetary policy. Events in China, Russia and the Middle-East, as well as terrorist activity, have the potential to trigger changes in market risk pricing which could lead to rising funding costs.	– Current risk appetite criteria limits single counterparty bank and non-bank exposures complemented by a UK-focused strategy. – The Group's Financial Stability Forum is in place to develop and maintain the Group's Stability Response Plan, whilst also acting as a Rapid Reaction Group, meeting when external crises occur.

CAPITAL STRESS TESTING

Overview

Stress testing is recognised as a key risk management tool within the Group by the Board, senior management, the businesses and the Risk and Finance functions. Stress testing is fully embedded in the planning process of the Group as a key activity in medium term planning. Senior management is actively involved in stress testing activities via a strict governance process.

The Group uses scenario stress testing to:

- Assess its strategic plans to adverse economic conditions and understand key vulnerabilities of the Group.
- Assess results against Board risk appetite to ensure the Group is managed within its risk parameters, allowing senior management and the Board to adjust strategies if the plan does not meet risk appetite in a stressed scenario. At the same time, the results of the stress tests will also inform the setting of risk appetite by assessing the underlying risks under stress conditions.
- Drive the development of potential actions and contingency plans to mitigate the impact of adverse scenarios. Stress testing also links directly to the Group's Recovery Planning process.
- Support the Internal Capital Adequacy Assessment Process (ICAAP) by demonstrating capital adequacy, and meet the requirements of regulatory stress tests that are used to inform the setting of the Group's PRA buffer (see Capital Risk on pages 160 to 165).
- Meet the required standards and the information needs of internal and external stakeholders, including regulators.

Regulatory stress tests

During 2015, the Group was subject to the UK-wide concurrent stress test run by the Bank of England. As announced in December, the Group comfortably exceeded the capital thresholds set by the regulator and was not required to take any action as a result of this test.

Internal stress tests

At least on an annual basis, the Group conducts a detailed macroeconomic stress test of the operating plan, which is supplemented with higher-level refreshes if 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 internal stress test includes different economic scenarios, both in terms of severity and focus (for example exploring the impacts of both low and high interest rate environments).

Reverse stress testing

Reverse stress testing is used to explore the vulnerabilities of the Group's strategies and plans to extreme adverse events that would cause the business to fail, in order to facilitate contingency planning. The scenarios used are those that would cause the Group to be unable to carry on its business activities. Where reverse stress testing reveals plausible scenarios with an unacceptably high risk when considered against the Group's risk appetite, the Group will adopt measures to prevent or mitigate that risk, which are then reflected in strategic plans.

Other stress testing activity

The Group's stress testing programme also involves undertaking assessment of operational risk scenarios, liquidity scenarios, market risk sensitivities and business specific scenarios (see the principal risks on pages 120 to 169 for further information on risk specific stress testing). If required, ad hoc stress testing exercises are also undertaken to assess emerging risks, as well as in response to regulatory requests. This wide ranging programme 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 stress tests at all levels must comply with all regulatory requirements, achieved through comprehensive construction of macroeconomic scenarios and a rigorous divisional, functional and executive review and challenge process, supported by analysis and insight into impacts on customers and business drivers.

The Chief Economist's Office develops the internal macroeconomic scenarios used by the Group, based on key uncertainties for the Group's 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 and corporate failures to facilitate modelling of scenarios across the Group. Where an external scenario is provided, as was the case with the UK-wide concurrent Bank of England stress exercise, the Chief Economist's Office broadens the externally supplied parameters to the level of detail required by the Group.

The engagement of all required Risk and control areas is built into the preparation process, so that the appropriate analysis of each risk driver's impact upon the business plans is understood and documented. The methodologies and modelling approach used for stress testing ensure that a clear link is shown between the macroeconomic 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 and is subject to the Group 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 and trading losses.
- The Group Corporate Treasury team reviews the stress outputs and evaluates the impact upon the Group's Capital and Funding Plan.
- The Central Finance and Tax teams consolidate the Group position and assess the tax and regulatory capital impacts.
- The Group Financial Risk team provides oversight of the Finance and Risk stress submissions as well as the consolidated Group position and capital ratios, and produces analysis packs for the Group's senior committees.

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 Group Business Planning and Stress Testing Policy and Procedures, which are reviewed at least annually.

The Group Financial Risk Committee (GFRC), chaired by the Chief Risk Officer and attended by the Chief Finance Officer and other senior Risk and Finance colleagues, is the Committee that has primary responsibility for overseeing the development and execution of the Group's stress tests.

The review and challenge of the detailed stress forecasts, the key assumptions behind these, and the methodology used to translate the economic assumptions into stressed outputs are finalised by the divisional Finance Director's, appropriate Risk Director's and Managing Director's sign-off. The outputs are then presented to GFRC, Group Risk Committee/ Group Executive Committee and Board Risk Committee for Group-level executive review and challenge, before being approved by the Board.

Risk management continued

HOW RISK IS MANAGED IN LLOYDS BANKING GROUP

The Group's Risk Management Framework (RMF) (see risk overview, page 29) is structured around the following nine components which meet and align with the industry-accepted internal control framework issued by the Committee of Sponsoring Organisations of the Treadway Commission. The RMF 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.

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 Groupwide risk principles and policies;
– the cascade of delegated authority (for example to Board sub-committees and the Group Chief Executive); and
– effective oversight over risk management consistent with the risk appetite.

Risk appetite

– Risk appetite is defined within the Group as 'the amount and type of risk that the Group is prepared to seek, accept or tolerate'.
– Risk appetite is documented in a Board Risk Appetite Statement reviewed by the Board Risk Committee and approved annually by the Board. The Board Risk Appetite is aligned to the Risk Appetite Framework, and in turn the RMF and Group Risk Principles. An updated Board Risk Appetite Statement was approved by the Board in 2015.
– The Board metrics are supported by more detailed sub-Board appetite functional risk metrics and sub-Board appetite divisional risk metrics.
– The Group's strategy operates in tandem with the Board Risk Appetite and business planning is undertaken with a view to meeting the requirements of the Board Risk Appetite.
– Risk appetite is embedded within principles, policies, authorities and limits across the Group and continues to evolve to reflect external market developments and composition of the Group.
– The Board Risk Committee is responsible for overseeing the development, implementation and maintenance of the Group's overall risk management framework and its risk appetite, to ensure they are in line with emerging regulatory, corporate governance and industry best practice.

Accountabilities under the Risk Appetite Framework are apportioned as follows:

Board:

– Approves the type and level of risk the Group is prepared to accept and the boundaries within which management must operate when setting strategy and executing the business plan.
– Holds the Group Chief Executive and other Senior Executives accountable for the integrity of the Board Risk Appetite Statement.
– Reviews and approves reporting against the Board Risk Appetite Statement.
– Ensure executive remuneration is aligned with risk appetite adherence.

Group Chief Executive and Group Executive Committee members (GEC):

– Ensure that the Board Risk Appetite Statement is developed in collaboration with the Chief Risk Officer and is fully embedded in the business.
– Ensure resources and processes are in place to support the Board Risk Appetite framework.
– Are accountable for the integrity of the Board Risk Appetite Statement, including the timely identification and escalation of breaches and for developing mitigating actions.
– Ensure risk appetite is fully embedded across strategy, planning, decision-making processes and remuneration.
– Monitor compliance with Board Risk Appetite.

Group Chief Risk Officer:

– Develops the Board Risk Appetite Statement in collaboration with the Group Chief Executive and other GEC members.
– Obtains the Board's support and approval of the Board Risk Appetite Statement.
– Oversees that the metrics are fully embedded by the business and reported on a monthly basis.
– Ensures breaches are identified, escalated and appropriate mitigating action is taken by the business.

Risk appetite is embedded across the Group in the following ways:

– Communication – Board Risk Appetite metrics developed and agreed with business and operational teams. In addition Board Risk Appetite cascaded down into more detailed metrics and limits within Functional and Divisional sub-Board Risk Appetite Statements along with additional supporting metrics which should be used to drive local decision making and behaviours.
– Policies – Group policies are aligned with Risk Appetite Statement.
– Reporting – Performance against Board Risk Appetite metrics reported to Divisional, Functional, and Group Risk Committees and the BRC and Board.
– Performance Management – Group and Divisional Scorecards include adherence to risk appetite as a general measure and include more detailed risk appetite measures which are pertinent for that area of the Group.
– Key Decision Making – Strategy operates in tandem with risk appetite and the Group's annual Operating Plan is developed within the boundaries set by risk appetite.

Governance frameworks – the Policy framework is founded on Board-approved key principles for the overall management of risk in the organisation, which are aligned with Group strategy and risk appetite and based on a current and comprehensive risk profile that identifies all material risks to the organisation. The principles are underpinned by a hierarchy of policies which define mandatory requirements for risk management and control which are consistently implemented across the Group. The risk committee governance framework is outlined below.

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 oversight and assurance activities take place covering key decisions.

– Business lines (first line) have primary responsibility for risk decisions, identifying, measuring, monitoring and controlling risks within their areas of accountability. They are required to establish effective governance, and control frameworks for their business to be 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 constructive challenge to the effectiveness of risk decisions taken by business management, providing proactive 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. 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 the business, and seeks to ensure objective challenge to the effectiveness of the risk governance framework.

Mandate of the Risk Division – the objective of Risk Division is to provide both proactive advice and constructive 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 effective risk management processes;
– transparent 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 including pending regulatory changes; and
– a constructive dialogue with the first line through provision of advice, development of common methodologies, understanding, education, training, and development of new tools.

Risk Division, headed by the Chief Risk Officer, consists of six 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 overseeing performance of the Group against risk appetite;
– developing an effective RMF which meets regulatory requirements for approval by the Board, and overseeing 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.

The Risk Directors:

– provide independent advice, oversight and challenge to the business;
– design, develop and maintain policies, specific functional risk type 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
– propose 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 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 and risk events.

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 GEC member challenge and certify the accuracy of their assessment. This key process is overseen and independently challenged by Policy Owners, Risk Division and Group Audit, and reported to the Board.

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, clear accountabilities, effective communication and challenge and an appropriately aligned performance incentive and structure.

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 serve 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.

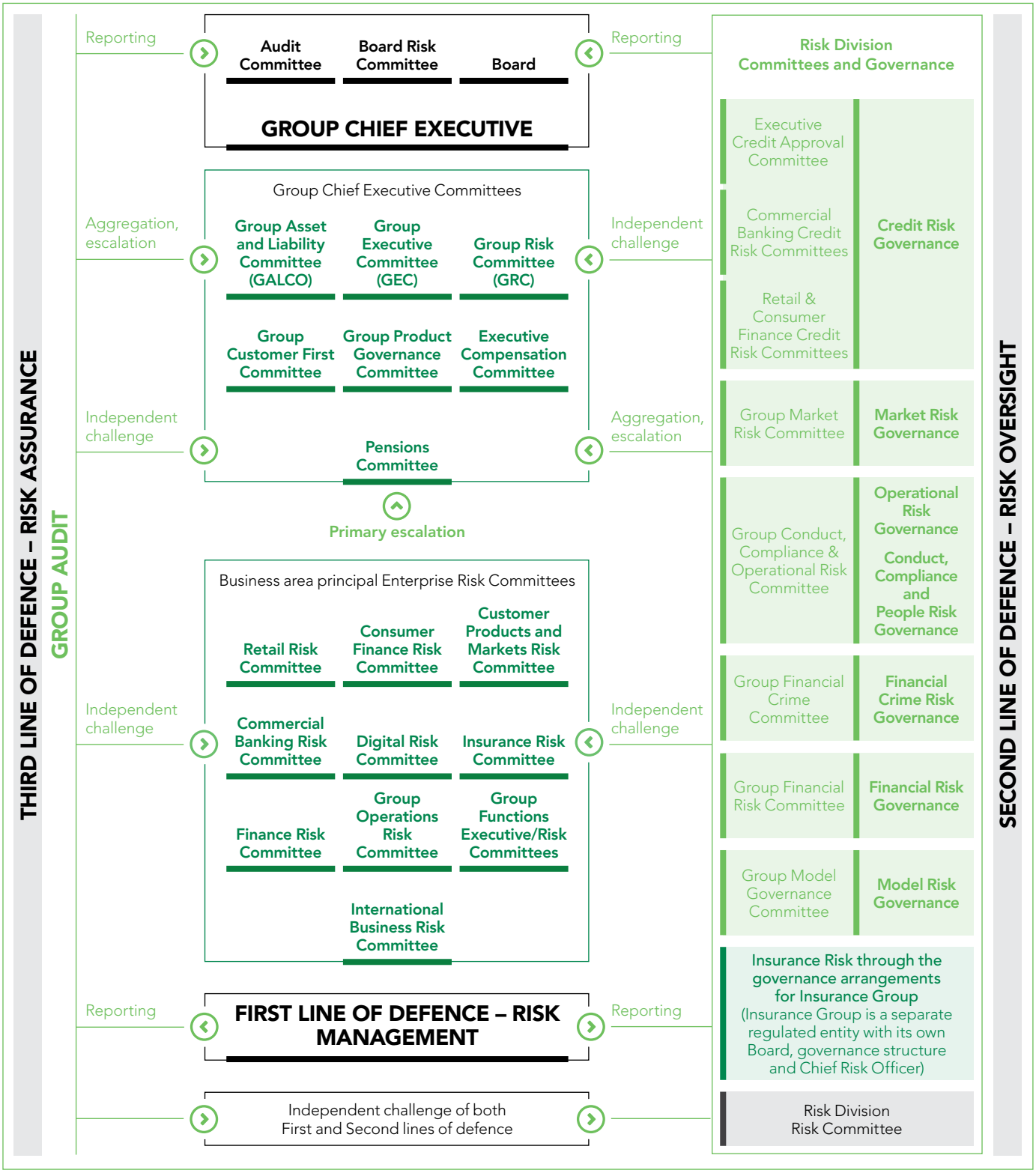
Risk management continued

RISK GOVERNANCE

The risk governance structure below is integral to effective risk management across the Group. Risk Division is appropriately represented on key committees to ensure 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 GEC and Board. Conversely, strategic direction and guidance is cascaded down from the Board and GEC.

Company Secretariat support senior and Board level committees, and support the Chairs in agenda planning. This gives a further line of escalation outside the Three Lines of Defence.

Table 1.2: **Risk governance structure**



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 60 to 81, for further information on Board committees.

The divisional/functional risk committees review and recommend divisional/functional risk appetite and monitor local risk profile and adherence to appetite.

Insurance, which is subject to separate regulation, 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 the Insurance business and the Insurance business risk appetite, ensuring it aligns with the Group's framework and risk appetite.

Table 1.3: **Executive and Risk Committees**

The Group Chief Executive is supported by the following:

Committees	Risk focus
Group Executive Committee (GEC)	Supports the Group Chief Executive in exercising his authority in relation to material matters having strategic, cross-business area or Groupwide implications.
Group Risk Committee (GRC)	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 (GALCO)	Responsible for the strategic management of the Group's assets and liabilities and the profit and loss implications of balance sheet management actions. It is also responsible for the risk management framework for market risk, liquidity risk, capital risk and earnings volatility.
Group Customer First Committee (GCFC)	Provides a Groupwide perspective on the progress of Group's, Divisions' and Functions' implementation of initiatives which enhance the delivery of customer outcomes and customer trust, and set and promote the appropriate tone from the top to fulfil the Group's vision to become the Best Bank for Customers and Help Britain Prosper.
Group Product Governance Committee	Provides strategic and senior oversight over design, launch and management of products including new product approval, periodic product reviews and management of risk in the back book.
Executive Compensation Committee	Provides governance and oversight for Groupwide remuneration matters and policies.
Pensions Committee	Supports the Chief Financial Officer in relation to Group pension arrangements.
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 (GMRC)	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 Conduct, Compliance and Operational Risk Committee	Responsible for monitoring breaches, material events and risk issues and conducting deep dive assessments on specific Conduct, Compliance or Operational Risk subjects to inform corrective action along with the sharing of information and best practice.
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 coordinated and implemented across the Group.
Group Financial Risk Committee	Responsible for reviewing, challenging and recommending to GEC/GRC, 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, PRA and EBA stress tests, and any other analysis as required.
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 GRC.

Risk management continued

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 and legal risk[1]	Insurance risk[1]	People risk[1]	Financial reporting risk	Governance risk[1]
Page 121	Page 143	Page 144	Page 151	Page 153	Page 160	Page 166	Page 166	Page 167	Page 168	Page 169

1 The Group considers these to be principal risks. See risk overview pages 28 to 33 for further details.

Secondary risk drivers

Portfolio concentration risk	Customer risk	Interest rate risk	Regulatory and legal process	Funding risk	Capital sufficiency	Compliance risk	Longevity risk	Resourcing	Financial and prudential regulatory reporting	Governance
Counterparty credit risk	Product risk	Equity risk	Client money/ fiduciary obligations	Liquidity risk	Capital efficiency	Competition risk	Mortality risk	Performance and reward	Tax reporting and compliance	Disclosure
Country risk	Product distribution/ advice risk	Foreign exchange risk	Conduct process			Legal risk	Morbidity risk	Culture and engagement	Pillar 3 disclosure	Model risk
Collateral management risk		Credit spread risk	Financial crime				Customer behaviour risk (including persistency risk)	Talent and succession	Financial delegated authorities	Ethics
		Inflation risk	Fraud				Property insurance risk	Learning		
		Property risk	People process				Expenses risk	Well-being		
		Alternative assets risk	Sourcing					Legal and regulatory (people)		
		Basis risk	Service provision							
		Commodity risk	Physical security and health and safety							
			Information and cyber security							
			IT systems							
			Change							
			Business process							
			Financial reporting process							
			Governance process							
			Risk process							
			Operational resilience							

The Group considers both reputational and financial impact in the course of managing all its risks and therefore does not classify reputational impact as a separate risk driver.

CREDIT RISK

Definition

The risk that customers to whom we have lent money or other counterparties with whom we have contracted, fail to meet their financial obligations (both on and off balance sheet), resulting in loss to the Group.

Risk appetite

Credit risk appetite is described and reported on a monthly basis through a suite of Board metrics derived from credit portfolio performance measures. The Board metrics are supported by more detailed sub-Board appetite metrics at Divisional and Business level and by a comprehensive suite of credit risk appetite statements, credit policies, sector caps, and product and country limits to manage concentration risk and exposures within the Group's approved risk appetite. The metrics cover but are not limited to geographic concentration, single name customer concentration, product exposure, Loan to Value ratios (LTVs), higher risk sector concentration, limit utilisation, leveraged exposure, equity exposure, affordability and the obligor quality of new to bank lending.

Credit risk appetite statements and credit policies are regularly reviewed to ensure that the metrics continue to reflect the Group's risk appetite appropriately. For further information on risk appetite, refer to page 112.

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 53 on page 266. Credit risk exposures are categorised as 'retail', arising primarily in the Retail, Consumer Finance and Run-off divisions, and some small and medium sized enterprises (SMEs) and 'corporate' (including corporates, banks, financial institutions, sovereigns and larger SMEs) arising primarily in the Commercial Banking, Run-off and Insurance divisions and Group Corporate Treasury (GCT).

In terms of loans and advances, (for example loans and overdrafts) and contingent liabilities (for example credit instruments such as guarantees and standby, documentary and commercial letters of credit), credit risk arises both from amounts advanced and commitments to extend credit to a customer or bank as required within documentation. With respect to commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most retail commitments to extend credit can be cancelled without notice and the creditworthiness of customers is monitored regularly. Most commercial term commitments to extend credit are contingent upon customers maintaining specific credit standards, which together with the creditworthiness of customers are monitored regularly.

Credit risk also arises from debt securities and derivatives. The total notional principal amount of interest rate, exchange rate, credit derivative and other contracts outstanding at 31 December 2015 is shown on page 129. 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 53 on page 265.

Credit risk exposures in the Insurance business largely result from holding bond and loan assets in the shareholder funds (including the annuity portfolio) and from exposure to reinsurers.

The investments held in the Group's defined benefit pension schemes also expose the Group to credit risk. Note 31 on page 226 provides further information on the defined benefit schemes' assets and liabilities.

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 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 heightened refinance risk exists (such as in Commercial Banking's Business Support Unit (BSU) or the Run-off book) exposures are minimised through intensive account management and would be impaired and/or forborne where appropriate.

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 Risk-Weighted Assets (RWAs) and regulatory Expected Loss (EL). 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 regulatory expected loss models. Note 2(H) on page 191 provides details of the Group's approach to the impairment of financial assets.

The obligor quality measurement of both retail and commercial counterparties is largely based on the outcomes of credit risk (probability of default – PD) models. The Group operates a number of different regulatory 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 the principal retail portfolios, exposure at default and loss given default models are also in use. For regulatory 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. The Retail Master scale comprises 13 non-default ratings and one default rating.

Risk management continued

Mitigation

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

Prudent, through the cycle credit principles, risk policies and appetite statements: The independent Risk Division sets out the credit principles, risk policies and risk appetite statements. Principles and policies are reviewed regularly, and any changes are subject to a review and approval process. Policies and risk appetite statements, where appropriate, are supported by procedures, which provide a disciplined and focused benchmark for credit decisions. 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, which includes tracking portfolio performance against an agreed set of key appetite tolerances. Oversight and reviews are also undertaken by Group Audit and Credit Risk Assurance.

Strong rating systems and controls: 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. The designated model owner takes responsibility for ensuring the validation of the rating systems, supported and challenged by an independent specialist Group function.

Limitations on concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite as well as individual, customer and bank limit guidelines. Credit policies and appetite statements are aligned to the Group's risk appetite and restricts exposure to higher risk countries and more vulnerable sectors and segments. Note 18 on page 214 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 exposure, 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 detailed to the Board and reported in accordance with regulatory reporting requirements.

Robust country risk management: The Board sets country risk appetite. Within this, country limits are authorised by the country risk appetite 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. Exercises focused on individual divisions and portfolios are performed in addition to the Group led and regulatory stress tests. For further information on the stress testing process, methodology and governance refer to page 115.

Frequent and robust credit risk oversight and assurance: Undertaken by independent Credit Risk Assurance functions operating within Retail and Consumer Credit Risk and Commercial Banking which are part of the Group's second line of defence. Its primary objective is to provide reasonable and independent oversight that credit risk is being managed with appropriate and effective controls.

Group Audit performs the third line of credit risk assurance. A specialist team within Group Audit, comprising experienced credit professionals, is in place to carry out independent risk based internal control audits, providing an assessment of the effectiveness of internal credit controls, credit risk classification and the raising of impairment provisions. These audits 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, senior management and Board Audit Committee with assurance on effectiveness of credit risk controls, as well as appropriateness of impairments.

Additional mitigation for Retail and Consumer Finance customers

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 a stressed interest rate scenario. 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, Retail and Consumer Finance affordability assessments are compliant with relevant regulatory conduct guidelines.

For UK mortgages, the Group's policy is to reject all standard applications with a Loan to Value (LTV) greater than 90 per cent. Applications with an LTV up to 95 per cent are permitted for certain schemes, for example the UK government's Help to Buy scheme. For mainstream mortgages the Group has maximum per cent LTV limits which depend upon the loan size. These limits are currently:

Table 1.4: **UK mainstream loan to value analysis**

Loan size From	To	Maximum LTV
£1	£570,000	95%
£570,001	£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.

The Group's approach to underwriting applications for unsecured products ensures that lending is affordable and sustainable. The Group takes reasonable steps to validate information used in the assessment of a customer's income and expenditure. The Group rejects any application for an unsecured lending product where a customer is registered as bankrupt or insolvent, or has a County Court Judgment in excess of £1,000 registered at a CRA used by the Group. In addition, the Group rejects any applicant with total unsecured debt greater than £50,000 registered at the CRA; policy rules are also in place to provide additional scrutiny to applications where an applicant's total unsecured debt-to-income ratio greater than 100 per cent.

Where credit acceptance scorecards are used, Risk Division reviews model effectiveness, while new models and model changes are referred by them to the appropriate Model Governance Committees for approval. All 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 of customer and bank limits: With the exception of small exposures to SME customers where relationship managers have limited delegated sanctioning authority, credit risk in commercial customer portfolios are subject to sanction by the independent Risk Division, which considers the strengths and weaknesses of individual transactions, the balance of risk and reward, and how credit risk aligns to the Group's risk appetite. 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 and customer underwriting is generally the same as that for assets intended to be held to maturity. All underwriting must be sanctioned via credit limits.

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 against agreed confidence intervals. 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 and bank counterparties/customers are:

– properties;
– charges over business assets such as premises, inventory and accounts receivables;
– financial instruments such as debt securities;
– vehicles;
– cash; 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 underlying exposure. Debt securities, including 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 (CSA) in conjunction with the ISDA Master Agreement. Derivative transactions with non-bank customers are not usually supported by a CSA.

No collateral is held in respect of retail credit card or unsecured personal lending. For non-mortgage retail lending to small businesses, collateral may include second charges over residential property and the assignment of life cover.

It is policy that commercial lending decisions must be based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. The types of collateral taken and the requirement for which collateral is required at origination is dependent upon the credit quality, size and structure of the borrower. For non-retail exposures, 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 key man insurance. The Group maintains policies setting out acceptable collateral, maximum LTV ratios and other criteria to be considered when reviewing an 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/counterparty. 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 an application. Notwithstanding this, the fundamental business proposition must evidence the ability of the business to generate funds from normal business sources to repay a customer/counterparty's financial commitment.

The extent to which collateral values are actively managed will depend on the credit quality and other circumstances of the obligor and type of underlying transaction. Although lending decisions are 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 and returns.

Collateral values are rigorously assessed at the time of loan origination. 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 values are 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 when estimating credit losses. In order to minimise the credit loss, the Group may seek additional collateral from the counterparty as soon as early warning signs 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.

Credit policies are in place to avoid correlation or wrong way risk. Under the repo policies, the issuer of the collateral and the repo counterparty should be neither the same nor connected. The same rule applies for derivatives under collateral policies. The Risk Division has the necessary discretion to extend this rule to other cases where there is significant correlation. Countries with a rating equivalent to AA- and above may be considered to have no adverse correlation between the counterparty domiciled in the country and that country of risk (issuer of securities).

Refer to note 53 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

Risk management continued

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.

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 and monitored 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 Divisional Risk Committees, Group Risk Committee and the Board Risk Committee.

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.

Retail and Consumer Finance 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.

The specific tools available to assist customers vary by 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 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.

Customers receiving support from UK government sponsored programmes

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 Department of Work and Pensions.
- Mortgage Rescue Schemes – This is a government 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. Government sponsored Mortgage Rescue Scheme (MRS) options are currently available in Wales and Scotland (in Scotland the MRS option is called the Home Owner's Support Fund). No MRS options are available in Northern Ireland although one may be launched by the government in the future. In England, the government ceased funding and closed its MRS option in the second quarter of 2015.

The Group assesses whether a loan benefiting from a UK government sponsored programme is impaired using the same accounting policies and practices as it does for loans not benefiting from such a programme. There is no direct impact on the impairment status of a loan benefiting 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 £2.2 billion of its mortgage exposures are receiving this benefit. This includes those who are also receiving other treatments for financial difficulty.

Forbearance identification, classification and measurement

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 on page 126. 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.

Those forborne loans which fall below individual assessment limits are grouped with other assets of similar characteristics and assessed collectively for impairment in accordance with the Group impairment policy detailed in note 2(H). The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the underlying loss risk of exposures. The performance and output of models are monitored and challenged on an ongoing basis, in line with the Group's model governance policies.

Customers in financial difficulty receiving support under other schemes

The Group measures the success of a forbearance scheme based upon the proportion of customers performing (less than or equal to three months in arrears) over the 24 months following the exit from a forbearance treatment. For temporary treatments, 79 per cent of customers accepting reduced payment arrangements are performing. For permanent treatments, 82 per cent of customers who have accepted capitalisations of arrears and 84 per cent of customers who have accepted term extensions are performing.

Commercial customers

Early identification, control and monitoring are key in order to support the customer and protect the Group. With the exception of small exposures in SME all non-retail exposures in the Commercial Banking and Run-off divisions 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 exposure 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 regularly, and the 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.

Those customers deemed higher risk where there is cause for concern over future repayment capability or where there is a risk of impairment will lead to the customer being transferred to the Business Support Unit (BSU) at an early stage. The over-arching aim of the BSU is to provide support and work consensually 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 a combination of restructuring, work out strategies and other types of forbearance.

BSU case officers manage non-retail distressed assets in Commercial Banking and Run-off divisions, and 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.

A detailed assessment is undertaken for cases in BSU to assist in reducing and minimising risk exposure and to also 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 level of Commercial Banking division BSU gross lending to customers reduced from £5.0 billion to £4.2 billion between 31 December 2014 and 31 December 2015. The net reduction of £0.8 billion in BSU managed lending in Commercial Banking was driven by returns to mainstream, disposals, write-offs and repayments.

The Group's accounting policy for loan renegotiations is set out in note 2(H) on page 191. Income statement information set out in the credit risk tables is on an underlying basis (see page 40).

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 experiences, or is believed to be about to experience, financial difficulty and which is outside the Group's current risk appetite. Where a concession is granted to a customer that is not in financial difficulty or the risk profile is considered within the Group's current risk appetite, the concession would not be considered to be an act of forbearance. The Group does not believe forbearance reporting is appropriate for derivatives, available for sale assets and 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 it is a trigger for the review of the customer's credit profile. If there is any concern over the future cash flows and/or the Group incurring a loss, then forborne loans will be classified as impaired in accordance with the Group's impairment policy. All impaired loans, including recoveries portfolios, are reported as forborne.

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. The Group expects to have unimpaired forborne assets within its portfolios, where default has been avoided, or when no longer considered impaired, although the majority of these cases will be managed in the BSU, where more intensive management and monitoring is available.

Risk management continued

Unimpaired forborne assets are included in calculating the overall collective unidentified impairment provision, which uses the historical observed default rate and loss emergence period of the relevant portfolio as a whole as part of its calculation.

Whilst the material portfolios have been reviewed for forbearance, some non-retail loans and advances in Commercial Banking and Run-Off divisions have not been reviewed on the basis that the level of unimpaired forbearance is relatively immaterial, or because the concept of forbearance is not relevant.

Types of forbearance

The Group's strategy and offer of forbearance is largely dependent on the individual situation and early identification, control and monitoring are key to supporting the customer and protecting the Group. Concessions are often provided to help the customer with their day to day liquidity and working capital. 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.

For commercial customers, the Group currently looks at forbearance concessions including changes to:

– Contractual payment terms (for example loan maturity extensions, or changes to capital and/or interest servicing arrangements, including capital repayment holidays or conversion to interest only terms); and
– Non-payment contractual terms (for example covenant amendments or waivers) where the concession enables default to be avoided.

The 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 and the customer is kept under review in the event that further forbearance is necessary;
– 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 capital and/or interest servicing arrangements including capital repayment holidays or conversion to interest only terms; and
– Multiple type of forbearance (a combination of the above two).

Forbearance identification, classification and measurement

All non-retail loans and advances on the watchlist are 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 independent Risk function regularly, and the classification is updated if required.

Any event that causes concern over future payments is likely to result in the customer being assessed for impairment and, if required, an impairment allowance recognised. If impairment is identified, the customer is immediately transferred to BSU (if not already managed there) and the lending will be treated as impaired.

All of a customer's impaired loans are treated as forborne as they are considered as having been (or will be) granted some form of forbearance. Most impaired loans and advances exist only in the BSU within Commercial Banking division, and Run-off division.

A portfolio approach is taken for SME customers with exposures below £1 million managed in BSU. All customers with exposures below £1 million are reported as forborne whilst they are managed by SME BSU (whether impaired or unimpaired).

All reviews performed in the good book, BSU within Commercial Banking or in the Run-off division 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

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 cure period is currently expected to be at least 12 months following a forbearance event.

The exception to this 12 month minimum period is where a permanent structural cure is made (for example, an injection of new collateral security or a partial repayment of debt to restore an LTV back to within a covenant). In this case, the customer may exit forbearance once the permanent cure has been made.

However, notwithstanding this, the overriding requirement for exit from forbearance in all cases is that the customer is not impaired and the reason for the forbearance event is no longer present.

Upon exit from forbearance the customer may be returned to the mainstream good classification. It is important to note that such a decision can be made only by the independent Risk Division.

The Group credit risk portfolio in 2015

Significant reduction in impairments and impaired assets

– Excluding TSB, the impairment charge decreased by 48 per cent to £568 million in 2015 compared to £1,102 million in 2014. The impairment charge is lower across all divisions and benefited from provision releases, but at lower levels than seen during 2014.

– The reduction reflects lower levels of new impairment as a result of effective risk management, a favourable credit environment, improving UK economic conditions and continued low interest rates.

– The asset quality ratio (impairment charge as a percentage of average loans and advances to customers) improved to 0.14 per cent compared to 0.23 per cent during 2014.

– At the Group Strategic Update in October 2014, we outlined that although it would be lower between 2015 to 2017, we expect the Group asset quality ratio to be c.40 basis points through the economic cycle.

– In 2016, the Group expects to benefit from its continued disciplined approach to the management of credit and the resilient UK economy. Write-backs and provision releases, however, are expected to be at a lower level and as a result, the Group expects the asset quality ratio for the 2016 full year to be around 20 basis points.

– Impaired loans as a percentage of closing loans and advances reduced to 2.1 per cent at 31 December 2015, from 2.9 per cent at 31 December 2014 driven by reductions within the continuing and run-off portfolios, including the sale of Irish commercial loans during the third quarter. Provisions as a percentage of impaired loans reduced from 56.4 per cent to 46.1 per cent reflecting the disposal of highly covered assets during the year.

– Retail division impairment provisions as a percentage of impaired loans have increased to 40.4 per cent from 38.8 per cent at 31 December 2014, with Secured increasing by 0.5 percentage points to 37.5 per cent. Consumer Finance division impairment provisions as a percentage of impaired loans have increased to 72.8 per cent from 70.5 per cent at 31 December 2014, with Credit Cards increasing by 5.3 percentage points to 81.8 per cent and Asset Finance UK decreasing by 2.8 percentage points to 67.2 per cent.

Low risk culture and prudent risk appetite

– The Group is delivering sustainable lending growth by maintaining its lower risk origination discipline and underwriting standards despite terms and conditions in some of the Group's markets being impacted by increased competition. The overall quality of the portfolio has improved over the last 12 months.

– Credit performance of the UK Retail secured portfolio has been good, with improvements in LTVs, arrears, impaired loans and impairment charge on both Mainstream and Buy-to-let portfolios. Loans and advances to mainstream customers were broadly flat during the year at £227.3 billion with the Buy-to-let portfolio growing by 4 per cent to £55.6 billion. The closed specialist portfolio has continued to run-off, reducing by 10 per cent to £19.5 billion.

– The Group's UK Direct Real Estate gross lending (defined internally as exposure which is directly supported by cash flows from property activities) at 31 December 2015 in Commercial Banking, Wealth (within Retail division) and Run-off divisions was £19.5 billion (31 December 2014: gross £21.6 billion). The portfolio continues to reduce significantly, and the higher risk Run-off element of the book has reduced from gross £3.3 billion to gross £1.1 billion during 2015. The remaining gross lending of £18.4 billion (31 December 2014: £18.3 billion) is the lower risk element in Commercial Banking and Wealth, where the Group continues to write new business within conservative risk appetite parameters.

– Our Commercial Banking portfolios continue to benefit from our robust focus on credit at origination and our through the cycle risk appetite.

– Sector concentrations within the lending portfolios are closely monitored and controlled, with mitigating actions taken. Sector and product caps limit exposure to certain higher risk sectors and asset classes.

– The Group's extensive and thorough credit processes and controls ensure effective risk management, including early identification and management of potential concern customers and counterparties.

Re-shaping of the Group is substantially complete

– The run-off portfolio has materially reduced through de-risking and the strategic desire to exit the residual portfolio still remains. There was a 38 per cent reduction in gross loans and advances in 2015 to £11,422 million (31 December 2014: £18,316 million).

– Run-off net external assets have reduced from £16,857 million to £12,154 million during 2015. The portfolio now represents only 2.3 per cent of the overall Group's loans and advances (31 December 2014: 3.0 per cent).

Table 1.5: **Group impairment charge**

	2015						
	Loans and advances to customers £m	Debt securities classified as loans and receivables £m	Available-for-sale financial assets £m	Other credit risk provisions £m	Total £m	2014 £m	Change %
Retail	432	–	–	–	432	599	28
Commercial Banking	9	–	–	(31)	(22)	83	
Consumer Finance	152	–	–	–	152	215	29
Run-off	28	(2)	4	(22)	8	203	96
Central items	–	–	–	(2)	(2)	2	
Total impairment charge excluding TSB	621	(2)	4	(55)	568	1,102	48
TSB					–	98	
Total impairment charge					568	1,200	53
Impairment charge as a % of average advances[1]					0.14%	0.23%	(9)bps

1 Excludes TSB.

Risk management continued

Table 1.6: Movement in gross impaired loans

	2015						
	Retail £m	Commercial Banking £m	Consumer Finance £m	Run-off £m	TSB £m	Total £m	2014 Total £m
At 1 January	4,927	3,241	720	5,215	205	14,308	32,259
Classified as impaired during the year	2,008	631	179	583	–	3,401	4,825
Transferred to not impaired during the year	(1,080)	(146)	(72)	(60)	–	(1,358)	(4,526)
Repayments	(831)	(693)	(68)	(137)	–	(1,729)	(3,075)
Amounts written off	(523)	(225)	(107)	(648)	–	(1,503)	(7,004)
Impact of disposal of business and asset sales	(3)	(48)	(55)	(3,092)	(205)	(3,403)	(7,288)
Exchange and other movements	(4)	(232)	(54)	164	–	(126)	(883)
At 31 December	4,494	2,528	543	2,025	–	9,590	14,308

Table 1.7: Group impaired loans and provisions

	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 2015					
Retail	316,036	4,494	1.4	1,670	40.4
Commercial Banking	102,435	2,528	2.5	1,087	43.0
Consumer Finance	23,938	543	2.3	265	72.8
Run-off	11,422	2,025	17.7	1,150	56.8
TSB					
Reverse repos and other items[3]	5,798	–		–	
Total gross lending	459,629	9,590	2.1	4,172	46.1
Impairment provisions	(4,172)				
Fair value adjustments[4]	(282)				
Total Group	455,175				
At 31 December 2014					
Retail	317,347	4,927	1.6	1,734	38.8
Commercial Banking	102,459	3,241	3.2	1,594	49.2
Consumer Finance	21,273	720	3.4	309	70.5
Run-off	18,316	5,215	28.5	3,927	75.3
TSB	21,729	205	0.9	88	42.9
Reverse repos and other items[3]	9,635				
Total gross lending	490,759	14,308	2.9	7,652	56.4
Impairment provisions	(7,652)				
Fair value adjustments[4]	(403)				
Total Group	482,704				

1 Impairment provisions include collective unidentified impairment provisions.

2 Impairment provisions as a percentage of impaired loans are calculated excluding Retail and Consumer Finance loans in recoveries (31 December 2015: £335 million in Retail Loans and Overdrafts, £28 million in Retail other and £179 million in Consumer Finance credit cards; 31 December 2014: £437 million in Retail loans and overdrafts, £26 million in Retail other and £282 million in Consumer Finance Credit Cards).

3 Includes £5.7 billion (31 December 2014: £4.4 billion) of lower risk loans sold by Commercial Banking and Retail to Insurance to back annuitant liabilities.

4 The fair value adjustments relating to loans and advances were made on the acquisition of HBOS to reflect the fair value of the acquired assets and took into account both the expected losses and market liquidity at the date of acquisition. The unwind relating to future impairment losses requires management judgement to assess 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 commercial 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 £97 million for the period ended 31 December 2015 (31 December 2014: £251 million). 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.

Table 1.8: **Derivative credit risk exposures**

	2015 Traded over the counter				2014 Traded over the counter			
	Traded on recognised exchanges £m	Settled by central counterparties £m	Not settled by central counterparties £m	Total £m	Traded on recognised exchanges £m	Settled by central counterparties £m	Not settled by central counterparties £m	Total £m
Notional balances								
Foreign exchange	6,568	–	383,722	390,290	–	–	456,215	456,215
Interest rate	31,128	3,598,307	791,351	4,420,786	82,201	5,768,373	972,531	6,823,105
Equity and other	4,837	–	9,337	14,174	4,808	–	10,034	14,842
Credit	–	–	4,566	4,566	–	–	18,063	18,063
Total	42,533	3,598,307	1,188,976	4,829,816	87,009	5,768,373	1,456,843	7,312,225
Fair values								
Assets		103	28,811			127	35,322	
Liabilities		(131)	(26,149)			(117)	(32,988)	
Net asset		(28)	2,662			10	2,334	

The total notional principle amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2015 and 31 December 2014 is shown in the table above. The notional principle 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 53 on page 266.

Retail

- The impairment charge was £432 million in 2015, a decrease of 28 per cent against 2014. The decrease reflects continued low risk underwriting discipline, strong portfolio management and a favourable credit environment with low unemployment, increasing house prices and continued low interest rates.
- The impairment charge, as a percentage of average loans and advances to customers, improved to 14 basis points in 2015 from 19 basis points in 2014.
- Impaired loans decreased by £433 million to £4,494 million, which represented 1.4 per cent of closing loans and advances to customers at 31 December 2015 (31 December 2014: 1.6 per cent).
- Retail Division Impairment coverage has increased to 40.4 per cent from 38.8 per cent at the end of 2014, with Secured coverage increasing 0.5 per cent to 37.5 per cent.

Table 1.9: **Retail impairment charge**

	2015 £m	2014 £m	Change %
Secured	98	281	65
Loans and overdrafts	311	279	(11)
Wealth	2	8	75
Retail Business Banking	21	31	32
Total impairment charge	432	599	28
Impairment charge as a % of average advances	0.14%	0.19%	(5)bps

Risk management continued

Table 1.10: **Retail impaired loans and 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[2] %
At 31 December 2015					
Secured	302,413	3,818	1.3	1,431	37.5
Loans and overdrafts:					
Collections		243		197	81.8
Recoveries[3]		335		–	–
	9,917	578	5.8	197	81.1
Wealth	2,811	55	2.0	23	41.8
Retail Business Banking:					
Collections		15		19	
Recoveries[3]		28		–	
	895	43	4.8	19	126.7
Total gross lending	316,036	4,494	1.4	1,670	40.4
Impairment provisions	(1,670)				
Fair value adjustments	(273)				
Total	314,093				
At 31 December 2014					
Secured	303,121	3,911	1.3	1,446	37.0
Loans and overdrafts:					
Collections		258		220	85.3
Recoveries[3]		437		–	–
	10,395	695	6.7	220	85.3
Wealth	2,962	270	9.1	40	14.8
Retail Business Banking:					
Collections		25		28	
Recoveries[3]		26		–	
	869	51	5.9	28	112.0
Total gross lending	317,347	4,927	1.6	1,734	38.8
Impairment provisions	(1,734)				
Fair value adjustments	(392)				
Total	315,221				

1 Impairment provisions include collective unidentified impairment provisions.

2 Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.

3 Recoveries assets are written down to the present value of future expected cash flows on these assets.

Secured

– The impairment charge was £98 million, a decrease of 65 per cent against 2014. The impairment charge as a percentage of average loans and advances to customers, improved to 3 basis points from 9 basis points in 2014.

– Loans and advances to Mainstream customers were broadly flat during the year at £227.3 billion with the Buy-to-let portfolio growing by 4 per cent to £55.6 billion. The closed Specialist portfolio has continued to run-off, reducing by 10 per cent to £19.5 billion.

– Impaired loans reduced by £93 million in 2015 to £3,818 million at 31 December 2015 with reductions in both the Mainstream and Buy-to-let portfolios. Impairment provisions as a percentage of impaired loans increased to 37.5 per cent from 37.0 per cent at 31 December 2014.

– The value of mortgages greater than three months in arrears (excluding repossessions) decreased by £439 million to £5,905 million at 31 December 2015 (31 December 2014: £6,344 million), with reductions in both the Mainstream and Buy-to-let portfolios.

– The average indexed loan to value (LTV) of the residential mortgage portfolio at 31 December 2015 decreased to 46.1 per cent compared with 49.2 per cent at 31 December 2014. The percentage of closing loans and advances with an indexed LTV in excess of 100 per cent decreased to 1.1 per cent at 31 December 2015, compared with 2.2 per cent at 31 December 2014.

– The average LTV for new residential mortgages written in 2015 was 64.7 per cent compared with 64.8 per cent for 2014.

Loans and overdrafts

– The impairment charge was £311 million, an increase of 11 per cent against 2014.

– The impairment charge as a percentage of average loans and advances to customers, increased to 3.0 per cent in 2015 from 2.6 per cent in 2014.

– Impaired loans reduced by £117 million in 2015 to £578 million representing 5.8 per cent of closing loans and advances to customers, compared with 6.7 per cent at 31 December 2014.

Table 1.11: **Retail secured and unsecured loans and advances to customers**

	At 31 Dec 2015 £m	At 31 Dec 2014 £m
Secured:		
Mainstream	227,267	228,176
Buy-to-let	55,598	53,322
Specialist[1]	19,548	21,623
	302,413	303,121
Loans and overdrafts:		
Loans	7,889	8,204
Overdrafts	2,028	2,191
	9,917	10,395
Wealth	2,811	2,962
Retail Business Banking	895	869
Total gross lending	316,036	317,347

1 Specialist lending has been closed to new business since 2009.

Table 1.12: **Mortgages greater than three months in arrears (excluding repossessions)**

	Number of cases		Total mortgage accounts %		Value of loans[1]		Total mortgage balances %	
	2015 cases	2014 cases	2015 %	2014 %	2015 £m	2014 £m	2015 %	2014 %
Mainstream	34,850	37,849	1.6	1.7	3,803	4,102	1.7	1.8
Buy-to-let	5,021	5,077	1.0	1.1	626	658	1.1	1.2
Specialist	8,777	9,429	6.4	6.3	1,476	1,584	7.6	7.3
Total	48,648	52,355	1.7	1.8	5,905	6,344	2.0	2.1

1 Value of loans represents total gross book value of mortgages more than three months in arrears.

The stock of repossessions decreased to 654 cases at 31 December 2015 compared to 1,740 cases at 31 December 2014.

Risk management continued

Table 1.13: **Period end and average LTVs across the Retail mortgage portfolios**

	Mainstream %	Buy-to-let %	Specialist %	Total %	Unimpaired %	Impaired %
At 31 December 2015						
Less than 60%	52.2	45.4	43.7	50.4	50.7	30.9
60% to 70%	19.1	26.8	19.7	20.6	20.6	17.5
70% to 80%	15.5	15.0	15.5	15.4	15.4	16.9
80% to 90%	9.0	8.0	11.6	9.0	8.9	13.3
90% to 100%	3.2	3.9	5.5	3.5	3.4	9.5
Greater than 100%	1.0	0.9	4.0	1.1	1.0	11.9
Total	100.0	100.0	100.0	100.0	100.0	100.0
Outstanding loan value (£m)	227,267	55,598	19,548	302,413	298,595	3,818
Average loan to value:[1]						
Stock of residential mortgages	43.6	56.3	53.3	46.1		
New residential lending	65.2	63.0	n/a	64.7		
Impaired mortgages	55.6	74.6	66.8	60.0		
At 31 December 2014						
Less than 60%	44.6	32.4	31.4	41.5	41.7	22.5
60% to 70%	19.9	27.3	19.5	21.2	21.3	15.3
70% to 80%	18.5	21.8	19.8	19.2	19.2	17.8
80% to 90%	10.6	9.4	14.9	10.7	10.6	16.7
90% to 100%	4.5	6.8	8.7	5.2	5.2	11.9
Greater than 100%	1.9	2.3	5.7	2.2	2.0	15.8
Total	100.0	100.0	100.0	100.0	100.0	100.0
Outstanding loan value (£m)	228,176	53,322	21,623	303,121	299,210	3,911
Average Loan to value:[1]						
Stock of residential mortgages	46.3	61.3	59.2	49.2		
New residential lending	65.3	62.7	n/a	64.8		
Impaired mortgages	60.1	81.0	72.6	64.9		

1 Average loan to value is calculated as total loans and advances as a percentage of the indexed total collateral of these loans and advances.

Interest only mortgages

The Group provides interest only mortgages to customers, whereby payments of interest only are made 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 owner occupier interest only mortgages throughout 2015. New owner occupier interest only mortgages are limited to a maximum loan to value of 75 per cent, with a verifiable repayment vehicle sufficient to repay the loan. Interest only mortgages represented 0.1 per cent of new residential mortgages in 2015 (0.1 per cent in 2014).

Table 1.14: **Analysis of owner occupier interest-only mortgages**

	2015	2014
Interest only balances (£m)[1]	81,558	90,649
Impaired Loans (£m)	2,071	2,012
Interest only balances as a % of owner occupier balances	33.9	37.2
Average loan to value (%)	46.6	51.0

1 In addition the Group has Buy-to-let interest only balances of £49,751 million (2014: £47,761 million) and certain other interest only balances of £3,705 million (2014: £4,153 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 obligations 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 11 years; the profile of owner occupier interest only maturities is shown below.

Table 1.15: **Analysis of owner occupier interest-only mortgages maturities**

	1 Year £bn	2-5 Years £bn	6-10 Years £bn	> 11 Years £bn
Value of loans as at 31 December 2015[1]	2.0	9.1	14.5	45.2
Value of loans as at 31 December 2014[1]	1.8	9.2	14.6	52.7

1 Excludes mortgage accounts which consist of partial interest only and partial capital repayment.

Treatment strategies exist to help customers who may not be able to fully repay the principal balance at maturity. Of the owner occupier interest only mortgages that have missed the payment of principal at the end of term, balances of £1,313 million remain at 31 December 2015 (£1,117 million at 31 December 2014). The average indexed loan to value of these accounts is 28.0 per cent at 31 December 2015 (28.7 per cent at 31 December 2014). Of these accounts, 9.1 per cent are impaired (8.4 per cent at 31 December 2014).

Forborne loans

At 31 December 2015, UK secured loans and advances currently or recently subject to forbearance were 1.0 per cent (31 December 2014: 1.4 per cent) of total UK secured loans and advances. The reduction in forbearance is due to the overall improvement of credit quality in the portfolio. Loans and overdrafts currently or recently subject to forbearance were 1.5 per cent (31 December 2014: 1.6 per cent) of total loans and overdrafts.

Further analysis of the forborne loan balances is set out below:

Table 1.16: **UK retail forborne loans and advances (audited)**

	Total loans and advances which are forborne[1]		Total forborne loans and advances which are impaired[1]		Impairment provisions as % of loans and advances which are forborne[1]	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 %	2014 %
UK secured lending:						
Temporary forbearance arrangements						
Reduced contractual monthly payment[2]	–	146	–	29	–	6.0
Reduced payment arrangements[3]	414	552	41	69	4.2	3.4
	414	698	41	98	4.2	4.0
Permanent treatments						
Repair and term extensions[4]	2,688	3,696	132	168	4.2	3.5
Total	3,102	4,394	173	266	4.2	3.5
Loans and overdrafts[5]:	147	162	119	139	40.0	39.4

1 Includes accounts where the customer is currently benefiting from a forbearance treatment or the treatment has recently ended.

2 Includes temporary interest-only arrangements and short-term payment holidays granted in collections where the customer is currently benefiting 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).

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 where the borrowers remain as customers at 31 December.

5 Includes temporary treatments where the customer is currently benefiting from the change or the treatment has ended within the previous six months. Permanent changes which commenced during the last 24 months for existing customers as at 31 December are also included.

UK secured forborne loans and advances have reduced by £1,292 million in 2015 to £3,102 million, driven primarily by an improvement in the underlying quality of the portfolio, with a greater value exiting forbearance than entering. Loans and Overdrafts forborne loans and advances have reduced by £15 million in 2015.

Further analysis of the movements in UK retail lending forborne loans and advances during the year is as follows:

Table 1.17: **Movement in UK retail forborne loans and advances (audited)**

	2015		2014	
	Secured lending £m	Loans and Overdrafts lending £m	Secured lending £m	Loans and Overdrafts lending £m
At 1 January	4,394	162	6,153	191
Classified as forborne during the year	1,290	69	1,805	123
Written-off/sold	(25)	(55)	(93)	(77)
Good exit from forbearance	(2,252)	(25)	(2,957)	(35)
Redeemed or repaid	(263)	(6)	(462)	(10)
Exchange and other movements	(42)	2	(52)	(30)
At 31 December	3,102	147	4,394	162

Commercial Banking

– There was a net impairment release of £22 million in 2015, compared to a charge of £83 million in 2014. This has been driven by lower levels of new impairment as a result of effective risk management, improving UK economic conditions and the continued low interest rate environment; as well as write backs and provision releases, but at lower levels than seen during 2014.

– The credit quality of the portfolio and new business remains good. Surplus market liquidity continues to lead to some relaxation of credit conditions in the marketplace, although the Group remains disciplined within its low risk appetite approach.

– Impaired loans reduced by 22 per cent to £2,528 million at 31 December 2015 compared with 31 December 2014 (£3,241 million) and as a percentage of closing loans and advances reduced to 2.5 per cent from 3.2 per cent at 31 December 2014.

– Impairment provisions reduced to £1,087 million at 31 December 2015 (December 2014: £1,594 million) and includes collective unidentified impairment provisions of £229 million (31 December 2014: £338 million). Provisions as a percentage of impaired loans reduced from 49.2 per cent to 43.0 per cent, predominantly due to the change in the mix of impaired assets during 2015, with newly impaired connections having lower coverage levels compared

Risk management continued

to the portfolio average. The decrease is also partly due to the reduction in the collective unidentified impairment provisions fund during the year as a result of improved conditions.

– The Group expects to benefit from its continued disciplined approach to the management of credit, and sustained UK economic growth. Nevertheless, market volatility and the uncertain global economic outlook such as the continued slowdown in Chinese economic growth and the fall in commodity prices may impact the Commercial portfolios.

– The Group manages and limits exposure to certain sectors and asset classes, and closely monitors credit quality, sector and single name concentrations. This together with our conservative through the cycle risk appetite approach, means our portfolios are well positioned.

Table 1.18: **Commercial Banking impairment charge**

	2015 £m	2014 £m	Change %
SME	(22)	15	
Other	–	68	
Total impairment (release)/charge	(22)	83	
Impairment charge as a % of average advances[1]	0.01%	0.08%	(7)bps

1 In respect of loans and advances to customers.

Table 1.19: **Commercial Banking impaired loans and 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 2015					
SME	29,393	1,149	3.9	213	18.5
Other	73,042	1,379	1.9	874	63.4
Total gross lending	102,435	2,528	2.5	1,087	43.0
Reverse repos	–				
Impairment provisions	(1,087)				
Total	101,348				
At 31 December 2014					
SME	28,256	1,546	5.5	398	25.7
Other	74,203	1,695	2.3	1,196	70.6
Total gross lending	102,459	3,241	3.2	1,594	49.2
Reverse repos	5,145				
Impairment provisions	(1,594)				
Total	106,010				

1 Impairment provisions include collective unidentified impairment provisions.

SME

– The SME Banking portfolio continues to grow within prudent credit risk appetite parameters.

– Portfolio credit quality has remained stable or improved across all key metrics.

– There was a net impairment release of £22 million compared to a net charge of £15 million in 2014 with lower new impairment offset by writebacks and releases.

Other Commercial Banking

– Other Commercial Banking comprises £73,042 million of gross loans and advances to customers in Mid Markets, Global Corporates and Financial Institutions.

– In the Mid Markets portfolio, credit quality has remained stable. The portfolio is focused on UK businesses and dependent on the performance of the domestic economy and to some extent, the global economy. The oil and gas services element of the portfolio has been reviewed given ongoing low oil prices and this review has not revealed any material concerns with portfolio quality at this time.

– The Global Corporate business continues to have a predominance of investment grade clients, primarily UK based. As a result of this profile, allied to our conservative risk appetite, our portfolio remains of good quality despite the current global economic headwinds particularly relating to the energy and mining sectors. We continue to monitor the portfolio closely to ensure there is no material deterioration.

– The real estate business within the Group's Mid Markets and Global Corporate portfolio is focused on clients operating in the UK commercial property market ranging in size from medium sized private real estate entities up to publicly listed property companies. The market for UK real estate has been buoyant and credit quality remains good with minimal impairments/stressed loans. All asset classes are attracting investment but, recognising this is a cyclical sector, appropriate caps are in place to control exposure and business propositions continue to be written in line with prudent risk appetite with conservative LTV, strong quality of income and proven management teams.

– Financial Institutions serves predominantly investment grade counterparties with whom relationships are either client focused or held to support the Group's funding, liquidity or general hedging requirements.

– Trading exposures continue to be predominantly short-term and/or collateralised with inter-bank activity mainly undertaken with acceptable investment grade counterparties.
– The Group continues to adopt a conservative stance across the Eurozone maintaining close portfolio scrutiny and oversight particularly given the current macro environment and horizon risks.

Commercial Banking UK Direct Real Estate LTV analysis

– 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.
– Approximately 70 per cent of loans and advances to UK Direct Real Estate relate to commercial real estate with the remainder residential real estate.
– 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 indices, models and subject matter expert judgement.
– The LTV profile of the UK Direct Real Estate portfolio in Commercial Banking continues to improve.

Table 1.20: **LTV – UK Direct Real Estate**

	At 31 December 2015[1]				At 31 December 2014[1]			
	Unimpaired £m	Impaired £m	Total £m	%	Unimpaired £m	Impaired £m	Total £m	%
UK exposures >£5 million								
Less than 60%	4,989	72	5,061	63.7	3,985	52	4,037	47.8
60% to 70%	1,547	6	1,553	19.5	1,644	62	1,706	20.2
70% to 80%	610	13	623	7.9	964	17	981	11.6
80% to 100%	75	36	111	1.4	66	211	277	3.3
100% to 120%	–	8	8	0.1	–	–	–	–
120% to 140%	–	–	–	–	130	6	136	1.6
Greater than 140%	5	100	105	1.3	–	95	95	1.1
Unsecured	487	–	487	6.1	1,222	–	1,222	14.4
	7,713	235	7,948	100.0	8,011	443	8,454	100.0
UK exposures <£5 million	9,656	508	10,164		8,833	644	9,477	
Total	17,369	743	18,112		16,844	1,087	17,931	

1 Exposures exclude £0.3 billion (31 December 2014: £0.4 billion) of gross UK Direct Real Estate lending in Wealth (within Retail division) and £1.1 billion (31 December 2014: £3.3 billion) of UK Direct Real Estate lending in Run-off. Also excludes Social Housing and Housebuilder lending.

Forborne loans

Commercial Banking forbearance

At 31 December 2015, £3,514 million (31 December 2014: £5,137 million) of total loans and advances were forborne of which £2,528 million (31 December 2014: £3,241 million) were impaired. Impairment provisions as a percentage of forborne loans and advances decreased marginally from 31.0 per cent at 31 December 2014 to 30.9 per cent at 31 December 2015.

Table 1.21: **Commercial Banking forborne loans and advances (audited)**

	Total loans and advances which are forborne		Impairment provisions as % of loans and advances which are forborne	
	2015 £m	2014 £m	2015 %	2014 %
Impaired	2,528	3,241	43.0	49.2
Unimpaired	986	1,896	–	–
Total	3,514	5,137	30.9	31.0

All impaired assets are considered forborne.

Risk management continued

Impaired loans and advances

The movements in Commercial Banking impaired forborne loans and advances were as follows:

Table 1.22: **Movement in Commercial Banking impaired forborne loans and advances (audited)**

	2015 £m	2014 £m
At 1 January	3,241	5,047
Classified as impaired during the year:		
Exposures >£5m	505	775
Exposures <£5m	126	188
	631	963
Transferred to unimpaired:		
Exposures >£5m but still reported as forborne	(15)	(268)
Exposures >£5m no longer reported as forborne	(20)	–
Exposures <£5m	(111)	(477)
	(146)	(745)
Written-off	(225)	(719)
Asset disposal/sales of impaired assets	(48)	(357)
Drawdowns/repayments	(693)	(732)
Exchange and other movements	(232)	(216)
At 31 December	2,528	3,241

Unimpaired loans and advances

Unimpaired forborne loans and advances were £986 million at 31 December 2015 (31 December 2014: £1,896 million).

The table below sets out the largest unimpaired forborne loans and advances to Commercial Banking customers (exposures over £5 million) as at 31 December 2015 by type of forbearance:

Table 1.23: **Commercial Banking unimpaired forborne loans and advances (audited)**

	31 December 2015 £m	31 December 2014 £m
Exposures >£5 million:		
Covenants	310	1,018
Extensions/alterations	350	426
Multiple	9	6
	669	1,450
Exposures < £5 million	317	446
Total	986	1,896

Table 1.24: **Movement in Commercial Banking unimpaired forborne loans and advances >£5m[1] (audited)**

	31 December 2015 £m	31 December 2014 £m
At 1 January	1,450	1,654
Classified as impaired during the year	(141)	(147)
Cured no longer forborne	(655)	(1,004)
Classified as forborne during the year	156	709
Transferred from impaired but still reported as forborne[2]	15	743
Asset disposal/sales	–	(451)
Net drawdowns/repayments	(153)	(6)
Exchange and other movements	(3)	(48)
At 31 December	669	1,450

1 Balances exclude intra-year movements.

2 2014 included £475 million in respect of two loans transferred from Run-off.

Consumer Finance

– The impairment charge reduced by 29 per cent to £152 million from £215 million in 2014. The reduction was driven by a continued underlying improvement of portfolio quality supported by an increased level of write-backs from the sale of recoveries assets in the Credit Cards portfolio.

– Impairment provisions as a percentage of impaired loans have increased to 72.8 per cent from 70.5 per cent at 31 December 2014, with Credit Cards increasing by 5.3 percentage points to 81.8 per cent and Asset Finance UK decreasing by 2.8 percentage points to 67.2 per cent.

– Loans and advances increased by £2,665 million to £23,938 million during 2015. The growth was achieved in both Asset Finance UK and Credit Cards portfolio with no relaxation in risk appetite and underwriting standards. Impaired loans decreased by £177 million in 2015 to £543 million which represented 2.3 per cent of closing loans and advances to customers (31 December 2014: 3.4 per cent).

Table 1.25: Consumer Finance impairment charge

	2015 £m	2014 £m	Change %
Credit Cards	129	186	31
Asset Finance UK	22	30	27
Asset Finance Europe	1	(1)	
Total impairment charge	152	215	29
Impairment charge as a % of average advances	0.68%	1.05%	(37) bps

Table 1.26: Consumer Finance impaired loans and 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[2] %
At 31 December 2015					
Credit Cards:					
Collections		187		153	81.8
Recoveries[3]		179		–	
	9,425	366	3.9	153	81.8
Asset Finance UK	9,582	134	1.4	90	67.2
Asset Finance Europe	4,931	43	0.9	22	51.2
	14,513	177	1.2	112	63.3
	23,938	543	2.3	265	72.8
Impairment provisions	(265)				
Fair value adjustments	(9)				
Total	23,664				
At 31 December 2014					
Credit Cards:					
Collections		217		166	76.5
Recoveries[3]		282		–	
	9,119	499	5.5	166	76.5
Asset Finance UK	7,204	160	2.2	112	70.0
Asset Finance Europe	4,950	61	1.2	31	50.8
	12,154	221	1.8	143	64.7
	21,273	720	3.4	309	70.5
Impairment provisions	(309)				
Fair value adjustments	(30)				
Total	20,934				

1 Impairment provisions include collective unidentified impairment provisions.

2 Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.

3 Recoveries assets are written down to the present value of expected cash flows on these assets.

Risk management continued

Forborne loans

At 31 December 2015, Consumer Credit Card loans and advances currently or recently subject to forbearance were 2.4 per cent (31 December 2014: 2.6 per cent) of total Consumer Credit Card loans and advances. At 31 December 2015, Asset Finance UK Retail loans and advances on open portfolios currently or recently subject to forbearance were 1.4 per cent (31 December 2014: 2.1 per cent) of total Asset Finance UK Retail loans and advances. Further analysis of the forborne loans and advances is set out below:

Table 1.27: **Consumer Finance forborne loans and advances (audited)**

	Total loans and advances which are forborne[1]		Total forborne loans and advances which are impaired[1]		Impairment provisions as % of loans and advances which are forborne[1]	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 %	2014 %
Consumer Credit Cards[2]	225	234	120	140	26.8	29.1
Asset Finance UK Retail[2]	100	109	51	53	25.5	20.5

1 Includes accounts where the customer is currently benefiting from a forbearance treatment or the treatment recently ended.

2 Includes temporary treatments where the customer is currently benefiting from the change or the treatment has ended within the last six months. Permanent changes which commenced during the last 24 months for existing customers as at 31 December are also included.

Consumer Credit Cards and Asset Finance UK Retail forborne loans have reduced in 2015 by £9 million and £9 million respectively, driven primarily by improvements in the underlying quality of the portfolios. The movements in forborne loans and advances during the year were as follows:

Table 1.28: **Movement in Consumer Finance forborne loans and advances (audited)**

	2015		2014	
	Consumer credit cards £m	Asset Finance £m	Consumer credit cards £m	Asset Finance £m
At 1 January	234	109	326	149
Classified as forborne during the year	108	61	128	56
Written off/sold	(48)	(14)	(93)	(25)
Good exit from forbearance	(36)	(17)	(92)	(19)
Redeemed or repaid	(9)	(19)	(14)	(26)
Exchange and other movements	(24)	(20)	(21)	(26)
At 31 December	225	100	234	109

Run-off

- With the exception of a small residual book (£37 million of which £5 million is impaired), the Irish Wholesale book (which contained the Commercial Real Estate portfolio), is now effectively exited following completion of the divestment announced on 30 July 2015. The Ireland Retail portfolio has reduced from £4,464 million at 31 December 2014 to £4,040 million at 31 December 2015.
- The Corporate real estate and other corporate portfolio has continued to reduce significantly ahead of expectations. Net loans and advances reduced by £1,908 million, from £3,036 million to £1,128 million for 2015.
- Net loans and advances for the specialist finance asset based run-off portfolio stood at £4,001 million at 31 December 2015 (gross £4,190 million), and include Ship Finance, Aircraft Finance and Infrastructure, with around half of the remaining lending in the lower risk leasing sector. Including the reducing Treasury Asset Legacy investment portfolio, and operating losses, total net external assets reduced to £5,552 million at 31 December 2015 (gross £5,742 million).
- Ireland retail loans and advances with an indexed LTV in excess of 100 per cent decreased to £1,269 million (31.4 per cent) at 31 December 2015, compared with £1,737 million (38.9 per cent) at 31 December 2014. Of this amount £71 million were impaired (31 December 2014: £78 million).

Table 1.29: **Run-off impairment charge**

	2015 £m	2014 £m	Change %
Ireland retail	(5)	(6)	(17)
Ireland commercial real estate	11	67	84
Ireland corporate	61	247	75
Corporate real estate and other corporate	21	(28)	
Specialist finance	(45)	22	
Other	(35)	(99)	(65)
Total	8	203	96
Impairment charge as a % of average advances[1]	0.20%	0.64%	(44)bps

1 In respect of loans and advances to customers.

Table 1.30: **Run-off impaired loans and provisions**

	Advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions £m	Impairment provisions as a % of impaired loans %
At 31 December 2015					
Ireland retail	4,040	132	3.3	120	90.9
Ireland commercial real estate	8	5	62.5	–	
Ireland corporate	29	–		–	
Corporate real estate and other corporate	1,873	1,410	75.3	745	52.8
Specialist finance	4,190	361	8.6	189	52.4
Other	1,282	117	9.1	96	82.1
	11,422	2,025	17.7	1,150	56.8
Impairment provisions	(1,150)				
Fair value adjustments	–				
Total	10,272				
At 31 December 2014					
Ireland retail	4,464	120	2.7	141	117.5
Ireland commercial real estate	1,797	1,659	92.3	1,385	83.5
Ireland corporate	1,639	1,393	85.0	1,095	78.6
Corporate real estate and other corporate	3,947	1,548	39.2	911	58.9
Specialist finance	4,835	364	7.5	254	69.8
Other	1,634	131	8.0	141	107.6
	18,316	5,215	28.5	3,927	75.3
Impairment provisions	(3,927)				
Fair value adjustments	19				
Total	14,408				

Forborne loans

Run-off Ireland retail lending

At 31 December 2015, £169 million or 4.2 per cent (31 December 2014: £280 million or 6.3 per cent) of Irish retail secured loans and advances were subject to current or recent forbearance. Of this amount £26 million (31 December 2014: £41 million) were impaired.

Run-off Corporate real estate, other corporate and Specialist Finance

At 31 December 2015 £1,780 million (31 December 2014: £1,998 million) of total loans and advances were forborne of which £1,771 million (31 December 2014: £1,912 million) were impaired. Impairment provisions as a percentage of forborne loans and advances decreased from 58.3 per cent at 31 December 2014 to 52.5 per cent at 31 December 2015.

Unimpaired forborne loans and advances were £9 million at 31 December 2015 (31 December 2014: £86 million).

Risk management continued

Impaired loans and advances

The movements in Run-off corporate real estate, other corporate and Specialist Finance impaired forborne loans and advances were as follows:

Table 1.31: **Movement in Run-off corporate real estate, other corporate and Specialist Finance impaired forborne loans and advances (audited)**

	2015 £m	2014 £m
At 1 January	**1,912**	9,499
Classified as impaired during the year:		
Exposures >£5m	**414**	557
Exposures <£5m	**11**	46
	425	603
Transferred to unimpaired but still reported as forborne during the year:		
Exposures >£5m[1]	**(13)**	(961)
Exposures <£5m	**(11)**	(12)
	(24)	(973)
Write offs	**(238)**	(2,565)
Asset disposal/sales of impaired assets	**(763)**	(4,363)
Drawdowns/repayments	**(19)**	(248)
Exchange and other movements	**478**	(41)
At 31 December	**1,771**	1,912

1 2014 included £475 million in respect of two loans classified as impaired during the year and subsequently transferred to Commercial Banking.

Run-off Ireland commercial real estate and corporate

All loans and advances (whether impaired or unimpaired) are treated as forborne. At 31 December 2015, £37 million (31 December 2014: £3,436 million) of total loans and advances were forborne of which £5 million (31 December 2014: £3,052 million) were impaired. Impairment provisions as a percentage of forborne loans and advances decreased from 72.2 per cent at 31 December 2014 to nil at 31 December 2015.

The movements in forborne loans and advances were:

Table 1.32: **Movement in Run-off: Ireland commercial real estate and corporate forborne loans and advances (audited)**

	2015 £m	2014 £m
At 1 January	**3,436**	9,430
Write-offs	**(419)**	(2,589)
Asset disposal/sales	**(2,563)**	(1,444)
Drawdowns/repayments	**(99)**	(1,413)
Exchange and other movements	**(318)**	(548)
At 31 December	**37**	3,436

Eurozone exposures

The following section summarises the Group's direct exposure to Eurozone countries at 31 December 2015. 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, where available 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, where information is available, 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.

Exposures to Eurozone countries are detailed in the following tables and are based on balance sheet exposures, net of provisions. 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 on the domicile of the issuer.

For Insurance, the Group has reported shareholder exposures i.e. where the Group is directly exposed to risk of loss. These shareholder exposures relate to direct investments where the issuer is resident in the named Eurozone country and the credit rating is consistent with the tight credit criteria defined under the appropriate investment mandate. Insurance also has interests in two funds domiciled in Ireland (Global Liquidity Fund and the Investment Cash Fund) where, in line with the investment mandates, cash is invested in short term financial instruments. For these funds, the exposure is analysed on a look through basis to the country risk of the obligors of the underlying assets rather than treating the insurance holding in the funds as exposure to Ireland.

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 1.33: **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 2015									
Ireland	–	–	748	445	87	731	3,921	–	5,932
Spain	–	–	77	102	–	870	39	9	1,097
Portugal	–	–	7	–	–	86	6	–	99
Italy	–	–	32	–	–	51	–	73	156
Greece	–	–	–	–	–	1	–	–	1
	–	–	864	547	87	1,739	3,966	82	7,285
At 31 December 2014									
Ireland	–	–	359	–	115	1,672	4,325	–	6,471
Spain	–	–	57	116	–	1,160	49	13	1,395
Portugal	–	–	9	5	–	133	6	–	153
Italy	–	–	354	5	–	93	–	34	486
Greece	–	–	–	–	–	3	–	–	3
	–	–	779	126	115	3,061	4,380	47	8,508

1 Excludes reverse repurchase exposure to Institutional funds domiciled in Ireland secured by UK gilts of £11,267 million (2014: £10,456 million) on a gross basis.

Risk management continued

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 1.34: **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 2015									
Netherlands	281	11,515	328	164	37	1,275	4,863	428	18,891
France	173	–	1,809	216	98	1,953	64	953	5,266
Germany	151	97	888	21	66	1,924	177	573	3,897
Luxembourg	–	–	74	1,178	618	1,614	–	36	3,520
Belgium	20	–	830	1	–	298	–	51	1,200
Austria	–	–	3	–	–	280	–	–	283
All other Eurozone countries	15	–	400	–	–	62	–	80	557
	640	11,612	4,332	1,580	819	7,406	5,104	2,121	33,614
At 31 December 2014									
Netherlands	320	5,611	597	129	307	1,682	4,888	432	13,966
France	245	–	3,198	1,435	134	2,453	73	1,069	8,607
Germany	181	133	806	1,180	339	1,729	32	877	5,277
Luxembourg	–	–	8	799	74	2,241	–	11	3,133
Belgium	75	–	906	2	–	404	–	27	1,414
Austria	311	–	913	–	–	163	–	–	1,387
All other Eurozone countries	116	–	449	–	–	64	–	94	723
	1,248	5,744	6,877	3,545	854	8,736	4,993	2,510	34,507

1 Excludes reverse repurchase exposure to Institutional funds secured by UK gilts of £1,955 million (2014: £1,455 million) on a gross basis.

Environmental risk management

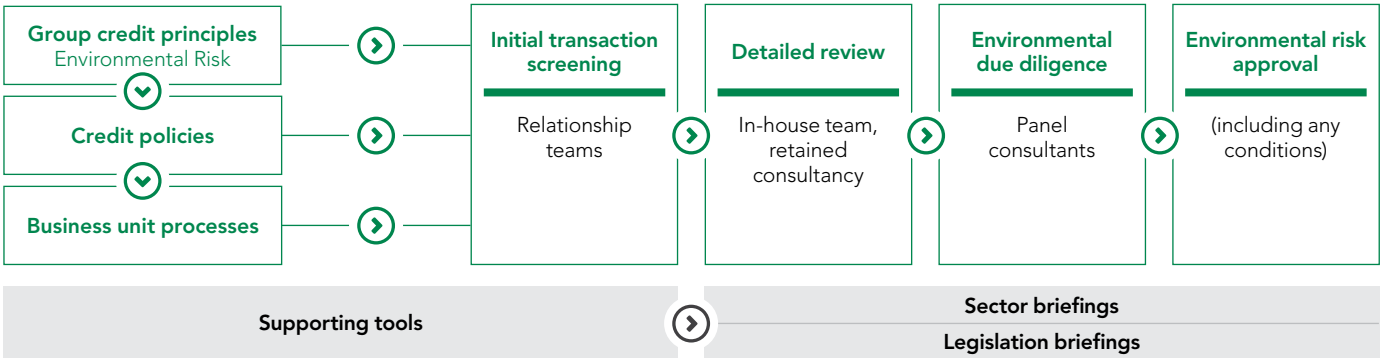
The Group ensures appropriate management of the environmental impact of its lending activities. The Groupwide credit risk principles require all credit risk to be incurred with due regard to environmental legislation and the Group's Code of Business Responsibility.

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 results in 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 Review (http://www.lloydsbankinggroup.com/our-group/responsible-business/our-approach/managing-risk/).

Table 1.35: **Environmental risk management approach**



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's conduct risk appetite is designed to safeguard customers from systemic unfair outcomes and is monitored through a number of key metrics with defined limits and triggers which are reviewed and approved by the Board annually. The metrics and their outputs are regularly assessed by Executive and Board Risk committees to ensure that the Group operates within appetite policies, processes and standards. These are in place to provide a framework for businesses and colleagues to operate in accordance with the laws, regulations and voluntary codes, which apply to the Group and its activities.

For further information on risk appetite refer to page 112.

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; failure to deal with a customer's complaint effectively where the Group has not met customer expectations, which may lead to a referral to the Financial Ombudsman Service; or engaging in conduct which disrupts the fair and effective operation of a market in which it is active. Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media, politicians and consumer groups, there is a risk that certain aspects of the Group's current or legacy business may be determined by the Financial Conduct Authority and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or in a manner that fails to deliver fair and reasonable treatment. 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 product families offered by the Group; a set of common metrics have been agreed for all products to support a consistent approach. These contain a range of product, sales and post-sales metrics to provide a more holistic view of conduct risks; each product also has additional bespoke metrics. The common metrics are sales volume, product governance adherence, target market, outcome testing: meets customer needs, outcome testing: information disclosure, outcome testing: regulatory compliance, retention, usage, claims (decline rates), complaints, Financial Ombudsman Service uphold rate and complaints outcome testing. Each of the tolerances for the metrics are agreed for the individual product and are tracked month by month. At a consolidated level these metrics are part of the Board approved risk appetite. The Group also continues to measure how effectively the overall Conduct Strategy is embedded across all divisions and functions and its impact on customer outcomes through the Group Customer First Committee (GCFC). In relation to market conduct, metrics have also been generated, covering, for example, the way in which confidential information and potential conflicts of interest are managed.

Mitigation

The Group takes a range of mitigating actions with respect to this risk; it has implemented a customer-focused, UK-centric strategy, strengthened its culture and values, improved systems and processes, and implemented more effective controls. These actions are being further embedded throughout the Group (across all business areas and all supporting functional areas) as part of the transition of the Group's Conduct Strategy from a programme to business as usual supported by the GCFC, including:

- Conduct risk appetite established at Group and business area level;
- Customer needs explicitly considered within business and product level planning and strategy;
- Cultural transformation, supported by strong direction and tone from senior executives and the Board. This is underpinned by 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 fair value, and meet the needs of the relevant target market throughout their life cycle;
- Sales processes and governance framework to deliver consistently fair outcomes;
- Enhanced complaints management through effectively responding to, and learning from, root causes to reduce complaint volumes and the Financial Ombudsman Service change rate;
- Enhanced recruitment and training, and a focus on how the Group manages colleagues' performance with clearer customer accountabilities; and
- Application of the Conduct Strategy to third parties involved in serving the Group's customers.

The Group has also prioritised activity designed to reinforce good conduct in its engagement with the markets in which it operates, together with the development of preventative and detective controls in order to be able to demonstrate this.

The Group's leadership team is committed to embedding the Conduct Strategy within the business following its approved transition into business as usual to support the development of the right customer centric culture. The Board and Group Risk Committee receive regular reports and metrics to track progress on how the Group is meeting customer needs and minimising conduct risk.

All Group business areas have continued to apply significant resources to the Conduct Strategy to achieve the target of transition to business as usual and to continue delivering improved outcomes for customers.

The Group actively engages with regulatory bodies and other stakeholders in developing its understanding of current customer treatment concerns, and those relating to the fairness and effectiveness of markets, to ensure that the implementation of the Group's conduct strategy meets evolving stakeholder expectations.

Monitoring

Monitoring and reporting is undertaken at Board, Group and business area committees. As part of the reporting of CRAMs, a robust outcomes testing regime is in place to test performance of customer critical activities. The GCFC has responsibility for monitoring and reviewing integrated measurement of enhanced outcomes, customer views and cultural transformation, including challenging Divisions to make changes based on key learnings to support the delivery of the Group's vision and foster a customer centric culture. There is also focus on the enhancement of preventative and detective controls to encourage and demonstrate the Group's support for the fair and effective operation of relevant markets.

Risk management continued

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

Risk appetite is defined within the Group as the amount and type of risk that the Group is prepared to seek, accept or tolerate. The Group's Risk Management Framework and Market Risk Principle, reviewed and approved annually by the Board, articulate accountabilities for the management of market risk across the Group, and how this is discharged through a robust governance structure with the objective of seeking an optimal risk profile which supports sustainable business growth and minimises losses. The Group Asset and Liability Committee (GALCO), chaired by the Chief Financial Officer, is responsible for approving and monitoring group market risks, management techniques, market risk measures, behavioural assumptions, and the market risk policy.

The market risk policy defines the framework and mandatory requirements for market risk management and oversight adopted by the Group. The policy is owned by Group Corporate Treasury (GCT) and refreshed annually. The policy is underpinned by supplementary market risk procedures, which define specific market risk management and oversight requirements.

For further information on risk appetite refer to page 112.

Balance sheet linkages

The information provided in table 1.36 (below) aims to facilitate the understanding of linkages between banking, trading, and insurance balance sheet items and the positions disclosed in the Group's market risk disclosures. This breakdown of financial instruments included and not included in trading book Value at Risk (VaR) provides a linkage with the trading book market risk measures reported later on in the market risk section. It is important to highlight that this table does not reflect how the Group manages trading book market risk, since it does not discriminate between assets and liabilities in its VaR model.

Table 1.36: **Market risk linkage to the balance sheet**

		Banking			
2015	Total £m	Trading book only £m	Non-trading £m	Insurance £m	Primary risk factor
Assets					
Cash and balances at central banks	58,417	–	58,417	–	Interest rate
Items in the course of collection from banks	697	–	697	–	Interest rate
Trading and other financial assets at fair value through profit or loss	140,536	42,661	2,181	95,694	Interest rate, foreign exchange, credit spread
Derivative financial instruments	29,467	25,305	2,570	1,592	Interest rate, foreign exchange, credit spread
Loans and receivables:					
Loans and advances to banks	25,117	–	3,385	21,732	Interest rate
Loans and advances to customers	455,175	–	455,175	–	Interest rate
Debt securities	4,191	–	4,191	–	Interest rate, credit spread
	484,483	–	462,751	21,732	
Available-for-sale financial assets	33,032	–	33,030	2	Interest rate, credit spread, foreign exchange
Held-to-maturity investments	19,808	–	19,808	–	Interest rate
Value of in-force business	4,596	–	–	4,596	Equity
Other assets	35,652	–	16,656	18,996	Interest rate
Total assets	806,688	67,966	596,110	142,612	
Liabilities					
Deposits from banks	16,925	–	16,925	–	Interest rate
Customer deposits	418,326	–	418,326	–	Interest rate
Items in course of transmission to banks	717	–	717	–	Interest rate
Trading and other financial liabilities at fair value through profit or loss	51,863	43,984	7,879	–	Interest rate, foreign exchange
Derivative financial instruments	26,301	22,124	2,413	1,764	Interest rate, foreign exchange, credit spread
Debt securities in issue	82,056	–	82,056	–	Interest rate
Liabilities arising from insurance and investment contracts	103,071	–	–	103,071	Credit spread
Subordinated liabilities	23,312	–	21,638	1,674	Interest rate, foreign exchange
Other liabilities	37,137	–	7,103	30,034	Interest rate
Total liabilities	759,708	66,108	557,057	136,543	

The Group's trading book assets and liabilities are 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. The assets and liabilities are classified as trading books if they have been acquired or incurred for the purpose of selling or repurchasing in the near future. These consist of government, corporate and financial institution bonds and loans/deposits and repos.

Derivative assets and liabilities are held for three main purposes; to provide risk management solutions for clients, to manage portfolio risks arising from client business and to manage and hedge the Group's own risks. The majority of derivatives exposure arises within Financial Markets.

Insurance business assets and liabilities relate to policyholder funds, as well as shareholder invested assets, including annuity funds. The Group recognises the value of in-force business in respect of Insurance's long-term life assurance contracts as an asset in the balance sheet (see note 25, page 218).

The Group ensures that it has adequate cash and balances at central banks and stocks of high quality liquid assets (e.g. Gilts or US Treasury Securities) that can be converted easily into cash to meet liquidity requirements. The majority of these assets are held as available-for-sale with the remainder held as financial assets at fair value through profit and loss. Further information on these balances can be found under the Funding and Liquidity Risk on page 155. Interest rate risk in the asset portfolios is swapped into floating.

The majority of debt issuance originates from the Issuance, Capital Vehicles and Medium Term Notes desks and the interest rate risk of the debt issued is hedged by swapping them into a floating rate.

Table 1.37 shows the key market risks for the Group's banking, defined benefit pension schemes and trading, banking and Insurance and trading activities.

Table 1.37: **Key market risks for the Group by individual business activity (profit before tax impact measured against Group single stress scenarios)**

	Risk type					
	Interest rate	Basis risk	FX	Credit spread	Equity	Inflation
Banking activities	●	●	□	●	●	□
Defined benefit pension scheme	●		□	■	●	□
Insurance portfolios	○		○	●	●	○
Trading portfolios	□		□	○		□

Key

Profit before tax:	Loss	Gain
>£500m	●	■
£250m – £500m	●	■
<£250m	●	■
<£50m	○	□

Measurement

Group market risk is managed within a Board approved framework and risk appetite. Board risk appetite is calibrated primarily to five economic multi-risk scenarios, and is supplemented with sensitivity based measures. The scenarios assess the impact of unlikely, but plausible adverse stresses on income, with the worst case for banking activities, defined benefit pensions, insurance and trading portfolios reported against independently, and across the Group as a whole.

The Board risk appetite is cascaded first to GALCO where risk appetite is approved and monitored by risk type, and then to Group Market Risk Committee (GMRC) where risk appetite is sub allocated by Division. These levels of risk appetite comprise scenarios/stress based measures (single factor stresses), percentile based measures (e.g. VaR and Stressed VaR), and sensitivity based measures (e.g. sensitivity to 1 basis point move in interest rates), as well as stochastic measures within the Insurance business. These measures are reviewed regularly by senior management to inform effective decision making.

Mitigation

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

Monitoring

GALCO and the GMRC 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 Group 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.

How market risks arise and are managed across the Group's activities is considered in more detail below.

Risk management continued

Banking activities

Exposures

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

Interest rate risk

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 1.36) and off balance sheet positions of the Group. Behavioural assumptions are applied to (i) embedded optionality within products; (ii) the duration of balances that are contractually repayable on demand, such as current accounts and overdrafts, together with net free reserves of the group; and (iii) to the re-pricing behaviour of managed rate liabilities namely variable rate savings.

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.

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.

Foreign exchange risk

Economic foreign exchange exposure arises from the Group's investment in its overseas operations (net investment exposures are disclosed in note 53 on page 265). In addition, the Group incurs foreign exchange risk through non-functional currency flows from services provided by customer facing divisions and the Group's debt and capital management programmes.

Equity risk

Equity risk arises primarily from three different sources; (i) the Group's strategic equity holdings in Banco Sabadell, Aberdeen, and Visa Europe; (ii) exposure to Lloyds Banking Group share price through deferred shares and deferred options granted to employees as part of their benefits package; and (iii) the Group's private equity investments held by Lloyds Development Capital.

Credit spread risk

Credit spread risk arises largely from i) liquid asset portfolio held in the management of Group liquidity comprising government, supranational, and other eligible assets; and ii) the Credit Valuation Adjustment (CVA) and Debit Valuation Adjustment (DVA) sensitivity to credit spreads.

Measurement

Interest rate risk exposure is monitored monthly using, primarily:

(i) 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 an appropriate floor).

(ii) 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 an appropriate floor). 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.

(iii) Market Value notional limit: this caps the amount of conventional and inflation-linked government bonds held by the Group for liquidity purposes.

(iv) Structural hedge limits; these metrics enhance understanding of assumption and duration risk taken within the behaviouralisation of this portfolio.

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 repricing profiles 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 1.38 below shows, split by material currency, the Group's market value sensitivities to an instantaneous parallel up and down 25 and 100 basis points change to all interest rate.

Table 1.38: **Banking activities: market value sensitivity**

	2015				2014			
	Up 25bps £m	Down 25bps £m	Up 100bps £m	Down 100bps £m	Up 25bps £m	Down 25bps £m	Up 100bps £m	Down 100bps £m
Sterling	48.7	(48.8)	194.2	(115.9)	(15.7)	15.5	(63.8)	3.9
US dollar	1.9	(1.9)	7.5	(5.9)	4.7	(4.9)	17.8	(15.9)
Euro	1.7	(2.1)	6.9	(6.8)	(7.2)	4.8	(27.3)	15.0
Australian dollar	(0.1)	0.1	(0.2)	0.2	(0.4)	0.4	(1.3)	1.8
Other	(0.3)	0.3	(1.4)	0.9	(0.3)	0.3	(1.2)	0.8
Total	51.9	(52.4)	207.0	(127.5)	(18.9)	16.1	(75.8)	5.6

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.

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.

Table 1.39 below shows supplementary value sensitivity to a steepening and flattening in the yield curve. This ensures there are no unintended consequences to managing risk to parallel shifts in rates.

Table 1.39: **Banking activities: market value sensitivity to a steepening and flattening of the yield curve**

	2015		2014	
	Steepener £m	Flattener £m	Steepener £m	Flattener £m
Sterling	(105.7)	97.1	69.3	(85.7)
US dollar	(3.4)	4.8	19.5	(6.8)
Euro	(0.5)	2.0	(8.6)	3.0
Australian dollar	(0.0)	(0.0)	0.5	7.5
Other	0.2	(0.2)	0.2	(0.2)
Total	(109.4)	103.7	80.9	(82.2)

The table below shows the banking book income sensitivity to an instantaneous parallel up and down 25 and 100 basis points change to all interest rates.

Table 1.40: **Banking activities: net interest income sensitivity (audited)**

	2015				2014			
	Up 25bps £m	Down 25bps £m	Up 100bps £m	Down 100bps £m	Up 25bps £m	Down 25bps £m	Up 100bps £m	Down 100bps £m
Client facing activity and associated hedges	152.4	(140.1)	604.7	(464.2)	(4.6)	(46.0)	176.3	(222.3)

Income sensitivity is measured over a rolling 12 month basis.

The interest income sensitivity continues to reflect structural hedging against margin compression. The increased sensitivity reflects both the timing of margin management, and the level of floors giving rise to increased compression risk in the Group.

Basis risk, foreign exchange, equity, and credit spread risks are measured primarily through scenario analysis by assessing the impact on profit before tax over a 12 month horizon arising from a change in market rates, and reported within the Board Risk Appetite on a monthly basis. Supplementary measures such as sensitivity and exposure limits are applied where they provide greater insight into risk positions. Frequency of reporting supplementary measures varies from daily to quarterly appropriate to each asset class.

Risk management continued

Mitigation

The Group's policy is to optimise reward whilst managing its market risk exposures within the risk appetite defined by the Board. The Group Market Risk policy and procedures outlines the hedging process, and the centralisation of risk from divisions into GCT, e.g. via Transfer Pricing Framework. GCT is responsible for managing the centralised risk 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 GALCO within the Board risk appetite. Derivative desks in Financial Markets will then externalise the hedges to the market. The largest residual risk exposure arises from balances that are deemed to be insensitive to changes in market rates (including current accounts, a portion of variable rate deposits and investable equity), and is managed through the Group's structural hedge. Consistent with the Group's strategy to deliver stable returns, GALCO seeks to minimise large reinvestment risk, and to smooth earnings over a range of investment tenors. The amount and duration of the hedging activity is reviewed regularly by GALCO, with current target duration of around four years.

Whilst the bank faces margin compression in the current low rate environment, its exposure to pipeline and prepayment risk are not considered material, and are hedged in line with expected customer behaviour. These are appropriately monitored and controlled through Divisional ALCOs.

Net investment foreign exchange exposures are managed centrally by GCT, by hedging non GBP asset values with currency borrowing. Economic foreign exchange exposures arising from non-functional currency flows are identified by divisions and transferred and managed centrally. The Group also has a policy of forward hedging its forecasted currency profit and loss to year end.

Monitoring

The Risk Management Framework, Policy and Procedures document articulate the monitoring of Banking book market risk through the committee structure. The Group's Three Lines of Defence ensure risk is identified, and appropriately measured, reported and understood. The appropriate limits and triggers are monitored by senior executive Committees within the Banking divisions. Banking assets, liabilities and associated hedging are actively monitored and if necessary rebalanced to be within agreed tolerances.

Defined benefit pension schemes

Exposures

The Group's defined benefit pension schemes are exposed to significant risks from both their assets and from the present value of their liabilities, primarily real interest rate, credit spread, equity, and alternative asset risks. The liability discount rate provides exposure to interest rate risk and credit spread risk, which are partially offset by fixed interest assets (such as gilts and corporate bonds) and swaps. Equity and alternative asset risk arises from direct asset holdings.

For further information on defined benefit pension scheme assets and liabilities please refer to note 37 on page 226.

Measurement

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.

Mitigation

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 and inflation hedging programme is in place to reduce liability risk. The schemes have also reduced equity allocation and are investing the proceeds in credit assets as part of a programme to de-risk the portfolio.

Monitoring

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).

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. The impact on Group capital resources of the schemes is monitored monthly. Performance against risk appetite triggers is also regularly monitored. Hedges are in place and asset/liability matching positions are also actively monitored.

Insurance portfolios

Exposures

The main elements of market risk to which the Group is exposed through the Insurance business are equity, credit spread, interest rate and inflation.

- Equity risk arises indirectly through the value of future management charges on policyholder funds. These management charges form part of the value of in-force business (see note 25 on page 218). Equity risk also arises in the with-profits funds but is less material.
- Credit spread risk mainly arises from annuities where policyholders' future cashflows are guaranteed at retirement. Exposure arises if the assets which are held to back these liabilities, mainly corporate bonds and loans, do not perform in line with expectations. Within the Group accounts a large amount of this exposure is removed as accounting rules require that assets Insurance have acquired from Group are maintained at the original amortised book value.
- Interest rate risk arises through holding credit and interest assets mainly in the annuity book and also to cover general insurance liabilities, capital requirements and risk appetite.
- Inflation exposure is from a combination of inflation linked policyholder benefits and inflation assumptions used to project future expenses.

Measurement

Current and potential future market risk exposures within Insurance are assessed using a range of stress testing exercises and scenario analyses. Risk measures include 1-in-200 year stresses used for regulatory capital assessments and single factor stresses for profit before tax.

Table 1.41 demonstrates the impact of the Group's Fiscal Solvency stress scenario (with no diversification benefit) on Insurance's portfolio; this is the most onerous scenario for Insurance out of the Group scenarios. The amounts include movements in assets, liabilities and the value of in-force business in respect of insurance contracts and participating investment contracts.

Table 1.41: **Insurance business: profit before tax sensitivities**

	Increase (reduction) in profit before tax	
	2015 £m	2014 £m
Interest rates – increase 100 basis points	**(43)**	(124)
Inflation – increase 50 basis points	**(23)**	(143)
Credit spreads – 100% widening	**(864)**	(582)
Equity – 30% fall	**(616)**	(745)
Property – 25% fall	**(51)**	(60)

Credit spread exposure increased in 2015 reflecting the Insurance business entry into the bulk annuity market, with a £0.4 billion deal in the fourth quarter, building on the £2.4 billion Scottish Widows with-profits deal earlier in the year.

Further stresses that show the effect of reasonably possible changes in key assumptions, including the risk-free rate, equity investment volatility, widening of credit default spreads on corporate bonds and an increase in illiquidity premia, as applied to profit before tax are set out in note 34.

Mitigation

Equity and credit spread risks are inherent within Insurance products and are closely monitored to ensure they remain within risk appetite. A hedging strategy is in place to reduce exposure from the with-profit funds.

Interest rate risk in the annuity book is mitigated by investing in assets whose cash flows closely 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.

Other market risks (e.g. interest rate exposure outside the annuity book and inflation) are also closely monitored and where considered appropriate, hedges are put in place to reduce exposure.

Monitoring

Market risks in the Insurance business are monitored by Insurance senior executive Committees and ultimately the Insurance Board. Monitoring includes 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 agreed tolerances. In addition market risk is controlled via approved investment policies and mandates.

Trading portfolios

Exposures

The Group's trading activity is small relative to its peers and the Group does not have a programme of proprietary trading activities. The Group's trading activity is undertaken solely to meet the financial requirements of commercial and retail customers for foreign exchange, credit and interest rate products. These activities support customer flow and market making activities.

All trading activities are performed within the Commercial Banking division. While the trading positions taken are generally small, any extreme moves in the main risk factors and other related risk factors could cause significant losses in the trading book depending on the positions at the time. The average 95 per cent 1-day trading VaR (diversified across risk factors) was £1.4 million for year end 2015 compared to £3.0 million for year end 2014. This decrease was due to the significant de-risking activities that took place at the portfolio level.

Trading market risk measures are applied to all the Group's regulatory trading books and they include daily VaR (table 1.42), sensitivity based measures, and stress testing calculations.

Risk management continued

Measurement

The Group internally uses VaR as the primary risk measure for all trading book positions.

Table 1.42 shows some relevant statistics for the Group's 1-day 95 per cent confidence level VaR that are based on 300 historical consecutive business days to year end 2015 and year end 2014.

The risk of loss measured by the VaR model is the minimum expected loss in earnings given the 95 per cent confidence. The total and average trading VaR numbers reported below have been obtained after the application of the diversification benefits 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 at Group level.

Table 1.42: **Trading portfolios: VaR (1-day 95 per cent confidence level) (audited)**

	At 31 December 2015				At 31 December 2014			
	Close £m	Average £m	Maximum £m	Minimum £m	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	0.8	1.4	3.5	0.8	1.7	2.8	4.8	1.3
Foreign exchange risk	0.2	0.3	0.8	0.1	0.2	0.4	1.3	0.0
Equity risk	–	–	–	–	–	–	–	–
Credit spread risk	0.2	0.4	1.0	0.2	0.6	0.7	1.1	0.5
Inflation risk	0.1	0.3	1.6	0.1	0.4	0.3	0.8	0.2
Sub-total								
Sum of risk factors	1.3	2.3	6.2	1.3	2.8	4.3	6.4	2.5
Portfolio Diversification	(0.4)	(0.9)			(0.9)	(1.3)		
Total VaR[1]	0.9	1.4	3.1	0.8	1.9	3.0	4.6	1.6

1 VaR over 2015 is based on diversified VaR across risk factors following the PRA granting the Group permission to calculate VaR on a diversified basis. We have applied the same diversification approach for 2014.

The market risk for the trading book continues to be low with respect to the size of the Group and compared to our peers. This reflects the fact that the Group's trading operations are customer-centric and focused on hedging and recycling client risks.

Although it is an important market standard measure of risk, VaR has limitations. One of them is the use of limited historical data sample which influences the output by the implicit assumption that future market behaviour will not differ greatly from the historically observed period. Another known limitation is the use of defined holding periods which assumes that the risk can be liquidated or hedged within that holding period. Also calculating the VaR at the chosen confidence interval does not give enough information about potential losses which may occur if this level is exceeded. The Group fully recognises these limitations and supplements the use of VaR with a variety of other measurements which reflect the nature of the business activity. These include detailed sensitivity analysis, position reporting and a stress testing programme.

Trading book VaR (1-day 99 per cent) is compared daily against both hypothetical and clean profit and loss. 1-day 99 per cent VaR charts for Lloyds Bank, HBOS and Lloyds Banking Group models can be found in the Group's Pillar 3 Report.

Mitigation

Active management of the Group portfolio is necessary such that the level of exposure is strictly controlled and managed within the approved risk limits.

Monitoring

Trading risk appetite is monitored daily with 1-day 95 per cent VaR and Stress Testing limits. These limits are complemented with position level action triggers and profit and loss referrals. Risk and position limits are set and managed at both desk and overall trading book levels. They are reviewed at least annually and can be changed as required within the overall Group risk appetite framework.

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 Management 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 four 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 Committee (BRC):

– Customer: The Group builds trust and does not expect its customers to be impacted negatively.
– Reputation: The Group does not expect to suffer events or behaviours that have a material negative impact on its reputation. The Group minimises the impact from cyber attacks that could result in a significant loss of customer confidence or undermine the stability of the Group.
– Financial loss: The Group does not expect to experience cumulative fraud or operational losses above 3 per cent or more of budgeted Group income, or individual losses of more than £100 million.
– 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.

For further information on risk appetite refer to page 112.

Exposures

The principal operational risks to the Group are:

– The risk that the Group is unable to provide services to customers as a result of an IT systems failure;
– Cyber risks associated with malicious attacks on the confidentiality or integrity of electronic data, or the availability of systems;
– External fraud arising from an act of deception or omission;
– Risks arising from inadequate delivery of services to customers; and
– The risk associated with the ongoing provision of services to TSB and other organisations.

The risks below also have potential to negatively impact customers and the Group's future results:

– 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 are implemented and maintained by the Group to comply with increasingly complex and detailed anti-money laundering and anti-terrorism laws and regulations. However, these may not always be fully effective in preventing third parties from using the Group as a conduit for money laundering, terrorist financing and other illegal or prohibited activities. Should the Group be associated with money laundering, terrorist financing or breaches of financial crime regulations and prohibitions, 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 upon 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.

Based on data captured on the Group's Operational Risk System, in 2015, the highest frequency of events occurred in external fraud (71.96 per cent) and execution, delivery and process management (15.81 per cent). Clients, products and business practices accounted for 83.43 per cent of losses by value, driven by legacy issues where impacts materialised in 2015 (excluding PPI).

Table 1.43 below shows high level loss and event trends for the Group using Basel II categories.

Table 1.43: **Operational risk events by risk category (losses greater than or equal to £10,000)**

	% of total volume		% of total losses	
	2015	2014[1]	2015	2014[1]
Business disruption and system failures	0.40	1.20	0.13	0.39
Clients, products and business practices	11.46	14.31	83.43	80.87
Damage to physical assets	0.06	–	0.04	–
Employee practices and workplace safety	0.03	0.04	–	–
Execution, delivery and process management	15.81	20.30	11.08	14.12
External fraud	71.96	63.69	5.27	4.58
Internal fraud	0.28	0.46	0.05	0.04
Total	100.00	100.00	100.00	100.00

1 During the year, the Group undertook a review of the internal classification of operational risk events to improve alignment to the Basel categories. As a result of this review, the Group has changed the classification categories for a number of events. 2014 has been revised to reflect the new categorisations.

Risk management continued

Operational risk scenario assessments 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 minimum (Pillar I) operational risk capital requirements using The Standardised Approach (TSA), which the Basel Committee has stated as being appropriate for an 'internationally active' bank.

Mitigation

The Group continues to review and invest in its control environment to ensure it addresses the inherent risks faced. Risks are reported and discussed at local governance forums and escalated to executive management as appropriate. This ensures the correct level of visibility and engagement. The Group employs a range of risk management strategies, including: avoidance, mitigation, transfer (which would also include insurance) and acceptance. Contingency plans are maintained for a range of potential scenarios, with regular disaster recovery and scenario testing scheduled to test and challenge the readiness of the Group to respond in the event of an incident.

- The Group continues to mature its approach to operational resilience. The IT Resilience Programme is making significant progress in addressing the observations and associated resilience risks raised in the Independent IT Resilience Review performed by PwC (2013). The Board recognises the role that resilient technology plays in achieving the Group's strategy of becoming the best bank for customers and in maintaining banking services across the wider industry. As such, the Board dedicates considerable time and focus to this subject at both the Board and the Board Risk Committee, and continues to sponsor key investment programmes that enhance our resilience.
- The threat landscape associated with cyber risk has continued to evolve alongside increasing Regulatory attention. The Board has defined a Cyber Risk Appetite and is supporting investment to help mitigate this risk.
- In addition to initiatives that protect the Group against a malicious cyber-attack the Group continues to invest in enhanced protection of customer information, including limiting access to key systems and enhancing the security, durability and accessibility of critical information.
- 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. Groupwide policies and operational control frameworks are maintained and designed to provide customer confidence, protect the Group's commercial interests and reputation, comply with legal requirements and meet regulatory expectations. The Group's fraud awareness programme remains a key component of its fraud control environment.
- The Group remediates issues that are identified in its customer processes, addressing root cause and rectifying customers as required. Enhancing the overall servicing environment remains a focus of dedicated Group programmes such as Simplification.
- Following the successful divestment of TSB the Group retains responsibility for the ongoing provision of key services which are 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, cyber, economic instability, pandemic planning and operational incidents.
- The Group has adopted policies and procedures designed to detect and prevent the use of its banking network for money laundering, terrorist financing, bribery and activities prohibited by legal and regulatory sanctions. The Group regularly reviews and assesses these policies to keep them current, effective and consistent across markets. The Group requires mandatory training on these topics for all employees. Specifically, the anti-money laundering procedures include 'know-your-customer' requirements, transaction monitoring technologies and reporting of suspicions of money laundering or terrorist financing to the applicable regulatory authorities and the Anti-Bribery Policy prohibits the payment, offer, acceptance or request of a bribe, including 'facilitation payments' by any employee or agent and provides a confidential reporting service for anonymous reporting for suspected or actual bribery activity. The Sanctions and the Related Prohibitions Policy sets out a framework of controls for compliance with legal and regulatory sanctions.

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 Group Conduct, Compliance and Operational Risk Committee, and matters are escalated to the Chief Risk Officer, or higher committees, if appropriate. A combination of: regular management information and reporting from business areas, oversight and challenge from Risk Division, Group Audit and other assurance activities ensures that key risks are regularly presented and debated by executive management.

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, where possible 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.

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 is managed separately for the Banking and Insurance businesses. Funding and liquidity risk appetite for the Banking business is set with the support of the Group Asset and Liability Committee (GALCO). The liquidity risk appetite for the Insurance business is reviewed and set annually by the Insurance Board.

For the Banking Group, the liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position, including a number of stressed metrics, with regular reporting to GALCO and the Board. Risk appetite is a key element of the annual Group planning process with risk appetite defined over the life of the funding plan. For further information on risk appetite refer to page 112.

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

Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturity. Note 53 on page 265 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. The analysis takes into account items such as early repayment, forbearance and impairment for assets; rollover and early withdrawal for liabilities. The assumptions are subject to governance via divisional asset and liability committees. The behavioural reviews form the foundation of the Group's Liquidity Transfer Pricing (LTP) and are applied to the contractual profile of the Group for the liquidity risk stress testing framework.

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 over the life of the funding plan, combining business as usual and stressed conditions. The Group manages its risk appetite and liquidity position as a coverage ratio (proportion of stressed outflows covered by eligible liquid assets) corresponding with the PRA and CRD IV liquidity requirements. Longer term funding is used to manage the Group's strategic liquidity profile, 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. 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. Funding concentration by counterparty and currency is monitored on an ongoing basis. Where concentrations do exist (for example, maturity profile), these are limited by the internal risk appetite and considered manageable. 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.

To assist in managing the balance sheet the Group operates an LTP process which: allocates relevant interest expenses from the centre 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.

Liquidity risk within the Insurance business may result from: the inability to sell financial assets quickly at their fair values; an insurance liability falling due for payment earlier than expected; the inability to generate cash inflows as anticipated; an unexpected large operational event; or from a general insurance catastrophe e.g. a significant weather event. Following the implementation of Solvency II, the annuity portfolio is ring-fenced and assets held to match annuity liability cashflows are excluded from shareholder liquidity. In the event a liquidity shortfall arises on the annuity portfolio, shareholder liquidity will be required to support this. As a result, the shareholder's exposure to liquidity risk is through Insurance's non-annuity and surplus assets, any shortfall arising in the annuity portfolio and the investment portfolios within the general insurance business. Liquidity risk is actively managed and monitored within the Insurance business to ensure that, even under stress conditions, there is sufficient liquidity to meet obligations and remain 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.

Risk management continued

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 one month) and longer term (up to three months) horizons against a range of scenarios reflecting possible future liquidity risks. 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. For further information on the Group's 2015 liquidity stress testing results refer to page 158. In addition to the liquidity stress testing framework, the Group funding plan is stressed against a range of macroeconomic scenarios, including those prescribed by the PRA. The Group also applies its own macroeconomic stress scenarios, including a one in 20 year recession. Liquidity Risk Appetite and regulatory metrics are calculated and monitored over the life the plan under base and stress conditions.

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.

Funding and liquidity management in 2015

During 2015 the Group has maintained its strong funding and liquidity position, with a loan to deposit ratio of 109 per cent, LCR eligible liquid assets broadly equal to total wholesale funding and over five times money market funding less than one year to maturity at 31 December 2015. The Group has a diverse funding platform which comprises a strong customer deposit base along with wholesale funding comprising of a range of secured and unsecured funding products.

Total funded assets reduced by £22.2 billion to £471.2 billion during 2015. Loans and advances to customers, excluding reverse repos, reduced by £22.4 billion. Mortgage lending increased by 1 per cent, slightly below market growth, reflecting the Group's focus on protecting margin in a low growth environment. UK loan growth in Consumer Finance was strong at 17 per cent and SME lending growth was 5 per cent, both outperforming the market. The growth was offset by the sale of TSB, the further reduction in run-off and other lending portfolios which are closed to new business.

Total customer deposits fell by £28.8 billion to £418.3 billion at 31 December 2015, largely due to the sale of TSB and the planned reduction in tactical deposits.

Wholesale funding has increased by £3.4 billion to £119.9 billion; the amount with a residual maturity less than one year falling to £37.9 billion (£41.1 billion at 31 December 2014). The Group's term funding ratio (wholesale funding with a remaining life of over one year as a percentage of total wholesale funding) increased to 68 per cent (65 per cent at 31 December 2014). In 2015 the Group's term issuance costs were lower than 2014 and significantly lower than previous years.

In 2015 Standard and Poor's (S&P), Moody's and Fitch completed their exceptional reviews of Lloyds Bank's ratings following the UK implementation of the EU Bank Recovery and Resolution Directive. In all cases, Lloyds Bank's ratings were either affirmed or upgraded due to the delivery of our strategy to be a low risk, customer focused UK bank and/or recognition of the protection Lloyds' sizeable subordinated debt buffer provides to senior creditors. In particular, Fitch upgraded Lloyds Bank to 'A+' from 'A' and revised the outlook to 'Stable' from 'Negative'. Moody's affirmed Lloyds' rating at 'A1' with a 'Positive' outlook. S&P affirmed Lloyds' rating at 'A' with a 'Stable' outlook. Following these rating actions, Lloyds Bank's median rating has improved to 'A+' (previously 'A'). The effects of a potential downgrade from all three rating agencies are included in the Group liquidity stress testing.

The LCR became the Pillar 1 standard for liquidity in the UK in October 2015. The Group comfortably meets the requirements and has a robust and well governed reporting framework in place for both regulatory reporting and internal management information. The Net Stable Funding Ratio (NSFR) is due to become a minimum standard from January 2018. The Group continues to monitor the requirements and expects to meet the minimum requirements once these are confirmed by the PRA.

The combination of a strong balance sheet and access to a wide range of funding markets, including government and central bank schemes, provides the Group with a broad range of options with respect to funding the balance sheet.

Table 1.44: **Summary funding and liquidity metrics**

	At 31 Dec 2015	At 31 Dec 2014	Change %
LCR eligible liquidity buffer (£bn)[1]	**123.4**	109.3	13
Term funding ratio (%)	**68.4**	64.7	6
Loan to deposit ratio (%)	**108.8**	106.8	2
LCR eligible liquid assets/money market funding less than one year maturity[1]	**5.7**	5.8	(2)

1 Comparative 2014 data relates to Individual Liquidity Adequacy Standards (ILAS) eligible primary liquid assets.

Table 1.45: **Group funding position**

	At 31 Dec 2015 £bn	At 31 Dec 2014 £bn	Change %
Funding requirement			
Loans and advances to customers[1]	455.2	477.6	(5)
Loans and advances to banks[2]	3.4	3.0	13
Debt securities	4.2	1.2	
Reverse repurchase agreements	1.0	–	
Available-for-sale financial assets – non LCR eligible[3]	2.7	8.0	(66)
Cash and balances at central banks – non LCR eligible[4]	4.7	3.6	31
Funded assets	471.2	493.4	(4)
Other assets[5]	234.2	265.2	(12)
	705.4	758.6	(7)
On balance sheet LCR eligible liquid assets[6]			
Reverse repurchase agreements	–	7.0	
Cash and Balances at central banks[4]	53.7	46.9	14
Available-for-sale financial assets	30.3	48.5	(38)
Held to maturity financial assets	19.8	–	
Trading and fair value through profit and loss	3.0	(6.1)	
Repurchase agreements	(5.5)	–	
	101.3	96.3	5
Total Group assets	806.7	854.9	(6)
Less: Other liabilities[5]	(221.5)	(240.3)	(8)
Funding requirement	585.2	614.6	(5)
Funded by			
Customer deposits	418.3	447.1	(6)
Wholesale funding[7]	119.9	116.5	3
	538.2	563.6	(5)
Repurchase agreements	–	1.1	
Total equity	47.0	49.9	(6)
Total funding	585.2	614.6	(5)

1 Excludes £nil (31 December 2014: £5.1 billion) of reverse repurchase agreements.

2 Excludes £20.8 billion (31 December 2014: £21.3 billion) of loans and advances to banks within the Insurance business and £0.9 billion (31 December 2014: £1.9 billion) of reverse repurchase agreements.

3 Non LCR eligible liquidity assets comprise a diversified pool of highly rated unencumbered collateral (including retained issuance).

4 Cash balances and balances at central banks are combined in the Group's balance sheet.

5 Other assets and other liabilities primarily include balances in the Group's Insurance business and the fair value of derivative assets and liabilities.

6 2014 comparators are on an ILAS basis.

7 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.

Table 1.46: **Reconciliation of Group funding to the balance sheet (audited)**

	At 31 December 2015				At 31 December 2014			
	Included in funding analysis £bn	Repos and cash collateral received by Insurance £bn	Fair value and other accounting methods £bn	Balance sheet £bn	Included in funding analysis £bn	Repos and cash collateral received by Insurance £bn	Fair value and other accounting methods £bn	Balance sheet £bn
Deposits from banks	8.5	8.4	–	16.9	9.8	1.1	–	10.9
Debt securities in issue	88.1	–	(6.0)	82.1	80.6	–	(4.4)	76.2
Subordinated liabilities	23.3	–	–	23.3	26.1	–	(0.1)	26.0
Total wholesale funding	119.9	8.4			116.5	1.1		
Customer deposits	418.3	–	–	418.3	447.1	–	–	447.1
Total	538.2	8.4			563.6	1.1		

Risk management continued

Table 1.47: **Analysis of 2015 total wholesale funding by residual maturity**

	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 2015 £bn	Total at 31 Dec 2014 £bn
Deposit from banks	6.7	0.8	0.5	0.1	0.1	–	–	0.3	8.5	9.8
Debt securities in issue:										
Certificates of deposit	1.0	4.3	2.0	2.5	0.8	–	–	–	10.6	6.8
Commercial paper	3.7	2.3	0.3	0.2	0.1	–	–	–	6.6	7.3
Medium-term notes[1]	0.9	0.6	2.0	0.9	0.5	5.2	13.6	13.9	37.6	29.2
Covered bonds	–	–	1.2	1.1	0.5	5.3	7.4	10.3	25.8	25.2
Securitisation	0.4	–	0.8	0.2	0.2	3.6	0.9	1.4	7.5	12.1
	6.0	7.2	6.3	4.9	2.1	14.1	21.9	25.6	88.1	80.6
Subordinated liabilities	–	0.2	0.2	0.5	2.3	0.9	7.6	11.6	23.3	26.1
Total wholesale funding[2]	12.7	8.2	7.0	5.5	4.5	15.0	29.5	37.5	119.9	116.5
Of which is issued by Lloyds Banking Group plc[3]	–	–	–	–	0.3	–	–	3.1	3.4	2.6

1 Medium-term notes include funding from the National Loan Guarantee Scheme (31 December 2015: £1.4 billion; 31 December 2014: £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.

3 Comprises £3.4 billion of subordinated liabilities (31 December 2014: £2.0 billion) and £nil of medium term notes (31 December 2014: £0.6 billion) issued by the holding company, Lloyds Banking Group plc.

Table 1.48: **Total wholesale funding by currency (audited)**

	Sterling £bn	US dollar £bn	Euro £bn	Other currencies £bn	Total £bn
At 31 December 2015	34.9	37.6	41.3	6.1	119.9
At 31 December 2014	34.4	35.6	40.1	6.4	116.5

Table 1.49: **Analysis of 2015 term issuance (audited)**

	Sterling £bn	US dollar £bn	Euro £bn	Other currencies £bn	Total £bn
Securitisation	1.0	1.2	0.3	–	2.5
Medium-term notes	0.3	4.8	3.3	1.2	9.6
Covered bonds	1.7	–	2.0	–	3.7
Private placements[1]	1.0	2.1	2.3	–	5.4
Subordinated liabilities	–	0.3	–	–	0.3
Total issuance	4.0	8.4	7.9	1.2	21.5
Of which is issued by Lloyds Banking Group plc[2]	–	0.3	–	–	0.3

1 Private placements include structured bonds and term repurchase agreements (repos).

2 Comprises £0.3 billion of subordinated liabilities issued by the holding company, Lloyds Banking Group plc. In addition Lloyds Banking Group plc issued c.£1.2 billion of subordinated liabilities as part of an exchange of outstanding operating company securities for new holding company securities.

Term issuance for 2015 totalled £21.5 billion. The Group continued to maintain a diversified approach to markets with trades in public and private format, secured and unsecured products and a wide range of currencies and markets. For 2016, the Group will continue to maintain this diversified approach to funding, including capital and funding from the holding company, Lloyds Banking Group plc, as needed to optimise the capital and funding position to transition towards final UK Minimum Requirements for Own Funds and Eligible Liabilities (MREL) which is still being consulted on in the UK. Continued use 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. In 2015 the Group drew down £12.1 billion under the FLS, bringing total drawings under the FLS to £32.1 billion. The maturities for the FLS are fully factored into the Group's funding plan.

Liquidity portfolio

The UK regulator adopted the EU delegated Act on 1 October 2015. Prior to this, liquidity was managed on an Individual Liquidity Adequacy Standards (ILAS) basis where liquid assets were divided into Primary and Secondary categories. Post 1 October 2015, liquid assets are classed as LCR eligible or non-LCR eligible.

At 31 December 2015, the Banking business had £123.4 billion of highly liquid unencumbered LCR eligible assets, of which £122.9 billion is LCR level 1 eligible and £0.5 billion is LCR level 2 eligible. These assets are available to meet cash and collateral outflows and PRA regulatory requirements. A separate liquidity portfolio to mitigate any insurance liquidity risk is managed within the Insurance business. LCR eligible liquid assets represent 5.7 times the Group's money market funding less than one year maturity (excluding derivative collateral margins and settlement accounts) and is broadly equivalent to total wholesale funding, and thus provides a substantial buffer in the event of continued market dislocation. During 2015 the Group has increased regulatory liquidity to strengthen the overall liquidity position.

Table 1.50: **LCR eligible assets**

	At 31 Dec 2015 £bn	Average 2015[1] £bn
Level 1		
Cash and central bank reserves	**53.7**	57.2
High quality government/MDB/agency bonds[2]	**65.8**	63.0
High quality covered bonds	**3.4**	3.3
Total Level 1	**122.9**	123.5
Level 2[3]	**0.5**	0.7
Total LCR eligible assets	**123.4**	124.2

1 Average for fourth quarter 2015 only.

2 Designated multilateral development bank (MDB). Includes eligible government guaranteed bonds.

3 Includes Level 2A and Level 2B.

Table 1.51: **LCR eligible assets by currency**

	At 31 December 2015			
	Sterling £bn	US Dollar £bn	Euro £bn	Total £bn
Level 1	**90.9**	**15.8**	**16.2**	**122.9**
Level 2	**0.1**	**–**	**0.4**	**0.5**
Total	**91.0**	**15.8**	**16.6**	**123.4**

Table 1.52: **ILAS eligible assets**

	At 31 Dec 2015 £bn	At 31 Dec 2014 £bn	Average 2015 £bn	Average 2014 £bn
Primary liquidity[1]				
Cash and balances at central bank	**52.6**	46.9	**65.1**	62.3
Government/MDB bonds[2]	**64.4**	62.4	**51.3**	47.9
Total	**117.0**	109.3	**116.4**	110.2
Secondary liquidity[1]				
High-quality ABS/covered bonds[3]	**3.3**	3.9	**3.6**	3.6
Credit institution bonds[3]	**0.2**	0.9	**0.5**	1.4
Corporate bonds[3]	**0.3**	0.6	**0.4**	0.3
Own securities (retained issuance)	**14.7**	20.6	**15.9**	22.2
Other securities	**9.1**	5.7	**6.5**	5.5
Other[4]	**76.6**	67.5	**65.2**	74.1
Total	**104.2**	99.2	**92.1**	107.1
Total liquidity	**221.2**	208.5		

1 Primary and secondary liquidity as defined under the ILAS regulatory system.

2 Designated multilateral development bank (MDB).

3 Assets rated A- or above.

4 Includes other central banks eligible assets.

Risk management continued

Table 1.53: **ILAS eligible assets by currency**

	At 31 December 2015				At 31 December 2014			
	Sterling £bn	US Dollar £bn	Euro £bn	Total £bn	Sterling £bn	US Dollar £bn	Euro £bn	Total £bn
At 31 December 2015								
Primary liquidity[1]	88.6	14.8	13.6	117.0	81.1	14.5	13.7	109.3
Secondary liquidity[1]	97.0	2.2	5.0	104.2	91.3	1.2	6.7	99.2
Total	185.6	17.0	18.6	221.2	172.4	15.7	20.4	208.5

1 Primary and secondary liquidity as defined under the ILAS regulatory system.

The Banking business also had £98.9 billion of secondary, non-LCR eligible liquidity, the vast majority of which, however, is eligible for use in a range of central bank or similar facilities and 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. 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.

Stress testing results

Internal stress testing results at 31 December 2015 showed that the Banking business had liquidity resources representing 163 per cent of modelled outflows from all wholesale funding sources, retail and corporate deposits, intraday requirements and rating dependent contracts under the Group's most severe liquidity stress scenario (the three month PRA combined scenario).

The liquidity 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 £1.5 billion of cash over a period of up to one year, £2.1 billion of collateral posting related to customer financial contracts and £5.6 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.

Encumbered assets

This disclosure provides further detail on the availability of assets that could be used to support potential future funding requirements of the Group. The disclosure is not designed to identify assets that would be available in the event of a resolution or bankruptcy.

The Group's analysis separately identifies those assets held at central banks; assets not held at central banks are classified as either encumbered or unencumbered.

– Encumbered assets: Assets recognised on the Group's balance sheet which have been pledged as collateral against an existing liability, and as a result are assets which are unavailable to the Group to secure funding, satisfy collateral needs or be sold to reduce potential future funding requirements.
– Pre-positioned and encumbered assets held with central banks: Assets which have been delivered to central banks to facilitate future drawdowns under central bank funding schemes and assets which are encumbered under such schemes.

The following sub analyses have been provided for unencumbered assets not pre-positioned at central banks:

– Unencumbered – Readily realisable: Assets regarded by the Group to be readily realisable in the normal course of business, to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements, and are not subject to any restrictions on their use for these purposes.
– Unencumbered – Other realisable: Assets where there are no restrictions on their use to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements, but are not readily realisable in the normal course of business in their current form.
– Unencumbered – Cannot be used: Assets that have not been pledged but which the Group has assessed could not be pledged and therefore could not be used to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements.

The following assets are classified as unencumbered – cannot be used: assets held within the Group's Insurance businesses which are generally held to either back liabilities to policyholders or to support the solvency of the Insurance subsidiaries; assets held within consolidated limited liability partnerships which provide security for the Group's obligations to its pension schemes; assets pledged to facilitate the use of intra-day payment and settlement systems; and reverse repos and derivatives balance sheet ledger items.

The Board and GALCO monitor and manage total balance sheet encumbrance via a number of risk appetite metrics. At 31 December 2015, the Group had £77.4 billion (31 December 2014: £105.2 billion) of externally encumbered on balance sheet assets with counterparties other than central banks. The reduction in encumbered assets was driven by securitisation and covered bond maturities. The Group also had £573.7 billion (31 December 2014: £641.8 billion) of unencumbered on balance sheet assets, and £155.6 billion (31 December 2014: £107.8 billion) of pre-positioned and encumbered assets held with central banks. Primarily the Group encumbers mortgages, unsecured lending and credit card receivables through the issuance programmes and tradable securities through securities financing activity. The Group mainly positions mortgage assets at central banks.

Table 1.54: **On balance sheet encumbered and unencumbered assets**

	Encumbered with counterparties other than central banks				Pre-positioned and encumbered assets held with central banks	Unencumbered assets not pre-positioned with central banks				Total
	Securitisations £m	Covered bonds £m	Other £m	Total £m	£m	Readily realisable £m	Other realisable assets £m	Cannot be used £m	Total £m	£m
At 31 December 2015										
Cash and balances at central banks	–	–	–	–	–	56,323	–	2,094	58,417	58,417
Trading and other financial assets at fair value through profit or loss	–	–	6,922	6,922	–	7,459	17	126,138	133,614	140,536
Derivative financial instruments	–	–	–	–	–	–	–	29,467	29,467	29,467
Loans and receivables:										
Loans and advances to banks	–	–	37	37	–	431	910	23,739	25,080	25,117
Loans and advances to customers	13,668	32,641	7,418	53,727	150,086	7,678	159,510	84,174	251,362	455,175
Debt securities	–	–	855	855	–	3,150	62	124	3,336	4,191
	13,668	32,641	8,310	54,619	150,086	11,259	160,482	108,037	279,778	484,483
Available-for-sale financial assets	–	–	15,810	15,810	5,548	11,048	31	595	11,674	33,032
Held-to-maturity investments	–	–	–	–	–	19,808	–	–	19,808	19,808
Other[1]	–	–	–	–	–	10	2,716	38,219	40,945	40,945
Total assets	13,668	32,641	31,042	77,351	155,634	105,907	163,246	304,550	573,703	806,688
At 31 December 2014										
Cash and balances at central banks	–	–	–	–	–	48,302	–	2,190	50,492	50,492
Trading and other financial assets at fair value through profit or loss	–	–	13,389	13,389	–	5,149	2,259	131,134	138,542	151,931
Derivative financial instruments	–	–	–	–	–	–	–	36,128	36,128	36,128
Loans and receivables:										
Loans and advances to banks	–	–	26	26	–	424	712	24,993	26,129	26,155
Loans and advances to customers	25,534	39,280	7,850	72,664	107,803	16,086	161,458	124,693	302,237	482,704
Debt securities	–	–	728	728	–	281	100	104	485	1,213
	25,534	39,280	8,604	73,418	107,803	16,791	162,270	149,790	328,851	510,072
Available-for-sale financial assets	119	–	18,321	18,440	–	37,711	30	312	38,053	56,493
Held-to-maturity investments	–	–	–	–	–	–	–	–	–	–
Other[1]	–	–	–	–	–	2,054	2,598	45,128	49,780	49,780
Total assets	25,653	39,280	40,314	105,247	107,803	110,007	167,157	364,682	641,846	854,896

1 Other comprises: items in the course of collection from banks, investment properties, goodwill, value of in-force business, other intangible assets, tangible fixed assets, current tax recoverable, deferred tax assets, retirement benefit assets and other assets.

The above table sets out the carrying value of the Group's encumbered and unencumbered assets, separately identifying those that are available to support the Group's funding needs. It should be noted that the table does not include collateral received by the Group (i.e. from reverse repos) that is not recognised on its balance sheet, the vast majority of which the Group is permitted to repledge. The Group provides collateralised security financing services to its clients, providing them with cash financing or specific securities. Collateralised security financing is also used to manage the Group's own short-term cash and collateral needs. For securities accepted as collateral mandates are credit rating driven with appropriate notional limits per rating, asset and individual bond concentration. The vast majority of collateral the Group uses in repo/reverse repo and stock lending/stock borrowing transactions is investment grade government issued, primarily UK government debt. The majority of repo/reverse repo and stock lending/stock borrowing transactions are short-term, having a residual maturity of less than three months.

Risk management continued

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 Group Board, reflecting the Group's strategic plans, regulatory capital constraints and market expectations. It is defined by a number of minimum capital ratios, a minimum leverage ratio and a minimum buffer over regulatory solvency requirements for the Insurance business set by the Insurance Board. The Group monitors its actual and forecast capital positions aiming to remain within its appetite at all times.

For further information on risk appetite refer to page 112.

Exposures

A capital risk exposure arises when the Group has insufficient capital resources to support its strategic objectives and plans, and to meet external stakeholder requirements and expectations. This could arise due to a depletion of the Group's capital resources as a result of the crystallisation of any of the risks to which it is exposed. Alternatively a shortage of capital could arise from an increase in the amount of capital that is needed to be held. 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 defined by the Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the Prudential Regulation Authority (PRA). Full details of the Group's regulatory capital framework are provided on page 14 of the Pillar 3 Report.

The minimum amount of total capital, under Pillar 1 of the regulatory framework, is determined as 8 per cent of aggregate risk-weighted assets. At least 4.5 per cent of risk-weighted assets are required to be covered by common equity tier 1 (CET1) capital and at least 6 per cent of risk-weighted assets are required to be covered by tier 1 capital. These minimum Pillar 1 requirements are supplemented by additional minimum requirements under Pillar 2 of the regulatory framework and a number of regulatory capital buffers as described below.

Additional minimum requirements are set by the PRA by the issuance of bank specific Individual Capital Guidance (ICG). This reflects a point in time estimate by the PRA, which may change over time, of the total amount of capital that is needed by the bank. It includes the assessment of risks that are not fully covered by Pillar 1, such as credit concentration and operational risk, and those risks not covered at all by Pillar 1 such as pensions and interest rate risk. During 2015 the PRA increased the Group's ICG such that at 31 December 2015 it represented 4.6 per cent of risk-weighted assets of which 2.6 per cent had to be covered by CET1 capital. The Group believes that the increase reflects the impact of market and economic factors and the reduction in risk-weighted assets rather than any fundamental changes to the nature of the underlying risks. However the Group is not permitted by the PRA to give any further details of the quantum of the individual components.

The Group is also required to maintain a number of regulatory capital buffers which are required to be met with CET1 capital.

Systemic risk buffers are designed to hold systemically important banks to higher capital standards. The Group is not currently categorised as a global systemically important bank (G-SIB) for which the Financial Stability Board (FSB) has set buffer rates. The Financial Policy Committee (FPC) has recently issued a consultation on the UK systemic risk buffer requirements for ring-fenced banks and large building societies proposing a rate of up to 2.5 per cent. The requirements will come into force from 2019 and the Group awaits finalisation of these later in 2016.

The capital conservation buffer is a general buffer of 2.5 per cent of risk-weighted assets designed to provide for losses in the event of stress and is being phased in over the period from 1 January 2016 to 1 January 2019.

The countercyclical capital buffer is time-varying and is designed to require banks to hold additional capital to remove or reduce the build up of systemic risk in times of credit boom, providing additional loss absorbing capacity and acting as an incentive for banks to constrain further credit growth. The amount of the buffer is determined by reference to buffer rates set by the FPC for the individual countries where the Group has credit risk exposures. The current requirement for the Group is negligible.

The FPC can also set sectoral capital requirements which are temporary increases to banks' capital requirements on exposures to specific sectors, if the FPC judges that exuberant lending to those sectors poses risks to financial stability. No sectoral capital requirements currently apply to the Group.

As part of the capital planning process, forecast capital positions are subjected to extensive stress analyses to determine the adequacy of the Group's capital resources against the minimum requirements, including ICG. The PRA uses the outputs from some of these stress analyses to inform the setting of a minimum level of capital buffer for the Group. Prior to 2016 this was known as the Capital Planning Buffer but has now been replaced by the PRA Buffer which is set taking account of the capital conservation buffer, countercyclical capital buffer and any sectoral capital requirements that already apply to the Group. The PRA requires the PRA Buffer to remain confidential between the Group and the PRA.

In addition to the risk-based capital framework outlined above, the Group is also subject to minimum capital requirements under the UK's leverage ratio framework. The leverage ratio is calculated by dividing 'fully loaded' tier 1 capital resources by a defined measure of on-balance sheet assets and off-balance sheet items.

The minimum leverage ratio is 3 per cent, in line with current Basel Committee proposals. In addition the UK framework requires two buffers to be maintained: The Additional Leverage Ratio Buffer (ALRB), which it is proposed should be up to 0.9 per cent, and a time-varying Countercyclical Leverage Buffer (CCLB) of up to 0.9 per cent (currently negligible for the Group). At least 75 per cent of the minimum 3 per cent requirement and the entirety of any buffers that may apply must be met by CET1 capital. The ALRB applies from 1 January 2016 but only for G-SIBs and as the Group is not categorised as a G-SIB it is not currently subject to the ALRB. Final rules are awaited on the wider application of the ALRB to ring-fenced banks and large building societies within the UK from 2019.

The proposed leverage ratio framework does not currently give rise to higher capital requirements for the Group than the risk-based capital framework.

Mitigation

The Group has a capital management framework including policies and procedures that are designed to ensure that it operates within its risk appetite, uses its capital resources efficiently and continues to comply with regulatory requirements.

The Group is able to accumulate additional capital through the retention of profits over time, which can be enhanced through cutting costs and reducing or cancelling dividend payments, by raising new equity via, for example, a rights issue or debt exchange and by raising additional tier 1 or tier 2 capital through issuing tier 1 instruments or 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.

Additional measures to manage the Group's capital position include seeking to optimise the generation of capital demand within the Group's businesses to strike an appropriate balance of capital held within the Group's 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. Multi-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.

Regular reporting of actual and projected ratios, including those in stressed scenarios, is undertaken, including submissions to the Group Asset and Liability Committee (GALCO), Group Risk Committee (GRC), Board Risk Committee (BRC) and the Board. Capital policies and procedures are subject to independent oversight.

The regulatory framework within which the Group operates continues to evolve. In particular, the Basel Committee is continuing to review the treatment of the standardised risk-weighted asset frameworks for credit risk and operational risk and the credit valuation adjustment risk framework. It is also to finalise recommendations for the capital treatment of interest rate risk in the banking book (IRRBB), the calibration of leverage ratio requirements and continues to consider the treatment of sovereign risk and the setting of additional constraints on the use of internally modelled approaches including the design of a new capital floors framework. In addition the Bank of England is consulting on proposals for the application of the European Commission's MREL (minimum requirements for own funds and eligible liabilities).

In December 2015, the FPC published a document alongside its Financial Stability Report in which it expressed its views on the overall calibration of the capital requirements framework for the UK banking system together with a description of how it expected the framework to transition from its current state to its end point in 2019 as well as ongoing work to refine capital requirements during that transitional period.

The Group continues to monitor these developments very closely, analysing the potential capital impacts to ensure that, through organic capital generation, the Group continues to maintain a strong capital position that exceeds the minimum regulatory requirements and the Group's risk appetite and is consistent with market expectations.

Stress testing

In addition to the internal stress testing activity undertaken in 2015, the Group participated in the UK-wide concurrent stress testing run by the Bank of England, comfortably exceeding both the capital and leverage minimum thresholds.

Capital management in 2015

The continued strengthening of the Group's capital position during 2015, through a combination of increased underlying profits, net of PPI and other conduct charges, and a reduction in risk-weighted assets, provided the Group with the ability to pay both an interim dividend at half year and to recommend the payment of both a full year ordinary dividend and a special dividend whilst maintaining strong capital ratios.

- The CET1 ratio before dividends in respect of 2015 increased 0.9 percentage points from 12.8 per cent to 13.7 per cent.
- The CET1 ratio after dividends in respect of 2015 was unchanged at 12.8 per cent, increasing to 13.0 per cent on a pro-forma basis upon recognition of the dividend paid by the Insurance business in February 2016 in relation to its 2015 earnings.
- The leverage ratio after dividends in respect of 2015 reduced from 4.9 per cent to 4.8 per cent.
- The transitional total capital ratio after dividends in respect of 2015 reduced 0.5 percentage points from 22.0 per cent to 21.5 per cent.

Dividends

The Group has established a dividend policy that is both progressive and sustainable. We expect ordinary dividends to increase over the medium term to a dividend payout ratio of at least 50 per cent of sustainable earnings. The Board interprets progressive to indicate a dividend per share that is expected to increase over the medium term. Sustainable earnings represents the long term earnings generation of the business. Sustainable earnings are defined as earnings after tax attributable to ordinary shareholders adjusted to remove the effects of market volatility, exceptional conduct or litigation events, major liability management or restructuring and other one off items such as the sale of businesses, and exceptional underlying business performance.

The Board also gives due consideration to the distribution of surplus capital through the use of special dividends or share buy-backs. Surplus capital represents capital over and above the amount management wish to retain to grow the business, meet regulatory requirements and cover uncertainties. The amount of required capital may vary from time to time depending on circumstances and the Board will continue to give due consideration, subject to the situation at the time, to the distribution of any surplus capital. By its nature, there can be no guarantee that this level of special dividends or any surplus capital distribution will be appropriate in future years.

The ability of the Group to pay a dividend is also subject to constraints including the availability of distributable reserves, legal and regulatory restrictions and the financial and operating performance of the entity.

Distributable reserves are determined as required by the Companies Act 2006 by reference to a company's individual financial statements. At 31 December 2015 Lloyds Banking Group plc ('the Company') had accumulated distributable reserves of approximately £7,500 million. Substantially all of the Company's merger reserve is available for distribution under UK company law as a result of transactions undertaken to recapitalise the Company in 2009.

Risk management continued

Lloyds Banking Group plc acts as a holding company which also issues capital and other securities to capitalise and fund the activities of the Group. The profitability of the holding company, and consequently its ability to sustain dividend payments, is therefore dependent upon the continued receipt of dividends from its subsidiaries (representing both banking and Insurance). A number of Group subsidiaries, principally those with banking and insurance activities, are also subject to regulatory capital requirements. These require entities to maintain minimum amounts of capital related to their size and risk. The principal operating subsidiary is Lloyds Bank plc which, at 31 December 2015, had a consolidated CET1 capital ratio of 15.2 per cent (31 December 2014: 15.1 per cent). The Group actively manages the capital of its subsidiaries, which includes monitoring the regulatory capital ratios for its banking and insurance subsidiaries against approved risk appetite limits. It operates a formal capital management policy which requires all subsidiary entities to remit any surplus capital to their parent companies.

During 2014 and 2015 the Group has undertaken significant capital management actions in order to simplify the Group's internal capital structure and to ensure that profits generated by subsidiary entities can be more easily remitted to the Company. These activities relate to a number of subsidiary entities, and include the court approved capital reductions by HBOS plc and Bank of Scotland plc, the part VII transfers within insurance businesses and obtaining PRA approval for our internal model, which will support the Solvency II capital regime for the Insurance subsidiaries with effect from 1 January 2016.

The Group remains strongly capitalised, increasing its CET1 capital ratio from 12.8 per cent at 31 December 2014 to 13.7 per cent (pre 2015 dividends) at 31 December 2015. The interim and recommended final dividends totalling 2.25 pence per ordinary share and the special dividend of 0.5 pence per ordinary share reduce the Group's CET1 ratio to 12.8 per cent. Recognising the 2015 insurance dividend, paid in February 2016 following the implementation of Solvency II, this rises to13.0 per cent on a pro forma basis.

Capital position at 31 December 2015

The Group's capital position as at 31 December 2015 is presented in the following section applying CRD IV transitional arrangements, as implemented in the UK by the PRA, and also on a fully loaded CRD IV basis.

The table below summarises the consolidated capital position of the Group. The Group's Pillar 3 Report provides a comprehensive analysis of the own funds of the Group.

Table 1.55: **Capital resources (audited)**

	Transitional		Fully loaded	
	At 31 Dec 2015 £m	At 31 Dec 2014[2] £m	**At 31 Dec 2015 £m**	At 31 Dec 2014[2] £m
Capital resources				
Common equity tier 1				
Shareholders' equity per balance sheet	**41,234**	43,335	**41,234**	43,335
Adjustment to retained earnings for foreseeable dividends	**(1,427)**	(535)	**(1,427)**	(535)
Deconsolidation of insurance entities[1]	**(1,199)**	(623)	**(1,199)**	(623)
Adjustment for own credit	**67**	158	**67**	158
Cash flow hedging reserve	**(727)**	(1,139)	**(727)**	(1,139)
Other adjustments	**72**	132	**72**	132
	38,020	41,328	**38,020**	41,328
Deductions from common equity tier 1				
Goodwill and other intangible assets	**(1,719)**	(1,875)	**(1,719)**	(1,875)
Significant investments[1]	**(2,723)**	(2,546)	**(2,752)**	(2,546)
Deferred tax assets	**(3,874)**	(4,533)	**(3,884)**	(4,533)
Other deductions	**(1,160)**	(1,685)	**(1,160)**	(1,685)
Common equity tier 1 capital	**28,544**	30,689	**28,505**	30,689
Additional tier 1 instruments	**9,177**	9,728	**5,355**	5,355
Deductions from tier 1[1]	**(1,177)**	(859)	**–**	–
Total tier 1 capital	**36,544**	39,558	**33,860**	36,044
Tier 2 instruments and eligible provisions	**13,208**	14,530	**9,189**	11,169
Deductions from tier 2[1]	**(1,756)**	(1,288)	**(2,933)**	(2,146)
Total capital resources	**47,996**	52,800	**40,116**	45,067
Risk-weighted assets (unaudited)	**222,845**	239,734	**222,747**	239,734
Common equity tier 1 capital ratio	**12.8%**	12.8%	**12.8%**	12.8%
Tier 1 capital ratio	**16.4%**	16.5%	**15.2%**	15.0%
Total capital ratio	**21.5%**	22.0%	**18.0%**	18.8%

1 For regulatory capital purposes, the Group's Insurance business is deconsolidated and replaced by the amount of the Group's investment in the business. A part of this amount is deducted from capital and the remaining amount is risk weighted, forming part of threshold risk-weighted assets.

2 Other comprehensive income related to the Group's Insurance business defined benefit pension scheme has been reclassified from common equity tier 1 other adjustments to deconsolidation of insurance entities.

The key differences between the transitional capital calculation as at 31 December 2015 and the fully loaded equivalent are as follows:

– Capital securities that previously qualified as tier 1 or tier 2 capital, but do not fully qualify under CRD IV, can be included in tier 1 or tier 2 capital (as applicable) up to specified limits which reduce by 10 per cent per annum until 2022.

– The significant investment deduction from additional tier 1 (AT1) will gradually transition to tier 2.

The movements in the transitional CET1, AT1, tier 2 and total capital positions in the period are provided below.

Table 1.56: **Movements in capital resources**

	Common equity tier 1 £m	Additional tier 1 £m	Tier 2 £m	Total capital £m
At 31 December 2014	30,689	8,869	13,242	52,800
Profit attributable to ordinary shareholders[1]	434			434
Eligible minority interest	(470)			(470)
Movement in foreseeable dividends	(892)			(892)
Dividends paid out on ordinary shares during the year	(1,070)			(1,070)
Movement in treasury shares and employee share schemes	(537)			(537)
Available-for-sale reserves	(371)			(371)
Deferred tax assets	659			659
Movements in subordinated debt		(551)	(1,210)	(1,761)
Significant investments	(177)	(318)	(468)	(963)
Other movements	279		(112)	167
At 31 December 2015	**28,544**	**8,000**	**11,452**	**47,996**

1 Under the regulatory framework, profits made by Insurance are removed from CET1 capital. However, when dividends are paid to the Group by Insurance these can then be recognised as CET1 capital.

CET1 capital resources have reduced by £2,145 million in the year largely as a result of dividends paid out during the year and the accrual of the full year ordinary dividend and special dividend, representing returns to ordinary shareholders following strong underlying profit generation. Other reductions to CET1 capital primarily reflected the removal of eligible minority interest related to TSB and movements in treasury shares, employee share schemes and the AFS reserve. These reductions in CET 1 capital were partially offset by reductions in both the deferred tax asset deduction and the excess of expected losses over impairment provisions and value adjustments.

AT1 capital resources have reduced by £869 million in the year, primarily reflecting the annual reduction in the transitional limit applied to grandfathered AT1 capital instruments and an increase in the significant investments deduction.

Tier 2 capital resources have reduced by £1,790 million in the year largely reflecting calls and redemptions, amortisation of dated instruments, foreign exchange movements and an increase in the significant investments deduction, partly offset by the issuance of new tier 2 instruments.

Table 1.57: **Risk-weighted assets**

	At 31 December 2015 £m	At 31 December 2014 £m
IRB Approach	151,563	160,603
Standardised Approach	20,443	25,444
Contributions to the default fund of a central counterparty	488	515
Credit risk	172,494	186,562
Counterparty credit risk	7,981	9,108
Credit valuation adjustment risk	1,684	2,215
Operational risk	26,123	26,279
Market risk	3,775	4,746
Underlying risk-weighted assets	212,057	228,910
Threshold risk-weighted assets[1]	10,788	10,824
Total risk-weighted assets	222,845	239,734
Movement to fully loaded risk-weighted assets[2]	(98)	–
Fully loaded risk-weighted assets	222,747	239,734

1 Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of deducted from CET1 capital. Significant investments primarily arise from the investment in the Group's Insurance business.

2 Differences may arise between transitional and fully loaded threshold risk-weighted assets where deferred tax assets reliant on future profitability and arising from temporary timing differences and significant investments exceed the fully loaded threshold limit, resulting in an increase in amounts deducted from CET1 capital rather than being risk-weighted. At 31 December 2014 the fully loaded threshold was not exceeded and therefore no further adjustment was applied to the transitional threshold risk-weighted assets.

Risk management continued

Table 1.58: **Risk-weighted assets movement by key driver**

	Credit risk[1] £m	Counter party credit risk[1] £m	Market risk £m	Operational risk £m	Total £m
Risk-weighted assets at 31 December 2014	186,562	11,323	4,746	26,279	228,910
Management of the balance sheet	1,772	(474)	(838)	–	460
Disposals	(8,582)	(115)	–	–	(8,697)
External economic factors	(6,370)	(518)	80	–	(6,808)
Model and methodology changes	(888)	(551)	(213)	–	(1,652)
Other	–	–	–	(156)	(156)
Risk-weighted assets	172,494	9,665	3,775	26,123	212,057
Threshold risk-weighted assets[2]					10,788
Total risk-weighted assets					222,845
Movement to fully loaded risk-weighted assets[3]					(98)
Fully loaded risk-weighted assets					222,747

1 Credit risk includes movements in contributions to the default fund of central counterparties and counterparty credit risk includes the movements in credit valuation adjustment risk.

2 Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of deducted from CET1 capital. Significant investments primarily arise from the investment in the Group's Insurance business.

3 Differences may arise between transitional and fully loaded threshold risk-weighted assets where deferred tax assets reliant on future profitability and arising from temporary timing differences and significant investments exceed the fully loaded threshold limit, resulting in an increase in amounts deducted from CET1 capital rather than being risk-weighted. At 31 December 2014 the fully loaded threshold was not exceeded and therefore no further adjustment was applied to the transitional threshold risk-weighted assets.

The risk-weighted assets movement tables provide analyses of the reduction in risk-weighted assets in the period by risk type and an insight into the key drivers of the movements. The key driver analysis is compiled on a monthly basis through the identification and categorisation of risk-weighted asset movements and is subject to management judgment.

Credit risk-weighted assets reductions of £14.1 billion were driven by the following key movements:

– Management of the balance sheet includes risk-weighted asset movements arising from new lending and asset run-off. During 2015, credit risk-weighted assets increased by £1.8 billion, primarily as a result of targeted net lending growth in core businesses, as well as an increase in risk-weighted assets for the Group's strategic equity investments.
– Disposals include risk-weighted asset reductions arising from the sale of assets, portfolios and businesses. Disposals reduced credit risk-weighted assets by £8.6 billion, primarily driven by the completion of the sale of TSB as well as disposals in the run-off business.
– External economic factors capture movements driven by changes in the economic environment. The reduction in credit risk-weighted assets of £6.4 billion is mainly due to improvements in credit quality, which primarily impacted the Retail and Consumer Finance businesses, and favourable movements in HPI that benefited retail mortgage portfolios.
– Model and methodology reductions of £0.9 billion include the movement in credit risk-weighted assets arising from model and methodology refinements and changes in credit risk approach applied to certain portfolios.

Counterparty credit risk and CVA risk reductions of £1.7 billion are principally driven by trading activity and compressions, hedging and yield curve movements.

Risk-weighted assets related to market risk reduced by £1.0 billion primarily due to active portfolio management and model and methodology refinements.

Leverage ratio

In January 2015 the existing CRD IV rules on the calculation of the leverage ratio were amended to align with the European Commission's interpretation of the revised Basel III leverage ratio framework. The Group's leverage ratio has been calculated in accordance with the amended CRD IV rules on leverage.

The table on the next page summarises the component parts of the Group's leverage ratio. Further analysis is provided in the Group's Pillar 3 Report.

Table 1.59: **Leverage ratio**

	Fully loaded	
	At 31 Dec 2015 £m	At 31 Dec 2014[1] £m
Total tier 1 capital	**33,860**	36,044
Exposure measure		
Derivative financial instruments	**29,467**	36,128
Securities financing transactions (SFTs)	**34,136**	43,772
Loans and advances and other assets	**743,085**	774,996
Total statutory balance sheet assets	**806,688**	854,896
Deconsolidation and other adjustments[2]	**(135,926)**	(144,122)
Derivatives adjustments	**(9,235)**	(12,064)
Counterparty credit risk add-on for SFTs	**3,361**	1,364
Off-balance sheet items	**56,424**	50,980
Regulatory deductions and other adjustments	**(9,112)**	(10,362)
Total exposure	**712,200**	740,692
Leverage ratio	**4.8%**	4.9%

1 Restated to align with the amended CRD IV rules on leverage implemented in January 2015.

2 Deconsolidation adjustments predominantly reflect the deconsolidation of assets related to Group subsidiaries that fall outside the scope of the Group's regulatory consolidation (primarily the Group's insurance entities).

Key movements

The Group's fully loaded leverage ratio reduced by 0.1 per cent to 4.8 per cent reflecting the impact of the reduction in tier 1 capital offset by the £28.5 billion reduction in the exposure measure, the latter largely reflecting the reduction in balance sheet assets arising, in part, from the disposal of TSB.

The derivatives exposure measure, representing derivative financial instruments per the balance sheet net of deconsolidation and derivatives adjustments, reduced by £3.7 billion reflecting a combination of market movements, trading activity and trade compressions and the recognition and subsequent deduction of receivable assets for eligible cash variation margin provided in derivative transactions.

The SFT exposure measure, representing SFTs per the balance sheet inclusive of deconsolidation adjustments and counterparty credit risk add-on, reduced by £9.7 billion primarily reflecting active balance sheet management and reduced trading volumes.

Off-balance sheet items increased by £5.4 billion, primarily reflecting an increase in new corporate lending facilities and corporate customer limits and an increase in new residential mortgage offers placed.

G-SIB requirements

Although the Group is not currently classified as a Global Systemically Important Bank (G-SIB), by virtue of the leverage exposure exceeding €200 billion, the Group is required to report G-SIB metrics to the PRA. The Group's metrics used within the 2015 Basel G-SIBs annual exercise will be disclosed from April 2016, and the results are expected to be made available by the Basel Committee later this year.

Insurance businesses

The business transacted by the insurance companies within the Group comprises both life insurance business and general insurance business. Life insurance business comprises unit-linked business, non-profit business and with-profits business.

On 31 December 2015, the long-term insurance business of seven life insurance companies within the Group were transferred to Clerical Medical Investment Group Limited (CMIG) pursuant to an insurance business transfer scheme, under Part VII of the Financial Services and Markets Act 2000. Scottish Widows plc and CMIG hold the only with-profit funds managed by the Group, and the Scottish Widows plc with-profit fund was transferred to a new with-profit fund within CMIG. On 31 December 2015, CMIG changed its name to Scottish Widows Limited (SW Ltd), and Scottish Widows plc changed its name to SW Funding plc.

Each life insurance company within the Group is regulated by the PRA. The PRA specifies the minimum amount of capital that must be held by each life insurance company within the Group. Under the PRA rules, applying during the year, each life insurance company within the Group must hold assets in excess of the higher of:

(i) the Pillar 1 amount, which is calculated by applying fixed percentages of mathematical reserves and capital at risk; and

(ii) the Pillar 2 amount, which is derived from an economic capital assessment undertaken by each regulated life insurance company, which is reviewed by the PRA.

The minimum required capital must be maintained at all times throughout the year. These capital requirements and the capital available to meet them are regularly estimated in order to ensure that capital maintenance requirements are being met.

During the year Scottish Widows Group Limited (SWG) was also subject to the capital adequacy requirements of the Insurance Group Directive (IGD), which comprises the consolidated surplus of the Group's regulated insurance subsidiaries.

All minimum regulatory requirements of the life insurance companies are expected to be met during the year.

The new Solvency II regime for insurers and insurance groups is in force from 1 January 2016. The insurance businesses are required to calculate capital requirements and available capital on a revised risk-based approach. The insurance business of the Group will calculate regulatory capital from 1 January 2016 on the basis of an internal model, which was approved by the PRA on 5 December 2015. The estimated solvency II capital ratio of SWG at 1 January 2016 was 148 per cent before allowing for dividends.

Risk management continued

REGULATORY AND LEGAL RISK

Definition

Regulatory and legal risk is defined as the risk that the Group is exposed to fines, censure, legal or enforcement action, civil or criminal proceedings in the courts (or equivalent) and risk that the Group is unable to enforce its rights as anticipated.

Risk appetite

The Group has a zero risk appetite for material regulatory breaches or material legal incidents. 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 applicable laws (including Codes of Practice), regulations, codes of conduct and legal obligations.

For further information on risk appetite refer to page 112.

Exposures

The Group periodically experiences material regulatory breaches and material legal incidents outside its risk appetite. Exposure is also driven by significant ongoing and new legislation, regulation and court proceedings within the UK and overseas with which the Group has to comply, which in each case needs to be interpreted, implemented and embedded into day-to-day operational and business practices across the Group. The industry continues to witness increased levels of government and regulatory intervention in the financial sector with increasing regulatory rules and laws from both the UK and overseas affecting the Group's operations.

Measurement

Regulatory and legal risks are measured against a set of risk appetite metrics, with appropriate thresholds, which are approved annually 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:

- The Board establishes a group wide risk appetite and metrics for Regulatory and Legal Risk.
- Group policies and procedures set out the principles and key controls that should apply across the business which are aligned to the group risk appetite. Mandated policies and processes require appropriate control frameworks, management information, standards and colleague training to be implemented to identify and manage regulatory and legal risk.
- Business units assess and implement policy and regulatory requirements and establish local controls to assure compliance.
- Material risks and issues are escalated to divisional and then Group-level bodies which challenge and support the business on its management of them.
- Business units produce regularly management information to assist in the identification of issues and test management controls are working effectively.
- Risk Division and Legal provide oversight and proactive support and constructive challenge to the business in identifying and managing regulatory and legal issues.
- When appropriate Risk Division will conduct thematic reviews of regulatory compliance across businesses and divisions.
- Business units with the support of divisional and Group-Level bodies conduct ongoing horizon scanning to identify and address changes in regulatory and legal requirements.

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 Conduct, Compliance and Operational Risk Committee. This committee may escalate matters to the Chief Risk Officer, or higher committees. The report also forms the basis of the regulatory and legal sections in the Group's consolidated risk reporting.

INSURANCE RISK

Definition

Insurance risk is defined as the risk of adverse developments in the timing, frequency or severity of claims for insured/underwritten events and in customer behaviour, leading to reductions or volatility in earnings and/or value.

Risk appetite

Insurance risk appetite in the Insurance business is set by the Insurance Board and includes capital and earnings limits on insurance risk drivers.

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.

For further information on risk appetite, refer to page 112.

Exposures

The major sources of insurance risk within the Group are the Insurance business and the Group's defined benefit pension schemes.

Longevity and persistency are key risks within the life and pensions business. Longevity risk arises from the annuity portfolios where policyholders' future cashflows are guaranteed at retirement and increases in life expectancy, beyond current assumptions, will increase the cost of annuities. Longevity risk exposures are expected to increase following the 2015 entry into the bulk annuity market. Persistency assumptions are set to give a best estimate however, customer behaviour may result in increased cancellations or cessation of contributions.

Property insurance risk is a key risk within the general insurance business, through Home Insurance, and exposures can arise, for example, in extreme weather conditions, such as flooding, when property damage claims are higher than expected.

The prime insurance risk of the Group's defined benefit pension schemes is longevity.

Measurement

Insurance risks are measured using a variety of techniques including stress, reverse stress and scenario testing, as well as 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 regulatory capital assessments (Group defined benefit pension schemes utilise 1-in-20 year stresses) and other supporting measures where appropriate, including those set out in note 34 to the financial statements.

Mitigation

Insurance risk in the Insurance business is mitigated in a number of ways:

– Longevity risk transfer and hedging solutions are considered on a regular basis. A team of longevity and bulk pricing experts has been built to support the new bulk annuity proposition.
– General insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements broadly spread over different reinsurers. Detailed modelling, including that of the potential losses under various catastrophe scenarios, supports the choice of reinsurance arrangements.
– Insurance processes on underwriting, claims management, pricing and product design.
– 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 risk in the defined benefit pension schemes is longevity risk. The merits of longevity risk transfer and hedging solutions are regularly reviewed.

Monitoring

Insurance risks in the Insurance business are monitored by Insurance senior executive Committees and ultimately the Insurance Board. Governance of the Group's defined benefit pension schemes includes two specialist pension committees (one Group executive sub-committee and a supporting management committee). Significant risks from the Insurance business and the defined benefit pension schemes are reviewed by the Group executive and Group Risk Committees and/or Board.

Insurance risk exposures within the Insurance business are monitored against risk appetite. The Insurance business monitors experiences against expectations, for example business volumes and mix, claims and persistency experience. 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.

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 an inability to deliver the Group's strategy.

Risk appetite

The Group's people risk appetite and corresponding measures enable the Group to lead responsibly and proficiently, manage people resources effectively, support and develop colleague talent, and meet legal and regulatory obligations related to its people.

The appetite is reviewed and approved annually by the Board. To stay within appetite, the Group has policies, processes and standards which provide the framework for business and colleagues to operate in accordance with the laws, regulations and voluntary codes which apply to the Group and its activities.

For further information on risk appetite, refer to page 112.

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:

– The new Senior Managers and Certification Regime (SM&CR), which brings a statutory duty of responsibility and increased accountability may impact the Group's ability to attract and retain talent;
– Attracting and retaining talent may be impacted by a more active external market alongside increasing regulatory constraints around remuneration structures;
– The increasing digitisation of the business is changing the capability mix required and may impact our ability to attract and retain talent;
– Colleague engagement may continue to be challenged by ongoing media attention on banking sector culture, sales practices and ethical conduct; and
– Maintaining organisational people capability and capacity levels in response to increasing volumes of organisational and external market change.

Measurement

People risk is measured through a series of quantitative and qualitative indicators, aligned to key sources of people risk for the Group such as succession, retention, colleague engagement and performance management. In addition to risk appetite measures and limits, people risks and controls are monitored on a monthly basis via the Group's risk governance framework and reporting structures.

Mitigation

The Group takes many mitigating actions with respect to people risk. Key areas of focus include:

– Working with the regulators to ensure their guidance on increased accountability in the new SM&CR strengthens remuneration governance to balance implementation costs with the benefits gained from enhanced governance;

Risk management continued

– Continued focus on the Group's culture by developing and delivering initiatives that reinforce the appropriate conduct behaviours which generate the best possible long-term outcomes for customers and colleagues;
– Maintain effective remuneration arrangements to ensure they promote an appropriate culture and colleague 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;
– Ensuring compliance with legal and regulatory requirements related to SM&CR, embedding compliant and appropriate colleague behaviours in line with Group policies, values and its people risk priorities; and
– Ongoing consultation with the Group's recognised unions on changes which impact their members.

Monitoring

People risks from across the Group are monitored and reported through Board and Group Governance Committees in accordance with the Group's Risk Management Framework and People Risk sub-framework. Risk exposures are discussed monthly via the Group HR & People Risk Committee with upwards reporting to Group Risk and Executive Committees. In addition oversight, challenge and reporting is completed at Risk Division level and combined with Risk Assurance reviews, is intended to assess the effectiveness of controls, recommending follow up remedial action if relevant. All material People Risk events are escalated in accordance with the formal Group Operational Risk Policy and People Policies to the respective Divisional Managing Directors and the Group Director, Compliance, Conduct and Operational Risk.

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 and regulatory 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.

For further information on risk appetite refer to page 112.

Exposures

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 (i) the effectiveness of internal controls over financial reporting; and (ii) the effectiveness of the Group's disclosure controls and procedures, both in accordance with the requirements of the US Sarbanes Oxley Act; and
– 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 74 to 77.

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 Framework 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 and the vision of being the best bank for customers, maximise shareholder value and meet regulatory and social expectations.

For further information on risk appetite refer to page 112.

Exposures

The internal and corporate 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 (RMF) 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 Groupwide 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.

Under the banner of the RMF, training modules are in place to support all colleagues in understanding and fulfilling their risk responsibilities.

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 RMF 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 RMF, 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.

This includes a review of the Group's current approach to governance and ongoing initiatives in light of the latest regulatory guidance, including in 2015 evolution of frameworks to address Senior Managers and Certification Regime (SM&CR) requirements and the recommendations from a third party review of the Three Lines of Defence.

For further information on Corporate Governance see pages 60 to 81.

FINANCIAL STATEMENTS

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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:

– Lloyds Banking Group plc's consolidated financial statements and parent company financial statements (the 'financial statements') give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2015 and of the Group's profit and the Group's and the parent company's cash flows for the year then ended;

– the consolidated 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 consolidated financial statements, Article 4 of the IAS Regulation.

What we have audited

The financial statements, included within the Annual Report and Accounts (the 'Annual Report'), comprise:

– the consolidated and parent company balance sheets as at 31 December 2015;

– the consolidated income statement and the consolidated statement of comprehensive income for the year then ended;

– the consolidated and parent company cash flow statements for the year then ended;

– the consolidated and parent company statements of changes in equity for the year then ended; and

– the notes to the financial statements, which include a summary of accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Our audit approach

Overview

Set out below is an overview of our audit approach, highlighting key aspects including materiality level, scope and areas of focus of our audit. These are described in further detail later in this audit report.

Materiality	Overall Group materiality: £300 million which represents 5 per cent of the 3 year average of adjusted profit before tax. Profit was adjusted to remove the effect of certain items which were considered to have a disproportionate impact.
Audit scope	The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of reporting units and other qualitative factors (including history of misstatement through fraud or error). We performed audit procedures over reporting units considered financially significant in the context of the Group (full scope audit) or in the context of individual primary statement account balances (audit of specific account balances). We also performed other procedures including testing entity level controls, information technology general controls and analytical review procedures to mitigate the risk of material misstatement in the residual reporting units.
Areas of focus	The areas of focus for our audit which involved the greatest allocation of our resources and effort were: – Credit risk and impairment of loans and advances to customers – Conduct risk and provisions – Actuarial assumptions used in the valuation of insurance contracts (liabilities and assets representing the value of in-force business) – Hedge accounting – Uncertain tax positions – Recognition of deferred tax assets – Valuation of pension obligations – Fair value adjustments applied to uncollateralised derivative financial instruments – Sale of TSB Banking Group plc

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)').

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors or management that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as 'areas of focus' in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks 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 75.

Independent auditors' report to the members of Lloyds Banking Group plc continued

Area of focus	How our audit addressed the area of focus
Credit risk and impairment of loans and advances to customers *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), page 197 (Critical Accounting Estimates and Judgements) and page 226 (notes).* Impairment is a subjective area due to the level of judgement applied by management in determining provisions. Our work covered impairment of loans and advances to customers within Retail Banking, Consumer Finance and Commercial Banking. We focused on the identification of impairment events, which differs based upon the type of lending product and customer. Judgement is required to determine whether a loss has been incurred. We also focused on the measurement of impairment, including the assessment of whether historic experience is appropriate when assessing the likelihood of incurred losses in the portfolios (particularly given the prolonged period of low interest rates). Judgement is applied to determine appropriate parameters and assumptions used to calculate impairment. For example, the assumption of customers that will default, the valuation of collateral for secured lending and the future cash flows of commercial loan customers. Management also applies adjustments, or overlays, where they believe the data driven parameters and calculations are not appropriate, either due to emerging trends or models not capturing the risks in the loan portfolio. An example of this is an overlay for the current low interest rates which management apply on top of the impairment model output in Retail Banking. These overlays require significant judgement.	We understood and tested key controls and focused on: – the identification of impairment events; – the governance over the impairment processes, including the continuous re-assessment by management that impairment models are still calibrated in a way which is appropriate for the impairment risks in the Group's loan portfolios; – the transfer of data between underlying source systems and the impairment models that the Group operates; and – the review and approval process that management have in place for the outputs of the Group's impairment models, and the adjustments and overlays that are applied to modelled outputs. We found these key controls were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these key controls for the purposes of our audit. In addition we have performed the following substantive procedures: *Retail Banking and Consumer Finance* We understood management's basis for determining whether a loan is impaired and assessed the reasonableness using our understanding of the Group's lending portfolios and our broader industry knowledge. Impairment is calculated using models. We therefore tested the completeness and accuracy of data from underlying systems and data warehouses that is used in those models. We understood and critically assessed the models used. Modelling assumptions and parameters, such as probability of default, are based on historic data. We challenged whether historic experience was representative of current circumstances and of the recent losses incurred in the portfolios. Where changes had been made in model parameters and assumptions, we understood the reasons why changes had taken place and used our industry knowledge and experience to evaluate the appropriateness of such changes. We also performed sensitivity analysis, and for certain portfolios, re-performed the provision calculation using our own independent models. We understood and corroborated any material differences identified. In evaluating the models and assumptions, we also considered whether all relevant risks were reflected in the modelled provision, and where not, whether overlays to modelled calculations appropriately reflected those risks. We challenged management to provide objective evidence to support the overlay adjustments made to the modelled provision. Based on the evidence obtained we found that the impairment model assumptions, data used within the models and overlays to modelled outputs were reasonable. *Commercial Banking* We understood and evaluated the processes for identifying impairment events within the loan portfolios, as well as the impairment assessment processes for loans within the business support unit and run-off portfolio. We assessed critically the criteria for determining whether an impairment event had occurred and therefore whether there was a requirement to calculate an impairment provision. We tested a sample of performing loans with characteristics that might imply an impairment event had occurred (for example a customer experiencing financial difficulty or approaching a refinancing deadline) to challenge whether all impairment events had been identified by management. We also haphazardly selected a sample of performing loans to further challenge whether all impairment events had been identified by management. We did not identify further impairment events. For a sample of individually impaired loans we understood the latest developments at the borrower and the basis of measuring the impairment provisions and considered whether key judgments were appropriate given the borrowers' circumstances. We also re-performed management's impairment calculation. In addition, we tested key inputs to the impairment calculation including the expected future cash flows and valuation of collateral held, and challenged management to demonstrate that the valuations were up to date, consistent with the strategy being followed in respect of the particular borrower and appropriate for the purpose. We further challenged management on the value of the provisions held by comparing the gains or losses crystallised when impaired loans have been sold. This provided evidence that provisions held were appropriate. From the testing performed we determined that sufficient specific impairment provisions had been made in respect of incurred losses in the Commercial Banking loan portfolios. For the collective unidentified impaired provision, which reflects losses incurred but not yet identified, we tested the completeness and accuracy of the underlying loan information used in the impairment models by agreeing details to the Group's source systems as well as re-performing the calculation of the modelled provision. For the key assumptions in the model, we challenged management to provide objective evidence that they were appropriate. Further, we used our industry experience and knowledge to consider the appropriateness of the provision. For overlays to the modelled output, we challenged management to provide objective evidence that the overlays were appropriate. We found that the overlays were reasonable and appropriate.

Area of focus	How our audit addressed the area of focus
Conduct risk and provisions *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), page 197 (Critical Accounting Estimates and Judgements) and page 234 (notes).* Given the continued regulatory focus on the financial services sector there is a significant risk that further claims or regulatory investigations will emerge that impact the financial statements. There is a risk across the Group that emerging conduct risk areas have not yet been identified or appropriately assessed by management for financial reporting purposes, including whether a provision is required or a contingent liability disclosed. Where provisions or contingent liability disclosures are made, judgement is required in measuring the liabilities. Judgement is required in estimating future redress payments to be made to customers, regulatory fines, and operational costs of processing complaints and reviewing past business.	We understood and tested the key controls and management's processes for: – identifying conduct risk exposures and assessing whether provisions or disclosures were necessary; and – the calculation and review of conduct provisions including governance processes and approvals of model assumptions and outputs. We found these key controls were designed, implemented and operated effectively and therefore we determined that we could place reliance on these key controls for the purposes of our audit. We met with Divisional and Group management to understand the emerging and potential issues that they had identified. We assessed independently emerging and potential areas where exposures might have arisen based upon our knowledge and experience of emerging industry issues and the regulatory environment. We used this to challenge the completeness of the issues identified by management and whether a provision was required. We understood customer complaints received, assessed the trends and tested a sample of complaints to ensure they were appropriately categorised. We used this analysis to understand whether there were indicators of more systemic issues being present for which provisions or disclosures may need to be made in the financial statements. We read the Group's correspondence with the Financial Conduct Authority and Prudential Regulation Authority and discussed the output of any meetings held. We met on a trilateral basis with the Financial Conduct Authority, Prudential Regulation Authority and the Chair of the Group Audit Committee. We also met on a bilateral basis with each regulator. We read the minutes of key governance meetings including those of the Board, and of various management committees, as well as attending Audit Committee and Board Risk Committee meetings. We also understood the key activities of the Conduct and Compliance function. The majority of our detailed audit work was on the significant conduct provisions in relation to past sales of Payment Protection Insurance (PPI) policies, interest rate hedging products to small and medium-sized businesses, insurance products in the German branch of Clerical Medical Investment Group Limited (now Scottish Widows Limited) and packaged bank accounts. We also examined other areas of compensation payments made to customers. For significant provisions made, we understood and challenged the provisioning methodologies and underlying assumptions used by management. For example, we challenged the basis that management used for forecasting the number of PPI complaints that will be received in the future. We also considered regulatory developments and management's interactions with regulators. For those assumptions based on historic information, we challenged whether this was appropriate for future experience and challenged the appropriateness of any adjustments made by management. We also independently performed sensitivity analysis on the key assumptions. Given the inherent uncertainty in the calculation of conduct provisions and their judgemental nature, we evaluated the disclosures made in the financial statements. In particular, we focused on challenging management that the disclosures were sufficiently clear in highlighting the exposures that remain, significant uncertainties that exist in respect of the provisions and the sensitivity of the provisions to changes in the underlying assumptions. No additional material conduct issues that would require either provision or disclosure in the financial statements were identified as a result of the audit work performed.

Independent auditors' report to the members of Lloyds Banking Group plc continued

Area of focus	How our audit addressed the area of focus
Actuarial assumptions used in the valuation of insurance contracts (liabilities and assets representing the value of in-force business) *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), page 197 (Critical Accounting Estimates and Judgements) and page 218 (notes).* The valuation of the Group's insurance contracts is dependent on a number of subjective assumptions about future experience. Some of the economic and non-economic actuarial assumptions used in valuing insurance contracts are judgemental, in particular persistency (the retention of policies over time), longevity (the expectation of how long an annuity policyholder will live and how that might change over time), expenses (future expenses incurred to maintain existing policies to maturity), credit risk and illiquidity premium (adjustments made to the discount rate). Persistency can be impacted by changes to regulation for products sold by the Group. Recently the Group's products have been affected by regulatory changes including the Retail Distribution Review, Pensions Auto Enrolment and more recently the Finance Act 2014. We focused on whether management's assumptions were appropriate given this changing regulatory background. The Group's accounting policy is that the discount rate applied to cash flows is consistent with that applied to such cash flows in the capital markets. Management use the actual asset mix as a proxy for deriving a market consistent view of the illiquidity adjustment to the discount rate. Small changes in each of these assumptions can result in material impacts to the valuation of insurance contract liabilities, the value of in-force assets and the related movements in the income statement.	We understood and tested key controls and governance around the processes for analysing economic and non-economic assumptions. We found the key controls for the setting of assumptions, including the experience analysis data, were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these controls for the purposes of our audit. We engaged our actuarial specialists to assess the actuarial assumptions, including the consideration and challenge of management's rationale for the judgements applied and any reliance placed on industry information. The assessment included reference to our independent benchmarking data which considers each of these principal areas. For persistency, longevity and expenses we considered recent experience and the appropriateness of the judgements applied by management on how future experience will evolve. For persistency, we also considered the appropriateness of assumptions set by management in light of regulatory changes. In particular, we considered how the assumptions reflect expected persistency improvements from the removal of commission for qualifying pension schemes and greater outflows of funds expected as a result of increased options available to pension policyholders (Finance Act 2014). For longevity and expenses we assessed the appropriateness of the assumptions by comparing them to experience and latest industry data. For credit risk and illiquidity premium we assessed the appropriateness of the methodology and any modifications made against our knowledge and experience of the regulatory requirements and of the industry. We assessed the assumptions with reference to wider market practice and prevailing economic conditions. We challenged whether the actual asset mix remained an appropriate proxy to a market consistent portfolio by comparing the proportion of illiquid assets held to the most recent public information for other similar companies. We performed testing to confirm that the assumptions approved were those applied. Based on the results of our audit work we concluded that the data and assumptions used by management were reasonable.
Hedge accounting *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), and page 211 (notes).* The Group enters into a number of hedges to manage structural interest rate risk. These arrangements create accounting mismatches which are addressed through hedge accounting arrangements, predominantly fair value hedges or cash flow hedges. For example, one of the macro cash flow hedge models uses a portfolio of Base Rate mortgage assets which are designated into hedge relationships with LIBOR based swaps. The application of hedge accounting and ensuring hedge effectiveness can be highly judgemental and requires close monitoring from management.	We understood and tested key controls over the designation and ongoing management of hedge accounting relationships, including testing of hedge ineffectiveness. We found the key controls were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these controls for the purposes of our audit. We examined hedge documentation to assess whether the documentation complied with all the requirements of IAS 39. We tested key year-end reconciliations between underlying source systems and spreadsheets used to manage hedging models, including testing the calculation of hedge effectiveness adjustments. We also tested a sample of manual adjustments posted to hedge reserves relating to hedge ineffectiveness arising in hedging models. We found that hedge accounting methodology was appropriately applied.
Uncertain tax positions *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), and page 246 (notes).* The Group has a number of open tax matters, for which management is required to make certain judgements as to the likely outturn for the purposes of calculating the Group's tax liabilities. Such matters include an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary.	We examined the analyses performed by management which set out the bases for their judgements in respect of the material tax exposures identified, together with relevant supporting evidence such as correspondence with tax authorities and legal opinions obtained. We used our understanding of the business and also read correspondence with tax authorities to challenge the completeness of identified exposures and the need for provisions. We made our own assessment of the likelihood of the tax exposures occurring based on our knowledge of tax legislation and applicable precedent. In making our assessment we considered the range of interpretation of the applicable tax legislation in the relevant jurisdictions. We also evaluated the calculation of the exposures and agreed these to the financial statements. We assessed whether the extent of the disclosures made, in particular, in relation to contingent liabilities and judgements was appropriate. Management's judgements in respect of the Group's positions on uncertain tax items are supportable in the context of the information currently available.

Area of focus	How our audit addressed the area of focus
Recognition of deferred tax assets *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), and page 232 (notes).* The recognition of a deferred tax asset in respect of tax losses is permitted only to the extent that it is probable that future taxable profits will be available to utilise the tax losses carried forward. When considering the availability of future taxable profits, judgement is required when assessing projections of future taxable income which are based on approved business plans/forecasts. The allocation of forecast profits is also judgemental when considering the utilisation of the deferred tax assets in the separate legal entities where the assets reside.	We understood and tested key controls over the production and approval of the forecast taxable profits used to support the recognition of various deferred tax assets. We found the key controls were designed, implemented and operated effectively, and therefore we were able to place reliance on these controls for the purposes of our audit. We assessed whether the forecast profits were appropriate by challenging both the underlying and economic assumptions, focusing on those directly impacting the adjusted profit figures, for example interest rates, consumer spending rates and gross domestic product. We used our independent benchmarking data to benchmark a number of the economic assumptions to external data sources where possible, and also assessed the accuracy of previous forecasts. We also tested management's basis for allocating forecast profits between legal entities and the related disclosures by testing the allocation methodology, challenging significant assumptions and using our experience of the Group's activities. We have evaluated the impact of recent tax law changes on the calculation of the Group's deferred tax balances, including confirming that the loss restriction rules, the banking surcharge and the restriction of deductions for certain compensation payments have been correctly applied. We found that the utilisation period and the related disclosures were appropriate.
Valuation of pension obligations *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), page 197 (Critical Accounting Estimates and Judgements) and page 226 (notes).* The Group operates a number of defined benefit schemes which in total are significant in the context of both the overall balance sheet and results of the Group. The valuations of the pension obligations are calculated with reference to a number of actuarial assumptions and inputs including discount rate, rate of inflation and mortality rates. The treatment of curtailments, settlements, past service costs and measurements and other amendments can significantly impact the balance sheet and results of the Group. Small changes in assumptions can result in material impacts to the net pension liability or asset.	We understood and tested key controls over the completeness and accuracy of data extracted and supplied to the Group's actuary, which is used to calculate the pension scheme surplus or deficit. We also tested the controls for determining and approving the fair value of the scheme assets and the actuarial assumptions and valuations. We found the key controls were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these controls for the purposes of our audit. We engaged our actuarial specialists and met with management and their actuary to understand the judgements made in determining key economic assumptions used in the calculation of the liability. We assessed the reasonableness of those assumptions by comparing to our own independently determined benchmarks and concluded that the assumptions used by management were appropriate. We tested the consensus and employee data used in calculating the obligation. We also considered the treatment of curtailments, settlements, past service costs and measurements, and any other amendments made to obligations during the year. We tested the fair value of scheme assets by independently calculating a fair value for a sample of the assets held. Based on the evidence obtained, we found that the data and assumptions used by management in the actuarial valuations and the fair value of the scheme assets are within a range we consider to be reasonable. We also read and assessed the disclosures made in the financial statements, including disclosures of the assumptions, and found them to be appropriate.
Fair value adjustments applied to uncollateralised derivative financial instruments *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), and page 257 (notes).* The Group applies fair value adjustments to uncollateralised derivative positions, such as credit and debit valuation adjustments (CVA and DVA) and funding valuation adjustments (FVA). These are highly judgemental and complex calculations dependent on market data, and models developed by management. For CVA and DVA, the adjustments are sensitive to factors such as the value of the uncollateralised derivative financial instruments, their expected future market volatility and credit risks. For FVA, the adjustment is sensitive to funding rates observed in market transactions which are difficult to isolate from other elements of pricing.	We understood and tested the key controls over derivative valuations, which included the derivative valuation adjustments. In particular, we tested: – the key governance controls management had over the derivative valuation adjustments; – the controls over the completeness and accuracy of data inputs to the valuation models; and – the review of the derivative valuation adjustments calculated by the valuation models. We found the key controls were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these controls for the purposes of our audit. We assessed the models used by management to calculate the fair value adjustments. Where there have been no significant changes to models over the year, we challenged management to demonstrate to us that the models and the underlying methodologies remained appropriate. For the data inputs used in the models, such as the creditworthiness of the Group's counterparties, we challenged management to demonstrate their appropriateness. We also performed procedures to obtain evidence to support the inputs used in the model. For FVA, the Group has refined its methodology in line with developing industry practice, and based on data from observed transactions over the last 18 months. We assessed the methodology for calculating FVA based on our knowledge of current industry practices, and tested underlying transactions back to supporting evidence. We also read and assessed the disclosures made in the financial statements for valuation adjustments and concluded they are sufficient.
Sale of TSB Banking Group plc *Refer to page 74 (Audit Committee Report), page 187 (Significant Accounting Policies), and page 278 (notes).* The accounting for the sale and subsequent derecognition of TSB Banking Group plc in the consolidated financial statements has been judgmental and complex, and has required transaction specific controls to be designed and operate effectively. The disposal of the entire shareholding in TSB Banking Group plc had a material impact on the financial statements.	We met with management prior to the sale of TSB Banking Group plc to discuss the accounting and disclosure implications. We tested the design, implementation and operating effectiveness of the one-off transactions key control, and determined that we could rely on this control for the purposes of our audit. We read the analysis prepared by management for the accounting treatment for the sale of TSB Banking Group plc to Banco Sabadell, and challenged the appropriateness of assumptions and whether all the relevant accounting implications had been considered relating to the staged disposal of the shareholding. We read the relevant legal contracts to ensure the analysis prepared by management considered all accounting and disclosure impacts. We agreed the receipt of the cash consideration. No issues were noted with the accounting treatments adopted. We examined relevant disposal cost estimates and analysis regarding the early exit of support arrangements for TSB Banking Group plc and related provisions made in the year. Given the judgmental nature of the accounting for the sale of TSB Banking Group plc, we assessed the disclosures made in the financial statements to check they complied with the relevant accounting standards and other pronouncements on disclosures. We particularly focused on challenging management that the disclosures were complete and sufficiently clear in highlighting the nature, accounting treatment and financial statement impact of the transaction.

Independent auditors' report to the members of Lloyds Banking Group plc continued

How we tailored the audit scope

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

The Group is structured into five segments being Retail Banking, Commercial Banking, Insurance, Consumer Finance and Run-off and Central Items. Each of the segments comprises a number of business reporting units. The consolidated financial statements are a consolidation of the business reporting units.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed over the business reporting units by us, as the Group engagement team, or auditors within PwC UK and from other PwC network firms operating under our instruction ('component auditors'). Almost all of our audit work is undertaken by PwC UK component auditors.

Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those business reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements as a whole. This included regular communication with the component auditors throughout the audit, the issuance of instructions, a review of the results of their work on the areas of focus and attendance at formal clearance meetings.

Any business reporting units which were considered individually financially significant in the context of the Group's consolidated financial statements were considered full scope components. We then considered the individual financial significance of other business reporting units in relation to primary statement account balances. We also considered the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). Any business reporting unit which was not already included as a full scope audit component but was identified as being individually financially significant in respect of one of more account balances was subject to specific audit procedures over those account balances. Inconsequential components (defined as business reporting units which did not represent a reasonable possibility of a risk of material misstatement either individually or in aggregate) were eliminated from further consideration for specific audit procedures although they were subject to Group level analytical review procedures. All remaining business reporting units which were neither inconsequential nor individually financially significant were within our audit scope, with the risk of material misstatement mitigated through audit procedures including testing of entity level controls, information technology general controls and Group and component level analytical review procedures.

Some account balances were audited centrally by the Group engagement team.

Business reporting units within the scope of our audit contributed 99 per cent of Group total assets. Audit coverage on account balances in the consolidated income statement ranged between 60 per cent and 94 per cent.

Materiality

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

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

Overall group materiality	£300 million (2014: £268 million)
How we determined it	5 per cent of the 3 year average of adjusted profit before tax.
Rationale for benchmark applied	Our starting point was 5 per cent of profit before tax, a generally accepted auditing practice. However, profit before tax was adjusted to remove the disproportionate effect of certain, but not all, items excluded by management from underlying profit. The costs associated with the disposal of TSB Banking Group plc and conduct expenses and for which specific audit procedures were undertaken were excluded from profit before tax in 2015. In 2015 for the first time we used an average over 3 years (2013 to 2015) which reduces the potential for volatility and large increases in materiality year-on-year.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £20 million (2014: £8 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the directors' statement, set out on page 108, in relation to going concern. We have nothing to report having performed our review.

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the directors' statement, the directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. 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 incur 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.

As part of our audit 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 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 challenged key economic and other assumptions used in both the capital and liquidity plan and the Group's operating plan; and

– substantiated the Group's unencumbered collateral position and potential to access central bank liquidity facilities.

OTHER REQUIRED REPORTING

Consistency of other information

Companies Act 2006 opinion

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 information given in the corporate governance report set out on pages 60 to 71 with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

ISAs (UK & Ireland) reporting

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 – otherwise misleading.	We have no exceptions to report.
– the statement given by the directors on page 110, in accordance with provision C.1.1 of the UK Corporate Governance Code (the 'Code'), 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 and parent company's performance, business model and strategy is materially inconsistent with our knowledge of the Group and parent company acquired in the course of performing our audit.	We have no exceptions to report.
– the section of the Annual Report on page 75, as required by provision C.3.8 of the Code, 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.

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:

– the directors' confirmation on page 108 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.	We have nothing material to add or to draw attention to.
– the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.	We have nothing material to add or to draw attention to.
– the directors' explanation on page 108 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.

Under the Listing Rules we are required to review the directors' statement that they have carried out a robust assessment of the principal risks facing the Group and the directors' statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.

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.

Independent auditors' report to the members of Lloyds Banking Group plc continued

Directors' remuneration

Directors' remuneration report – Companies Act 2006 opinion

In our opinion, the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other Companies Act 2006 reporting

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

Corporate governance statement

Under the Companies Act 2006 we are required to report to you if, in our opinion, a corporate governance statement has not been prepared by the parent company. We have no exceptions to report arising from this responsibility.

Under the Listing Rules we are required to review the part of the corporate governance statement relating to ten further provisions of the Code. We have nothing to report having performed our review.

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 110, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and 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.

What an audit of financial statements involves

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 the parent company's circumstances and have been consistently applied and adequately disclosed;

– the reasonableness of significant accounting estimates made by the directors; and

– the overall presentation of the financial statements.

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

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

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Philip Rivett (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
24 February 2016

(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	2015 £ million	2014 £ million	2013 £ million
Interest and similar income		17,615	19,211	21,163
Interest and similar expense		(6,297)	(8,551)	(13,825)
Net interest income	5	11,318	10,660	7,338
Fee and commission income		3,252	3,659	4,119
Fee and commission expense		(1,442)	(1,402)	(1,385)
Net fee and commission income	6	1,810	2,257	2,734
Net trading income	7	3,714	10,159	16,467
Insurance premium income	8	4,792	7,125	8,197
Other operating income	9	1,516	(309)	3,249
Other income		11,832	19,232	30,647
Total income		23,150	29,892	37,985
Insurance claims	10	(5,729)	(13,493)	(19,507)
Total income, net of insurance claims		17,421	16,399	18,478
Regulatory provisions		(4,837)	(3,125)	(3,455)
Other operating expenses		(10,550)	(10,760)	(11,867)
Total operating expenses	11	(15,387)	(13,885)	(15,322)
Trading surplus		2,034	2,514	3,156
Impairment	12	(390)	(752)	(2,741)
Profit before tax		1,644	1,762	415
Taxation	13	(688)	(263)	(1,217)
Profit (loss) for the year		956	1,499	(802)
Profit (loss) attributable to ordinary shareholders		466	1,125	(838)
Profit attributable to other equity holders[1]		394	287	–
Profit (loss) attributable to equity holders		860	1,412	(838)
Profit attributable to non-controlling interests		96	87	36
Profit (loss) for the year		956	1,499	(802)
Basic earnings (loss) per share	14	0.8p	1.7p	(1.2)p
Diluted earnings (loss) per share	14	0.8p	1.6p	(1.2)p

[1] The profit after tax attributable to other equity holders of £394 million (2014: £287 million; 2013: £nil) is partly offset in reserves by a tax credit attributable to ordinary shareholders of £80 million (2014: £62 million; 2013: £nil).

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated statement of comprehensive income

for the year ended 31 December

	2015 £ million	2014 £ million	2013 £ million
Profit (loss) for the year	**956**	1,499	(802)
Other comprehensive income			
Items that will not subsequently be reclassified to profit or loss:			
Post-retirement defined benefit scheme remeasurements:			
Remeasurements before taxation	**(274)**	674	(136)
Taxation	**59**	(135)	28
	(215)	539	(108)
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	**(318)**	690	(680)
Income statement transfers in respect of disposals	**(51)**	(131)	(629)
Income statement transfers in respect of impairment	**4**	2	18
Taxation	**(6)**	(13)	277
	(371)	548	(1,014)
Movement in cash flow hedging reserve:			
Effective portion of changes in fair value taken to other comprehensive income	**537**	3,896	(1,229)
Net income statement transfers	**(956)**	(1,153)	(550)
Taxation	**7**	(549)	374
	(412)	2,194	(1,405)
Currency translation differences (tax: nil)	**(42)**	(3)	(6)
Other comprehensive income for the year, net of tax	**(1,040)**	3,278	(2,533)
Total comprehensive income for the year	**(84)**	4,777	(3,335)
Total comprehensive income attributable to ordinary shareholders	**(574)**	4,403	(3,371)
Total comprehensive income attributable to other equity holders	**394**	287	–
Total comprehensive income attributable to equity holders	**(180)**	4,690	(3,371)
Total comprehensive income attributable to non-controlling interests	**96**	87	36
Total comprehensive income for the year	**(84)**	4,777	(3,335)

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated balance sheet

at 31 December

	Note	2015 £ million	2014 £ million
Assets			
Cash and balances at central banks		58,417	50,492
Items in the course of collection from banks		697	1,173
Trading and other financial assets at fair value through profit or loss	15	140,536	151,931
Derivative financial instruments	16	29,467	36,128
Loans and receivables:			
Loans and advances to banks	17	25,117	26,155
Loans and advances to customers	18	455,175	482,704
Debt securities		4,191	1,213
		484,483	510,072
Available-for-sale financial assets	22	33,032	56,493
Held-to-maturity investments	23	19,808	–
Goodwill	24	2,016	2,016
Value of in-force business	25	4,596	4,864
Other intangible assets	26	1,838	2,070
Property, plant and equipment	27	12,979	12,544
Current tax recoverable		44	127
Deferred tax assets	38	4,010	4,145
Retirement benefit assets	37	901	1,147
Other assets	28	13,864	21,694
Total assets		806,688	854,896

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated balance sheet continued

at 31 December

Equity and liabilities	Note	2015 £ million	2014 £ million
Liabilities			
Deposits from banks	29	**16,925**	10,887
Customer deposits	30	**418,326**	447,067
Items in course of transmission to banks		**717**	979
Trading and other financial liabilities at fair value through profit or loss	31	**51,863**	62,102
Derivative financial instruments	16	**26,301**	33,187
Notes in circulation		**1,112**	1,129
Debt securities in issue	32	**82,056**	76,233
Liabilities arising from insurance contracts and participating investment contracts	33	**80,294**	86,918
Liabilities arising from non-participating investment contracts	35	**22,777**	27,248
Other liabilities	36	**29,661**	28,425
Retirement benefit obligations	37	**365**	453
Current tax liabilities		**279**	69
Deferred tax liabilities	38	**33**	54
Other provisions	39	**5,687**	4,200
Subordinated liabilities	40	**23,312**	26,042
Total liabilities		**759,708**	804,993
Equity			
Share capital	41	**7,146**	7,146
Share premium account	42	**17,412**	17,281
Other reserves	43	**12,260**	13,216
Retained profits	44	**4,416**	5,692
Shareholders' equity		**41,234**	43,335
Other equity instruments	45	**5,355**	5,355
Total equity excluding non-controlling interests		**46,589**	48,690
Non-controlling interests		**391**	1,213
Total equity		**46,980**	49,903
Total equity and liabilities		**806,688**	854,896

The accompanying notes are an integral part of the consolidated financial statements.

The directors approved the consolidated financial statements on 24 February 2016.

Lord Blackwell
Chairman

António Horta-Osório
Group Chief Executive

George Culmer
Chief Financial Officer

Consolidated statement of changes in equity

for the year ended 31 December

	Attributable to equity shareholders						
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2015	24,427	13,216	5,692	43,335	5,355	1,213	49,903
Comprehensive income							
Profit for the year	–	–	860	860	–	96	956
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of taxation	–	–	(215)	(215)	–	–	(215)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(371)	–	(371)	–	–	(371)
Movements in cash flow hedging reserve, net of tax	–	(412)	–	(412)	–	–	(412)
Currency translation differences (tax: £nil)	–	(42)	–	(42)	–	–	(42)
Total other comprehensive income	–	(825)	(215)	(1,040)	–	–	(1,040)
Total comprehensive income	–	(825)	645	(180)	–	96	(84)
Transactions with owners							
Dividends	–	–	(1,070)	(1,070)	–	(52)	(1,122)
Distributions on other equity instruments, net of tax	–	–	(314)	(314)	–	–	(314)
Redemption of preference shares	131	(131)	–	–	–	–	–
Movement in treasury shares	–	–	(816)	(816)	–	–	(816)
Value of employee services:							
Share option schemes	–	–	107	107	–	–	107
Other employee award schemes	–	–	172	172	–	–	172
Adjustment on sale of interest in TSB Banking Group plc (TSB, note 55)	–	–	–	–	–	(825)	(825)
Other changes in non-controlling interests	–	–	–	–	–	(41)	(41)
Total transactions with owners	131	(131)	(1,921)	(1,921)	–	(918)	(2,839)
Balance at 31 December 2015	24,558	12,260	4,416	41,234	5,355	391	46,980

Further details of movements in the Group's share capital, reserves and other equity instruments are provided in notes 41, 42, 43, 44 and 45.

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity continued

	Attributable to equity shareholders						
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2014	24,424	10,477	4,088	38,989	–	347	39,336
Comprehensive income							
Profit for the year	–	–	1,412	1,412	–	87	1,499
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of taxation	–	–	539	539	–	–	539
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	548	–	548	–	–	548
Movements in cash flow hedging reserve, net of tax	–	2,194	–	2,194	–	–	2,194
Currency translation differences (tax: £nil)	–	(3)	–	(3)	–	–	(3)
Total other comprehensive income	–	2,739	539	3,278	–	–	3,278
Total comprehensive income	–	2,739	1,951	4,690	–	87	4,777
Transactions with owners							
Dividends	–	–	–	–	–	(27)	(27)
Distributions on other equity instruments, net of tax	–	–	(225)	(225)	–	–	(225)
Issue of ordinary shares	3	–	–	3	–	–	3
Issue of other equity instruments (note 45)	–	–	(21)	(21)	5,355	–	5,334
Movement in treasury shares	–	–	(286)	(286)	–	–	(286)
Value of employee services:							
Share option schemes	–	–	123	123	–	–	123
Other employee award schemes	–	–	233	233	–	–	233
Adjustment on sale of non-controlling interest in TSB	–	–	(171)	(171)	–	805	634
Other changes in non-controlling interests	–	–	–	–	–	1	1
Total transactions with owners	3	–	(347)	(344)	5,355	779	5,790
Balance at 31 December 2014	24,427	13,216	5,692	43,335	5,355	1,213	49,903

The accompanying notes are an integral part of the consolidated financial statements.

	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	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
Changes 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

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated cash flow statement

for the year ended 31 December

	Note	2015 £ million	2014 £ million	2013 £ million
Profit before tax		**1,644**	1,762	415
Adjustments for:				
Change in operating assets	54(A)	**34,700**	(872)	20,383
Change in operating liabilities	54(B)	**(11,985)**	11,992	(47,687)
Non-cash and other items	54(C)	**(7,808)**	(2,496)	11,382
Tax paid		**(179)**	(33)	(24)
Net cash provided by (used in) operating activities		**16,372**	10,353	(15,531)
Cash flows from investing activities				
Purchase of financial assets		**(19,354)**	(11,533)	(36,959)
Proceeds from sale and maturity of financial assets		**22,000**	4,668	21,552
Purchase of fixed assets		**(3,417)**	(3,442)	(2,982)
Proceeds from sale of fixed assets		**1,537**	2,043	2,090
Acquisition of businesses, net of cash acquired		**(5)**	(1)	(6)
Disposal of businesses, net of cash disposed	54(E)	**(4,071)**	543	696
Net cash used in investing activities		**(3,310)**	(7,722)	(15,609)
Cash flows from financing activities				
Dividends paid to ordinary shareholders		**(1,070)**	–	–
Distributions on other equity instruments		**(394)**	(287)	–
Dividends paid to non-controlling interests		**(52)**	(27)	(25)
Interest paid on subordinated liabilities		**(1,840)**	(2,205)	(2,451)
Proceeds from issue of subordinated liabilities		**338**	629	1,500
Proceeds from issue of ordinary shares		**–**	3	350
Repayment of subordinated liabilities		**(3,199)**	(3,023)	(2,442)
Changes in non-controlling interests		**(41)**	635	–
Net cash used in financing activities		**(6,258)**	(4,275)	(3,068)
Effects of exchange rate changes on cash and cash equivalents		**2**	(6)	(53)
Change in cash and cash equivalents		**6,806**	(1,650)	(34,261)
Cash and cash equivalents at beginning of year		**65,147**	66,797	101,058
Cash and cash equivalents at end of year	54(D)	**71,953**	65,147	66,797

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 IFRS Interpretations Committee (IFRS IC) 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 108, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

During 2015, government debt securities with a carrying value of £19,938 million, previously classified as available-for-sale, were reclassified to held-to-maturity. Unrealised gains on the transferred securities of £194 million previously taken to equity continue to be held in the available-for-sale revaluation reserve and are being amortised to the income statement over the remaining lives of the securities using the effective interest method or until the assets become impaired.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2015 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. Details of the Group's subsidiaries and related undertakings are given on pages 299 to 307.

(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 although in certain circumstances a holding of less than one half of the voting rights may still result in the ability of the Group to exercise control. 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.

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 (Q)(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 cost and adjusted each year to reflect the Group's share of the post-acquisition results of the joint venture or associate based on accounts which are coterminous with the Group or made up

Notes to the consolidated financial statements continued

NOTE 2: ACCOUNTING POLICIES continued

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.

(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 (N) below); those relating to leases are set out in (J)(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 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.

NOTE 2: ACCOUNTING POLICIES continued

(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 50(3) (Financial instruments: Financial assets and liabilities carried at fair value) 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 classified 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 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.

Notes to the consolidated financial statements continued

NOTE 2: ACCOUNTING POLICIES continued

(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.

Securities which carry a discretionary coupon and have no fixed maturity or redemption date are classified as other equity instruments. Interest payments on these securities are recognised, net of tax, as distributions from equity in the period in which they are paid.

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.

(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 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 50(3) (Financial instruments: Financial assets and liabilities carried at fair value) 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, 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

NOTE 2: ACCOUNTING POLICIES continued

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. Cash collateral on exchange traded derivative transactions is presented gross unless the collateral cash flows are always settled net with the derivative cash flows. 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.

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 commercial lending portfolios. 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 Consumer Finance 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 commercial 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 could 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.

Notes to the consolidated financial statements continued

NOTE 2: ACCOUNTING POLICIES continued

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 commercial 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 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 commercial 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

NOTE 2: ACCOUNTING POLICIES continued

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) Property, plant and equipment

Property, plant and equipment (other than investment property) is 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.

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.

Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital accretion or both, primarily within the life insurance funds. In accordance with the guidance published by the Royal Institution of Chartered Surveyors, investment property is carried at fair value based on current prices for similar properties, adjusted for the specific characteristics of the property (such as location or condition). If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices in less active markets. These valuations are reviewed at least annually by independent professionally qualified valuers. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be valued at fair value. 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. Changes in fair value are recognised in the income statement as net trading income.

(J) 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.

(K) 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

Notes to the consolidated financial statements continued

NOTE 2: ACCOUNTING POLICIES continued

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. In assessing whether a surplus is recoverable, the Group considers its current right to obtain a refund or a reduction in future contributions and does not anticipate any future acts by other parties that could change the amount of the surplus that may ultimately be recovered.

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 (L) below.

(L) 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.

(M) 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.

(N) 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.

NOTE 2: ACCOUNTING POLICIES continued

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.

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). 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.

(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

Notes to the consolidated financial statements continued

NOTE 2: ACCOUNTING POLICIES continued

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.

(O) Foreign currency translation

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in sterling, which is the Company's functional and presentation currency.

Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when recognised in other comprehensive income as qualifying cash flow or net investment hedges. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on equities and similar non-monetary items held at fair value through profit and loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on available-for-sale non-monetary financial assets, such as equity shares, are included in the fair value reserve in equity unless the asset is a hedged item in a fair value hedge.

The results and financial position of all group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

– The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into sterling at foreign exchange rates ruling at the balance sheet date.
– The income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions in which case income and expenses are translated at the dates of the transactions.

Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income and accumulated in a separate component of equity together with exchange differences arising from the translation of borrowings and other currency instruments designated as hedges of such investments (see (F)(3) above). On disposal or liquidation 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 or liquidation.

(P) 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.

NOTE 2: ACCOUNTING POLICIES continued

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.

(Q) 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.

(R) 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 2015 gross loans and receivables totalled £487,613 million (2014: £516,612 million) against which impairment allowances of £3,130 million (2014: £6,540 million) had been made (see note 21). 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. In determining the required level of impairment provisions, the Group uses the output from various statistical models. Management judgement is required to assess the robustness of the outputs from these models and, where necessary, make appropriate adjustments. 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 commercial lending portfolios. The determination of individual impairment allowances requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer, and the value of the security held, for which there may not be a readily accessible market. 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 2015, the impairment charge would increase by approximately £228 million in respect of UK mortgages.

In addition, a collective unidentified impairment 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. Management use a significant level of judgement when determining the collective unidentified impairment provision, including the assessment of the level of overall risk existing within particular sectors and the impact of the low interest rate environment on loss emergence periods. In the Commercial Banking division, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unidentified impairment provisions would result in an increase in the collective unidentified impairment provision of approximately £36 million (at 31 December 2014, a one month increase in the loss emergence period would have increased the collective unidentified impairment provision by an estimated £53 million).

Payment protection insurance and other regulatory provisions

At 31 December 2015, the Group carried provisions of £4,463 million (2014: £3,378 million) against the cost of making redress payments to customers and the related administration costs in connection with historical regulatory breaches, principally the mis-selling of payment protection insurance (2015: £3,458 million; 2014: £2,549 million). The Group's accounting policy in respect of these provisions is set out in note 2(P).

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 scope of reviews required by regulators, the number of future complaints, the extent to which they will be upheld, the average cost of redress and the impact of legal decisions that

Notes to the consolidated financial statements continued

NOTE 3: CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS continued

may be relevant to claims received. 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 39 contains more detail on the nature of the assumptions that have been made and key sensitivities.

Defined benefit pension scheme obligations

The net asset recognised in the balance sheet at 31 December 2015 in respect of the Group's defined benefit pension scheme obligations was £736 million (comprising an asset of £901 million and a liability of £165 million) (2014: a net asset of £890 million comprising an asset of £1,147 million and a liability of £257 million). The Group's accounting policy for its defined benefit pension scheme obligations is set out in note 2(K).

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 discount rate is required to be set with reference to market yields at the end of the reporting period on high quality corporate bonds with the currency and term of the corporate bonds consistent with the defined benefit pension schemes' obligations. The average duration of the schemes' obligations is approximately 20 years. The market for bonds with a 20 year duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate. The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Following the completion of the latest triennial funding valuations, the Group has updated its demographic assumptions for both current mortality expectations and the rate of future mortality improvement. However, given the advances in medical science in recent years, it is uncertain whether this rate of improvement will be sustained going forward and, as a result, actual experience may differ from current expectations. 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 37.

Fair value of financial instruments

At 31 December 2015, the carrying value of the Group's financial instrument assets held at fair value was £203,035 million (2014: £244,552 million), and its financial instrument liabilities held at fair value was £78,212 million (2014: £95,340 million). Included within these balances are derivative assets of £29,467 million (2014: £36,128 million) and derivative liabilities of £26,301 million (2014: £33,187 million). The group's accounting policy for its financial instruments is set out in note 2(E) and 2(F).

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. In addition, in line with market practice, the Group applies credit, debit and funding valuation adjustments in determining the fair value of its uncollateralised derivative positions. A description of these adjustments is set out in note 50, on page 257. 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. 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 50. Details about sensitivities to market risk arising from trading assets and other treasury positions can be found in the Risk Management section on page 144.

Recoverability of deferred tax assets

At 31 December 2015 the Group carried deferred tax assets on its balance sheet of £4,010 million (2014: £4,145 million) and deferred tax liabilities of £33 million (2014: £54 million) (note 38). 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 38 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 board approved operating plan and the expected future economic outlook as set out in the Group Chief Executive's Review and Market Overview, as well as the risks associated with future regulatory change.

The Group's total deferred tax asset includes £4,890 million (2014: £5,758 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. Following the enactment of the Finance Act 2015, there is now a restriction imposed on the amount of banks' profits that can be offset by certain carried forward tax losses for the purposes of calculating corporation tax liabilities. The losses are expected to be fully utilised by 2025.

As disclosed in note 38, deferred tax assets totalling £1,109 million (2014: £921 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.

NOTE 3: CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS continued

Valuation of assets and liabilities arising from insurance business

At 31 December 2015, the Group recognised a value of in-force business asset of £4,219 million (2014: £4,446 million) and an acquired value of in-force business asset of £377 million (2014: £418 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 25. 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 2015 are set out in note 25.

At 31 December 2015, the Group carried total liabilities arising from insurance contracts and participating investment contracts of £80,294 million (2014: £86,918 million). The methodology used to value these liabilities is described in note 33. 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 33.

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 34.

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. GEC considers interest income and expense on a net basis and consequently the total interest income and expense for all reportable segments is presented net. The segments are differentiated by the type of products provided, by whether the customers are individuals or corporate entities.

The segmental results and comparatives are presented on an underlying basis, the basis reviewed by the chief operating decision maker. The effects of asset sales, volatile items, liability management, simplification costs, TSB build and dual running costs, regulatory provisions, certain past service pension credits or charges, the amortisation of purchased intangible assets and the unwind of acquisition-related fair value adjustments are excluded in arriving at underlying profit.

Following the disposal of TSB in 2015, the Group's activities are organised into four financial reporting segments: Retail; Commercial Banking; Consumer Finance and Insurance. The results of TSB up to the point of disposal are included in Other.

Retail offers a broad range of financial service products, including current accounts, savings, personal loans and mortgages, to UK retail customers, incorporating wealth and small business customers. It is also a distributor of insurance, protection and credit cards and a range of long-term savings and investment products.

Commercial Banking is client led, focusing on SME, Mid Markets, Global Corporates and Financial Institution clients providing products across Lending, Global Transaction Banking, Financial Markets and Debt Capital Markets and private equity financing through Lloyds Development Capital.

Consumer Finance comprises the Group's consumer and corporate Credit Card businesses, along with the Black Horse motor financing and Lex Autolease car leasing businesses in Asset Finance. The Group's European deposits, German lending and Dutch retail mortgage businesses are managed within Asset Finance.

Insurance is a core part of Lloyds Banking Group and is focused on five key markets: Corporate Pensions, Protection, Retirement, Bulk Annuities and Home Insurance, to enable customers to protect themselves today and prepare for a secure financial future.

Other includes certain assets previously reported as outside of the Group's risk appetite and the results and gains on sale relating to businesses disposed in 2013 and 2014. Other also includes income and expenditure not recharged to divisions, including the costs of certain central and head office functions and 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.

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.

Notes to the consolidated financial statements continued

NOTE 4: SEGMENTAL ANALYSIS continued

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 derivative 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, which is managed centrally and reported within Other.

	Retail £m	Commercial Banking £m	Consumer Finance £m	Insurance £m	Other £m	Underlying basis total £m
Year ended 31 December 2015						
Net interest income	7,397	2,510	1,287	(163)	451	11,482
Other income (net of insurance claims)	1,122	2,066	1,358	1,827	(218)	6,155
Total underlying income, net of insurance claims	8,519	4,576	2,645	1,664	233	17,637
Total costs	(4,573)	(2,167)	(1,488)	(702)	(145)	(9,075)
Impairment	(432)	22	(152)	–	(6)	(568)
TSB	–	–	–	–	118	118
Underlying profit	3,514	2,431	1,005	962	200	8,112
External income	9,391	3,616	2,946	2,065	(381)	17,637
Inter-segment income	(872)	960	(301)	(401)	614	–
Segment income	8,519	4,576	2,645	1,664	233	17,637
Segment external assets	316,343	178,189	28,694	143,217	140,245	806,688
Segment customer deposits	279,559	126,158	11,082	–	1,527	418,326
Segment external liabilities	284,882	220,182	15,437	137,233	101,974	759,708
Other segment items reflected in income statement above:						
Depreciation and amortisation	409	203	838	124	538	2,112
(Decrease) increase in value of in-force business	–	–	–	(162)	–	(162)
Defined benefit scheme charges	124	30	9	11	141	315
Other segment items:						
Additions to fixed assets	385	146	1,752	344	790	3,417
Investments in joint ventures and associates at end of year	7	–	–	–	40	47

NOTE 4: SEGMENTAL ANALYSIS continued

	Retail £m	Commercial Banking £m	Consumer Finance £m	Insurance £m	Other £m	Underlying basis total £m
Year ended 31 December 2014						
Net interest income	7,079	2,480	1,290	(131)	257	10,975
Other income (net of insurance claims)	1,212	1,956	1,364	1,725	210	6,467
Total underlying income, net of insurance claims	8,291	4,436	2,654	1,594	467	17,442
Total costs	(4,464)	(2,147)	(1,429)	(672)	(330)	(9,042)
Impairment	(599)	(83)	(215)	–	(205)	(1,102)
TSB	–	–	–	–	458	458
Underlying profit	3,228	2,206	1,010	922	390	7,756
External income	9,034	3,800	2,803	1,206	599	17,442
Inter-segment income	(743)	636	(149)	388	(132)	–
Segment income	8,291	4,436	2,654	1,594	467	17,442
Segment external assets	317,246	241,754	25,646	150,615	119,635	854,896
Segment customer deposits	285,539	119,882	14,955	–	26,691	447,067
Segment external liabilities	295,880	231,400	18,581	144,921	114,211	804,993
Other segment items reflected in income statement above:						
Depreciation and amortisation	353	153	773	127	189	1,595
(Decrease) increase in value of in-force business	–	–	–	(428)	–	(428)
Defined benefit scheme charges	121	37	9	9	168	344
Other segment items:						
Additions to fixed assets	419	242	1,633	449	699	3,442
Investments in joint ventures and associates at end of year	12	–	–	–	62	74

	Retail £m	Commercial Banking £m	Consumer Finance £m	Insurance £m	Other £m	Underlying basis total £m
Year ended 31 December 2013						
Net interest income	6,500	2,113	1,333	(107)	431	10,270
Other income (net of insurance claims)	1,435	2,259	1,359	1,864	840	7,757
Total underlying income, net of insurance claims	7,935	4,372	2,692	1,757	1,271	18,027
Total costs	(4,160)	(2,084)	(1,384)	(669)	(775)	(9,072)
Impairment	(760)	(398)	(343)	–	(1,394)	(2,895)
TSB	–	–	–	–	106	106
Underlying profit (loss)	3,015	1,890	965	1,088	(792)	6,166
External income	8,526	2,959	2,772	2,439	1,331	18,027
Inter-segment income	(591)	1,413	(80)	(682)	(60)	–
Segment income	7,935	4,372	2,692	1,757	1,271	18,027
Segment external assets	317,146	227,771	25,025	155,378	117,060	842,380
Segment customer deposits	283,189	111,654	18,733	–	25,891	439,467
Segment external liabilities	300,412	206,729	21,868	149,445	124,590	803,044
Other segment items reflected in income statement above:						
Depreciation and amortisation	299	136	754	136	220	1,545
Increase (decrease) in value of in-force business	–	–	–	425	(9)	416
Defined benefit scheme charges	109	44	6	12	228	399
Other segment items:						
Additions to fixed assets	446	160	1,320	373	683	2,982
Investments in joint ventures and associates at end of year	23	–	1	–	77	101

Notes to the consolidated financial statements continued

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	Asset sales and other items[1] £m	Simplification £m	TSB[3] £m	Insurance gross up £m	PPI and other conduct provisions[2] £m	Underlying basis £m
Year ended 31 December 2015							
Net interest income	11,318	318	–	(192)	38	–	11,482
Other income, net of insurance claims	6,103	214	–	(36)	(126)	–	6,155
Total income, net of insurance claims	17,421	532	–	(228)	(88)	–	17,637
Operating expenses	(15,387)	381	170	836	88	4,837	(9,075)
Impairment	(390)	(197)	–	19	–	–	(568)
TSB	–	–	–	118	–	–	118
Profit	1,644	716	170	745	–	4,837	8,112

1 Comprises the effects of asset sales (gain of £54 million), volatile items (loss of £208 million), liability management (loss of £28 million), the fair value unwind (loss of £192 million) and the amortisation of purchased intangibles (£342 million).
2 Comprises the payment protection insurance provision (£4,000 million) and other regulatory provisions (£837 million).
3 Comprises the underlying results of TSB, dual running and build costs and the charge related to the disposal of TSB.

		Removal of:					
	Lloyds Banking Group statutory £m	Asset sales and other items[1] £m	Simplification £m	TSB[3] £m	Insurance gross up £m	PPI and other conduct provisions[2] £m	Underlying basis £m
Year ended 31 December 2014							
Net interest income	10,660	619	–	(786)	482	–	10,975
Other income, net of insurance claims	5,739	1,460	22	(140)	(614)	–	6,467
Total income, net of insurance claims	16,399	2,079	22	(926)	(132)	–	17,442
Operating expenses	(13,885)	(286)	944	928	132	3,125	(9,042)
Impairment	(752)	(448)	–	98	–	–	(1,102)
TSB	–	–	–	458	–	–	458
Profit	1,762	1,345	966	558	–	3,125	7,756

1 Comprises the effects of asset sales (gain of £138 million), volatile items (gain of £58 million), liability management (loss of £1,386 million), the past service pension credit of £710 million (which represents the curtailment credit of £843 million following the Group's decision to reduce the cap on pensionable pay partly offset by the cost of other changes to the pay, benefits and reward offered to employees), the fair value unwind (loss of £529 million) and the amortisation of purchased intangibles (£336 million).
2 Comprises the payment protection insurance provision (£2,200 million) and other regulatory provisions (£925 million).
3 Comprises the underlying results of TSB, dual running and build costs.

		Removal of:					
	Lloyds Banking Group statutory £m	Asset sales and other items[1] £m	Simplification £m	TSB[3] £m	Insurance gross up £m	PPI and other conduct provisions[2] £m	Underlying basis £m
Year ended 31 December 2013							
Net interest income	7,338	617	–	(615)	2,930	–	10,270
Other income, net of insurance claims	11,140	(146)	–	(163)	(3,074)	–	7,757
Total income, net of insurance claims	18,478	471	–	(778)	(144)	–	18,027
Operating expenses	(15,322)	571	830	1,250	144	3,455	(9,072)
Impairment	(2,741)	(263)	–	109	–	–	(2,895)
TSB	–	–	–	106	–	–	106
Profit	415	779	830	687	–	3,455	6,166

1 Comprises the effects of asset sales (gain of £100 million), volatile items (loss of £10 million), liability management (loss of £142 million), the fair value unwind (loss of £228 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).
3 Comprises the underlying results of TSB, dual running and build costs.

Geographical areas

Following the reduction in the Group's non-UK activities, an analysis between UK and non-UK activities is no longer provided.

NOTE 5: NET INTEREST INCOME

	Weighted average effective interest rate					
	2015 %	2014 %	2013 %	2015 £m	2014 £m	2013 £m
Interest and similar income:						
Loans and advances to customers	3.50	3.53	3.84	16,256	17,806	19,928
Loans and advances to banks	0.42	0.52	0.45	397	406	457
Debt securities held as loans and receivables	1.87	2.57	1.52	40	42	32
Interest receivable on loans and receivables	2.98	3.12	3.28	16,693	18,254	20,417
Available-for-sale financial assets	1.77	1.90	1.92	725	957	746
Held-to-maturity investments	1.49	–	–	197	–	–
Total interest and similar income	2.86	3.03	3.20	17,615	19,211	21,163
Interest and similar expense:						
Deposits from banks, excluding liabilities under sale and repurchase transactions	0.41	0.74	0.65	(43)	(86)	(129)
Customer deposits, excluding liabilities under sale and repurchase transactions	0.87	1.15	1.54	(3,299)	(4,781)	(6,119)
Debt securities in issue	0.69	0.63	1.30	(586)	(552)	(1,451)
Subordinated liabilities	8.37	8.44	8.57	(2,091)	(2,475)	(2,956)
Liabilities under sale and repurchase agreements	0.57	2.61	1.21	(34)	(55)	(79)
Interest payable on liabilities held at amortised cost	1.19	1.45	1.88	(6,053)	(7,949)	(10,734)
Amounts payable to unitholders in consolidated open-ended investment vehicles	1.16	3.23	12.08	(244)	(602)	(3,091)
Total interest and similar expense	1.19	1.51	2.32	(6,297)	(8,551)	(13,825)
Net interest income				11,318	10,660	7,338

Included within interest and similar income is £248 million (2014: £407 million; 2013: £901 million) in respect of impaired financial assets. Net interest income also includes a credit of £956 million (2014: credit of £1,153 million; 2013: credit of £550 million) transferred from the cash flow hedging reserve (see note 43).

NOTE 6: NET FEE AND COMMISSION INCOME

	2015 £m	2014 £m	2013 £m
Fee and commission income:			
Current accounts	804	918	973
Credit and debit card fees	918	1,050	984
Other	1,530	1,691	2,162
Total fee and commission income	3,252	3,659	4,119
Fee and commission expense	(1,442)	(1,402)	(1,385)
Net fee and commission income	1,810	2,257	2,734

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.

Notes to the consolidated financial statements continued

NOTE 7: NET TRADING INCOME

	2015 £m	2014 £m	2013 £m
Foreign exchange translation (losses) gains	(80)	(95)	162
Gains on foreign exchange trading transactions	335	344	238
Total foreign exchange	255	249	400
Investment property gains (note 27)	416	513	156
Securities and other gains (see below)	3,043	9,397	15,911
Net trading income	3,714	10,159	16,467

Securities and other gains comprise net gains (losses) arising on assets and liabilities held at fair value through profit or loss and for trading as follows:

	2015 £m	2014 £m	2013 £m
Net income arising on assets held at fair value through profit or loss:			
Debt securities, loans and advances	451	4,805	55
Equity shares	2,384	3,816	15,813
Total net income arising on assets held at fair value through profit or loss	2,835	8,621	15,868
Net income (expense) arising on liabilities held at fair value through profit or loss – debt securities in issue	14	(75)	(93)
Total net gains arising on assets and liabilities held at fair value through profit or loss	2,849	8,546	15,775
Net gains on financial instruments held for trading	194	851	136
Securities and other gains	3,043	9,397	15,911

NOTE 8: INSURANCE PREMIUM INCOME

	2015 £m	2014 £m	2013 £m
Life insurance			
Gross premiums:			
Life and pensions	3,613	6,070	6,823
Annuities	430	327	549
Other	–	–	10
	4,043	6,397	7,382
Ceded reinsurance premiums	(122)	(142)	(182)
Net earned premiums	3,921	6,255	7,200
Non-life insurance			
Net earned premiums	871	870	997
Total net earned premiums	4,792	7,125	8,197

Premium income in 2015 has been reduced by a charge of £1,959 million relating to the recapture by a third party insurer of a portfolio of policies previously reassured with the Group.

NOTE 9: OTHER OPERATING INCOME

	2015 £m	2014 £m	2013 £m
Operating lease rental income	1,165	1,126	1,120
Rental income from investment properties (note 27)	268	269	308
Gains less losses on disposal of available-for-sale financial assets (note 43)	51	131	629
Movement in value of in-force business (note 25)	(162)	(428)	416
Liability management	(28)	(1,386)	(142)
Share of results of joint ventures and associates	(3)	32	43
Other	225	(53)	875
Total other operating income	1,516	(309)	3,249

Liability management

In April 2014, the Group completed concurrent Sterling, Euro and Dollar exchange offers with holders of certain series of its Enhanced Capital Notes (ECNs) to exchange the ECNs for new Additional Tier 1 (AT1) securities. In addition the Group completed a tender offer to eligible retail holders outside the United States to sell their Sterling-denominated ECNs for cash. The exchange offers completed with the equivalent of £5.0 billion of ECNs being exchanged for the equivalent of £5.35 billion of AT1 securities, before issue costs. The retail tender offer completed with approximately £58.5 million of ECNs being repurchased for cash. A loss of £1,362 million was recognised in relation to these exchange and tender transactions in the year ended 31 December 2014.

Losses of £28 million arose in the year ended 31 December 2015 (2014: losses of £24 million; 2013: losses of £142 million) on other transactions undertaken as part of the Group's management of its wholesale funding and subordinated debt.

Other

During 2013 the Group had completed a number of disposals of assets and businesses, including the sale of its shareholding in St James's Place plc (profit of £540 million), a portfolio of US residential mortgage-backed securities (profit of £538 million), its Spanish retail banking operations (loss of £256 million), its Australian operations (profit of £49 million) and its German life insurance business (this disposal completed in the first quarter of 2014, but an impairment of £382 million was recognised in the year ended 31 December 2013).

NOTE 10: INSURANCE CLAIMS

Insurance claims comprise:

	2015 £m	2014 £m	2013 £m
Life insurance and participating investment contracts			
Claims and surrenders	(7,983)	(7,506)	(8,495)
Change in insurance and participating investment contracts (note 33)	2,898	(4,392)	(5,184)
Change in non-participating investment contracts	(438)	(1,448)	(5,409)
	(5,523)	(13,346)	(19,088)
Reinsurers' share	101	109	60
	(5,422)	(13,237)	(19,028)
Change in unallocated surplus	63	74	(123)
Total life insurance and participating investment contracts	(5,359)	(13,163)	(19,151)
Non-life insurance			
Total non-life insurance claims, net of reinsurance	(370)	(330)	(356)
Total insurance claims	(5,729)	(13,493)	(19,507)
Life insurance and participating investment contracts gross claims and surrenders can also be analysed as follows:			
Deaths	(631)	(549)	(611)
Maturities	(1,348)	(1,656)	(2,240)
Surrenders	(4,811)	(4,102)	(4,489)
Annuities	(902)	(884)	(860)
Other	(291)	(315)	(295)
Total life insurance gross claims and surrenders	(7,983)	(7,506)	(8,495)

Notes to the consolidated financial statements continued

NOTE 11: OPERATING EXPENSES

	2015 £m	2014 £m	2013 £m
Staff costs:			
Salaries	2,808	3,178	3,331
Performance-based compensation	409	390	473
Social security costs	349	398	385
Pensions and other post-retirement benefit schemes (note 37):			
Past service (credits) charges[1]	–	(822)	104
Other	548	596	654
	548	(226)	758
Restructuring costs	104	264	111
Other staff costs	459	741	783
	4,677	4,745	5,841
Premises and equipment:			
Rent and rates	368	424	467
Repairs and maintenance	173	221	178
Other	174	246	325
	715	891	970
Other expenses:			
Communications and data processing	893	1,118	1,169
Advertising and promotion	253	336	313
Professional fees	262	481	425
UK bank levy	270	237	238
TSB disposal (note 55)	665	–	–
Other	703	1,017	971
	3,046	3,189	3,116
Depreciation and amortisation:			
Depreciation of property, plant and equipment (note 27)	1,534	1,391	1,374
Amortisation of acquired value of in-force non-participating investment contracts (note 25)	41	43	54
Amortisation of other intangible assets (note 26)	537	501	512
	2,112	1,935	1,940
Total operating expenses, excluding regulatory provisions	10,550	10,760	11,867
Regulatory provisions:			
Payment protection insurance provision (note 39)	4,000	2,200	3,050
Other regulatory provisions (note 39)	837	925	405
	4,837	3,125	3,455
Total operating expenses	15,387	13,885	15,322

1 On 11 March 2014 the Group announced a change to its defined benefit pension schemes, revising the existing cap on the increases in pensionable pay used in calculating the pension benefit, from 2 per cent to nil with effect from 2 April 2014. The effect of this change was to reduce the Group's retirement benefit obligations recognised on the balance sheet by £843 million with a corresponding curtailment gain recognised in the income statement. This has been partly offset by a charge of £21 million following changes to pension arrangements for staff within the TSB business.

In 2013, the Group agreed certain changes to early retirement and commutation factors in two of its principal defined benefit pension schemes, resulting in a curtailment cost of £104 million recognised in the Group's income statement in the year ended 31 December 2013.

NOTE 11: OPERATING EXPENSES continued

Performance-based compensation

The table below analyses the Group's performance-based compensation costs between those relating to the current performance year and those relating to earlier years.

	2015 £m	2014 £m	2013 £m
Performance-based compensation expense comprises:			
Awards made in respect of the year ended 31 December	280	324	394
Awards made in respect of earlier years	129	66	79
	409	390	473
Performance-based compensation expense deferred until later years comprises:			
Awards made in respect of the year ended 31 December	114	152	47
Awards made in respect of earlier years	56	32	30
	170	184	77

Performance-based awards expensed in 2015 include cash awards amounting to £96 million (2014: £104 million; 2013: £126 million).

Average headcount

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2015	2014	2013
UK	84,922	94,241	96,001
Overseas	781	847	1,868
Total	85,703	95,088	97,869

Fees payable to the auditors

Fees payable to the Company's auditors by the Group are as follows:

	2015 £m	2014 £m	2013 £m
Fees payable for the audit of the Company's current year annual report	1.2	1.4	1.5
Fees payable for other services:			
Audit of the Company's subsidiaries pursuant to legislation	14.9	15.5	17.4
Other services supplied pursuant to legislation	2.2	2.1	2.6
Total audit fees	18.3	19.0	21.5
Other services – audit related fees	3.2	9.1	4.5
Total audit and audit related fees	21.5	28.1	26.0
Services relating to taxation:			
Taxation compliance services	0.2	0.2	0.3
All other taxation advisory services	0.1	0.3	0.3
	0.3	0.5	0.6
Other non-audit fees:			
Services relating to corporate finance transactions	0.2	0.3	0.3
Other services	2.3	3.2	5.6
Total other non-audit fees	2.5	3.5	5.9
Total fees payable to the Company's auditors by the Group	24.3	32.1	32.5

Notes to the consolidated financial statements continued

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 all engagements of that type provided the fee is below that cap.

All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant fee cap must be pre-approved by the Audit Committee on an individual engagement basis. On a quarterly basis, the Audit Committee receives and reviews 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:

	2015 £m	2014 £m	2013 £m
Audits of Group pension schemes	**0.3**	0.3	0.3
Audits of the unconsolidated Open Ended Investment Companies managed by the Group	**0.4**	0.4	0.5
Reviews of the financial position of corporate and other borrowers	**3.1**	5.0	6.5
Acquisition due diligence and other work performed in respect of potential venture capital investments	**1.2**	1.0	2.1

NOTE 12: IMPAIRMENT

	2015 £m	2014 £m	2013 £m
Impairment losses on loans and receivables:			
Loans and advances to customers	**443**	735	2,725
Debt securities classified as loans and receivables	**(2)**	2	1
Total impairment losses on loans and receivables (note 21)	**441**	737	2,726
Impairment of available-for-sale financial assets	**4**	5	15
Other credit risk provisions	**(55)**	10	–
Total impairment charged to the income statement	**390**	752	2,741

NOTE 13: TAXATION

(A) Analysis of tax charge for the year

	2015 £m	2014 £m	2013 £m
UK corporation tax:			
Current tax on profit for the year	(485)	(162)	(226)
Adjustments in respect of prior years	(90)	213	(205)
	(575)	51	(431)
Foreign tax:			
Current tax on profit for the year	(24)	(39)	(60)
Adjustments in respect of prior years	27	3	26
	3	(36)	(34)
Current tax (charge) credit	(572)	15	(465)
Deferred tax (note 38):			
Origination and reversal of temporary differences	(185)	(72)	(434)
Due to change in UK corporation tax rate	(27)	(24)	(594)
Adjustments in respect of prior years	96	(182)	276
	(116)	(278)	(752)
Tax charge	(688)	(263)	(1,217)

The charge for tax on the profit for 2015 is based on a UK corporation tax rate of 20.25 per cent (2014: 21.5 per cent; 2013: 23.25 per cent).

The income tax charge is made up as follows:

	2015 £m	2014 £m	2013 £m
Tax credit (charge) attributable to policyholders	3	(18)	(328)
Shareholder tax charge	(691)	(245)	(889)
Tax charge	(688)	(263)	(1,217)

(B) Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to the profit before tax to the actual tax charge for the year is given below:

	2015 £m	2014 £m	2013 £m
Profit before tax	1,644	1,762	415
Tax charge thereon at UK corporation tax rate of 20.25 per cent (2014: 21.5 per cent; 2013: 23.25 per cent)	(333)	(379)	(96)
Factors affecting charge:			
UK corporation tax rate change and related impacts	(27)	(24)	(594)
Disallowed items[1]	(630)	(195)	(167)
Non-taxable items	162	153	132
Overseas tax rate differences	(4)	(24)	(116)
Gains exempted or covered by capital losses	67	181	57
Policyholder tax	3	(14)	(251)
Deferred tax on losses no longer recognised following sale of Australian operations	–	–	(348)
Deferred tax on Australian tax losses not previously recognised	–	–	60
Tax losses not previously recognised	42	–	–
Adjustments in respect of previous years	33	34	97
Effect of results of joint ventures and associates	(1)	7	9
Other items	–	(2)	–
Tax charge on profit on ordinary activities	(688)	(263)	(1,217)

1 The Finance (No. 2) Act 2015 introduced restrictions on the tax deductibility of provisions for conduct charges arising on or after 8 July 2015. This has resulted in an additional income statement tax charge of £459 million.

Notes to the consolidated financial statements continued

NOTE 13: TAXATION continued

The Finance (No. 2) Act 2015 (the Act) was substantively enacted on 26 October 2015. The Act reduced the main rate of corporation tax to 19 per cent from 1 April 2017 and 18 per cent from 1 April 2020; however from 1 January 2016 banking profits will be subject to an additional surcharge of 8 per cent. The change in the main rate of corporation tax from 20 per cent to 18 per cent, and the additional surcharge of 8 per cent, have resulted in a movement in the Group's net deferred tax asset at 31 December 2015 of £123 million, comprising the £27 million charge included in the income statement and a £96 million charge included in equity.

NOTE 14: EARNINGS PER SHARE

	2015 £m	2014 £m	2013 £m
Profit (loss) attributable to equity shareholders – basic and diluted	466	1,125	(838)
Tax relief on distributions to other equity holders	80	62	–
	546	1,187	(838)

	2015 million	2014 million	2013 million
Weighted average number of ordinary shares in issue – basic	71,272	71,350	71,009
Adjustment for share options and awards	1,068	1,097	–
Weighted average number of ordinary shares in issue – diluted	72,340	72,447	71,009
Basic earnings (loss) per share	0.8p	1.7p	(1.2)p
Diluted earnings (loss) per share	0.8p	1.6p	(1.2)p

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 101 million (2014: 22 million; 2013: 18 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 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 1 million at 31 December 2015 (2014: 7 million; 2013: 28 million).

NOTE 15: TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

These assets are comprised as follows:

	2015			2014		
	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	30,109	–	30,109	28,513	–	28,513
Loans and advances to banks	3,065	–	3,065	8,212	–	8,212
Debt securities:						
Government securities	8,269	13,848	22,117	7,976	17,497	25,473
Other public sector securities	–	2,039	2,039	–	2,170	2,170
Bank and building society certificates of deposit	–	135	135	554	–	554
Asset-backed securities:						
Mortgage-backed securities	516	842	1,358	187	847	1,034
Other asset-backed securities	85	762	847	129	721	850
Corporate and other debt securities	612	19,704	20,316	1,486	20,604	22,090
	9,482	37,330	46,812	10,332	41,839	52,171
Equity shares	5	60,471	60,476	–	61,576	61,576
Treasury and other bills	–	74	74	1,437	22	1,459
Total	42,661	97,875	140,536	48,494	103,437	151,931

NOTE 15: 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 £90,492 million (2014: £94,314 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 £13,282 million (2014: £27,255 million), see note 20; and

(ii) private equity investments of £2,415 million (2014: £2,350 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.

For amounts included above which are subject to repurchase and reverse repurchase agreements see note 53.

NOTE 16: 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 53; 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 50.

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, £455 million (2014: £611 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.

Notes to the consolidated financial statements continued

NOTE 16: DERIVATIVE FINANCIAL INSTRUMENTS continued

The fair values and notional amounts of derivative instruments are set out in the following table:

	31 December 2015			31 December 2014		
	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading and other						
Exchange rate contracts:						
Spot, forwards and futures	39,817	852	774	36,894	941	801
Currency swaps	293,536	5,585	4,323	301,451	4,849	4,706
Options purchased	20,352	751	–	49,085	1,244	–
Options written	22,708	–	984	49,784	–	1,443
	376,413	7,188	6,081	437,214	7,034	6,950
Interest rate contracts:						
Interest rate swaps	2,316,071	14,442	13,050	3,999,343	18,733	16,569
Forward rate agreements	1,159,099	6	57	1,791,219	9	56
Options purchased	55,962	3,003	–	58,600	3,755	–
Options written	52,202	–	3,116	54,031	–	3,725
Futures	105,475	7	8	134,117	9	24
	3,688,809	17,458	16,231	6,037,310	22,506	20,374
Credit derivatives	4,566	295	407	18,063	279	1,066
Embedded equity conversion feature	–	545	–	–	646	–
Equity and other contracts	14,174	1,295	1,145	14,842	1,430	1,181
Total derivative assets/liabilities – trading and other	4,083,962	26,781	23,864	6,507,429	31,895	29,571
Hedging						
Derivatives designated as fair value hedges:						
Currency swaps	2,649	52	107	7,281	113	131
Interest rate swaps	121,063	1,572	724	115,394	2,342	831
Options purchased	–	–	–	553	17	–
	123,712	1,624	831	123,228	2,472	962
Derivatives designated as cash flow hedges:						
Interest rate swaps	460,829	816	1,534	518,746	1,606	2,536
Futures	150,085	3	–	151,102	–	5
Currency swaps	11,228	243	72	11,720	155	113
	622,142	1,062	1,606	681,568	1,761	2,654
Total derivative assets/liabilities – hedging	745,854	2,686	2,437	804,796	4,233	3,616
Total recognised derivative assets/liabilities	4,829,816	29,467	26,301	7,312,225	36,128	33,187

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 53 Credit risk.

The embedded equity conversion feature of £545 million (2014: £646 million) reflects the value of the equity conversion feature contained in the Enhanced Capital Notes issued by the Group in 2009; the loss of £101 million arising from the change in fair value over 2015 (2014: gain of £401 million; 2013: loss of £209 million) is included within net gains on financial instruments held for trading within net trading income (note 7).

NOTE 16: 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.

2015	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	363	298	499	500	376	1,876	137	75	4,124
Forecast payable cash flows	(1,235)	(758)	(714)	(667)	(440)	(1,116)	(532)	(145)	(5,607)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	381	439	515	453	345	1,777	136	78	4,124
Forecast payable cash flows	(1,261)	(741)	(715)	(671)	(440)	(1,115)	(523)	(141)	(5,607)

2014	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	250	458	680	845	745	1,928	112	111	5,129
Forecast payable cash flows	(130)	(136)	(53)	(58)	(57)	(346)	(459)	(104)	(1,343)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	391	536	769	830	646	1,736	114	107	5,129
Forecast payable cash flows	(174)	(105)	(54)	(57)	(63)	(358)	(433)	(99)	(1,343)

There were no transactions for which cash flow hedge accounting had to be ceased in 2015 or 2014 as a result of the highly probable cash flows no longer being expected to occur.

NOTE 17: LOANS AND ADVANCES TO BANKS

	2015 £m	2014 £m
Lending to banks	2,273	2,902
Money market placements with banks	22,844	23,253
Total loans and advances to banks before allowance for impairment losses	25,117	26,155
Allowance for impairment losses	–	–
Total loans and advances to banks	25,117	26,155

For amounts included above which are subject to reverse repurchase agreements see note 53.

Notes to the consolidated financial statements continued

NOTE 18: LOANS AND ADVANCES TO CUSTOMERS

	2015 £m	2014 £m
Agriculture, forestry and fishing	**6,924**	6,586
Energy and water supply	**3,247**	3,853
Manufacturing	**5,953**	6,000
Construction	**4,952**	6,425
Transport, distribution and hotels	**13,526**	15,112
Postal and telecommunications	**2,563**	2,624
Property companies	**32,228**	36,682
Financial, business and other services	**43,072**	44,979
Personal:		
Mortgages	**312,877**	333,318
Other	**20,579**	23,123
Lease financing	**2,751**	3,013
Hire purchase	**9,536**	7,403
Total loans and advances to customers before allowance for impairment losses	**458,208**	489,118
Allowance for impairment losses (note 21)	**(3,033)**	(6,414)
Total loans and advances to customers	**455,175**	482,704

For amounts included above which are subject to reverse repurchase agreements see note 53.

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

	2015 £m	2014 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**497**	573
Later than 1 year and not later than 5 years	**1,225**	1,214
Later than 5 years	**2,407**	3,136
	4,129	4,923
Unearned future finance income on finance leases	**(1,316)**	(1,837)
Rentals received in advance	**(62)**	(73)
Net investment in finance leases	**2,751**	3,013

The net investment in finance leases represents amounts recoverable as follows:

	2015 £m	2014 £m
Not later than 1 year	**319**	339
Later than 1 year and not later than 5 years	**859**	763
Later than 5 years	**1,573**	1,911
Net investment in finance leases	**2,751**	3,013

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 2015 and 2014 no contingent rentals in respect of finance leases were recognised in the income statement. There was no allowance for uncollectable finance lease receivables included in the allowance for impairment losses (2014: £1 million).

NOTE 19: 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.

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 32.

	2015		2014	
	Loans and advances securitised £m	Notes in issue £m	Loans and advances securitised £m	Notes in issue £m
Securitisation programmes[1]				
UK residential mortgages	39,154	20,931	50,250	28,392
Commercial loans	9,345	8,720	13,372	12,533
Credit card receivables	7,305	5,277	6,762	4,278
Dutch residential mortgages	1,981	2,044	3,866	4,004
Personal loans	–	–	1,318	751
PFI/PPP and project finance loans	305	94	402	99
	58,090	37,066	75,970	50,057
Less held by the Group		(29,303)		(38,149)
Total securitisation programmes (note 32)		7,763		11,908
Covered bond programmes				
Residential mortgage-backed	43,323	29,697	47,795	31,730
Social housing loan-backed	2,544	1,700	2,826	1,800
	45,867	31,397	50,621	33,530
Less held by the Group		(4,197)		(6,339)
Total covered bond programmes (note 32)		27,200		27,191
Total securitisation and covered bond programmes		34,963		39,099

[1] Includes securitisations utilising a combination of external funding and credit default swaps.

Cash deposits of £8,383 million (2014: £11,251 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 arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2015 these obligations had not been triggered; the maximum exposure under these facilities was £381 million (2014: £392 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 cash flows 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 2015 (2014: none). Such repurchases are made in order to ensure that the expected maturity dates of the notes issued from these programmes are met.

Notes to the consolidated financial statements continued

NOTE 20: 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 19 for securitisations and covered bond vehicles, note 37 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 19, which are used for securitisation and covered bond programmes, the Group sponsors an active asset-backed conduit, Cancara, which invests in debt securities and client receivables. The total consolidated exposure of Cancara at 31 December 2015 was £7,295 million (2014: £5,245 million), comprising £6,440 million of loans and advances (2014: £4,605 million) and £855 million of asset-backed securities (2014: £640 million).

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 2015 and 2014 these obligations had not been triggered.

In addition, the Group sponsors a further asset-backed conduit, which is being run down. This asset-backed conduit has no commercial paper in issue and no external liquidity providers.

The external assets in all of the Group's conduits are consolidated in the Group's financial statements.

(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 2015, the total carrying value of these consolidated collective investment vehicle assets and liabilities held by the Group was £67,122 million (2014: £66,070 million).

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 £13,282 million at 31 December 2015 (2014: £27,255 million), included within financial assets designated at fair value through profit and loss (see note 15). These investments include both those entities managed by third parties and those managed by the Group. At 31 December 2015, the total asset value of these unconsolidated structured entities, including the portion in which the Group has no interest, was £603 billion (2014: £620 billion).

The Group's maximum exposure to loss is equal to the carrying value of the investment. However, the Group's investments in these entities 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 entities and has no current intention of providing any financial or other support. There were no transfers from/to these unconsolidated collective investment vehicles and limited partnerships.

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 sponsors 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 these entities, including those in which the Group held no ownership interest at 31 December 2015, are reported in note 6.

NOTE 21: ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	2015			2014		
	Loans and advances to customers £m	Debt securities £m	Total £m	Loans and advances to customers £m	Debt securities £m	Total £m
At 1 January	6,414	126	6,540	11,966	125	12,091
Exchange and other adjustments	(246)	–	(246)	(410)	9	(401)
Disposal of businesses	(82)	–	(82)	–	–	–
Advances written off	(4,204)	(31)	(4,235)	(6,432)	(10)	(6,442)
Recoveries of advances written off in previous years	764	4	768	681	–	681
Unwinding of discount	(56)	–	(56)	(126)	–	(126)
Charge (release) to the income statement (note 12)	443	(2)	441	735	2	737
At 31 December	3,033	97	3,130	6,414	126	6,540

Of the total allowance in respect of loans and advances to customers, £2,425 million (2014: £5,551 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, £1,170 million (2014: £1,482 million) was assessed on a collective basis.

NOTE 22: AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2015			2014		
	Conduits £m	Other £m	Total £m	Conduits £m	Other £m	Total £m
Debt securities:						
Government securities	–	25,329	25,329	–	47,402	47,402
Bank and building society certificates of deposit	–	186	186	–	298	298
Asset-backed securities:						
Mortgage-backed securities	26	171	197	27	647	674
Other asset-backed securities	209	110	319	223	462	685
Corporate and other debt securities	–	5,808	5,808	–	5,529	5,529
	235	31,604	31,839	250	54,338	54,588
Equity shares	–	1,193	1,193	–	1,042	1,042
Treasury and other bills	–	–	–	–	863	863
Total available-for-sale financial assets	235	32,797	33,032	250	56,243	56,493

Details of the Group's asset-backed conduits shown in the table above are included in note 20.

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).

NOTE 23: HELD-TO-MATURITY INVESTMENTS

	2015 £m	2014 £m
Debt securities: government securities	19,808	–

On 1 May 2015, the Group reclassified £19,938 million of government securities from available-for-sale financial assets to held-to-maturity investments.

NOTE 24: GOODWILL

	2015 £m	2014 £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 (2014: £2,016 million), £1,836 million, or 91 per cent of the total (2014: £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 (2014: £170 million, 8 per cent of the total) to Asset Finance in the Group's Consumer Finance division.

The recoverable amount of the goodwill relating to 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 10 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 the goodwill relating to 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.

Notes to the consolidated financial statements continued

NOTE 25: VALUE OF IN-FORCE BUSINESS

The gross value of in-force business asset in the consolidated balance sheet is as follows:

	2015 £m	2014 £m
Acquired value of in-force non-participating investment contracts	377	418
Value of in-force insurance and participating investment contracts	4,219	4,446
Total value of in-force business	4,596	4,864

The movement in the acquired value of in-force non-participating investment contracts over the year is as follows:

	2015 £m	2014 £m
At 1 January	418	461
Amortisation taken to income statement (note 11)	(41)	(43)
Disposal of businesses	–	–
At 31 December	377	418

The acquired value of in-force non-participating investment contracts includes £228 million (2014: £251 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:

	2015 £m	2014 £m
At 1 January	4,446	4,874
Exchange and other adjustments	(5)	–
Movements in the year:		
New business	454	425
Existing business:		
Expected return	(365)	(441)
Experience variances	(130)	(65)
Assumption changes	(209)	(586)
Economic variance	88	239
Movement in the value of in-force business taken to income statement (note 9)	(162)	(428)
Disposal of businesses	(60)	–
At 31 December	4,219	4,446

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:

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 in note 33.

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 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 in the range of 85 to 144 basis points at 31 December 2015 (2014: 120 basis points).

The risk-free rate is derived from the relevant swap curve with a deduction for credit risk.

NOTE 25: VALUE OF IN-FORCE BUSINESS continued

The table below shows the resulting range of yields and other key assumptions at 31 December:

	2015 %	2014 %
Risk-free rate (value of in-force non-annuity business)[1]	**0.00 to 4.20**	0.00 to 3.27
Risk-free rate (value of in-force annuity business)[1]	**0.85 to 5.64**	1.02 to 4.56
Risk-free rate (financial options and guarantees)[1]	**0.00 to 2.54**	0.29 to 2.20
Retail price inflation	**3.27**	3.26
Expense inflation	**3.65**	3.92

[1] All risk-free rates 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. Further information on these assumptions is given in note 33 and the effect of changes in key assumptions is given in note 34.

NOTE 26: 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 2014	596	2,770	315	538	1,320	5,539
Additions	–	–	–	–	297	297
Disposals	–	–	–	–	(108)	(108)
At 31 December 2014	596	2,770	315	538	1,509	5,728
Additions	**–**	**–**	**–**	**–**	**306**	**306**
Disposals	**–**	**–**	**–**	**–**	**(1)**	**(1)**
At 31 December 2015	**596**	**2,770**	**315**	**538**	**1,814**	**6,033**
Accumulated amortisation:						
At 1 January 2014	107	1,860	300	442	551	3,260
Charge for the year	21	300	5	14	161	501
Disposals	–	–	–	–	(103)	(103)
At 31 December 2014	128	2,160	305	456	609	3,658
Charge for the year	**21**	**300**	**4**	**16**	**196**	**537**
Disposals	**–**	**–**	**–**	**–**	**–**	**–**
At 31 December 2015	**149**	**2,460**	**309**	**472**	**805**	**4,195**
Balance sheet amount at 31 December 2015	**447**	**310**	**6**	**66**	**1,009**	**1,838**
Balance sheet amount at 31 December 2014	468	610	10	82	900	2,070

Included within brands above are assets of £380 million (31 December 2014: £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 2015 shown above will be amortised, in accordance with the Group's accounting policy, on a straight line basis over its remaining useful life of one year.

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.

Notes to the consolidated financial statements continued

NOTE 27: PROPERTY, PLANT AND EQUIPMENT

	Investment properties £m	Premises £m	Equipment £m	Operating lease assets £m	Total £m
Cost or valuation:					
At 1 January 2014	4,864	2,866	3,894	4,667	16,291
Exchange and other adjustments	(6)	1	1	24	20
Additions	–	212	971	1,673	2,856
Expenditure on investment properties (see below)	376	–	–	–	376
Change in fair value of investment properties (note 7)	513	–	–	–	513
Disposals	(1,255)	(186)	(223)	(1,759)	(3,423)
At 31 December 2014	4,492	2,893	4,643	4,605	16,633
Exchange and other adjustments	(5)	–	–	23	18
Additions	–	141	1,071	1,702	2,914
Expenditure on investment properties (see below)	272	–	–	–	272
Change in fair value of investment properties (note 7)	416	–	–	–	416
Disposals	(814)	(172)	(281)	(1,307)	(2,574)
Disposal of businesses	–	(273)	(167)	–	(440)
At 31 December 2015	**4,361**	**2,589**	**5,266**	**5,023**	**17,239**
Accumulated depreciation and impairment:					
At 1 January 2014	–	1,299	1,573	985	3,857
Exchange and other adjustments	–	–	1	7	8
Depreciation charge for the year	–	142	462	787	1,391
Disposals	–	(67)	(153)	(947)	(1,167)
At 31 December 2014	–	1,374	1,883	832	4,089
Exchange and other adjustments	–	9	(2)	7	14
Depreciation charge for the year	–	116	588	830	1,534
Disposals	–	(90)	(245)	(752)	(1,087)
Disposal of businesses	–	(162)	(128)	–	(290)
At 31 December 2015	**–**	**1,247**	**2,096**	**917**	**4,260**
Balance sheet amount at 31 December 2015	**4,361**	**1,342**	**3,170**	**4,106**	**12,979**
Balance sheet amount at 31 December 2014	4,492	1,519	2,760	3,773	12,544

Expenditure on investment properties is comprised as follows:

	2015 £m	2014 £m
Acquisitions of new properties	165	293
Additional expenditure on existing properties	107	83
	272	376

Rental income of £268 million (2014: £269 million) and direct operating expenses arising from properties that generate rental income of £27 million (2014: £37 million) have been recognised in the income statement.

Capital expenditure in respect of investment properties which had been contracted for but not recognised in the financial statements was £37 million (2014: £47 million).

The table above analyses movements in investment properties, all of which are categorised as level 3. See note 50 for details of levels in the fair value hierarchy.

At 31 December the future minimum rentals receivable under non-cancellable operating leases were as follows:

	2015 £m	2014 £m
Receivable within 1 year	1,003	965
1 to 5 years	1,163	1,103
Over 5 years	172	203
Total future minimum rentals receivable	**2,338**	2,271

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2015 and 2014 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £72 million at 31 December 2015 (£45 million at 31 December 2014) is expected to be received under non-cancellable sub-leases of the Group's premises.

NOTE 28: OTHER ASSETS

	2015 £m	2014 £m
Assets arising from reinsurance contracts held (notes 33 and 35)	675	682
Deferred acquisition and origination costs	106	114
Settlement balances	264	1,676
Corporate pension asset	7,725	12,741
Investments in joint ventures and associates	47	74
Other assets and prepayments	5,047	6,407
Total other assets	**13,864**	21,694

NOTE 29: DEPOSITS FROM BANKS

	2015 £m	2014 £m
Liabilities in respect of securities sold under repurchase agreements	7,061	1,075
Other deposits from banks	9,864	9,812
Deposits from banks	**16,925**	10,887

For amounts included above which are subject to repurchase agreements see note 53.

NOTE 30: CUSTOMER DEPOSITS

	2015 £m	2014 £m
Non-interest bearing current accounts	48,518	46,487
Interest bearing current accounts	85,491	86,131
Savings and investment accounts	224,137	256,701
Liabilities in respect of securities sold under repurchase agreements	–	–
Other customer deposits	60,180	57,748
Customer deposits	**418,326**	447,067

For amounts included above which are subject to repurchase agreements, see note 53.

Included in the amounts reported above are deposits of £230,110 million (2014: £260,129 million) which are protected under the UK Financial Services Compensation Scheme.

NOTE 31: TRADING AND OTHER FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2015 £m	2014 £m
Liabilities held at fair value through profit or loss	7,879	6,744
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	38,431	50,007
Short positions in securities	4,440	3,219
Other	1,113	2,132
	43,984	55,358
Trading and other financial liabilities at fair value through profit or loss	**51,863**	62,102

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 2015 was £12,034 million, which was £4,156 million higher than the balance sheet carrying value (2014: £10,112 million, which was £3,373 million higher than the balance sheet carrying value). At 31 December 2015 there was a cumulative £67 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 £114 million arose in 2015 and a decrease of £33 million arose in 2014.

For the fair value of collateral pledged in respect of repurchase agreements see note 53.

Notes to the consolidated financial statements continued

NOTE 32: DEBT SECURITIES IN ISSUE

	2015 £m	2014 £m
Medium-term notes issued	29,329	22,728
Covered bonds (note 19)	27,200	27,191
Certificates of deposit issued	11,101	7,033
Securitisation notes (note 19)	7,763	11,908
Commercial paper	6,663	7,373
Total debt securities in issue	82,056	76,233

NOTE 33: LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS

Insurance contract and participating investment contract liabilities are comprised as follows:

	2015			2014		
	Gross £m	Reinsurance[1] £m	Net £m	Gross £m	Reinsurance[1] £m	Net £m
Life insurance (see below):						
Insurance contracts	66,122	(629)	65,493	72,168	(636)	71,532
Participating investment contracts	13,460	–	13,460	14,102	–	14,102
	79,582	(629)	78,953	86,270	(636)	85,634
Non-life insurance contracts:						
Unearned premiums	461	(12)	449	424	(7)	417
Claims outstanding	251	–	251	224	–	224
	712	(12)	700	648	(7)	641
Total	80,294	(641)	79,653	86,918	(643)	86,275

[1] Reinsurance balances are reported within other assets (note 28).

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 2014	67,626	14,416	82,042	(675)	81,367
New business	3,123	28	3,151	(20)	3,131
Changes in existing business	1,582	(341)	1,241	12	1,253
Change in liabilities charged to the income statement (note 10)	4,705	(313)	4,392	(8)	4,384
Exchange and other adjustments	(163)	(1)	(164)	47	(117)
At 31 December 2014	72,168	14,102	86,270	(636)	85,634
New business	2,422	28	2,450	(4)	2,446
Changes in existing business	(4,681)	(667)	(5,348)	11	(5,337)
Change in liabilities charged to the income statement (note 10)	(2,259)	(639)	(2,898)	7	(2,891)
Exchange and other adjustments	39	(1)	38	–	38
Disposal of businesses	(3,826)	(2)	(3,828)	–	(3,828)
At 31 December 2015	66,122	13,460	79,582	(629)	78,953

NOTE 33: LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

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:

	2015			2014		
	With-profit fund £m	Non-profit fund £m	Total £m	With-profit fund £m	Non-profit fund £m	Total £m
Insurance contracts	9,023	57,099	66,122	12,334	59,834	72,168
Participating investment contracts	9,341	4,119	13,460	8,957	5,145	14,102
Total	18,364	61,218	79,582	21,291	64,979	86,270

With-profit fund realistic liabilities

(i) Business description

During the year the Group had with-profit funds within Scottish Widows plc and Clerical Medical Investment Group Limited (CMIG) containing both insurance contracts and participating investment contracts. On 31 December 2015, the long-term insurance businesses of seven life insurance companies within the Group were transferred to CMIG pursuant to an insurance business transfer scheme, under Part VII of the Financial Services and Markets Act 2000, and the Scottish Widows plc with-profit fund was transferred to a with-profit fund within CMIG. On 31 December 2015, CMIG changed its name to Scottish Widows Limited, and Scottish Widows plc changed its name to SW Funding plc. From 31 December 2015, Scottish Widows Limited has the only with-profit funds within the Group.

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 25.

(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 below.

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.

Notes to the consolidated financial statements continued

NOTE 33: LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

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.

(iv) 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 originally held in Scottish Widows plc and subsequently transferred into Scottish Widows Limited, 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 2015 of £2.5 billion (2014: £2.6 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 the With-Profit Funds are valued using a market-consistent stochastic simulation model which places 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 and investment volatility.

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.

(ii) Method of calculation of liabilities

The non-profit fund liabilities are determined on the basis of recognised actuarial methods and consistent with the approach required by regulatory rules. The methods used involve estimating future policy cash flows over the duration of the in-force book of policies, and discounting the cash flows back to the valuation date allowing for probabilities of occurrence.

(iii) Assumptions

Generally, assumptions used to value non-profit fund liabilities are prudent in nature and therefore contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgement and reflects management's views on the inherent level of uncertainty. The key assumptions used in the measurement of non-profit fund liabilities are:

Interest rates

The rates used are derived in accordance with the guidelines set by local regulatory bodies. These limit the rates of interest that can be used by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

Margins for risk are allowed for in the assumed interest rates. These are derived from the limits in the guidelines set by local regulatory bodies, including reductions made to the available yields to allow for default risk based upon the credit rating of the securities allocated to the insurance liability.

Mortality and morbidity

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and include a margin for adverse deviation.

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.

Key changes in assumptions

A detailed review of the Group's assumptions in 2015 resulted in the following key impacts on profit before tax:

– Change in persistency assumptions (£196 million decrease).

– Change in the assumption in respect of current and future mortality rates (£224 million increase).

– Change in expenses assumptions (£70 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.

NOTE 33: LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

(iv) 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 £68 million (2014: £61 million) in respect of those guarantees.

NOTE 34: 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.

		2015		2014	
	Change in variable	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m
Non-annuitant mortality and morbidity[1]	5% reduction	32	26	37	30
Annuitant mortality[2]	5% reduction	(190)	(156)	(176)	(141)
Lapse rates[3]	10% reduction	85	70	105	84
Future maintenance and investment expenses[4]	10% reduction	231	190	259	208
Risk-free rate[5]	0.25% reduction	(44)	(37)	(10)	(8)
Guaranteed annuity option take up[6]	5% addition	2	2	1	1
Equity investment volatility[7]	1% addition	(7)	(5)	(3)	(3)
Widening of credit default spreads on corporate bonds[8]	0.25% addition	(183)	(151)	(168)	(132)
Increase in illiquidity premia[9]	0.10% addition	120	98	101	81

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.

NOTE 35: LIABILITIES ARISING FROM NON-PARTICIPATING INVESTMENT CONTRACTS

The movement in liabilities arising from non-participating investment contracts may be analysed as follows:

	2015 £m	2014 £m
At 1 January	27,248	27,590
New business	539	257
Changes in existing business	(4,461)	(583)
Disposal of businesses	(549)	–
Exchange and other adjustments	–	(16)
At 31 December	22,777	27,248

The balances above are shown gross of reinsurance. As at 31 December 2015, related reinsurance balances were £34 million (2014: £39 million); reinsurance balances are reported within other assets (note 28). Liabilities arising from non-participating investment contracts are categorised as level 2. See note 50 for details of levels in the fair value hierarchy.

Notes to the consolidated financial statements continued

NOTE 36: OTHER LIABILITIES

	2015 £m	2014 £m
Settlement balances	467	1,024
Unitholders' interest in Open Ended Investment Companies	22,621	19,525
Unallocated surplus within insurance businesses	257	320
Other creditors and accruals	6,316	7,556
Total other liabilities	29,661	28,425

NOTE 37: RETIREMENT BENEFIT OBLIGATIONS

	2015 £m	2014 £m	2013 £m
Charge to the income statement			
Past service (credits) charges [1]	–	(822)	104
Other	307	334	392
Defined benefit pension schemes	307	(488)	496
Other post-retirement benefit schemes	8	10	7
Total defined benefit schemes	315	(478)	503
Defined contribution pension schemes	233	252	255
Total charge (credit) to the income statement (note 11)	548	(226)	758

[1] On 11 March 2014 the Group announced a change to its defined benefit pension schemes, revising the existing cap on the increases in pensionable pay used in calculating the pension benefit, from 2 per cent to nil with effect from 2 April 2014. The effect of this change was to reduce the Group's retirement benefit obligations recognised on the balance sheet by £843 million with a corresponding curtailment gain recognised in the income statement. This was partly offset by a charge of £21 million following changes to pension arrangements for staff within the TSB business. In 2013, the Group 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.

	2015 £m	2014 £m
Amounts recognised in the balance sheet		
Retirement benefit assets	901	1,147
Retirement benefit obligations	(365)	(453)
Total amounts recognised in the balance sheet	536	694

The total amount recognised in the balance sheet relates to:

	2015 £m	2014 £m
Defined benefit pension schemes	736	890
Other post-retirement benefit schemes	(200)	(196)
Total amounts recognised in the balance sheet	536	694

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 2015 is 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 has not provided for these deficit contributions as the future economic benefits arising from these contributions are expected to be available to the Group. 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 2014; the results have been updated to 31 December 2015 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 2015 by qualified independent actuaries.

NOTE 37: 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. As all scheduled distributions have now been made, the value of the partnership interests equates to a nominal amount and the limited liability partnerships will continue to hold assets to provide security for the Group's obligations to the Lloyds Bank Pension Scheme No 1 and Lloyds Bank Pension Scheme No 2. At 31 December 2015, the limited liability partnerships held assets of approximately £5.2 billion and no cash payments were made to the pension schemes during the year (2014: £215 million). The limited liability partnerships are consolidated fully in the Group's balance sheet (see note 20).

The Group has also established three private limited companies which hold assets to provide security for the Group's obligations to the HBOS Final Salary Pension Scheme, a section of the Lloyds Bank Pension Scheme No 1 and the Lloyds Bank Offshore Pension Scheme. At 31 December 2015 these held assets of approximately £4.1 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 2015.

The Group currently expects to pay contributions of approximately £600 million to its defined benefit schemes in 2016.

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

	2015 £m	2014 £m
Amount included in the balance sheet		
Present value of funded obligations	**(36,903)**	(37,243)
Fair value of scheme assets	**37,639**	38,133
Net amount recognised in the balance sheet	**736**	890

	2015 £m	2014 £m
Net amount recognised in the balance sheet		
At 1 January	**890**	(787)
Net defined benefit pension (charge) credit	**(307)**	488
Actuarial gains (losses) on defined benefit obligation	**607**	(4,272)
Return on plan assets	**(879)**	4,928
Employer contributions	**427**	531
Exchange and other adjustments	**(2)**	2
At 31 December	**736**	890

Notes to the consolidated financial statements continued

NOTE 37: RETIREMENT BENEFIT OBLIGATIONS continued

	2015 £m	2014 £m
Movements in the defined benefit obligation		
At 1 January	(37,243)	(33,355)
Current service cost	(302)	(277)
Interest expense	(1,340)	(1,471)
Remeasurements:		
Actuarial (losses) gains – experience	195	186
Actuarial (losses) gains – demographic assumptions	(747)	(13)
Actuarial (losses) gains – financial assumptions	1,159	(4,445)
Benefits paid	1,371	1,147
Past service cost	(12)	(20)
Employee contributions	(1)	(2)
Curtailments	–	822
Settlements	8	117
Exchange and other adjustments	9	68
At 31 December	(36,903)	(37,243)

	2015 £m	2014 £m
Changes in the fair value of scheme assets		
At 1 January	38,133	32,568
Return on plan assets excluding amounts included in interest income	(879)	4,928
Interest income	1,383	1,477
Employer contributions	427	531
Employee contributions	1	2
Benefits paid	(1,371)	(1,147)
Settlements	(14)	(124)
Administrative costs paid	(30)	(36)
Exchange and other adjustments	(11)	(66)
At 31 December	37,639	38,133

NOTE 37: RETIREMENT BENEFIT OBLIGATIONS continued

Composition of scheme assets:

	2015			2014		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equity instruments	947	–	947	1,047	–	1,047
Debt instruments[1]:						
Fixed interest government bonds	4,841	–	4,841	4,150	–	4,150
Index-linked government bonds	9,944	–	9,944	10,396	–	10,396
Corporate and other debt securities	7,243	–	7,243	6,623	–	6,623
Asset-backed securities	74	–	74	74	–	74
	22,102	–	22,102	21,243	–	21,243
Property	–	1,361	1,361	–	1,138	1,138
Pooled investment vehicles	3,464	9,698	13,162	3,603	10,555	14,158
Money market instruments, cash, derivatives and other assets and liabilities	525	(458)	67	1,179	(632)	547
At 31 December	27,038	10,601	37,639	27,072	11,061	38,133

1 Of the total debt instruments, £18,428 million (31 December 2014: £19,209 million) were investment grade (credit ratings equal to or better than 'BBB').

The assets of all the funded plans are held independently of the Group's assets in separate trustee administered funds.

The pension schemes' pooled investment vehicles comprise:

	2015 £m	2014 £m
Equity funds	2,412	2,581
Hedge and mutual funds	2,078	2,170
Liquidity funds	918	2,566
Bond and debt funds	2,807	2,570
Other	4,947	4,271
At 31 December	13,162	14,158

The expense (credit) recognised in the income statement for the year ended 31 December comprises:

	2015 £m	2014 £m	2013 £m
Current service cost	302	277	351
Net interest amount	(43)	(6)	22
Past service credits and curtailments (see page 206)	–	(822)	104
Settlements	6	7	(7)
Past service cost – plan amendments	12	20	5
Plan administration costs incurred during the year	30	36	21
Total defined benefit pension expense (credit)	307	(488)	496

Notes to the consolidated financial statements continued

NOTE 37: RETIREMENT BENEFIT OBLIGATIONS continued

Assumptions

The principal actuarial and financial assumptions used in valuations of the defined benefit pension schemes were as follows:

	2015 %	2014 %
Discount rate	**3.87**	3.67
Rate of inflation:		
Retail Prices Index	**2.99**	2.95
Consumer Price Index	**1.99**	1.95
Rate of salary increases	**0.00**	0.00
Weighted-average rate of increase for pensions in payment	**2.58**	2.59

	2015 Years	2014 Years
Life expectancy for member aged 60, on the valuation date:		
Men	**28.1**	27.5
Women	**30.4**	29.8
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**29.5**	28.7
Women	**31.9**	31.1

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 at 31 December 2015 is assumed to live for, on average, 28.1 years for a male and 30.4 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 37: 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	
	2015 £m	2014 £m	2015 £m	2014 £m
Inflation (including pension increases):[1]				
Increase of 0.1 per cent	17	18	363	383
Decrease of 0.1 per cent	(16)	(16)	(346)	(362)
Discount rate:[2]				
Increase of 0.1 per cent	(29)	(30)	(605)	(611)
Decrease of 0.1 per cent	30	29	621	623
Expected life expectancy of members:				
Increase of one year	43	34	952	750
Decrease of one year	(41)	(32)	(927)	(738)

1 At 31 December 2015, the assumed rate of RPI inflation is 2.99 per cent and CPI inflation 1.99 per cent (2014: RPI 2.95 per cent and CPI 1.95 per cent).

2 At 31 December 2015, the assumed discount rate is 3.87 per cent (2014: 3.67 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 change in the rate of salary increases as pensionable salaries have been frozen since 2 April 2014.

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 prior year.

Asset-liability matching strategies

The main schemes' assets are invested in a diversified portfolio, consisting primarily of debt securities. 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 schemes, 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 asset-liability matching strategy currently mitigates substantially all of the interest rate and inflation rate volatility of the liabilities.

Notes to the consolidated financial statements continued

NOTE 37: RETIREMENT BENEFIT OBLIGATIONS continued

Duration of defined benefit obligation

The weighted average duration of the defined benefit pension obligation was 19 years (31 December 2014: 19 years).

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 2015 the charge to the income statement in respect of defined contribution schemes was £233 million (2014: £252 million; 2013: £255 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 31 December 2014 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 6.59 per cent (2014: 6.55 per cent).

Movements in the other post-retirement benefits obligation:

	2015 £m	2014 £m
At 1 January	(196)	(211)
Actuarial (loss) gain	(2)	18
Insurance premiums paid	6	7
Charge for the year	(8)	(10)
At 31 December	(200)	(196)

NOTE 38: DEFERRED TAX

The movement in the net deferred tax balance is as follows:

	2015 £m	2014 £m
Asset at 1 January	4,091	5,101
Exchange and other adjustments	5	9
Disposals	(59)	(60)
Income statement charge (note 13):		
Due to change in UK corporation tax rate and related impacts	(27)	(24)
Other	(89)	(254)
	(116)	(278)
Amount credited (charged) to equity:		
Post-retirement defined benefit scheme remeasurements	59	(135)
Available-for-sale financial assets (note 43)	(7)	(13)
Cash flow hedges (note 43)	7	(549)
Share-based compensation	(3)	16
	56	(681)
Asset at 31 December	3,977	4,091

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	2015 £m	2014 £m	Tax disclosure	2015 £m	2014 £m
Deferred tax assets	4,010	4,145	Deferred tax assets	6,400	7,033
Deferred tax liabilities	(33)	(54)	Deferred tax liabilities	(2,423)	(2,942)
Asset at 31 December	3,977	4,091	**Asset at 31 December**	3,977	4,091

NOTE 38: DEFERRED TAX continued

The deferred tax charge in the income statement comprises the following temporary differences:

	2015 £m	2014 £m	2013 £m
Accelerated capital allowances	377	34	482
Pensions and other post-retirement benefits	(40)	(243)	(14)
Long-term assurance business	303	312	86
Allowances for impairment losses	(5)	(24)	(86)
Tax losses carried forward	(855)	(565)	(1,049)
Tax on fair value of acquired assets	178	159	322
Other temporary differences	(74)	49	(493)
Deferred tax charge in the income statement	(116)	(278)	(752)

Deferred tax assets and liabilities are comprised as follows:

	2015 £m	2014 £m
Deferred tax assets:		
Accelerated capital allowances	1,089	682
Allowances for impairment losses	–	5
Other provisions	28	15
Tax losses carried forward	4,890	5,758
Other temporary differences	393	573
Total deferred tax assets	6,400	7,033

	2015 £m	2014 £m
Deferred tax liabilities:		
Pensions and other post-retirement benefits	(72)	(87)
Long-term assurance business	(641)	(944)
Available-for-sale asset revaluation	(11)	(13)
Tax on fair value of acquired assets	(891)	(1,072)
Effective interest rates	–	(10)
Derivatives	(395)	(421)
Other temporary differences	(413)	(395)
Total deferred tax liabilities	(2,423)	(2,942)

The Finance (No. 2) Act 2015 (the Act) was substantively enacted on 26 October 2015. The Act reduced the main rate of corporation tax to 19 per cent from 1 April 2017 and 18 per cent from 1 April 2020.

In addition, the Government announced that from 1 January 2016 banking profits will be subject to an additional surcharge of 8 per cent.

The change in the main rate of corporation tax from 20 per cent to 18 per cent, and the additional surcharge of 8 per cent, have resulted in a movement in the Group's net deferred tax asset at 31 December 2015 of £123 million, comprising the £27 million charge included in the income statement and a £96 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 £4,890 million (2014: £5,758 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 £140 million (2014: £190 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 £893 million (2014: £614 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 2015 of £76 million (2014: £117 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.

Notes to the consolidated financial statements continued

NOTE 39: 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 2015	101	2,549	829	70	651	4,200
Exchange and other adjustments	26	–	–	(2)	34	58
Provisions applied	(22)	(3,091)	(661)	(34)	(349)	(4,157)
Charge for the year	(55)	4,000	837	3	801	5,586
At 31 December 2015	50	3,458	1,005	37	1,137	5,687

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

The Group increased the provision for PPI costs by a further £4,000 million in 2015, bringing the total amount provided to £16,025 million. This included an additional £2,600 million in the second half of 2015, largely to reflect the impact of our interpretation of the proposals contained within the Financial Conduct Authority's (FCA) consultation paper regarding a potential time bar and the Plevin case. As at 31 December 2015, £3,458 million or 22 per cent of the total provision, remained unutilised with £2,950 million relating to reactive complaints and associated administration costs.

The volume of reactive PPI complaints has continued to fall, with an 8 per cent reduction in 2015 compared with 2014, to approximately 8,000 complaints per week. Whilst direct customer complaint levels fell 30 per cent year-on-year, those from Claims Management Companies (CMCs) have remained broadly stable and as a result, CMCs now account for over 70 per cent of complaints.

On 26 November 2015, the FCA published a consultation paper (CP15/39: Rules and guidance on payment protection insurance complaints) proposing (i) the introduction of a deadline by which consumers would need to make their PPI complaints including an FCA led communications campaign, and (ii) rules and guidance about how firms should handle PPI complaints in light of the Supreme Court's decision in Plevin v Paragon Personal Finance Limited [2014] UKSC 61 (Plevin).

Based on recent trends, and in light of the proposals from the FCA, the Group now expects a higher level of complaints than previously assumed including those related to Plevin. As a result the Group has increased the total expected reactive complaint volumes to 4.7 million with approximately 1.3 million still expected to be received. This is equivalent to approximately 10,000 net complaints per week on average through to the proposed time bar of mid 2018.

Monthly complaints trends could vary significantly throughout this period, given they are likely to be impacted by a number of factors including the potential impact of the FCA's proposed communication campaign as well as changes in the regulation of CMCs.

The provision includes an estimate to cover redress that would be payable under the FCA's proposed new rules and guidance in light of Plevin.

Quarter	Average monthly reactive complaint volume	Quarter on quarter %	Year on year %
Q1 2013	61,259	(28%)	
Q2 2013	54,086	(12%)	
Q3 2013	49,555	(8%)	
Q4 2013	37,457	(24%)	
Q1 2014	42,259	13%	(31%)
Q2 2014	39,426	(7%)	(27%)
Q3 2014	40,624	3%	(18%)
Q4 2014	35,910	(12%)	(4%)
Q1 2015	37,791	5%	(11%)
Q2 2015	36,957	(2%)	(6%)
Q3 2015	37,586	2%	(7%)
Q4 2015	33,998	(10%)	(5%)

The Group continues to progress the re-review of previously handled cases and expects this to be substantially complete by the end of the first quarter of 2016. During the year the scope has been extended by 0.5 million to 1.7 million cases relating largely to previously redressed cases, in addition to which, higher overturn rates and average redress have been experienced. At the end of January 2016, 77 per cent of cases had been reviewed and 77 per cent of all cash payments made.

The Group has completed its Past Business Review (PBR) where it has been identified that there was a risk of potential mis-sale for certain customers, albeit active monitoring continues. No further change has been made to the amount provided.

The Group expects to maintain the PPI operation on its current scale for longer than previously anticipated given the update to volume related assumptions and the re-review of previously handled cases continuing into the first quarter of 2016. The estimate for administrative expenses, which comprise complaint handling costs and costs arising from cases subsequently referred to the FOS, is included in the provision increase outlined above.

Sensitivities

The Group estimates that it has sold approximately 16 million policies since 2000. These include policies that were not mis-sold. Since the commencement of the PPI redress programme in 2011 the Group estimates that it has contacted, settled or provided for almost 49 per cent of the policies sold since 2000, covering both customer-initiated complaints and actual and PBR mailings undertaken by the Group.

NOTE 39: OTHER PROVISIONS continued

The total amount provided for PPI represents the Group's best estimate of the likely future cost. However a number of risks and uncertainties remain in particular with respect to future volumes. The cost could differ materially from the Group's estimates and the assumptions underpinning them, and could result in a further provision being required. There is significant uncertainty around the impact of the proposed FCA media campaign and CMC and customer activity in the lead up to the proposed time bar.

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]	3.4	1.3	0.1 = £200m
Average uphold rate per policy[3]	76%	89%	1% = £35m
Average redress per upheld policy[4]	£1,810	£1,400	£100 = £170m
Administrative expenses (£m)	2,710	665	1 case = £450

1 All sensitivities exclude claims where no PPI policy was held.

2 Sensitivity includes complaint handling costs. Future volume includes complaints falling into the Plevin rules and guidance. As a result, the sensitivity per 100,000 complaints includes cases where the average redress would be lower than historical trends.

3 The percentage of complaints where the Group finds in favour of the customer excluding PBR. The 76 per cent uphold rate per policy is based on the six months to 31 December 2015. Future uphold rate and sensitivities are influenced by a proportion of complaints falling under the Plevin rules and guidance which would otherwise be defended.

4 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 the six months to 31 December 2015. Future average redress is influenced by expected compensation payments for complaints falling under the Plevin rules and guidance.

Other regulatory provisions

Customer claims in relation to insurance branch business in Germany

The Group has received a number of claims from customers relating to policies issued by Clerical Medical Investment Group Limited (recently renamed Scottish Widows Limited) 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 provisions totalling £520 million during the period to 31 December 2014. Recent experience has been slightly adverse to expectations and the Group has noted decisions of the FCJ in 2014 and 2015 involving German insurers in relation to a German industry-wide issue regarding notification of contractual 'cooling off' periods. Accordingly, a provision increase of £25 million has been recognised giving a total provision of £545 million. The remaining unutilised provision as at 31 December 2015 is £124 million (31 December 2014: £199 million).

The validity of the claims facing the Group depends 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 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 2015 the Group had identified 1,735 sales of IRHPs to customers within scope of the agreement with the FCA which have opted in and are being reviewed and, where appropriate, redressed. The Group agreed that it would provide redress to any in-scope customers where appropriate. The Group continues to review the remaining cases within the scope of the agreement with the FCA and has met all of the regulator's requirements to date.

During 2015, the Group has charged a further £40 million in respect of redress and related administration costs, increasing the total amount provided for redress and related administration costs for in-scope customers to £720 million (31 December 2014: £680 million). As at 31 December 2015, the Group has utilised £652 million (31 December 2014: £571 million), with £68 million (31 December 2014: £109 million) of the provision remaining.

FCA review of complaint handling

On 5 June 2015 the FCA announced a settlement with the Group totalling £117 million following its investigation into aspects of the Group's PPI complaint handling process during the period March 2012 to May 2013. The FCA did not find that the Group acted deliberately. The Group has reviewed all customer complaints fully defended during the Relevant Period. The remediation costs of reviewing these affected cases are not materially in excess of existing provisions.

Other legal actions and 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 other governmental authorities on a range of matters. The Group also receives complaints and claims from customers in connection with its past conduct and, where significant, provisions are held against the costs expected to be incurred as a result of the conclusions reached. During 2015, the Group charged an additional £655 million (2014: £430 million), including £225 million (2014: £nil) in response to complaints concerning packaged bank accounts and £282 million (2014: £318 million) in respect of other matters within the Retail division. In addition, the Group has charged a further £148 million (2014: £112 million) in respect of a number of other product rectifications primarily in Insurance and Commercial Banking.

At 31 December 2015, provisions for other legal actions and regulatory matters of £813 million (31 December 2014: £521 million) remained unutilised, principally in relation to the sale of bancassurance products and packaged bank accounts and other Retail provisions. The ultimate financial effect, which could be different from the current provision, of these matters will only be known once they have been resolved, the timing of which is uncertain.

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 four years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

Notes to the consolidated financial statements continued

NOTE 39: OTHER PROVISIONS continued

Other

Following the sale of TSB Banking Group plc (TSB, see note 55) the Group raised a provision of £665 million in relation to the Transitional Service Agreement entered into between Lloyds Bank plc and TSB and the contribution to be provided to TSB in moving to alternative IT provision.

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 also 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 £30 million at 31 December 2015 represents management's current best estimate of the cost after having regard to actuarial estimates of future losses.

NOTE 40: SUBORDINATED LIABILITIES

The movement in subordinated liabilities during the year was as follows:

	Preference shares £m	Preferred securities £m	Undated subordinated liabilities £m	Enhanced capital notes £m	Dated subordinated liabilities £m	Total £m
At 1 January 2015	1,091	3,819	1,852	3,683	15,597	26,042
Issued during the year:						
5.3% Subordinated Fixed Rate Notes 2045 (US$824 million)	–	–	–	–	543	543
4.582% Subordinated Fixed Rate Notes 2025 (US$1,353 million)	–	–	–	–	893	893
	–	–	–	–	1,436	1,436
Repurchases and redemptions during the year:						
6.625% Subordinated Notes 2015	–	–	–	–	(350)	(350)
4.875% Subordinated Notes 2015	–	–	–	–	(723)	(723)
7.834% Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015	–	(5)	–	–	–	(5)
8.117% Non-cumulative Perpetual Preferred Securities (Class A)	–	(250)	–	–	–	(250)
6.0884% Non-Cumulative Fixed to Floating Rate Preference Shares callable 2015	(10)	–	–	–	–	(10)
6.625% Undated Subordinated Step-Up Notes callable 2010	–	–	(5)	–	–	(5)
6.9625% Callable Subordinated Fixed to Floating Rate Notes 2020 callable 2015	–	–	–	–	(737)	(737)
5.125% Step-up Perpetual Subordinated Notes callable 2015 (Scottish Widows plc)	–	–	(560)	–	–	(560)
5.92% Non-cumulative Fixed to Floating Rate Preference shares callable 2015	(140)	–	–	–	–	(140)
Floating Rate Undated Subordinated Step-up Notes	–	–	(29)	–	–	(29)
6.05% Fixed to Floating Rate Undated Subordinated Notes	–	–	(18)	–	–	(18)
5.125% Undated Subordinated Fixed to Floating Rate Notes	–	–	(50)	–	–	(50)
5.109% Callable Fixed to Floating Rate Notes 2017	–	–	–	–	(14)	(14)
6.305% Subordinated Callable Fixed to Floating Notes 2017	–	–	–	–	(35)	(35)
6.50% Subordinated Fixed Rate Notes 2020	–	–	–	–	(764)	(764)
6% Subordinated Notes 2033	–	–	–	–	(191)	(191)
4.25% Perpetual Fixed to Floating Rate Reset Subordinated Guaranteed Notes	–	–	(276)	–	–	(276)
	(150)	(255)	(938)	–	(2,814)	(4,157)
Foreign exchange and other movements	39	184	51	(73)	(210)	(9)
At 31 December 2015	980	3,748	965	3,610	14,009	23,312

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 2015 (2014: 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 Regulation Authority.

NOTE 40: SUBORDINATED LIABILITIES continued

	Preference shares £m	Preferred securities £m	Undated subordinated liabilities £m	Enhanced capital notes £m	Dated subordinated liabilities £m	Total £m
At 1 January 2014	876	4,301	1,916	8,938	16,281	32,312
Issued during the year:						
4.5% Fixed Rate Subordinated Debt Securities due 2024 (US$1,000 million)	–	–	–	–	629	629
Exchange offer in respect of Enhanced Capital Notes	–	–	–	(4,961)	–	(4,961)
Other repurchases and redemptions during the year:						
Retail tender offer in respect of Enhanced Capital Notes	–	–	–	(58)	–	(58)
6.35% Step-up Perpetual Capital Securities callable 2013	–	(215)	–	–	–	(215)
6.071% Non-cumulative Perpetual Preferred Securities	–	(439)	–	–	–	(439)
4.875% Undated Subordinated Fixed to Floating Rate Instruments	–	–	(78)	–	–	(78)
Floating Rate Undated Subordinated Notes	–	–	(50)	–	–	(50)
11% Subordinated Bonds 2014	–	–	–	–	(250)	(250)
5.875% Subordinated Notes 2014	–	–	–	–	(150)	(150)
6.90% Perpetual Capital Securities	–	(207)	–	–	–	(207)
5.875% Subordinated Guaranteed Bonds 2014	–	–	–	–	(596)	(596)
Subordinated Step-up Floating Rate Notes 2016	–	–	–	–	(165)	(165)
Subordinated Step-up Floating Rate Notes 2016	–	–	–	–	(179)	(179)
6.75% Subordinated Callable Fixed to Floating Rate Instruments 2017	–	–	–	–	(9)	(9)
Subordinated Callable Floating Rate Instruments 2017	–	–	–	–	(36)	(36)
4.375% Callable Fixed to Floating Rate Subordinated Notes 2019	–	–	–	–	(591)	(591)
	–	(861)	(128)	(58)	(1,976)	(3,023)
Foreign exchange and other movements	215	379	64	(236)	663	1,085
At 31 December 2014	1,091	3,819	1,852	3,683	15,597	26,042

NOTE 41: 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

	2015 Number of shares	2014 Number of shares	2013 Number of shares	2015 £m	2014 £m	2013 £m
Ordinary shares of 10p (formerly 25p) each						
At 1 January	71,373,735,357	71,368,435,941	70,342,844,289	7,138	7,137	7,034
Issued in relation to the payment of coupons on certain hybrid capital securities	–	–	712,973,022	–	–	71
Issued under employee share schemes	–	5,299,416	312,618,630	–	1	32
At 31 December	71,373,735,357	71,373,735,357	71,368,435,941	7,138	7,138	7,137
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				7,146	7,146	7,145

Share issuances

No shares were issued in 2015 in respect of employee share schemes (2014: 5 million shares; 2013: 312 million shares). In 2013 the Group issued 713 million new ordinary shares in relation to payment of coupons in the year on certain hybrid capital securities that are non-cumulative.

(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);

Notes to the consolidated financial statements continued

NOTE 41: SHARE CAPITAL continued

– 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 108.

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 14 May 2015. 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 2015, 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 2015, 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 40.

NOTE 42: SHARE PREMIUM ACCOUNT

	2015 £m	2014 £m	2013 £m
At 1 January	17,281	17,279	16,872
Issued in relation to the settlement of coupons on certain hybrid capital securities	–	–	279
Issued under employee share schemes	–	2	128
Redemption of preference shares[1]	131	–	–
At 31 December	**17,412**	17,281	17,279

1 During the year ended 31 December 2015, the Company redeemed all of its outstanding 6.0884% Non-cumulative Fixed to Floating Rate Preference Shares and 5.92% Non-cumulative Fixed to Floating Rate Preference Shares at their combined sterling equivalent par value of £131 million. These preference shares had been accounted for as subordinated liabilities. On redemption an amount of £131 million was transferred from the distributable merger reserve to the share premium account.

NOTE 43: OTHER RESERVES

	2015 £m	2014 £m	2013 £m
Other reserves comprise:			
Merger reserve	7,976	8,107	8,107
Capital redemption reserve[1]	4,115	4,115	4,115
Revaluation reserve in respect of available-for-sale financial assets	(438)	(67)	(615)
Cash flow hedging reserve	727	1,139	(1,055)
Foreign currency translation reserve	(120)	(78)	(75)
At 31 December	**12,260**	13,216	10,477

1 There were no movements in this reserve during 2015, 2014 or 2013.

NOTE 43: OTHER RESERVES continued

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.

	2015 £m	2014 £m	2013 £m
Merger reserve			
At 1 January	8,107	8,107	8,107
Redemption of preference shares[1]	(131)	–	–
At 31 December	7,976	8,107	8,107

1 During the year ended 31 December 2015, the Company redeemed all of its outstanding 6.0884% Non-cumulative Fixed to Floating Rate Preference Shares and 5.92% Non-cumulative Fixed to Floating Rate Preference Shares at their combined par value of £131 million. These preference shares had been accounted for as subordinated liabilities. On redemption an amount of £131 million was transferred from the distributable merger reserve to the share premium account.

Movements in other reserves were as follows:

	2015 £m	2014 £m	2013 £m
Revaluation reserve in respect of available-for-sale financial assets			
At 1 January	(67)	(615)	399
Change in fair value of available-for-sale financial assets	(318)	690	(680)
Deferred tax	(18)	(65)	86
Current tax	2	–	3
	(334)	625	(591)
Income statement transfers:			
Disposals (note 9)	(51)	(131)	(629)
Deferred tax	3	52	191
Current tax	(1)	–	–
	(49)	(79)	(438)
Impairment	4	2	18
Deferred tax	8	–	(3)
	12	2	15
At 31 December	(438)	(67)	(615)

	2015 £m	2014 £m	2013 £m
Cash flow hedging reserve			
At 1 January	1,139	(1,055)	350
Change in fair value of hedging derivatives	537	3,896	(1,229)
Deferred tax	(186)	(765)	320
	351	3,131	(909)
Income statement transfers (note 5)	(956)	(1,153)	(550)
Deferred tax	193	216	54
	(763)	(937)	(496)
At 31 December	727	1,139	(1,055)

Notes to the consolidated financial statements continued

NOTE 43: OTHER RESERVES continued

	2015 £m	2014 £m	2013 £m
Foreign currency translation reserve			
At 1 January	(78)	(75)	(69)
Currency translation differences arising in the year	(59)	(25)	(155)
Foreign currency gains on net investment hedges (tax: £nil)	17	22	149
At 31 December	(120)	(78)	(75)

NOTE 44: RETAINED PROFITS

	2015 £m	2014 £m	2013 £m
At 1 January	5,692	4,088	5,080
Profit (loss) for the year	860	1,412	(838)
Dividends paid (note 46)	(1,070)	–	–
Issue costs of other equity instruments (net of tax) (note 45)	–	(21)	–
Distributions on other equity instruments (net of tax) (note 45)	(314)	(225)	–
Post-retirement defined benefit scheme remeasurements	(215)	539	(108)
Movement in treasury shares	(816)	(286)	(480)
Value of employee services:			
Share option schemes	107	123	142
Other employee award schemes	172	233	292
Adjustment on sale of non-controlling interest in TSB (note 55)	–	(171)	–
At 31 December	4,416	5,692	4,088

Retained profits are stated after deducting £740 million (2014: £565 million; 2013: £480 million) representing 943 million (2014: 648 million; 2013: 578 million) treasury shares held.

The payment of dividends by subsidiaries and the ability of members of the Group to lend money to other members of the Group may be subject to regulatory or legal restrictions, the availability of reserves and the financial and operating performance of the entity. Details of such restrictions and the methods adopted by the Group to manage the capital of its subsidiaries are provided under Capital Risk on page 162.

NOTE 45: OTHER EQUITY INSTRUMENTS

	2015 £m	2014 £m	2013 £m
At 1 January	5,355	–	–
Additional Tier 1 securities issued in the year:			
Sterling notes (£3,725 million nominal)	–	3,725	–
Euro notes (€750 million nominal)	–	622	–
US dollar notes ($1,675 million nominal)	–	1,008	–
At 31 December	5,355	5,355	–

The AT1 securities are Fixed Rate Resetting Perpetual Subordinated Contingent Convertible Securities with no fixed maturity or redemption date.

The principal terms of the AT1 securities are described below:

- The securities rank behind the claims against Lloyds Banking Group plc of (a) unsubordinated creditors, (b) claims which are, or are expressed to be, subordinated to the claims of unsubordinated creditors of Lloyds Banking Group plc but not further or otherwise or (c) whose claims are, or are expressed to be, junior to the claims of other creditors of Lloyds Banking Group, whether subordinated or unsubordinated, other than those whose claims rank, or are expressed to rank, pari passu with, or junior to, the claims of the holders of the AT1 Securities in a winding-up occurring prior to the Conversion Trigger.
- The securities bear a fixed rate of interest until the first call date. After the initial call date, in the event that they are not redeemed, the AT1 securities will bear interest at rates fixed periodically in advance for five year periods based on market rates.
- Interest on the securities will be due and payable only at the sole discretion of Lloyds Banking Group plc, and Lloyds Banking Group plc may at any time elect to cancel any Interest Payment (or any part thereof) which would otherwise be payable on any Interest Payment Date. There are also certain restrictions on the payment of interest as specified in the terms.
- The securities are undated and are repayable, at the option of Lloyds Banking Group plc, in whole at the first call date, or on any fifth anniversary after the first call date. In addition, the AT1 securities are repayable, at the option of Lloyds Banking Group plc, in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the PRA.
- The securities convert into ordinary shares of Lloyds Banking Group plc, at a pre-determined price, should the fully loaded Common Equity Tier 1 ratio of the Group fall below 7.0 per cent.

NOTE 46: DIVIDENDS ON ORDINARY SHARES

The directors have recommended a final dividend, which is subject to approval by the shareholders at the Annual General Meeting, of 1.5 pence per share (2014: 0.75 pence per share; 2013: nil pence per share) representing a total dividend of £1,070 million (2014: £535 million; 2013: £nil), which will be paid on 17 May 2016. The directors have also recommended a special dividend of 0.5 pence per share (2014: nil; 2013: nil) representing a total dividend of £357 million (2014: nil; 2013: nil). These financial statements do not reflect these recommended dividends.

Dividends paid during the year were as follows:

	2015 pence per share	2014 pence per share	2013 pence per share	2015 £m	2014 £m	2013 £m
Recommended by directors at previous year end	0.75	–	–	535	–	–
Interim dividend paid in the year	0.75	–	–	535	–	–
	1.50	–	–	1,070	–	–

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 2015: 24,275,824 shares, 31 December 2014: 21,158,651 shares, waived rights to all dividends), the HBOS Share Incentive Plan Trust (holding at 31 December 2015: 446,169 shares, 31 December 2014: 433,252 shares, waived rights to all dividends) the Lloyds Banking Group Employee Share Ownership Trust (holding at 31 December 2015: 164,141,179 shares, 31 December 2014: 18,704,412 shares, on which it waived rights to all dividends), Lloyds Group Holdings (Jersey) Limited (holding at 31 December 2015: 42,846 shares, 31 December 2014: 42,846 shares, waived rights to all but a nominal amount of one penny in total) and the Lloyds Banking Group Qualifying Employee Share Ownership Trust (holding at 31 December 2015: 1,398 shares, 31 December 2014: 1,398 shares, waived rights to all but a nominal amount of one penny in total).

NOTE 47: SHARE-BASED PAYMENTS

Charge to the income statement

The charge to the income statement is set out below:

	2015 £m	2014 £m	2013 £m
Deferred bonus plan	255	213	276
Executive and SAYE plans:			
Options granted in the year	12	29	42
Options granted in prior years	99	78	74
	111	107	116
Share plans:			
Shares granted in the year	15	14	3
Shares granted in prior years	6	6	4
	21	20	7
Total charge to the income statement	387	340	399

During the year ended 31 December 2015 the Group operated the following share-based payment schemes, all of which are equity settled.

Deferred bonus plans

The Group operates a number of deferred bonus plans that are equity settled. Bonuses in respect of employee performance in 2015 have been recognised in the charge in line with the proportion of the deferral period completed.

Notes to the consolidated financial statements continued

NOTE 47: SHARE-BASED PAYMENTS continued

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn schemes to save up to £500 per month and, at the expiry of a fixed term of three or five 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:

	2015		2014	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	783,626,383	48.73	500,969,617	41.16
Granted	156,797,949	60.70	326,565,564	60.02
Exercised	(32,683,177)	41.83	(7,287,899)	41.29
Forfeited	(27,740,207)	48.69	(18,949,167)	41.68
Cancelled	(24,943,674)	56.04	(15,561,144)	54.04
Expired	(4,911,054)	48.34	(2,110,588)	48.15
Outstanding at 31 December	850,146,220	50.99	783,626,383	48.73
Exercisable at 31 December	533,654	180.66	1,852	180.66

The weighted average share price at the time that the options were exercised during 2015 was £0.77 (2014: £0.77). The weighted average remaining contractual life of options outstanding at the end of the year was 1.9 years (2014: 2.6 years).

The weighted average fair value of SAYE options granted during 2015 was £0.17 (2014: £0.22). 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 2015 or 2014. The options outstanding at 31 December 2015 had an exercise price of £1.8066 (2014: £1.8066) and a weighted average remaining contractual life of 0.4 years (2014: 1.4 years).

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 is used not only to 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.

For options granted on 27 March 2014 under the Commercial Banking Transformation Plan (CBTP), the number of options that may be delivered in March 2017 may vary by a factor of 0-4 from the original 'on-target' award, depending on the degree to which the performance conditions have been met. An 'on-target' vesting is contingent upon Commercial Banking achieving £2.5 billion underlying profit and 2 per cent Return on Risk-weighted Assets ('RoRWA') on 31 December 2016. The Plan will pay out at between £1.9 billion and £3 billion underlying profit, and between 1.6 per cent and 2.5 per cent RoRWA.

Participants are not entitled to any dividends paid during the vesting period.

	2015		2014	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	233,389,084	Nil	37,354,979	Nil
Granted	9,813,363	Nil	225,424,109	Nil
Exercised	(13,313,421)	Nil	(21,870,649)	Nil
Forfeited	(8,374,250)	Nil	(7,114,199)	Nil
Lapsed	(117,179)	Nil	(405,156)	Nil
Outstanding at 31 December	221,397,597	Nil	233,389,084	Nil
Exercisable at 31 December	3,972,911	Nil	9,068,802	Nil

The weighted average fair value of options granted in the year was £0.75 (2014: £0.72). 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 2015 was £0.83 (2014: £0.75). The weighted average remaining contractual life of options outstanding at the end of the year was 6.1 years (2014: 7.0 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.

NOTE 47: SHARE-BASED PAYMENTS continued

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. Details of the performance conditions for the plan are provided in the Directors' remuneration report.

At the end of the performance period for the 2012 grant, the targets had not been fully met and therefore these awards vested in 2015 at a rate of 96.6 per cent.

	2015 Number of shares	2014 Number of shares
Outstanding at 1 January	522,836,111	548,885,895
Granted	121,676,131	120,952,253
Vested	(196,193,904)	(73,516,122)
Forfeited	(50,251,592)	(73,485,915)
Outstanding at 31 December	398,066,746	522,836,111

Awards in respect of the 2013 grant will vest in 2016 at a rate of 94.18 per cent.

The fair value calculations at 31 December 2015 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	Commercial Banking Transformation Program
Weighted average risk-free interest rate	0.76%	0.56%	0.85%	0.68%
Weighted average expected life	3.3 years	1.4 years	3.0 years	1.7 years
Weighted average expected volatility	24%	21%	28%	20%
Weighted average expected dividend yield	2.5%	2.5%	2.5%	2.5%
Weighted average share price	£0.76	£0.80	£0.80	£0.78
Weighted average exercise price	£0.61	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.

Matching shares

The Group undertakes to match shares purchased by employees up to the value of £45 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 2015 was 18,001,413 (2014: 16,248,562), with an average fair value of £0.78 (2014: £0.78), based on market prices at the date of award.

Fixed share awards

Fixed share awards were introduced in 2014 in order to ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for certain Lloyds Banking Group employees, with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements. The fixed share awards are delivered in Lloyds Banking Group shares, released over five years with 20 per cent being released each year following the year of award. The number of shares purchased in 2015 was 8,237,469 (2014: 7,761,624).

The fixed share award is not subject to any performance conditions, performance adjustment or clawback. On an employee leaving the Group, there is no change to the timeline for which shares will become unrestricted.

Notes to the consolidated financial statements continued

NOTE 48: 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:

	2015 £m	2014 £m	2013 £m
Compensation			
Salaries and other short-term benefits	14	15	15
Post-employment benefits	–	1	–
Share-based payments	18	17	21
Total compensation	32	33	36

Aggregate contributions in respect of key management personnel to defined contribution pension schemes were £0.1 million (2014: £0.1 million; 2013: £0.2 million).

	2015 million	2014 million	2013 million
Share option plans			
At 1 January	13	14	25
Granted, including certain adjustments (includes entitlements of appointed key management personnel)	3	–	5
Exercised/lapsed (includes entitlements of former key management personnel)	(7)	(1)	(16)
At 31 December	9	13	14

	2015 million	2014 million	2013 million
Share plans			
At 1 January	102	105	70
Granted, including certain adjustments (includes entitlements of appointed key management personnel)	37	19	42
Exercised/lapsed (includes entitlements of former key management personnel)	(57)	(22)	(7)
At 31 December	82	102	105

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:

	2015 £m	2014 £m	2013 £m
Loans			
At 1 January	3	2	2
Advanced (includes loans of appointed key management personnel)	4	2	2
Repayments (includes loans of former key management personnel)	(2)	(1)	(2)
At 31 December	5	3	2

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 3.99 per cent and 23.95 per cent in 2015 (2014: 0.5 per cent and 23.95 per cent; 2013: 2.5 per cent and 23.9 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2014 and 2013: £nil).

	2015 £m	2014 £m	2013 £m
Deposits			
At 1 January	16	13	10
Placed (includes deposits of appointed key management personnel)	58	32	29
Withdrawn (includes deposits of former key management personnel)	(61)	(29)	(26)
At 31 December	13	16	13

Deposits placed by key management personnel attracted interest rates of up to 4.7 per cent (2014: 4.7 per cent; 2013: 2.9 per cent).

NOTE 48: RELATED PARTY TRANSACTIONS continued

At 31 December 2015, the Group did not provide any guarantees in respect of key management personnel (2014 and 2013: none).

At 31 December 2015, 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 four directors and six connected persons (2014: £1 million with six directors and six connected persons; 2013: £1 million with six directors and five connected persons).

Subsidiaries

Details of the Group's subsidiaries and related undertakings are provided on pages 299 to 307. In accordance with IFRS 10 Consolidated financial statements, transactions and balances with subsidiaries have been eliminated on consolidation.

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. As at 31 December 2015, HM Treasury held an interest of 9.14 per cent in the Company's ordinary share capital, with its interest having fallen below 20 per cent on 11 May 2015. As a consequence of HM Treasury no longer being considered to have a significant influence, it ceased to be a related party of the Company for IAS 24 purposes at that date.

In accordance with IAS 24, UK government-controlled entities were related parties of the Group until 11 May 2015. The Group regarded the Bank of England and entities controlled by the UK government, including The Royal Bank of Scotland Group plc (RBS), NRAM plc and Bradford & Bingley plc, as related parties.

During the year ended 31 December 2015, 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 participates in the UK government's National Loan Guarantee Scheme, providing eligible UK businesses with discounted funding 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 pre-agreed period of time.

Funding for Lending

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, focusing primarily on providing small businesses with cheaper finance to invest and grow. In November 2015, the Bank of England announced that the deadline for banks to draw down their borrowing allowance would be extended for a further two years until 31 January 2018. At 31 December 2015, the Group had drawn down £32 billion (31 December 2014: £20 billion) under the Scheme.

Enterprise Finance Guarantee Scheme

The Group participates in the Enterprise Finance Guarantee Scheme which supports viable businesses with access to lending where they would otherwise be refused a loan due to a lack of lending security. The Department for Business, Innovation and Skills provides the lender with a guarantee of up to 75 per cent of the capital of each loan subject to the eligibility of the customer. As at 31 December 2015, the Group had offered 6,509 loans to customers, worth over £550 million. Under the most recent renewal of the terms of the scheme, Lloyds Bank plc and Bank of Scotland plc, on behalf of the Group, contracted with The Secretary of State for Business, Innovation and Skills.

Help to Buy

The Help to Buy Scheme is a scheme promoted by the UK 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. £3,133 million of outstanding loans at 31 December 2015 (31 December 2014: £1,950 million) had been advanced under this scheme.

Business Growth Fund

The Group has invested £176 million (31 December 2014: £118 million) in the Business Growth Fund (under which an agreement was entered into with RBS amongst others) and, as at 31 December 2015, carries the investment at a fair value of £170 million (31 December 2014: £105 million).

Big Society Capital

The Group has invested £36 million (31 December 2014: £31 million) in the Big Society Capital Fund under which an agreement was entered into with RBS amongst others.

Housing Growth Partnership

The Group has committed to invest up to £50 million into the Housing Growth Partnership under which an agreement was entered into with the Homes and Communities Agency.

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.

Notes to the consolidated financial statements continued

NOTE 48: RELATED PARTY TRANSACTIONS continued

Other related party transactions

Pension funds

The Group provides banking and some investment management services to certain of its pension funds. At 31 December 2015, customer deposits of £145 million (2014: £129 million) and investment and insurance contract liabilities of £694 million (2014: £3,278 million) related to the Group's pension funds.

Collective investment vehicles

The Group manages 168 (2014: 132) collective investment vehicles, such as Open Ended Investment Companies (OEICs) and of these 95 (2014: 80) are consolidated. The Group invested £818 million (2014: £811 million) and redeemed £616 million (2014: £984 million) in the unconsolidated collective investment vehicles during the year and had investments, at fair value, of £2,129 million (2014: £2,243 million) at 31 December. The Group earned fees of £187 million from the unconsolidated collective investment vehicles during 2015 (2014: £201 million).

Joint ventures and associates

At 31 December 2015 there were loans and advances to customers of £225 million (2014: £1,901 million) outstanding and balances within customer deposits of £8 million (2014: £24 million) relating to 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 2015, these companies had total assets of approximately £3,911 million (2014: £5,553 million), total liabilities of approximately £4,104 million (2014: £6,312 million) and for the year ended 31 December 2015 had turnover of approximately £4,660 million (2014: £5,634 million) and made a loss of approximately £181 million (2014: net loss of £272 million). In addition, the Group has provided £1,710 million (2014: £2,364 million) of financing to these companies on which it received £125 million (2014: £149 million) of interest income in the year.

NOTE 49: CONTINGENT LIABILITIES AND COMMITMENTS

Interchange fees

With respect to multi-lateral interchange fees (MIFs), the Group is not directly involved in the on-going investigations and litigation (as described below) which involve card schemes such as Visa and MasterCard. However, the Group is a member of Visa and MasterCard and other card schemes.

- The European Commission continues to pursue certain competition investigations into MasterCard and Visa probing, amongst other things, MIFs paid in respect of cards issued outside the EEA;
- Litigation continues in the English Courts against both Visa and MasterCard. This litigation has been brought by several retailers who are seeking damages for allegedly 'overpaid' MIFs. From publicly available information, it is understood these damages claims are running to different timescales with respect to the litigation process, and their outcome remains uncertain. It is also possible that new claims may be issued.

On 2 November 2015, Visa Inc announced its proposed acquisition of Visa Europe, which remains subject to completion. As set out in the announcement by the Group on 2 November, the Group's share of the sale proceeds will comprise upfront consideration of cash (the amount of which remains subject to adjustment prior to completion) and preferred stock. The preferred stock will be convertible into Class A Common Stock of Visa Inc or its equivalent upon occurrence of certain events. As part of this transaction, the Group and certain other UK banks also entered into a Loss Sharing Agreement (LSA) with Visa Inc, which clarifies how liabilities will be allocated between the parties should the litigation referred to above result in Visa Inc being liable for damages payable by Visa Europe. Visa Inc may only have recourse to the LSA once €1 billion of damages have been applied to the value of the UK preferred stock received by Visa UK members (including the Group) as part of the consideration to the transaction. The value of the preferred stock will be reduced (by making a downward adjustment to the conversion rate) in an amount equal to any covered losses. The maximum amount of liability to which the Group may be subject under the LSA is capped at the cash consideration to be received by the Group. Visa Inc may also have recourse to a general indemnity, currently in place under Visa Europe's Operating Regulations, for damages claims concerning inter or intra-regional MIF setting activities.

The ultimate impact on the Group of the above investigations and the litigation against Visa and MasterCard cannot be known before the conclusion of these matters.

LIBOR and other trading rates

In July 2014, the Group announced that it had reached settlements totalling £217 million (at 30 June 2014 exchange rates) to resolve with UK and US federal authorities legacy issues regarding the manipulation several years ago of Group companies' submissions to the British Bankers' Association (BBA) London Interbank Offered Rate (LIBOR) and Sterling Repo Rate. The Group continues to cooperate with various other government and regulatory authorities, including the Serious Fraud Office, the Swiss Competition Commission, and a number of US State Attorneys General, in conjunction with their investigations into submissions made by panel members to the bodies that set LIBOR and various other interbank offered rates.

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, Japanese Yen and Sterling LIBOR. The lawsuits, which contain broadly similar allegations, allege violations of the Sherman Antitrust Act, the Racketeer Influenced and Corrupt Organizations Act and the Commodity Exchange Act, as well as various state statutes and common law doctrines. Certain of the plaintiffs' claims, including those asserted under US anti-trust laws, have been dismissed by the US Federal Court for Southern District of New York (the District Court). That court's dismissal of plaintiffs' anti-trust claims has been appealed to the New York Federal Court of Appeal. The OTC and Exchange – Based plaintiffs' claims were dismissed in November 2015 for lack of personal jurisdiction against the Group.

Certain Group companies are also named as defendants in UK based claims raising LIBOR manipulation allegations in connection with interest rate hedging products.

It is currently not possible to predict the scope and ultimate outcome on the Group of the various outstanding regulatory investigations not encompassed by the settlements, any private lawsuits or any related challenges to the interpretation or validity of any of the Group's contractual arrangements, including their timing and scale.

NOTE 49: CONTINGENT LIABILITIES AND COMMITMENTS continued

UK shareholder litigation

In August 2014, the Group and a number of former directors were named as defendants in a claim filed in the English High Court by a number of claimants who held shares in Lloyds TSB Group plc (LTSB) prior to the acquisition of HBOS plc, alleging breaches of fiduciary and tortious duties in relation to information provided to shareholders in connection with the acquisition and the recapitalisation of LTSB. It is currently not possible to determine the ultimate impact on the Group (if any), but the Group intends to defend the claim vigorously.

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. At 31 March 2015, the end of the latest FSCS scheme year, the principal balance outstanding on these loans was £15,797 million (31 March 2014: £16,591 million). Although the substantial majority of this loan 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. The amount of future levies payable by the Group depends on a number of factors including the amounts recovered by the FSCS from asset sales, the Group's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of deposit-taking participants.

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 including open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law. 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 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. There are a number of other open matters on which the Group is in discussion with HMRC; none of these is expected to have a material impact on the financial position of the Group.

Residential mortgage repossessions

In August 2014, the Northern Ireland High Court handed down judgment in favour of the borrowers in relation to three residential mortgage test cases, concerning certain aspects of the Group's practice with respect to the recalculation of contractual monthly instalments of customers in arrears. The FCA has indicated that it will issue a Consultation Paper in relation to industry practice in this area in February 2016. The Group will respond as appropriate to this and any investigations, proceedings, or regulatory action that may in due course be instigated as a result of these issues.

The Financial Conduct Authority's announcement on time-barring for PPI complaints and Plevin v Paragon Personal Finance Limited

On 26 November 2015 the FCA issued a Consultation Paper on the introduction of a deadline by which consumers would need to make their PPI complaints or else lose their right to have them assessed by firms or the Financial Ombudsman Service, and proposed rules and guidance concerning the handling of PPI complaints in light of the Supreme Court's decision in *Plevin v Paragon Personal Finance Limited* [2014] UKSC 61 (*Plevin*). The Financial Ombudsman Service is also considering the implications of *Plevin* for PPI complaints. The implications of potential time-barring and the *Plevin* decision in terms of the scope of any court proceedings or regulatory action remain uncertain.

Other legal actions and regulatory matters

In addition, during the ordinary course of business the Group is subject to other complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, 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 at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed properly to assess the merits of the case, and no provisions are held in relation to 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.

Notes to the consolidated financial statements continued

NOTE 49: CONTINGENT LIABILITIES AND COMMITMENTS continued

	2015 £m	2014 £m
Contingent liabilities		
Acceptances and endorsements	52	59
Other:		
Other items serving as direct credit substitutes	458	330
Performance bonds and other transaction-related contingencies	2,123	2,293
	2,581	2,623
Total contingent liabilities	2,633	2,682

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.

	2015 £m	2014 £m
Commitments		
Documentary credits and other short-term trade-related transactions	–	101
Forward asset purchases and forward deposits placed	421	162
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	9,995	8,809
Other commitments	57,809	64,015
	67,804	72,824
1 year or over original maturity	44,691	34,455
Total commitments	112,916	107,542

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £63,086 million (2014: £55,029 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:

	2015 £m	2014 £m
Not later than 1 year	267	301
Later than 1 year and not later than 5 years	885	945
Later than 5 years	1,049	1,141
Total operating lease commitments	2,201	2,387

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 27), capital expenditure contracted but not provided for at 31 December 2015 amounted to £388 million (2014: £373 million). Of this amount, £380 million (2014: £368 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.

NOTE 50: 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 2015								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	58,417	–	58,417
Items in the course of collection from banks	–	–	–	–	–	697	–	697
Trading and other financial assets at fair value through profit or loss	–	42,661	97,875	–	–	–	–	140,536
Derivative financial instruments	2,686	26,781	–	–	–	–	–	29,467
Loans and receivables:								
Loans and advances to banks	–	–	–	–	25,117	–	–	25,117
Loans and advances to customers	–	–	–	–	455,175	–	–	455,175
Debt securities	–	–	–	–	4,191	–	–	4,191
	–	–	–	–	484,483	–	–	484,483
Available-for-sale financial assets	–	–	–	33,032	–	–	–	33,032
Held-to-maturity investments	–	–	–	–	–	19,808	–	19,808
Total financial assets	2,686	69,442	97,875	33,032	484,483	78,922	–	766,440
Financial liabilities								
Deposits from banks	–	–	–	–	–	16,925	–	16,925
Customer deposits	–	–	–	–	–	418,326	–	418,326
Items in course of transmission to banks	–	–	–	–	–	717	–	717
Trading and other financial liabilities at fair value through profit or loss	–	43,984	7,879	–	–	–	–	51,863
Derivative financial instruments	2,437	23,864	–	–	–	–	–	26,301
Notes in circulation	–	–	–	–	–	1,112	–	1,112
Debt securities in issue	–	–	–	–	–	82,056	–	82,056
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	80,294	80,294
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	22,777	22,777
Unallocated surplus within insurance businesses	–	–	–	–	–	–	260	260
Financial guarantees	–	–	48	–	–	–	–	48
Subordinated liabilities	–	–	–	–	–	23,312	–	23,312
Total financial liabilities	2,437	67,848	7,927	–	–	542,448	103,331	723,991

Notes to the consolidated financial statements continued

NOTE 50: FINANCIAL INSTRUMENTS continued

	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 2014								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	50,492	–	50,492
Items in the course of collection from banks	–	–	–	–	–	1,173	–	1,173
Trading and other financial assets at fair value through profit or loss	–	48,494	103,437	–	–	–	–	151,931
Derivative financial instruments	4,233	31,895	–	–	–	–	–	36,128
Loans and receivables:								
Loans and advances to banks	–	–	–	–	26,155	–	–	26,155
Loans and advances to customers	–	–	–	–	482,704	–	–	482,704
Debt securities	–	–	–	–	1,213	–	–	1,213
	–	–	–	–	510,072	–	–	510,072
Available-for-sale financial assets	–	–	–	56,493	–	–	–	56,493
Total financial assets	4,233	80,389	103,437	56,493	510,072	51,665	–	806,289
Financial liabilities								
Deposits from banks	–	–	–	–	–	10,887	–	10,887
Customer deposits	–	–	–	–	–	447,067	–	447,067
Items in course of transmission to banks	–	–	–	–	–	979	–	979
Trading and other financial liabilities at fair value through profit or loss	–	55,358	6,744	–	–	–	–	62,102
Derivative financial instruments	3,616	29,571	–	–	–	–	–	33,187
Notes in circulation	–	–	–	–	–	1,129	–	1,129
Debt securities in issue	–	–	–	–	–	76,233	–	76,233
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	86,918	86,918
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	27,248	27,248
Unallocated surplus within insurance businesses	–	–	–	–	–	–	320	320
Financial guarantees	–	–	51	–	–	–	–	51
Subordinated liabilities	–	–	–	–	–	26,042	–	26,042
Total financial liabilities	3,616	84,929	6,795	–	–	562,337	114,486	772,163

NOTE 50: FINANCIAL INSTRUMENTS continued

(2) 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. It is a measure as at a specific date and may be significantly different from the amount which will actually be paid or received on maturity or settlement 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.

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.

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, notes in circulation and liabilities arising from non-participating investment contracts.

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.

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.

Notes to the consolidated financial statements continued

NOTE 50: FINANCIAL INSTRUMENTS continued

(3) Financial assets and liabilities carried at fair value

(A) Financial assets, excluding derivatives

Valuation hierarchy

At 31 December 2015, the Group's financial assets carried at fair value, excluding derivatives, totalled £173,568 million (31 December 2014: £208,424 million). The table below analyses these financial assets by balance sheet classification, asset type and valuation methodology (level 1, 2 or 3, as described on page 251). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

Valuation hierarchy

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2015				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	30,109	–	30,109
Loans and advances to banks	–	3,065	–	3,065
Debt securities:				
Government securities	20,881	1,235	1	22,117
Other public sector securities	–	759	1,280	2,039
Bank and building society certificates of deposit	–	135	–	135
Asset-backed securities:				
Mortgage-backed securities	–	1,295	63	1,358
Other asset-backed securities	–	839	8	847
Corporate and other debt securities	38	18,241	2,037	20,316
	20,919	22,504	3,389	46,812
Equity shares	58,457	292	1,727	60,476
Treasury and other bills	74	–	–	74
Total trading and other financial assets at fair value through profit or loss	79,450	55,970	5,116	140,536
Available-for-sale financial assets				
Debt securities:				
Government securities	25,259	70	–	25,329
Bank and building society certificates of deposit	–	186	–	186
Asset-backed securities:				
Mortgage-backed securities	–	197	–	197
Other asset-backed securities	–	264	55	319
Corporate and other debt securities	7	5,801	–	5,808
	25,266	6,518	55	31,839
Equity shares	43	521	629	1,193
Treasury and other bills	–	–	–	–
Total available-for-sale financial assets	25,309	7,039	684	33,032
Total financial assets carried at fair value, excluding derivatives	104,759	63,009	5,800	173,568

NOTE 50: FINANCIAL INSTRUMENTS continued

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2014				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	28,513	–	28,513
Loans and advances to banks	–	8,212	–	8,212
Debt securities:				
Government securities	23,950	1,523	–	25,473
Other public sector securities	–	781	1,389	2,170
Bank and building society certificates of deposit	–	554	–	554
Asset-backed securities:				
Mortgage-backed securities	24	963	47	1,034
Other asset-backed securities	1	849	–	850
Corporate and other debt securities	255	19,814	2,021	22,090
	24,230	24,484	3,457	52,171
Equity shares	59,607	322	1,647	61,576
Treasury and other bills	1,459	–	–	1,459
Total trading and other financial assets at fair value through profit or loss	85,296	61,531	5,104	151,931
Available-for-sale financial assets				
Debt securities:				
Government securities	47,402	–	–	47,402
Bank and building society certificates of deposit	–	298	–	298
Asset-backed securities:				
Mortgage-backed securities	–	674	–	674
Other asset-backed securities	–	685	–	685
Corporate and other debt securities	35	5,494	–	5,529
	47,437	7,151	–	54,588
Equity shares	45	727	270	1,042
Treasury and other bills	852	11	–	863
Total available-for-sale financial assets	48,334	7,889	270	56,493
Total financial assets carried at fair value, excluding derivatives	133,630	69,420	5,374	208,424

Notes to the consolidated financial statements continued

NOTE 50: FINANCIAL INSTRUMENTS continued

Movements in Level 3 portfolio

The table below analyses movements in level 3 financial assets, excluding derivatives, carried at fair value (recurring measurement).

	2015			2014		
	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m
At 1 January	5,104	270	5,374	4,232	449	4,681
Exchange and other adjustments	–	–	–	5	(7)	(2)
Gains recognised in the income statement within other income	192	–	192	579	–	579
Gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	–	302	302	–	(61)	(61)
Purchases	965	68	1,033	552	229	781
Sales	(1,070)	(11)	(1,081)	(587)	(266)	(853)
Transfers into the level 3 portfolio	71	55	126	708	–	708
Transfers out of the level 3 portfolio	(146)	–	(146)	(385)	(74)	(459)
At 31 December	5,116	684	5,800	5,104	270	5,374
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	34	–	34	547	–	547

Valuation methodology for financial assets, excluding derivatives

Loans and advances to customers and banks

These assets are principally reverse repurchase agreements. The fair value of these assets is determined using discounted cash flow techniques. The discount rates are derived from observable repo curves specific to the type of security purchased under the reverse repurchase agreement.

Debt securities

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.

NOTE 50: FINANCIAL INSTRUMENTS continued

(B) Financial liabilities, excluding derivatives

Valuation hierarchy

At 31 December 2015, the Group's financial liabilities carried at fair value, excluding derivatives, totalled £51,911 million (31 December 2014: £62,153 million). The table below analyses these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on page 251). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2015				
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	–	7,878	1	7,879
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	38,431	–	38,431
Short positions in securities	4,153	287	–	4,440
Other	–	1,113	–	1,113
	4,153	39,831	–	43,984
Total trading and other financial liabilities at fair value through profit or loss	4,153	47,709	1	51,863
Financial guarantees	–	–	48	48
Total financial liabilities carried at fair value, excluding derivatives	4,153	47,709	49	51,911
At 31 December 2014				
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	–	6,739	5	6,744
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	50,007	–	50,007
Short positions in securities	2,700	519	–	3,219
Other	–	2,132	–	2,132
	2,700	52,658	–	55,358
Total trading and other financial liabilities at fair value through profit or loss	2,700	59,397	5	62,102
Financial guarantees	–	–	51	51
Total financial liabilities carried at fair value, excluding derivatives	2,700	59,397	56	62,153

The table below analyses movements in the level 3 financial liabilities portfolio, excluding derivatives. There were no transfers into or out of level 3 during 2014 or 2015.

	2015			2014		
	Trading and other financial liabilities at fair value through profit or loss £m	Financial guarantees £m	Total level 3 financial liabilities carried at fair value, excluding derivatives £m	Trading and other financial liabilities at fair value through profit or loss £m	Financial guarantees £m	Total level 3 financial liabilities carried at fair value, excluding derivatives £m
At 1 January	5	51	56	39	50	89
Losses (gains) recognised in the income statement within other income	–	(3)	(3)	(5)	1	(4)
Redemptions	(4)	–	(4)	(29)	–	(29)
At 31 December	1	48	49	5	51	56
Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December	–	3	3	–	1	1

Valuation methodology for financial liabilities, excluding derivatives

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. The carrying amount of the securities 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 2015, the own credit adjustment arising from the fair valuation of £7,878 million (2014: £6,739 million) of the Group's debt securities in issue designated at fair value through profit or loss resulted in a gain of £114 million (2014: gain of £33 million).

Notes to the consolidated financial statements continued

NOTE 50: FINANCIAL INSTRUMENTS continued

Trading liabilities in respect of securities sold under repurchase agreements

The fair value of these liabilities is determined using discounted cash flow techniques. The discount rates are derived from observable repo curves specific to the type of security sold under the repurchase agreement.

(C) Derivatives

All of the Group's derivative assets and liabilities are carried at fair value. At 31 December 2015, such assets totalled £29,467 million (31 December 2014: £36,128 million) and liabilities totalled £26,301 million (31 December 2014: £33,187 million). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 251). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

	2015				2014			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative assets	43	27,955	1,469	29,467	94	33,263	2,771	36,128
Derivative liabilities	(41)	(25,537)	(723)	(26,301)	(68)	(31,663)	(1,456)	(33,187)

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 £545 million (2014: £646 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.

The table below analyses movements in level 3 derivative assets and liabilities carried at fair value. Following changes in the valuation methodology in 2015, uncollateralised inflation swaps are considered not to have significant unobservable inputs and have been transferred from level 3 to level 2.

	2015		2014	
	Derivative assets £m	Derivative liabilities £m	Derivative assets £m	Derivative liabilities £m
At 1 January	2,771	(1,456)	3,019	(986)
Exchange and other adjustments	(25)	18	(11)	4
Gains (losses) recognised in the income statement within other income	(87)	(36)	755	(375)
Purchases (additions)	72	(74)	68	(59)
(Sales) redemptions	(125)	120	(154)	66
Derecognised pursuant to exchange and retail tender offers in respect of Enhanced Capital Notes	–	–	(967)	–
Transfers into the level 3 portfolio	126	(114)	114	(110)
Transfers out of the level 3 portfolio	(1,263)	819	(53)	4
At 31 December	1,469	(723)	2,771	(1,456)
Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets or liabilities held at 31 December	(95)	(12)	755	(376)

NOTE 50: 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 2015 and 2014:

	2015 £m	2014 £m
At 1 January	608	498
Income statement (credit) charge	(38)	95
Transfers	28	15
At 31 December	598	608

Represented by:

	2015 £m	2014 £m
Credit Valuation Adjustment	511	568
Debit Valuation Adjustment	(78)	(85)
Funding Valuation Adjustment	165	125
	598	608

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 £99 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 £2 million of the overall CVA balance at 31 December 2015).

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 £122 million to £200 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 £200 million fall in the overall valuation adjustment to £233 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 uncollateralised derivative positions. 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 £30 million.

(ii) 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 2015, the Group's derivative trading business held mid to bid-offer valuation adjustments of £76 million (2014: £74 million).

Notes to the consolidated financial statements continued

NOTE 50: FINANCIAL INSTRUMENTS continued

(D) Sensitivity of level 3 valuations

			At 31 December 2015			At 31 December 2014		
				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) (168bps/211bps)	92	7	(7)	35	5	(5)
Asset-backed securities	Lead manager or broker quote	n/a	62	–	–	65	–	(2)
Equity and venture capital investments	Market approach	Earnings multiple (1.0/17.5)	2,279	72	(72)	2,214	75	(75)
	Underlying asset/ net asset value (incl. property prices)[3]	n/a	145	8	(14)	173	26	(23)
Unlisted equities and debt securities, property partnerships in the life funds	Underlying asset/ net asset value (incl. property prices)[3]	n/a	2,538	–	(48)	2,617	4	(2)
			5,116			5,104		
Available-for-sale financial assets								
Asset-backed securities	Lead manager or broker quote/consensus pricing	n/a	55	–	–	–	–	–
Equity and venture capital investments	Underlying asset/net asset value (incl. property prices)[3]	n/a	339	25	(27)	270	10	(18)
Other	Various	n/a	290	–	–	–	–	–
			684			270		
Derivative financial assets								
Embedded equity conversion feature	Lead manager or broker quote	Equity conversion feature spread (171 bps/386 bps)	545	14	(14)	646	21	(21)
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (55 bps/107 bps)	–	–	–	1,382	17	(16)
	Option pricing model	Interest rate volatility (1%/63%)	924	20	(19)	743	6	(6)
			1,469			2,771		
Level 3 financial assets carried at fair value			7,269			8,145		
Trading and other financial liabilities at fair value through profit or loss			1	–	–	5	–	–
Derivative financial liabilities								
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (55 bps/107 bps)	–	–	–	807	–	–
	Option pricing model	Interest rate volatility (1%/63%)	723	–	–	649	–	–
			723			1,456		
Financial guarantees			48			51		
Level 3 financial liabilities carried at fair value			772			1,512		

[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] Underlying asset/net asset values represent fair value.

NOTE 50: 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 55 bps and 107 bps (2014: 3 bps and 167 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 1 per cent to 63 per cent (2014: 4 per cent and 120 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.

Notes to the consolidated financial statements continued

NOTE 50: FINANCIAL INSTRUMENTS continued

(4) Financial assets and liabilities carried at amortised cost

(A) Financial assets

Valuation hierarchy

The table below analyses the fair values of the financial assets of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 251). Loans and receivables are mainly classified as level 3 due to significant unobservable inputs used in the valuation models. Where inputs are observable, debt securities are classified as level 1 or 2.

			Valuation hierarchy		
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2015					
Loans and receivables:					
Loans and advances to customers: unimpaired	**448,010**	**447,808**	**–**	**–**	**447,808**
Loans and advances to customers: impaired	**7,165**	**6,989**	**–**	**–**	**6,989**
Loans and advances to customers	**455,175**	**454,797**	**–**	**–**	**454,797**
Loans and advances to banks	**25,117**	**25,130**	**–**	**–**	**25,130**
Debt securities	**4,191**	**4,107**	**7**	**4,090**	**10**
Held-to-maturity investments	**19,808**	**19,851**	**19,851**	**–**	**–**
Reverse repos included in above amounts:					
Loans and advances to customers	**–**	**–**	**–**	**–**	**–**
Loans and advances to banks	**963**	**963**	**–**	**–**	**963**
At 31 December 2014					
Loans and receivables:					
Loans and advances to customers: unimpaired	473,947	472,036	–	–	472,036
Loans and advances to customers: impaired	8,757	8,595	–	–	8,595
Loans and advances to customers	482,704	480,631	–	–	480,631
Loans and advances to banks	26,155	26,031	–	–	26,031
Debt securities	1,213	1,100	7	1,050	43
Reverse repos included in above amounts:					
Loans and advances to customers	5,148	5,148	–	–	5,148
Loans and advances to banks	1,899	1,899	–	–	1,899

Valuation methodology

Loans and advances to customers

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates due to their short term nature. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value.

To determine the fair value of loans and advances to customers, loans are segregated into portfolios of similar characteristics. A number of techniques are used to estimate the fair value of fixed rate lending; these take account of expected credit losses based on historic trends, prevailing market interest rates and expected future cash flows. For retail exposures, fair value is usually 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 commercial 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. No adjustment is made to put it in place by the Group to manage its interest rate exposure.

Loans and advances to banks

The carrying value of short dated loans and advances to banks is assumed to be their fair value. The fair value of loans and advances to banks is estimated by discounting the anticipated cash flows at a market discount rate adjusted for the credit spread of the obligor or, where not observable, the credit spread of borrowers of similar credit quality.

Debt securities

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.

Reverse repurchase agreements

The carrying amount is deemed a reasonable approximation of fair value given the short-term nature of these instruments.

NOTE 50: FINANCIAL INSTRUMENTS continued

(B) Financial liabilities

Valuation hierarchy

The table below analyses the fair values of the financial liabilities of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 251).

	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2015					
Deposits from banks	**16,925**	**16,934**	**–**	**16,934**	**–**
Customer deposits	**418,326**	**418,512**	**–**	**407,417**	**11,095**
Debt securities in issue	**82,056**	**85,093**	**–**	**81,132**	**3,961**
Subordinated liabilities	**23,312**	**26,818**	**–**	**26,818**	**–**
Repos included in above amounts:					
Deposits from banks	**7,061**	**7,061**	**–**	**7,061**	**–**
Customer deposits	**–**	**–**	**–**	**–**	**–**
At 31 December 2014					
Deposits from banks	10,887	10,902	–	10,902	–
Customer deposits	447,067	450,038	–	435,073	14,965
Debt securities in issue	76,233	80,244	–	80,244	–
Subordinated liabilities	26,042	30,175	–	30,175	–
Repos included in above amounts:					
Deposits from banks	1,075	1,075	–	1,075	–
Customer deposits	–	–	–	–	–

Valuation methodology

Deposits from banks and customer deposits

The fair value of bank and customer deposits repayable on demand is assumed to be equal to their carrying value.

The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Debt securities in issue

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities is calculated based on quoted market prices where available. Where quoted market prices are not available, fair value is estimated using discounted cash flow techniques at a rate which reflects market rates of interest and the Group's own credit spread.

Subordinated liabilities

The fair value of subordinated liabilities is determined by reference to quoted market prices where available or by reference to quoted market prices of similar instruments. Subordinated liabilities are classified as level 2, since the inputs used to determine their fair value are largely observable.

Repurchase agreements

The carrying amount is deemed a reasonable approximation of fair value given the short term nature of these instruments.

(5) Reclassification of financial assets

In 2015 the Group reviewed its approach to managing a portfolio of government securities held as a separately identifiable component of the Group's liquidity portfolio. Given the long-term nature of this portfolio, the Group concluded that certain of these securities will be able to be held until they reach maturity. Consequently, on 1 May 2015, government securities with a fair value of £19,938 million were reclassified from available-for-sale financial assets to held-to-maturity investments reflecting the Group's positive intent and ability to hold them until maturity.

No financial assets were reclassified in 2014.

Notes to the consolidated financial statements continued

NOTE 51: TRANSFERS OF FINANCIAL ASSETS

(1) 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 19, 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 32). Except as otherwise noted below, none of the liabilities shown in the table below have recourse only to the transferred assets.

	2015		2014	
	Carrying value of transferred assets £m	**Carrying value of associated liabilities £m**	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	**13,711**	**7,460**	16,803	6,673
Available-for-sale financial assets	**18,141**	**14,295**	18,835	10,301
Loans and receivables:				
Loans and advances to customers	**1,491**	**–**	2,353	908
Debt securities classified as loans and receivables	**–**	**–**	88	–
Securitisation programmes				
Loans and receivables:				
Loans and advances to customers[1]	**58,090**	**7,763**	75,970	11,908

1 The carrying value of associated liabilities excludes securitisation notes held by the Group of £29,303 million (31 December 2014: £38,149 million).

(2) Transferred financial assets derecognised in their entirety with ongoing exposure

Transferred financial assets which were derecognised in their entirety, but with ongoing exposure, consisted of £9 million of debt securities (2014: £33 million) with a fair value of £9 million (2014: £33 million) and a maximum exposure to loss of £9 million (2014: £33 million).

NOTE 52: OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES

The following information relates to financial assets and liabilities which have been offset in the balance sheet and those which have not been offset but for which the Group has enforceable master netting agreements in place with counterparties.

At 31 December 2015	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3]		Potential net amounts if offset of related amounts permitted £m
				Cash collateral received/ pledged £m	Non-cash collateral received/ pledged £m	
Financial assets						
Trading and other financial assets at fair value through profit or loss:						
Excluding reverse repos	107,362	–	107,362	–	(7,175)	100,187
Reverse repos	39,083	(5,909)	33,174	–	(33,174)	–
	146,445	(5,909)	140,536	–	(40,349)	100,187
Derivative financial instruments	62,937	(33,470)	29,467	(3,228)	(20,091)	6,148
Loans and advances to banks:						
Excluding reverse repos	24,154	–	24,154	(1,810)	–	22,344
Reverse repos	963	–	963	–	(963)	–
	25,117	–	25,117	(1,810)	(963)	22,344
Loans and advances to customers:						
Excluding reverse repos	457,546	(2,371)	455,175	(1,001)	(7,250)	446,924
Reverse repos	–	–	–	–	–	–
	457,546	(2,371)	455,175	(1,001)	(7,250)	446,924
Debt securities	4,191	–	4,191	–	–	4,191
Available-for-sale financial assets	33,032	–	33,032	–	(13,895)	19,137
Held-to-maturity investments	19,808	–	19,808	–	–	19,808
Financial liabilities						
Deposits from banks:						
Excluding repos	9,864	–	9,864	(2,770)	(1,387)	5,707
Repos	7,061	–	7,061	–	(7,061)	–
	16,925	–	16,925	(2,770)	(8,448)	5,707
Customer deposits:						
Excluding repos	420,330	(2,004)	418,326	(458)	(7,250)	410,618
Repos	–	–	–	–	–	–
	420,330	(2,004)	418,326	(458)	(7,250)	410,618
Trading and other financial liabilities at fair value through profit or loss:						
Excluding repos	13,432	–	13,432	–	–	13,432
Repos	44,340	(5,909)	38,431	–	(38,431)	–
	57,772	(5,909)	51,863	–	(38,431)	13,432
Derivative financial instruments	60,138	(33,837)	26,301	(2,811)	(22,586)	904

Notes to the consolidated financial statements continued

NOTE 52: OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES continued

At 31 December 2014	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3]: Cash collateral received/ pledged £m	Related amounts where set off in the balance sheet not permitted[3]: Non-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:						
Excluding reverse repos	115,206	–	115,206	–	(6,670)	108,536
Reverse repos	42,640	(5,915)	36,725	–	(36,725)	–
	157,846	(5,915)	151,931	–	(43,395)	108,536
Derivative financial instruments	72,378	(36,250)	36,128	(3,651)	(22,336)	10,141
Loans and advances to banks:						
Excluding reverse repos	24,256	–	24,256	(2,133)	–	22,123
Reverse repos	1,899	–	1,899	–	(1,899)	–
	26,155	–	26,155	(2,133)	(1,899)	22,123
Loans and advances to customers:						
Excluding reverse repos	480,376	(2,820)	477,556	(1,254)	(4,967)	471,335
Reverse repos	5,148	–	5,148	–	(5,148)	–
	485,524	(2,820)	482,704	(1,254)	(10,115)	471,335
Debt securities	1,213	–	1,213	–	–	1,213
Available-for-sale financial assets	56,493	–	56,493	–	(10,299)	46,194
Financial liabilities						
Deposits from banks:						
Excluding repos	9,812	–	9,812	(3,119)	–	6,693
Repos	1,075	–	1,075	–	(1,075)	–
	10,887	–	10,887	(3,119)	(1,075)	6,693
Customer deposits:						
Excluding repos	449,361	(2,294)	447,067	(532)	(4,094)	442,441
Repos	–	–	–	–	–	–
	449,361	(2,294)	447,067	(532)	(4,094)	442,441
Trading and other financial liabilities at fair value through profit or loss:						
Excluding repos	12,095	–	12,095	–	–	12,095
Repos	55,922	(5,915)	50,007	–	(50,007)	–
	68,017	(5,915)	62,102	–	(50,007)	12,095
Derivative financial instruments	69,963	(36,776)	33,187	(3,387)	(25,559)	4,241

1 After impairment allowance.

2 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.

3 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 53: 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 111 to 169. 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

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.

At 31 December 2015 the aggregate notional principal of interest rate swaps designated as fair value hedges was £121,063 million (2014: £115,394 million) with a net fair value asset of £848 million (2014: asset of £1,511 million) (note 16). The losses on the hedging instruments were £618 million (2014: losses of £2,866 million). The gains on the hedged items attributable to the hedged risk were £511 million (2014: gains of £2,720 million).

In addition the Group has cash flow hedges which are primarily used to hedge the variability in the cost of funding within the commercial business. Note 16 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 2015 was £460,829 million (2014: £518,746 million) with a net fair value liability of £718 million (2014: liability of £930 million) (note 16). In 2015, ineffectiveness recognised in the income statement that arises from cash flow hedges was a gain of £3 million (2014: gain of £56 million).

Currency risk

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 150.

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 2015 the aggregate principal of these currency borrowings was £670 million (2014: £587 million). In 2015, an ineffectiveness gain of £5 million before tax and £4 million after tax (2014: 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 and Europe. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

Functional currency of Group operations

	Euro £m	US Dollar £m	Other non-sterling £m
31 December 2015			
Gross exposure	**246**	**447**	**32**
Net investment hedges	**(254)**	**(415)**	**(1)**
Total structural foreign currency exposures, after net investment hedges	**(8)**	**32**	**31**
31 December 2014			
Gross exposure	286	392	100
Net investment hedges	(218)	(342)	(27)
Total structural foreign currency exposures, after net investment hedges	68	50	73

Notes to the consolidated financial statements continued

NOTE 53: 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. Information about the Group's exposure to credit risk, credit risk management, measurement and mitigation can be found on pages 121 to 143.

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.

	At 31 December 2015			At 31 December 2014		
	Maximum exposure £m	Offset[2] £m	Net exposure £m	Maximum exposure £m	Offset[2] £m	Net exposure £m
Loans and receivables:						
Loans and advances to banks, net[1]	25,117	–	25,117	26,155	–	26,155
Loans and advances to customers, net[1]	455,175	(7,250)	447,925	482,704	(4,094)	478,610
Debt securities, net[1]	4,191	–	4,191	1,213	–	1,213
	484,483	(7,250)	477,233	510,072	(4,094)	505,978
Available-for-sale financial assets[3]	31,839	–	31,839	55,451	–	55,451
Held-to-maturity investments	19,808	–	19,808	–	–	–
Trading and other financial assets at fair value through profit or loss:[3,4]						
Loans and advances	33,174	–	33,174	36,725	–	36,725
Debt securities, treasury and other bills	46,886	–	46,886	53,630	–	53,630
	80,060	–	80,060	90,355	–	90,355
Derivative assets	29,467	(19,466)	10,001	36,128	(21,929)	14,199
Assets arising from reinsurance contracts held	675	–	675	682	–	682
Financial guarantees	7,165	–	7,165	7,161	–	7,161
Off-balance sheet items:						
Acceptances and endorsements	52	–	52	59	–	59
Other items serving as direct credit substitutes	458	–	458	330	–	330
Performance bonds and other transaction-related contingencies	2,123	–	2,123	2,293	–	2,293
Irrevocable commitments	63,086	–	63,086	55,029	–	55,029
	65,719	–	65,719	57,711	–	57,711
	719,216	(26,716)	692,500	757,560	(26,023)	731,537

1 Amounts shown net of related impairment allowances.

2 Offset items comprise deposit amounts available for offset and amounts available for offset under master netting arrangements that 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.

3 Excluding equity shares.

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.

B. Concentrations of exposure

The Group's management of concentration risk includes single name, industry sector and country limits as well as controls over the Group's overall exposure to certain products. Further information on the Group's management of this risk is included within Credit risk mitigation, Risk management on page 122.

At 31 December 2015 the most significant concentrations of exposure were in mortgages (comprising 68 per cent of total loans and advances to customers) and to financial, business and other services (comprising 9 per cent of the total). For further information on concentrations of the Group's loans, refer to note 18.

Following the continuing reduction in the Group's non-UK activities, an analysis of credit risk exposures by geographical region has not been provided.

NOTE 53: FINANCIAL RISK MANAGEMENT continued

C. Credit quality of assets

Loans and receivables

The disclosures in the table below and those on pages 268 and 269 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 commercial 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 commercial are exposures to corporate customers and other large institutions.

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	Commercial £m	Total £m	
At 31 December 2015						
Neither past due nor impaired	25,006	302,063	38,886	100,001	440,950	33,174
Past due but not impaired	111	8,233	393	463	9,089	–
Impaired – no provision required	–	732	690	1,092	2,514	–
– provision held	–	3,269	911	2,896	7,076	–
Gross	25,117	314,297	40,880	104,452	459,629	33,174
Allowance for impairment losses	–	(1,617)	(448)	(2,107)	(4,172)	–
Fair value adjustments	–				(282)	–
Net balance sheet carrying value	25,117				455,175	33,174
At 31 December 2014						
Neither past due nor impaired	26,003	320,324	37,886	106,768	464,978	36,725
Past due but not impaired	152	10,311	674	488	11,473	–
Impaired – no provision required	–	578	938	847	2,363	–
– provision held	–	3,766	1,109	7,070	11,945	–
Gross	26,155	334,979	40,607	115,173	490,759	36,725
Allowance for impairment losses	–	(1,702)	(577)	(5,373)	(7,652)	–
Fair value adjustments	–				(403)	–
Net balance sheet carrying value	26,155				482,704	36,725

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2(H). Included in loans and receivables are advances which are individually determined to be impaired with a gross amount before impairment allowances of £4,406 million (31 December 2014: £8,522 million).

The table below sets out the reconciliation of the allowance for impairment losses of £3,033 million (2014: £6,414 million) shown in note 21 to the allowance for impairment losses on an underlying basis of £4,172 million (2014: £7,652 million) shown above:

	2015 £m	2014 £m
Allowance for impairment losses on loans and advances to customers	3,033	6,414
HBOS allowance at 16 January 2009[1]	11,147	11,147
HBOS charge covered by fair value adjustments[2]	12,166	12,066
Amounts subsequently written off	(22,623)	(22,426)
	690	787
Foreign exchange and other movements	449	451
Allowance for impairment losses on loans and advances to customers on an underlying basis	4,172	7,652

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.

Notes to the consolidated financial statements continued

NOTE 53: 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				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	
At 31 December 2015						
Good quality	24,670	301,403	33,589	63,453		33,156
Satisfactory quality	311	527	4,448	28,899		15
Lower quality	4	27	476	7,210		3
Below standard, but not impaired	21	106	373	439		–
Total loans and advances which are neither past due nor impaired	25,006	302,063	38,886	100,001	440,950	33,174
At 31 December 2014						
Good quality	25,654	318,967	30,993	65,106		36,482
Satisfactory quality	263	1,159	5,675	28,800		238
Lower quality	49	72	623	11,204		5
Below standard, but not impaired	37	126	595	1,658		–
Total loans and advances which are neither past due nor impaired	26,003	320,324	37,886	106,768	464,978	36,725

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and commercial are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Commercial 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 121.

Loans and advances which are past due but not impaired

	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	Commercial £m	Total £m	
At 31 December 2015						
0-30 days	111	4,066	276	248	4,590	–
30-60 days	–	1,732	81	100	1,913	–
60-90 days	–	1,065	9	52	1,126	–
90-180 days	–	1,370	8	19	1,397	–
Over 180 days	–	–	19	44	63	–
Total loans and advances which are past due but not impaired	111	8,233	393	463	9,089	–
At 31 December 2014						
0-30 days	152	4,854	453	198	5,505	–
30-60 days	–	2,309	110	51	2,470	–
60-90 days	–	1,427	90	139	1,656	–
90-180 days	–	1,721	5	38	1,764	–
Over 180 days	–	–	16	62	78	–
Total loans and advances which are past due but not impaired	152	10,311	674	488	11,473	–

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

NOTE 53: 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:

	2015			2014		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Asset-backed securities:						
Mortgage-backed securities	2,528	–	2,528	190	–	190
Other asset-backed securities	1,140	94	1,234	780	205	985
	3,668	94	3,762	970	205	1,175
Corporate and other debt securities	417	109	526	–	164	164
Gross exposure	4,085	203	4,288	970	369	1,339
Allowance for impairment losses			(97)			(126)
Total debt securities classified as loans and receivables			4,191			1,213

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2015: £87 million; 2014: £198 million) and not rated (2015: £116 million; 2014: £171 million).

Available-for-sale financial assets (excluding equity shares)

An analysis of the Group's available-for-sale financial assets is included in note 22. The credit quality of the Group's available-for-sale financial assets (excluding equity shares) is set out below:

	2015			2014		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Debt securities:						
Government securities	25,329	–	25,329	47,402	–	47,402
Bank and building society certificates of deposit	186	–	186	298	–	298
Asset-backed securities:						
Mortgage-backed securities	197	–	197	674	–	674
Other asset-backed securities	315	4	319	681	4	685
	512	4	516	1,355	4	1,359
Corporate and other debt securities	5,808	–	5,808	5,490	39	5,529
Total debt securities	31,835	4	31,839	54,545	43	54,588
Treasury bills and other bills	–	–	–	863	–	863
Total held as available-for-sale financial assets	31,835	4	31,839	55,408	43	55,451

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2015: £4 million; 2014: £20 million) and not rated (2015: £nil; 2014: £23 million).

Held-to-maturity investments

An analysis of the credit quality of the Group's held-to-maturity investments at 31 December 2015 is set out below:

	Investment grade[1] £m	Other £m	Total £m
Government securities	19,808	–	19,808

1 Credit ratings equal to or better than 'BBB'.

The Group did not carry any held-to-maturity investments at 31 December 2014.

Notes to the consolidated financial statements continued

NOTE 53: 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 15. 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:

	2015			2014		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Debt securities, treasury and other bills held at fair value through profit or loss						
Trading assets:						
Government securities	8,269	–	8,269	7,976	–	7,976
Bank and building society certificates of deposit	–	–	–	554	–	554
Asset-backed securities:						
Mortgage-backed securities	516	–	516	187	–	187
Other asset-backed securities	85	–	85	117	12	129
	601	–	601	304	12	316
Corporate and other debt securities	582	30	612	1,288	198	1,486
Total debt securities held as trading assets	9,452	30	9,482	10,122	210	10,332
Treasury bills and other bills	–	–	–	1,437	–	1,437
Total held as trading assets	9,452	30	9,482	11,559	210	11,769
Other assets held at fair value through profit or loss:						
Government securities	13,848	–	13,848	17,496	1	17,497
Other public sector securities	2,023	16	2,039	2,170	–	2,170
Bank and building society certificates of deposit	135	–	135	–	–	–
Asset-backed securities:						
Mortgage-backed securities	801	41	842	845	2	847
Other asset-backed securities	762	–	762	699	22	721
	1,563	41	1,604	1,544	24	1,568
Corporate and other debt securities	17,371	2,333	19,704	18,119	2,485	20,604
Total debt securities held at fair value through profit or loss	34,940	2,390	37,330	39,329	2,510	41,839
Treasury bills and other bills	74	–	74	22	–	22
Total other assets held at fair value through profit or loss	35,014	2,390	37,404	39,351	2,510	41,861
Total held at fair value through profit or loss	44,466	2,420	46,886	50,910	2,720	53,630

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2015: £544 million; 2014: £629 million) and not rated (2015: £1,876 million; 2014: £2,091 million).

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.

NOTE 53: FINANCIAL RISK MANAGEMENT continued

Derivative assets

An analysis of derivative assets is given in note 16. 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 £10,001 million (2014: £14,199 million), cash collateral of £3,228 million (2014: £3,651 million) was held and a further £94 million was due from OECD banks (2014: £2,043 million).

	2015			2014		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Trading and other	24,764	2,017	26,781	26,574	5,321	31,895
Hedging	2,653	33	2,686	4,185	48	4,233
Total derivative financial instruments	27,417	2,050	29,467	30,759	5,369	36,128

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2015: £1,418 million; 2014: £1,896 million) and not rated (2015: £632 million; 2014: £3,473 million).

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.

D. Collateral held as security for financial assets

A general description of collateral held as security in respect of financial instruments is provided on page 123. 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

There were reverse repurchase agreements which are accounted for as collateralised loans within loans and advances to banks with a carrying value of £963 million (2014: £1,899 million), against which the Group held collateral with a fair value of £1,009 million (2014: £1,886 million).

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Loans and advances to customers

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.

	2015				2014			
	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70 per cent	211,631	4,907	1,965	218,503	202,789	4,895	1,601	209,285
70 per cent to 80 per cent	45,764	1,350	671	47,785	58,837	1,998	726	61,561
80 per cent to 90 per cent	27,529	935	528	28,992	32,771	1,526	702	34,999
90 per cent to 100 per cent	10,908	610	247	11,765	15,858	1,005	486	17,349
Greater than 100 per cent	6,231	431	590	7,252	10,069	887	829	11,785
Total	302,063	8,233	4,001	314,297	320,324	10,311	4,344	334,979

Notes to the consolidated financial statements continued

NOTE 53: FINANCIAL RISK MANAGEMENT continued

Other

The majority of non-mortgage retail lending is unsecured. At 31 December 2015, impaired non-mortgage lending amounted to £1,153 million, net of an impairment allowance of £448 million (2014: £1,470 million, net of an impairment allowance of £577 million). The fair value of the collateral held in respect of this lending was £107 million (2014: £110 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 £39,279 million (2014: £38,560 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.

Commercial lending

Reverse repurchase transactions

At 31 December 2014 there were reverse repurchase agreements which were accounted for as collateralised loans with a carrying value of £5,148 million, against which the Group held collateral with a fair value of £5,155 million, all of which the Group was able to repledge. Included in these amounts were collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £35 million. These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

There were no such transactions in 2015.

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 2015, impaired secured commercial lending amounted to £1,245 million, net of an impairment allowance of £577 million (2014: £2,539 million, net of an impairment allowance of £3,799 million). The fair value of the collateral held in respect of impaired secured commercial lending was £1,367 million (2014: £2,517 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 commercial 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 commercial 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 commercial lending amounted to £51,298 million (2014: £57,647 million).

For unimpaired secured commercial 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 commercial 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 commercial lending portfolio is provided to key management personnel.

Trading and other financial assets at fair value through profit or loss (excluding equity shares)

Included in trading and other financial assets at fair value through profit or loss are reverse repurchase agreements treated as collateralised loans with a carrying value of £33,174 million (2014: £36,725 million). Collateral is held with a fair value of £36,493 million (2014: £42,858 million), all of which the Group is able to repledge. At 31 December 2015, £15,438 million had been repledged (2014: £10,319 million).

In addition, securities held as collateral in the form of stock borrowed amounted to £58,621 million (2014: £33,721 million). Of this amount, £29,859 million (2014: £32,686 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.

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 £10,001 million (2014: £14,199 million), cash collateral of £3,228 million (2014: £3,651 million) was held.

Irrevocable loan commitments and other credit-related contingencies

At 31 December 2015, the Group held irrevocable loan commitments and other credit-related contingencies of £65,719 million (2014: £57,711 million). Collateral is held as security, in the event that lending is drawn down, on £9,551 million (2014: £8,673 million) of these balances.

Collateral repossessed

During the year, £203 million of collateral was repossessed (2014: £828 million), consisting primarily of residential property.

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

NOTE 53: FINANCIAL RISK MANAGEMENT continued

collateral against commercial lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

E. Collateral pledged as security

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.

Repurchase transactions

Deposits from banks

Included in deposits from banks are deposits held as collateral for facilities granted, with a carrying value of £7,061 million (2014: £1,075 million) and a fair value of £6,707 million (2014: £1,075 million).

Customer deposits

Customer deposits included no deposits held as collateral for facilities granted (2014: £nil). Collateral balances in the form of cash provided in respect of repurchase agreements amounted to £5 million (2014: £6 million).

Trading and other financial liabilities at fair value through profit or loss

The fair value of collateral pledged in respect of repurchase transactions, accounted for as secured borrowing, where the secured party is permitted by contract or custom to repledge was £44,655 million (2014: £56,696 million).

Securities lending transactions

The following on balance sheet financial assets have been lent to counterparties under securities lending transactions:

	2015 £m	2014 £m
Trading and other financial assets at fair value through profit or loss	6,478	9,955
Loans and advances to customers	1,491	1,393
Debt securities classified as loans and receivables	–	88
Available-for-sale financial assets	4,247	8,363
	12,216	19,799

Securitisations and covered bonds

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 19 and 20.

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. Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturity. 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.

Notes to the consolidated financial statements continued

NOTE 53: FINANCIAL RISK MANAGEMENT continued

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 2015									
Assets									
Cash and balances at central banks	58,411	2	4	–	–	–	–	–	58,417
Trading and other financial assets at fair value through profit or loss	25,696	12,877	6,526	3,008	680	1,495	6,411	83,843	140,536
Derivative financial instruments	1,226	1,257	841	585	607	1,480	3,889	19,582	29,467
Loans and advances to banks	9,802	4,676	4,157	915	1,095	1,784	2,076	612	25,117
Loans and advances to customers	19,392	6,351	11,864	8,318	11,426	28,061	68,685	301,078	455,175
Debt securities held as loans and receivables	9	–	–	1	98	208	28	3,847	4,191
Available-for-sale financial assets	109	269	56	535	120	1,000	7,178	23,765	33,032
Held-to-maturity investments	–	–	–	–	–	297	3,357	16,154	19,808
Other assets	4,620	1,068	884	1,589	1,421	2,204	9,561	19,598	40,945
Total assets	119,265	26,500	24,332	14,951	15,447	36,529	101,185	468,479	806,688
Liabilities									
Deposits from banks	6,586	1,076	5,958	42	132	22	2,543	566	16,925
Customer deposits	340,445	20,365	13,758	10,584	9,277	15,927	6,742	1,228	418,326
Derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	24,326	14,191	5,070	1,625	806	4,020	5,135	22,991	78,164
Debt securities in issue	5,822	7,273	5,556	4,757	1,661	11,697	21,984	23,306	82,056
Liabilities arising from insurance and investment contracts	1,580	1,558	2,279	2,066	2,269	7,817	20,674	64,828	103,071
Other liabilities	4,240	2,800	449	2,326	1,906	634	5,079	20,420	37,854
Subordinated liabilities	269	307	329	466	2,083	648	9,321	9,889	23,312
Total liabilities	383,268	47,570	33,399	21,866	18,134	40,765	71,478	143,228	759,708
At 31 December 2014									
Assets									
Cash and balances at central banks	50,476	1	13	2	–	–	–	–	50,492
Trading and other financial assets at fair value through profit or loss	31,766	10,523	6,818	2,982	1,526	1,880	5,976	90,460	151,931
Derivative financial instruments	1,460	1,562	1,096	867	562	2,326	4,627	23,628	36,128
Loans and advances to banks	10,709	4,926	3,107	1,274	1,170	1,107	2,579	1,283	26,155
Loans and advances to customers	20,072	11,026	10,860	10,216	11,332	27,292	80,257	311,649	482,704
Debt securities held as loans and receivables	–	–	–	–	–	32	4	1,177	1,213
Available-for-sale financial assets	963	1,533	724	28	203	939	6,085	46,018	56,493
Other assets	4,684	1,284	1,347	1,933	1,393	4,801	9,490	24,848	49,780
Total assets	120,130	30,855	23,965	17,302	16,186	38,377	109,018	499,063	854,896
Liabilities									
Deposits from banks	4,270	1,711	603	530	176	93	2,840	664	10,887
Customer deposits	364,040	13,852	14,051	12,706	11,517	20,845	9,528	528	447,067
Derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	34,690	14,446	5,078	3,708	846	3,867	6,461	26,193	95,289
Debt securities in issue	8,862	5,678	2,850	5,024	3,409	7,257	17,330	25,823	76,233
Liabilities arising from insurance and investment contracts	1,436	1,693	2,434	2,286	2,303	8,232	20,969	74,813	114,166
Other liabilities	4,689	4,473	313	1,788	2,425	518	2,829	18,274	35,309
Subordinated liabilities	74	1,241	1,331	10	192	3,174	5,428	14,592	26,042
Total liabilities	418,061	43,094	26,660	26,052	20,868	43,986	65,385	160,887	804,993

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.

NOTE 53: FINANCIAL RISK MANAGEMENT continued

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 2015						
Deposits from banks	6,673	1,143	6,156	2,785	400	17,157
Customer deposits	339,387	21,234	34,012	23,932	312	418,877
Trading and other financial liabilities at fair value through profit or loss	15,055	15,465	5,365	5,897	10,662	52,444
Debt securities in issue	7,526	9,131	18,467	34,515	24,540	94,179
Liabilities arising from non-participating investment contracts	22,777	–	–	–	–	22,777
Subordinated liabilities	522	366	4,132	13,238	20,476	38,734
Total non-derivative financial liabilities	391,940	47,339	68,132	80,367	56,390	644,168
Derivative financial liabilities:						
Gross settled derivatives – outflows	31,932	28,059	27,510	29,962	28,508	145,971
Gross settled derivatives – inflows	(30,432)	(26,967)	(26,337)	(27,883)	(26,521)	(138,140)
Gross settled derivatives – net flows	1,500	1,092	1,173	2,079	1,987	7,831
Net settled derivatives liabilities	16,600	115	321	953	2,587	20,576
Total derivative financial liabilities	18,100	1,207	1,494	3,032	4,574	28,407
At 31 December 2014						
Deposits from banks	4,288	1,734	1,427	2,895	954	11,298
Customer deposits	365,261	13,672	38,520	31,614	578	449,645
Trading and other financial liabilities at fair value through profit or loss	32,209	15,145	1,316	3,658	7,508	59,836
Debt securities in issue	11,070	6,163	15,186	34,028	31,116	97,563
Liabilities arising from non-participating investment contracts	17,136	–	–	–	–	17,136
Subordinated liabilities	757	1,433	2,842	12,908	19,784	37,724
Total non-derivative financial liabilities	430,721	38,147	59,291	85,103	59,940	673,202
Derivative financial liabilities:						
Gross settled derivatives – outflows	39,616	32,166	34,932	42,416	41,128	190,258
Gross settled derivatives – inflows	(37,928)	(30,408)	(32,999)	(39,883)	(35,858)	(177,076)
Gross settled derivatives – net flows	1,688	1,758	1,933	2,533	5,270	13,182
Net settled derivatives liabilities	21,959	114	341	1,150	3,650	27,214
Total derivative financial liabilities	23,647	1,872	2,274	3,683	8,920	40,396

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 £7,165 million at 31 December 2015 (2014: £7,161 million) with £4,014 million expiring within one year; £942 million between one and three years; £1,182 million between three and five years; and £1,027 million over five years (2014: £4,133 million expiring within one year; £1,823 million between one and three years; £674 million between three and five years; and £531 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 £39 million (2014: £80 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.

Notes to the consolidated financial statements continued

NOTE 53: FINANCIAL RISK MANAGEMENT continued

Further information on the Group's liquidity exposures is provided on pages 153 to 157.

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 2015	**1,477**	**1,081**	**4,745**	**10,444**	**62,547**	**80,294**
At 31 December 2014	1,036	1,276	5,100	20,916	58,590	86,918

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 2015									
Acceptances and endorsements	16	34	–	–	–	1	1	–	52
Other contingent liabilities	331	441	433	116	142	365	107	646	2,581
Total contingent liabilities	347	475	433	116	142	366	108	646	2,633
Lending commitments	46,443	1,989	4,444	3,276	11,575	18,803	19,234	6,731	112,495
Other commitments	–	–	2	31	5	4	83	296	421
Total commitments	46,443	1,989	4,446	3,307	11,580	18,807	19,317	7,027	112,916
Total contingents and commitments	**46,790**	**2,464**	**4,879**	**3,423**	**11,722**	**19,173**	**19,425**	**7,673**	**115,549**

	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 2014									
Acceptances and endorsements	51	6	1	–	–	–	–	1	59
Other contingent liabilities	432	415	217	80	162	504	130	683	2,623
Total contingent liabilities	483	421	218	80	162	504	130	684	2,682
Lending commitments	49,773	2,576	4,738	3,397	12,209	13,750	15,733	5,103	107,279
Other commitments	38	32	–	31	–	162	–	–	263
Total commitments	49,811	2,608	4,738	3,428	12,209	13,912	15,733	5,103	107,542
Total contingents and commitments	50,294	3,029	4,956	3,508	12,371	14,416	15,863	5,787	110,224

NOTE 54: CONSOLIDATED CASH FLOW STATEMENT

(A) Change in operating assets

	2015 £m	2014 £m	2013 £m
Change in loans and receivables	**6,081**	12,852	29,909
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**20,689**	(11,767)	(5,078)
Change in other operating assets	**7,930**	(1,957)	(4,448)
Change in operating assets	**34,700**	(872)	20,383

(B) Change in operating liabilities

	2015 £m	2014 £m	2013 £m
Change in deposits from banks	**6,107**	(3,029)	(25,529)
Change in customer deposits	**(4,252)**	7,745	15,599
Change in debt securities in issue	**5,657**	(11,089)	(29,032)
Change in derivative financial instruments, trading and other liabilities at fair value through profit or loss	**(16,924)**	24,020	(8,376)
Change in investment contract liabilities	**(3,922)**	(342)	3,171
Change in other operating liabilities	**1,349**	(5,313)	(3,520)
Change in operating liabilities	**(11,985)**	11,992	(47,687)

NOTE 54: CONSOLIDATED CASH FLOW STATEMENT continued

(C) Non-cash and other items

	2015 £m	2014 £m	2013 £m
Depreciation and amortisation	2,112	1,935	1,940
Revaluation of investment properties	(416)	(513)	(156)
Provision for impairment of disposal groups	–	–	382
Allowance for loan losses	441	737	2,726
Write-off of allowance for loan losses	(3,467)	(5,761)	(5,858)
Impairment of available-for-sale financial assets	4	2	15
Change in insurance contract liabilities	(2,856)	4,070	5,300
Payment protection insurance provision	4,000	2,200	3,050
Other regulatory provisions	837	925	405
Other provision movements	337	222	153
Net charge (credit) in respect of defined benefit schemes	315	(478)	503
Impact of consolidation and deconsolidation of OEICs[1]	(5,978)	(5,277)	6,303
Unwind of discount on impairment allowances	(56)	(126)	(351)
Foreign exchange impact on balance sheet[2]	507	770	89
Liability management losses (gains) within other income[3]	–	–	80
Loss on ECN exchange transaction	–	1,336	–
Interest expense on subordinated liabilities	1,970	2,374	2,956
Loss (profit) on disposal of businesses	46	(208)	(362)
Net gain on sale of available-for-sale financial assets	(51)	(131)	(629)
Hedging valuation adjustments on subordinated debt	(162)	559	(1,083)
Value of employee services	279	340	434
Issue of shares (non-cash)	–	–	160
Transactions in own shares	(816)	(286)	(480)
Accretion of discounts and amortisation of premiums and issue costs	339	122	286
Share of post-tax results of associates and joint ventures	3	(32)	(43)
Transfers to income statement from reserves	(956)	(1,153)	(550)
Profit on disposal of tangible fixed assets	(51)	(44)	(43)
Other non-cash items	(11)	(8)	(26)
Total non-cash items	(3,630)	1,575	15,201
Contributions to defined benefit schemes	(433)	(538)	(811)
Payments in respect of payment protection insurance provision	(3,091)	(2,458)	(2,674)
Payments in respect of other regulatory provisions	(661)	(1,104)	(360)
Other	7	29	26
Total other items	(4,178)	(4,071)	(3,819)
Non-cash and other items	(7,808)	(2,496)	11,382

1 These OEICs (Open-ended investment companies) are mutual funds which are consolidated if the Group manages the funds and also has a sufficient 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.

2 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.

3 A number of capital transactions entered into by the Group involved the exchange of existing securities for new issues and as a result there was no related cash flow.

Notes to the consolidated financial statements continued

NOTE 54: CONSOLIDATED CASH FLOW STATEMENT continued

(D) Analysis of cash and cash equivalents as shown in the balance sheet

	2015 £m	2014 £m	2013 £m
Cash and balances at central banks	58,417	50,492	49,915
Less: mandatory reserve deposits[1]	(941)	(980)	(937)
	57,476	49,512	48,978
Loans and advances to banks	25,117	26,155	25,365
Less: amounts with a maturity of three months or more	(10,640)	(10,520)	(7,546)
	14,477	15,635	17,819
Total cash and cash equivalents	71,953	65,147	66,797

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.

Included within cash and cash equivalents at 31 December 2015 is £13,545 million (2014: £12,855 million; 2013: £14,058 million) held within the Group's life funds, which is not immediately available for use in the business.

(E) Disposal and closure of group undertakings and businesses

	2015 £m	2014 £m	2013 £m
Trading and other assets at fair value through profit or loss	3,420	11	35,159
Loans and advances to customers	21,333	256	2,612
Loans and advances to banks	5,539	55	1,701
Available-for-sale financial assets	654	–	–
Investment property	–	–	582
Value of in-force business	60	–	831
Other intangible assets	–	–	251
Property, plant and equipment	150	–	67
	31,156	322	41,203
Customer deposits	(24,613)	(266)	(1,923)
Debt securities in issue	(9)	–	(264)
Liabilities arising from insurance contracts and participating investment contracts	(3,828)	–	(451)
Liabilities arising from non-participating investment contracts	(549)	–	(29,953)
Non-controlling interests	(825)	–	(357)
Other net assets (liabilities)	(314)	802	(6,160)
	(30,138)	536	(39,108)
Net assets	1,018	858	2,095
Non-cash consideration received	–	(518)	(59)
(Loss) profit on sale	(46)	208	362
Cash consideration received on losing control of group undertakings and businesses	972	548	2,398
Cash and cash equivalents disposed	(5,043)	(5)	(1,702)
Net cash inflow (outflow)	(4,071)	543	696

NOTE 55: DISPOSAL OF INTEREST IN TSB BANKING GROUP PLC

On 20 March 2015 the Group announced that it had agreed to sell a 9.99 per cent interest in TSB Banking Group plc (TSB) to Banco de Sabadell S.A. (Banco Sabadell) and that it had entered into an irrevocable undertaking to accept Banco Sabadell's recommended cash offer in respect of its remaining 40.01 per cent interest in TSB. The offer by Banco Sabadell was conditional upon, amongst other things, regulatory approval.

The sale of the 9.99 per cent interest completed on 24 March 2015, reducing the Group's holding in TSB to 40.01 per cent; this sale led to a loss of control and the deconsolidation of TSB. The Group's residual investment in 40.01 per cent of TSB was then recorded at fair value, as an asset held for sale. The Group recognised a loss of £660 million reflecting the net costs of the Transitional Service Agreement between Lloyds and TSB, the contribution to be provided by Lloyds to TSB in moving to alternative IT provision and the net result on sale of the 9.99 per cent interest and fair valuation of the residual investment.

The Group announced on 30 June 2015 that all relevant regulatory clearances for the sale of its remaining 40.01 per cent holding in TSB had been received and that the sale was therefore unconditional in all respects; the proceeds were received on 10 July 2015.

At 31 December 2015, the Group held a £2,349 million interest in Cape Funding No.1 PLC, a securitisation funding vehicle set up by TSB.

NOTE 56: EVENTS SINCE THE BALANCE SHEET DATE

In 2015, the Group participated in the UK-wide concurrent stress testing run by the Bank of England; the Enhanced Capital Notes (ECNs) in issue were not taken into account for the purposes of core capital in the PRA stress tests and the Group has determined that a Capital Disqualification Event (CDE), as defined in the conditions of the ECNs, has occurred. This determination was confirmed by a unanimous decision by the Court of Appeal on 10 December 2015 and on 29 January 2016 the Group announced the redemption of certain series of ECNs using the Regulatory Call Right. The Group also launched tender offers for the remaining series of ECNs on 29 January 2016 and has announced that, subsequent to completion of such offers, it will redeem those ECNs not validly tendered using the Regulatory Call Right. The offers and redemptions will be completed before the end of the first quarter, resulting in a net loss to the Group currently estimated to be approximately £700 million, principally comprising the write-off of the embedded equity conversion feature and premiums paid under the terms of the transaction.

The trustee of the ECNs has been granted leave by the Supreme Court to appeal the Court of Appeal decision. In the event that the Supreme Court were to determine that a CDE had not occurred, the Group would compensate fairly the holders of the ECNs whose securities are redeemed using the Regulatory Call Right for losses suffered as a result of early redemption.

NOTE 57: FUTURE ACCOUNTING DEVELOPMENTS

The following pronouncements are not applicable for the year ending 31 December 2015 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. As at 24 February 2016, these pronouncements are awaiting EU endorsement.

IFRS 9 *Financial Instruments*
IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income 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. These changes are not expected to have a significant impact on the Group.

IFRS 9 also replaces the existing 'incurred loss' impairment approach with an expected credit loss approach, resulting in earlier recognition of credit losses. The IFRS 9 impairment model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk (stage 2). The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology and involves quantitative measures, such as forward looking probabilities of default, and qualitative factors and therefore requires considerable management judgement. Stage 3 requires objective evidence of impairment which is similar to the guidance on incurred losses in IAS 39. IFRS 9 requires the use of more forward looking information including reasonable and supportable forecasts of future economic conditions. The need to consider multiple economic scenarios and how they could impact the loss allowance is a very subjective feature of the IFRS 9 impairment model. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope.

These changes may result in a material increase in the Group's balance sheet provisions for credit losses although the extent of any increase will depend upon, amongst other things, the composition of the Group's lending portfolios and forecast economic conditions at the date of implementation. The requirement to transfer assets between stages and to incorporate forward looking data into the expected credit loss calculation, including multiple economic scenarios, is likely to result in impairment charges being more volatile when compared to the current IAS 39 impairment model.

The IFRS 9 expected credit loss model differs from the regulatory models in a number of ways, for example stage 2 assets under IFRS 9 carry a lifetime expected loss amount whereas regulatory models generate 12 month expected losses for non defaulted loans. In addition, different assets are in scope of each reporting base and therefore the size of the regulatory expected losses should not be taken as a proxy to the size of the loss allowance under IFRS 9.

In 2015, the Basel Committee on Banking Supervision published finalised guidance on credit risk and accounting for expected credit losses. The paper sets out supervisory guidance on how expected credit loss accounting models should interact with a bank's credit risk practices. The existing impairment processes, controls and governance will be reviewed and changed where necessary to reflect the increased demands of an expected credit loss impairment model.

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. The accounting policy choice to continue with IAS 39 hedge accounting is still being considered by the Group.

The Group has an established IFRS 9 programme to ensure a high quality implementation in compliance with the standard and regulatory guidance. The programme involves Finance and Risk functions across the Group with Divisional and Group steering committees providing oversight. The key responsibilities of the programme include defining IFRS 9 methodology and accounting policy, identifying data and system requirements, and establishing an appropriate operating model and governance framework. The impairment workstreams have developed methodologies for many of the IFRS 9 requirements, although additional validation of these decisions will be on-going to reflect the uncertainty around regulatory and audit expectations. Some risk model build has started and detailed plans, including resource needs, are in place. We expect the majority of model build to be completed in 2016 to allow robust testing and the development of management information to take place in 2017.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018.

IFRS 15 *Revenue from Contracts with Customers*
IFRS 15 replaces IAS 18 Revenue and IAS 11 Construction Contracts. Financial instruments, leases and insurance contracts are out of scope and so this standard is not expected to have a significant impact on the Group.

IFRS 15 is effective for annual periods beginning on or after 1 January 2018.

IFRS 16 *Leases*
On 13 January 2016 the IASB issued IFRS 16 to replace IAS 17 Leases. IFRS 16 requires lessees to recognise a right of use asset and a liability for future payments arising from a lease contract. Lessor accounting requirements remain aligned to the current approach under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019.

Amendments to IAS 7 Statement of Cash Flows and IAS 12 Income Taxes
In January 2016, the IASB issued amendments to IAS 7 Statement of Cash Flows which require additional disclosure about an entity's financing activities and IAS 12 Income Taxes which clarify when a deferred tax asset should be recognised for unrealised losses. These revised requirements, which are effective for annual periods beginning on or after 1 January 2017, are not expected to have a significant impact on the Group.

Parent company balance sheet

at 31 December

	Note	2015 £ million	2014 £ million
Assets			
Non-current assets:			
Investment in subsidiaries	8	**40,785**	41,102
Loans to subsidiaries	8	**13,963**	13,848
Deferred tax asset		**51**	19
		54,799	54,969
Current assets:			
Derivative financial instruments		**590**	752
Other assets		**909**	791
Amounts due from subsidiaries	2	**67**	67
Cash and cash equivalents		**24**	195
Current tax recoverable		**32**	–
		1,622	1,805
Total assets		**56,421**	56,774
Equity and liabilities			
Capital and reserves:			
Share capital	3	**7,146**	7,146
Share premium account	3	**17,412**	17,281
Merger reserve	4	**7,633**	7,764
Capital redemption reserve	4	**4,115**	4,115
Retained profits	5	**785**	1,720
Shareholders' equity		**37,091**	38,026
Other equity instruments	3	**5,355**	5,355
Total equity		**42,446**	43,381
Non-current liabilities:			
Debt securities in issue	7	**–**	561
Subordinated liabilities	6	**3,065**	1,688
		3,065	2,249
Current liabilities:			
Current tax liabilities		**–**	107
Other liabilities		**10,910**	11,037
		10,910	11,144
Total liabilities		**13,975**	13,393
Total equity and liabilities		**56,421**	56,774

The accompanying notes are an integral part of the parent company financial statements.

The directors approved the parent company financial statements on 24 February 2016.

Lord Blackwell
Chairman

António Horta-Osório
Group Chief Executive

George Culmer
Chief Financial Officer

Parent company statement of changes in equity

for the year ended 31 December

	Share capital and premium £ million	Merger reserve £ million	Capital redemption reserve £ million	Retained profits[1] £ million	Total shareholders' equity £ million	Other equity instruments £ million	Total equity £ million
Balance at 1 January 2013	23,914	7,764	4,115	2,017	37,810	–	37,810
Total comprehensive income[1]	–	–	–	(846)	(846)	–	(846)
Issue of ordinary shares	510	–	–	–	510	–	510
Movement in treasury shares	–	–	–	(165)	(165)	–	(165)
Value of employee services:							
Share option schemes	–	–	–	116	116	–	116
Other employee award schemes	–	–	–	292	292	–	292
Balance at 31 December 2013	24,424	7,764	4,115	1,414	37,717	–	37,717
Total comprehensive income[1]	–	–	–	379	379	–	379
Distributions on other equity instruments, net of tax	–	–	–	(225)	(225)	–	(225)
Issue of ordinary shares	3	–	–	–	3	–	3
Issue of other equity instruments	–	–	–	(21)	(21)	5,355	5,334
Movement in treasury shares	–	–	–	(182)	(182)	–	(182)
Value of employee services:							
Share option schemes, net of tax	–	–	–	122	122	–	122
Other employee award schemes	–	–	–	233	233	–	233
Balance at 31 December 2014	24,427	7,764	4,115	1,720	38,026	5,355	43,381
Total comprehensive income[1]	–	–	–	897	897	–	897
Dividends paid	–	–	–	(1,070)	(1,070)	–	(1,070)
Distributions on other equity instruments, net of tax	–	–	–	(314)	(314)	–	(314)
Redemption of preference shares	131	(131)	–	–	–	–	–
Movement in treasury shares	–	–	–	(753)	(753)	–	(753)
Value of employee services:							
Share option schemes, net of tax	–	–	–	133	133	–	133
Other employee award schemes	–	–	–	172	172	–	172
Balance at 31 December 2015	**24,558**	**7,633**	**4,115**	**785**	**37,091**	**5,355**	**42,446**

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.

The accompanying notes are an integral part of the parent company financial statements.

Parent company cash flow statement

for the year ended 31 December

	2015 £ million	2014 £ million	2013 £ million
Profit (loss) before tax	969	273	(1,090)
Fair value and exchange adjustments and other non-cash items	(594)	1,118	137
Change in other assets	(566)	558	124
Change in other liabilities and other items	(127)	(4,242)	4,699
Dividends received	(1,080)	(720)	–
Tax (paid) received	(142)	301	(35)
Net cash provided by (used in) operating activities	(1,540)	(2,712)	3,835
Cash flows from investing activities			
Return of capital contribution	600	198	–
Dividends received	1,080	720	–
Amounts advanced to subsidiaries	(1,157)	(7,892)	(3,082)
Redemption of loans to subsidiaries	1,155	4,420	197
Net cash (used in) provided by investing activities	1,678	(2,554)	(2,885)
Cash flows from financing activities			
Dividends paid to ordinary shareholders	(1,070)	–	–
Distributions on other equity instruments	(394)	(287)	–
Issue of other equity instruments	–	5,329	–
Issue of subordinated liabilities	1,436	629	–
Interest paid on subordinated liabilities	(129)	(128)	(253)
Repayment of subordinated liabilities	(152)	(596)	(2,767)
Proceeds from issue of ordinary shares	–	3	350
Net cash used in financing activities	(309)	4,950	(2,670)
Change in cash and cash equivalents	(171)	(316)	(1,720)
Cash and cash equivalents at beginning of year	195	511	2,231
Cash and cash equivalents at end of year	24	195	511

The accompanying notes are an integral part of the parent company financial statements.

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 2015. 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 IFRS 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: 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 3: SHARE CAPITAL, SHARE PREMIUM AND OTHER EQUITY INSTRUMENTS

Details of the Company's share capital, share premium account and other equity instruments are as set out in notes 41, 42 and 45 to the consolidated financial statements.

NOTE 4: 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, offset by adjustments on the redemption of preference shares. Substantially all of the Company's merger reserve is available for distribution.

Movements in the merger reserve were as follows:

	2015 £m	2014 £m	2013 £m
At 1 January	7,764	7,764	7,764
Redemption of preference shares[1]	(131)	–	–
At 31 December	7,633	7,764	7,764

1 During the year ended 31 December 2015, the Company redeemed all of its outstanding 6.0884% Non-cumulative Fixed to Floating Rate Preference Shares and 5.92% Non-cumulative Fixed to Floating Rate Preference Shares callable 2015 at their combined par value of £131 million. These preference shares had been accounted for as subordinated liabilities. On redemption an amount of £131 million was transferred from the distributable merger reserve to the share premium account.

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.

There were no movements in the capital redemption reserve in 2015, 2014 or 2013.

NOTE 5: RETAINED PROFITS

	2015 £m	2014 £m	2013 £m
At 1 January	1,720	1,414	2,017
Profit (loss) for the year	897	379	(846)
Issue costs of other equity instruments, net of tax	–	(21)	–
Dividends paid	(1,070)	–	–
Distributions on other equity instruments, net of tax	(314)	(225)	–
Movement in treasury shares	(753)	(182)	(165)
Value of employee services:			
Share option schemes	133	122	116
Other employee award schemes	172	233	292
At 31 December	785	1,720	1,414

Details of the Company's dividends are as set out in note 46 to the consolidated financial statements.

Notes to the parent company financial statements continued

NOTE 6: 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 Regulation Authority.

	Preference shares £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2014	1,001	10	658	1,669
Issued during the year:				
4.5% Fixed Rate Subordinated Debt Securities due 2024 (US$1,000 million)	–	–	629	629
Repurchases and redemptions during the year:				
5.875% Subordinated Guaranteed Bonds 2014	–	–	(596)	(596)
Foreign exchange and other movements	38	–	(52)	(14)
At 31 December 2014	1,039	10	639	1,688
Issued during the year:				
5.3% Subordinated Fixed Rate Notes 2045 (US$824 million)	–	–	543	543
4.582% Subordinated Fixed Rate Notes 2025 (US$1,353 million)	–	–	893	893
	–	–	1,436	1,436
Repurchases and redemptions during the year:				
6.0884% Non-cumulative Fixed to Floating Rate Preference Shares[1]	(10)	–	–	(10)
5.92% Non-cumulative Fixed to Floating Rate Preference Shares callable 2015[1]	(140)	–	–	(140)
	(150)	–	–	(150)
Foreign exchange and other movements	22	–	69	91
At 31 December 2015	911	10	2,144	3,065

1 During the year ended 31 December 2015, the Company redeemed all of its outstanding 6.0884% Non-cumulative Fixed to Floating Rate Preference Shares and 5.92% Non-cumulative Fixed to Floating Rate Preference Shares callable 2015 at their combined par value of £131 million. These preference shares had been accounted for as subordinated liabilities. On redemption an amount of £131 million was transferred from the distributable merger reserve to the share premium account.

NOTE 7: DEBT SECURITIES IN ISSUE

These comprised US$862.5 million 7.75% Public Income Notes due 2050 issued by the Company in July 2010; these were redeemed by the Company in 2015.

NOTE 8: RELATED PARTY TRANSACTIONS

In January 2009 HM Treasury became a related party of the Company and has remained so until 11 May 2015. 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 48 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 48 to the consolidated financial statements.

The Company has no employees (2014: 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.

Investment in subsidiaries

	2015 £m	2014 £m
At 1 January	41,102	40,933
Capital contribution	283	367
Return of capital contribution	(600)	(198)
At 31 December	40,785	41,102

NOTE 8: RELATED PARTY TRANSACTIONS continued

Details of the subsidiaries and related undertakings are given on pages 299 to 307 and are incorporated by reference.

Certain subsidiary companies currently have insufficient distributable reserves to make dividend payments, however, 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

	2015 £m	2014 £m
At 1 January	13,848	11,043
Exchange and other adjustments	113	19
New issues	1,157	7,849
Redemptions	(1,155)	(5,063)
At 31 December	13,963	13,848

In addition the Company carries out banking activities through its subsidiary, Lloyds Bank plc. At 31 December 2015, the Company held deposits of £24 million with Lloyds Bank plc (2014: £195 million). Given the volume of transactions flowing through the account, it is not meaningful to provide gross inflow and outflow information. Included within other liabilities is £10,516 million (2014: £10,944 million) due to subsidiary undertakings. In addition, at 31 December 2015 the Company had interest rate and currency swaps with Lloyds Bank plc with an aggregate notional principal amount of £734 million and a net positive fair value of £45 million (2014: notional principal amount of £1,446 million and a net positive fair value of £106 million). Of this amount an aggregate notional principal amount of £325 million and a net positive fair value of £26 million (2014: notional principal amount of £449 million and a net positive fair value of £43 million) were designated as fair value hedges to manage the Company's issuance of subordinated liabilities and debt securities in issue.

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 48 to the consolidated financial statements.

Notes to the parent company financial statements continued

NOTE 9: 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 2015					
Financial assets:					
Cash and cash equivalents	–	–	–	24	24
Derivative financial instruments	26	564	–	–	590
Loans to subsidiaries	–	–	13,963	–	13,963
Amounts due from subsidiaries	–	–	67	–	67
Total financial assets	26	564	14,030	24	14,644
Financial liabilities:					
Debt securities in issue	–	–	–	–	–
Subordinated liabilities	–	–	–	3,065	3,065
Total financial liabilities	–	–	–	3,065	3,065
At 31 December 2014					
Financial assets:					
Cash and cash equivalents	–	–	–	195	195
Derivative financial instruments	106	646	–	–	752
Loans to subsidiaries	–	–	13,848	–	13,848
Amounts due from subsidiaries	–	–	67	–	67
Total financial assets	106	646	13,915	195	14,862
Financial liabilities:					
Debt securities in issue	–	–	–	561	561
Subordinated liabilities	–	–	–	1,688	1,688
Total financial liabilities	–	–	–	2,249	2,249

Note 50 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:

	2015 £m	2014 £m
At 1 January	646	1,212
Derecognised following completion of the Group's ECN exchange and retail offers	–	(967)
(Losses) gains recognised in the income statement	(101)	401
At 31 December	545	646

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 8, the Company has entered into interest rate and currency swaps with its subsidiary, Lloyds Bank plc, to manage these risks.

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.

NOTE 9: FINANCIAL INSTRUMENTS continued

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 2015						
Subordinated liabilities	2	–	191	770	6,487	7,450
Total financial instrument liabilities	2	–	191	770	6,487	7,450
At 31 December 2014						
Debt securities in issue	10	–	30	165	1,810	2,015
Subordinated liabilities	–	14	258	468	4,055	4,795
Total financial instrument liabilities	10	14	288	633	5,865	6,810

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £1 million (2014: £1 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.

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. No assets or liabilities were categorised as level 1 (2014: nil).

Fair value of financial assets and liabilities

	2015				2014			
			Valuation hierarchy				Valuation hierarchy	
	Carrying value £m	Fair value £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 2 £m	Level 3 £m
Derivative financial instruments	590	590	45	545	752	752	106	646
Loans to subsidiaries	13,963	13,963	13,963	–	13,848	14,053	14,053	–
Amounts due from subsidiaries	67	67	67	–	67	67	67	–
Total financial assets	14,620	14,620	14,075	545	14,667	14,872	14,226	646
Debt securities in issue	–	–	–	–	561	580	580	–
Subordinated liabilities	3,065	3,639	3,639	–	1,688	2,040	2,040	–
Total financial liabilities	3,065	3,639	3,639	–	2,249	2,620	2,620	–

The carrying amount of cash and cash equivalents (2015: £24 million; 2014: £195 million) is a reasonable approximation of fair value.

Notes to the parent company financial statements continued

NOTE 9: FINANCIAL INSTRUMENTS continued

Sensitivity of level 3 valuations

	Valuation technique(s)	Significant unobservable inputs[1]	Carrying value £m	Effect of reasonably possible alternative assumptions	
				Favourable changes £m	Unfavourable changes £m
Financial assets carried at fair value at December 2015					
Derivative financial assets					
Embedded equity conversion feature	Lead manager or broker quote	Equity conversion feature spread (171 bps/386 bps)	**545**	**14**	**(14)**
			545		
Financial assets carried at fair value at December 2014					
Derivative financial assets					
Embedded equity conversion feature	Lead manager or broker quote	Equity conversion feature spread (175 bps/432 bps)	646	21	(21)
			646		

1 Ranges represent the highest and lowest inputs used in the level 3 valuations.

NOTE 10: OTHER INFORMATION

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.

OTHER INFORMATION

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Shareholder information

Annual general meeting (AGM)

The AGM will be held at the Edinburgh International Conference Centre, The Exchange, Edinburgh EH3 8EE on Thursday 12 May 2016 at 11.00 am. Further details about the meeting, including the proposed resolutions, can be found in our Notice of AGM which will be available shortly on our website at www.lloydsbankinggroup.com

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 at www.lloydsbankinggroup.com, where our statutory reports and shareholder communications are available. A summary of the reports and communications to be issued in 2016 are listed below:

		Available format			
Report/Communication	Month	Online	Email	RNS	Paper
Preliminary results	Feb	✔	✔	✔	
Group Chief Executive update to shareholders	Mar	✔	✔		✔
Annual Report and Accounts, Annual Review or Performance Summary	Mar	✔	✔		✔
Pillar 3 report	Mar	✔			
Notice of AGM and voting materials	Mar	✔	✔		✔
Q1 interim management statement[1]	Apr	✔	✔	✔	
Country analysis[2]	Jun/Jul	✔			
Interim results	Jul	✔	✔	✔	
Group Chief Executive update to shareholders	Aug	✔	✔		✔
Q3 interim management statement[1]	Oct	✔	✔	✔	

[1] Despite changes to regulations which remove the requirement to issue interim management statements, Lloyds Banking Group still intends to issue these reports.

[2] To be published on the Group's website by 1 July 2016 in accordance with the Capital Requirements (country analysis) Regulations 2013.

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	0345 606 1188	www.bankofscotlandsharedealing.co.uk
Halifax Share Dealing	03457 22 55 25	www.halifaxsharedealing.co.uk
Lloyds Bank Direct Investments	0345 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 dealing for the Lloyds Banking Group Shareholder Account

Share dealing services for the Lloyds Banking Group Shareholder Account are provided by Equiniti Shareview Dealing, operated by Equiniti Financial Services Limited. Details of the services provided can be found either on the Shareholder Information page of our website at www.lloydsbankinggroup.com or by contacting Equiniti using the contact details provided on the next page.

Share price information

Shareholders can access both the latest and historical share prices via our website at 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 above.

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 above.

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 2015	Shareholders		Number of ordinary shares	
Size of shareholding	Number	%	Millions	%
1 – 999	2,090,776	81.59	631.1	0.88
1,000 – 9,999	410,400	16.02	1,081.1	1.51
10,000 – 99,999	57,751	2.25	1,375.9	1.93
100,000 – 999,999	2,441	0.10	579.8	0.81
1,000,000 – 4,999,999	544	0.02	1,318.6	1.85
5,000,000 – 9,999,999	204	0.01	1,399.8	1.96
10,000,000 – 49,999,999	308	0.01	7,022.6	9.84
50,000,000 – 99,999,999	62	–	4,344.6	6.09
100,000,000 – 499,999,999	85	–	17,621.6	24.69
500,000,000 – 999,999,999	15	–	10,776.6	15.10
1,000,000,000 and over	12	–	25,222.0	35.34
	2,562,598	100.00	71,373.7	100.00

Security – share 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 and we would ask that shareholders take steps to protect themselves. We strongly recommend seeking advice from an independent financial adviser authorised by the Financial Conduct Authority (FCA). Shareholders can verify whether a firm is authorised via the Financial Services Register which is available at www.fca.org.uk

If a shareholder is concerned that they 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 contacting the Police through Action Fraud on 0300 123 2040 or visiting www.actionfraud.org.uk for further information.

IMPORTANT SHAREHOLDER AND REGISTRAR INFORMATION

Company website

www.lloydsbankinggroup.com

Shareholder information

help.shareview.co.uk
(from here you will be able to email your query securely)

Registrar

Equiniti Limited
Aspect House, Spencer Road, Lancing
West Sussex BN99 6DA

Shareholder helpline

0371 384 2990* from within the UK
+44 121 415 7066 from outside the UK

*Lines are open from 8.30 am to 5.30 pm Monday to Friday, excluding English and Welsh public holidays.

The company registrar is Equiniti Limited. They provide a shareholder service, including a telephone helpline and shareview which is a free secure portfolio service.

Register today to manage your shareholding online

Get online in just three easy steps:

step 1

Register at www.shareview.co.uk/info/register

step 2

Receive activation code in post

step 3

Log on

Forward looking statements

This Annual Report contains certain forward looking statements with respect to the business, strategy and plans of Lloyds Banking Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds Banking Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will 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, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; statements of plans, objectives or goals of Lloyds Banking Group or its management including in respect of statements about the future business and economic environments in the 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; market related trends and developments; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; the ability to derive cost savings; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, the potential for one or more countries to exit the Eurozone or European Union (EU) (including the UK as a result of a referendum on its EU membership) and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to cyber security; natural, pandemic and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, accounting standards or taxation, including as a result of further Scottish devolution; changes to regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation; 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; actions or omissions by the Group's directors, management or employees including industrial action; changes to the Group's post-retirement defined benefit scheme obligations; the provision of banking operations services to TSB Banking Group plc; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the Group; 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 exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. 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.

Abbreviations

ADRs	American Depositary Receipts
BSU	Business Support Unit
CDS	Credit Default Swap
CET1	Common Equity Tier 1
CRD IV	Capital Requirements Directive IV
CUIP	Collective unidentified impairment provision
CVA	Credit Valuation Adjustment
DVA	Debit Valuation Adjustment
EBA	European Banking Authority
ECNs	Enhanced Capital Notes
EP	Economic Profit
EPS	Earnings Per Share
FCA	Financial Conduct Authority
FLS	Funding for Lending Scheme
FRC	Financial Reporting Council
HMRC	Her Majesty's Revenue & Customs
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICG	Individual Capital Guidance
IFRS	International Financial Reporting Standards
LCR	Liquidity Coverage Ratio
LIBOR	London Inter-Bank Offered Rate
LTIP	Long-Term Incentive Plan
OEICs	Open Ended Investment Companies
PFI	Private Finance Initiative
PPI	Payment Protection Insurance
PPP	Public Private Partnership
PRA	Prudential Regulation Authority
PVNBP	Present Value of New Business Premiums
SEC	Securities and Exchange Commission
TSR	Total Shareholder Return
VaR	Value-at-Risk

Glossary

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 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.
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.
Central counterparty (CCP)	An institution mediating between the buyer and seller in a financial transaction, such as a derivative contract or repurchase agreement. 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.
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.
Collective unidentified impairment provision	A provision held for loan losses that have been incurred but not separately identified at the balance sheet date.
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	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.
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.
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.
Coverage ratio	Impairment provisions as a percentage of impaired loans.
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 together form the CRD IV package. Amendments published on 30 November 2013 were made to the Regulation. The package implements the Basel III reforms in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. CRD IV rules apply from 1 January 2014 onwards, with certain requirements 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 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 51.
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.
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.

Glossary continued

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 41.
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**.
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.
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 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.
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.
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.
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.
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.
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 32.
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.
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.
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.
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.
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.
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 41.
Trading book	Positions in financial instruments and commodities held for trading purposes or to hedge other elements of the trading book.
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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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 Report can be found at www.lloydsbankinggroup.com

	EDTF Recommendations (summarised)	Page
	General commentary	
1	Present all related risk information together or provide an index or an aid to navigation.	111
2	Define the bank's risk terminology and risk measures and present key parameter values used.	112-169
3	Describe and discuss top and emerging risks.	30-33, 114
4	Outline plans to meet each new key regulatory ratio.	154, 160
	Risk Governance and risk management strategies/business model	
5	Summarise prominently the bank's risk management organisation, processes and key functions.	118-119
6	Describe risk culture and how procedures and strategies are applied to support the culture.	112
7	Describe the key risks that arise from the bank's business models and activities, the bank's risk appetite in the context of its business models and how the bank manages such risks.	113, 120-169
8	Describe the use of stress testing within the bank's risk governance and capital frameworks.	115
	Capital adequacy and risk-weighted assets	
9	Pillar 1 capital requirements and the application of counter-cyclical and capital conservation buffers or the minimum internal ratio established by management.	160
10	Main components of capital and a reconciliation of the accounting balance sheet to the regulatory balance sheet.	162, Pillar 3
11	Flow statement of movements since the prior reporting date in regulatory capital, including changes in common equity tier 1, tier 1 and tier 2 capital.	163
12	Discuss capital planning, including a description of management's view of the required or targeted level of capital and how this will be established.	160-161
13	Explain how risk-weighted assets (RWAs) relate to business activities and related risks.	113, 163-164, Pillar 3
14	Present a table showing the capital requirements for each method used for calculating RWAs for each Basel asset class.	Pillar 3
15	Tabulate credit risk for Basel asset classes.	Pillar 3
16	Present a flow statement that reconciles movements in RWAs for the period for each RWA risk type.	164
17	Provide narrative putting Basel Pillar 3 back-testing requirements into context.	Pillar 3
	Liquidity	
18	Describe how the bank manages its potential liquidity needs.	153-154, 157-158
	Funding	
19	Tabulate encumbered and unencumbered assets by balance sheet categories	158-159
20	Tabulate consolidated total assets, liabilities and off-balance sheet commitments by remaining contractual maturity at the balance sheet date.	156, 274-276
21	Discuss the bank's funding strategy, including key sources and any funding concentrations.	154-156
	Market risk	
22	Describe linkages between line items in the balance sheet with positions included in the traded and non-traded market risk disclosures.	145
23	Provide breakdowns of significant trading and non trading market risk factors.	146-150
24	Describe significant market risk measurement model limitations, assumptions and validation procedures.	146-150, Pillar 3
25	Describe the primary risk management techniques employed to measure and assess the risk of loss beyond reported risk measures and parameters, such as VaR, earnings or economic value scenario results.	146-150, Pillar 3
	Credit risk	
26	Describe the bank's credit risk profile, including any significant credit risk concentrations. Detailing aggregate credit risk exposures that reconciles to the balance sheet, including detailed tables for both retail and corporate portfolios.	121-142, Pillar 3
27	Describe the policies for identifying impaired or non-performing loans, defining impaired or non-performing, restructured and returned-to-performing (cured) loans as well as explanations of loan forbearance policies.	124-126, 191-192
28	A reconciliation of the opening and closing balances of non-performing or impaired loans in the period and the allowance for loan losses.	128, 216
29	Provide analysis of the bank's counterparty credit risk that arises from its derivatives transactions.	129, 271
30	Discuss credit risk mitigation, including collateral held for all sources of credit risk.	122-124
	Other	
31	Describe 'other risk' types and discuss how each one is identified, governed, measured and managed.	143-144, 151-152, 166-169
32	Discuss publicly known risk events related to other risks.	143-144, 151-152, 166-169

Subsidiaries and related undertakings

Group companies

In compliance with Section 409 of the Companies Act 2006, the following comprises a list of all related undertakings of the Group, as at 31 December 2015. The list includes each undertaking's country of incorporation (UK unless otherwise stated) and the percentage of class(es) of shares held by the immediate parent company. Where different, the ultimate percentage held by the Group is given in brackets. All shares are ordinary shares indirectly held by Lloyds Banking Group plc unless indicated otherwise.

Subsidiary undertakings

The Group holds a majority of the voting rights of the following undertakings.

Name of undertaking	% of class held by immediate parent company
A G Finance Limited	100% ii, #
A.C.L. Limited	100%
ACL Autolease Holdings Limited	100%
ADF No.1 Pty Ltd, (Australia)	100%
Alex Lawrie Factors Limited	100%
Alex. Lawrie Receivables Financing Limited	100%
Amberdate Limited	100% iv
	100%
AN Vehicle Finance Limited	100%
Anglo Scottish Utilities Partnership 1	n/a *
Aquilus Limited	100%
Automobile Association Personal Finance Limited	100%
Bank Of Scotland (B.G.S) London Nominees Limited	n/a *
Bank Of Scotland (Stanlife) London Nominees Limited	n/a *
Bank Of Scotland Branch Nominees Limited	100%
Bank Of Scotland Capital Funding (Jersey) Limited, (Jersey)	100%
Bank of Scotland Capital Funding L.P, (Jersey)	n/a *
Bank Of Scotland Central Nominees Limited	n/a *
Bank Of Scotland Edinburgh Nominees Limited	n/a *
Bank Of Scotland Equipment Finance Limited	100%
Bank Of Scotland Foundation Limited	n/a *
Bank Of Scotland Hong Kong Nominees Limited, (Hong Kong)	n/a *
Bank Of Scotland Insurance Services Limited	99.99% (100%)
Bank Of Scotland Leasing Limited	100%
Bank Of Scotland LNG Leasing (No 1) Limited	100%
Bank Of Scotland London Nominees Limited	n/a *
Bank Of Scotland Nominees (Unit Trusts) Limited	n/a *
Bank Of Scotland P.E.P. Nominees Limited	n/a *
Bank Of Scotland Plc	99.99% (100%)
	0% (100%) iii
Bank Of Scotland Structured Asset Finance Limited	100%
Bank Of Scotland Transport Finance 1 Limited	100%
Bank Of Wales Limited	100%
Barbirolli Square Limited Partnership	n/a *
Barents Leasing Limited	100%
Barnwood Mortgages Limited	100%
Bavarian Mortgages No. 5 Limited	99.99% (100%)
Bavarian Mortgages No.2 Limited (In Liquidation)	100%
Birchcrown Finance Limited	100% iv
	100% vi
Birmingham Midshires Asset Management Limited	100%
Birmingham Midshires Financial Services Limited	100%
Birmingham Midshires Land Development Limited	100%
Birmingham Midshires Mortgage Services Limited	100%
Birmingham Midshires Mortgage Services No.1 Limited	100%
Birmingham Midshires Property Services Limited (In Liquidation)	100%
	100% xii
Black Horse (TRF) Limited	100%
Black Horse Executive Mortgages Limited	100%
Black Horse Finance Holdings Limited	100% i
	100% ii
Black Horse Finance Limited (In Liquidation)	100%
Black Horse Finance Management Limited	100%
Black Horse Group Limited	100%
	0% (100%) iv
Black Horse Limited	100%
Black Horse Offshore Limited, (Jersey)	100%
Black Horse Property Services Limited	100%
Boltro Nominees Limited	100%
BOS (Boston) Inc, (USA)	100%
BOS (Ireland) Nominees Limited, (Ireland)	100%
BOS (Ireland) Property Services 2 Limited, (Ireland)	100%
BOS (Ireland) Property Services Limited, (Ireland)	100%
BOS (PB) LLC, (USA)	100%
BOS (Shared Appreciation Mortgages (Scotland) No. 2) Limited	100%
BOS (Shared Appreciation Mortgages (Scotland) No. 3) Limited	100%
BOS (Shared Appreciation Mortgages (Scotland)) Limited	100%
BOS (Shared Appreciation Mortgages) No. 1 Plc	99.99% (100%)
BOS (Shared Appreciation Mortgages) No. 2 Plc	99.99% (100%)
BOS (Shared Appreciation Mortgages) No. 3 Plc	99.99% (100%)
BOS (Shared Appreciation Mortgages) No. 4 Plc	99.99% (100%)
BOS (Shared Appreciation Mortgages) No. 5 Plc	99.99% (100%)
BOS (Shared Appreciation Mortgages) No. 6 Plc	99.99% (100%)
BOS (Southport) Holding LLC, (USA)	100%
BOS (USA) Al Inc., (USA)	100%
BOS (USA) Fund Investments Inc., (USA)	100%
BOS (USA) Inc, (USA)	100%
BOS Aircraft Holdings Limited (In Liquidation)	100%
BOS Edinburgh No 1 Limited	100%
BOS Mistral Limited	100%
BOSIC Inc, (Canada)	100%
BOSSAF Rail Limited	100%
Boundary Business Centre Limited (In Liquidation)	100%
Britannia Personal Lending Limited	100% i
British Linen Leasing (London) Limited	100%
British Linen Leasing Limited	100%
British Linen Shipping Limited	100%
Brooklyn Properties Limited, (Ireland)	100% i
	100% ii
C & G Financial Services Limited	100%
C & G Homes Limited	100%
C&G Estate Agents Limited	100%
C&G Property Holdings Limited (In Liquidation)	100%
C.T.S.B. Leasing Limited	100%
Capital 1945 Limited	100%
Capital Bank Insurance Services Limited	100%
Capital Bank Leasing 1 Limited	100%
Capital Bank Leasing 10 Limited	100%
Capital Bank Leasing 11 Limited	100%
Capital Bank Leasing 12 Limited	100%
Capital Bank Leasing 2 Limited	100%
Capital Bank Leasing 3 Limited	100%
Capital Bank Leasing 4 Limited	100%
Capital Bank Leasing 5 Limited	100%
Capital Bank Leasing 6 Limited	100%
Capital Bank Leasing 7 Limited	100%
Capital Bank Leasing 8 Limited	100%
Capital Bank Leasing 9 Limited	100%
Capital Bank Property Investments (3) Limited	100%
Capital Bank Property Investments (6) Limited	100%
Capital Bank Vehicle Management Limited	100%
Capital Leasing (Edinburgh) Limited	100%
Capital Leasing Limited	100%
Capital Personal Finance Limited	100%
Car Ownership Finance Limited	100%
Cardnet Merchant Services Limited	97.85% (100%) ii, #
^shares held directly by Lloyds Banking Group plc	^0% (100%) iii
Carlease Limited	100%
Cartwright Finance Limited	100% viii
	0.08% vii, #
CashFriday Limited	100%
Cashpoint Limited	100%
Castle Baynard Funding Limited	100%
Castlemill Investments Limited (In Liquidation)	100%
Caveminster Limited	100%
CBRail Limited (In Liquidation)	100%
CBRail S.A.R.L., (Luxembourg)	100%
Cedar Holdings Limited	100%
Central Mortgage Finance Limited	100%
CF Asset Finance Limited	100%
Chariot Finance Limited	100%
Chartered Trust (Nominees) Limited	100%

Subsidiaries and related undertakings continued

Chartered Trust Limited (In Liquidation)	100%	
Chartered Trust Marine Limited (In Liquidation)	100%	
Charterhall (No. 1) Limited	100%	
Charterhall (No. 2) Limited	100%	
Charterhall (No. 3) Limited	100%	
Cheltenham & Gloucester Plc	99.99% (100%)	
Cheshire Holdings Europe Limited, (Jersey)	100%	
	100%	xii
Chiswell Stockbrokers Limited	100%	
Clerical Medical (Dartford Number 2) Limited	100%	
Clerical Medical (Dartford Number 3) Limited	100%	
Clerical Medical (Waterlooville One) Limited, (Jersey)	100%	
Clerical Medical (Waterlooville Two) Limited, (Jersey)	100%	
Clerical Medical Finance Plc	99.99% (100%)	
Clerical Medical Financial Services Limited	99.99% (100%)	
Clerical Medical Forestry Limited	99.99% (100%)	
Clerical Medical International Holdings B.V.	100%	
Clerical Medical Investment Fund Managers Limited	100%	
Clerical Medical Investment Group Limited	100%	
Clerical Medical Managed Funds Limited	99.99% (100%)	
Clerical Medical Non Sterling Property Company SARL	100%	
Clerical Medical Properties Limited	99.99% (100%)	
Cloak Lane Finance (Cayman) Limited (In Liquidation), (Cayman)	100%	
	0% (100%)	iv
Cloak Lane Funding Limited, (Jersey)	100%	
	100%	iv
Cloak Lane Investments Limited	100%	
CM Venture Investments Limited, (Isle of Man)	100%	
	100%	iv
CMI Asset Management (Luxembourg) S.A (In Liquidation), (Luxembourg)	99.99%	
CMI Insurance (Luxembourg) S.A, (Luxembourg)	99.99% (100%)	
Coate Homes Limited (In Liquidation)	100%	
Coleman Staffordshire Funding Limited (In Liquidation)	100%	
Coleman Staffordshire Investments Limited (In Liquidation)	100%	
Conquest Securities Limited	100%	iv
	100%	vi
Corbiere Asset Investments Ltd	100%	i
	0% (100%)	ii
County Wide Property Investments Limited	100%	
Create Services Limited	100%	
Dalkeith Corporation, (USA)	100%	
Delancey Rolls UK Limited	100%	ii, #
Denham Funding Limited	100%	
	100%	iv
Deva Lease 2 Limited	100%	
Deva Lease 3 Limited	100%	
Direct LB Limited	100%	
Dunstan Investments (UK) Limited	100%	
Eastareap Funding Limited (in liquidation)	100%	
Enterprise Car Finance Limited	100%	ii
Equipment Leasing (No. 3) Limited	100%	
Equipment Leasing (No. 6) Limited	100%	
Eurolead Services Holdings Limited	100%	
Exclusive Finance No. 1 Limited	100%	
	100%	i
Faryner's House Funding Limited (In Liquidation),	100%	
(Cayman Islands)	100%	x
	100%	x
Financial Consultants LB Limited	100%	
First Alternative Limited	100%	
First Retail Finance (Chester) Limited	100%	
Flexifly Limited	100%	
Fontview Limited	100%	
Forthright Finance Limited	100%	
Fortrose Investments Limited (In Liquidation)	100%	
France Industrial Premises Holding Company, (France)	100%	
Freeway Limited	100%	
General Insurance Services Limited	100%	
General Leasing (No. 10) Limited (In Liquidation)	100%	
General Leasing (No. 12) Limited	100%	
General Leasing (No. 14) Limited	100%	
General Leasing (No. 15) Limited	100%	
General Leasing (No. 19) Limited (In Liquidation)	100%	
General Leasing (No. 2) Limited	100%	
General Leasing (No. 4) Limited	100%	
General Reversionary And Investment Company	80%	
Gensar Design Limited (In Liquidation)	100%	
GFP Holdings LLC, (USA)	100%	
Gleacher Mezzanine LLC, (USA)	66.67%	
Glosstrips Limited	100%	
Godfrey Davis (Contract Hire) Limited	100%	
Goldbond Limited (In Liquidation), (Hong Kong)	100%	
Gresham Nominee 1 Limited	100%	
Gresham Nominee 2 Limited	100%	
Halifax Credit Card Limited	100%	i
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Halifax Equitable Limited	100%	
Halifax Financial Brokers Limited	100%	
Halifax Financial Services (Holdings) Limited	100%	
Halifax Financial Services Limited	100%	
Halifax General Insurance Services Limited	100%	
Halifax Group Limited	100%	
Halifax Investment Services Limited	100%	
Halifax Leasing (June) Limited	100%	
Halifax Leasing (March No.2) Limited	100%	
Halifax Leasing (September) Limited	100%	
Halifax Life Limited	100%	
Halifax Limited	99.99% (100%)	
Halifax Loans Limited	100%	
Halifax Mortgage Services (Holdings) Limited	100%	
Halifax Mortgage Services Limited	100%	
Halifax Nominees Limited	100%	
Halifax Pension Nominees Limited	100%	
Halifax Premises Limited	100%	
Halifax Share Dealing Limited	100%	
Halifax Vehicle Leasing (1998) Limited	100%	
HBOS Canada Inc, (Canada)	100%	
HBOS Capital Funding (Jersey) Limited, (Jersey)	100%	
HBOS Covered Bonds LLP	n/a	*
HBOS Directors Limited	100%	
HBOS Final Salary Trust Limited	100%	
HBOS Financial Services Limited	100%	
HBOS Insurance & Investment Group Limited	100%	
HBOS International Financial Services Holdings Limited	99.99% (100%)	
HBOS Investment Fund Managers Limited	100%	
HBOS Investment Management (Mediterranean) Limited (In Liquidation)	100%	
HBOS Investment Management Holdings (Malta) Limited (In Liquidation), (Malta)	100%	
HBOS Management (Jersey) Limited, (Jersey)	100%	
HBOS Plc	99.99% (100%)	
	100%	iv
	100%	vi
HBOS Social housing Covered Bonds LLP	n/a	*
HBOS Treasury Services Limited	100%	
HBOS UK Limited	99.99% (100%)	
HECM Customer Services Limited (In Liquidation)	99.99% (100%)	
Heidi Finance Holdings (UK) Limited	100%	
High Street Marketing Services S.A. (In Liquidation), (Argentina)	99.99% (100%)	
Highway Contract Hire Limited (In Liquidation)	100%	
Highway Vehicle Leasing Limited (In Liquidation)	100%	
	100%	iv
Highway Vehicle Management Limited	100%	
Hill Samuel (USA), Inc., (USA)	100%	
Hill Samuel Bank Limited	100%	
Hill Samuel Finance (No.22) Limited (In Liquidation)	100%	
Hill Samuel Finance Limited	100%	xi
	100%	iv
Hill Samuel International Holdings Limited (In Liquidation)	100%	i
Hill Samuel Investments Limited (In Liquidation)	36.61% (100%)	
Hill Samuel Leasing (No 2) Limited	100%	
Hill Samuel Leasing Co. Limited	100%	
Hill Samuel Nominees Asia Private Limited, (Singapore)	100%	
HL Group (Holdings) Limited	100%	
Home Shopping Personal Finance Limited	100%	
Horizon Capital 2000 Limited	100%	
Horizon Capital Limited	100%	
Horizon Hotel Investments Limited	100%	
Horizon Property Investments Limited	100%	
Horizon Residential Developments Limited (In Liquidation)	100%	
Horizon Resources Limited	100%	

Horsham Investments Limited, (Jersey)	100%	
Housing Growth Partnership GP LLP	n/a	*
Housing Growth Partnership LP	n/a	*
Housing Growth Partnership Limited	100%	i
Housing Growth Partnership Manager Limited	100%	
HSDL Nominees Limited	100%	
HVF Limited	100%	
Hyundai Car Finance Limited	100%	i
	100%	ii
IAI International Limited	100%	
IBOS Finance Limited	100%	
IBOS Securities	n/a	*
ICC Enterprise Partners Limited, (Ireland)	100%	
ICC Equity Partners Limited, (Ireland)	100%	
ICC ESOP Trustee Limited, (Ireland)	100%	
ICC Holdings, (Ireland)	99.09% (100%)	
ICC Software Partners Limited, (Ireland)	100%	
IF Covered Bonds Limited Liability Partnership	n/a	*
In Store Credit Limited	100%	
Inchcape Financial Services Limited	100%	i
Industrial Real Estate (General Partner) Limited	100%	
Industrial Real Estate (Nominee) Limited	100%	
Intelligent Finance Financial Services Limited	100%	
Intelligent Finance Software Limited	100%	
International Motors Finance Limited	100%	i
IWEB (UK) Limited (In Liquidation)	100%	
Kanaalstraat Funding C.V., (Netherlands)	n/a	*
Kanto Leasing Limited	100%	
Katrine Leasing Limited, (Jersey)	100%	
Kingsbarns Investments Limited (In Liquidation)	100%	
Kripton Properties Limited (In Liquidation), (Ireland)	100%	
Langbourn Holdings Limited, (Guernsey)	99.99% (100%)	
LB Comhold Limited	100%	
LB Healthcare Trustee Limited	100%	
LB Leasing L.P, (USA)	n/a	*
LB Mortgages Limited	100%	
LB Motorent Limited	100%	
LB Quest Limited	100%	
LB Share Schemes Trustees Limited	100%	
LBCF Limited	100%	
LBG Capital Holdings Limited		
^shares held directly by Lloyds Banking Group plc	^100%	
LBG Capital No. 2 Plc	100%	
LBG Capital No.1 Plc	100%	
LBI Finanz Anstalt (In Liquidation), (Liechtenstein)	100%	
LBI Leasing Limited	100%	
LDC (Asia) Limited, (Hong Kong)	100%	
LDC (General Partner) Limited	100%	
LDC (Managers) Limited	100%	
LDC (Nominees) Limited	100%	
LDC (UK) Ltd (applied for strike off)	100%	
LDC Carry V LP	n/a	*
LDC Equity V LLP	n/a	*
LDC GP LLP	n/a	*
LDC I LP	n/a	*
LDC II LP	n/a	*
LDC III LP	n/a	*
LDC IV LP	n/a	*
LDC Parallel (Nominees) Limited	100%	
LDC Parallel I LP	n/a	*
LDC Parallel II LP	n/a	*
LDC Parallel III LP	n/a	*
LDC Parallel IV LP	n/a	*
LDC Parallel V LP	n/a	*
LDC PE Limited (applied for strike off)	100%	
LDC Private Equity Ltd (applied for strike off)	100%	
LDC Ventures Carry Ltd	100%	
LDC Ventures Trustees Ltd	100%	
LDC V LP	n/a	*
Leasing (No. 2) Limited	100%	
Legacy Renewal Company Limited	99.99% (100%)	
Lex Autolease (CH) Limited	100%	
Lex Autolease (FMS) Limited	100%	
Lex Autolease (Shrewsbury) Limited	100%	
	100%	iv
	100%	v
Lex Autolease (VC) Limited	100%	
Lex Autolease (VH) Limited (In Liquidation)	100%	
Lex Autolease (VL) Limited	100%	
Lex Autolease Carselect Limited	100%	
Lex Autolease Limited	100%	
Lex Vehicle Finance 2 Limited	100%	
Lex Vehicle Finance 3 Limited	100%	
Lex Vehicle Finance Limited	100%	
Lex Vehicle Leasing (Holdings) Limited	100%	i
	100%	ii
	100%	x
Lex Vehicle Leasing Limited	100%	
Lex Vehicle Partners (1) Limited	100%	
Lex Vehicle Partners (2) Limited	100%	
Lex Vehicle Partners (3) Limited	100%	
Lex Vehicle Partners (4) Limited	100%	
Lex Vehicle Partners Limited	100%	
Lime Street (Funding) Limited	100%	
Lloyds (FDC) Company	99% (100%)	
Lloyds (General Partner) Limited, (Jersey)	100%	
Lloyds (Gresham) Limited	100%	
	100%	x
Lloyds (Gresham) No. 1 Limited	100%	
Lloyds (Nimrod) Leasing Industries Limited	100%	
Lloyds (Nimrod) Specialist Finance Limited	100%	
Lloyds America Securities Corporation	100%	
Lloyds Asset Leasing Limited	100%	
Lloyds Bank (BLSA)	50% (100%)	
Lloyds Bank (Branches) Nominees Limited	100%	
Lloyds Bank (Colonial & Foreign) Nominees Limited	100%	
Lloyds Bank (Fountainbridge 1) Limited	100%	
Lloyds Bank (Fountainbridge 2) Limited	100%	
Lloyds Bank (Gibraltar) Limited, (Gibraltar)	100%	
Lloyds Bank (I.D.) Nominees Limited	100%	
Lloyds Bank (Pep Nominees) Limited	100%	
Lloyds Bank (Stock Exchange Branch) Nominees Limited	100%	
Lloyds Bank Asset Finance Limited	100%	
Lloyds Bank Commercial Finance Limited	100%	
Lloyds Bank Commercial Finance Scotland Limited	100%	
Lloyds Bank Corporate Asset Finance (HP) Limited	100%	
Lloyds Bank Corporate Asset Finance (No. 3) Limited	100%	
Lloyds Bank Corporate Asset Finance (No. 4) Limited	100%	
Lloyds Bank Corporate Asset Finance (No.1) Limited	100%	
Lloyds Bank Corporate Asset Finance (No.2) Limited	100%	
Lloyds Bank Covered Bonds LLP	n/a	*
Lloyds Bank Equipment Leasing (No. 1) Limited	100%	
Lloyds Bank Equipment Leasing (No. 10) Limited	100%	
Lloyds Bank Equipment Leasing (No. 11) Limited	100%	
Lloyds Bank Equipment Leasing (No. 2) Limited	100%	
Lloyds Bank Equipment Leasing (No. 5) Limited	100%	
Lloyds Bank Equipment Leasing (No. 7) Limited	100%	
Lloyds Bank Equipment Leasing (No. 9) Limited	100%	
Lloyds Bank Financial Advisers Limited	100%	i
	100%	ii
Lloyds Bank Financial Services (Holdings) Limited	99.99% (100%)	
	0% (100%)	iv
Lloyds Bank Financial Services Limited (In Liquidation)	100%	
Lloyds Bank Foundation for England & Wales	n/a	*
Lloyds Bank Foundation for Northern Ireland	n/a	*
Lloyds Bank Foundation for the Channel Islands	n/a	*
Lloyds Bank General Insurance Holdings Limited	100%	
Lloyds Bank General Insurance Limited	100%	
Lloyds Bank General Leasing (No. 1) Limited	100%	
Lloyds Bank General Leasing (No. 11) Limited	100%	
Lloyds Bank General Leasing (No. 17) Limited	100%	
Lloyds Bank General Leasing (No. 18) Limited	100%	
Lloyds Bank General Leasing (No. 20) Limited	100%	
Lloyds Bank General Leasing (No. 3) Limited	100%	
Lloyds Bank General Leasing (No. 5) Limited	100%	
Lloyds Bank General Leasing (No. 9) Limited	100%	
Lloyds Bank GF (Holdings) Limited	100%	
	100%	vi
Lloyds Bank Hill Samuel Holding Company Limited	100%	
Lloyds Bank Insurance Services (Direct) Limited	100%	
Lloyds Bank Insurance Services Limited	100%	
Lloyds Bank International Limited, (Jersey)	100%	
Lloyds Bank Leasing (No. 3) Limited	100%	
Lloyds Bank Leasing (No. 4) Limited	100%	
Lloyds Bank Leasing (No. 6) Limited	100%	
Lloyds Bank Leasing (No. 7) Limited	100%	

Subsidiaries and related undertakings continued

Lloyds Bank Leasing (No. 8) Limited	100%	
Lloyds Bank Leasing Limited	100%	
Lloyds Bank Maritime Leasing (No. 10) Limited	100%	
Lloyds Bank Maritime Leasing (No. 12) Limited	100%	
Lloyds Bank Maritime Leasing (No. 13) Limited	100%	
Lloyds Bank Maritime Leasing (No. 15) Limited	100%	
Lloyds Bank Maritime Leasing (No. 16) Limited	100%	
Lloyds Bank Maritime Leasing (No. 17) Limited	100%	
Lloyds Bank Maritime Leasing (No. 18) Limited	100%	
Lloyds Bank Maritime Leasing (No. 2) Limited	100%	
Lloyds Bank Maritime Leasing (No. 3) Limited	100%	
Lloyds Bank Maritime Leasing (No. 8) Limited	100%	
Lloyds Bank Maritime Leasing Limited	100%	
Lloyds Bank Mtch Limited	100%	
Lloyds Bank Nominees Limited	100%	
Lloyds Bank Offshore Pension Trust Limited, (Jersey)	91% (100%)	
Lloyds Bank Pension ABCS (No. 1) LLP	n/a	*
Lloyds Bank Pension ABCS (No. 2) LLP	n/a	*
Lloyds Bank Pension Trust (No. 1) Limited	100%	
Lloyds Bank Pension Trust (No. 2) Limited	100%	
Lloyds Bank Pensions Property (Guernsey) Limited,	100%	i
(Guernsey)	100%	ii
Lloyds Bank Plc	^99.99% (100%)	
^shares held directly by Lloyds Banking	^100%	ix
Group plc	^100%	ix
	^100%	x
	^100%	x
	^100%	x
Lloyds Bank Private Banking Limited	100%	
Lloyds Bank Properties Limited	100%	
Lloyds Bank Property Company Limited	100%	
Lloyds Bank S.F. Nominees Limited	100%	
Lloyds Bank Subsidiaries Limited	100%	
	100%	iv
Lloyds Bank Trust Company (International) Limited	100%	
Lloyds Bank Trustee Services Limited	100%	
Lloyds Bank Trustees Limited	100%	
Lloyds Banking Group Insurance PCC Limited (In Liquidation), (Guernsey)	77.16% (100%)	
Lloyds Banking Group Pensions Trustees Limited	100%	
Lloyds Capital 2 L.P, (Jersey)	n/a	*
Lloyds Commercial Leasing Limited	100%	
Lloyds Commercial Properties Limited	100%	
Lloyds Commercial Property Investments Limited	100%	
Lloyds Corporate Services (Jersey) Limited, (Jersey)	100%	
Lloyds Development Capital (Holdings) Limited	100%	
Lloyds Development Capital Ltd (applied for strike off)	100%	
Lloyds Engine Capital (No.1) U.S LLC, (USA)	100%	
Lloyds Far East Limited, (Jersey)	100%	
Lloyds Financial Leasing Limited	100%	
Lloyds Financial Services Limited	100%	
Lloyds General Leasing Limited	100%	
Lloyds Group Holdings (Jersey) Limited, (Jersey)	99.4%	i
	100%	ii
	100%	vii
Lloyds Holdings (Jersey) Limited, (Jersey)	100%	
Lloyds Industrial Leasing Limited	100%	
Lloyds International Pty Limited, (Australia)	100%	
	0% (100%)	x
Lloyds Investment Bonds Limited	100%	
Lloyds Investment Fund Managers Limited, (Jersey)	100%	
Lloyds Investment Securities No.5 Limited	100%	
Lloyds Leasing (North Sea Transport) Limited	100%	
Lloyds Leasing Developments Limited	100%	
Lloyds Nominees (Guernsey) Limited, (Guernsey)	98% (100%)	
Lloyds Offshore Global Services Private Limited, (India)	99.99% (100%)	
Lloyds Plant Leasing Limited	100%	
Lloyds Portfolio Leasing Limited	100%	
Lloyds Premises Investments Limited	100%	
Lloyds Project Leasing Limited	100%	
Lloyds Property Investment Company Limited	100%	
Lloyds Property Investment Company No. 4 Limited	100%	
Lloyds Property Investment Company No. 5 Limited	100%	
Lloyds Property Investment Company No.3 Limited	100%	
Lloyds Secretaries Limited	100%	
Lloyds Securities Inc, (USA)	100%	
Lloyds Trade & Project Finance Limited	100%	
Lloyds Trust Company (Gibraltar) Limited, (Gibraltar)	100%	
Lloyds TSB Fomento Comercial LTDA, (Brazil)	99.99% (100%)	
Lloyds TSB Foundation for Scotland	n/a	*
Lloyds TSB Merchant Bank Limited, (Singapore)	100%	
	100%	v
Lloyds TSB Montracon Limited (In Liquidation)	100%	
Lloyds TSB Pacific Limited, (Hong Kong)	99.99% (100%)	
Lloyds TSB Rail Capital Inc., (USA)	100%	
Lloyds TSB Representaçóes LTDA, (Brazil)	99.99% (100%)	
Lloyds UDT (Marlow) Limited (In Liquidation)	100%	
Lloyds UDT Asset Leasing Limited	100%	
Lloyds UDT Asset Rentals Limited	100%	
Lloyds UDT Business Development Limited	100%	
Lloyds UDT Business Equipment Limited	100%	
Lloyds UDT Hiring Limited	100%	
Lloyds UDT Leasing Limited	100%	
Lloyds UDT Limited	100%	
Lloyds UDT Rentals Limited (In Liquidation)	100%	
Lloyds Your Tomorrow Trustee Limited	100%	
London Taxi Finance Limited	100%	i
	100%	ii
London Uberior (L.A.S.Group) Nominees Limited	n/a	*
Lothian Road LLC, (USA)	100%	
Lotus Finance Limited	100%	i, #
Lovat Funding (Holdings) Limited	100%	
LTGP Limited Partnership Incorporated, (Guernsey)	n/a	*
Maritime Leasing (No. 1) Limited (In Liquidation)	100%	
Maritime Leasing (No. 11) Limited	100%	
Maritime Leasing (No. 14) Limited (In Liquidation)	100%	
Maritime Leasing (No. 19) Limited	100%	
Maritime Leasing (No. 4) Limited (In Liquidation)	100%	
Maritime Leasing (No. 7) Limited	100%	
Maritime Leasing (No. 9) Limited (In Liquidation)	100%	
Meadowfield Investments Limited	100%	
Membership Services Finance Limited	100%	
Mitre Street Funding Limited, (Jersey)	100%	
Moor Lane Holdings Limited, (Jersey)	100%	
Moray Investments Limited	100%	
Morrison Street LLC, (USA)	100%	
Mortgage Services Funding Limited (In Liquidation)	100%	
Murrayfield LLC, (USA)	100%	
Nevis Leasing Limited, (Jersey)	74%	
Newfont Limited	100%	
NFU Mutual Finance Limited	100%	i, #
	100%	vii
Nominees (Jersey) Limited, (Jersey)	100%	
Nordic Leasing Limited	100%	
Northern Mortgage Corporation Limited (In Liquidation)	100%	
NW Motor Finance Limited (In Liquidation)	100%	
NWS 2	n/a	*
NWS Trust Limited	100%	
Ocean Leasing (July) Limited	100%	
Ocean Leasing (No 1) Limited	100%	
Ocean Leasing (No 2) Limited	100%	
Old Park Limited (In Liquidation), (Cayman)	100%	
Omnistone Limited, (Ireland)	100%	i
	100%	ii
	98% (100%)	vii
Oystercatcher Nominees Limited	100%	
Oystercatcher Residential Limited	100%	
Pacific Leasing Limited	100%	
Pensions Management (S.W.F.) Limited	n/a	*
Peony Eastern Leasing Limited	100%	
Peony Leasing Limited	100%	
Peony Western Leasing Limited	100%	
Perry Nominees Limited	100%	
Personal Motoring Plan Limited (In Liquidation)	100%	
Pips Asset Investments Limited	100%	i
	0% (100%)	ii
Portland Funding Limited	100%	
Prestonfield Investments Limited	100%	
Prestonfield P1 Limited	100%	
Prestonfield P2 Limited	100%	
Prestonfield P3 Limited	100%	
Proton Finance Limited	99.99% (100%)	ii, #
Quion 6 BV, (Netherlands)	100%	
R I G P Finance Limited (In Liquidation)	100%	
	100%	iii

	100%	iii
	100%	iv
R.F. Spencer And Company Limited	100%	
Ranelagh Nominees Limited	100%	
Retail Revival (Burgess Hill) Investments Limited	100%	
Retail Revival (Stratford) Investments Limited (In Liquidation)	100%	
Retail Revival (Trowbridge) Investments Limited (In Liquidation)	100%	
Rig Funding (Cayman) Limited (In Liquidation), (Cayman)	100%	
Saint Michel Holding Company No1, (France)	100%	
Saint Michel Investment Property, (France)	99% (100%)	
Saint Witz 2 Holding Company No1, (France)	100%	
Saint Witz 2 Investment Property, (France)	99% (100%)	
Saleslease Purchase Limited	100%	
Savban Leasing Limited	100%	
Scotland International Finance B.V., (Netherlands)	100%	
Scotland International Finance No. 2 B.V., (Netherlands)	100%	
Scotmar Commercial Equipment Finance Limited	100%	i, #
Scottish Widows (Port Hamilton) Limited	100%	
Scottish Widows Active Management Fund	n/a	*
Scottish Widows Administration Services Limited	100%	
Scottish Widows Annuities Limited	100%	
Scottish Widows Bank Plc	100%	
Scottish Widows Financial Services Holdings	100%	
Scottish Widows' Fund And Life Assurance Society	n/a	*
Scottish Widows Fund Management Limited	100%	
Scottish Widows Group Limited	100%	i
	0% (100%)	ii
	0% (100%)	iv
	0% (100%)	x
Scottish Widows Industrial Properties Europe B.V., (Netherlands)	100%	
Scottish Widows Limited	100%	
Scottish Widows Pension Trustees Limited	100%	
Scottish Widows Property Management Limited	100%	
Scottish Widows Services Limited	100%	
Scottish Widows Trustees Limited	100%	
Scottish Widows Unit Funds Limited	100%	
Scottish Widows Unit Trust Managers Limited	100%	
Seabreeze Leasing Limited	100%	
Seadance Leasing Limited	100%	
Seaforth Maritime (Highlander) Limited	100%	
Seaforth Maritime (Jarl) Limited	100%	
Seaspirit Leasing Limited	100%	
SeaSpray Leasing Limited	100%	
Services LB (No. 2) Limited	100%	
	100%	iv
Services LB (No. 3) Limited	100%	
Services LB (No. 4) Limited	100%	
	100%	iv
SG Motor Finance Limited (In Liquidation)	100%	iv
Share Dealing Nominees Limited	100%	
Shibden Dale Limited	100%	
Shogun Finance Limited	100%	ii, #
Silentdale Limited	100%	iv
	100%	vi
	100%	vi
St Andrew's Group Plc	99.99% (100%)	
St Andrew's Insurance Plc	99.99% (100%)	
St Andrew's Life Assurance Plc	99.99% (100%)	
St. Mary's Court Investments	99.99% (100%)	
Standard Property Investment (1987) Limited	0% (100%)	i
Standard Property Investment Limited	60.34%	
Starfort Limited	100%	
Sussex County Homes Limited	100%	
Suzuki Financial Services Limited	100%	i, #
SW No.1 Limited	100%	
SWAMF (GP) Limited	100%	
SWAMF Nominee (1) Limited	100%	
SWAMF Nominee (2) Limited	100%	
SW Funding plc	99% (100%)	
SWUF Nominee 1 Limited, (Jersey)	100%	
SWUF Nominee 2 Limited, (Jersey)	100%	
SWUF Nominee 3 Limited, (Jersey)	100%	
SWUF Nominee 4 Limited, (Jersey)	100%	
Tantallon Investments, Inc	100%	
Target Corporate Services Limited	100%	
The Agricultural Mortgage Corporation Plc	99.99% (100%)	
The British Linen Company Limited	99.98%	
The Clearwater Partnership LLP, (USA)	n/a	*
The Emerson Partnership LLP, (USA)	n/a	*
The Freight Leasing Partnership LLP, (USA)	n/a	*
The Grand Leasing Partnership LLP, (USA)	n/a	*
The Mortgage Business Public Limited Company	99.99% (100%)	
Three Copthall Avenue Limited	99% (100%)	
Tower Hill Property Investments (10) Limited	90%	
Tower Hill Property Investments (7) Limited	90%	
Tranquillity Leasing Limited	100%	
TSB Intermediate Company 1 Limited (In Liquidation)	n/a	*
TSB Intermediate Company 2 Limited (In Liquidation)	100%	
Uberior (Moorfield) Limited	100%	
Uberior Europe Limited	100%	
Uberior Canada LP Ltd, (Canada)	100%	
Uberior Co-Investments Limited	100%	
Uberior ENA Limited	100%	
Uberior Equity Limited	100%	
Uberior Fund Investments Limited	100%	
Uberior Infrastructure Investments (No 2) Limited	100%	
Uberior Infrastructure Investments Limited	100%	
Uberior Investments Limited	99% (100%)	
Uberior ISAF CIP 2007 L.P	n/a	*
Uberior Nominees Limited	n/a	*
Uberior Trading Limited	100%	
Uberior Trustees Limited	n/a	*
Uberior Ventures Australia Pty Limited, (Australia)	100%	
Uberior Ventures Limited	100%	
UDT Autolease Limited	100%	
UDT Budget Leasing Limited	100%	
UDT Limited	100%	
UDT Sales Finance Limited	100%	
United Dominions Leasing Limited	100%	
United Dominions Trust Limited	100%	
Upsaala Limited, (Ireland)	100%	
Vehicle Leasing (1) Limited	100%	
Vehicle Leasing (2) Limited	100%	
Vehicle Leasing (3) Limited	100%	
Vehicle Leasing (4) Limited	100%	
Vintry Holdings (UK) Limited (In Liquidation)	100%	
Ward Nominees (Abingdon) Limited	100%	
Ward Nominees (Birmingham) Limited	100%	
Ward Nominees (Bristol) Limited	100%	
Ward Nominees Limited	100%	
Warwick Leasing Limited	100%	i
	100%	ii
Waverley - Boca LLC, (USA)	100%	
Waverley - Fund II Investor LLC, (USA)	100%	
Waverley - Fund III Investor LLC, (USA)	100%	
Waverley - Wilshire Rodeo LLC, (USA)	100%	
Waymark Asset Investments Limited	100%	i
	0% (100%)	ii
WCS Limited, (Isle of Man)	100%	
West Craigs Limited	100%	
Western Trust & Savings Holdings Limited	100%	
Western Trust Holdings Limited	100%	
Whitestar Securities Limited	100%	ii
	100%	xi
Wood Street Leasing Limited	100%	

* The undertaking does not have share capital
# An undertaking external to the Group holds a separate class of share
(i) A Ordinary shares
(ii) B Ordinary shares
(iii) Deferred Shares
(iv) Preference shares
(v) Preferred Ordinary shares
(vi) Non-voting shares
(vii) C Ordinary shares
(viii) N Ordinary shares
(ix) Callable preference shares
(x) Redeemable preference shares
(xi) Ordinary limited voting shares
(xii) Redeemable ordinary shares

Subsidiaries and related undertakings continued

Subsidiary undertakings[i]

Name of undertaking
Addison Social Housing Holdings Limited, (Jersey)
Addison Social Housing Limited
ARKLE Finance Trustee Limited, (Jersey)
ARKLE Funding (No. 1) Ltd
ARKLE Holdings Limited
ARKLE Master Issuer plc
ARKLE PECOH Holdings Ltd
ARKLE PECOH Limited
Cancara Asset Securitisation Limited, (Jersey)
Candide Financing 2006 BV, (Netherlands)
Candide Financing 2007 NHG BV, (Netherlands)
Candide Financing 2008-1 BV, (Netherlands)
Candide Financing 2008-2 BV, (Netherlands)
Candide Financing 2011-1 BV, (Netherlands)
Candide Financing 2012-1 BV, (Netherlands)
Celsius European Lux 2 SARL, (Luxembourg)
Chepstow Blue Holdings Limited
Chepstow Blue plc
Clerical Medical Non Sterling Arts FSA, (Belgium)
Clerical Medical Non Sterling Arts LSA, (Belgium)
Clerical Medical Non Sterling Guadalix Hold Co BV, (Netherlands)
Clerical Medical Non Sterling Guadalix Spanish Prop Co SL, (Spain)
Clerical Medical Non Sterling Megapark Hold Co BV, (Netherlands)
Clerical Medical Non Sterling Megapark Prop Co SA, (Spain)
Computershare Trustees (Jersey) Limited, (Jersey)
Continuity Air Finance (Ireland) I Limited (In Liquidation)
Craig Finance Limited
Craig Financing Holdings Limited
Derby Blue 2009 plc
Derby Blue Holdings Limited
Deva Financing Holdings Limited
Deva Financing plc
Edgbaston RMBS 2010-1 plc
Edgbaston RMBS Holdings Limited
Exeter Blue Limited (Jersey)
Farnham Funding Limited, (Cayman Islands) 100% preference shares
Gable Funding plc (In Liquidation)
Gable Holdco Limited, (Jersey)
Gresham Receivables (No. 1) Limited, (Jersey)
Gresham Receivables (No. 10) Limited, (Jersey)
Gresham Receivables (No. 12) Limited, (Jersey)
Gresham Receivables (No. 15) UK Limited
Gresham Receivables (No. 19) UK Limited
Gresham Receivables (No. 20) Limited, (Jersey)
Gresham Receivables (No. 21) Limited, (Jersey)
Gresham Receivables (No. 22) Limited, (Jersey)
Gresham Receivables (No. 23) Limited, (Jersey)
Gresham Receivables (No. 24) Limited, (Jersey)
Gresham Receivables (No. 25) UK Limited
Gresham Receivables (No. 26) UK Limited
Gresham Receivables (No. 28) Limited, (Jersey)
Gresham Receivables (No. 29) Limited, (Jersey)
Gresham Receivables (No. 3) Limited, (Jersey)
Gresham Receivables (No. 30) UK Limited
Gresham Receivables (No. 31) UK Limited
Gresham Receivables (No. 32) UK Limited
Gresham Receivables (No. 33) UK Limited
Gresham Receivables (No. 34) UK Limited
Gresham Receivables (No. 35) Limited, (Jersey)
Gresham Receivables (No.11) UK Limited
Gresham Receivables (No.13) UK Limited
Gresham Receivables (No.14) UK Limited
Gresham Receivables (No.16) UK Limited
Gresham Receivables (No.27) UK Limited
Gresham Receivables (No.36) UK Limited
Gresham Receivables (No.37) UK Limited
Gresham Receivables (No.38) UK Limited
Gresham Receivables (No.39) UK Limited
Gresham Receivables (No.40) UK Limited
Guildhall Asset Purchasing Company (No 3) Limited, (Jersey)
Guildhall Asset Purchasing Company (No.11) UK Limited
Hart 2014-1 Limited, (Jersey)
Headingley RMBS 2011-1 Holdings Limited
Headingley RMBS 2011-1 plc
Leicester Securities 2014 Limited, (Ireland)
Lingfield 2014 I Holdings Limited
Lingfield 2014 I plc
Lloyds Bank Covered Bonds (Holdings) Limited
Lloyds Bank Covered Bonds (LM) Limited
Lloyds TSB Secured Finance (Holdings) Limited
Mound Holdings Limited
Mound Holdings No.2 Limited
Penarth Asset Securitisation Holdings Limited
Penarth Funding 1 Limited, (Jersey)
Penarth Funding 2 Limited, (Jersey)
Penarth Master Issuer plc
Penarth Receivables Trustee Limited, (Jersey)
Performer Financing Holdings Limited
Performer Financing plc (In Liquidation)
Permanent Funding (No. 1) Limited
Permanent Funding (No. 2) Limited
Permanent Holdings Limited
Permanent Master Issuer plc
Permanent Mortgages Trustee Limited, (Jersey)
Permanent PECOH Holdings Limited
Permanent PECOH Limited
Sandown 2012-2 Holdings Limited
Sandown 2012-2 plc
Sandown Gold 2011-1 Holdings Limited
Sandown Gold 2011-1 plc
Sandown Gold 2012-1 Holdings Limited
Sandown Gold 2012-1 plc
Sandown Gold Holdings Limited
Sandown Gold plc
SARL Coliseum, (France)
SARL Fonciere De Rives, (France)
SARL Hiram, (France)
SAS Compagnie Fonciere De France, (France)
SCI A-AP1, (France)
SCI Archos, (France)
SCI Argenteuil PPI, (France)
SCI Astoria Invest, (France)
SCI De L'Horloge, (France)
SCI Equinoxe, (France)
SCI Gandre, (France)
SCI Laval Invest, (France)
SCI Massy AP1, (France)
SCI Mercury Invest, (France)
SCI Millenium AP1, (France)
SCI Norli, (France)
SCI Rambuteau CFF, (France)
SCI Synergie, (France)
SCI Toulouse Capitouls, (France)
Stichting Candide Financing Holding, (Netherlands)
Swan Funding 1 Limited, (Jersey)
Swan Funding 2 Limited, (Jersey)
The Hual Carolita Limited Partnership
The SAFA 0494 Limited Partnership (to be placed into liquidation), (Cayman Islands)
Thistle Investments (ERM) Limited
Trinity Financing Holdings Limited
Trinity Financing plc
Trinity Holdings Limited
Wolfhound Funding 2 Limited, (Ireland)
Wolfhound Funding 2008-1 Limited, (Ireland)

(i) The Group has determined that it has the power to exercise control without having the majority of the voting rights of the undertakings. Unless otherwise stated, the undertakings do not have a share capital or the Group does not have any shares.

Associated undertakings

The Group has a participating interest in the following undertakings:

Name of undertaking	% of class held by immediate parent company
A G Germany Limited	100% vii
Aceso Healthcare Limited	27.52%
Adler & Allan Group Limited	43.61%
A-Gas (Orb) Limited	57%
Agora Shopping Centres Limited (In Administration)	50% ii
Airline Services And Components Group Limited	46.2%
Alderley Capital Limited (In Administration) (Isle of Man)	50% ii

Angus International Safety Group Limited	48.09%
Antler Limited	63.38%
Aqualisa Holdings Limited	64.71%
Aspin Group Holdings Limited	35.6%
Aspire Oil Services Limited	23.67%
Atcore Technology Group Limited	71.2%
Australand Apartments No.6 Pty Ltd, (Australia)	50%
Australand Residential Trust, (Australia)	n/a *
AVJBOS Nominees Proprietary Limited, (Australia)	50%
Away Resorts Limited	64.26%
Bergamot Ventures Limited	50% ii
Bluestone Consolidated Holdings Limited	0.25%
	47.15% iii
BOFA International Ltd	73.19%
Business Growth Fund Plc	23%
Capital Economics Research Limited	31.15%
Capital Gardens Limited	30.5%
Cary Towne Parke Holdings LLC, (USA)	98%
Cary Towne Parke LLC, (USA)	98%
Case Topco Limited	53.4%
Caspian Media Holdings	7.76%
	80.68% v
Cherry Topco Limited	32.4%
City & General Securities Limited	32.7%
Clifford Thames (Topco) Limited	50.27%
Cobaco Holdings Limited	50.34%
Connect Managed Holdings Limited	58.8%
Connery Limited, (Jersey)	20%
Continental Shelf 225 Limited (In Liquidation)	49% i
Continental Shelf 291 Limited (In Liquidation)	40.09% i
D.U.K.E Real Estate Limited	50% ii
Dale Erskine Power Solutions Limited	74.25%
Delancey Arnold UK Limited	100% ii
DCK Group Limited	75% viii
Dino Newco Limited	50.78%
EDM Business Services Holdings Limited	65.32%
Eley Group Limited	70.76%
Equiom Holdings Limited, (Isle of Man)	53.4%
Europa Property Company (Northern) Limited	35%
European Property Fund (Holdings) Limited SARL, (Luxembourg)	24.9%
Fern Bay Seaside Village Limited (In Liquidation), (Australia)	34.48%
FHR European Ventures LLP	n/a *
Forest Holidays Group Limited	59.28%
Golfview Apartment Holdings LLC, (USA)	88%
Golfview Apartments LLC, (USA)	88%
Great Wigmore Property Limited	100%
HBOS Capital Funding LP, (Jersey)	n/a *
HBOS Capital Funding No. 1 LP, (Jersey)	n/a *
HBOS Capital Funding No. 3 LP, (Jersey)	n/a *
HBOS Capital Funding No. 4 LP, (Jersey)	n/a *
HBOS Euro Finance (Jersey) LP, (Jersey)	n/a *
HBOS Sterling Finance (Jersey) LP, (Jersey)	n/a *
Hillview (Watford) Limited	50%
ICB Brands Holdings Limited	58.49%
Icon Polymer Group Limited	46.59%
Iglufastnet Limited	41.95%
Independent Group (UK) Limited	57.61%
Ingleby (1884) Limited	76%
Injection Directe Immobilier SAS, (France)	48.50%
Inprova Group Ltd	21.14%
Joules Investment Holdings Limited	27.04%
Kee Safety Group Limited	20.86%
Kenmore Capital 2 Limited (In Liquidation)	50% ii
Kenmore Capital 3 Limited (In Administrative Receivership)	50% ii
Kenmore Capital Limited (In Liquidation)	50% ii
Keoghs Topco Limited	22.28%
Kimberly Holdings Limited	59.08%
LCP Baby Investors LP (In process of disposal), (Cayman)	n/a *
Lighthouse Healthcare Group Limited	41.6%
LKR Holdings Limited	53.4%
Lothian Fifty (150) Limited	47.50%
Marvel Newco Limited	44.06%
Mini-Cam Limited	38.29%
Morston Assets Limited (In Administration)	20%
Motability Operations Group plc	20% (40%)
	20% (40%) iii
Murray International Holdings Limited (In Liquidation)	30%
	100% iii
Nevada Topco Limited	73.19%
New World Trading Company (UK) Holdings Limited	34.55%
Node 4 Holdings Limited	41.21%
Northern Edge Limited	23.27%
Octagon (Richmond) Limited	50% ii
Omnium Leasing Company	n/a *
Onapp (Topco) Limited	28.88%
Onapp (Topco) II Limited	28.88%
Original Additions Topco Limited	60.28%
Orion Media Holdings Limited	57.61%
Osprey Aviation Services (UK) Ltd	65.5%
Panther Partners Limited	61.41%
PE Media Group Limited	34.89%
Pertemps Network Group Limited	27.23%
PIHL Equity Administration Limited	35% ii
PIMCO (Holdings) Limited	61.88%
Prestbury 1 Limited Partnership	n/a *
Prestbury Hotel Holdings Limited (In Liquidation)	27.50% vii
Prestbury Wentworth Holdings Limited (In Liquidation)	29.41% vii
Prism Medical Healthcare Limited	65.05%
Property Software Holdings Limited	64.08%
Quantel Holdings (2010) Limited	54.83%
	54.83% iii
	95% iv
	86.45% v
Ramco Acquisition Limited	59.96%
Rolls Development UK Limited	100% ii
Sapphire Retail Fund Limited (In Liquidation)	50% ii
Seabrook Crisps Limited	66.94%
Secure Income REIT Plc	23.64%
Southport Green Acquisition LLC, (USA)	50%
Specialist People Services Group Limited	51.56%
SSP Topco Limited	54.17%
Stainton Capital Holdings Limited (In Liquidation)	50%
Stewart Milne (Glasgow) Limited	100% i
Stewart Milne (West) Limited	100% i
Stratus (Holdings) Limited	66.63%
Stroma Group Limited	36.42%
Synexus Clinical Research Topco Limited	49.57%
T D Travel (Holdings) Limited	53.56%
Tantallon Acquisition LLC, (USA)	100%
Tantallon Austin Hotel LLC, (USA)	100%
Tantallon Austin LLC, (USA)	100%
Tantallon LLC, (USA)	75%
Tantallon Orlando LLC, (USA)	100%
TCFG Holdings Limited	16.09%
Test Equipment Asset Management Limited	63.95%
The Great Wigmore Partnership (G.P.) Limited	n/a *
The Great Wigmore Partnership	n/a *
The Moment Content Group Limited	60.28%
The Power Industrial Group Limited	71%
The Scottish Agricultural Securities Corporation P.L.C.	33.33%
The Training Grp Holdings Limited	40.94%
Thread Real Estate Cary Towne Park LLC, (USA)	50%
Thread Real Estate Golfview LLC, (USA)	50%
TPN Group Holdings Limited	53.63%
Travellers Cheque Associates Limited	36%
Tropical Marine Centre (2012) Ltd	35%
Valad Canadian Partners LP, (Canada)	n/a *
Vocalink Holdings Limited	19.05% (33.47%)
	18.22% (20%) iii
WASP Management Software Limited	66%
Waterfall Catering Group Limited	59.95%
Whitefleet Limited (In Liquidation)	100% i
Willoughby (873) Limited	47.44%
WRG Worldwide Limited	48.3%
York & Becket Nominees Limited	100% ii
	50% vi
York & Becket Nominees No.3 Limited	100% ii
York & Becket Nominees No.4 Limited	100% ii
Zog Brownfield Ventures Limited (In Administration)	50%

* The undertaking does not have share capital

(i) A Ordinary Shares
(ii) B Ordinary Shares
(iii) Preferences Shares
(iv) Investor Preference Shares
(v) Preferred Ordinary Shares
(vi) Redeemable Preference Shares
(vii) C Ordinary Shares
(viii) F Ordinary Shares

Subsidiaries and related undertakings continued

Open Ended Investment Companies and Other Funds

The following comprises a list of the Group's Open Ended Investment Companies and other Funds

Name of undertaking	% of fund held by immediate parent
ABERDEEN EUROPEAN PROPERTY FUND viii	59%
ABERDEEN GLOBAL HIGH YIELD BOND viii	35%
ABERDEEN GLOBAL LIQUIDITY FUNDS PLC, (Ireland) i	
Aberdeen Sterling Liquidity Fund	39% (53%)
Euro Liquidity Fund	51% (93%)
ABERDEEN INVESTMENT CASH OEIC PLC Aberdeen Sterling Investment Cash Fund, (Ireland) iv	50% (60%)
ABERDEEN INVESTMENT FUND ICVC viii	
Aberdeen World Emerging Markets Equity Fund	75%
Aberdeen World Government Bond Fund	49%
ABERDEEN PRIVATE EQUITY FUND OF FUNDS (2007) PLC, (Ireland) iv	97%
ABERDEEN STERLING BOND FUND viii	100%
ACS POOLED PROPERTY iii	
Scottish Widows Pooled Property ACS Fund	100%
Scottish Widows Pooled Property ACS Fund 2	100%
AGFE UK REAL ESTATE SENIOR DEBT MUTUAL FUND xiii	83%
BLACKROCK BALANCED GROWTH PORTFOLIO FUND xiv 35%	
BLACKROCK EMERGING MARKETS FUND xiv	20%
BLACKROCK UK SMALLER COMPANIES FUND xiv	24%
BNY MELLON INVESTMENTS FUNDS ICVC ix	
Insight Global Absolute Return Fund	83%
Insight Global Multi-Strategy Fund	44%
Newton Managed Income Fund	29%
Newton Multi-Asset Growth Fund	31%
Newton Oriental Fund	39%
Newton UK Equity Fund	22%
Newton UK Opportunities Fund	44%
The Boston Company UK Opportunities Fund	21%
CLERICAL MEDICAL OEIC ICVC ii	
Clerical Medical Income Fund	23%
Clerical Medical Balanced Managed Fund	22%
CMIG EURO ADVENTUROUS MANAGED xv	51%
CMIG EURO BALANCED MANAGED xv	57%
CMIG EURO CAUTIOUS MANAGED xv	33%
CMIG GLOBAL MULTI ASSETS xv	31%
ETFS LIVERSTOCK, (USA) xvi	55%
ETFS PRECIOUS METALS, (USA) xvi	21%
HBOS ACTIVELY MANAGED PORTFOLIO FUNDS ICVC ii	
Absolute Return Fund	93%
Diversified Income Fund	82%
Diversified Return Fund	97%
Dynamic Return Fund	97%
HBOS GLOBAL INVESTMENT FUNDS ICVC ii	
Emerging Markets Focus Fund	81%
European Focus Fund	87%
European Strategic Fund	97%
Far Eastern Focus Fund	93%
Japanese Focus Fund	97%
US Focus Fund	79%
US Strategic Fund	98%
HBOS INTERNATIONAL INVESTMENT FUNDS ICVC ii	
European Fund	73%
Far Eastern Fund	45%
International Growth Fund	52%
Japanese Fund	92%
North American Fund	85%
HBOS PROPERTY INVESTMENT FUNDS ICVC UK Property Fund ii	45%
HBOS SPECIALISED INVESTMENT FUNDS ICVC ii	
Cautious Managed Fund	54%
Ethical Fund	70%
Fund of Investment Trusts	42%
Smaller Companies Fund	49%
Special Situations Fund	47%
HBOS UK INVESTMENT FUNDS ICVC ii	
UK Equity Income Fund	60%
UK FTSE All-Share Index Tracking Fund	56%
UK Growth Fund	62%
HBOS UK & FIXED INTEREST INVESTMENT FUNDS ICVC ii	
International Fixed Income Fund	93%
UK Focus Fund	90%
UK Gilt Fund	79%
UK High Income Fund	83%
UK Index-Linked Gilt Fund	24%
UK Smaller Companies Alpha Fund	81%
UK Strategic Fund	94%
INSIGHT INVESTMENT FUNDS-OF-FUNDS II ICVC Absolute Insight Fund ix	39%
INVESCO PERPETUAL FAR EASTERN INVESTMENT SERIES Invesco Perpetual Asian Equity Income Fund x	25%
JP MORGAN FUND II ICVC JPM Balanced Managed Fund xi	69%
MULTI-MANAGER ICVC iii	
Multi Manager UK Equity Growth Fund	67%
Multi Manager UK Equity Income Fund	20%
NORDEA 1 Diversified Return Fund, (Luxembourg) xviii	91%
SCHRODER GILT AND FIXED INTEREST FUND xvii	23%
SCOTTISH WIDOWS INCOME AND GROWTH FUNDS ICVC iii	
Adventurous Growth Fund	67%
Balanced Growth Fund	27%
Corporate Bond 1 Fund	100%
Corporate Bond PPF Fund	100%
Scottish Widows GTAA 1	82%
SW Corporate Bond Tracker	100%
UK Index Linked Gilt Fund	100%
SCOTTISH WIDOWS INVESTMENT SOLUTIONS FUNDS ICVC iii	
Adventurous Solution	78%
Asia Pacific (Ex Japan) Equity Fund	98%
Balanced Solution	51%
Cautious Solution	46%
Defensive Solution	75%
Discovery Solution	51%
Dynamic Solution	60%
European (Ex UK) Equity Fund	98%
Fundamental Index Emerging Markets Equity Fund	96%
Fundamental Index Global Equity Fund	96%
Fundamental Index UK Equity Fund	86%
Japan Equities Fund	95%
SSTL ADF SW FDMTL Index Glo EQ	100%
Strategic Solution	59%
US Equities Fund	100%
SCOTTISH WIDOWS MANAGED INVESTMENT FUNDS ICVC iii	
Balanced Portfolio Fund	82%
Cash Fund	99%
Cautious Portfolio Fund	60%
International Equity Tracker Fund	99%
Opportunities Portfolio Fund	93%
Progressive Portfolio Fund	74%
SCOTTISH WIDOWS OVERSEAS GROWTH INVESTMENT FUNDS ICVC iii	
American Growth Fund	88%
European Growth Fund	89%
Global Growth Fund	52%
Japan Growth Fund	99%
Pacific Growth Fund	37%

SCOTTISH WIDOWS TRACKER AND SPECIALIST INVESTMENT FUNDS ICVC iii	
Emerging Markets Fund	90%
International Bond Fund	68%
Overseas Fixed Interest Tracker Fund	99%
UK All Share Tracker Fund	93%
UK Fixed Interest Tracker Fund	98%
UK Index Linked Tracker Fund	88%
UK Smaller Companies Fund	28%
UK Tracker Fund	48%
SCOTTISH WIDOWS UK AND INCOME INVESTMENT FUNDS ICVC iii	
Corporate Bond Fund	52%
Environmental Investor Fund	68%
Ethical Fund	70%
Gilt Fund	97%
High Income Bond Fund	24%
Safety Plus Fund	72%
Strategic Income Fund	61%
UK Growth Fund	62%
SSGA ASIA PACIFIC TRACKER FUND v	82%
SSGA EUROPE v	95%
SSGA UK EQUITY TRACKER FUND v	91%
SWIP EUROPEAN BALANCED PROPERTY FUND, (Luxembourg) vi	85%
UBS INVESTMENT FUNDS ICVC UBS UK Opportunities Fund xii	50%

UNIVERSE, THE CMI GLOBAL NETWORK, (Luxembourg) vii	
CMIG Access 80%	100%
CMIG Focus Euro Bond	100%
CMIG GA 70 Flexible	100%
CMIG GA 80 Flexible	100%
CMIG GA 90 Flexible	100%
Continental Euro Equity	96%
Euro Bond	53%
Euro Currency Reserve	93%
European Enhanced Equity	100%
Japan Enhanced Equity	95%
Pacific Enhanced Basin	57%
UK Equity	75%
US Bond	91%
US Currency Reserve	68%
US Enhanced Equity	87%

Principal place of business
(i) 25/28 North Wall Quay, Dublin, Ireland
(ii) Trinity Road, Halifax West Yorkshire, HX1 2RG
(iii) 15 Dalkeith Road Edinburgh EH16 5WL
(iv) 39/40 Upper Mount Street, Dublin, Ireland
(v) 20 Churchill Place, Canary Wharf London E14 5HJ
(vi) 80 route d'Esch, L-1470 Luxembourg
(vii) 106 route d'Arlon, L-8210 Mamer Grand Duchy of Luxembourg
(viii) 1 Bread Street London EC4M 9HH
(ix) 160 Queen Victoria St London EC4V 4LA
(x) 30 Finsbury Square, London EC2A 1AG
(xi) 60 Victoria Embankment EC4Y 0JP
(xii) 21 Lombard Street London EC3V 9AH
(xiii) 55 Baker Street, London, W1U 8EW
(xiv) 12 Throgmorton Avenue, London EC2N 2DL
(xv) 33 Old Broad Street London
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