LLOYDS BANKING GROUP

# HELPING BRITAIN PROSPER

Annual Report and Accounts 2019

## Our Group

We are the largest UK retail and commercial financial services provider with around 26 million customers and a presence in nearly every community.

The Group's main business activities are retail and commercial banking, general insurance and long-term savings, provided through well recognised brands including Lloyds Bank, Halifax, Bank of Scotland and Scottish Widows.

Our shares are quoted on the London and New York stock exchanges and we are one of the largest companies in the FTSE 100 index.

## Our reporting

We aim to report in an integrated way to reflect the way we operate. As well as reporting our financial results, we also report on our strategy and approach to operating responsibly and take into account relevant economic, political, social, regulatory and environmental factors.

Within this year's report we have also sought to address the additional reporting requirements arising from Section 172 of the Companies Act 2006 and the 2018 UK Corporate Governance Code.

This Annual Report and Accounts contains forward looking statements with respect to 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 330.

## Picture this

In 2019, we offered colleagues from across the Group an opportunity to submit photographs that they felt represented our purpose of Helping Britain Prosper. The winning photos are marked with this symbol alongside the photographer's name.

The 2019 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
19 February 2020

## Group highlights

Solid financial performance in a challenging environment

**£3.0bn**
(33)%
**Statutory profit after tax** was lower largely due to the additional PPI charge. Tax expense of £1.4 billion

**3.37p**
+5%
Progressive and sustainable **ordinary dividend per share** including interim and final dividends

**27%**
**Total shareholder return** increased in the year reflecting the increased ordinary dividend and higher share price

**7.8%**
(3.9)pp
Lower **return on tangible equity** given lower statutory profit

**48.5%**
(0.8)pp
**Cost: income ratio** continues to improve

**13.8%**
(0.1)pp
**Common equity tier 1 ratio** remains strong

**16.4m**
+4%
**Digitally active customers** continued to increase and we remain the largest digital bank in the UK

**74%**
+1pp
**Employee engagement index** improved, two points above the norm for top performing UK companies

**20 of 22**
**Helping Britain Prosper Plan** targets achieved including the new sustainability KPI

All the above key performance indicators directly impact remuneration outcomes and support the delivery of our reward principles.

## Inside this year's Annual Report

Strategic report
Financial results
Governance
Risk management
Financial statements
Other information


During 2019, we've lent £13.8 billion to support people to **buy their first home**, helped over 350,000 more people **save for their future** and supported more than 100,000 **businesses across the UK to start up and grow**.

Given our **customer focused** strategy, **ambitious transformation** programme and **digital strength**, the Group remains well placed to continue to support its customers, **Help Britain Prosper** and **deliver long-term sustainable success.**

Helping Britain Prosper Plan
on **pages 27 to 34**

## Chairman's statement

# Significant strategic progress positioning us well to respond to the changing environment

**Given our unique position at the heart of the UK economy, the successful transition to a more sustainable, lower-carbon economy is of strategic importance to us.**

**Lord Blackwell**
Chairman

## Overview and strategy

During 2019, the Group has continued to make significant strategic progress and deliver solid financial performance in a challenging external environment. Much of the year was impacted by economic and political uncertainty, but our customer focus has remained strong and the cornerstone of our business.

The Group is driven by our powerful purpose of Helping Britain Prosper. As I have mentioned in previous years, despite the external challenges, the Board are determined to continue building value for shareholders by maintaining our focus on results delivery whilst simultaneously investing in the major transformation required to serve our customers and operate effectively in a digital world. This transformation not only requires adopting new technologies, but also adapting to the new skills, culture and ways of working that the digital revolution requires. Delivering this effectively while remaining true to our traditional values and focusing on customer service is a tremendous challenge, but we are committed to building a successful and sustainable Group of which we can all be proud.

We remain on track to deliver our commitment of more than £3 billion of strategic investment over the three year plan period, having invested around £2 billion to date. This investment, which in 2019 continued to focus on further enhancing our leading customer experience, digitising the Group, maximising Group capabilities and transforming ways of working, is essential to sustain our long-term competitive advantage.

At the same time we continue to invest in new growth opportunities. In 2019 we successfully launched Schroders Personal Wealth with the ambition of becoming a top three financial planning business by the end of 2023 as a complement to our growing pensions and retirement business in Scottish Widows. We also acquired Tesco Bank's £3.5 billion UK prime residential mortgage portfolio.

Our weak spot continued to be the ongoing legacy from past misconduct, with another significant provision for PPI mis-selling as we approached the deadline for customer compensation claims last August. In addition, despite the organisation's best intentions to provide rapid and generous compensation to victims of the historic HBOS Reading Fraud, we also had to acknowledge that the independent review of this process by Sir Ross Cranston highlighted shortcomings which now require us to ensure customers can opt into a further review if they are not satisfied with their outcome. We have learned a number of lessons from this, on how to improve our handling of small business customers, which we will build into our ongoing operations. The Board and Executive team remain committed to doing whatever is necessary to ensure all victims impacted by past failures receive fair recompense that reflects the importance we attach to earning and retaining the trust of our customers.

## Performance and capital return

We delivered a solid financial performance in 2019 despite the challenging external environment. I am naturally disappointed that our statutory result was significantly impacted by the additional PPI charge in the year as noted above. Despite this, our performance continues to demonstrate the resilience of our customer franchise and business model, the appropriateness of our strategy and the strength of our balance sheet.

With this in mind I am pleased to announce that the Board has recommended an increased final ordinary dividend of 2.25 pence per share, bringing the total ordinary dividend for 2019 to 3.37 pence per share, an increase of 5 per cent on last year and in line with the Group's policy to deliver a progressive and sustainable ordinary dividend. While we concluded that we should be prudent in not distributing further capital this year, the Board will continue to assess this in future years.

I am also pleased, that as announced in May 2019, the Group will be moving to quarterly dividend payments this year with the first payment in respect of the first quarter of 2020 due in June.

## Supporting the UK economy through uncertain times

We have and will continue to play an active part in supporting the UK economy, to which our success is inextricably linked. As part of our purpose of Helping Britain Prosper, we believe we have a responsibility to help address the social, economic and environmental challenges that the UK faces, whether we're helping people buy a house, supporting businesses to start up and grow, building digital skills, being a leader in diversity or helping the transition to a low carbon economy.

We are supporting businesses by providing funding, once again lending them up to £18 billion in 2020, and the skills and tools they will need to develop and grow. For instance, our Digital Academies provide relevant free training and our International Trade Portal helps them find new customers overseas. Additionally we have helped 2,000 social entrepreneurs start up and scale and we have regional teams working with Be the Business to address productivity issues and provide a boost for local companies.

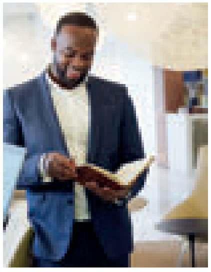
Given our unique position at the heart of the UK economy, the successful transition to a more sustainable, lower-carbon economy is of strategic importance to us. In response to the global issue of climate change, the Group reached a new milestone with the development of a new goal, working with customers, Government and the market to help reduce emissions we finance by more than 50 per cent by 2030. We have made sustainability a focus area in our Helping Britain Prosper Plan and throughout 2019 we have continued to build on this by developing the new reporting framework, which can be found on pages 28 to 31.

## OUR CONTRIBUTION TO THE UK

As the UK's leading financial services provider we are making a significant positive impact on the UK economy

### Customers

- £15.5 trillion of payments processed in 2019 = 7x UK GDP
- £61.2 billion SME and Mid Markets lending portfolio
- Biggest mortgage lender in UK with c.£289 billion portfolio
- £18 billion lending commitment to UK businesses



### Colleagues

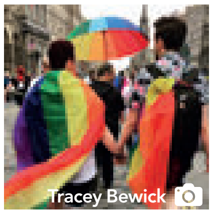
- One of the largest employers in the UK

### Shareholders

- £2.4 billion paid in dividends to c.2.4 million shareholders

### Communities and Environment

- £50.8 million donated to help communities in 2019
- More than 246,000 hours volunteered




### Regulators and Government

- £2.9 billion tax paid in 2019
- The UK's largest corporate tax payer

### Suppliers

- £5.9 billion paid in 2019
- >95 per cent of direct suppliers located in the UK

Our stakeholders on **pages 20 to 25**

Equally important is how we engage with our customers on this issue and to support this change we have trained over 800 colleagues, enhancing their awareness of the risks and opportunities the transition to a low carbon economy represents. We will also continue our partnership with the Cambridge Institute for Sustainability Leadership to provide high quality training to executives and colleagues in risk management, product development and client facing roles.

Our partnership with Mental Health UK began in 2017, with the aim of raising £4 million over a two year period, however we quickly exceeded that and have raised over £11 million to date. As a Group we believe that a shift in mindset is needed amongst UK employers when it comes to mental health and our approach focuses on a willingness to acknowledge, support and manage mental health in the workplace. In 2019, we announced that we are continuing our journey with Mental Health UK for another two years and aim to raise a further £4 million by the end of 2021. In addition, we aim to continue to raise awareness and reduce stigma. We have committed to training 2,500 colleagues to become Mental Health Advocates by 2020, and also provided colleagues with training to help support customers.

## Our colleagues and culture

Throughout 2019, I have travelled across Britain to see how colleagues are embracing new ways of working and the contribution they are making towards Helping Britain Prosper. These visits enabled me to see first-hand how we support customers and respond to their needs in a challenging environment.

I am delighted that we have been named as a top 10 employer for working families, and also retained our place on both the Stonewall Top 100 Employers list for the fifth year in a row and The Times' Top 50 Employers for Women for the eighth consecutive year. This great news demonstrates our clear commitment to ensuring all colleagues can feel confident in bringing their true selves to work and reach their full potential.

I also want to recognise the great work that is done by all of our Charitable Foundations. This was illustrated by the award recently won by the Lloyds Bank Foundation for England and Wales, recognised as the leading grant maker in the Civil Society Charity Awards for its commitment to helping small and local charities thrive for the long-term.

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 of 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, strategy and establishing a culture that supports long-term success. Throughout 2019, the Board has continued to evolve the Group's culture plan, focusing on our Group values; putting customers first, keeping it simple and making a difference together. Our aim is a culture where every colleague is encouraged to take responsibility for ensuring we do the right thing for every customer.

The results from the Group's 2019 colleague survey, which can be found on page 9, acknowledge the positive work that has been completed. Transforming our culture with colleagues, empowered to speak out and drive their personal development, is critical to the successful delivery of our current strategy.

## Remuneration

There has been a substantial focus on remuneration throughout 2019. The Remuneration Committee has engaged extensively with our shareholders and other key stakeholders to develop the proposed 2020 Directors' Remuneration Policy. The changes proposed within the new policy have been designed in the interests of our stakeholders and take on board feedback for a more simplified remuneration structure with a clear alignment to the purpose and strategy of the Group, whilst appropriately rewarding performance. The changes also support the long-term goal to narrow the gap between executive and wider colleague remuneration.

Full details of the proposed Policy and rationale for the proposed changes can be found within the Directors' Report on Remuneration on pages 98 to 102. The policy will be subject to shareholder approval at the AGM in May.

Despite facing a challenging external environment, we have delivered a solid financial performance for the year. The additional PPI charge has however significantly impacted our statutory results. As a result of this and other performance factors, the total Group Performance Share (GPS) outcome for the Group decreased 33 per cent to £310.1 million.

The total GPS outcome remains a small proportion of underlying profit at 3.7 per cent and an even smaller proportion of overall revenues. Cash GPS awards are capped at £2,000 per colleague, with additional amounts paid in shares and subject to deferral and performance adjustment to ensure their ultimate value reflects sustained performance. More information on this year's outcomes and on how we ensure our approach to remuneration supports our strategy can be found in the Directors' Remuneration Report on pages 98 to 123.

**Chairman's statement** continued

## SOCIETY OF THE FUTURE

We recognise that society's expectations of the Group as a major UK corporation are evolving

As a UK, customer-focused business, we recognise that our success and prospects are inextricably linked to the health of the UK economy. Our focus on helping to improve the prosperity of individuals, businesses and communities across the UK therefore not only makes commercial sense, but also represents a social responsibility for an organisation such as ours. In recent years, we have fully embraced this through our purpose of Helping Britain Prosper which continues to make a significant positive impact across the UK, while also giving our colleagues a real sense of pride and meaning.

As we look ahead, we recognise that the external environment is changing at an extraordinary rate and the UK is being confronted by a range of evolving social, economic and environmental challenges that are unprecedented in nature and require a bold response. At the same time, stakeholder expectations of how major UK institutions should respond are changing, raising fundamental questions regarding how companies can retain their implicit licence to operate while also remaining both relevant and attractive to a diverse range of stakeholders, including customers, colleagues, shareholders and the broader society.

In June 2019, the Board and the senior management team took part in an intensive two-day strategy meeting to revisit our expectations of the current strategy and review the key trends that have emerged since. As part of this, the Board debated the transformation required to meet these evolving expectations and obligations to the Society of the Future.

This recognised that, to continue to operate as a successful business, it will be increasingly important that we demonstrate the contribution we make to the communities in which we operate and the value we provide in Helping Britain Prosper, with an emphasis on demonstrating that acting responsibly and ethically and delivering good outcomes for customers, colleagues and shareholders should not come at the detriment of shareholder returns, but rather be an integral part of achieving them. This session provided a solid foundation for us to develop the next phase of our strategy during the course of 2020.

## Directors

We review the Board's composition and diversity regularly and have continued to strengthen and further diversify the knowledge and experience on our Board. During 2019, we have announced a number of Board changes, as outlined below.

George Culmer, our Group Financial Officer retired in the third quarter of 2019. George played a vital role in helping the Group navigate its way through the aftermath of the financial crisis to return to full private ownership. I want to pay tribute to George's tremendous contribution and to thank him on behalf of the Board, our colleagues and our shareholders.

I am pleased to welcome William Chalmers, who formally took the reins as the Group's Chief Financial Officer in August 2019. We are pleased to have been able to attract a candidate of William's calibre to the Board. He brings a wealth of experience that will be of significant benefit to the Group.

I am also pleased to welcome two new independent Non-Executive Directors to the Board; Sarah Legg, who became a member of the Audit and Board Risk Committee in December 2019 and Catherine Woods who will join us in March 2020. Catherine will join the Board Risk and Remuneration Committees.

In addition to these changes, after many years as a Senior Executive for the Group, Juan Colombás, Executive Director and Chief Operating Officer, announced his plan to retire in July 2020. The Board is grateful to Juan for the major contribution he has made to the transformation of the Group. Anita Frew stepped down as Senior Independent Director in December and will also retire as Deputy Chairman and Non-Executive Director in May 2020, having served nine years on the Board. Anita has been an extremely valuable Board member and will be much missed. Alan Dickinson succeeded Anita as Senior Independent Director and will also take on the role of Deputy Chairman, bringing his significant Board, financial and regulatory experience to these roles.

Last October I also announced that I plan to retire from my role as Chairman of Lloyds Banking Group once my successor is appointed, at or before the AGM in 2021, which would mark nine years on the Board. I will be sad to leave, but know I will do so with great pride in what has been accomplished to rebuild the Group's strength and shape its development so it can continue to play its important role in supporting the UK's prosperity.

## Summary

I would like to thank all of our colleagues for their significant contribution in 2019. It is the commitment, support and dedication from all of them that enables us to succeed and I believe the Group remains well positioned as a result of the transformation underway to continue delivering for customers and shareholders.

**Lord Blackwell**
Chairman

## Group Chief Executive's review

# Solid financial performance with market leading efficiency and returns

**We have made significant strategic progress and our performance continues to demonstrate the competitive advantage of our business model.**

**António Horta-Osório**
Group Chief Executive

In 2019 the Group has continued to deliver for customers while making significant strategic progress and delivering a solid financial performance in a challenging external market. While it is disappointing that this was impacted by the additional PPI charge in the year, as a result of this performance, the Board has been able to recommend an increased total ordinary dividend of 3.37 pence per share.

In February 2018 we announced an ambitious plan to transform the Group for success in a digital world, supported by over £3 billion of strategic investment. We are now two-thirds of the way through the plan and have made significant progress in further digitising the Group, enhancing customer experience, maximising our capabilities as an integrated financial services provider and transforming the way we work.

We have made significant progress in our customer proposition. For example, our unique Single Customer View capability provides customers with the ability to view their pensions and long-term savings products alongside their banking products. Insurance and Wealth has seen strong growth in life and pensions sales, driven by new members in existing workplace schemes, increased auto enrolment workplace contributions and bulk annuities. In partnership with Schroders, during the third quarter of 2019 we launched Schroders Personal Wealth, with the ambition of becoming a top three financial planning business by the end of 2023. Also in the third quarter, the Group announced the acquisition of Tesco Bank's prime UK residential mortgage portfolio, which complements our organic strategy.

Historic conduct issues remain disappointing but we continue to be focused on doing the right thing for our customers. The Group is fully committed to implementing all of the recommendations contained within Sir Ross Cranston's report relating to HBOS Reading and ensuring that victims of the HBOS Reading fraud have their claims assessed in an open and transparent manner. We have apologised to those impacted and are determined to put things right.

Given our clear UK focus, our performance is inextricably linked to the health of the UK economy. During 2019, UK economic performance has remained resilient in the face of significant political and economic uncertainty, supported by record employment, low interest rates and rising real wages. Although uncertainty remains given the ongoing negotiation of international trade agreements, there is now a clearer sense of direction and we remain well placed to Help Britain Prosper, support our customers and deliver strong and sustainable returns for shareholders.

## Financial performance

Statutory profit before tax of £4.4 billion was 26 per cent lower than 2018 and earnings per share at 3.5 pence was down 36 per cent, due to the PPI charge of £2.45 billion in 2019 (2018: £0.75 billion). Underlying profit of £7.5 billion was down 7 per cent on 2018, reflecting continued revenue pressure and higher impairments partly offset by lower total costs. Our relentless focus on cost efficiency has led to a reduction in operating costs, where we enhanced our guidance twice during 2019. This was achieved whilst increasing strategic investment and our net promoter scores. Our cost:income ratio improved again to 48.5 per cent. Credit quality remains strong with the Group's net asset quality ratio of 29 basis points in line with the target of less than 30 basis points, despite two material corporate cases.

Loans and advances decreased by £4 billion to £440 billion. The acquisition of Tesco Bank's prime UK residential mortgage portfolio, as well as organic growth in targeted segments including SME and UK Motor Finance, was more than offset by continued reductions in the closed mortgage book and lower balances in Mid Markets and Global Corporates. The reduction in Commercial balances is due to continued optimisation of the portfolio as we actively address low risk-adjusted return relationships.

The Group is strongly capital generative, although this has been impacted by PPI in 2019. Given our strong capital position at the year end, the Board has recommended a final ordinary dividend of 2.25 pence per share, bringing the total ordinary dividend for the year to 3.37 pence per share. This represents an increase of 5 per cent on 2018 and is in line with our progressive and sustainable ordinary dividend policy. The Group's capital position remains strong with a pro forma CET1 ratio of 13.8 per cent after allowing for ordinary dividends.

## Creating competitive advantages

## STRATEGIC PROGRESS


The Group's ambitious three year strategic plan was launched in February 2018 and we are on track to achieve our targeted strategic outcomes. We have made significant progress in transforming the Group for success in a digital world and, in line with our commitment to invest more than £3 billion over the period, have invested £2 billion to date across our four strategic pillars.

In addition to completing the third stage of our strategic plan, in 2020 we will also begin to consider the next phase of our journey. Work will begin at pace in the summer on the new strategic plan, which we expect to announce in February 2021, along with updated longer term financial targets. This work will take into account a wide range of factors, including the evolving external environment, emerging changes across society and changing expectations of how companies should respond to such challenges.

Our strategic priorities on **pages 16 to 19**

### Leading customer experience

- We are committed to maintaining the UK's number one branch network and customer-facing colleagues in branch now spend around 50 per cent of their time addressing customers' complex needs
- We are trialling new branch formats, including a new flagship Bank of Scotland branch and Home by Halifax
- We have continued to develop our digital proposition and our digitally-active customer base has increased again to 16.4 million, of which 10.7 million are active on their mobile banking app; 75 per cent of products are now originated digitally
- We are using our deep understanding of our diverse customer base to deliver tailored propositions such as Club Lloyds and the Halifax Prize Draw

**16.4m**
digitally active customers

### Digitising the Group

- Investment in technology remains a key strategic priority for the Group and enables us to improve the experience of our customers and colleagues; technology spend now represents 19 per cent of operating costs
- Having introduced automation for repetitive tasks, we have created over 1 million cumulative hours of colleague capacity and our transformation has covered around 55 per cent of the Group's cost base
- Virtual assistants are currently managing up to 5,000 customer conversations daily, with satisfaction increasing by more than 10 points. Around 25 per cent of queries are handled without being passed to a colleague and we expect this to increase
- In enhancing capabilities and accelerating our transformation, we are working in collaboration with a number of fintechs and we continue to monitor opportunities in this space

**14%**
year-on-year increase in technology spend

### Maximising Group capabilities

- Open Banking is now available to all digital customers and our unique Single Customer View capability is available to over 5 million customers
- We have exceeded our goal of attracting over 1 million new pension customers, a year ahead of target and we have continued to make progress towards the target of growing open book assets under administration by £50 billion by the end of 2020, with cumulative net growth of £37 billion since 2017
- We launched Schroders Personal Wealth, with the ambition of becoming a top three financial planning business by end of 2023
- Commercial Banking has supported Insurance and Wealth by sourcing £0.6 billion of new long-term assets to support five new bulk annuity transactions

**>5m**
customers with access to Single Customer View

### Transforming ways of working

- We are making our biggest ever investment in people, with a focus on ensuring that we are able to continue to attract, develop and retain the talent and capabilities we will need in the future
- We have significantly increased the 'skills of the future' training delivered to our colleagues to a cumulative 3.2 million hours since 2018 and around 33 per cent of change is now delivered using Agile methodologies
- The Group has hired over 1,200 colleagues in 2019 across critical areas such as engineering, data science and cyber security, in line with our plan to treble strategic hiring compared to 2018 and enabling the Group to reduce the use of external resource

**3.2m**
hours of future skills training delivered

## Helping Britain Prosper Plan

We are committed to the long-term success of the UK with our purpose of Helping Britain Prosper. This is why we launched our Helping Britain Prosper Plan in 2014 which also underpins our environmental, social and governance efforts. For 2019 we met 20 out of 22 objectives of the Plan, and some key achievements are outlined below.

The Group is committed to helping customers to buy a home. In 2019 we lent £13.8 billion to first time buyers across the UK including through innovative products like our Lloyds Bank Lend a Hand and Halifax Family Boost mortgages. We have also increased net lending to start-ups, SMEs and Mid Market customers to £3.4 billion since 2018 together with achieving our target of lending £18 billion to UK businesses in 2019.

We are working hard to help people save for the future and in 2019 in partnership with Schroders, we launched Schroders Personal Wealth. Our open book assets under administration have increased by £37 billion since the start of the current strategic plan. More generally, our banking savings range operates transparent pricing for all, with customers able to upgrade their accounts online with one click when better products become available.

The Group is committed to helping the UK transition to a sustainable, low carbon economy. Over the last five years we have raised over £2.8 billion in green bonds for UK corporate issuers, more than any other UK financial services company. We have also supported renewable energy projects that power the equivalent of 5.1 million homes.

As we look forward, we want to play our part in tackling climate change and we have targeted working with our customers, government and the market to help reduce the emissions we finance by more than 50 per cent by 2030, in line with the UK's Net Zero Goal and the Paris Agreement. We are one of the first organisations in the world to commit to all three of The Climate Group's ambitious sustainability initiatives, which aim to speed up the transition to a low carbon economy by committing to source 100 per cent of our electricity from renewable sources, improve energy productivity and transition to electric vehicles.

The Group was the first FTSE100 company to establish targets for championing diversity within its business and we now have 36.8 per cent of senior roles held by women, up almost 8 percentage points since 2014 and we continue to aim to meet our target of 40 per cent by the end of 2020. With 10.2 per cent of roles across the Group held by Black, Asian and Minority Ethnic (BAME) colleagues, we have exceeded our 2020 target of 10 per cent.

We have also helped over 700,000 individuals, small businesses and charities to develop digital skills in 2019, and we are on track for our target of 1.8 million by 2020. Our Digital Knowhow workshops have also helped thousands of organisations learn how to avoid fraud and take advantage of digital marketing techniques.

## Protecting the planet for future generations


In January 2020, the Group announced its new ambitious goal to work with customers, government and the market to help reduce the carbon emissions we finance by more than 50 per cent by 2030.

**>50% by 2030**

We aim to help reduce the emissions we finance by more than 50 per cent by 2030

This goal recognises the urgent need to tackle climate change, grow the green economy and promote green finance for the future prosperity of the UK. Read more on pages 28 to 31.

The next decade will be crucial for protecting the planet for future generations, and financial services has a critical role to play. We are fully committed to supporting our customers, clients and colleagues to transition to a low carbon economy, working closely with other organisations and government to create the solutions that will accelerate progress and ultimately Help Britain Prosper.

**António Horta-Osório,**
Group Chief Executive

Our colleagues have also taken an active role in supporting good causes, including raising over £11 million for Mental Health UK over a two year period, as well as volunteering 246,000 hours of their time through our Day to Make a Difference initiative.

In addition, the Group has paid £2.9 billion tax in 2019 and we are proud to be the largest corporate tax payer in the UK.

We have issued a separate presentation on our approach to environmental, social and governance issues, which can be found on the Group's external website.

## Outlook

Over 2019, UK economic performance has remained resilient in the face of significant political and economic uncertainty, supported by record employment, low interest rates and rising real wages. Although uncertainty remains given the ongoing negotiation of international trade agreements and the rate outlook remains challenging, there is now a clearer sense of direction and we remain well placed to Help Britain Prosper, support our customers and deliver strong and sustainable returns for shareholders. The Group's confidence in the business model and future performance is reflected in our guidance for 2020:

- Net interest margin of 2.75 to 2.80 per cent
- Operating costs to be less than £7.7 billion with the cost:income ratio lower than in 2019
- Net asset quality ratio expected to be less than 30 basis points
- Capital build expected to be within the Group's ongoing guidance range of 170 to 200 basis points per year and risk-weighted assets to be broadly in line with 2019
- Expect increased statutory return on tangible equity of 12 to 13 per cent, driven by resilient underlying profit and lower below the line charges

The Group faces the future with confidence. As a result, we will continue to target a progressive and sustainable ordinary dividend. In 2020, the Group will also commence paying dividends quarterly, accelerating payments to shareholders, with the first dividend being paid in June 2020.

António Horta-Osório

**António Horta-Osório**
Group Chief Executive

## Key performance indicators

# Our strategy has delivered solid performance

## Financial

### Pay for performance across the Group

Key performance indicators are regularly reviewed by the Board, with an aim to provide a fair, balanced and comprehensive view of the Group's performance. The measures outlined on these pages identify the most effective output measures for assessing financial and non-financial performance including progress towards becoming the best bank for customers, colleagues and shareholders.

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

Within this year's report we have updated our key performance indicators to reflect these priorities. All the key performance indicators directly impact remuneration outcomes and support the delivery of our reward principles.

The remuneration awarded to Executive Directors is heavily weighted towards the delivery of long-term, sustainable performance. As part of our 2020 Remuneration Policy, our proposed move to long-term share awards continues to support the Group's strategic aims and the long-term sustainable success of the business, page 117.

As per pages 101 and 110 our 2020 balanced scorecard measures will remain broadly unchanged from 2019 and will be used in both short term and long-term reward decision making. KPIs have been proposed to underpin the long term share awards focusing on capital strength, relative returns and a progressive and sustainable ordinary dividend.

### Underlying profit before tax

£m

**7,531**

| | |
|---|---|
| 2019 | **7,531** |
| 2018 | 8,066 |
| 2017[1] | 7,628 |
| 2016[1] | 6,782 |
| 2015[1] | 7,275 |

Underlying profit before tax was lower in 2019, reflecting lower net income and higher impairment charges, partly offset by the Group's continued progress in cost reductions.

1 Restated to include remediation.

### Statutory profit after tax

£m

**3,006**

| | |
|---|---|
| 2019 | **3,006** |
| 2018[1] | 4,506 |
| 2017[1] | 3,649 |
| 2016[1] | 2,605 |
| 2015[1] | 1,036 |

Statutory profit after tax was lower in 2019, largely due to the additional PPI charge. The tax expense was £1.4 billion.

We previously reported statutory profit before tax but changed to statutory profit after tax at full year 2019 to further align our key performance indicators to remuneration.

1 Restated to reflect amendments to IAS12.

### Ordinary dividend

p per share

**3.37**

| | |
|---|---|
| 2019 | **3.37** |
| 2018 | 3.21 |
| 2017 | 3.05 |
| 2016 | 2.55 |
| 2015 | 2.25 |

An increased ordinary dividend of 3.37 pence per share, in line with our progressive and sustainable ordinary dividend policy.

### Statutory return on tangible equity

%

**7.8**

| | |
|---|---|
| 2019 | **7.8** |
| 2018 | 11.7 |
| 2017 | 8.9 |
| 2016 | 6.6 |
| 2015 | 2.6 |

The statutory return on tangible equity was lower in 2019 given the lower statutory profit, largely due to additional PPI charges.

**2020 TARGET**
**Statutory return on tangible equity**
**12 to 13%**

### Cost:income ratio

%

**48.5**

| | |
|---|---|
| 2019 | **48.5** |
| 2018 | 49.3 |
| 2017 | 51.8 |
| 2016 | 55.3 |
| 2015[1] | 54.2 |

The Group's market-leading cost:income ratio including remediation continued to provide a competitive advantage and further strengthened to 48.5 per cent in 2019.

**CURRENT TARGET**
**Cost income ratio including remediation to be lower in 2020**

1 Excluding TSB.

### Common equity tier 1 ratio (CET1)

%

**13.8**

| | |
|---|---|
| 2019[1] | **13.8** |
| 2018[1] | 13.9 |
| 2017[1] | 13.9 |
| 2016[1] | 13.0 |
| 2015[1] | 13.0 |

Our common equity tier 1 ratio remains strong.

**CURRENT TARGET**
**Ongoing CET1 capital ratio target of c.12.5 per cent plus a management buffer of c.1 per cent**

1 Pro forma, reflecting insurance dividends paid in the subsequent reporting period. 2018 also includes share buyback and 2016 reflects MBNA.

Financial performance overview on pages 36 to 39

## Non-Financial

### Economic profit
£m

**3,138**

| | |
|---|---|
| 2019 | **3,138** |
| 2018 | 3,291 |
| 2017 | 3,987 |
| 2016 | 3,377 |
| 2015 | 2,233 |

Economic profit, a measure of profit taking into account expected losses, tax and a charge for equity utilisation. Economic profit in 2019 was impacted by lower net income received in the year.

### Total shareholder return
%

**27**

| | |
|---|---|
| 2019 | **27** |
| 2018 | (20) |
| 2017 | 14 |
| 2016 | (10) |
| 2015 | (2) |

Total shareholder return reflects share price performance and dividends received. Our share price increased by 21 per cent in 2019.

### Customer satisfaction
(net promoter score)

**62.8**

| | |
|---|---|
| 2019 | **62.8** |
| 2018 | 61.8 |
| 2017 | 61.2 |
| 2016 | 61.8 |
| 2015 | 58.5 |

Our net promoter score is the measure of customer service at key touch points and reflects the likelihood of customers recommending us. Customer satisfaction increased in 2019.

From a strategic perspective this measures how well we are delivering a **leading customer experience**. It tells us how effective we are in building strong customer relationships.

### Customer complaints
FCA reportable complaints per 1,000 accounts

**2.9**

| | |
|---|---|
| H1 2019 | **2.9** |
| H2 2018 | 3.4 |
| H1 2018 | 3.9 |
| H2 2017 | 4.2 |
| H1 2017 | 4.1 |

FCA reportable complaints excluding PPI and claims management companies have significantly reduced over the last five years.

We do make mistakes, but when this happens, we work hard to fix the issue quickly for the customers involved and learn from any mistakes.

From a strategic perspective, reduction in customer complaints confirms our achievements in delivering a **leading customer experience.**

### Helping Britain Prosper Plan targets achieved

**20/22**

| | |
|---|---|
| 2019 | **20/22** |
| 2018 | 20/22 |
| 2017 | 21/22 |
| 2016 | 20/24 |
| 2015 | 27/28 |

We have made strong progress since we launched the Plan in 2014. In 2019, we achieved 20 out of 22 targets, helping to address some of the social, economic and environmental challenges the UK faces. Find out more on page 27.

From a strategic perspective achievement of these targets helps us to learn what progress we are making in across all areas of our strategy.

### Digitally active customers
m

**16.4**

| | |
|---|---|
| 2019 | **16.4** |
| 2018 | 15.7 |
| 2017 | 13.4 |
| 2016 | 12.5 |
| 2015 | 11.5 |

Reflecting the pace of digital adoption, the number of active digital customers increased in the year to 16.4 million, with 10.7 million mobile banking app customers and average customer logons at 23 times per month.

From a strategic perspective this indicates the progress we are making in **digitising the Group** from the customer usage standpoint.

### Employee engagement index
% favourable

**74**

| | |
|---|---|
| 2019 | **74** |
| 2018 | 73 |
| 2017 | 76 |
| 2016 | 71 |
| 2015 | 71 |

Colleague engagement was two points above the norm for top performing UK companies with colleagues continuing to score pride and advocacy favourably. High scores were also achieved for customer focus, wellbeing, recognition and speaking out.

From a strategic perspective this indicates how much progress we are making in **transforming ways of working**.

**NEW KPI**

### Green finance
£bn

**>4.9**

This year an additional key performance indicator has been included to reflect the work we're doing to support the transition to a low carbon economy.

We have quantified the finance we provide through existing green finance products (Clean Growth Finance Initiative; Commercial Real Estate Green Loans Initiative; Renewable Energy Financing) and green bonds facilitation. Since 2016, this totalled more than £4.9 billion and we will continue to add to this activity in 2020.

## Our external environment

# The UK market, to which our performance is inextricably linked, continues to evolve

### ECONOMY

**Highlights**
- Given our focus on UK customers, the Group's prospects are closely linked to the fortunes of the UK economy
- On the assumption that the global economy remains broadly stable, we would expect the UK economy to grow in 2020 to 2022 at a pace slightly above that achieved in the past two years
- Our low risk business model and focus on efficiency positions us well irrespective of macro conditions. Nevertheless, if the economy was to be impacted significantly by crystallisation of either domestic or international risks, Group financial performance would be impacted

## Overview

As a leading UK bank, our prospects are closely aligned to the outlook for the UK economy. Through 2019, the economy continued to show resilience to twin challenges from a slowing global economy and increasing domestic political uncertainty. Although growth of the UK economy has slowed to its weakest since the financial crisis a decade ago, and interest rates remain very low, unemployment has fallen further to a 44 year low and house prices have continued to grow. Barring any sudden shocks to business or consumer confidence, growth is expected to rise mildly in 2020, but international trade-protectionism, the current coronavirus outbreak in China, geo-political instability and the nature of the UK's exit from the EU, all present risks to that outlook.

## Market dynamics

During 2019, there have been divergent trends between UK businesses and households. For businesses, uncertainty for the domestic political and economic outlook translated into a second consecutive year of reduced investment spending and commercial real estate prices fell slightly. Low productivity growth remains a key challenge for the UK economy, however, the flip-side has been buoyant employment. Households continued to increase spending in 2019 as low unemployment boosted pay growth whilst softening global growth reduced inflation.

The UK housing market remained subdued through much of 2019, although falling mortgage rates and the election of a government with a strong Parliamentary majority appeared to be beginning to stimulate the market towards the end of the year. The level of housing transactions was broadly flat at around 20 per cent lower than the norm prior to 2008, with muted price growth.

The economic outlook appears to be improving. Nevertheless, in a long-term context growth is expected to remain subdued and interest rates low - core to that is the low rate of productivity growth, with the recent weakness of businesses' investment spending suggesting a significant improvement is unlikely near-term. Uncertainty for some UK companies may persist in 2020 and drag on investment as the UK attempts to negotiate a comprehensive trade deal with the EU to a tight timescale. However, improved pay growth is likely to support households' spending, and the likely fiscal stimulus is expected to provide some boost to the economy.

The fundamental drivers behind the subdued trends in the housing market are expected to remain in place - the high level of prices relative to incomes that constrains first-time-buyer demand, and expectations that interest rates could rise from their current low level.

There are, or course, significant risks to this outlook. The growth-cycle in both of the world's largest economies - US and China - is in its mature stage, and the coronavirus outbreak and ongoing trade war could complicate the task of policymakers in guiding growth towards a stable and sustainable level. Conversely, high asset prices and corporate debt levels in some countries could be vulnerabilities if an improvement in global economic growth and a resulting rise in interest rates causes unexpected shifts in currencies or herd behaviour in financial markets as shareholders change their appetite between different types of investments. Domestically, the future trading relationship with the EU remains uncertain, as does businesses' response to that uncertainty.

Barring sudden shocks stemming from these challenges, the UK economy is expected to grow through 2020 to 2022 at around 1.5 per cent, slightly above the 1.4 per cent average across the past two years. The unemployment rate is expected to rise only a little from its current 44 year low. The outlook for the bank rate is uncertain, but capacity constraints and a fiscal boost may support a moderate increase in interest rates. House prices are expected to continue to grow mildly.

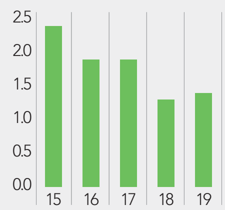
This picture of subdued but broadly stable growth is likely to be reflected across our markets. Consumer credit growth has slowed significantly over the past couple of years after a prior period of strong growth, but we expect that the slowdown has now run its course.

## Our response

Given our UK focus, the Group's prospects are closely linked to the performance of the UK economy. Our low risk, stable business model and focus on efficiency positions us well to continue to support customers irrespective of macro conditions.

**UK economic growth**

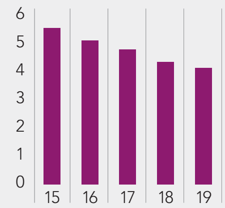
**1.4%**
GDP growth




Source: ONS

**UK unemployment rates**

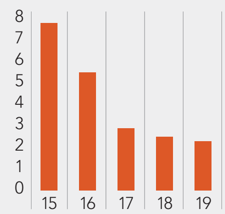
**3.8%**
Unemployment rate




Source: ONS

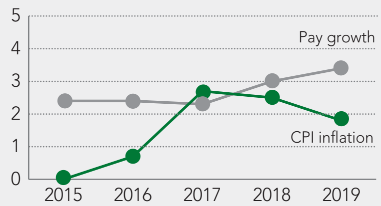
**UK housing market**

**2.3%**
House price growth
(Q4 vs. Q4 Basis)




Source: Halifax house price index

**Pay growth vs inflation**




Source: ONS

**Link to principal risks**
- Credit
- Capital
- Funding and liquidity
- Market

**Link to strategic priorities**
- Maximising Group capabilities

## CUSTOMER

### Highlights

- Customer expectations are being shaped by experiences outside of financial services, with convenience, choice and greater levels of personalisation becoming increasingly important
- While customers want to be in control of their finances through digital channels, human interaction is still valued for more complex financial needs
- Expectations on how companies engage with environment and societal issues are rising

## Market dynamics

Consistent with recent trends, customer expectations continue to be shaped by their experience outside of financial services, with speed and convenience and greater levels of choice and personalisation, based on richer data insight, becoming more important in an increasingly competitive market.

As technological capabilities across the banking sector continue to become more sophisticated, customers also increasingly want and expect to be in control of their finances, with the ability both to see their accounts and monitor transactions across multiple providers. Against this, human interaction for more complex or emotive needs continues to be valued as part of a multi-channel servicing approach.

Similar to personal customers, business client expectations spanning speed, convenience and insight-driven personalisation are being shaped by experiences outside of financial services. Alongside this, smaller business customers are starting to look for support beyond their banking needs.

While not yet a major driver of behaviour and preferences, customers are becoming increasingly aware of societal and environmental issues, with rising expectations of how the companies they engage with are responding to these challenges.

## Our response

We have a strong track record in providing our customers with the products and services they value, while also offering convenience and choice in the channel they choose to interact with us.

We remain committed to our multi-channel model, comprising the UK's largest digital bank and branch network, and are focused on ensuring that this remains relevant to evolving customer preferences. As part of this, we are continuing to strengthen our digital capabilities, with a number of recent enhancements putting our customers more in control of their finances and resulting in strong digital customer satisfaction scores.

We are also investing in our branch and telephony channels to ensure that these are able to address our customers' more complex needs more effectively, and continue to provide access to banking services for our more vulnerable customers.

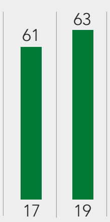
Given our history and scale, we have a wealth of customer data and remain focused on using this valuable insight ethically and responsibly to develop products and services that are more personalised to our different customers' needs.

Against the broader backdrop of increasing expectations and an evolving competitive environment, we cannot become complacent and need to continue to improve the customer experience to remain relevant and attractive to customers.

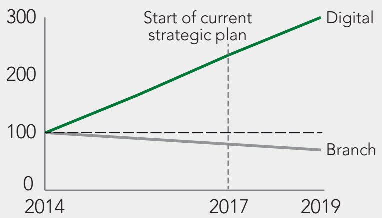
**Customer satisfaction**
(net promoter score)

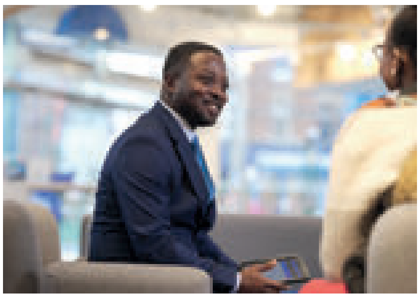
**+3%**

Improvement in customer satisfaction during our current strategic plan




**Adapting to changing behaviours**
Customer channel interactions
(indexed to 2014)



**Link to principal risks**
- Regulatory and legal
- Conduct
- Operational

**Link to strategic priorities**
- Delivering a leading customer experience

## REGULATION

### Highlights

- The UK financial services sector is expected to remain highly regulated
- New regulation and market reviews continue to be issued, with further regulatory changes anticipated
- Uncertainty remains around the impact of the UK's exit from the EU on the existing regulatory and legal framework

## Market dynamics

A number of regulatory changes have been implemented in the last 12 months including Open Banking, overdraft charging and the embedding of ring-fencing requirements with key areas of focus for 2020 as below:

**Customer treatment**
Fair treatment of customers remains a priority for the FCA, with particular focus on those in vulnerable circumstances as well as long standing customers.

**Capital regulation**
The Group continues to prepare for further regulatory capital developments in particular implementation of the final Basel III reforms.

**LIBOR transition**
The transition from LIBOR to alternative reference rates will mean changes to products and funding structures.

**Other**
A number of other regulatory initiatives are in the pipeline which seek to address, amongst other things; operational resilience, climate change, General Insurance, revised Payment Services Directive (PSD2) requirements, MIFIDII and fraud.

## Our response

As a Group we always seek to comply with all related regulation.

Given the Group's simple, low risk business model, it is well placed to meet these requirements and welcomes the positive effect that they will have on the industry, its customers and other stakeholders.

**Link to principal risks**
- Credit
- Capital
- Funding and liquidity
- Market

**Link to strategic priorities**
- Maximising Group capabilities

**Our external environment** continued

## TECHNOLOGY

### Highlights

- The pace of digital adoption and disruption continues to surpass expectations and is likely to increase further in the coming years
- The use of new technologies is increasing efficiency within the financial services sector and delivering meaningful improvements to the customer experience
- Cyber security and the protection and appropriate use of customer data remain important factors in retaining customer trust

## Market dynamics

Digital adoption trends continue to surpass expectations, with the significant uptake driven by changes in demographics and an increasing similarity in customer behaviour across multiple geographies. As a result, we are seeing a significant change in how customers interact with financial services providers, while expectations of service are often being influenced by technology-led experiences outside of financial services.

The combination of heightened expectations and increasing levels of competition has resulted in greater levels of investment in technology across the sector, with banks placing increasing importance on delivering innovative new features for customers as well as continually upgrading and modernising back-office infrastructure. Banks are also regularly adopting new technologies such as machine learning and artificial intelligence to increase the effectiveness and efficiency with which more routine tasks are performed, while also using greater data driven insight to deliver an improved customer experience.

In addition, as the sharing of data becomes increasingly important to both banks and customers, there is a growing onus on how this is safeguarded. For example, the shift towards cloud technologies from in-house data storage can deliver a number of benefits for customers. These include increasing levels of insight and faster rates of product innovation, but open up the financial services sector to new cyber-related risks which must be carefully managed. In a period in which competition from digital-only providers has grown significantly, trust remains a key differentiator for established banks and therefore security and resilience remain areas of great importance.

## Our response

In line with our position as the largest digital bank in the UK, we are investing heavily in technology to ensure that we can continue to deliver meaningful enhancements to the customer experience while also delivering organisational improvements in terms of responsiveness, insight and efficiency. Our technology spend is among the top quartile of global peers, with the amount spent in 2019 equivalent to 19 per cent of our operating cost base. Importantly, in excess of 75 per cent of this spend is focused on creating new capabilities and enhancing existing ones, with this investment critical to successfully delivering our modular approach to transformation.

We view our market leading efficiency position as a unique competitive advantage in this respect, as it creates capacity for further significant investment. This investment, such as in the increased use of intelligent systems and machine learning, is delivering improved processes and further productivity enhancements, and through this, is helping to future proof our business.

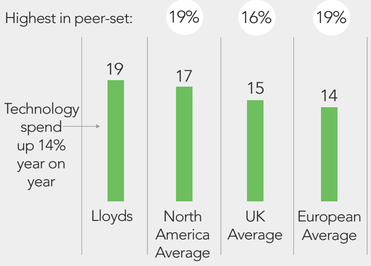
In 2019, we surpassed more than 1 million hours saved through the use of robotics since the launch of our latest strategic plan in 2018, creating significant capacity for our colleagues to focus their time on delivering tangible improvements to our customer experience. These improvements are being delivered in the form of new features, such as the roll out of location based searches to improve the identification of fraudulent payments, as well as by making better use of data for the benefit of our customers, such as harnessing the insights from robotics to improve credit decisioning.

We also continue to invest in the resilience and security of our systems, ensuring that customer data remains safe despite the significant pace of change in technological trends.

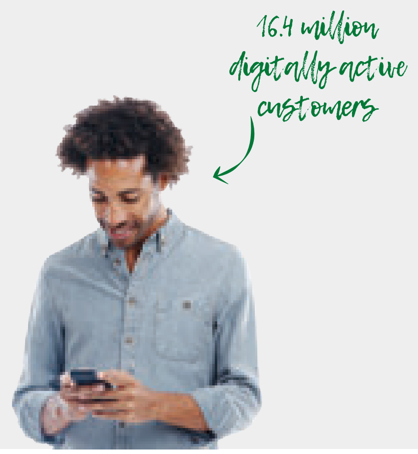
**Link to principal risks**
- Credit
- Capital
- Funding and liquidity
- Market

**Link to strategic priorities**
- Maximising Group capabilities

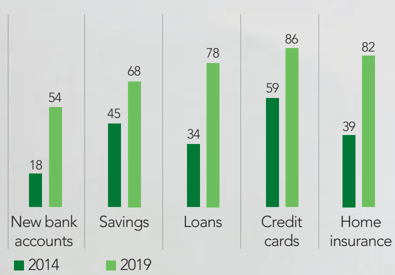
Technology spend[1]
as a % of operating costs




1 Estimated. Regional averages based on a selection of peers where disclosure exists. Proxy for technology spend calculated based on available disclosure in prior annual reports or shareholder presentations and may not be like for like.




Customers are using the digital channel more than ever for simpler needs
% volume of products originated digitally



**COMPETITION**

### Highlights

- Regulatory changes have resulted in increased competition across more traditional product lines, as excess liquidity is deployed within ring-fenced bank entities
- The competitive landscape also continues to evolve with growth across a number of digital-only providers, while we are also seeing emerging signs of participation from large technology companies

## Market dynamics

We continue to operate in an highly competitive environment, driven by regulatory changes, shifting customer behaviours and increasing levels of innovation across the sector.

Across our traditional business lines, ring-fencing regulation has seen a number of our competitors deploy excess liquidity to support asset growth within the UK, specifically within mortgages where customer rates have in the last few years hit record lows. While this is beneficial for our customers, this has depressed margins across the UK banking sector and more recently has resulted in some smaller participants stepping back from the market.

Beyond this, digital-only providers have grown their share of the UK market within the past year. This growth has predominantly been driven by neo-banks that provide a more traditional customer offering alongside leading digital functionality and are able to target selected customer segments. This is supported by the emergence of marketplace models which enable these providers to collaborate with more specialist fintechs to provide a broader suite of products and financial services, both for personal and business banking customers.

In response, a number of traditional competitors have attempted to replicate the success of neo-banks by developing their own digital-only offerings, often under separate and newly created brand names. A number of international peers have also entered the UK market through digital only challengers, taking advantage of the supportive regulatory environment and increasing similarity in customer behaviours across multiple geographies.

Elsewhere, we have also started to see the first signs of large technology companies participating in financial services, often partnering with local incumbent banks across different geographies. While the scale of their future ambitions is uncertain at this stage, the power of their brand and large customer bases pose future disruption threats.

## Our response

We continue to respond effectively to the increasingly competitive environment, supported by our significant reach and proven track record of providing products and services that our customers value with this underpinned by significant investment capacity.

Across our core markets such as mortgages, we have looked to prioritise value while maintaining share and supporting our purpose of Helping Britain Prosper. As marginal players have withdrawn from the market, we have more recently strengthened our position, including through the acquisition of Tesco Bank's mortgage portfolio in September. Alongside this, we have also continued to invest in areas where we are under-represented, such as Insurance and Commercial Banking, in line with the commitments outlined at the start of this strategic plan.

In response to changes to the competitive environment from the ongoing shift in digital usage and new entrants, our multi-channel and multi-brand offering enables us to continue to effectively meet the varying needs of our diverse customer base. Our digital channel is now our most prominent, with 75 per cent of products now originated digitally and we operate the largest digital bank in the UK with 16.4 million customers and 10.7 million mobile app customers, while our customer satisfaction scores remain strong.

In addition, we remain committed to retaining the largest branch network in the UK. This allows our customers to interact with us in whichever way they prefer, while also providing a human touch point for more complex financial needs. Our network is also key to building and deepening our business banking relationships. We see these as unique competitive advantages, and combined with our ongoing commitment to innovation, provide us with a strong platform to maintain relevance and deepen relationships with our customer base.

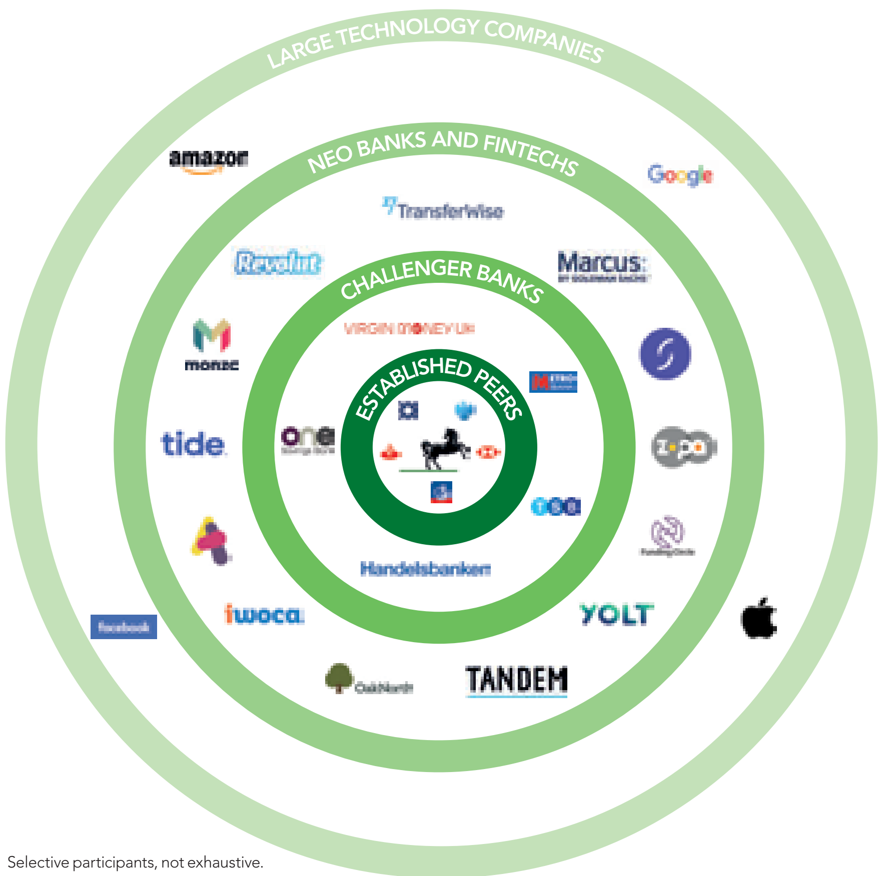
**Link to principal risks**

- Regulatory and legal
- Conduct
- Operational
- People

**Link to strategic priorities**

- Delivering a leading customer experience
- Maximising Group capabilities

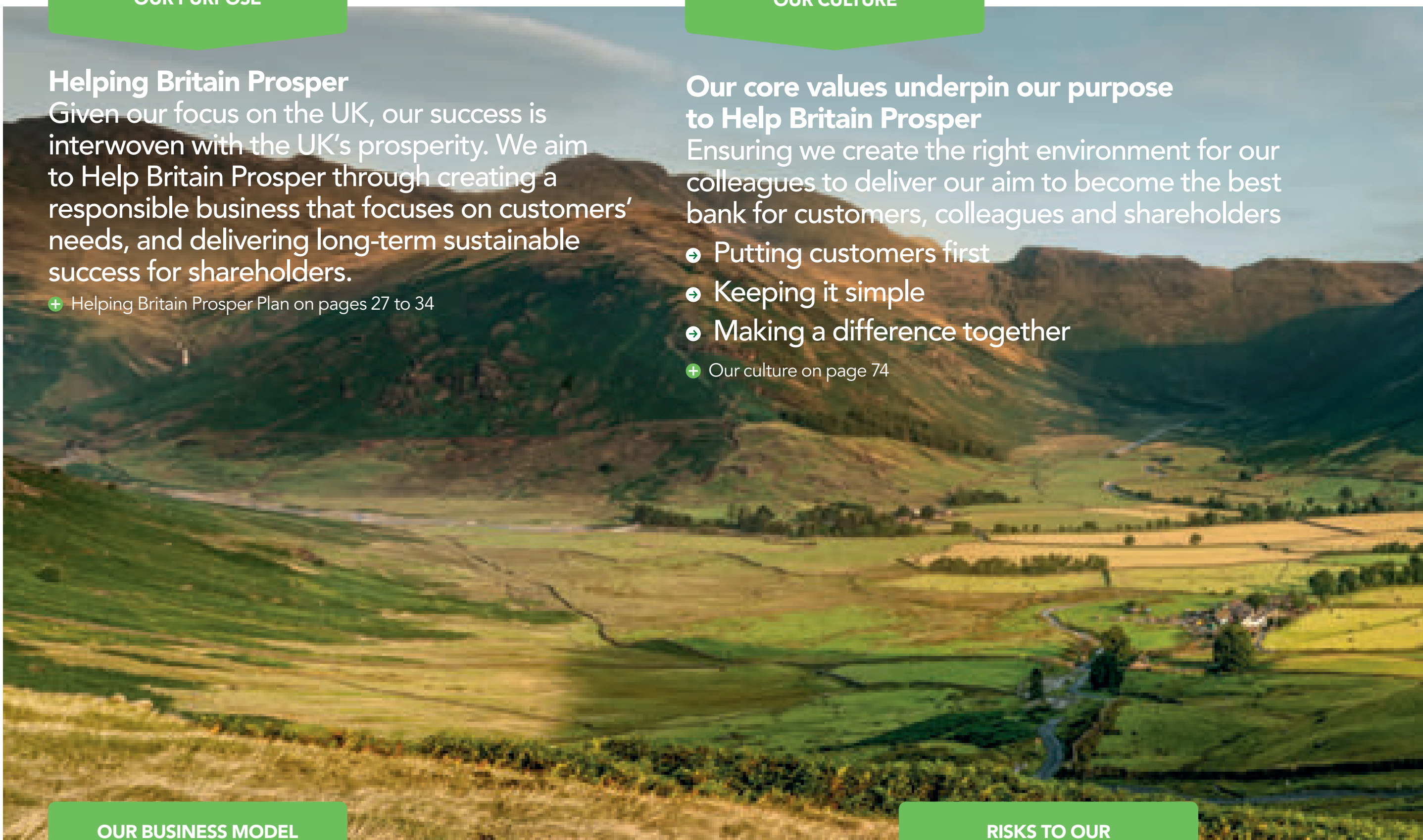
## The evolving competitive environment[1]




1 Selective participants, not exhaustive.

## Our business

# How we create value, and what sets us apart



### OUR PURPOSE

**Helping Britain Prosper**
Given our focus on the UK, our success is interwoven with the UK's prosperity. We aim to Help Britain Prosper through creating a responsible business that focuses on customers' needs, and delivering long-term sustainable success for shareholders.

Helping Britain Prosper Plan on pages 27 to 34

### OUR CULTURE

**Our core values underpin our purpose to Help Britain Prosper**
Ensuring we create the right environment for our colleagues to deliver our aim to become the best bank for customers, colleagues and shareholders

- Putting customers first
- Keeping it simple
- Making a difference together

Our culture on page 74

### OUR BUSINESS MODEL

We are a simple, low-risk, customer focused UK financial services provider with distinctive and sustainable competitive strengths:

**Multi-brand, multi-channel proposition with data driven customer experience**
Operating in an integrated way through a range of distribution channels and brands ensures our customers can interact with us when and how they want and enables us to address the needs of different customer segments more effectively.

**Comprehensive product range with all financial needs served in one place**
Our product range is driven by customer needs and is informed through comprehensive customer analysis and insight.

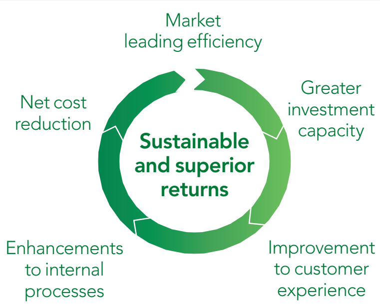
**UK's largest digital bank, branch network and customer franchise with leading integrated propositions**
Our scale and reach across the UK means that our franchise extends to around 26 million customers, with 16.4 million digitally active. We are uniquely positioned to deal with customers' banking and investment needs.

**Market leading efficiency through tech-enabled productivity improvements**
Our simpler operating model and focus on efficiency provide a cost advantage, enabling us to invest more to the benefit of both customers and shareholders.

**Prudent, low risk participation choices with strong capital position**
Being low risk is fundamental to our business model. Our low risk appetite is reflected through the quality of our loan portfolio and underwriting criteria. Our financial strength has been transformed in recent years and our capital position is strong.

**Rigorous execution and management discipline focusing on key skills of the future**
Experience of delivering change in recent years provides benefit as we further transform the business.

**Creating competitive advantages**
We believe that these capabilities provide competitive advantage and enable us to continue to deliver for customers whilst also delivering sustainable and superior returns over the longer term, as outlined below.




### RISKS TO OUR BUSINESS MODEL

As a large, UK focused financial services provider we face several external and internal challenges:
The main external challenges we face are as previously discussed on pages 10 to 13

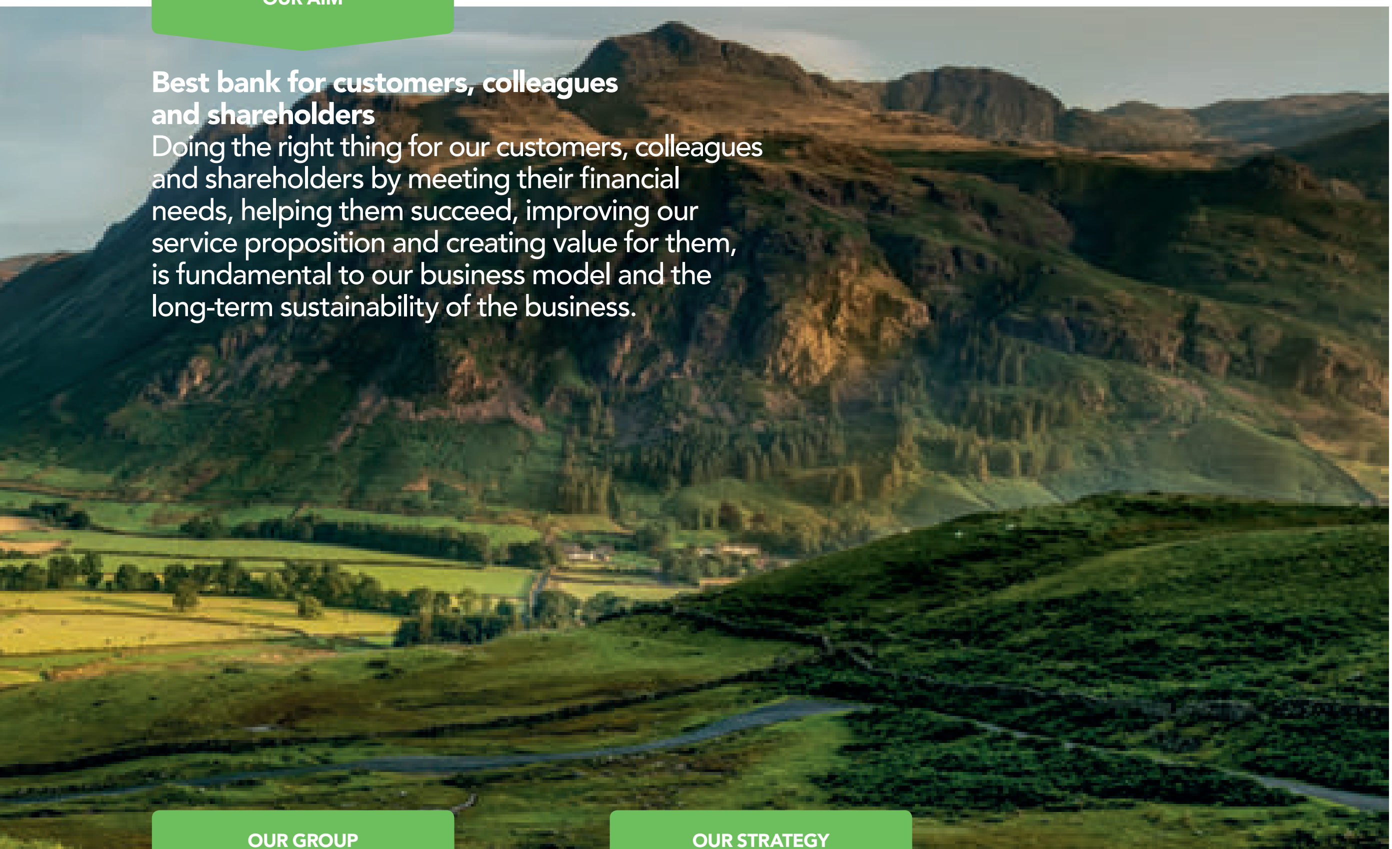
- Uncertain outlook for the UK economy
- Evolving customer needs and behaviours
- High levels of regulation
- Radically changing competitive and regulatory landscape
- Technologies and societal attitudes rapidly reshaping business models

We also face a number of internal challenges:

- Operating as efficiently as possible, while remaining the best bank for customers
- Attracting, developing and retaining the best talent to respond to new ways of working
- Ensuring IT systems are effective and resilient and that we are prepared for the threat of cyber risk

We recognise these challenges and continue to evolve our business model and strategy, to enhance their sustainability over the longer term.

Strategic report
Financial results
Governance
Risk management
Financial statements
Other information



## OUR AIM

### Best bank for customers, colleagues and shareholders

Doing the right thing for our customers, colleagues and shareholders 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.

## OUR GROUP

The Group has a unique customer proposition enabling us to serve the financial needs of customers in one place. We operate multiple-brands through three core divisions; Retail, Commercial Banking and Insurance and Wealth.

LLOYDS BANK
BANK OF SCOTLAND
HALIFAX
LEX AUTOLEASE
SCOTTISH WIDOWS
blackhorse
LDC
AMC
mbna
Schroders personalwealth
BIRMINGHAM MIDSHIRES
IWEB

## OUR STRATEGY

## Transforming the Group for success in a digital world

In February 2018, we launched our three year strategy to transform the Group for success in a digital world.

Our simple, low risk customer focused strategy builds on our purpose of Helping Britain Prosper and our distinctive strengths.

We identified four strategic priorities focused on the financial needs and behaviours of the customer of the future and are investing more than £3 billion in these strategic initiatives over the plan period.

+ Board oversight of our strategy on **page 75**
+ Strategic priorities on **pages 16 to 19**

### Strategic priorities

**Leading customer experience**
Driving stronger customer relationships through best-in-class propositions while continuing to provide our customers with brilliant servicing and a seamless experience across all channels.

**Digitising the Group**
Deploying new technology to improve our efficiency and make banking simpler and easier for customers.

**Maximising Group capabilities**
Aligning the Group's capabilities as the UK's sole integrated financial services provider to deepen customer relationships and grow in targeted segments.

**Transforming ways of working**
Enhancing colleague skills and processes, investing in agile working practices and embracing new technology to drive better outcomes for customers.

## Our strategic priorities

# Leading customer experience

**In order to be the best bank for customers, we recognise that we must continue to adapt to changes in customer behaviour, technology-driven competition and regulation. Our propositions must be reflective of heightened customer expectations for ease of access, personalisation and relevance, as well as the needs created by changing life patterns.**

**KEY OBJECTIVES FOR 2018 TO 2020**

Remain number 1 UK digital bank with Open Banking functionality

Unrivalled reach with UK's largest branch network, serving complex needs

Data-driven and personalised customer propositions

**MEASURING PERFORMANCE**

**16.4 million**
digitally active customers

**#1**
Maintained the largest branch network in the UK

## Progress in 2019

In 2019, we have built on the strong progress delivered in 2018, with further improvements in our customer propositions supporting the continued growth of our franchise and improved measures of customer satisfaction.

**Building a market leading digital experience**
We are the largest digital bank in the UK, with 16.4 million digitally active and 10.7 million mobile app customers. During the year, we have seen increased customer engagement with the enhanced digital features introduced in 2018 and have launched a range of new features that enable our customers to be more in control of their finances. These include the ability to change address via the mobile app and app statement searches, the latter of which is being used c.1.2 million times per month on average and is helping us to reduce our use of paper.

Consistent with this focus, we have also built on our progress in allowing our customers to see all their bank accounts, across different providers, in one place. In 2019, we were the first UK bank to expand this Open Banking aggregation capability to include both savings accounts and credit cards. We're unique amongst our banking peers in enabling our customers to also view these products together with their Group insurance and pensions products, with our Single Customer View demonstrating strong engagement levels.

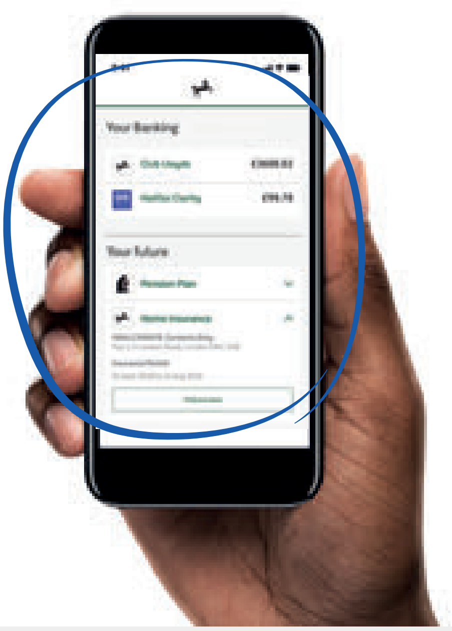
**#1 branch network, serving complex needs**
As a core element of our multi-channel model, we remain committed to maintaining the largest branch network in the UK and our market share of around 21 per cent by 2020. In the year we have continued to make a number of changes to ensure that our network reflects our customers' evolving needs. As part of this, we have expanded the reach of our remote advice service to around 580 branches, which alongside the ability to access the service from the comfort of their own homes, is providing our customers with increased choice and convenience in how they can discuss their financial needs with us. In addition, our branch colleagues have also been able to increase their focus on addressing customers more complex financial needs, with this now accounting for around 50 per cent of their time.

**Personalising our customer propositions**
We recognise that our diverse customer base want and expect different things and have continued to develop products and services that are more personalised to their specific needs. Among these, we have launched a range of smart tools that our customers can access digitally, including upcoming payment alerts and a 'Save the Change' feature, through which they can aim to achieve a range of financial goals through small behavioural changes.

## Focus for 2020

In 2020, we will continue to focus on improving our customers' digital banking experience, with new features providing them with greater insights into their transactional activity and ability to achieve their financial goals. We will also continue to deepen our customer insights to develop more personalised products and services, while also ensuring our branch network remains relevant to our customers' needs.

helping me see the full picture



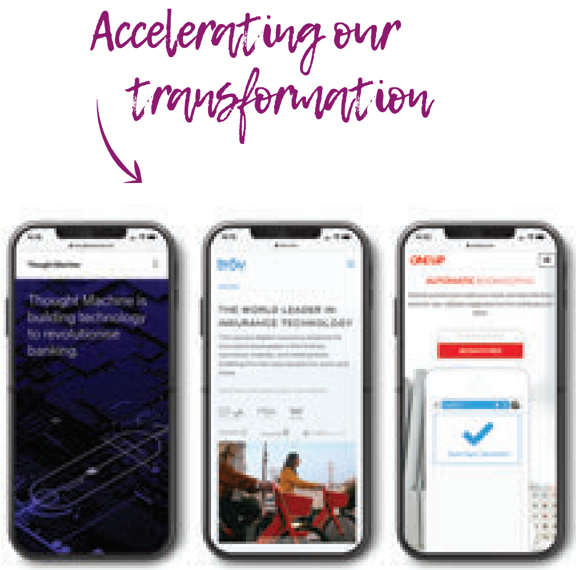
## Our unique Single Customer View

Our Single Customer View capability allows our customers to see all their financial needs in one place, from bank accounts to pension and insurance products. At the end of 2019, more than 5 million customers had access to this, with priorities for 2020 including extending this to around 9 million customers, while also increasing functionality.

**I can see my pension alongside my banking now which is great, really useful**
**Lloyds Banking Group customer**

# Digitising the Group

Our market leading cost position and customer franchise are sources of competitive advantage. However, we must not be complacent and must further digitise the Group to drive additional operational efficiencies, improve the experience of our customers and colleagues and allow us to invest more for the future. In addition, we must continue to simplify and progressively transform our IT architecture in order to use data more efficiently, enhance our multi-channel customer engagement and create a scalable and resilient infrastructure.




## Increased fintech engagement

As well as investing in technology capabilities, we recognise that we also need to embrace external innovation and work collaboratively to transform the Group for success in a digital world. Our Corporate Ventures Panel encourages colleagues from across the Group to propose opportunities to a panel of experts. This has already resulted in a number of exciting partnerships, such as with Thought Machine, Trov and OneUp, our most recent partnership which provides online financial management services for smaller businesses.

**KEY OBJECTIVES FOR 2018 TO 2020**

Deeper end-to-end transformation targeting 70 per cent of our cost base

Simplification and progressive modernisation of our data and IT infrastructure

Technology enabled productivity improvements across the business

**MEASURING PERFORMANCE**

**19%**
Top quartile technology spend, equivalent to 19% of operating costs

**55%**
of the cost base covered by transformation

## Progress in 2019

We have continued to progress our technology enabled transformation during the course of the year, delivering better products and services that customers value and reducing time to market. We are also driving additional operational efficiencies across the organisation as we progressively modernise our IT and data architecture and improve processes. This has been underpinned by a continued commitment to invest significantly in technology.

**Top quartile technology spend**
Consistent with the scale of our transformation, we continue to invest significantly in technology. In 2019, our technology spend, which increased by 14 per cent year on year, equated to 19 per cent of operating costs and remains among the top quartile of global peers. Importantly this was achieved while reducing operating costs, with our modular approach to transformation and IT modernisation delivering business efficiencies and creating capacity for greater levels of investment. The mix of our technology spend also continues to evolve, with greater emphasis on the development of new capabilities, with the combination of this and enhancing existing capabilities accounting for over 75 per cent of spend in 2019.

**Embracing the power of technology**
As our transformation progresses, we have significantly increased our adoption of new technologies and are seeing a number of tangible customer and colleague benefits as a result. For example, having introduced the use of robotics for simple, repetitive tasks in 2018, we have now created in excess of 1 million cumulative hours of colleague capacity, allowing them to focus on more value adding activities for our customers. In addition, around 55 per cent of our cost base has now been covered by transformation. This is up from just from 12 per cent at the end of 2017 and we expect this to surpass 70 per cent by the end of 2020.

The scaling of our use of machine learning is also delivering improved customer outcomes. For example, virtual assistants managed up to 5,000 customer conversations daily in 2019, with customer satisfaction increasing by more than 10 points. In addition, around 25 per cent of queries are handled without being passed to a colleague, a trend that is expected to increase further.

The Group has also significantly increased its adoption of private cloud, with more than 650 applications now migrated. These investments deliver a more efficient, scalable and flexible infrastructure and underpin the continuous improvement of our products and services for our customers' benefit.

**The largest digital bank in the UK**
With 16.4 million digitally active users and 10.7 mobile app users, we are the largest digital bank in the UK, with 75 per cent of products now originated digitally. In line with this continued shift to digital channels, we are continuing to roll out new features for our customers, resulting in increased engagement as adoption increases.

## Focus for 2020

Our technology investment will continue to focus on areas that deliver meaningful benefits for our customers and colleagues. We will further embrace new technologies and increase data capabilities to develop insight-driven propositions, while ensuring that these reflect customer expectations. This will be delivered alongside a rigorous focus on ensuring the safety and security of our customers' data.

**Our strategic priorities** continued

# Maximising Group capabilities

**To better address our customers' banking and insurance needs as an integrated financial services provider and improve their overall experience, we will make better use of our competitive strengths and unique business model.**

**KEY OBJECTIVES FOR 2018 TO 2020**

+£50 billion growth in financial planning and retirement open book assets under administration

>1 million new pensions customers

+£6 billion of additional net lending to start-ups, SMEs and Mid Market customers

**MEASURING PERFORMANCE**

**£37 billion**
cumulative open book assets under administration growth

**>5m**
customers on Single Customer View

**>1m**
new pension customers, achieving target a year ahead of schedule

**£3.4bn**
net lending to start-ups, SMEs and Mid Market customers

## Progress in 2019

In 2019 we have continued to enhance and leverage the Group's capabilities and unique business model to meet our customers' banking and insurance needs more effectively.

**Meeting our customers' growing financial planning and retirement needs**
As the UK's sole integrated financial services provider, we are unique in being able to show and serve all of our customers' financial needs in one place. In 2019, we extended our Single Customer View capability to over 5 million customers, who are now able to view their insurance and pension products alongside the banking products they hold with us and other providers. Importantly, this is enabling our customers to engage with their longer-term savings needs more proactively, with engagement levels surpassing those of stand alone insurers.

Building on our progress in 2018, we have also rolled out a number of improvements to our long-term savings and pensions customer propositions, with our workplace pensions offering also benefiting from the close coordination of our Commercial Banking and Insurance & Wealth businesses. Taken together with further transfers from the acquired Zurich book, we have successfully grown our open book retirement and investment assets under administration by around £30 billion in the year, or £37 billion since 2017.

**Leveraging our partnership with Schroders to accelerate our Wealth strategy**
In 2019 we formally launched Schroders Personal Wealth, a market-leading wealth proposition, which combines the investment capabilities and innovative product offering of Schroders with our distribution footprint and digital reach. This allows us to better serve our customers' financial planning and retirement needs, and underpins this joint-venture's target of becoming a top three UK financial planning business by the end of 2023. In addition, as part of our broader strategic partnership, we are developing a full service offering for our customers, including access to a leading wealth and investment management business and a mass market direct offering that is due to launch in 2020.

**Improving the experience of our Commercial Banking clients**
We have delivered material improvements to our client experience, while also meeting our £18 billion gross lending commitment to UK businesses, remaining a leader in green financing and maintaining our strong support for exporters and manufactures. We have significantly reduced the time taken to fulfil various client needs through the digitisation of key banking processes. In business banking, the average time to cash for new unsecured loans has been reduced from 6 days in 2018 to a few hours. Similarly, the launch of API connectivity has resulted in a response time of 1.5 seconds for payables transactions, while also driving significantly quicker and more accurate asset finance credit decisions. Through the enhancement of our cash management and payments capabilities, we have also successfully deepened our client relationships.

## Focus for 2020

In 2020, we will extend the reach and functionality of Single Customer View to around 9 million customers, introducing new features that will enable customers to engage with their long-term savings and investments more proactively. In addition, we will continue to support the development of Schroders Personal Wealth in line with its ambitious targets, while also making further improvements to our business clients' digital banking experience.


## Strong start for Schroders Personal Wealth

Our joint venture with Schroders has harnessed the unique strengths of two of the UK's strongest financial services businesses to create a market-leading wealth proposition with the expertise and broad spectrum of investment and retirement products to optimise customers' entire financial lives. Schroders Personal Wealth has got off to a strong start since its launch, with Retail wealth referrals from the Group up 33 per cent in 2019.

Scan the QR code to watch the advert

# Transforming ways of working

Our colleagues are crucial to the success of our business. In order to deliver our transformation during the current strategic plan and beyond, our colleagues will require new skills and capabilities to reflect the changing needs of the business as it adapts to the evolving operating environment. At the same time, colleagues' expectations of their employers are changing. As a result, we are making our biggest ever investment in colleagues to ensure that we continue to attract, develop and retain these skills and capabilities, while fostering a culture that supports a way of working that is agile, trust based and reinforces the Group's values.

**KEY OBJECTIVES FOR 2018 TO 2020**

50 per cent increase in training and development to 4.4 million hours

Up to 30 per cent change efficiency improvement

**MEASURING PERFORMANCE**

**3.2 million**
cumulative future skills training hours delivered

**33%**
of change delivered by Agile methodologies


## Colleague training and development

As part of our largest ever investment in our people, we are rolling out 4.4 million cumulative additional training hours to develop key skills of the future. These skills are split across 10 categories ranging from leadership to data analytics and customer excellence and will ensure that we are well positioned to transform the Group for success in a digital world, while also providing growth opportunities for our colleagues.

> **I think it's great that the bank is investing so heavily in my development. It has allowed me to develop new skills and gives me the confidence to put them into practice**
>
> **Lloyds Banking Group colleague**

## Progress in 2019

With our competitive environment increasingly influenced by technological change and innovation, it is critical that we continue to equip our colleagues with the skills needed to deliver our ongoing transformation. We have made significant progress in 2019 and are seeing tangible benefits as these changes take effect. These achievements also continue to be supported by improvements to our working environment, with benefits including greater collaboration and efficiency.

**Building skills for the future**

To deliver our significant transformation, we are continuing to make our biggest ever investment in our people during the course of the current strategic plan. In 2019, we delivered 5.5 million of total training hours, an increase of 28 per cent compared to 2018. We have also now delivered more than 3.2 million of cumulative training hours to develop the skills for the future since the end of 2017, and are well positioned to deliver our target of 4.4 million cumulative training hours by the end of 2020.

In addition to up-skilling our colleagues, we are also using targeted recruitment to introduce new skills into the organisation across areas that will support the new strategic competencies of the Group going forward. We have also hired over 1,200 colleagues across critical areas such as engineering, data science and cyber security. The integration of skills such as these into our colleague base positions us well to continue transforming the Group for success in a digital world, with other benefits including a reduced reliance on third-party providers.

**Changing the way we work**

Consistent with our aim to embrace new ways of working, we have continued to make things easier than ever before for our colleagues to work in a more collaborative manner. 96 per cent of our colleagues are now based in one of our six strategic hub locations. We continue to invest in improving the working environment with 34,000 colleagues benefiting from refreshed workplaces in 2019. Our ongoing changes to working environments are helping create a hub of agile working, focusing on collaborative activity-based spaces which foster innovation and make it easier for our colleagues to focus on delivering better experiences for our customers. Moreover, by creating an environment where colleagues can collaborate more easily regardless of location, this will help us as an organisation significantly reduce our carbon footprint. The combination of these factors is resulting in a cultural shift across the Group, with over 33 per cent of change now delivered using Agile methodologies and we continue to expect this number to surpass 50 per cent by the end of 2020.

## Focus for 2020

We will continue to provide our colleagues with the required skills to support our ongoing transformation, with more specialist skills gaps being addressed by targeted recruitment. This, combined with our shift towards a more collaborative culture will enable us to reduce bureaucracy, harness innovation and deliver change more efficiently than ever before, while also making the Group a more attractive place for people to work.

## Our key stakeholders and Board engagement

# Reflecting the needs of our stakeholders in Board decisions

**Engaging, consulting and acting on the needs of different stakeholders is critical for the development of a culture and strategy that achieves long-term sustainable success.**

The Board has a comprehensive stakeholder engagement programme and always aims to act in the best interest of the Group and to be fair and balanced in its approach. The needs of different stakeholders are always considered as well as the consequences of any decision in the long-term and the importance of our reputation for high standards of business conduct. It may not always be possible to provide a positive outcome for all stakeholders and the Board frequently has to make difficult decisions based on competing priorities. However, comprehensive engagement enables informed decision making taking into account the consequences for different stakeholders.

To enable and ensure stakeholder considerations are at the heart of all corporate decision making, a wide range of papers relating to different stakeholder groups are presented and discussed regularly by the Board. In addition all papers submitted to the Board are required to consider the impact of proposals on key stakeholder groups.

We engage in many different ways and this section outlines our key stakeholder groups, how we are interacting with them and how they inform strategic decision making. It also provides examples of key strategic decisions made during the year and the Board engagement involved.

This section (pages 20 to 27) acts as our Section 172(1) statement; however, given the importance of stakeholder focus, long-term strategy and reputation, these are integrated throughout the report.

**Section 172(1) Statement and Statement of Engagement with Employees and Other Stakeholders**

In accordance with the Companies Act 2006 (the 'Act') (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), the Directors provide this statement describing how they have had regard to the matters set out in section 172(1) of the Act, when performing their duty to promote the success of the Company, under section 172. Further details on key actions in this regard are also contained within the Corporate Governance Report on pages 65 to 94 and the Directors' Report on pages 94 to 97.

In accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), this statement also provides details of how the Directors have engaged with and had regard to the interest of our key stakeholders.

## CUSTOMERS

As a retail and commercial financial services provider we understand that long-term success is only possible with a customer-centric business model and therefore customer impact is critical to all Board decisions.

With around 26 million customers, we strive to treat them fairly, making it easy for them to find, understand and access products that are right for them, whatever their circumstances.

To ensure the Board truly understands the changing needs of customers and their views on the bank, various initiatives, direct and indirect have been implemented.

### Customer priorities

- Market leading digital proposition with branch access
- Single home for customers' banking and insurance needs
- Personalised customer propositions
- Better experience across all channels

### Direct engagement

The Board takes advantage of all available opportunities to engage with customers. In 2019, these included a series of branch/office visits and customer events for retail, commercial and insurance customers. Client contact enables direct feedback and informs strategic decision making.

In July 2019, we launched the reconnecting with customers pilot programme, specifically designed to bring senior leaders across the Group closer to our customers and customer-facing teams.

The Chairman and a number of Non-Executive Directors also attended customer insights sessions monthly across the UK to hear directly from customers about their lives and what is important to them.

Earning and retaining the trust of customers is a priority for the Board with regular updates received. The Group remains committed to doing whatever is necessary to ensure all customers impacted by past conduct failures receive fair recompense. During 2019, an independent review highlighted shortcomings in our approach to victims of the historic HBOS Reading fraud and as a result the Board is now taking swift action to contact the impacted victims and ensure they receive fair recompense.

Having identified the need to upgrade the skills of small businesses in technology, productivity and export opportunities, we have been engaging with government and other organisations to provide additional support.

### Indirect engagement

The Board reviews the customer dashboard, which provides a detailed insight into the Group's performance in respect of delivering on our customer related ambitions and agreed improvements in the dashboard's construct during the course of the year. The Board also approves the annual customer plans, which set out the customer related priorities for the Group's divisions for the coming year.

The Chairman, Chief Executive and other Board members regularly review customer complaints to understand areas where we can improve and review how we respond to complaints.

The Board also looks to benchmark performance among customers and uses insight from a range of internal and external research, including net promoter scores and other customer indices, to improve services.

The Board receives regular updates and reports on progress of the Group strategy, including the development of the next strategic phase, ensuring the customer remains at the heart of our strategic investment.

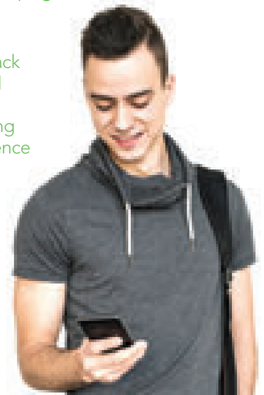
The Board receives insight and guidance in relation to the competitive environment and market shares, providing strategic insight and generating good discussion among the Board, resulting in either actions or key learnings taken in the Group.

The focus on customers is not just evidenced by the regularity of presentations to Board, but also by the existence of the Group Customer First Committee. This Committee is composed of members of senior management and regularly reports to the Board. The Committee acts as the custodian of Group wide customer experience and has responsibility for monitoring, reviewing and challenging the divisions to make changes to support the delivery of the Group's aim and customer-centric culture.

### Our response to customer priorities

- Leading customer experience Read more on page 16
- Digitising the Group Read more on page 17
- Maximising Group capabilities Read more on page 18
- Helping Britain Prosper Read more on pages 27 to 34

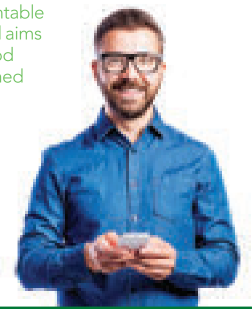
Customer feedback is crucial to Board discussions and achieving a leading customer experience



## We have a large footprint, with an important role in society and many different stakeholders to consider as we run the Group

**Lord Blackwell**
Chairman

The Board is accountable to shareholders and aims to ensure that a good dialogue is maintained



## SHAREHOLDERS

The Group has the largest shareholder base in the UK with around 2.4 million shareholders and we undertake a comprehensive shareholder engagement programme including both institutional and retail shareholders with regular feedback to management and the Board. We strive to consider all shareholder groups evenly when making key decisions for the Group.

### Shareholder priorities

- Superior returns and lower cost of equity
- Strong capital generation and attractive distribution policy
- Sustainable and low risk growth
- Responsible, sustainable business model

### Direct engagement

The Group understands the need to effectively communicate with existing and potential shareholders, briefing them on strategic and financial progress and attaining feedback. The Group therefore undertakes c.500 shareholder meetings a year, with the Group Chief Executive and Chief Financial Officer undertaking more than 80 meetings in 2019.

In addition, various Non-Executive Directors have engaged with shareholders through the year, including the Chairman and the Remuneration Committee Chair. The Chairman's meetings were largely focused on corporate strategy, governance and sustainability, whilst the Remuneration Committee Chair has been consulting widely on the new remuneration policy. In total, Non-Executive Board members have engaged directly with shareholders representing around 30 per cent of our issued share capital during the year.

The AGM is an opportunity for shareholders to hear directly from the Board on the Group's performance and strategic direction, and importantly, to ask questions. In 2019:

- around 200 shareholders attended
- over 67 per cent of total voting rights voted

During 2019, we hosted two retail shareholder briefings, one in London and one in Edinburgh, in which we updated shareholders on strategy and performance and obtained feedback. These briefings were hosted by Investor Relations and senior management.

## KEY BOARD DECISION
## ADOPTING A QUARTERLY DIVIDEND

In May 2019 the Group announced that it will move to the payment of quarterly dividends, from the first quarter of 2020.

The new approach will be to adopt three equal interim ordinary dividend payments for the first three quarters of the year followed by, subject to performance, a larger final dividend for the fourth quarter of the year.

The first three quarterly payments, payable in June, September and December will each be 20 per cent of the previous year's total ordinary dividend per share with the fourth quarter payment payable in May, following approval at the AGM.

The Group has around 2.4 million shareholders, the vast majority of whom are retail shareholders, and this approach will provide a more regular flow of dividend income to all shareholders whilst accelerating the receipt of payments.

Additional information on the changes, including how shareholders can move to direct credit payments, is available on the Group website www.lloydsbankinggroup.com/investors/shareholder-info/dividends/.

### Our decision process

- The decision to introduce quarterly dividends was made following shareholder feedback and extensive discussion at both management and Board level
- The Board considered the benefits and possible drawbacks for different types of shareholders, in particular retail shareholders given the size of their holdings, along with the Group impact
- The management team consulted with external advisors, with payment approaches by other large corporates considered, and engaged with the regulators
- The Board also looked at various options for the phasing of dividend payments, while remaining mindful of the goal to accelerate payments
- This approach both supports our purpose to Help Britain Prosper whilst aligning to the Group's progressive and sustainable ordinary dividend policy

Link to strategic priorities

Leading customer experience

### Indirect engagement

Board members are keen to be aware of shareholder sentiment and ensure follow up actions are taken as appropriate. As such all institutional shareholder letters are registered and discussed at the Group Nomination and Governance Committee.

Investor Relations provides regular reports and feedback to the Board on key market issues and shareholder concerns. This includes an annual presentation involving our corporate brokers on market dynamics and corporate perception.

Regular feedback is provided to the Board and appropriate Committees on retail shareholder correspondence.

The Group communicates with its shareholders through regular results and strategy announcements and has a comprehensive website on which detailed company information is available. To ensure effective communication, the Group Chief Executive also specifically writes to all shareholders, updating them on progress, every six months.

We regularly engage with our shareholders about the information we provide to them and, where appropriate, incorporate their feedback to enhance our disclosure. In support of this, in February 2020, we published our first ESG focused presentation online: 'Our approach to ESG' www.lloydsbankinggroup.com/investors/financial-performance/

Given the Group's significant retail shareholder base, we have actively looked to increase engagement in the past twelve months and will continue to do so in 2020. We aim to build a sustainable communications infrastructure, including an enhanced corporate website, to ensure improvements deliver better insight for all our shareholders.

### Our response to shareholder priorities

- Group financial performance
  Read more on pages 36 to 39
- ESG presentation online
  www.lloydsbankinggroup.com/investors/financial-performance/
- Our 2020 Remuneration policy
  Read more on pages 115 to 126

## Our key stakeholders and Board engagement continued

### COLLEAGUES

The Group has around 65,000 colleagues, who take pride in working for an inclusive and diverse Group and, with their support, we are building a culture in which everyone feels included, empowered and inspired to do the right thing for customers. Through our strategy we have made our biggest ever investment in colleagues to ensure that we continue to attract, develop and retain these skills and capabilities.

**Colleague priorities**
- Customer and value led culture
- Investment in training and IT
- Compelling colleague proposition
- Attractive reward structure

**Direct engagement**
We work to maintain an open dialogue with our colleagues. During the year the Board communicated directly with colleagues through videos, webcasts, and our Group intranet, detailing the Group's performance, changes in the economic and regulatory environment and updates on our key strategic initiatives. We also hosted regular Ask Me Anything sessions providing the opportunity for colleagues and contingent workers to ask questions and receive real time responses directly from members of the Board.

The Board places great importance on opportunities to engage directly with colleagues. The Board visited office locations throughout the UK, taking the opportunity to hear directly from colleagues about their work and their successes, passion, drive and commitment to improve the business for the benefit of the Group's customers.

The Chairman also held a number of Town Hall sessions in locations across the country, meeting with colleagues and answering their questions about the Group and its business, in addition to regular and informal lunches and breakfasts with members of the senior leadership team to discuss business issues.

The Group held its biggest signature annual event, Helping Britain Prosper LIVE, which was attended by over 5,000 colleagues and was broadcast live to all colleagues.

This event, hosted by the Group Chief Executive with support from key members of the executive leadership team, provided the opportunity for our colleagues to hear and see first-hand how we are progressing our strategy and Helping Britain Prosper every day.

The Board participated in the transforming ways of working labs, providing them with the opportunity to see first-hand the activity underway in support of improving the customer and colleague experience.

**Indirect engagement**
We held meetings throughout the year with our recognised unions, attended by the Chair of the Remuneration Committee and the Group Chief Executive. Key topics included the Living Wage, which applies to our whole workforce.

In 2019, the Board agreed how they would engage with the workforce. The definition of workforce, was agreed by the Board as: Our permanent colleagues, contingent workers and third-party suppliers that work on the Group's premises delivering services to our customers and supporting key business operations.

### KEY BOARD DECISION
### CHANGING OUR REMUNERATION POLICY

The Group's Remuneration Policy was last approved by shareholders at the AGM in 2017 and has been in operation for the last three years. We have published our proposed revised Remuneration Policy within the Directors' Remuneration Report on pages 98 to 123.

We have thought carefully about the purpose of remuneration and believe this is an opportune time to propose a simplified reward package that provides greater alignment with the Group's strategy and the experience of customers, colleagues and shareholders.

The proposed policy comprises:
- A significant reduction in executive pension contributions
- The introduction of a new long-term (restricted) share plan
- Continued simplification of the balanced scorecard

**Our engagement process**
- Proactive engagement took place throughout 2019 with key stakeholders including shareholders, colleagues and the regulator to understand some of the drivers for change
- Our Remuneration Committee Chair consulted with shareholders representing over 30 per cent of our issued share capital on initial proposals and continued the dialogue as the policy evolved
- Consultations with our recognised unions took place to discuss key changes to colleague pension provisions
- Management have been focused on ensuring key proposed changes in variable reward structures are fit for purpose for colleagues across the Group as part of a fair and consistent reward package

Please see page 99 and 101 for further information on key areas of focus discussed with stakeholders.

**Our decision process**
The engagement that has taken place in 2019 has heavily influenced the decisions made by the Remuneration Committee. Further details of the feedback we received can be found on page 99.

The Remuneration Committee has been mindful of the trend towards pay simplification across UK organisations. Shareholders have previously voiced that the Group's current construct is overly complex. Our new proposed Remuneration Policy has been designed to deliver a simplified variable reward approach.

In addition to wholesale change of some reward structures, such as the introduction of the Long Term Share Plan, the Committee also decided to maintain some existing components considered important parts of the overall package. We have agreed to maintain the existing Balanced Scorecard structure which is considered a transparent and effective tool to drive and assess performance. To provide further understanding for shareholders, an explanation alongside the Policy as to why the measures included in the scorecard provide good strategic alignment is provided within the Directors' Remuneration Report.

**Long-term implications**
We believe the revised reward structure will incentivise long-term stewardship and promote good governance through a simple alignment with shareholders. Reductions in fixed pay and potential variable reward payouts will support reducing the gap between colleague and executive remuneration.

We offer a competitive and fair reward package. Colleagues are also eligible to participate in HMRC approved share plans which promote share ownership by giving colleagues an opportunity to invest in Group shares. Further information can be found on page 116 in the Directors' Remuneration Report.

**Link to strategic priorities**

Maximising Group capabilities

A workplan was discussed and agreed in February 2019 and as a result, the Board now receives a quarterly Workforce Engagement report which comprises two component parts:
- A summary of the Board's engagement activity with colleagues
- Key themes raised by colleagues and trends on people matters, including, for example absence or attrition

The Board considers that the above arrangements are invaluable in giving them an understanding of the views of the workforce and encouraging meaningful dialogue between the Board and the workforce.

The Board are committed to improving the transparency of workforce disclosure, and the Group participates in the Workforce Disclosure Initiative.

In June 2019, the Group People and Productivity Director, presented to the Board on people and transforming ways of working, providing them with an update on the Group's people strategy, read more on page 19.
The Board also receives regular updates on culture, read more on page 74.

The Group believes that a diverse workforce is critical to performance and regular progress updates are provided to the Board.

As well as its own engagement survey, the Group also takes part in the Banking Standards Board assessment on a yearly basis, which provides member firms with the evidence, support and challenge to help them achieve and maintain high standards of behaviour and competence both individually and collectively. There are five parts to the assessment; an online employee survey, a set of Board questions, interviews with Executive and Non-Executive Directors and employee focus groups.

**Our response to colleague priorities**
- Improved employee engagement
- Fair and competitive pay and remuneration structure
- Championing Britain's diversity
  Read more on page 34
- Transforming ways of working
  Read more on page 19
- EU exit preparations

The Board recognises the responsibility the Group has to engage with and respond to some of the economic, social and environment challenges the UK faces

**We define key Board decisions as those that are significant to any of our stakeholders**

**Lord Blackwell**
Chairman

## COMMUNITIES AND ENVIRONMENT

As the largest retail and commercial financial services provider in the UK, we have a presence across the country. We specifically invest in local communities across Britain to help them prosper economically and build social cohesion by tackling disadvantage.

**Community and environmental priorities**
- Helping the transition to a sustainable low carbon economy
- Helping Britain get a home
- Helping people save for the future
- Helping businesses start up and grow
- Building capability and digital skills

**Direct engagement**
The Board continued to support the Group's four charitable Foundations and during Small Charities Week, the Group ran campaigns with each Foundation showcasing the work they do for small but vital charities including those tackling domestic abuse and mental health. This demonstrated the alignment between the Group supporting vulnerable customers and the work done by charities to support these social issues. Sara Weller, Chair of the Group's Responsible Business Committee, is a Bank Trustee of the Lloyds Bank Foundation, England and Wales.

Members of the Board visited several charities in 2019, including the Manchester Digital Academy, Angel Eyes in Northern Ireland and the Cathedral Archer project in Sheffield.

**Indirect engagement**
The Group's Helping Britain Prosper Plan is reviewed and approved annually by the Board to ensure it focuses on what matters most to people, businesses and communities in the UK.

The Responsible Business Committee, a sub-committee of the Board, provides oversight and support for the Group's Helping Britain Prosper Plan, and the plans for delivering the aspiration to be seen as a trusted and responsible business.

During 2019, the Board reviewed responses from the Responsible Business materiality study which outlined a wide range of views on the Group. These responses then informed and guided our responsible business strategy and reporting.

The Board undertook various related deep dives throughout 2019, including key areas of strategic focus such as ESG, cyber security and inclusion and diversity within the Group, with specific focus on BAME colleagues. This highlighted a number of strengths but also identified opportunities for the Group to further improve its behaviours and approach.

## KEY BOARD DECISION
## TACKLING CLIMATE CHANGE

Across the globe, action to combat climate change is needed. We support the Government's Clean Growth Strategy and are supporting our customers with a range of initiatives to help them become more sustainable and think about environmental impacts, including access to green finance.

The transition to a low carbon economy impacts us all and subsequently is a fundamental element of our strategy and core to Helping Britain Prosper.

In 2018 following a detailed review by the Board, we introduced a new sustainability metric to our Helping Britain Prosper Plan, signalling our intent and commitment and in January 2020, we announced an ambitious new goal to help reduce the carbon emissions we finance by more than 50 per cent by 2030. Read more about our ambitious goal and other commitments on pages 28 to 31 or in our approach to ESG presentation online www.lloydsbankinggroup.com/ investors/ financial-performance/

**Our engagement process**
- In developing our proposals, various stakeholder groups have been engaged including customers, colleagues, shareholders, suppliers, government and regulators
- The annual responsible business materiality study specifically identified environmental sustainability and climate change as a critical issue and as a result further detailed analysis was undertaken by the Group sustainability teams
- The Responsible Business Committee, a sub-committee of the Board, provides direction and oversight, whilst at Executive level, the Group Executive Sustainability Committee (GESC), supported by divisional Governance Forums and working groups, provide oversight
- The Board were briefed on key climate related issues by external industry experts and also engaged on a number of external fronts

**Long-term implications**
The Board believe we have a responsibility to help drive progress towards a sustainable and resilient UK economy, taking into consideration the needs of different stakeholders and risks to the business, and were comfortable endorsing ambitious plans, given the benefit to the Group and future generations.

**>£4.9bn**
**Green finance**
Read more about our approach to green finance on page 29

**>50% by 2030**
**We aim to help reduce the emissions we finance by more than 50 per cent by 2030**

Link to strategic priorities
- Leading customer experience
- Maximising Group capabilities

The Board supports the Group's 10 regional ambassadors that cover the home nations of Scotland, Wales and Northern Ireland, and the seven regions of England. Through the programme we have established strong relationships with politicians, the media, local councils and other community institutions to offer our insight on the major economic and social debates the country faces.

Given our unique position within the UK, we are eager to play our part in tackling climate change, by working with our stakeholders to help reduce the carbon emissions we finance. We want to finance a green future together. We are developing longer-term broader social impact goals during 2020, as we develop our thinking around the Society of the Future.

**Our response to community and environmental priorities**
- Help Britain Prosper
  Read more on pages 27 to 34
- ESG presentation online
  www.lloydsbankinggroup.com/investors/financial-performance/

## Our key stakeholders and Board engagement continued

### REGULATORS AND GOVERNMENT

We have a strong, open and transparent relationship with our regulators and other government authorities including HMRC. We liaise with them regularly to ensure the business is aligned to the evolving regulatory framework.

**Regulators and Government priorities**

- Ensuring firms have robust prudential standards and supervision in place
- Fair treatment of customers
- Adapting to market changes and horizon scanning (including climate change and developments in data and technology)
- Culture
- Financial and operational resilience
- Risk management
- Recovery and resolution
- Preparations for EU withdrawal

**Direct Engagement**

During 2019 we had regular meetings with our various regulators at different levels of the organisation from Board to senior management.

The Board and senior management continue to engage with our regulators through proactive meetings to discuss various key themes, such as: customer-centric culture; transformation and change; operational and financial resilience; and credit risk.

The Chairman has had extensive dialogue with both the FCA and PRA on all aspects of their regulatory agenda.

**Indirect Engagement**

The Board Risk Committee receives monthly updates on Group regulatory interaction providing a view of key areas of focus, alongside progress made addressing regulatory actions, and current enforcement activity.

**Our response to regulator and government priorities**

The Board are committed to complying with all relevant legislation, in particular that relating to prudential and conduct regulation. Appropriate regulation is considered in all Board decision making.

The Board continue to closely monitor the status of our regulatory relationships, enhancing proactive engagement across key regulatory changes and areas of focus. Read more on regulatory change on page 11.

In 2020, we will continue to adapt our engagement strategy, ensuring alignment with emerging areas of focus and the regulators' business plans.

### KEY BOARD DECISION
### EU EXIT PREPARATIONS

Given our UK focus, our performance is inextricably linked to the health of the UK economy and throughout 2019 we continued to prepare for an EU exit.

Given the importance of this topic for the Group and the country, numerous stakeholders were engaged to inform our approach including customers, colleagues, shareholders, suppliers, regulators and government.

**Our engagement process**

- The Chairman was an active member of CityUK's EU exit Steering Group, working with other major financial institutions to inform government decision making
- The extended EU Exit Executive Forum was established, chaired by the Group Chief Financial Officer, with comprehensive cross-Group representation, to provide an update to the Board on the Group's EU Exit contingency planning
- Additional updates from the EU Exit Forum were also submitted to the Board Risk Committee and Group Risk Committee
- Engagement with politicians, officials, media, trade and other bodies to reassure our commitment to Helping Britain Prosper

**Our decision process**

The Group's EU exit contingency plans continue to be monitored closely by the Board via specific regular updates, covering both operational status and external developments, a suite of early warning indicators and corresponding risk mitigation plans.

When reviewing the possible impacts of the EU exit, the Board have given particular consideration to the Group's strong UK focus and UK-centric strategy, with specific focus on the trading, financial, operational and reputational impacts for the Group, as well as the cyber, physical security and fraud risks, and the continued support of our customers.

We implemented a programme to assess the legal impacts and risks of an EU exit (including a no deal outcome) and to identify appropriate mitigants, such as establishing EU entities to ensure continuity of certain business activities.

**Long-term implications**

Like all UK banks impacted by the EU exit, we submitted contingency plans to the regulators both in the UK and elsewhere as to how we would manage potential EU exit scenarios and are well prepared to ensure continuity of our limited EU business activities at the end of transition period; new European entities have been established and are now operational.

Given the vast majority of our business is in the UK, the direct impact on the Group from leaving the EU is relatively modest.

**Link to strategic priorities**

Maximising Group capabilities

## Our approach to tax

Our comprehensive and diligent approach to regulation is typified by our approach to tax, with HMRC being a key stakeholder for the Group.

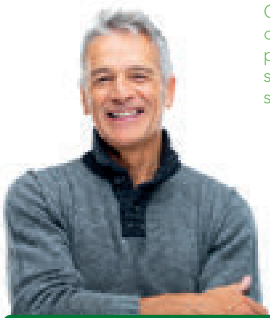
As a Group with the purpose to Help Britain Prosper, and with 98 per cent of our business subject to tax in the UK, we're proud to be one of the largest contributors of UK tax revenues. As well as our tax expense of £1.4 billion as seen in the income statement, in 2019 we also paid £0.8 billion of other business taxes (including the Bank levy and our employer NIC costs) and £0.8 billion of irrecoverable VAT, a total tax contribution for the year of £2.9 billion. In addition, we are also a major tax collector, gathering £1.9 billion on behalf of HMRC.

The Board recognise that tax is one of the ways in which the Group contributes to society, therefore appropriate, prudent and transparent tax behaviour is a key component of Board responsibility.

We have a clear tax policy which is part of our Board-approved Group risk management framework. This policy sets out clear actions for colleagues to manage tax risks. Like any business, our success rests on maintaining a good reputation. We understand that the way we approach our tax obligations has a powerful impact on this reputation, so finding the most responsible balance is vital. We comply with the HMRC Code of Practice on Taxation for Banks and Confederation of British Industry's Statement of tax principles.

Tax is also covered in our Code of Responsibility, a code that applies to every colleague, team and business in our Group – day in, day out. The code makes tax a personal responsibility for every colleague in the Group.

Read more about our tax strategy online www.lloydsbankinggroup.com/globalassets/our-group/responsible-business/reporting-centre/



Our two way communication and partnership with our suppliers is vital to the success of our Group

## SUPPLIERS

Given the size of our organisation, we are reliant on external suppliers for a number of key services. As well as being important for future success, we believe that dealing with suppliers in the right way is the right thing to do.

### Supplier priorities

- Being treated fairly and professionally during the sourcing process
- Clear guidance about the Group's payment procedures
- Working closely to share expertise in developing innovative, high quality products and services and effectively managing risk
- Engaging in ways that ensure we achieve the best value for customers in terms of price, quality and social impact
- Building strong, collaborative relationships and understanding the environment in which we operate so that they can meet our needs and our customers' needs
- Supporting suppliers in meeting our requirements for cybersecurity in our supply chain

### Direct engagement

We want to improve the experience of our suppliers. As such we regularly seek feedback on the Group's on-site assurance process from suppliers in order to continually improve the process.

Suppliers are encouraged to express their satisfaction or dissatisfaction to their points of contact within the Group e.g. the supplier manager, the sourcing manager, the finance contacts. Suppliers also have access to the Speak Up line.

The Group collaborates with its suppliers on key issues. The Group held a supplier breakfast with a roundtable discussion on cyber, resilience and information security.

### Indirect engagement

We work with around 3,100 active suppliers of varying sizes, most in professional services sectors such as IT, cyber, operations, management consultancy, legal, HR, marketing and communication.

All material contracts are subject to rigorous cost management governance and updates on key supplier risks are provided to the Board.

The Board Risk Committee oversees our detailed process to assess the cybersecurity of suppliers and help them meet our security requirements.

Board approved governance has been established to ensure that the ordering processes for all expenditure: allow challenge to be made in line with our cost management processes; maximise the use of appropriately sourced third party suppliers; offer appropriate pre-commitment controls to minimise risks and unnecessary costs; give the opportunity to negotiate further savings with third party suppliers; facilitate third party suppliers being paid in a timely manner and avoid risk and costs associated with the use of non-approved channels.

### Our response to supplier priorities

In 2019 our supplier expenditure was £5.9 billion with over 95 per cent of our third party suppliers located in the UK.

It is important that we have the right framework to operate responsibly. The Sourcing and Supply Chain Management Policy applies to all businesses, divisions, Group functions and legal entities across the Group, whether based in the UK or overseas, including joint ventures. This Policy has been designed to assist in managing the inherent risk in outsourcing services, and dealing with third party suppliers.

We require suppliers to adhere to relevant Group policies and UK suppliers are additionally required to comply with our Code of Supplier Responsibility. This outlines our expectations for responsible business behaviour, underpinning our efforts to share and extend good practice. This can be found on our Group website www.lloydsbankinggroup.com/our-group/working-with-suppliers/

The Board has a zero tolerance attitude towards modern slavery in our supply chain and continue to make enhancements to address the risk of and provide specific training on human trafficking and modern slavery for specialist colleagues.

## KEY BOARD DECISION
## ACQUISITION OF TESCO BANK'S UK RESIDENTIAL MORTGAGE PORTFOLIO

The Group announced in September 2019 that we had entered into an agreement with Tesco Bank to acquire its prime UK residential mortgage portfolio.

### Our decision process

- The Group has a clear strategy as outlined on pages 16 to 19, and the Board regularly reviews this strategy in light of the changing external environment to ensure that our focus remains the right one
- All potential acquisitions are assessed to ensure alignment with strategy and that they deliver appropriate returns
- The Board agreed the acquisition criteria and discussed the key risks that needed to be assessed
- Detailed analysis of the transaction was undertaken by senior management before attaining Board approval including consultation with regulators
- The acquisition of the Tesco mortgage book was proposed as it is expected to generate good returns to the Group, in excess of current organic market opportunities, while delivering open mortgage book growth within the Group's low risk strategy. It will also provide additional flexibility in participation choices in the mortgage market
- The Board received regular reports and feedback on the progress of the transaction from senior management
- The transaction is consistent with Group strategy and value accretive to shareholders
- As previously indicated, the Group's strong free capital build gives us flexibility to consider inorganic growth opportunities in selected target areas, where we see value for shareholders
- The transaction is in line with this approach and demonstrates the Group's strong commitment to the strategically core prime mortgage market
- Following this transaction, the Group's open mortgage book assets at the year end were ahead of the year end 2018 balance
- As a customer focused business the impact on the acquired customers was considered and we are working closely together with Tesco Bank to ensure a smooth transition for the 23,000 new customers

Link to strategic priorities

- Leading customer experience
- Maximising Group capabilities

Responsible business

# Responsible, sustainable and inclusive

With the Group's unique position at the heart of the British economy, we embrace our responsibility to help address some of the economic, social and environmental challenges the UK faces. We have been Helping Britain Prosper for the past 250 years, by delivering for our customers and communities, as a responsible, sustainable and inclusive business.

## Engaging with our stakeholders

Engaging and responding to stakeholders is fundamental to being a responsible business. Each year we gather a wide range of views through our formal materiality assessment with our stakeholders, which guides both our strategy and reporting. Our key response to their needs is the Helping Britain Prosper Plan which focuses on critical issues including environmental sustainability on page 28, digital skills on page 33, and support for homeowners, savers, and businesses on page 32. Further topics highlighted by stakeholders, and discussed below, include responsible governance and accountability, support for colleagues, customer privacy and data security, and support for vulnerable customers.

## Responsible governance and accountability

Creating and sustaining a values-based culture with good governance is crucial to ensuring our colleagues remain engaged, well informed and can effectively deliver our strategy. Our rigorous internal governance and controls, comprising numerous policies and standards ensure that we treat all stakeholders fairly, while minimising risk.

Our Board level Responsible Business Committee (RBC) oversees the Group's performance as a responsible business, and delivery of our sustainability strategy. Both the Board and RBC are supported by the Group Executive Committee, which is in turn supported by a dedicated Sustainability Committee.

## Helping colleagues to do the right thing

All of our colleagues must be equipped to make the right decisions. The Group supports this by consistently promoting and embedding our policies, processes and training. Each year as part of mandatory training, colleagues review our Code of Responsibility, which outlines Group values and behaviours, and our Anti-Bribery Policy.

If our colleagues witness something inappropriate, they can report the matter to the colleague conduct management team, or make use of our independent and confidential whistleblowing service, Speak Up. In 2019 colleagues reported 451 concerns, of which 216 were formally investigated following triage, with 39 per cent of those investigations substantiated, resulting in remedial action.

We are working to empower our colleagues and one example of this is our award winning behavioural experiments initiative, where colleagues test new ways of working that can lead to permanent process and policy changes, including those that improve customer satisfaction.

The Group understands that engagement is a two way process, so each year we ask colleagues to share their views via our independently run colleague survey, and participate in the annual Banking Standards Board Culture Assessment.

All Group colleagues receive a competitive and fair reward package. To encourage ownership, colleagues are eligible to participate in HMRC approved share plans. Further information can be found on page 116.

## Protecting our customers' finances and data

Customers trust us to keep their money and data safe, and the Group deploys sophisticated technology to protect both. In addition, we play a significant role in the Joint Fraud Taskforce, a collaboration between Government and industry, and champion the Banking Protocol, which enables colleagues to request immediate police support for at-risk customers.

The Group also works continuously to bolster defences against cyber-attacks, paying particular attention to reducing the risks that vulnerable people face. We are a founding member of the Financial Services Cyber Collaboration Centre, working with the Government's National Cyber Crime Centre, and the Cross-Market Operational Resilience Group. We also work closely with other banks, recognising the importance of collaboration when it comes to security, including being part of the Cyber Defence Alliance (CDA). We also meet all of the requirements set out in the EU General Data Protection Regulation (GDPR).

While there's much we can do, customers play a significant role in keeping their accounts secure. Public awareness campaigns are therefore crucial, and we support the Take Five campaign, while also training colleagues so that they can help protect our customers.

**We embrace our economic, social and environmental responsibilities to Help Britain Prosper by operating as a responsible, sustainable and inclusive Group.**

**Sara Weller**
Non-Executive Director and Chair, Responsible Business Committee

## Supporting vulnerable customers

Vulnerability for our customers exists in many forms, from a specific life event to something long-term. That's why the Group is committed to raising awareness, fighting stigma and providing meaningful support across a range of challenging issues. Whether supporting our customers' financial worries following a cancer diagnosis, with our partners at Macmillan, or working with Hope for Justice to provide bank accounts for modern slavery survivors, the Group continues to create innovative solutions for our customers.

Another example is the development of a domestic and financial abuse team, our contribution to a very complex issue that can impact a wide range of our customers. The Group has also signed up to the Financial Abuse Code of Practice, and we signpost the free-to-download Bright Sky app, that provides comprehensive support to people affected by domestic abuse.

In 2019, we were the first bank to sign up to the Mental Health Accessibility Standards, supporting customers with mental health problems. For customers at risk of gambling related harm, we have enabled controls on all of our credit and debit cards, and built on our own internal controls to run a pilot in partnership with Gamban, that helps restrict access to gambling websites and applications worldwide to provide further assistance.

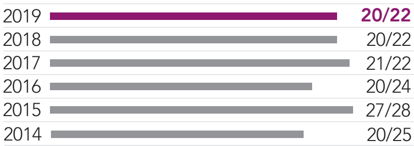
# Our Helping Britain Prosper Plan

Addressing some of the social, economic and environmental challenges facing the UK is the foundation of our Helping Britain Prosper Plan. The Plan takes us beyond business as usual, uniting the Group behind an inspiring set of objectives.

Launched in 2014 and reviewed annually, the Plan focuses on the areas where we believe we can make the biggest difference. In 2018, as part of its inclusion in the Group Balanced Scorecard, we set specific targets across seven areas of focus aligned to our three year strategy, including environmental sustainability and progress is outlined below.

## Helping Britain Prosper Plan targets achieved

**20/22**




Read more online
www.lloydsbankinggroup.com/our-group/responsible-business/prosper-plan/

## The Principles for Responsible Banking

In September 2019, the Group became a founding signatory of the United Nations Environment Programme Finance Initiative (UNEP FI) Principles for Responsible Banking. This sets out a framework for a reformed banking system that will better meet the changing expectations of society. Through both our responsible business activities and the Helping Britain Prosper Plan, we are supporting the UN's broader sustainable development agenda, and contributing towards reaching the UN Sustainable Development Goals (SDGs).

## HELPING BRITAIN PROSPER PLAN 2020

| Area of focus | 2019 achieved | 2020[1] targets | SDG Supported |
|---|---|---|---|
| **Helping the transition to a sustainable low carbon economy**<br>Average number of homes that could be powered as a result of our support of UK renewable energy projects | 5.1m[2] | 5m | 7, 9, 11, 12, 13 |
| **Helping Britain get a home**<br>Amount of lending committed to help people buy their first home | £13.8bn | £30bn | 11 |
| **Helping people save for the future**<br>Growth in assets that we hold on behalf of customers in retirement and investment products[3] | £37.1bn[2] | £50bn | 8 |
| **Supporting businesses to start up and grow**<br>Increased amount of net lending to start up, SME and Mid Market businesses | £3.4bn[2] | £6bn | 8, 9 |
| **Tackling social disadvantage across Britain**<br>Number of charities we support as a result of our £100 million commitment to the Group's independent charitable Foundations | 2,929 | 2,500 | 3, 8 |
| **Building capability and digital skills**<br>Number of individuals, SMEs and charities trained in digital skills, including internet banking | 738,504 | 1.8m | 4, 8 |
| **Championing Britain's diversity**<br>Percentage of senior roles to be held by women | 36.8% | 40% | 5 |
| Percentage of roles held by Black, Asian and Minority Ethnic colleagues | 10.2% | 10% | |
| Percentage of senior roles held by Black, Asian and Minority Ethnic colleagues | 6.7% | 8% | |

1 Figures are all cumulative 2018 to 2020 excluding Tackling social disadvantage across Britain and Championing Britain's diversity.

2 Figures are cumulative from 2018.

3 Growth in assets under administration in our open book.

Full year HBP plan www.lloydsbankinggroup.com/our-group/responsible-business/prosper-plan/

Responsible business

# Helping the transition to a sustainable low carbon economy

The UK is committed to the vision of a sustainable, low carbon future. Our unique position within the UK economy means that the successful transition to a more sustainable, low carbon economy is of strategic importance to us.

We support the aims of the 2015 Paris Agreement and the UK Government's Clean Growth Strategy, which will require a radical reinvention of ways of working, living and doing business including new Government policies and sustainable finance solutions. In 2018 we set out our Sustainability Strategy and when reporting on our progress, we support the Taskforce on Climate-Related Financial Disclosure (TCFD) framework, and currently plan to achieve full disclosure by 2022 in line with the TCFD recommendations and the UK Government's Green Finance Strategy.

**>50% by 2030**

We aim to help reduce the emissions we finance by more than 50 per cent by 2030

## OUR STRATEGY

### Our goal and approach

As a signal of our commitment we have set an ambitious goal, working with customers, Government and the market to help reduce the emissions we finance by more than 50 per cent by 2030, supporting the UK's ambition to be net zero by 2050 and the 2015 Paris Agreement. During the course of 2020, we intend to conduct a review of our portfolio to establish our current financed emissions and set appropriate metrics and targets for material sectors.

In order to meet our goal, we will:

- Identify new opportunities to support our customers and clients and finance the UK transition to a low carbon economy
- Identify and manage material sustainability and climate related risks across the Group, disclosing these, their impacts on the Group and its financial planning processes, in line with the TCFD framework
- Use our scale and reach to help drive progress towards a sustainable and resilient UK economy through engagement with customers, communities, industry, Government, shareholders and suppliers
- Embed sustainability into the way we do business and manage our own operations in a more sustainable way

### Our ambition

We have set ourselves seven leadership ambitions to support the UK's transition to a sustainable future:

**Business:** become a leading UK commercial bank for sustainable growth, supporting our clients to transition to sustainable business models and operations, and to pursue new clean growth opportunities

**Homes:** be a leading UK provider of customer support on energy efficient, sustainable homes

**Vehicles:** be a leading UK provider of low emission/green vehicle fleets

**Pensions and investments:** be a leading UK pension provider that offers our customers and colleagues sustainable investment choices, and challenge the companies we invest in to behave more sustainably and responsibly

**Insurance:** be a leading UK insurer in improving the resilience of customers' lives against extreme weather caused by climate change

**Green bonds:** be a leading UK bank in the green/sustainable bonds market

**Our own footprint:** be a leading UK bank in reducing our own carbon footprint and challenging our suppliers to ensure our own consumption of resources, goods and services is sustainable

Steven Pratt

Strategic report
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## Metrics and targets

In 2018, we committed to develop a reporting framework to track performance against our sustainability strategy. This includes measures for our energy use, emissions, water and waste; Group and portfolio metrics that drive emission reductions related to our financing activity; the amount of green finance we provide; and metrics that track climate change risk (including exposure to high carbon sectors and sectors at high risk from climate change).

The complexity of accessing robust data has prevented us from setting a full suite of targets in 2019. We intend, however, to set appropriate targets during 2020 for material sectors. Our new goal to reduce the emissions we finance by more than 50 per cent by 2030 will frame the level of ambition across our targets and metrics.

### Extending our own carbon footprint measurement

We met our 2030 carbon reduction target in 2019, having reduced emissions by 63 per cent since 2009. We also expanded our Scope 3 emissions measurement to include additional categories of emissions from business travel and colleague commuting. We continue to pursue our targets to reduce emissions by 80 per cent by 2050, operational waste by 80 per cent by 2025 (compared to 2014/15) and water consumption by 40 per cent by 2030 (compared to 2009). We will be developing new carbon, energy and travel targets in 2020. See Directors' report, page 97 for Group Emissions data.

### Green finance

We have provided more than £4.9 billion in green finance since 2016 through our Clean Growth Finance Initiative, Commercial Real Estate Green Loans Initiative, Renewable Energy Financing, and green bonds facilitation. While green loan standards are evolving, we have teamed up with leading sustainability consultants when developing green finance products to determine a list of qualifying green criteria. These green finance products support a range of eligible product activity including; reducing emissions, improving energy efficiency, reducing waste, improving water efficiency, and funding low carbon transport and renewable energy.

### Climate risk sectors

In line with TCFD recommendations, we have identified our loans and advances to customers in high carbon sectors and a selection of other sectors that will be exposed to transition risk (see table). This is our initial view and will be reviewed as our transition risk insight develops. We continue to work with our customers to support transition, taking into account both risks and opportunities.

Our exposure to high carbon sectors is low (less than 0.5 per cent of total loans and advances to customers). In addition, data for these loans and advances is presented at an overall sector level and not all customers in these sectors will have high emissions or be exposed to significant transition risks.

For example:

- Utilities includes financing to entities that have both renewable energy and non-renewable energy generation. We have provided finance for more than 40 renewable energy projects, including supporting projects such as the Neart na Gaoithe offshore wind farm
- Real estate and mortgages will include loans and advances supported by assets which have a full range of Energy Performance Certificate (EPC) ratings including energy efficient properties
- UK motor finance includes loans and advances for low emission vehicles

**Loans and advances to customers in high carbon sectors and selected other sectors subject to transition risks**

| Sector/area[1] | | | Loans and advances to customers (£m)[2] Dec 2019 | Dec 2018 | % of total loans and advances to customers[3] Dec 2019 | Dec 2018 |
|---|---|---|---|---|---|---|
| High carbon sectors | Energy | Coal Mining | **21** | 28 | **<0.01%** | <0.01% |
| | | Oil and Gas | **1,368** | 975 | **0.27%** | 0.20% |
| | Utilities | (Electric and Gas) | **964** | 1,251 | **0.19%** | 0.26% |
| | **Total** | | **2,353** | 2,254 | **0.47%** | 0.46% |
| Selected other sectors subject to transition risks | Agriculture, Forestry and Fishing | | **7,558** | 7,314 | **1.52%** | 1.50% |
| | Construction and Real Estate | | **28,228** | 29,470 | **5.67%** | 6.04% |
| | Transportation (Automotive, Aviation, Shipping and Rail) | | **4,353** | 5,429 | **0.87%** | 1.11% |
| | Cement, Chemicals and Steel Manufacture | | **143** | 250 | **0.03%** | 0.05% |
| | Mortgages | | **299,141** | 297,497 | **60.05%** | 60.96% |
| | UK Motor Finance | | **15,976** | 14,933 | **3.21%** | 3.06% |

1 Exposures are based on 2007 Standard Industrial Classification codes except for Agriculture, Forestry and Fishing (based on NACE code A00-0) and Mortgages and UK Motor Finance, where the full portfolios have been used. These exposures will include green and other sustainable finance loans, which support the transition to the low carbon economy. As such, these figures and/or trends should not be read as the only measure to gauge transition risk or financed emissions.

2 Disclosures are based on loans and advances to customers on a statutory basis, before allowance for impairment losses. Analysis covers at least 95 per cent of loans and advances and does not include data from the Insurance and Wealth division.

3 Total loan and advances to customers were £488,088 million at 31 December 2018 and £498,247 million at 31 December 2019, see page 293.

## £2.3bn greenfield offshore wind farm in Scotland

In November, Lloyds Banking Group provided funding and risk management services to the £2.3 billion Neart na Gaoithe (Strength of the Wind) offshore wind farm, a joint venture between EDF Energy Renewables and ESB Group. Located 15km off the coast of Fife, with the potential to power c.375,000 Scottish homes and offsetting 400,000 tonnes of $CO_2$ emissions annually.

# Responsible business

## Risk management

Climate risk is a key emerging risk for the Group. Our approach to identifying and managing climate risk is founded on embedding it into our existing risk management framework, and integrating it through policies, authorities and risk control mechanisms. During 2019, we updated our TCFD implementation plan to incorporate Prudential Regulatory Authority (PRA) supervisory expectations and refined deliverables, with further resource invested in the programme.

In 2019, we included commentary on climate change risk within our Internal Capital Capacity Adequacy Assessment Process (ICAAP) submission, and in 2020 we are building on this through our analysis of initial scenarios to assess the impact on capital requirements. We are also engaged in the industry response to the Bank of England Discussion Paper to identify the best approach to explore the financial risks posed by climate change within its 2021 Biennial Exploratory Scenario (BES).

We have updated our external sector statements to include positions on six new sectors including manufacturing, automotive, agriculture, animal welfare, fisheries and UNESCO World Heritage Sites. This is in addition to the existing statements on power, coal, mining, oil and gas, forestry and defence. www.lloydsbankinggroup.com/Our-Group/responsible-business/reporting-centre/. Our statement on coal has been updated and made more ambitious. We continue with our policy of not financing new coal fired power stations. We have now tightened our requirements for providing general banking or funding, and now require new clients to have less than 30 per cent of their revenue from the operation of coal fired power stations and/or coal mines (previously less than 50 per cent).

In addition, existing customers whose overall operations include coal mining and coal power generation or who supply equipment or services to the sector will be expected to explain how they plan to reduce their reliance on revenue from coal fired power stations and/or coal mines. This includes reducing such revenue to less than 30 per cent by 2025 and, where relevant, to eliminate UK coal power generation in line with UK Government commitments.

Sustainability is now a mandatory part of credit applications in Commercial Banking for facilities greater than £500,000, and we continue to develop sector specific guidance to help relationship managers identify climate risks. We will review climate risk as part of the 2020 annual refresh of the Group's Risk Appetite.

In line with TCFD, we are also developing forward-looking scenario analysis, incorporating physical and transition risks, to help us identify risks and opportunities over the short, medium and long-term. For example, Commercial Banking are conducting analysis on the real estate sector for business as usual and low carbon transition scenarios and our Insurance business has conducted an initial climate stress test. We are working with external consultants to enhance scenario analysis across our divisions and will use the outputs to support our scenario analysis assessments and inform our credit risk appetite decisions and future disclosures.

## Governance

Given the strategic importance of our sustainability ambitions, our governance structure provides clear oversight and ownership of the sustainability strategy. This includes:

**Lloyds Banking Group Board**

Responsible Business Committee

Group Executive Committee

Group Executive Sustainability Committee

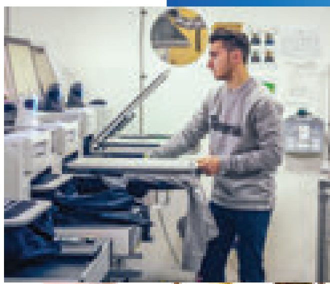
Other committees where issues are discussed as appropriate
- Audit Committee
- Board Risk Committee
- GEC Risk Committee
- Divisional Risk Committees

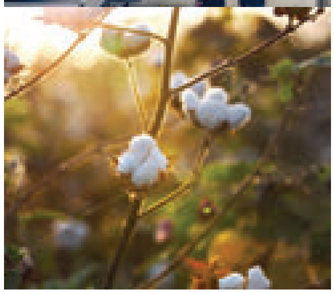
Group sustainability team

Divisional forums/ working groups | Group sustainability forum | TCFD working group

- The Responsible Business Committee (RBC), a sub-committee of the Board, chaired by Sara Weller, Group Non-Executive Director and which includes the Chairman, Lord Blackwell as a member
- The Group Executive Sustainability Committee (GESC) which provides oversight and recommends decisions to the Group Executive Committee (GEC)
- The TCFD working group, co-chaired by senior executives in risk and sustainability, coordinates the implementation of the TCFD recommendations and supports adherence to key regulatory requirements on climate risk
- The Group Chief Risk Officer (CRO) has assumed responsibility for identifying and managing the risks arising from climate change, alongside the CROs for key legal entities

Our Group sustainability team is supported by divisional sustainability governance forums led by Divisional Managing Directors, ensuring a coordinated approach to oversight, delivery and reporting of the Group's sustainability strategy.





## Clean growth in the fashion industry

Teemill Tech, a sustainable t-shirt manufacturer, bought a 15,000 square feet site to expand its operations with support from Lloyds Bank's Clean Growth Finance Initiative. Their renewable energy-powered factory on the Isle of Wight uses robotics and Artificial Intelligence, creating efficiencies that make sustainability affordable. Their expansion will increase capacity tenfold, creating 100 new jobs over the next three years.

Teemill Tech is an ambitious firm, which operates with sustainability at its core. The rapid growth of Teemill's customer base speaks for itself, with customers across the UK valuing the quality of its products.

**Ben Mackett**
Relationship Manager, Lloyds Bank

## How we are delivering against our ambitions

In 2019, we have focused on developing new products, services and processes to achieve our ambitions, and our progress has been recognised.

- Lloyds Banking Group achieved the Leadership level in the 2019 Carbon Disclosure Project (CDP) Climate Change survey, scoring an A minus; the highest placed financial services firm on the Fortune Sustainability All Stars list; and won the Real Estate Capital Sustainable Finance Provider of the Year
- One in 14 electric cars in the UK was supplied by Group subsidiary Lex Autolease in 2019, supported by a £1 million cashback offer on pure electric vehicle (EV) orders, reducing future carbon dioxide emissions by an estimated 28 kilotonnes
- We continue to partner with the Cambridge Institute for Sustainability Leadership to provide high quality training to executives and colleagues in risk management, product development and client facing roles. In 2019, over 800 colleagues were trained, ensuring they are able to support clients on this journey
- Since 2018 the Group has supported renewable energy projects that power the equivalent of 5.1 million homes, achieving our Helping Britain Prosper Plan 2020 target a year early


Our £2 billion Clean Growth Finance Initiative (CGFI) provides discounted lending to low carbon projects. In 2019, we expanded eligibility to include hire purchase and leasing in the agriculture and manufacturing sectors. We have provided more than £950 million since launching in 2018.

## Evolving our disclosure

In 2020, we will continue to review and enhance our methodologies and framework for reporting Environmental, Social and Governance risks. This review will take into account a range of industry guidelines including TCFD, Principles for Responsible Banking, Sustainability Accounting Standards Board (SASB), the evolving World Economic Forum (WEF) ESG standards, and regulatory reporting requirements with a view to further enhancing our disclosures and responding to the evolving needs of both our shareholders and other stakeholders.

## Initiatives and collaboration

Climate change is a global challenge that requires collaboration across companies and industries to ensure the risks and opportunities can be adequately identified and managed. To support this, we participate in several industry initiatives and have signed up to key principles that drive action on climate change and sustainability, including:

**United Nations Environment Programme Finance Initiative (UNEP FI)**
We became a member of UNEP FI in 2019 and joined its Phase 2 Banking TCFD Pilot. We also became a signatory to the Principles for Responsible Banking and Principles for Sustainable Insurance.

**Coalition for Climate Resilient Investment**
In September 2019, we joined the newly formed coalition that aims to transform infrastructure investment by integrating climate risks into decision making.

**University of Cambridge Banking Environment Initiative (BEI) – Bank 2030**
We have been working with 12 leading banks to develop a roadmap for how the industry can direct capital towards environmentally and socially sustainable economic development.

**The Climate Group**
In 2019, we were one of the first businesses globally to sign up to all three of The Climate Group's campaigns:

- RE100 – a commitment to source 100 per cent of our electricity from renewable sources by 2030 (which we achieved in 2019)
- EP100 – a commitment to set ambitious energy productivity targets by 2030
- EV100 – a commitment to accelerate the transition to Electric Vehicles by 2030

**Climate Financial Risk Forum**
In 2019, we joined the PRA and FCA's joint Climate Financial Risk Forum, participating in the Risk Management Working Group that aims to deliver a UK best practice handbook on implementation of the TCFD recommendations.

Responsible business

# Helping Britain get a home

As the largest lender to the UK housing sector, we recognise the importance of home ownership, and that a lack of affordable housing can lead to social disadvantage.

Working with more than 200 housing associations across the UK, we have provided more than £6.4 billion of finance for the social housing sector since 2018.

We also continue to support The Housing Growth Partnership, which provides help and mentoring to small and mid-sized house builders, who have built 1,636 new homes across the UK since 2018. In June, Vanessa Murden, Chief Operating Officer, Retail, joined the Board of Homes England, the UK Government's vehicle supporting the delivery of affordable housing.

This year we lent £13.8 billion to first-time buyers, and introduced the Lend a Hand and Family Boost mortgage propositions, which make it easier for those with little or no savings to buy their first home.

## Reducing waste, creating growth

Company Shop Group is the largest commercial redistributor of surplus food and household products in the UK, enabling some of the biggest retailers, manufacturers, food service and logistics providers to unlock value from surplus, which may have otherwise gone to waste. Supported by a £4.2 million funding package from the Lloyds Bank Clean Growth Financing Initiative (CGFI), Company Shop Group, whose head office is in South Yorkshire, opened three new stores in 2019, handled over 75 million units, saved over 25,000 tonnes of good food from going to waste and diversified into more non-food categories.

Lloyds Bank plays a key role in helping us to expand and increase our positive commercial, social and environmental impact as we aim to handle more stock, open more stores and attract more members.

**John Marren**
Founder and Chairman of Company Shop Group


## Supporting social housing ambitions

LiveWest own and manage over 36,000 homes from Cornwall to Gloucestershire, and plan to provide 7,000 new homes over the next 5 years and invest £2 billion in the regional economy over the next 10 years. In September they issued a £250 million bond. Lloyds Bank were delighted to support this finance package to deliver much needed new and affordable homes.

LiveWest offer affordable rent and shared ownership, building new homes, and using the profits to build more affordable homes. With sites across the South West and employing over 1,400 people, they have a strong positive social impact. Their investment plans will sustain around 7,000 jobs in the building supply chain, protecting livelihoods and offering fresh opportunities.

# Helping people save for the future

We want to make saving as easy as possible for our customers, as it helps to build financial resilience, and can play a meaningful role in tackling disadvantage. Accordingly, we continue to improve choice, flexibility and control for those who are investing, saving or planning for retirement.

We continually look at ways of widening access to savings for everyone. For example, our Next Generation Text service supports customers with hearing difficulties. And we are currently the only UK bank to offer EasyRead statements for savings accounts, where pictures are used to support the meaning of the text. Our Banking savings range operates with transparent pricing for all, and customers can upgrade their accounts online with one click when better products become available.

In 2019, we launched Schroders Personal Wealth. This market leading proposition aims to tackle a growing need for professional advice as the number of people taking responsibility for their financial future increases. In September Scottish Widows launched its standard annuity into the open Market, enabling us to deliver a secure income for life to customers in a market that many providers have left.

As a Group we remain committed to responsible investment, as signatory to both the Equator Principles and the UN Principles for Responsible Investment.

# Supporting businesses to start up and grow

Supporting businesses of all types and sizes is fundamental to Helping Britain Prosper. In 2019 small businesses and SMEs represent over 99 per cent of the business population, three fifths of employment and half of all turnover in the private sector. Since 2018 we have helped over 233,000 businesses start up, increased net lending to start up, SME and Mid Market businesses to £3.4 billion, and re-affirmed our commitment to the UK's manufacturing sector providing £2.6 billion of dedicated investment.

Our Clean Growth Finance Initiative (CGFI), which aims to offer the most inclusive UK green funding in the commercial banking market, provides the incentive of discounted borrowing to all types of businesses that invest in reducing their environmental impact. Since 2018, we helped 17.4 million sq. ft. of commercial real estate become more energy efficient, reducing greenhouse gas emissions in core business processes, properties and infrastructure.

This year, we also built on our financial commitments, broadening our support for a range of issues that impact businesses every day. For example, we are giving SMEs access to information and support on mental health so that they can manage it more effectively, and we are proud to be the first financial partner of Be the Business, which offers funding, research and tools to help UK businesses measure and increase their productivity.

# Tackling social disadvantage across Britain

As one of the UK's largest corporate donors, we use our scale to reach people in communities across the country. Our four independent charitable Foundations, which cover the whole of the UK and the Channel Islands, are critical to our vision of tackling social disadvantage by partnering with local charities to help overcome complex social issues and rebuild lives.

Our total community investment in 2019 was £50.8 million and includes our colleagues' time, direct donations, and a share of the Group's profits given annually to the Foundations. In 2019, the Foundations received £25.9 million, enabling them to support 2,929 charities. These charities are tackling issues such as domestic abuse, mental health, modern slavery and human trafficking, and employability. In addition to providing funding, colleagues across the UK also volunteered as mentors to charities supported by the Foundations.

## Looking to a brighter future

Angel Eyes Northern Ireland is a small charity based in Belfast, which was set up in 2007 by parents of visually impaired children, to improve the support available to other parents in the same situation. The charity offers a range of services to families including an education service, Saturday club and advocacy work. The Halifax Foundation for Northern Ireland was one of the first funders of this charity, helping it to secure five community grants since 2014.

The charity's work is delivered through its 2 full time and 2 part time staff and 44 volunteers. Last year, they were a winner of the Foundation's Pitching 4 Pounds programme, seeing the charity successfully pitch for a grant of £15,000 to develop an innovative virtual reality app, which will help parents and professionals see the world through the eyes of a partially sighted child.

In early 2019 the Chairman paid a personal visit to the charity to meet the staff and experience the developments for himself.

# Building capability and digital skills

The UK's skills and productivity gap requires significant enhancements in capability including digital skills. To help make that happen, we are facilitating digital training for 1.8 million people by 2020, at the same time as investing in a range of apprenticeship schemes.

**The digital skills gap**
The 2019 Lloyds Bank Consumer Digital Index showed that more people than ever are digitally connected. Digital skills help individuals find a job, make progress in work, save money on bills, and reduce social isolation by connecting them to support services, as well as friends and family. The 2019 Lloyds Bank Business Digital Index showed that digital benefits businesses and charities too. Digital marketing skills for businesses can open up growth opportunities, while cyber skills make them more secure.

Nearly one third of charities recognise they can save around a day a week due to increased digital capability. Not everyone, however, is enjoying the benefits that digital can bring. 11.9 million people do not have the essential digital skills for life, increasing to 17.3 million people lacking digital skills in the workplace. While the number of people who are digitally disengaged is dropping, it is forecast that 4.5 million people will remain disengaged by 2030.

Small businesses without essential digital skills are nearly two and a half times more likely to close in the next two years, than those with full digital skills. The Group is part of the Department of Digital Culture Media and Sport's Digital Skills Partnership, working with organisations like Google, Be the Business and Tata Consultancy Services to deliver impactful solutions. The Group also helped found future.now – a coalition led by organisations such as the City of London, Accenture, BT and Nominet, with over 60 partners all seeking to close the digital divide.

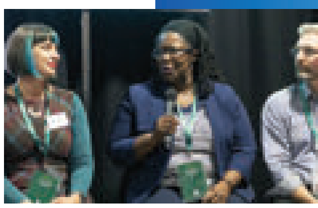
**Lloyds Bank Academy**
The Group has developed the Lloyds Bank Academy to take on these challenges. Initially launched in Manchester in November 2018, the Academy teaches basic digital and workplace skills through online and face-to-face courses. In November 2019 we launched the Bristol Academy, providing additional support for start ups and SMEs.

Working with a range of partner organisations, including our charitable Foundations, academia, industry and Government, the Academy has taught around 65,000 learners in Manchester and Bristol.

In addition, over 20,000 colleagues have volunteered to become Digital Champions supporting their local communities. Our Digital Knowhow workshops have helped thousands of organisations learn how to avoid fraud and take advantage of digital marketing techniques, read more online www.lloydsbankacademy.co.uk/

**Supporting apprenticeships**
Supporting diverse talent development is essential if we are to genuinely become the best bank for customers, colleagues and shareholders. Internally, we are delivering over 25 different apprenticeship programmes, available to all colleagues regardless of location, career stage or working pattern. The Group has partnered with a range of institutions including Manchester Metropolitan University who offered colleagues and new recruits the chance to join the degree-level Digital and Technology Solutions Degree Apprenticeship. This structured programme provided opportunities to benefit from applying the skills and knowledge developed at university.

Externally, we have committed £9 million over three years to help SMEs to develop apprenticeships through our Levy Transfer initiative. And our investment of £10 million over 10 years in the Lloyds Bank Advanced Manufacturing Training Centre in Coventry will support 3,500 apprentices, graduates and engineers to be trained by 2024. We also work with the National Autistic Society to recruit and train young people with autism, with Business in the Community to recruit and train ex-offenders, and with the National Apprenticeship Service as active members of the Apprenticeship Diversity Champions Network.



## Working Better Together

Angela Loveridge created Better Together after identifying a gap in parents' understanding of online safety for children. It provides training to help safeguard children online, delivering workshops for schools, childrens centres, businesses and charities, and in 2018 was nominated for the NSPCC Child Protection Trainer award.

Angela signed up to the Lloyds Bank Academy in Bristol to draw on our expert knowledge and experience, and generate ideas to improve her own business. Through the courses, Angela has gained digital confidence and now understands the positive difference that digital marketing can make such as how engaging with online reviewers can make a positive impact to her business.

# Championing Britain's diversity

Approaching diversity as a business issue reflects our firm view that diverse teams, working within inclusive environments, are more innovative, engaged, and deliver better outcomes for our customers. As the first FTSE 100 company to set targets to increase both gender and ethnic diversity at senior levels, we continue to invest in being a leading inclusive employer, where the unique differences our colleagues bring to work every day are valued.

**Focus on ethnic diversity**
Encouraging ethnic diversity starts with talking to colleagues and communities about their experiences. We know that role models and understanding cultural difference are vital, which is why we delivered cultural capability training to all colleagues in 2019, building knowledge of identity, race, faith and background.

This year, we published our Ethnicity Role Models list, featuring 70 Black, Asian and Minority Ethnic (BAME) colleagues, and in June, two colleagues were named in the top 100 ethnic minority executives, and a further two colleagues in the 50 future ethnic minority leaders in the EMpower Ethnic Minority Role Model lists.

As a result of our focus on the issue, we exceeded our 2020 target delivering 10.2 per cent of roles held by BAME colleagues, and increased the senior roles held by BAME colleagues to 6.7 per cent, working towards our stretching target of 8 per cent by 2020.

**Gender, gender identity and sexual orientation**
In 2019, 36.8 per cent of senior roles were held by women, and we remain focused on our target of 40 per cent by the end of 2020.

We remain on track to meet the voluntary 2020 target, set by the Hampton-Alexander Review, of having 33 per cent representation of women on, or reporting into, our Executive Committee, through a focus on dedicated succession planning and skills development. For the eighth year running the Group featured in the Times 'Top 50 employers for women' and the Bloomberg Gender Equality Index for the first time.

We are also creating an inclusive environment for our LGBT+ colleagues, being named Top Financial Employer, and seventh overall in 2019's Stonewall Top 100 Employers. Our LGBT+ colleague network Rainbow, has over 5,000 members, one of the largest of its kind in the UK.

**Supporting disability**
We are moving the debate on from accommodating disabilities, to developing talent and careers. In 2019, 2.8 per cent of colleagues disclosed a disability and we support them in a range of ways. We ensure full and fair consideration to applications from people with disabilities. We offer bespoke training, career development, promotions and adjustments for colleagues and applicants with disabilities, including those who became disabled while employed. We hold a Business Disability Forum (BDF) Gold Standard, and Disability Confident Leader status with the Department for Work and Pensions. In July, we received the National Autistic Society's Autism Friendly Award, marking our commitment to become the UK's first autism friendly bank for customers.

**Mental health**
We are passionate advocates for removing the stigma attached to mental ill-health, actively creating a culture of openness and support, while developing efforts to prevent mental health challenges.

In 2019, the Group featured in Fortune's Change the World list for our work with Mental Health UK and the Group Chief Executive was named a top 50 world leader by Fortune magazine for raising mental health awareness.

We are a founding signatory of the Mental Health at Work Commitment and our colleague wellbeing resources provide a range of support including direct access to counselling services. We also offer colleagues private medical benefits that give parity to mental and physical health conditions.

We recognise prevention is equally as important as support, and in September we launched a personal resilience portal, for colleagues to better understand preventative measures available for both mental and physical health.

In August, our Resilient Leader training course received a Princess Royal Training Award, recognising its lasting impact. Over 40,000 colleagues have completed our Mental Health e-learning and we're training 2,500 colleagues to become Mental Health Advocates by 2020. In July, Lloyds Bank was the first organisation to sign up to the Mental Health Accessibility Standards, which were developed to help companies support customers with mental health problems.

## Finding the right solution

Throughout 2019 many colleagues shared their experiences to help reduce stigma around mental illness in the workplace. One colleague accessed telephone counselling through the Employee Assistance Programme. He then saw his GP, which in turn led to treatment through Cognitive Behavioural Therapy and psychotherapy.

I am incredibly grateful for the support I have had from the Group. I recognise that I have been fortunate, and many others may not have access to the support I did. I'm sharing my story, to act as an advocate for the support I received.

## Our Inclusion and Diversity data

| | | 2019 | 2018 |
|---|---|---|---|
| **Gender** | | | |
| Board Members | Male | **9** | 9 |
| | Female | **4** | 4 |
| GEC and GEC Direct Reports | Male | **111** | 107 |
| | Female | **50** | 45 |
| Senior Managers | Male | **4,539** | 4,701 |
| | Female | **2,647** | 2,573 |
| Colleagues | Male | **29,522** | 30,458 |
| | Female | **41,033** | 42,372 |
| **Ethnic background** | | | |
| Percentage of colleagues from a BAME background | | **10.2%** | 9.5% |
| BAME managers | | **9.5%** | 9.0% |
| BAME senior managers | | **6.7%** | 6.4% |
| **Disability** | | | |
| Percentage of colleagues who disclose they have a disability | | **2.8%** | 1.7% |
| **Sexual orientation** | | | |
| Percentage of colleagues who disclose they are lesbian, gay, bisexual or transgender | | **2.2%** | 2.0% |

All data as at 31/12/2019. Group Executive Committee (GEC) assists the Group Chief Exec. in strategic, cross-business or Group-wide matters and inputs to Board. GEC and Direct Reports includes the Group Chief Exec., GEC and colleagues who report to a member or attendee of GEC, excluding administrative or executive support roles (personal assistant, executive assistant).

Reporting: A colleague is an individual who is paid via the Group's payroll and employed on a permanent or fixed term contract (employed for a limited period). Includes parental leavers, and internationals (UK includes Guernsey, IOM, Jersey and Gibraltar). Excludes leavers, Group Non-Executive Directors, contractors, temps, and agency staff

Diversity: Calculation is based on headcount, not FTE (full-time employee value). Data source is HR system (Workday) containing all permanent colleague details. Gender: includes international, those on parental/maternity leave, absent without leave (AWOL) and long-term sick. Excludes contractors, Group Non-Executive Directors, temps and agency staff. All other diversity information is UK Payroll only. All diversity information is based on voluntary self-declaration, apart from gender, so is not 100 per cent representative; our systems do not record diversity data of colleagues who have not declared this information.

BAME: comprising of mixed/multiple, Asia, Black, Middle Eastern, North African and other (non-white) ethnicities.

Colleague grades: from A through to J, Senior Executive (SE), Executive (EX) and Executive Director (ED) A being the lowest. Senior Managers: Grades F, G, H, J, SE, E and ED (F being the lowest). Managers: Grade D-E (D being the lowest).

## Non-Financial Information Statement

This section of the strategic report constitutes Lloyds Banking Group's Non-Financial Information Statement, produced to comply with sections 414CA and 414CB of the Companies Act. The information listed is incorporated by cross-reference.

| Reporting requirement | Policies and standards which govern our approach | Information necessary to understand our Group and its impact, policies due diligence and outcomes |
|---|---|---|
| **Stakeholders** | Annual materiality assessment[1]<br>Supplier management | – Engaging and responding to our stakeholders www.lloydsbankinggroup.com/our-group/responsible-business/reporting-centre/<br>– Code of Supplier Responsibility www.lloydsbankinggroup.com/our-group/working-with-suppliers/being-a-supplier-to-lloyds-banking-group/ |
| **Environmental matters** | Environmental (TCFD) statement | – Reflecting the needs of our stakeholders, pages 20 and 26<br>– Helping the transition to a sustainable low carbon economy, page 28 |
| **Employees** | Colleague Policy[1]<br>Code of Responsibility<br>Health and Safety Policy[1] | – Reflecting the needs of our stakeholders, pages 20 and 26<br>– Championing Britain's diversity, page 34 |
| **Respect for Human Rights** | Human Rights Policy statement<br>Colleague Policy[1]<br>Pre-Employment vetting standards[1]<br>Data Privacy Policy[1]<br>Modern Slavery and Human Trafficking Statement<br>Information and Cyber Security Policy[1] | – Reflecting the needs of our stakeholders, page 26<br>– Suppliers, page 25<br>– Championing Britain's diversity, page 34 |
| **Social matters** | Volunteering standards[1]<br>Matched giving guidelines[1] | – Reflecting the needs of our stakeholders: Customers, page 20<br>– Reflecting the needs of our stakeholders: Communities and Environment, page 23<br>– Helping Britain Prosper Plan, page 27<br>– Helping Britain get a home, Helping people save for the future, Supporting business to start up and grow, Building capability and digital skills, pages 32 to 33<br>– Tackling social disadvantage across Britain, page 33 |
| **Anti-corruption and anti-bribery** | Anti-Bribery Policy[1]<br>Anti-Bribery Policy Statement<br>Anti-Money Laundering and Counter Terrorist Financing Policy[1]<br>Fraud Risk Management Policy[1] | – Reflecting the needs of our stakeholders: Customers, page 20<br>– Reflecting the needs of our stakeholders: Colleagues, page 22 |
| **Description of principal risks and impact of business activity** | | – Helping the transition to a sustainable low carbon economy: Risk management, page 30<br>– Risk overview 2019 themes, page 40<br>– Our principal risks, page 42 |
| **Description of the business model** | | – Our Business Model, page 14 |
| **Non-financial key performance indicators** | | – Key performance indicators, page 08<br>– Our strategic priorities, page 06<br>– Helping Britain Prosper Plan, page 27<br>– Global Reporting Initiative (GRI) standards www.lloydsbankinggroup.com/our-group/responsible-business/reporting-centre/<br>– Reporting Criteria www.lloydsbankinggroup.com/our-group/responsible-business/reporting-centre/<br>– Responsible Business Data Sheet www.lloydsbankinggroup.com/our-group/responsible-business/reporting-centre/ |

1 Certain Group Policies, internal standards and guidelines are not published externally.

The policies mentioned above form part of the Group's Policy Framework which is founded on key risk management principles. The policies which underpin the principles define mandatory requirements for risk management. Robust processes and controls to identify and report policy outcomes are in place and were followed in 2019.

## Financial performance overview

# Group

### Solid financial performance

The Group's statutory profit after tax was £3,006 million, 33 per cent lower than in 2018 with resilient underlying profit partly offset by the significant payment protection insurance (PPI) charge of £2,450 million taken in the year. The statutory return on tangible equity was 7.8 per cent.

Trading surplus was resilient at £8,822 million (2018: £9,003 million) with lower net income partly offset by the Group's continued progress in delivering cost reductions. Underlying profit was £7,531 million compared to £8,066 million in 2018, reflecting lower net income and higher impairment charges, partly offset by the Group's strong cost performance. The Group's market-leading underlying return on tangible equity was 14.8 per cent.

The Group's balance sheet remains strong with lending growth in the open mortgage book as well as targeted segments, including SME and UK Motor Finance. This was more than offset by lower balances in Mid Markets and Global Corporates, primarily as a result of the optimisation of the Commercial portfolio, as well as continued reductions in the closed mortgage book. The Group's capital position remains strong with a pro forma CET1 ratio of 15.0 per cent pre dividend accrual and 13.8 per cent post dividend.

The Group is strongly capital generative and although this has been impacted by PPI in 2019, the Board has recommended a final ordinary dividend of 2.25 pence per share, making a total ordinary dividend of 3.37 pence per share, an increase of 5 per cent on 2018 and in line with our progressive and sustainable ordinary dividend policy.

### Income statement

| | 2019 £m | 2018 £m | Change % |
|---|---|---|---|
| Net interest income | **12,377** | 12,714 | (3) |
| Other income | **5,732** | 6,010 | (5) |
| Operating lease depreciation | **(967)** | (956) | (1) |
| **Net income** | **17,142** | 17,768 | (4) |
| Operating costs | **(7,875)** | (8,165) | 4 |
| Remediation | **(445)** | (600) | 26 |
| **Total costs** | **(8,320)** | (8,765) | 5 |
| **Trading surplus** | **8,822** | 9,003 | (2) |
| Impairment | **(1,291)** | (937) | (38) |
| **Underlying profit** | **7,531** | 8,066 | (7) |
| Restructuring | **(471)** | (879) | 46 |
| Volatility and other items | **(217)** | (477) | 55 |
| Payment protection insurance provision | **(2,450)** | (750) | |
| **Statutory profit before tax** | **4,393** | 5,960 | (26) |
| Tax expense[1] | **(1,387)** | (1,454) | 5 |
| **Statutory profit after tax[1]** | **3,006** | 4,506 | (33) |

| | | | |
|---|---|---|---|
| Earnings per share | **3.5p** | 5.5p | (36) |
| Dividends per share – ordinary | **3.37p** | 3.21p | 5 |
| Share buyback value | **–** | £1.1bn | |

| | | | |
|---|---|---|---|
| Banking net interest margin | **2.88%** | 2.93% | (5)bp |
| Average interest-earning banking assets | **£435bn** | £436bn | – |
| Cost:income ratio | **48.5%** | 49.3% | (0.8)pp |
| Asset quality ratio | **0.29%** | 0.21% | 8bp |
| Underlying return on tangible equity | **14.8%** | 15.5% | (0.7)pp |
| Return on tangible equity | **7.8%** | 11.7% | (3.9)pp |

### Key balance sheet metrics

| | At 31 Dec 2019 | At 31 Dec 2018 | Change % |
|---|---|---|---|
| Loans and advances to customers[2] | **£440bn** | £444bn | (1) |
| Customer deposits[3] | **£412bn** | £416bn | (1) |
| Loan to deposit ratio | **107%** | 107% | – |
| Capital build[4] | **86bp** | 210bp | (124)bp |
| Pro forma CET1 ratio[5] | **13.8%** | 13.9% | (0.1)pp |
| Pro forma transitional MREL ratio[5] | **32.6%** | 32.6% | – |
| Pro forma UK leverage ratio[5] | **5.2%** | 5.6% | (0.4)pp |
| Pro forma risk-weighted assets[5] | **£203bn** | £206bn | (1) |
| Tangible net assets per share | **50.8p** | 53.0p | (2.2)p |

1 2018 restated to reflect amendments to IAS 12, see basis of presentation on page 206.

2 Excludes reverse repos of £54.6 billion (31 December 2018: £40.5 billion).

3 Excludes repos of £9.5 billion (31 December 2018: £1.8 billion).

4 Capital build is reported on a pro forma basis, reflecting the dividend paid up by the Insurance business in the subsequent first quarter period and is also reported before accruing for ordinary dividends, the cancellation of the remaining 2019 share buyback and the acquisition of Tesco Bank's UK prime residential mortgage portfolio.

5 The CET1, MREL, leverage ratios and risk-weighted assets at 31 December 2019 and 31 December 2018 are reported on a pro forma basis, reflecting the dividend paid up by the Insurance business in the subsequent first quarter period. The pro forma CET1 ratio at 31 December 2018 incorporates the effects of the share buyback announced in February 2019 and is reported post dividend accrual.

# Retail

Retail offers a broad range of financial service products to personal and business banking customers, including current accounts, savings, mortgages, credit cards, unsecured loans, motor finance and leasing solutions.

Its aim is to be the best bank for customers in the UK, by building deep and enduring relationships that deliver value, and by providing customers with choice and flexibility, with propositions increasingly personalised to their needs.

Retail operates a multi-brand and multi-channel strategy. It continues to simplify its business and provide more transparent products, helping to improve service levels and reduce conduct risks, whilst working within a prudent risk appetite.

**£3,839m**
Underlying profit decreased by 9%

**£13.8bn**
Lending to first time buyers

**£3.5bn**
Acquired Tesco's Bank UK prime residential mortgage portfolio supporting 23,000 new customers

**#1**
Maintained the largest branch network in UK

**+5pts**
Improvement in branch net promoter score at 66pts

### UK's largest digital bank

Active online users (m)

**16.4**

| | |
|---|---|
| 2019 | **16.4** |
| 2018 | 15.7 |
| 2017 | 13.4 |
| 2016 | 12.5 |
| 2015 | 11.5 |

## Progress in 2019

### Leading customer experience

- UK's largest digital bank with 16.4 million active digital customers and 10.7 million mobile banking app customers, with average customer logons at 23 times per month and 75 per cent of new products now originated digitally
- Maintained the largest UK branch network while trialling new branch formats with the latest flagship Bank of Scotland branch in Glasgow, and Home by Halifax, an innovative store dedicated to supporting customers purchase a property
- Branch net promoter score up 5 points with around 50 per cent of customer facing time being spent on complex needs
- Supporting first time buyers with further £13.8 billion of lending, building on success of Lloyds Lend a Hand mortgage, launched Halifax Family Boost mortgage, providing customers' financial supporters with enhanced savings rates
- Encouraging customers to talk more openly about their finances, through the launch of the M Word campaign earlier this year and co-funding a brand new television series with Channel 4 called 'Save Well, Spend Better'
- Reduced complaints (excluding PPI) by 13 per cent in 2019 and mobile app NPS increased 3 per cent since 2017

### Digitising the Group

- Recognised for innovations by being first in the Business Insider mobile banking study, with recent updates including
  - Push notification alerts helping to plan ahead with upcoming payment reminders and confirmations
  - Statement search helping customers find transactions quicker and easier, with c.300,000 searches per week
- Remote mortgage applications up 30 per cent, with re-mortgage applications starting digitally up 50 per cent in value

### Maximising Group capabilities

- Acquired Tesco Bank's UK prime residential mortgage portfolio supporting 23,000 new customers
- Completed the integration of MBNA, realising a return on investment of 18 per cent, ahead of original target
- Renewed the successful Jaguar Land Rover relationship[1]

### Transforming ways of working

- Continued progress in 'skills of the future' training delivered to colleagues with over 750,000 additional hours in 2019

### Financial performance

- Net interest income was 3 per cent lower due to a 5 basis point reduction in net interest margin with continued pressure on mortgages margin, partly offset by lower funding costs and a benefit from aligning credit card terms
- Other income reduced 4 per cent reflecting a lower Lex fleet size. Operating lease depreciation includes an associated benefit, more than offset by some weakening in used car prices through the first three quarters of 2019
- Operating costs reduced 3 per cent, as increased investment in the business was more than offset by efficiency savings. Remediation decreased 11 per cent to £238 million
- Impairment increased 21 per cent, with some weakening in used car prices, methodology refinements and lower cash recoveries following prior year debt sales, while underlying drivers remain strong, particularly in the mortgage book
- Customer lending increased by 1 per cent with the acquisition of Tesco Bank's mortgage portfolio and growth in UK Motor Finance, partly offset by closed book mortgages. Organic open mortgage balances remained flat year on year
- Customer deposits include current account growth, stable relationship savings and reduced low margin tactical savings
- Risk-weighted assets increased by 5 per cent mainly driven by mortgage model refinements and the Tesco acquisition

1 Subject to contract.

## Providing a family boost

Following the successful launch of the Lloyds Bank campaign, Lend a Hand, Halifax launched the Family Boost mortgage, to help first time buyers without a deposit onto the property ladder by using savings from family members to provide 10 per cent of the loan.

In Peterlee, County Durham, one customer visited his local Halifax branch to enquire about the Family Boost scheme. The customer was very reluctant to rent, as he wanted to make a home for his son and himself.

Within 48 hours of applying, the customer secured a mortgage offer meaning that now with the help of his brother, he has bought a home to put down roots in an area he wanted his son to grow up in. It also enabled the customer's brother to get a better return on his savings whilst supporting a family member.

**Financial performance overview** continued

# Commercial Banking

Commercial Banking has a client-led, low risk, capital efficient strategy, committed to supporting UK based clients and international clients with a link to the UK.

Through its segmented client coverage model, it provides clients with a range of products and services such as lending, transaction banking, working capital management, risk management and debt capital markets.

Continued investment in capabilities and digital propositions enables the delivery of a leading customer experience, supported by increasingly productive relationship managers, with more time spent on value adding activity.

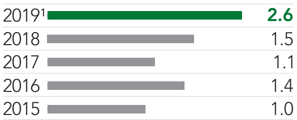
**£1,777m**
Underlying profit decreased by 19%

**2.14%**
Return on risk weighted assets, down 36bps

**19%**
Market share in SME and small business lending balances

### Funding for UK manufacturers
£bn

**2.6**




1 Figures are cumulative from 2018.

## Progress in 2019

**Leading customer experience**

- 95 per cent of SME and Mid Market clients migrated onto Commercial Banking Online platform with customers now having 24/7 access to their accounts, and 5 years of transaction history. The platform sees around 130,000 payments processed every day and around 1.2 million log ons per month
- Awarded 'Business Bank of the Year' at the FDs' Excellence Awards for the 15th consecutive year

**Digitising the Group**

- Cash management and payments API launched, allowing clients to send faster payments directly from their systems without human intervention and reducing payment times to 1.5 seconds
- Launched Asset Finance Broker API, linking new business proposals directly from broker to Group, reducing manual intervention by 87 per cent, enabling quicker and more accurate credit decisions with real-time updates
- Improved eTrading capability, enabling larger clients to undertake foreign exchange trades electronically 24 hours per day across multiple geographies and supporting clients in automating their businesses

**Maximising Group capabilities**

- Achieved the committed £18 billion gross new lending to UK businesses; a further £18 billion committed for 2020
- On track to meet the Group's target of £3 billion of investment in the UK manufacturing sector by the end of 2020
- Over 900 manufacturing apprentices, graduates and engineers trained since 2018 as a result of the £1 million annual investment in the Lloyds Bank Advanced Manufacturing Centre
- Beat the sustainability target of supporting energy efficient improvements for a further one million square feet of commercial real estate in 2019 and have supported renewable energy projects capable of powering 5 million homes by the end of 2019

**Transforming ways of working**

- Completed rollout of the SME Business Lending Tool, freeing up relationship manager time for increased client engagement, and new auto-credit decisioning capability with around 25 per cent of SME annual renewals now automated
- Continued progress in developing colleagues with the skills and capabilities needed for the future, with 210,000 colleague training hours completed in 2019, exceeding the year-end target

**Financial performance**

- In challenging market conditions, maintained a strong focus on risk-weighted asset (RWA) optimisation and actively addressed low returning client relationships, delivering a significant reduction in RWA of over £9 billion
- Net interest income of £2,918 million reduced 3 per cent, reflecting asset margin pressure
- Other income of £1,422 million was 15 per cent lower than in 2018, driven by lower levels of client activity in challenging market conditions in Global Corporates and Financial Institutions
- Operating costs of £2,081 million reduced 5 per cent, as increased investment in the business was more than offset by continued focus on efficiency savings
- Asset quality ratio of 30 basis points was 24 basis points higher, largely driven by material charges raised against two corporate cases, with stable underlying portfolio trends
- Return on risk-weighted assets of 2.14 per cent was 36 basis points lower, despite the acceleration of risk-weighted asset optimisation in the second half, driven by two material corporate impairment charges
- SME lending balances up c.1 per cent, continuing to grow slightly ahead of the market
- Customer deposits at £145.1 billion, down 2 per cent, reflecting funding optimisation activity including a reduction in short-term financial institutions deposits with growth in current accounts of 3 per cent in the second half of the year

## Supporting green ambitions

In a £4 million project supported by Bank of Scotland and the Scottish Government's Low Carbon Infrastructure Programme, ice cream maker, Mackie's of Scotland, is set to have one of the most sophisticated refrigeration systems in Europe. The results will see $CO_2$ emissions cut by 80 per cent and energy costs by up to 80 per cent, supporting Mackie's ambition of becoming the greenest company in the UK.

With Bank of Scotland's support we are realising our green ambitions and, in the long run, we hope that our new system will set a precedent and make the energy-intensive food and drink sector more sustainable.
**Gerry Stephens,**
Finance Director, Mackie's of Scotland

# Insurance and Wealth

Insurance and Wealth offers insurance, investment and wealth management products and services.

Our wealth management joint venture with Schroders harnesses the unique strengths of two of the UK's strongest financial services businesses.

The Group continues to invest significantly in the business, with the aims of capturing considerable opportunities in pensions and financial planning whilst driving growth across intermediary and relationship channels through a strong distribution model, offering customers a single home for their banking and insurance needs.

**£1,101m**
Underlying profit increased by 19%

**>1m**
new pension customers

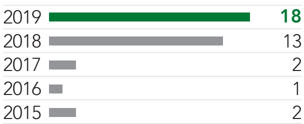
**19%**
increased new business income

**14%**
Market share in workplace pensions

### Strong open book AUA customer net inflows

£bn

**18**




## Progress in 2019

### Leading customer experience

- Scottish Widows now offers its standard annuities on the open market allowing a wider range of customers to access the product and secure income for retirement. Aiming to achieve a 15 per cent market share by end of 2020
- Successful migration of around 400,000 policies from a number of legacy systems to a single platform managed by the Group's partner Diligenta, enabling customers to better manage their policies with Scottish Widows
- New 'Plan and Protect' life and critical illness cover launched in 2019 helps create financially resilient families by understanding their needs and protecting what matters most, providing a safety net if the worst happens
- Scottish Widows won 5 star service awards at the Financial Adviser Service Awards for the fourth consecutive year

### Digitising the Group

- Significant progress on Single Customer View, with home insurance and individual pension customers added in 2019. Over 5 million customers now able to access their insurance products alongside their bank account
- Addressing an underserved customer need for home contents insurance for renters through a partnership with the fintech firm Trov. New online low cost product offers a flexible on-demand monthly subscription policy

### Maximising Group capabilities

- Schroders Personal Wealth launched with ambition of becoming a top 3 financial planning business by end of 2023
- Provided new functionality and customer choice in general insurance with full rollout in the last quarter of a flexible, multi-channel home insurance product offering to the branch network
- Continued progress towards target of growing open book assets under administration by £50 billion by the end of 2020, with strong customer net inflows of £18 billion (including Zurich transfer) in 2019. Cumulative net inflows of £30 billion and market movements give overall growth of £37 billion since the start of the current strategic plan in 2018
- Sourced £0.6 billion of new long-term assets in collaboration with Commercial Banking to support five bulk annuity transactions, generating over £2 billion of new business premiums

### Financial performance

- Strong growth in life and pensions sales, up 22 per cent, driven by increases in new members in existing workplace schemes, increased auto enrolment workplace contributions and bulk annuities. On track to achieve 15 per cent market share of workplace business by end of 2020 compared to 10 per cent market share at start of 2018
- New underwritten household premiums increased 19 per cent, resulting in number one market share for new business earlier than expected; total underwritten premiums decreased 3 per cent driven by a competitive renewal market
- Life and pensions new business income up 19 per cent to £628 million. Lower existing business income due to equity hedging strategy to reduce capital and earnings volatility. Higher experience and other items includes one-off benefit from the change in investment management provider. General insurance benefitted from benign weather in 2019
- Wealth income and operating costs impacted by the transfer of assets to Schroders Personal Wealth in October 2019
- Underlying profit increased by 19 per cent to £1,101 million. Net income increased by £145 million to £2,133 million, whilst operating costs decreased by £39 million with cost savings offsetting higher investment in the business

### Insurance capital

- Estimated pre final dividend Solvency II ratio of 170 per cent. The rise in the ratio over 2019 includes the impact of an equity hedge partly offset by lower long term interest rates. A final dividend of £250 million and a special dividend of £185 million related to the gain on the establishment of the Schroders Personal Wealth joint venture were paid to the Group in February 2020, with total dividends paid in respect of 2019 performance of £535 million

## Helping our customers secure an income for life

In September 2019, Scottish Widows launched its standard annuity into the open market enabling a wider range of customers to access the product.

Through significant investment in technology we are able to support customers looking to secure income for life with their pension savings.

Helping people save for the future is just one way in which we support the UK through our Helping Britain Prosper Plan.

## Risk overview

# Effective risk management and control

## Our approach to risk

**Risk management is at the heart of our strategy to become the best bank for customers.**

**Our mission is to protect our customers, colleagues and the Group, whilst enabling sustainable growth in targeted segments. This is achieved through informed risk decision-making and robust risk management, supported by a consistent risk-focused culture.**

This risk overview provides a summary of risk management within the Group, with a prudent approach and rigorous controls to support sustainable business growth and minimise losses. Through a strong and independent risk function, a robust control framework is maintained to identify and escalate current and emerging risks, support sustainable growth within Group risk appetite, and to drive and inform good risk reward decisions.

The risk management section from pages 129 to 187 provides a more in-depth picture of how risk is managed within the Group, detailing the Group's emerging risks from pages 133 to 134, approach to stress testing, risk governance, committee structure, appetite for risk and a full analysis of the principal risk categories, the framework by which risks are identified, managed, mitigated and monitored.

## Risk as a strategic differentiator

Risks are identified, managed, mitigated and monitored using our comprehensive enterprise risk management framework, and our well-articulated risk appetite provides a clear framework for decision-making. The principal risks we face, which could significantly impact the delivery of our strategy, are discussed on pages 139 to 187.

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

- **Prudent approach to risk**
  Being low risk is fundamental to our business model and drives our participation choices. Strategy and risk appetite are developed in tandem and together outline the parameters within which the Group operates
- **Strong control framework**
  Our enterprise risk management framework is the foundation for the delivery of effective risk control and ensures that the Group risk appetite is continually developed and controlled
  The Board is responsible for approving the Group's risk appetite statement annually. Board-level metrics are cascaded into more detailed business appetite metrics and limits
- **Business focus and accountability**
  Risk management is an integral feature of how we measure and manage performance – for individuals, businesses and the Group. In the first line of defence, business units are accountable for managing risk with oversight from a strong and independent second line of defence Risk division
- **Effective risk analysis, management and reporting**
  Regular close monitoring and comprehensive reporting to all levels of management and the Board ensures appetite limits are maintained and subject to stress analysis at a risk type and portfolio level, as appropriate

## Our enterprise risk management framework

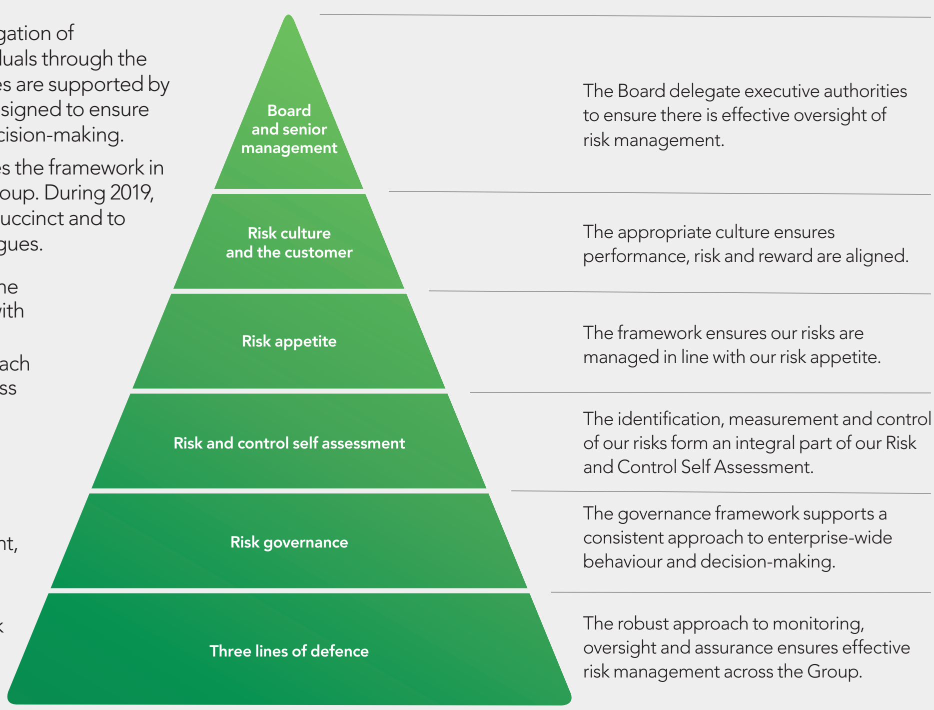
The Group's risk appetite, principles, policies, procedures, controls and reporting are regularly reviewed and updated where needed to ensure they remain fully in line with regulations, law, corporate governance and industry good practice.

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 enable effective decision-making.

Our risk management framework outlines the framework in place for risk management across the Group. During 2019, we updated this framework to be more succinct and to better ensure it is accessible to all colleagues.

A number of key components support the delivery of effective risk management, with four overarching objectives:

- Define a robust and consistent approach to risk governance to be applied across the Group and its legal entities
- Articulate individual and collective accountabilities for risk appetite, oversight and assurance
- Establish a common approach to categorise risks to support assessment, aggregation and reporting
- Provide colleagues and stakeholders with a single point of reference for risk management understanding, and supporting reference sources



## Risk culture and the customer

The effectiveness of our risk management approach relies upon a culture of transparency and openness that is encouraged by both the Board and senior management.

Based on the Group's conservative business model, prudent approach to risk management, and guided by the Board, senior management articulate the core risk values to which the Group aspires, and set the tone from the top, with a strong focus on building and sustaining long-term relationships with customers through the economic cycle. The Group's Code of Responsibility reinforces colleague accountability for the risks they take and their responsibility to prioritise their customers' needs.


**Tone from the top**
Senior leaders set a clear tone from the top and lead by example, reflecting our Group values; putting customers first, keeping it simple, and making a difference together, encouraging a culture of intellectual curiosity and proactive risk management amongst all colleagues.

**Accountability**
Risk management is a team effort with all colleagues playing their part and taking full individual responsibility for their actions.

**Effective communication and challenge**
As a Group we are open, honest and transparent with risk colleagues working in collaboration with business areas to:

- Support effective risk management
- Understand root causes when things go wrong
- Share lessons learned
- Provide constructive challenge

**Incentives**
Remuneration, performance management and succession planning that support our core values and put the customer at the heart of everything we do.

> **Managing risk means making the right decisions and doing the right thing for customers. It is at the heart of our Code of Responsibility and supports our aim to be the best bank for customers**
>
> **António Horta-Osório**
> Group Chief Executive

## 2019 themes

Our priorities for risk management have continued to evolve, alongside progression of the Group's strategy and development of external factors. Our principal risks are outlined over the next few pages but some themes have been particularly prevalent in 2019.

**Climate risk**
Climate change is a key global risk, impacting our customers, our investors and our business in making the required transition towards a low carbon economy. We are committed to delivering the Task Force for Climate-Related Financial Disclosures by 2022 and we are taking steps to fully integrate climate risk into our existing Enterprise Risk Management Framework, including our policies, risk appetite, controls and disclosures.

We continue to invest in supporting this activity as part of the wider sustainability strategy (see Responsible business section on pages 26 to 34), and are also active participants in a number of external initiatives to help drive consistency across the industry.

**EU exit**
Given the vast majority of our business is in the UK, the direct impact on the Group from leaving the EU is relatively small and we have taken the necessary steps to ensure continuity of our limited EU business activities, where permitted.

Our UK focus means our performance is inextricably linked to the health of the UK economy. Economic performance has remained resilient in recent years and whilst the near term outlook for the UK economy remains unclear given UK/EU trade agreement negotiations, we continue to monitor closely. We are also taking a prudent approach to our balance sheet, accelerating issuance where appropriate.

Our customer focused strategy remains the right one. Guided by the overriding principle of Helping Britain Prosper, we continue to focus on customer needs and support our personal and business customers. We have delivered on our commitment to lend £18 billion to UK businesses in 2019, reaffirming our support for the UK economy.

**Change / execution risk**
Delivering change is a key part of how the Group continues to serve our customers, fulfil our strategic objectives, and deliver our aim of Helping Britain Prosper.

During 2019 key change initiatives included continued digitisation of the Group and transforming ways of working. There has also been significant delivery of regulatory change in order to adapt to the changing regulatory landscape.

The Group continues its drive to deliver a leading customer experience whilst managing a varied change portfolio. Focus on improvements to the control environment and managing within risk appetite has enabled the safe delivery of change.

The need to protect existing processes and minimise adverse impact on colleagues and clients will support the delivery of a leading customer experience.

Risk overview continued

## Our principal risks

Principal risks and uncertainties are reported regularly to the Board Risk Committee. Change/execution, data and operational resilience have been elevated from existing risks to principal risks during 2019, and strategic added as a new principal risk

NEW

### CHANGE/EXECUTION

The risk that, in delivering our change agenda, we fail to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operate within our approved risk appetite.

**Example**
Ineffective change/execution risk management could lead to increased periods of time where we cannot serve our customers, and could lead to impacts associated with other risk types such as regulatory censure.

**Risk Appetite**
We have limited appetite for negative impacts on customers, colleagues, or the Group as a result of change activity.

**Mitigation**

- Continued focus on strengthening the control environment, maturation of the change policy and associated policies and procedures, which set out the principles and key controls that apply across the business and are aligned to the Group risk appetite. Senior Management continue to drive improvements to Change and Execution Risk metrics, in particular those affecting customers and colleagues
- Businesses assess the potential impacts of undertaking any change activity on their ability to execute effectively, and the potential consequences for the existing risk profiles

Further detail on principal risk, including mitigation on page 139

**Alignment to strategic priorities and future focus**

Delivering a leading customer experience

- We recognise the importance of delivering the Group's strategic priorities and will continue to invest in the transformation of the Group to deliver a leading customer experience

**New principal risk**
Change/execution risk was elevated from a secondary risk to a principal risk in recognition of the significant volumes of complex change the Group is currently undertaking to deliver its strategy. This includes key change initiatives, digitising the Group and transforming ways of working which will help to future-proof against the heightened risks associated with the use of new technologies and manage regulatory requirements and expectations. The decision aligns with the Group's progress in developing and embedding its change and execution risk management capabilities

NEW

### DATA

The risk that we fail to effectively govern, manage, and control our data (including data processed by third party suppliers) leading to unethical decisions, poor customer outcomes, loss of value and mistrust.

**Example**
The loss of trust from customers, colleagues, business partners or regulators arising from a failure to manage and control our data.

**Risk Appetite**
We have limited appetite for material events or losses that occur due to the inappropriate use of data.

**Mitigation**

- Significant investment has been made to enhance the maturity of data risk management in recent years
- In addition to the General Data Protection programme which delivered the necessary infrastructure to achieve compliance with the new regulations in May 2018, a number of other large investments have been made

Further detail on principal risk, including mitigation on page 139

**Alignment to strategic priorities and future focus**

Delivering a leading customer experience

- The quality of the data that the Group holds and the choices we make in how it is used is a key strategic enabler to future business growth, delivering a leading customer experience and Helping Britain Prosper
- We recognise that lawful, fair and transparent collection and appropriate use of data, is critical to delivering a leading customer experience and maintaining trust across the wider industry
- Internal programmes ensure that data is used correctly, and the control environment is regularly assessed through both internal and third-party testing

**New principal risk**
Data was elevated from a secondary risk to a principal risk as one of our most valuable assets. It is critical to our business and is the subject of significant regulatory oversight and media focus. Our Group is trusted with large volumes of data, and we must ensure that the information we hold is accurate, secure and managed appropriately

NEW

### OPERATIONAL RESILIENCE

The risk that we fail to design resilience into business operations, underlying infrastructure and controls (people, process, technology) so that it is able to withstand external or internal events which could impact the continuation of operations, and fails to respond in a way which meets customer and stakeholder expectations and needs when the continuity of operations is compromised.

**Example**
Ineffective risk management could lead to vital services not being available to customers and stakeholders.

**Risk Appetite**
We have a limited appetite for disruption to services to customers and stakeholders from significant unexpected events.

**Mitigation**

- The Group has increased its focus on operational resilience and has updated its strategy to reflect changing priorities of both customers and regulators

Further detail on principal risk, including mitigation on page 140

**Alignment to strategic priorities and future focus**

Delivering a leading customer experience

- End-to-end resilience of our critical processes is a key strategic priority and the Group operational resilience programmes continue to invest in improving our control environment and resilience. We continue to exercise, test and improve our resilience through scenario testing as well as learning from real events (those impacting ourselves but also those impacting others) through understanding the root cause
- We recognise the importance of the Group's operational resilience to our customers, markets and the wider financial sector

**New principal risk**
Operational resilience was elevated from a secondary risk to a principal risk as our ability to continue operations when subject to internal or external incidents, safeguarding our most critical processes and assets, protecting our colleagues, continuing to service our customers and minimising any impact on the banking systems is crucial

NEW

## STRATEGIC

The risks which result from strategic plans which do not adequately reflect trends in external factors, ineffective business strategy execution, or failure to respond in a timely manner to external environments or changes in stakeholder behaviours and expectations.

**Example**

- The financial services sector operates in evolving regulatory and competitive environments with an increased pace, scale and complexity of change which creates a risk to the Group's strategic plans
- Shareholder expectations continue to evolve potentially impacting the Group's role in society
- Greater competition for specialist skill sets (such as data science and engineering), alongside demographic challenges in the working population, may result in a skills shortage impacting delivery of key strategic initiatives

**Risk Appetite**

We have business plans that are responsive to internal and external factors including changes to the regulatory, macroeconomic and competitive environments.

**Mitigation**

- Continued digitisation of customer journeys, thereby enabling the delivery of market leading customer experiences that are seamless, accessible and personal
- Robust operating and contingency planning to ensure potential impacts of strategic initiatives and external drivers are mitigated

Further detail on principal risk, including mitigation on page 141

**Alignment to strategic priorities and future focus**

**Delivering a leading customer experience**

- The Group's forward looking approach to managing strategic risk will help the Group identify new risks and opportunities, and allow the Group to be better prepared to respond to changes in the regulatory and competitive environments

**New principal risk**

Strategic risk is a new principal risk in acknowledgment of the increasing rate of change in customer expectations, regulatory and competitive environments along with the demands for specialist skills to meet these evolving needs. This aligns with our strategic priorities to deliver a leading customer experience by digitising the Group, maximising Group capabilities and transforming ways of working

## CREDIT

The risk that parties with whom we have contracted fail to meet their financial obligations (both on or off balance sheet).

**Example**

Observed or anticipated changes in the economic environment could impact profitability due to an increase in delinquency, defaults, write-downs and/or expected credit losses.

**Risk Appetite**

We have a conservative and well balanced credit portfolio through the economic cycle, generating an appropriate return on equity, in line with our target return on equity in aggregate.

**Mitigation**

- Prudent, through the cycle credit principles, risk policies and appetite statements
- Robust models and controls

Further detail on principal risk, including mitigation on page 142

**Alignment to strategic priorities and future focus**

**Maximising Group capabilities**

- We seek to support sustainable growth in our targeted segments. We have a conservative and well-balanced credit portfolio, managed through the economic cycle and supported by strong credit portfolio management
- We are committed to better addressing our customers' banking needs through consistent, fair and responsible credit risk decisions, aligned to customers' circumstances, whilst staying within prudent risk appetite
- Portfolios have benefited from relatively favourable economic conditions and a prolonged period of low interest rates. Underlying impairments remain below long-term levels, but are expected to increase as impairments normalise

**Key risk indicators**

**£1,291m**
**Impairment charge**
2018: £937m

**1.8%**
**Stage 3 loans and advances as a % of total**
2018: 1.9%

## REGULATORY AND LEGAL

The risk of financial penalties, regulatory censure, criminal or civil enforcement action or customer detriment as a result of failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements.

**Example**

Failure to deliver key regulatory changes or to comply with ongoing requirements.

**Risk Appetite**

We interpret and comply with all relevant regulation and all applicable laws (including codes of conduct which could have legal implications) and/or legal obligations.

**Mitigation**

- 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
- Business units identify, assess and implement policy and regulatory requirements and establish local controls, processes, procedures and resources to ensure appropriate governance and compliance

Further detail on principal risk, including mitigation on page 162

**Alignment to strategic priorities and future focus**

**Delivering a leading customer experience**

- 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, regulation and associated consultations and participate in industry bodies. We continue to be proactive in responding to significant ongoing and new legislation, regulation and court proceedings

**Risk overview** continued

## CONDUCT

The risk of customer detriment across the customer lifecycle including: failures in product management, distribution and servicing activities; from other risks materialising, or other activities which could undermine the integrity of the market or distort competition, leading to unfair customer outcomes, regulatory censure, reputational damage or financial loss.

**Example**
The most significant conduct cost in recent years has been PPI mis-selling.

**Risk Appetite**
We deliver fair outcomes for our customers.

**Mitigation**

- Simplified and enhanced conduct policies and procedures in place to ensure appropriate controls and processes that deliver fair customer outcomes, and support market integrity and competition requirements
- Active engagement with regulatory bodies and other stakeholders to develop understanding of concerns related to customer treatment, effective competition and market integrity, to ensure that the Group's strategic conduct focus continues to meet evolving stakeholder expectations

Further detail on principal risk, including mitigation on page 163

**Alignment to strategic priorities and future focus**

**Delivering a leading customer experience**

- As we transform our business, minimising conduct risk is critical to achieving our strategic goals and meeting regulatory standards
- We have senior committees that ensure our focus on embedding a customer-centric culture and delivering fair outcomes across the Group. Our conduct risk framework continues to support this through robust and effective management. This supports our vision of being the best bank for customers, enabling the delivery of a leading customer experience through effective root cause analysis and learning from customer feedback

## OPERATIONAL

The risk of loss from inadequate or failed internal processes, people and systems, or from external events.

**Example**
Ineffective risk management could lead to adverse customer impact, reputational damage and financial loss, across all of our principal risks.

**Risk Appetite**
We have robust controls in place to manage operational losses, reputational events and regulatory breaches. We identify and assess emerging risks and act to mitigate these.

**Mitigation**

- The Group continues to review and invest in its control environment to ensure it addresses the inherent risks faced
- The Group employs a range of risk management strategies, including: avoidance, mitigation, transfer (including insurance) and acceptance

Further detail on principal risk, including mitigation on page 164

**Alignment to strategic priorities and future focus**

**Delivering a leading customer experience**

- The Group continues to manage operational risk within the appetite articulated by the Board and in compliance with legal and regulatory requirements to insurance a robust control environment and a positive customer experience

## PEOPLE

The risk that we fail to provide an appropriate colleague and customer-centric culture, supported by robust reward and wellbeing policies and processes; effective leadership to manage colleague resources; effective talent and succession management; and robust control to ensure all colleague-related requirements are met.

**Example**
Inability to attract or retain colleagues with key skills could impact the achievement of business objectives.

**Risk Appetite**
We lead responsibly and proficiently, manage people resource effectively, support and develop colleague talent, and meet legal and regulatory obligations related to our people.

**Mitigation**

- 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
- Continued focus on the Group's culture by developing and delivering initiatives that reinforce the appropriate behaviours which generate the best possible long-term outcomes for customers and colleagues

Further detail on principal risk, including mitigation on page 165

**Alignment to strategic priorities and future focus**

**Transforming ways of working**

- Regulatory requirements relating to personal accountability and remuneration rules could affect our ability to attract and retain the calibre of colleagues required to meet changing customer needs. We recognise the challenges in delivering the Group's strategic priorities and we will continue to invest in the development of colleague capabilities and agile working practices. This investment will deliver a leading customer experience and allow the Group to respond quickly to customers' rapidly changing decision-making in a digital era

## INSURANCE UNDERWRITING

The risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions in earnings and/or value.

### Example

Uncertain property insurance claims impact Insurance earnings and capital, e.g. extreme weather conditions, such as flooding, can result in high property damage claims.

### Risk Appetite

We have robust controls in place to manage the insurance underwriting risk inherent in the products our Insurance business offers to meet customer needs.

### Mitigation

- General Insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements broadly spread over different reinsurers
- Insurance processes on underwriting, claims management, pricing and product design

Further detail on principal risk, including mitigation on page 166

### Alignment to strategic priorities and future focus

**Delivering a leading 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 delivering a leading 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

### Key risk indicators

**£17,515m**
**Life and pensions present value of new business premiums**
2018: £14,384m

**£671m**
**General insurance underwritten total gross premiums**
2018: £690m

## CAPITAL

The risk that we have a sub-optimal quantity 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
- Alternatively a shortage of capital could arise from an increase in the amount of capital that needs to be held

### Risk Appetite

We maintain capital levels commensurate with a prudent level of solvency and aim to deliver consistent and high quality returns to shareholders.

### Mitigation

- The Group has a capital management framework that includes the setting of capital risk appetite
- The Group maintains a recovery plan which sets out a range of potential mitigating actions that could be taken in response to a stress

Further detail on principal risk, including mitigation on page 167

### Alignment to strategic priorities and future focus.

**Maximising Group capabilities**

- 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 growth in targeted segments through the cycle

### Key risk indicators

**13.8%[1]**
**CET1 ratio**
2018: 13.9%[1,2]

**5.2%[1]**
**UK leveraged ratio**
2018: 5.6%[1]

1 Pro forma basis

2 Incorporates the effects of the share buyback announced in February 2019.

## FUNDING AND LIQUIDITY

Funding risk is the risk that we do not have sufficiently stable and diverse sources of funding or the funding structure is inefficient. Liquidity risk is the risk that we do not have sufficient financial resources to meet our commitments when they fall due, or can only secure them at excessive cost.

### Example

A deterioration in either our or the UK's credit rating, or a sudden and significant withdrawal of customer deposits, would adversely impact our funding and liquidity position.

### Risk Appetite

We maintain a prudent liquidity profile and a balance sheet structure that limits our reliance on potentially volatile sources of funding.

### Mitigation

- The Group manages and monitors liquidity risks and ensures that liquidity risk management systems and arrangements are adequate with regard to the internal risk appetite, Group strategy and regulatory requirements
- The Group's funding and liquidity position is underpinned by its significant customer deposit base, and is supported by strong relationships across customer segments

Further detail on principal risk, including mitigation on page 175

### Alignment to strategic priorities and future focus

**Maximising Group capabilities**

- We maintain a strong funding position in line with our low risk strategy, and the loan to deposit ratio remains within our target range
- Our funding position allows us to grow targeted business segments, and better address our customers' needs

### Key risk indicators

**£118bn**
**LCR eligible assets**
2018: £129bn

**107%**
**Loan to deposit ratio**
2018: 107%

## GOVERNANCE

The risk that our organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively.

### Examples

- Inadequate or complex governance arrangements to address ring-fencing requirements and the potential impact of EU exit could result in a weaker control environment, delays in decision making and lack of clear accountability
- Non-compliance with, or breaches of SMCR requirements could result in lack of clear accountability, and legal and regulatory consequences

### Risk Appetite

We have governance arrangements that support the effective long-term operation of the business, maximise shareholder value and meet regulatory and societal expectations.

### Mitigation

- 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

Further detail on principal risk, including mitigation on page 181

### Alignment to strategic priorities and future focus

**Delivering a leading customer experience**

- Ring-fencing ensures that we are safer and continue to deliver a leading customer experience by providing further protection to core retail and SME deposits, increasing transparency of our operations and facilitating the options available in resolution
- Our governance framework and strong culture of ownership and accountability enabled effective, on time, compliance with the SMCR requirements and enable us to demonstrate clear accountability for decisions

## MARKET

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, equity, credit spreads and interest rates in the Insurance business, and credit spreads in 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 risk through the value of future management charges on policyholder funds. Credit spread and interest rate risk within the Insurance business primarily arises from bonds and loans used to back annuities
- Narrowing credit spreads will increase the cost of pension scheme benefits

### Risk Appetite

We have robust controls in place to manage our inherent market risk and do not engage in any proprietary trading, reflecting the customer focused nature of the Group's activities

### Mitigation

- Structural hedge programmes implemented to manage liability margins and margin compression
- Equity and credit spread risks are closely monitored and, where appropriate, asset and liability matching is undertaken
- The Group's defined benefit pension schemes continue to monitor their credit allocation as well as the hedges in place against nominal rate and inflation movements

Further detail on principal risk, including mitigation on page 183

### Alignment to strategic priorities and future focus

**Maximising Group capabilities**

- We actively manage our exposure to movements in market rates, to drive lower volatility earnings and offer a comprehensive customer proposition with hedging strategies to support strategic aims. Mitigating actions are implemented to reduce the impact of market movements, resulting in a more stable capital position
- Effective interest rate and inflation hedging has kept volatility in the Group's defined benefit pension schemes low. This combined with improved market conditions has helped keep the schemes in IAS 19 surplus in 2019. This allows us to more efficiently utilise available capital resources

### Key risk indicators

**£550m**

**IAS 19 pension surplus**

2018: £1,146m

## MODEL

The risk of financial loss, regulatory censure, reputational damage or customer detriment, as a result of deficiencies in the development, application and ongoing operation of Models and Rating Systems.

### Example

The consequences of inadequate models could include: inappropriate levels of capital or impairments; inappropriate credit or pricing decisions; and adverse impacts on funding or liquidity, or the Group's earnings and profits.

### Risk Appetite

Material models are performing in line with expectations.

### Mitigation

- The model risk management framework, established by and with continued oversight from an independent team in the Risk division, provides the foundation for managing and mitigating model risk within the Group

Further detail on principal risk, including mitigation on page 187

### Alignment to strategic priorities and future focus

**Digitising the Group**

- Our models play a vital role in supporting our Group strategy to ensure profitable growth in targeted segments and the drive toward automation and digital solutions to enhance customer outcomes. Model risk management helps ensure these models are implemented in a controlled and safe manner for both ourselves and customers.

The Group's Viability statement can be found on pages 95 to 96.

The Group's emerging risks are shown on pages 133 to 134 and a full analysis of the Group's risk categories is on pages 129 to 187.

## Financial results




## Anwyl Homes

One of the UK's leading independent housing developers has boosted its turnover by 60 per cent, after receiving support from Lloyds Bank to expand its presence across the North West.

Anwyl Homes, founded in 1930, builds high quality houses across North Wales and the North West of England. Lloyds Bank has worked with Anwyl Homes for more than 70 years, providing the firm with the funding and working capital support it's needed to expand. During the last five-year expansion plan the firm has built 754 new homes, completing developments across North Wales, Shropshire, Staffordshire, Cheshire, Merseyside and Lancashire. As a result of expansion, the firm has also been able to create a number of new jobs within the local area, boosting its workforce by 24 per cent over the same period.

**www.lloydsbankinggroup.com/our-group/responsible-business/**

# Summary of Group results

## Solid financial performance

The Group's statutory profit after tax was £3,006 million, 33 per cent lower than in 2018 with resilient underlying profit partly offset by the significant payment protection insurance (PPI) charge of £2,450 million taken in the year. The statutory return on tangible equity was 7.8 per cent.

Trading surplus was resilient at £8,822 million (2018: £9,003 million) with lower net income partly offset by the Group's continued progress in delivering cost reductions. Underlying profit was £7,531 million compared to £8,066 million in 2018, reflecting lower net income and higher impairment charges, partly offset by the Group's strong cost performance. The Group's market-leading underlying return on tangible equity was 14.8 per cent.

The Group's balance sheet remains strong with lending growth in the open mortgage book as well as targeted segments, including SME and UK Motor Finance. This was more than offset by lower balances in Mid Markets and Global Corporates, primarily as a result of the continued optimisation of the Commercial portfolio, as well as continued reductions in the closed mortgage book. The Group's capital position remains strong with a pro forma CET1 ratio of 15.0 per cent pre dividend accrual and 13.8 per cent post dividend.

The Group is strongly capital generative and although this has been impacted by PPI in 2019, the Board has recommended a final ordinary dividend of 2.25 pence per share, making a total ordinary dividend of 3.37 pence per share, an increase of 5 per cent on 2018 and in line with our progressive and sustainable ordinary dividend policy.

## Net income

| | 2019 £m | 2018 £m | Change % |
|---|---|---|---|
| Net interest income | **12,377** | 12,714 | (3) |
| Other income excluding Vocalink gain on sale | **5,682** | 6,010 | (5) |
| Vocalink gain on sale | **50** | – | |
| Other income | **5,732** | 6,010 | (5) |
| Operating lease depreciation[1] | **(967)** | (956) | (1) |
| **Net income** | **17,142** | 17,768 | (4) |
| Banking net interest margin | **2.88%** | 2.93% | (5)bp |
| Average interest-earning banking assets | **£434.7bn** | £436.0bn | – |

1 Net of profits on disposal of operating lease assets of £41 million (2018: £60 million).

Net income of £17,142 million was 4 per cent lower than in 2018, reflecting lower net interest income and other income, while operating lease depreciation increased by 1 per cent.

Net interest income of £12,377 million was down 3 per cent with a slightly lower net interest margin and stable average interest-earning banking assets. Net interest margin reduced in line with guidance to 2.88 per cent, with the benefit of lower deposit costs, higher Retail current account balances and a benefit from aligning credit card terms, more than offset by continued pressure on asset margins, particularly in the mortgage market.

Average interest-earning banking assets at £434.7 billion were stable, with growth in targeted segments, in particular SME (£0.3 billion) and UK Motor Finance (£1.4 billion), more than offset by lower balances in the closed mortgage book (£2.5 billion) and the effect of the sale of the Irish mortgage portfolio in the first half of 2018 (£1.6 billion).

The Group manages the risk to its earnings and capital from movements in interest rates centrally by hedging the net liabilities which are stable or less sensitive to movements in rates. As at 31 December 2019 the Group's structural hedge had a nominal balance of £179 billion (31 December 2018: £180 billion) and an average duration of around three years (31 December 2018: around four years). The Group generated £2.7 billion of income from the structural hedge balances in 2019 (2018: £2.7 billion). Within this, the benefit from the hedge in the year was £1.1 billion over LIBOR (2018: £1.4 billion) with a fixed earnings rate of approximately 0.7 per cent over LIBOR (2018: 0.7 per cent).

Other income at £5,732 million decreased by 5 per cent with healthy growth in new business in Insurance and Wealth more than offset by lower other income in Commercial Banking and Retail. Insurance and Wealth continued to perform well reflecting growth in workplace pensions new business from increased auto enrolment contributions in the first half of 2019 and higher general insurance income, net of claims. Insurance and Wealth other income also includes the benefit from the change in investment management provider taken in the first half of 2019 and longevity assumption change benefits. Commercial Banking was impacted by more subdued levels of client activity given challenging external conditions particularly in large corporate markets and Retail other income was impacted by a lower Lex fleet size. Other income includes a gain of £185 million on the sale of £8 billion of gilts and other liquid assets, compared with a £270 million gain on sale of such assets in 2018.

Operating lease depreciation increased by 1 per cent reflecting some weakening in used car prices through the first three quarters of 2019, partly offset by a lower fleet size.

## Total costs

| | 2019 £m | 2018 £m | Change % |
|---|---|---|---|
| Operating costs | **7,875** | 8,165 | 4 |
| Remediation | **445** | 600 | 26 |
| **Total costs** | **8,320** | 8,765 | 5 |
| Business as usual costs[1] | **5,478** | 5,836 | 6 |
| Cost: income ratio | **48.5%** | 49.3% | (0.8)pp |

1 2018 Business as usual costs are adjusted to reflect the impact of applying IFRS 16. Excluding the impact of IFRS 16 business as usual costs in 2018 were £6,048 million.

Total costs of £8,320 million were 5 per cent lower than in 2018, driven by the reduction in both operating costs and remediation charges.

Operating costs of £7,875 million were 4 per cent lower with a 6 per cent reduction in business as usual costs, largely driven by increased efficiency from digitalisation and process improvements, in parallel with strategic investment of £1.0 billion in the business, up 6 per cent in the year. During 2019 the Group capitalised around £1.5 billion of investment spend, of which around £1.0 billion related to intangible assets. Total capitalised spend was equivalent to around 60 per cent of above the line investment, in line with 2018.

Remediation charges of £445 million, including additional charges of £219 million in the fourth quarter of 2019 relating to a number of items across existing programmes, were significantly lower than the £600 million in 2018.

The Group's market-leading cost:income ratio continues to provide a competitive advantage and further strengthened to 48.5 per cent with positive jaws of 1 per cent.

The Group expects operating costs in 2020 to be less than £7.7 billion with the cost:income ratio lower than in 2019.

## Impairment

| | 2019 £m | 2018 £m | Change % |
|---|---|---|---|
| Impairment charge | **1,291** | 937 | (38) |
| Asset quality ratio | **0.29%** | 0.21% | 8bp |
| Gross asset quality ratio | **0.37%** | 0.28% | 9bp |
| | **At 31 Dec 2019[1] %** | At 31 Dec 2018[1] % | Change % |
| Stage 2 loans and advances to customers as % of total | **7.7** | 7.8 | (0.1)pp |
| Stage 2 ECL[2] allowances as % of Stage 2 drawn balances | **3.7** | 4.1 | (0.4)pp |
| Stage 3 loans and advances to customers as a % of total | **1.8** | 1.9 | (0.1)pp |
| Stage 3 ECL[2] allowances as % of Stage 3 drawn balances | **22.5** | 24.3 | (1.8)pp |
| Total ECL[2] allowances as % of drawn balances | **0.8** | 0.9 | (0.1)pp |

1 Underlying basis.

2 Expected credit loss.

Credit quality remains strong with a net asset quality ratio of 29 basis points and a gross asset quality ratio of 37 basis points compared with 21 basis points and 28 basis points respectively in 2018. The impairment charge increased to £1,291 million with the increase primarily driven by two material corporate cases in Commercial Banking, along with some weakening in used car prices in Black Horse.

The Group's loan portfolios continue to be well positioned, reflecting the Group's prudent, through the cycle approach to credit risk, and benefiting from continued low interest rates and a resilient UK economy.

Overall credit performance in the secured book remains strong with the average mortgage loan to value increasing slightly to 44.9 per cent (31 December 2018: 44.3 per cent). New business average loan to value was 64.3 per cent and 88 per cent of the portfolio has a loan to value ratio of less than 80 per cent. New to arrears as a proportion of the total book remains low in both the secured and unsecured books. In Commercial Banking, the book continues to benefit from low interest rates and effective risk management, including a prudent approach to vulnerable sectors.

The Group's outlook and IFRS 9 base case economic scenario used to calculate expected credit loss (ECL) have remained broadly stable throughout 2019, reflecting an orderly exit of the UK from the European Union. During 2019 the Group made small improvements to its economic scenario modelling. The Group's ECL allowance continues to reflect a probability-weighted view of future economic scenarios including a 30 per cent weighting of downside and a 10 per cent weighting of severe downside.

Stage 2 loans and advances to customers as a proportion of total lending reduced by 0.1 percentage points to 7.7 per cent, whilst Stage 3 loans and advances fell by the same amount to 1.8 per cent. The Group's coverage of Stage 2 assets reduced by 0.4 percentage points to 3.7 per cent, reflecting a number of model refinements, including an enhanced approach to loan amortisation in the Commercial Banking portfolio. Coverage of Stage 3 assets reduced by 1.8 percentage points to 22.5 per cent largely as a result of the improved performance of mortgage cases in long-term default, and a change in the mix of Commercial assets due to a combination of write-offs and the transfer in of cases with lower likelihood of net loss. The Group's total underlying ECL at 31 December 2019 was £4.2 billion and broadly stable compared to prior year (31 December 2018: £4.4 billion). Total ECL allowances as a percentage of drawn balances fell slightly to 0.8 per cent. The Group expects the 2020 net asset quality ratio to be less than 30 basis points.

Summary of Group results continued

## Statutory profit

| | 2019 £m | 2018 £m | Change % |
|---|---|---|---|
| **Underlying profit** | **7,531** | 8,066 | (7) |
| Restructuring | **(471)** | (879) | 46 |
| Volatility and other items | | | |
| Market volatility and asset sales | **126** | (50) | |
| Amortisation of purchased intangibles | **(68)** | (108) | 37 |
| Fair value unwind and other | **(275)** | (319) | 14 |
| | **(217)** | (477) | 55 |
| Payment protection insurance provision | **(2,450)** | (750) | |
| **Statutory profit before tax** | **4,393** | 5,960 | (26) |
| Tax expense[1] | **(1,387)** | (1,454) | 5 |
| **Statutory profit after tax**[1] | **3,006** | 4,506 | (33) |
| Earnings per share | **3.5p** | 5.5p | (36) |
| Return on tangible equity | **7.8%** | 11.7% | (3.9)pp |

1 Comparatives restated to reflect amendments to IAS12, see basis of presentation on page 206.

Further information on the reconciliation of underlying to statutory results is included on page 61.

The Group's statutory profit after tax was £3,006 million, 33 per cent lower than in 2018 with resilient underlying profit partly offset by the PPI charge. The return on tangible equity was 7.8 per cent (2018: 11.7 per cent) and earnings per share was 3.5 pence (2018: 5.5 pence).

Restructuring costs of £471 million were down 46 per cent, primarily reflecting the completion of both the integration of MBNA and the ring-fencing programme, which were partially offset by costs associated with establishing the Schroders Personal Wealth joint venture.

Market volatility and asset sales of £126 million included adverse movements in banking volatility, a gain on the establishment of the Schroders Personal Wealth joint venture as well as the one-off charge for exiting the Standard Life Aberdeen investment management agreement, taken in the first half of 2019. In 2018 market volatility and asset sales included a loss on sale of the Irish mortgage portfolio and an adjustment to past service pension liability.

The decrease in amortisation of purchased intangibles to £68 million (2018: £108 million) and fair value unwind and other items to £275 million (2018: £319 million) were driven by a number of assets fully amortising in 2018 and the run down of the subordinated liabilities acquired during the HBOS acquisition.

The PPI provision charge of £2,450 million was largely due to the significant increase in PPI information requests (PIRs) leading up to the deadline for submission of claims on 29 August 2019, and also reflects costs relating to complaints received from the Official Receiver as well as administration costs. An initial review of around 60 per cent of the five million PIRs received in the run-up to the PPI deadline has been undertaken, with the conversion rate remaining low, and consistent with the provision assumption of around 10 per cent. The Group has also reached final agreement with the Official Receiver. The unutilised provision at 31 December 2019 was £1,578 million.

## Taxation

The tax expense was £1,387 million (2018: £1,454 million) representing an effective tax rate of 32 per cent (2018: 24 per cent). This reflected the increase in non-deductible conduct provision charges in relation to PPI, partially offset by the release of a deferred tax liability.

The Group continues to expect a medium term effective tax rate around 25 per cent, although this is likely to be lower in 2020 if the UK's corporate tax rate remains unchanged, given a revaluation of the Group's deferred tax assets.

## Return on tangible equity

The underlying return on tangible equity was 14.8 per cent, primarily reflecting resilient underlying profit and slightly lower average tangible equity. The statutory return on tangible equity was 7.8 per cent and was impacted by PPI.

In 2020, the Group expects an increased statutory return on tangible equity of 12 to 13 per cent, driven by resilient underlying profit and lower below the line charges.

## Balance sheet

| | At 31 Dec 2019 | At 31 Dec 2018 | Change % |
|---|---|---|---|
| Loans and advances to customers[1] | **£440bn** | £444bn | (1) |
| Customer deposits[2] | **£412bn** | £416bn | (1) |
| Loan to deposit ratio | **107%** | 107% | – |
| Wholesale funding | **£128bn** | £123bn | 4 |
| Wholesale funding <1 year maturity | **£43bn** | £33bn | 31 |
| *Of which money-market funding <1 year maturity*[3] | **£22bn** | £21bn | 5 |
| Liquidity coverage ratio – eligible assets[4] | **£131bn** | £126bn | 4 |
| Liquidity coverage ratio[5] | **137%** | 128% | 9pp |

1 Excludes reverse repos of £54.6 billion (31 December 2018: £40.5 billion).

2 Excludes repos of £9.5 billion (31 December 2018: £1.8 billion).

3 Excludes balances relating to margins of £4.2 billion (31 December 2018: £3.8 billion) and settlement accounts of £1.9 billion (31 December 2018: £1.2 billion).

4 Eligible assets are calculated as a simple average of month end observations over the previous 12 months.

5 The Liquidity coverage ratio is calculated as a simple average of month end observations over the previous 12 months.

Loans and advances to customers were £440 billion (31 December 2018: £444 billion). Growth in the open mortgage book and targeted segments including SME and Motor Finance, was more than offset by continued reductions in the closed mortgage book and lower balances in Mid Markets and Global Corporates. Commercial Banking has continued to optimise its portfolio in challenging market conditions, maintaining a strong focus on risk-weighted asset reduction and actively addressing low risk-adjusted returning client relationships. In line with the Group's expectations, the open mortgage book grew by £3.5 billion driven by the acquisition of Tesco Bank's UK prime residential mortgage portfolio and was broadly flat excluding the acquisition.

The Group continues to optimise funding and target current account balance growth, with Retail current accounts up 4 per cent at £76.9 billion (31 December 2018: £73.7 billion). The loan to deposit ratio was flat at 107 per cent.

Wholesale funding increased by 4 per cent to £128 billion (31 December 2018: £123 billion) in part as a result of refinancing Funding for Lending Scheme maturities in the year. The proportion maturing in less than one year increased by 31 per cent to £43.4 billion (31 December 2018: £33.1 billion) due to higher term funding maturities in 2020. The Group's liquidity position continues to exceed the regulatory minimum and internal risk appetite.

## Capital

| | At 31 Dec 2019 | At 31 Dec 2018 | Change % |
|---|---|---|---|
| Capital build[1] | **86bp** | 210bp | (124)bp |
| Pro forma CET1 ratio[2] | **13.8%** | 13.9% | (0.1)pp |
| CET1 ratio | **13.6%** | 14.6% | (1.0)pp |
| Pro forma transitional total capital ratio[2] | **21.5%** | 23.1% | (1.6)pp |
| Pro forma transitional MREL ratio[2] | **32.6%** | 32.6% | – |
| Pro forma UK leverage ratio[2] | **5.2%** | 5.6% | (0.4)pp |
| Pro forma risk-weighted assets[2] | **£203bn** | £206bn | (1) |
| Shareholders' equity | **£42bn** | £43bn | (4) |
| Tangible net assets per share | **50.8p** | 53.0p | (2.2)p |

1 Capital build is reported on a pro forma basis, reflecting the dividend paid up by the Insurance business in the subsequent first quarter period and is also reported before accruing for ordinary dividends, the cancellation of the remaining 2019 share buyback and the acquisition of Tesco Bank's UK prime residential mortgage portfolio.

2 The CET1, total, MREL, leverage ratios and risk-weighted assets at 31 December 2019 and 31 December 2018 are reported on a pro forma basis, reflecting the dividend paid up by the Insurance business in the subsequent first quarter period. The pro forma CET1 ratio at 31 December 2018 incorporates the effects of the share buyback announced in February 2019 and is reported post dividend accrual.

The Group's capital position remains strong with the CET1 capital ratio increasing to 15.0 per cent pre dividend accrual. After accruing 123 basis points for the ordinary dividend, the CET1 ratio stands at 13.8 per cent.

A summary of the CET1 capital build is set out in the table below.

| | |
|---|---|
| Pro forma CET1 ratio at 31 December 2018 | 13.9% |
| Banking business underlying capital build (bps) | **180** |
| Insurance dividends (bps) | **18** |
| Impact from the implementation of IFRS 16 on risk-weighted assets (bps) | **(11)** |
| RWA and other movements (bps) | **20** |
| | **207** |
| PPI charge (bps) | **(121)** |
| | **86** |
| Cancellation of the remaining 2019 share buyback programme (bps) | **34** |
| Capital used for the acquisition of the Tesco Bank's mortgage portfolio (bps) | **(9)** |
| Ordinary dividend accrual (bps) | **(123)** |
| **Pro forma CET1 ratio at 31 December 2019** | **13.8%** |

The Group's CET1 capital build in the year amounted to 207 basis points before PPI, and to 86 basis points after the in-year PPI charge, equivalent to 121 basis points. Solid financial performance has driven underlying capital build of 198 basis points, including 18 basis points from the dividend from the Insurance business. Capital build also included 20 basis points from favourable, risk-weighted asset and other movements (reflecting market movements and the continued optimisation of Commercial Banking risk-weighted assets, net of additional pension contributions and model updates), partly offset by the 11 basis points impact of IFRS 16. The Group's capital position also benefitted by 34 basis points from the cancellation of the remaining c.£650 million of the 2019 buyback programme, as announced in September 2019. The Group used 9 basis points of capital for the acquisition of Tesco Bank's UK prime residential mortgage portfolio.

During 2019 the Prudential Regulation Authority (PRA) reduced the Group's Pillar 2A CET1 requirement from 2.7 per cent to 2.6 per cent. Separately, the Financial Policy Committee of the Bank of England announced an increase in the Countercyclical Capital Buffer (CCYB) rate for the UK from 1.0 per cent to 2.0 per cent, effective from December 2020. During 2020 the PRA will consult on a proposed reduction in Pillar 2A total capital requirements by 50 per cent of this increase in the CCYB, equivalent to reducing the Pillar 2A CET1 requirement by 28 per cent of the increase. Taking into account the current and potential future changes to capital requirements, the Board's view of the current level of CET1 capital required by the Group to grow the business, meet regulatory requirements and cover uncertainties continues to be c.12.5 per cent plus a management buffer of c.1 per cent.

The transitional total capital ratio reduced to 21.5 per cent on a pro forma basis (31 December 2018: 23.1 per cent) and the Group's transitional minimum requirement for own funds and eligible liabilities (MREL), which came into force on 1 January 2020, is 32.6 per cent on pro forma basis (31 December 2018: 32.6 per cent). The UK leverage ratio remains strong at 5.2 per cent on a pro forma basis.

Risk-weighted assets on a pro forma basis have reduced by £3.0 billion to £203.4 billion driven primarily by the optimisation of the Commercial Banking portfolio, offset in part by model updates in mortgages, the implementation of IFRS 16 and the acquisition of the Tesco Bank's mortgage portfolio. We now expect risk-weighted assets at the end of 2020 to be broadly in line with the end of 2019, including regulatory headwinds.

Tangible net assets per share reduced by 2.2 pence in 2019 to 50.8 pence (31 December 2018: 53.0 pence) with the effects of the Group's statutory profit after tax and positive cash flow hedge movements being more than offset by dividends paid in 2019, the revaluation of the Group's retirement benefit obligations, the effects of the share buyback and other reserve movements.

**Summary of Group results** continued

## Dividend

The Group has a progressive and sustainable ordinary dividend policy whilst maintaining the flexibility to return surplus capital through buybacks or special dividends.

Given the solid financial performance in 2019, the Board has recommended a final ordinary dividend of 2.25 pence per share. This is in addition to the interim ordinary dividend of 1.12 pence per share that was announced in the 2019 half year results. The recommended total ordinary dividend per share for 2019 is therefore 3.37 pence per share and has increased by 5 per cent from 3.21 pence per share in 2018.

The Group has announced that it will move to the payment of quarterly dividends in 2020, with the first quarterly dividend in respect of the first quarter of 2020 payable in June 2020. The new approach will be to adopt three equal interim ordinary dividend payments for the first three quarters of the year followed by, subject to performance, a larger final dividend for the fourth quarter of the year. The first three quarterly payments, payable in June, September and December will be 20 per cent of the previous year's total ordinary dividend per share. The fourth quarter payment will be announced with the full year results, with the amount continuing to deliver a full year dividend payment that reflects the Group's financial performance and its objective of a progressive and sustainable ordinary dividend. The final dividend will continue to be paid in May, following approval at the AGM. The Group believes that this approach will provide a more regular flow of dividend income to all shareholders whilst accelerating the receipt of payments.

The key dates for the payment of the three interim dividends are:

| First interim dividend | |
|---|---|
| Shares quoted ex-dividend | 4 June 2020 |
| Record date | 5 June 2020 |
| Final date for joining or leaving the dividend reinvestment plan | 19 June 2020 |
| Dividends paid | 30 June 2020 |

| Second interim dividend | |
|---|---|
| Shares quoted ex-dividend | 6 August 2020 |
| Record date | 7 August 2020 |
| Final date for joining or leaving the dividend reinvestment plan | 21 August 2020 |
| Dividends paid | 14 September 2020 |

| Third interim dividend | |
|---|---|
| Shares quoted ex-dividend | 5 November 2020 |
| Record date | 6 November 2020 |
| Final date for joining or leaving the dividend reinvestment plan | 20 November 2020 |
| Dividends paid | 11 December 2020 |

# Income statement – underlying basis

| | 2019 £m | 2018 £m | Change % |
|---|---|---|---|
| Net interest income | **12,377** | 12,714 | (3) |
| Other income | **5,732** | 6,010 | (5) |
| Operating lease depreciation | **(967)** | (956) | (1) |
| **Net income** | **17,142** | 17,768 | (4) |
| Operating costs | **(7,875)** | (8,165) | 4 |
| Remediation | **(445)** | (600) | 26 |
| **Total costs** | **(8,320)** | (8,765) | 5 |
| **Trading surplus** | **8,822** | 9,003 | (2) |
| Impairment | **(1,291)** | (937) | (38) |
| **Underlying profit** | **7,531** | 8,066 | (7) |
| Restructuring | **(471)** | (879) | 46 |
| Volatility and other items | **(217)** | (477) | 55 |
| Payment protection insurance provision | **(2,450)** | (750) | |
| **Statutory profit before tax** | **4,393** | 5,960 | (26) |
| Tax expense[1] | **(1,387)** | (1,454) | 5 |
| **Statutory profit after tax**[1] | **3,006** | 4,506 | (33) |
| Earnings (loss) per share | **3.5p** | 5.5p | (36) |
| Dividends per share – ordinary | **3.37p** | 3.21p | 5 |
| Share buyback value | **–** | £1.1bn | |
| Banking net interest margin | **2.88%** | 2.93% | (5)bp |
| Average interest-earning banking assets | **£435bn** | £436bn | – |
| Cost:income ratio | **48.5%** | 49.3% | (0.8)pp |
| Asset quality ratio | **0.29%** | 0.21% | 8bp |
| Underlying return on tangible equity | **14.8%** | 15.5% | (0.7)pp |
| Return on tangible equity | **7.8%** | 11.7% | (3.9)pp |

# Key balance sheet metrics

| | At 31 Dec 2019 | At 31 Dec 2018 | Change % |
|---|---|---|---|
| Loans and advances to customers[2] | **£440bn** | £444bn | (1) |
| Customer deposits[3] | **£412bn** | £416bn | (1) |
| Loan to deposit ratio | **107%** | 107% | – |
| Capital build[4] | **86bp** | 210bp | (124)pp |
| Pro forma CET1 ratio[5] | **13.8%** | 13.9% | (0.1)pp |
| Pro forma transitional MREL ratio[5] | **32.6%** | 32.6% | – |
| Pro forma UK leverage ratio[5] | **5.2%** | 5.6% | (0.4)pp |
| Pro forma risk-weighted assets[5] | **£203bn** | £206bn | (1) |
| Tangible net assets per share | **50.8p** | 53.0p | (2.2)pp |

1 2018 restated to reflect amendments to IAS 12, see basis of presentation on page 206.

2 Excludes reverse repos of £54.6 billion (31 December 2018: £40.5 billion).

3 Excludes repos of £9.5 billion (31 December 2018: £1.8 billion).

4 Capital build is reported on a pro forma basis, reflecting the dividend paid up by the Insurance business in the subsequent first quarter period and is also reported before accruing for ordinary dividends, the cancellation of the remaining 2019 share buyback and the acquisition of Tesco Bank's UK prime residential mortgage portfolio.

5 The CET1, MREL, leverage ratios and risk-weighted assets at 31 December 2019 and 31 December 2018 are reported on a pro forma basis, reflecting the dividend paid up by the Insurance business in the subsequent first quarter period. The pro forma CET1 ratio at 31 December 2018 incorporates the effects of the share buyback announced in February 2019 and is reported post dividend accrual.

# Quarterly information

| | Quarter ended 31 Dec 2019 £m | Quarter ended 30 Sept 2019 £m | Quarter ended 30 June 2019 £m | Quarter ended 31 Mar 2019 £m | Quarter ended 31 Dec 2018 £m | Quarter ended 30 Sept 2018 £m | Quarter ended 30 June 2018 £m | Quarter ended 31 Mar 2018 £m |
|---|---|---|---|---|---|---|---|---|
| Net interest income | 3,102 | 3,130 | 3,062 | 3,083 | 3,170 | 3,200 | 3,173 | 3,171 |
| Other income | 1,267 | 1,315 | 1,594 | 1,556 | 1,400 | 1,486 | 1,713 | 1,411 |
| Operating lease depreciation | (236) | (258) | (254) | (219) | (225) | (234) | (245) | (252) |
| **Net income** | 4,133 | 4,187 | 4,402 | 4,420 | 4,345 | 4,452 | 4,641 | 4,330 |
| Operating costs | (2,058) | (1,911) | (1,949) | (1,957) | (2,151) | (1,990) | (2,016) | (2,008) |
| Remediation | (219) | (83) | (123) | (20) | (234) | (109) | (197) | (60) |
| **Total costs** | (2,277) | (1,994) | (2,072) | (1,977) | (2,385) | (2,099) | (2,213) | (2,068) |
| **Trading surplus** | 1,856 | 2,193 | 2,330 | 2,443 | 1,960 | 2,353 | 2,428 | 2,262 |
| Impairment | (341) | (371) | (304) | (275) | (197) | (284) | (198) | (258) |
| **Underlying profit** | 1,515 | 1,822 | 2,026 | 2,168 | 1,763 | 2,069 | 2,230 | 2,004 |
| Restructuring | (191) | (98) | (56) | (126) | (267) | (235) | (239) | (138) |
| Volatility and other items | 122 | 126 | (126) | (339) | (270) | (17) | (16) | (174) |
| Payment protection insurance provision | – | (1,800) | (550) | (100) | (200) | – | (460) | (90) |
| **Statutory profit before tax** | 1,446 | 50 | 1,294 | 1,603 | 1,026 | 1,817 | 1,515 | 1,602 |
| Tax expense[1] | (427) | (288) | (269) | (403) | (260) | (394) | (369) | (431) |
| **Statutory profit (loss) after tax**[1] | 1,019 | (238) | 1,025 | 1,200 | 766 | 1,423 | 1,146 | 1,171 |
| Banking net interest margin | 2.85% | 2.88% | 2.89% | 2.91% | 2.92% | 2.93% | 2.93% | 2.93% |
| Average interest-earning banking assets | £437bn | £435bn | £433bn | £433bn | £436bn | £435bn | £436bn | £437bn |
| Cost:income ratio | 55.1% | 47.6% | 47.1% | 44.7% | 54.9% | 47.1% | 47.7% | 47.8% |
| Asset quality ratio | 0.30% | 0.33% | 0.27% | 0.25% | 0.18% | 0.25% | 0.18% | 0.23% |
| Gross asset quality ratio | 0.39% | 0.40% | 0.38% | 0.30% | 0.30% | 0.30% | 0.26% | 0.27% |
| Underlying return on tangible equity | 12.2% | 14.3% | 15.6% | 17.0% | 13.6% | 15.9% | 17.3% | 15.4% |
| Return on tangible equity | 11.0% | (2.8)% | 10.5% | 12.5% | 7.8% | 14.8% | 11.9% | 12.3% |
| Loans and advances to customers[2] | £440bn | £447bn | £441bn | £441bn | £444bn | £445bn | £442bn | £445bn |
| Customer deposits[3] | £412bn | £419bn | £418bn | £417bn | £416bn | £422bn | £418bn | £413bn |
| Loan to deposit ratio | 107% | 107% | 106% | 106% | 107% | 105% | 106% | 108% |
| Pro forma risk-weighted assets[4] | £203bn | £209bn | £207bn | £208bn | £206bn | £207bn | £207bn | £211bn |
| Tangible net assets per share | 50.8p | 52.0p | 53.0p | 53.4p | 53.0p | 51.3p | 52.1p | 52.3p |

1 Comparatives for 2018 restated to reflect amendments to IAS 12, see basis of presentation on page 206.

2 Excludes reverse repos.

3 Excludes repos.

4 Risk-weighted assets at 30 June 2018 are reported on a pro forma basis reflecting the sale of the Irish mortgage portfolio.

# Balance sheet analysis

| | At 31 Dec 2019 £bn | At 30 Sept 2019 £bn | Change % | At 30 June 2019 £bn | Change % | At 31 Dec 2018 £bn | Change % |
|---|---|---|---|---|---|---|---|
| **Loans and advances to customers** | | | | | | | |
| Open mortgage book | **270.1** | 271.0 | – | 264.9 | 2 | 266.6 | 1 |
| Closed mortgage book | **18.5** | 19.1 | (3) | 19.8 | (7) | 21.2 | (13) |
| Credit cards | **17.7** | 17.7 | – | 17.7 | – | 18.1 | (2) |
| UK Retail unsecured loans | **8.4** | 8.4 | – | 8.2 | 2 | 7.9 | 6 |
| UK Motor Finance | **15.6** | 15.6 | – | 15.5 | 1 | 14.6 | 7 |
| Overdrafts | **1.3** | 1.3 | – | 1.2 | 8 | 1.3 | – |
| Retail other[1] | **9.0** | 9.2 | (2) | 9.0 | – | 8.6 | 5 |
| SME[2] | **32.1** | 32.4 | (1) | 32.3 | (1) | 31.8 | 1 |
| Mid Markets[3] | **29.1** | 30.7 | (5) | 30.6 | (5) | 31.7 | (8) |
| Global Corporates and Financial Institutions | **30.8** | 33.7 | (9) | 34.7 | (11) | 34.4 | (10) |
| Commercial Banking other | **5.2** | 5.2 | – | 4.3 | 21 | 4.3 | 21 |
| Wealth | **0.9** | 0.9 | – | 0.9 | – | 0.9 | – |
| Central items | **1.7** | 2.0 | (15) | 1.9 | (11) | 3.0 | (43) |
| **Loans and advances to customers[4]** | **440.4** | 447.2 | (2) | 441.0 | – | 444.4 | (1) |
| **Customer deposits** | | | | | | | |
| Retail current accounts | **76.9** | 76.1 | 1 | 76.0 | 1 | 73.7 | 4 |
| Commercial current accounts[2,5] | **34.9** | 34.6 | 1 | 34.0 | 3 | 34.9 | – |
| Retail relationship savings accounts | **144.5** | 144.3 | – | 144.4 | – | 145.9 | (1) |
| Retail tactical savings accounts | **13.3** | 14.1 | (6) | 15.3 | (13) | 16.8 | (21) |
| Commercial deposits[2,6] | **127.6** | 135.8 | (6) | 133.2 | (4) | 130.1 | (2) |
| Wealth | **13.7** | 13.6 | 1 | 13.8 | (1) | 14.1 | (3) |
| Central items | **0.9** | 0.7 | 29 | 0.9 | – | 0.8 | 13 |
| **Total customer deposits[7]** | **411.8** | 419.2 | (2) | 417.6 | (1) | 416.3 | (1) |
| **Total assets[8]** | **833.9** | 858.5 | (3) | 822.2 | 1 | 797.6 | 5 |
| **Total liabilities[8]** | **786.1** | 810.4 | (3) | 773.2 | 2 | 747.4 | 5 |
| Shareholders' equity | **41.7** | 42.5 | (2) | 43.4 | (4) | 43.4 | (4) |
| Other equity instruments | **5.9** | 5.4 | 9 | 5.4 | 9 | 6.5 | (9) |
| Non-controlling interests | **0.2** | 0.2 | – | 0.2 | – | 0.3 | (33) |
| **Total equity** | **47.8** | 48.1 | (1) | 49.0 | (2) | 50.2 | (5) |
| Ordinary shares in issue, excluding own shares | **70,031m** | 70,007m | – | 70,740m | (1) | 71,149m | (2) |

1 Primarily Europe.

2 Includes Retail Business Banking.

3 Includes Mid Corporates (31 December 2019: £5.3 billion; 30 September 2019: £5.2 billion; 30 June 2019: £5.4 billion; 31 December 2018: £5.8 billion).

4 Excludes reverse repos.

5 Primarily non-interest-bearing Commercial Banking current accounts.

6 Primarily Commercial Banking interest-bearing accounts.

7 Excludes repos.

8 The adoption of IFRS 16 on 1 January 2019 resulted in the recognition of a right-of-use asset of £1.7 billion and lease liabilities of £1.8 billion.

# Segmental analysis – underlying basis

| 2019 | Retail £m | Commercial Banking £m | Insurance and Wealth £m | Central items £m | Group £m |
|---|---|---|---|---|---|
| Net interest income | 8,807 | 2,918 | 112 | 540 | 12,377 |
| Other income | 2,014 | 1,422 | 2,021 | 275 | 5,732 |
| Operating lease depreciation | (946) | (21) | – | – | (967) |
| **Net income** | 9,875 | 4,319 | 2,133 | 815 | 17,142 |
| Operating costs | (4,760) | (2,081) | (982) | (52) | (7,875) |
| Remediation | (238) | (155) | (50) | (2) | (445) |
| **Total costs** | (4,998) | (2,236) | (1,032) | (54) | (8,320) |
| **Trading surplus** | 4,877 | 2,083 | 1,101 | 761 | 8,822 |
| Impairment | (1,038) | (306) | – | 53 | (1,291) |
| **Underlying profit** | 3,839 | 1,777 | 1,101 | 814 | 7,531 |

| | | | | | |
|---|---|---|---|---|---|
| Banking net interest margin | 2.63% | 3.14% | | | 2.88% |
| Average interest-earning banking assets | £341.6bn | £92.2bn | £0.9bn | – | £434.7bn |
| Asset quality ratio | 0.30% | 0.30% | | | 0.29% |
| Return on risk-weighted assets | 3.99% | 2.14% | | | 3.65% |
| Loans and advances to customers[1] | £342.3bn | £95.5bn | £0.9bn | £1.7bn | £440.4bn |
| Customer deposits[2] | £252.1bn | £145.1bn | £13.7bn | £0.9bn | £411.8bn |
| Risk-weighted assets | £98.4bn | £77.4bn | £1.3bn | £26.3bn | £203.4bn |

| 2018 | Retail[3] £m | Commercial Banking[3] £m | Insurance and Wealth £m | Central items[3] £m | Group £m |
|---|---|---|---|---|---|
| Net interest income | 9,060 | 3,013 | 123 | 518 | 12,714 |
| Other income | 2,097 | 1,670 | 1,865 | 378 | 6,010 |
| Operating lease depreciation | (921) | (35) | – | – | (956) |
| Net income | 10,236 | 4,648 | 1,988 | 896 | 17,768 |
| Operating costs | (4,897) | (2,191) | (1,021) | (56) | (8,165) |
| Remediation | (267) | (203) | (39) | (91) | (600) |
| Total costs | (5,164) | (2,394) | (1,060) | (147) | (8,765) |
| Trading surplus | 5,072 | 2,254 | 928 | 749 | 9,003 |
| Impairment | (861) | (71) | (1) | (4) | (937) |
| Underlying profit | 4,211 | 2,183 | 927 | 745 | 8,066 |

| | | | | | |
|---|---|---|---|---|---|
| Banking net interest margin | 2.68% | 3.27% | | | 2.93% |
| Average interest-earning banking assets | £342.3bn | £91.2bn | £0.8bn | £1.7bn | £436.0bn |
| Asset quality ratio | 0.25% | 0.06% | | | 0.21% |
| Return on risk-weighted assets | 4.57% | 2.50% | | | 3.86% |
| Loans and advances to customers[1] | £340.1bn | £100.4bn | £0.9bn | £3.0bn | £444.4bn |
| Customer deposits[2] | £252.8bn | £148.6bn | £14.1bn | £0.8bn | £416.3bn |
| Risk-weighted assets | £93.5bn | £86.5bn | £1.2bn | £25.2bn | £206.4bn |

1 Excludes reverse repos.

2 Excludes repos.

3 Prior period segmental comparatives restated to reflect the transfer of the Cardnet business from Retail into Commercial Banking and certain equities business from Commercial Banking into Central items.

## Alternative performance measures

The Group uses a number of alternative performance measures, including underlying profit, in the discussion of its business performance and financial position. Further information is provided on page 331.

## Underlying basis

In order to allow a comparison of the Group's underlying performance, the results are adjusted for certain items including restructuring, severance related costs, the rationalisation of the non-branch property portfolio, the establishment of the Schroders partnership, the integration of MBNA and Zurich's UK workplace pensions and savings business, volatility and other items, which includes the effects of certain asset sales, the volatility relating to the Group's hedging arrangements and that arising in the insurance businesses, insurance gross up, the unwind of acquisition related fair value adjustments and the amortisation of purchased intangible assets and payment protection insurance provisions.

# Divisional results – Retail

## Performance Summary

| | 2019 £m | 2018[1] £m | Change % |
|---|---|---|---|
| Net interest income | **8,807** | 9,060 | (3) |
| Other income | **2,014** | 2,097 | (4) |
| Operating lease depreciation | **(946)** | (921) | (3) |
| **Net income** | **9,875** | 10,236 | (4) |
| Operating costs | **(4,760)** | (4,897) | 3 |
| Remediation | **(238)** | (267) | 11 |
| **Total costs** | **(4,998)** | (5,164) | 3 |
| **Trading surplus** | **4,877** | 5,072 | (4) |
| Impairment | **(1,038)** | (861) | (21) |
| **Underlying profit** | **3,839** | 4,211 | (9) |

| | | | |
|---|---|---|---|
| Banking net interest margin | **2.63%** | 2.68% | (5)bp |
| Average interest-earning banking assets | **£341.6bn** | £342.3bn | – |
| Asset quality ratio | **0.30%** | 0.25% | 5bp |
| Return on risk-weighted assets | **3.99%** | 4.57% | (58)bp |

| | At 31 Dec 2019 £bn | At 31 Dec 2018 £bn | Change % |
|---|---|---|---|
| Open mortgage book | **270.1** | 266.6 | 1 |
| Closed mortgage book | **18.5** | 21.2 | (13) |
| Credit cards | **17.7** | 18.1 | (2) |
| UK unsecured loans | **8.4** | 7.9 | 6 |
| UK Motor Finance | **15.6** | 14.6 | 7 |
| Business Banking | **1.7** | 1.8 | (6) |
| Overdrafts | **1.3** | 1.3 | – |
| Other[2] | **9.0** | 8.6 | 5 |
| **Loans and advances to customers** | **342.3** | 340.1 | 1 |
| Operating lease assets | **4.3** | 4.7 | (9) |
| **Total customer assets** | **346.6** | 344.8 | 1 |
| Current Accounts | **76.9** | 73.7 | 4 |
| Relationship savings[3] | **161.9** | 162.3 | – |
| Tactical savings | **13.3** | 16.8 | (21) |
| **Customer deposits** | **252.1** | 252.8 | – |
| **Risk-weighted assets** | **98.4** | 93.5 | 5 |

1 Prior period comparatives restated to reflect the transfer of the Cardnet business from Retail into Commercial Banking.

2 Includes Europe and run-off.

3 Includes Business Banking.

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# Divisional results – Commercial Banking

## Performance summary

| | 2019 £m | 2018[1] £m | Change % |
|---|---|---|---|
| Net interest income | **2,918** | 3,013 | (3) |
| Other income | **1,422** | 1,670 | (15) |
| Operating lease depreciation | **(21)** | (35) | 40 |
| **Net income** | **4,319** | 4,648 | (7) |
| Operating costs | **(2,081)** | (2,191) | 5 |
| Remediation | **(155)** | (203) | 24 |
| **Total costs** | **(2,236)** | (2,394) | 7 |
| **Trading surplus** | **2,083** | 2,254 | (8) |
| Impairment | **(306)** | (71) | |
| **Underlying profit** | **1,777** | 2,183 | (19) |

| | | | |
|---|---|---|---|
| Banking net interest margin | **3.14%** | 3.27% | (13)bp |
| Average interest-earning banking assets | **£92.2bn** | £91.2bn | 1 |
| Asset quality ratio | **0.30%** | 0.06% | 24bp |
| Return on risk-weighted assets | **2.14%** | 2.50% | (36)bp |

| | At 31 Dec 2019 £bn | At 31 Dec 2018 £bn | Change % |
|---|---|---|---|
| SME | **30.4** | 30.0 | 1 |
| Mid Markets[2] | **29.1** | 31.7 | (8) |
| Global Corporates and Financial Institutions | **30.8** | 34.4 | (10) |
| Other | **5.2** | 4.3 | 21 |
| **Loans and advances to customers** | **95.5** | 100.4 | (5) |
| | | | |
| *SME including Retail Business Banking* | **32.1** | 31.8 | 1 |
| | | | |
| **Customer deposits** | **145.1** | 148.6 | (2) |
| *Current accounts including Retail Business Banking* | **34.9** | 34.9 | – |
| *Other deposits including Retail Business Banking* | **127.6** | 130.1 | (2) |
| Risk-weighted assets | **77.4** | 86.5 | (11) |

1 Prior period segmental comparatives restated to reflect the transfer of the Cardnet business from Retail into Commercial Banking and certain equities business from Commercial Banking into Central items.

2 Includes Mid Corporates (31 December 2019: £5.3 billion; 31 December 2018: £5.8 billion).

# Divisional results – Insurance and Wealth

## Performance summary

| | 2019 £m | 2018 £m | Change % |
|---|---|---|---|
| Net interest income | 112 | 123 | (9) |
| Other income | 2,021 | 1,865 | 8 |
| **Net income** | 2,133 | 1,988 | 7 |
| Operating costs | (982) | (1,021) | 4 |
| Remediation | (50) | (39) | (28) |
| **Total costs** | (1,032) | (1,060) | 3 |
| **Trading surplus** | 1,101 | 928 | 19 |
| Impairment | – | (1) | |
| **Underlying profit** | 1,101 | 927 | 19 |

| | | | |
|---|---|---|---|
| Life and pensions sales (PVNBP)[1] | 17,515 | 14,384 | 22 |
| General insurance underwritten new GWP[2] | 127 | 107 | 19 |
| General insurance underwritten total GWP[2] | 671 | 690 | (3) |
| General insurance combined ratio | 82% | 89% | (7)pp |

| | At 31 Dec 2019 £bn | At 31 Dec 2018 £bn | % |
|---|---|---|---|
| Insurance Solvency II ratio[3] | 170% | 165% | 5pp |
| UK Wealth Loans and advances to customers | 0.9 | 0.9 | – |
| UK Wealth Customer deposits | 13.7 | 14.1 | (3) |
| UK Wealth Risk-weighted assets | 1.3 | 1.2 | 8 |
| Total customer assets under administration | 170.0 | 141.3 | 20 |

## Income by product group

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | New business £m | Existing business £m | Total £m | New business £m | Existing business £m | Total £m |
| Workplace, planning and retirement | 387 | 120 | 507 | 333 | 153 | 486 |
| Individual and bulk annuities | 209 | 68 | 277 | 160 | 84 | 244 |
| Protection | 21 | 24 | 45 | 20 | 22 | 42 |
| Longstanding LP&I | 11 | 384 | 395 | 13 | 414 | 427 |
| | 628 | 596 | 1,224 | 526 | 673 | 1,199 |
| Life and pensions experience and other items | | | 255 | | | 143 |
| General insurance | | | 326 | | | 272 |
| | | | 1,805 | | | 1,614 |
| Wealth | | | 328 | | | 374 |
| **Net income** | | | 2,133 | | | 1,988 |

1 Present value of new business premiums. Further information on page 331.

2 Gross written premiums.

3 Equivalent regulatory view of ratio (including With Profits funds) at 31 December 2019 was 154 per cent (31 December 2018: 156 per cent).

# Central items

| | 2019 £m | 2018[1] £m | Change % |
|---|---|---|---|
| Net income | **815** | 896 | (9) |
| Operating costs | **(52)** | (56) | 7 |
| Remediation | **(2)** | (91) | 98 |
| **Total costs** | **(54)** | (147) | 63 |
| **Trading surplus** | **761** | 749 | 2 |
| Impairment | **53** | (4) | |
| **Underlying profit** | **814** | 745 | 9 |

1 Prior periods segmental comparatives restated to reflect the transfer of certain equities business from Commercial Banking into Central items.

Central items includes income and expenditure not attributed to divisions, including the costs of certain central and head office functions, and the Group's private equity business, Lloyds Development Capital.

Net income includes the central recovery of the Group's distributions on other equity instruments and gains and losses on the sale of gilts and other liquid assets.

During 2019, impairment included releases relating to the reassessment of credit risk associated with debt instruments held within the Group's equity investments business.

# Other financial information



## Reconciliation between statutory and underlying basis results

The table below sets out the reconciliation from the statutory results to the underlying basis results.

| | | Removal of: | | | |
|---|---|---|---|---|---|
| **2019** | **Statutory basis £m** | **Volatility and other items[1,2] £m** | **Insurance gross up[3] £m** | **PPI £m** | **Underlying basis £m** |
| Net interest income | **10,180** | **379** | **1,818** | **–** | **12,377** |
| Other income, net of insurance claims | **8,179** | **(426)** | **(2,021)** | **–** | **5,732** |
| Operating lease depreciation | | **(967)** | **–** | **–** | **(967)** |
| **Net income** | **18,359** | **(1,014)** | **(203)** | **–** | **17,142** |
| Operating expenses[4] | **(12,670)** | **1,697** | **203** | **2,450** | **(8,320)** |
| **Trading surplus** | **5,689** | **683** | **–** | **2,450** | **8,822** |
| Impairment | **(1,296)** | **5** | **–** | **–** | **(1,291)** |
| **Profit before tax** | **4,393** | **688** | **–** | **2,450** | **7,531** |
| 2018 | | | | | |
| Net interest income | 13,396 | 152 | (834) | – | 12,714 |
| Other income, net of insurance claims | 5,230 | 107 | 673 | – | 6,010 |
| Operating lease depreciation | | (956) | – | – | (956) |
| Net income | 18,626 | (697) | (161) | – | 17,768 |
| Operating expenses[4] | (11,729) | 2,053 | 161 | 750 | (8,765) |
| Trading surplus | 6,897 | 1,356 | | 750 | 9,003 |
| Impairment | (937) | – | – | – | (937) |
| Profit before tax | 5,960 | 1,356 | – | 750 | 8,066 |

1 In the year ended 31 December 2019 this comprises the effects of market volatility and asset sales (gains of £126 million); the amortisation of purchased intangibles (£68 million); restructuring (£471 million, comprising severance related costs, the integration of Zurich's UK workplace pensions and savings business and costs associated with the establishment of the Schroders Personal Wealth Joint venture); and the fair value unwind and other items (losses of £275 million).

2 In the year ended 31 December 2018 this comprises the effects of market volatility and asset sales (losses of £50 million); the amortisation of purchased intangibles (£108 million); restructuring (£879 million, comprising severance related costs, the rationalisation of the non-branch property portfolio, the work on implementing the ring-fencing requirements and the integration of MBNA and Zurich's UK workplace pensions and savings business); and the fair value unwind and other items (losses of £319 million).

3 The Group's insurance businesses' income statements include income and expenditure which are attributable to the policyholders of the Group's long-term assurance funds. These items have no impact in total upon the profit attributable to equity shareholders and, in order to provide a clearer representation of the underlying trends within the business, these items are shown net within the underlying results.

4 The statutory basis figure is the aggregate of operating costs and operating lease depreciation.

Other financial information continued

## Banking net interest margin and average interest-earning assets

| | 2019 | 2018 |
|---|---|---|
| **Group net interest income – statutory basis (£m)** | **10,180** | 13,396 |
| Insurance gross up (£m) | **1,818** | (834) |
| Volatility and other items (£m) | **379** | 152 |
| **Group net interest income – underlying basis (£m)** | **12,377** | 12,714 |
| Non-banking net interest expense (£m)[1] | **145** | 54 |
| **Banking net interest income – underlying basis (£m)** | **12,522** | 12,768 |
| **Net loans and advances to customers (£bn)[2]** | **440.4** | 444.4 |
| Impairment provision and fair value adjustments (£bn) | **3.9** | 4.0 |
| Non-banking items: | | |
| Fee-based loans and advances (£bn) | **(6.3)** | (7.2) |
| Other non-banking (£bn) | **(3.1)** | (4.7) |
| **Gross banking loans and advances (£bn)** | **434.9** | 436.5 |
| Averaging (£bn) | **(0.2)** | (0.5) |
| **Average interest-earning banking assets (£bn)** | **434.7** | 436.0 |
| **Banking net interest margin (%)** | **2.88** | 2.93 |

1 2019 includes impact from the implementation of IFRS 16.

2 Excludes reverse repos.

## Volatility arising in insurance businesses

Volatility included in the Group's statutory results before tax comprises the following:

| | 2019 £m | 2018 £m |
|---|---|---|
| Insurance volatility | **230** | (506) |
| Policyholder interests volatility | **193** | 46 |
| Total volatility | **423** | (460) |
| Insurance hedging arrangements | **(347)** | 357 |
| **Total** | **76** | (103) |

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.

In-year volatility movements were largely driven by insurance volatility arising from interest rate and credit spread movements. The capital impact of equity market movements is now hedged within Insurance and this also reduces the IFRS earnings exposure to equity market movements.

The Group actively manages its exposures to interest rate, foreign currency exchange rate, inflation and market movements within the banking book through a comprehensive hedging strategy. This helps to mitigate earnings volatility and reduces the impact of market movements on the capital position.

## Tangible net assets per share

The table below sets out a reconciliation of the Group's shareholders' equity to its tangible net assets.

| | At 31 Dec 2019 £m | At 31 Dec 2018 £m |
|---|---|---|
| Shareholders' equity | **41,697** | 43,434 |
| Goodwill | **(2,324)** | (2,310) |
| Intangible assets | **(3,808)** | (3,347) |
| Purchased value of in-force business | **(247)** | (271) |
| Other, including deferred tax effects | **269** | 228 |
| **Tangible net assets** | **35,587** | 37,734 |
| | | |
| Ordinary shares in issue, excluding own shares | **70,031m** | 71,149m |
| Tangible net assets per share | **50.8p** | 53.0p |

## Return on tangible equity

| | 2019 | 2018 |
|---|---|---|
| Average shareholders' equity (£bn) | **43.0** | 43.0 |
| Average intangible assets (£bn) | **(5.9)** | (5.4) |
| **Average tangible equity (£bn)** | **37.1** | 37.6 |
| | | |
| Underlying profit after tax (£m)[1] | **5,690** | 6,057 |
| Add back amortisation of intangible assets (post tax) (£m) | **364** | 296 |
| Less profit attributable to non-controlling interests and other equity holders (£m) | **(547)** | (531) |
| **Adjusted underlying profit after tax (£m)** | **5,507** | 5,822 |
| | | |
| **Underlying return on tangible equity (%)[1]** | **14.8** | 15.5 |
| | | |
| Group statutory profit after tax (£m)[1] | **3,006** | 4,506 |
| Add back amortisation of intangible assets (post tax) (£m) | **364** | 296 |
| Add back amortisation of purchased intangible assets (post tax) (£m) | **74** | 111 |
| Less profit attributable to non-controlling interests and other equity holders (£m)[1] | **(547)** | (531) |
| **Adjusted statutory profit after tax (£m)** | **2,897** | 4,382 |
| | | |
| **Statutory return on tangible equity (%)** | **7.8** | 11.7 |

1 Prior period restated to reflect amendments to IAS 12, see basis of presentation on page 206.

## Share buyback

During 2019, the Group completed £1.1 billion of the announced up to £1.75 billion share buyback programme, with an average price paid of 57.89 pence per share. Through a reduction in the weighted average number of ordinary shares in issue, share buybacks have the effect of increasing earnings per share and, depending on the average price paid per share, can either increase or decrease the tangible net assets per share. The 2019 share buyback had the effect of increasing the earnings per share by 0.1 pence and decreasing the tangible net assets per share by 0.2 pence.

## Number of employees (full-time equivalent)

| | At 31 Dec 2019 | At 31 Dec 2018[1] |
|---|---|---|
| Retail | **35,327** | 35,344 |
| Commercial Banking | **6,605** | 7,188 |
| Insurance and Wealth | **5,246** | 5,610 |
| Group functions and services | **17,797** | 18,470 |
| | **64,975** | 66,612 |
| Agency staff | **(1,906)** | (1,685) |
| **Total number of employees** | **63,069** | 64,927 |

1 2018 figures restated to reflect the Group's current structure.

## Governance




# Top 50 Women in Engineering

A second year apprentice training with the Coventry-based Lloyds Bank Advanced Manufacturing Training Centre has been named as one of the top 50 women in engineering in the UK.

Melissa Chigubu aged 19, has been given the accolade by the Women's Engineering Society at a ceremony at the Royal Academy of Engineering. The award was founded by the Women's Engineering Society in 2016.

It aims to address the skills shortage in engineering and highlight the discrepancy between men and women entering engineering and manufacturing.

Melissa came to the UK in 2012 and was the first female to complete the Foundation Gateway in the Advanced Manufacturing Training Centre's new Apprenticeship Engineering Standard programme.

**www.lloydsbankinggroup.com/our-group/responsible-business/**

## A letter from our Chairman

# Delivering on our purpose – Helping Britain Prosper

**The Board recognises the importance of meeting the Group's responsibilities and duties both to shareholders and the communities we serve across the UK.**

**Lord Blackwell**
Chairman

## Chairman's Letter

This Corporate Governance Report details our approach to governance in practice, how the Board operates and the key activities of the Board during the year, together with information on the annual Board evaluation process. It also includes the reports from each of the Board's principal Committees.

The Board recognises the importance of meeting the Group's responsibilities and duties both to shareholders and the communities we serve across the UK. These are embedded into our processes and thinking. Our commitment to good governance and the directors' duties, including under s.172 of the Companies Act 2006, make sure that we continually challenge our assumptions and risks. Our purpose to Help Britain Prosper reflects our understanding that a sustainable business organisation needs to continuously demonstrate its value as a responsible corporate citizen. Further details of how the Board takes account of shareholder and wider stakeholder interests in its strategic planning and decision making processes are set out on pages 20 to 25.

A major focus over the last year has been the continued implementation of our strategic transformation programme. This has required a substantial investment in colleague skills and culture to support the re-shaping of roles around the new ways of working. The Board has devoted considerable time to reviewing the way this is being implemented, including a two day joint Board and Executive offsite. We have paid particular attention to the management of the risks arising from the implementation of new technologies, the new ways of working and the overall pace of change. 2019 has also been the first year in which we have operated under the new ring-fencing governance requirements. Further details of the Group's ring-fencing governance structure and the Board's oversight of our strategic transformation programme are set out on pages 76 and 75 respectively.

## Board and Committee changes

Succession planning and the composition of the Board and its committees are important components of good governance. There were a number of changes to the Board and Committees during the year. George Culmer retired as Chief Financial Officer and Executive Director of the Group on 1 August 2019 and was succeeded by William Chalmers, who brought a wealth of experience to the Group. George was a crucial member of the team that helped turn Lloyds around and left with our thanks and best wishes for the future.

Following a recruitment process led by the Nomination and Governance Committee, Sarah Legg was appointed to the Board in December 2019 as a new independent Non-Executive Director and Catherine Woods will join the Board on 1 March 2020 as a new independent Non-Executive Director. While selected on merit, these appointments help meet our commitments to both gender and BAME diversity. Sarah became a member of the Audit and Board Risk Committees and Catherine will join the Board Risk and Remuneration Committees.

Anita Frew stepped down as Senior Independent Director on 1 December 2019 and will retire as Deputy Chairman and Non-Executive Director at the AGM in May 2020. Anita has been an extremely valuable Board member, and will be much missed. Alan Dickinson succeeded Anita as Senior Independent Director on 1 December 2019 and will also take on the role of Deputy Chairman following Anita's retirement from the Board. Alan's significant board, financial and regulatory experience, including as a chairman, make him ideally suited to this role.

Juan Colombás, Executive Director and Chief Operating Officer, announced that he plans to retire in July 2020 after many years as a senior executive in which he has made a major contribution to the transformation of the Group. In line with the UK Corporate Governance Code 2018 (the Code), I also announced that I plan to retire as Group Chairman at or before the AGM in 2021 as I will by then have served some nine years on the Group Board. The Board has initiated a search process to allow time to identify my successor and enable an orderly handover.

## Quarterly dividend

I am pleased to report that the Board approved the Group moving to the payment of quarterly dividends in 2020, with the first quarterly dividend in respect of the first quarter of 2020 payable in June 2020. The Group has around 2.4 million shareholders, the vast majority of whom are retail shareholders, and this approach will provide a more regular flow of dividend income to all shareholders whilst accelerating the receipt of payments. Further information on quarterly dividends can be found on pages 21 and 268.

## Board effectiveness

The Board carried out an annual evaluation of its effectiveness during the year. This was an internal evaluation, which ran between October 2019 and January 2020 and was overseen by the Nomination and Governance Committee. The process which was undertaken and the findings of the review can be found on pages 77 to 78, together with information about our progress against the 2018 review actions.

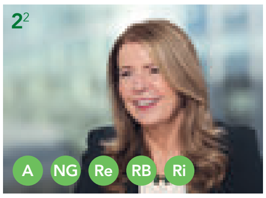
## Corporate Governance Code

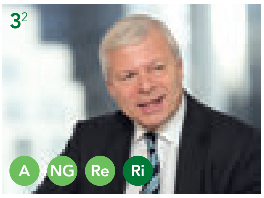
The year under review was the first year that the Code has applied to the Group. Our statement of compliance with the Code and a summary of the requirements of the Code can be found on pages 80 to 81. The Group also implemented our approach to workforce engagement and further information on this can be found on page 22.

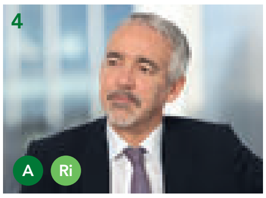
**Lord Blackwell**
Chairman

# Board of Directors

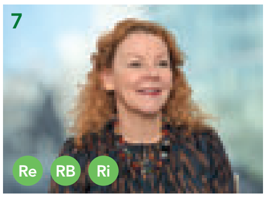
## Comprising Directors with the right mix of skills and experience, the Board is collectively responsible for overseeing delivery of the Group's strategy

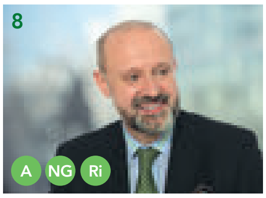



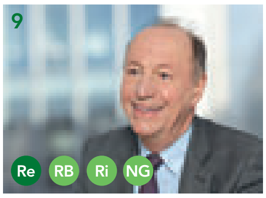



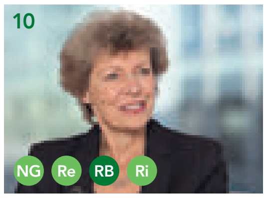









A Member of Audit Committee

Re Member of Remuneration Committee

NG Member of Nomination and Governance Committee

Ri Member of Board Risk Committee

RB Member of Responsible Business Committee

● Committee Chairman

1 Lord Blackwell has announced his plan to retire as Group Chairman at or before the AGM in 2021.

2 Alan Dickinson succeeded Anita Frew as Senior Independent Director on 1 December 2019 and will succeed her as Deputy Chairman when she retires from the Board at the AGM in May 2020.

3 Juan Colombás has announced his plan to retire from the Group in July 2020.

### 1. Lord Blackwell Chairman

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

**Skills, experience and contribution:**

Deep financial services knowledge including insurance and banking

Significant experience with strategic planning and implementation

Regulatory and public policy experience gained from senior positions in Downing Street, Regulators and a wide range of industries

Credibility with key stakeholders

Strong leadership qualities

Lord Blackwell is an experienced Chairman and Non-Executive Director within the financial services sector having previously been Chairman of Scottish Widows Group. He was previously Senior Independent Director and Chairman of the UK Board for Standard Life and Director of Group Development at NatWest Group. His past Board roles have also included Chairman of Interserve plc, and Non-Executive Director of Halma plc, Dixons Group, SEGRO and Ofcom. He was Head of the Prime Minister's Policy Unit from 1995 to 1997 and was appointed a Life Peer in 1997.

**External appointments:** Governor of the Yehudi Menuhin School and a member of the Governing Body of the Royal Academy of Music.

### 2. Anita Frew Deputy Chairman

**Appointed:** December 2010 (Board), May 2014 (Deputy Chairman), May 2017 to December 2019 (Senior Independent Director)

**Skills, experience and contribution:**

Significant board, financial and general management experience

Experience across a range of sectors, including banking, asset and investment management, manufacturing and utilities

Extensive experience as chairman in a range of industries

Strong board governance experience, including investor relations and remuneration

Anita was previously Chairman of Victrex plc, the Senior Independent Director of Aberdeen Asset Management and IMI plc, an Executive Director of Abbott Mead Vickers, a Non-Executive Director of Northumbrian Water and 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.

### 3. Alan Dickinson Senior Independent Director

**Appointed:** September 2014 (Board), December 2019 (Senior Independent Director)

**Skills, experience and contribution:**

Highly regarded retail and commercial banker

Strong strategic, risk and core banking experience

Regulatory and public policy experience

Alan has 37 years' experience with the Royal Bank of Scotland, most notably as Chief Executive of RBS UK. Alan was a Non-Executive Director of Willis Limited and Chairman of its Risk Committee. He was formerly Chairman of Brown, Shipley & Co. Limited, a Non-Executive Director of Nationwide Building Society, where he was Chairman of its Risk Committee and a Governor of Motability.

**External appointments:** Chairman of Urban&Civic plc and Non-Executive Director of England and Wales Cricket Board.

### 4. Simon Henry Independent Director

**Appointed:** June 2014

**Skills, experience and contribution:**

Deep international experience in board level strategy and execution

Extensive knowledge of financial markets, treasury and risk management

Qualification as an Audit Committee Financial Expert

Strong board governance experience, including investor relations and remuneration

Simon was formerly Chief Financial Officer and Executive Director of Royal Dutch Shell plc. He was also previously Chair of the European Round Table CFO Taskforce and a Member of the Main Committee of the 100 Group of UK FTSE CFOs.

**External appointments:** Non-Executive Director of Rio Tinto plc and Rio Tinto Limited and Chair of their Audit Committee, Independent Director of PetroChina Company Limited, Member of the Defence Board and Chair of the Defence Audit Committee, UK Government, Member of the Advisory Panel of CIMA and of the Advisory Board of the Centre for European Reform.

### 5. Sarah Legg Independent Director

**Appointed:** December 2019

**Skills, experience and contribution:**

Strong financial leadership skills

Significant experience in financial and regulatory reporting

Strong transformation programme experience

Sarah has spent her entire career in financial services with HSBC in finance leadership roles. She was the Group Financial Controller and a Group General Manager of HSBC until early 2019 and previously Chief Financial Officer for HSBC's Asia Pacific region. She also spent 8 years as a Non-Executive Director on the Board of Hang Seng Bank Limited, a Hong Kong listed bank.

**External appointments:** Honorary Vice President of The Hong Kong Society for Rehabilitation and Chair of the Campaign Advisory Board of King's College, Cambridge University.

**6. Lord Lupton CBE** Independent Director and Chairman of Lloyds Bank Corporate Markets plc

**Appointed:** June 2017

**Skills, experience and contribution:**

- Extensive international corporate experience, especially in financial markets
- Strong board governance experience, including investor relations and remuneration
- Regulatory and public policy experience
- Significant experience in strategic planning and implementation

Lord Lupton was Deputy Chairman of Baring Brothers, co-founded the London office of Greenhill & Co., and was Chairman of Greenhill Europe. He was previously Chairman of Trustees of Dulwich Picture Gallery, a Trustee of the British Museum, Governor of Downe House School and a member of the International Advisory Board of Global Leadership Foundation. He became a Life Peer in October 2015 and is a former Treasurer of the Conservative Party. He served on the House of Lords Select Committee on Charities.

**External appointments:** Senior Advisor to Greenhill Europe, Trustee of the Lovington Foundation and Chairman of the Board of Visitors of the Ashmolean Museum with effect from 1 January 2020.

**7. Amanda Mackenzie OBE** Independent Director

**Appointed:** October 2018

**Skills, experience and contribution:**

- Extensive experience in responsible business
- Considerable customer engagement experience
- Strong digital technology experience
- Significant marketing and brand background

Amanda was a member of Aviva's Group Executive for seven years and Chief Marketing and Communications Officer. Prior to her current role, Amanda was seconded from Aviva as Executive Adviser to Project Everyone, to help launch the United Nations Sustainable Development Goals. She has over 25 years' of commercial business practice, including director roles at British Airways AirMiles, BT, Hewlett Packard Inc, British Gas and as a Non-Executive Director of Mothercare plc. Amanda is a Life Fellow of the Royal Society of Arts and Fellow and past President of the Marketing Society.

**External appointments:** Chief Executive of Business in the Community – The Prince's Responsible Business Network.

**8. Nick Prettejohn** Independent Director and Chairman of Scottish Widows Group

**Appointed:** June 2014

**Skills, experience and contribution:**

- Deep financial services experience, particularly in insurance
- In-depth regulatory knowledge and experience
- Governance experience and strong leadership qualities
- Significant experience in strategic planning and implementation

Nick has served as Chief Executive of Lloyd's of London, Prudential UK and Europe and Chairman of Brit Insurance. He is a former Non-Executive Director of the Prudential Regulation Authority and of Legal & General Group Plc as well as Chairman of the Financial Services Practitioner Panel and the Financial Conduct Authority's Financial Advice Working Group. He was previously a Member of the BBC Trust and Chairman of the Britten-Pears Foundation.

**External appointments:** Chairman of Reach plc (formerly Trinity Mirror plc) and of their Nomination Committee. He is also Chairman of the Royal Northern College of Music and a member of the Board of Opera Ventures.

**9. Stuart Sinclair** Independent Director

**Appointed:** January 2016

**Skills, experience and contribution:**

- Extensive experience in retail banking, insurance and consumer finance
- Governance and regulatory experience
- Significant experience in strategic planning and implementation
- Experience in consumer analysis, marketing and distribution

Stuart is a former Non-Executive Director of TSB Banking Group plc, TSB Bank plc, LV Group, Virgin Direct and Vitality Health (formerly Prudential Health). He was previously the Interim Chairman of Provident Financial plc and a former Senior Independent Director of Swinton Group Limited. In his executive career, he was President and Chief Operating Officer of Aspen Insurance after spending nine years with General Electric as Chief Executive Officer of the UK Consumer Finance business then President of GE Capital China. Before that he was Chief Executive Officer of Tesco Personal Finance and Director of UK Retail Banking at the Royal Bank of Scotland. He was a Council member of The Royal Institute for International Affairs (Chatham House).

**External appointments:** Senior Independent Director and Chair of the Risk & Capital Committee at QBE UK Limited (formerly QBE Insurance (Europe) Limited).

**10. Sara Weller CBE** Independent Director

**Appointed:** February 2012

**Skills, experience and contribution:**

- Background in retail and associated sectors, including financial services
- Strong board governance experience, including investor relations and remuneration
- Passionate advocate of customers, the community, financial inclusion and the development of digital skills
- Considerable experience of boards at both executive and non-executive level

Sara's previous appointments include Managing Director of Argos, various senior positions at J Sainsbury (including Deputy Managing Director), Chairman of the Planning Inspectorate, Lead Non-Executive Director at the Department of Communities and Local Government, a Board member at the Higher Education Funding Council, a Governing Council Member of Cambridge University, a Non-Executive Director of Mitchells & Butlers 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, Lead Non-Executive Director at the Department for Work and Pensions, Chair of the Remuneration Committee of New College, Oxford and Trustee of Lloyds Bank Foundation for England and Wales.

**11. António Horta-Osório** Executive Director and Group Chief Executive

**Appointed:** January 2011 (Board), March 2011 (Group Chief Executive)

**Skills, experience and contribution:**

- Extensive experience in, and understanding of, both retail and commercial banking built over a period of more than 30 years, working both internationally and in the UK
- Drive, enthusiasm and commitment to customers
- Proven ability to build and lead strong management teams

António previously worked for Citibank and Goldman Sachs and held various senior management positions at Grupo Santander before becoming its Executive Vice President and member of the Group's Management Committee. He was a Non-Executive Director of Santander UK and subsequently its Chief Executive. He is also a former Non-Executive Director of the Court of the Bank of England.

**External appointments:** Non-Executive Director of EXOR N.V., Fundação Champalimaud and Sociedade Francisco Manuel dos Santos in Portugal, a member of the Board of Stichting INPAR Management/Enable and Chairman of the Wallace Collection.

**12. William Chalmers** Executive Director and Chief Financial Officer

**Appointed:** August 2019

**Skills, experience and contribution:**

- Significant board level strategic and financial leadership experience including strategic planning and development, mergers and acquisitions, equity and debt capital structuring and risk management
- Worked in financial services for over 25 years

William was previously Co-Head of the Global Financial Institutions Group at Morgan Stanley. Prior to that, he held a number of senior roles at Morgan Stanley, including Head of EMEA Financial Institutions Group. Before joining Morgan Stanley, William worked for JP Morgan, again in the Financial Institutions Group.

**External appointments:** None.

**13. Juan Colombás** Executive Director and Chief Operating Officer

**Appointed:** November 2013 (Board), January 2011 to September 2017 (Chief Risk Officer), September 2017 (Chief Operating Officer)

**Skills, experience and contribution:**

- Significant banking and risk management experience
- International business and management experience

Juan is responsible for leading a number of critical Group functions and driving the transformation activities across the Group in order to build the Bank of the Future. He was previously the Chief Risk Officer and an Executive Director of Santander's UK business. Prior to this, 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 was previously the Vice Chairman of the International Financial Risk Institute.

**External appointments:** Member of the FCA Practitioner Panel.

# Group Executive Committee

## Delivering our vision and managing a more agile organisation

### Executive Director members

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

**António Horta-Osório**
Executive Director and Group Chief Executive

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

Read his full biography on page 67

**William Chalmers**
Executive Director and Chief Financial Officer

William joined the Board in August 2019 as an executive director and the Chief Financial Officer.

Read his full biography on page 67.

**Juan Colombás**
Executive Director and Chief Operating Officer

Juan joined the Group as Chief Risk Officer in January 2011 and joined the Board as an Executive Director in November 2013. He became Chief Operating Officer in September 2017.

Read his full biography on page 67.

### Other members and attendees

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**1. Carla Antunes da Silva** Group Strategy, Corporate Development and Investor Relations Director

**Appointed:** June 2018 (GEC attendee)

**Skills and experience:** Carla joined the Group in October 2015 and led the 2018 to 2020 Group Strategic Review and, prior to that, the work on the Bank of the Future. Carla is responsible for supporting senior management with strategic decision making such as recommendations on mergers, acquisitions/disposals and corporate ventures, and also manages the Group's relationships with shareholders, analysts and the wider investment community. Prior to that Carla spent 18 years as an equity analyst leading the European Banks research team, with coverage of UK banks at Credit Suisse, JPMorgan and Deutsche Bank. Carla currently serves as a Non-Executive Director of Lloyds Bank Corporate Markets plc.

**2. John Chambers** Group Chief Information Officer

**Appointed:** June 2018 (GEC attendee)

**Skills and experience:** John joined the Group in February 2015 as Chief Information Officer for Group Operations, Functions and Enterprise and was appointed as the Group's Chief Information Officer in September 2017. During the course of his career, John has been responsible for delivering large scale IT solutions, building teams that can operate at scale and working as part of global operating environments such as Barclays, Capita and Indian headquartered IT and business process outsourcing firms.

**3. Kate Cheetham** Group General Counsel and Company Secretary

**Appointed:** July 2017 (GEC attendee)

**Skills and experience:** Kate was appointed Group General Counsel in January 2015 and Group Company Secretary in July 2019. Kate joined the Group in 2005 from Linklaters, where she was a corporate lawyer specialising in mergers and acquisitions transactions. Before her current role, Kate held a number of senior positions including Deputy Group General Counsel and General Counsel for Group Legal. Kate is a trustee of the Lloyds Bank Foundation for England and Wales and is a Non-Executive Director of Scottish Widows.

**4. Paul Day** Chief Internal Auditor

**Appointed:** September 2016 (GEC attendee)

**Skills and experience:** Paul joined the Group as a contractor in September 2016 and was formally employed by the Group in June 2017. He joined from Deloitte where he was a partner in the UK Financial Services practice and led the UK Financial Services Internal Audit business. Paul has specialised in internal and external audit roles across financial services for over 20 years, including 10 years in various leadership roles in Barclays Internal Audit.

**5. Antonio Lorenzo** Chief Executive, Scottish Widows and Group Director, Insurance and Wealth

**Appointed:** March 2011 (GEC)

**Skills and experience:** Antonio joined the Group 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 and Group Corporate Development, leading the division's growth strategy whilst completing the sale of TSB. At the end of 2015 he was appointed Chief Executive, Scottish Widows and Group Director, Insurance and during 2017 he also assumed responsibility for the Wealth division. 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 Alliance & Leicester and Bradford & Bingley and was Chief Financial Officer of Santander UK. Before Santander, Antonio spent over nine years at Arthur Andersen.

**6. Vim Maru** Group Director, Retail

**Appointed:** September 2013 (GEC)

**Skills and experience:** Vim joined the Group in June 2011 and is currently responsible for the Group's Retail products and distribution, as well as Customer Services and brands and marketing activity for the Group. He is also Executive Co-Sponsor for Ethnicity and holds a position on the UK Finance Board. Vim has extensive experience in Retail banking having worked in financial services for nearly 20 years. Prior to joining the Group, Vim spent 12 years at Santander in a range of roles in corporate strategy, mergers and acquisitions, the Life Division and most recently held the position of Director, Retail Products.

**7. Zak Mian** Group Director, Transformation

**Appointed:** August 2016 (GEC)

**Skills and experience:** Zak joined the Group in 1989 as a Business Analyst in IT and has carried out multiple roles involving Retail CIO, Head of IT Architecture and leading the Digital Transformation programme. He was appointed Group Director, Digital and Transformation in 2016 and his responsibilities increased in September 2017 as the Group Director, Transformation. He is responsible for the digital transformation of the Group, including all IT and business change, and ensuring we are ready to meet the future expectations of our customers.

**8. David Oldfield** Group Director, Commercial Banking

**Appointed:** May 2014 (GEC)

**Skills and experience:** David was appointed as Group Director for the Commercial Banking division in September 2017 responsible for supporting corporate clients from SMEs and Mid Corporates through to Large Corporates and Financial Institutions. David started his career with Lloyds Bank in 1986 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 his current role he was Group Director Retail and Consumer Finance, responsible for the Lloyds, Halifax, Bank of Scotland, Lex Autolease and Black Horse Brands including the retail branch networks, customer products and telephone banking, in addition to Retail Business Banking and UK Wealth businesses. David is a Fellow of the Chartered Institute of Bankers. He is also Group Executive Sponsor for Disability.

**9. Janet Pope** Chief of Staff and Group Director, Responsible Business and Inclusion

**Appointed:** January 2015 (GEC)

**Skills and experience:** Janet joined the Group in 2008 to run the Savings business. She was previously Chief Executive at Alliance Trust Savings, prior to which she was EVP Global Strategy at Visa International. Janet spent 10 years at Standard Chartered Bank where she held a variety of roles including Retail Banking MD for Africa and non-executive directorships at Standard Chartered Bank Zimbabwe, Kenya, Zambia and Botswana. Janet is Chair of the Charities Aid Foundation Bank and a Non-Executive Director of the Banking Standards Board. She is also the Group's Executive Sponsor for Sexual Orientation and Gender Identity.

**10. Stephen Shelley** Chief Risk Officer

**Appointed:** September 2017 (GEC)

**Skills and experience:** Stephen was appointed Chief Risk Officer in September 2017. He joined the Group in May 2011 as Chief Credit Officer for Wholesale, Commercial and International. In October 2012 he became Risk Director, Commercial Banking Risk and was also a member of the Commercial Banking Management Group. Prior to joining the Group, Stephen was Chief Risk Officer at Barclays Corporate and prior to that was Chief Credit Officer for the UK Retail and Corporate business in Barclays. In a 21-year career at Barclays, Stephen undertook a variety of roles in the front office and risk. Stephen is also the Group's Executive Sponsor for Gender Diversity and Equality.

**11. Letitia Smith** Group Director, Conduct, Compliance and Operational Risk

**Appointed:** June 2019 (GEC attendee)

**Skills and experience:** Letitia joined the Group in 2014, undertaking Conduct, Compliance and Operational Risk roles across both Retail and Commercial divisions before being appointed into her current role as the Group Director, Conduct, Compliance and Operational Risk in 2016. Prior to joining the Group, Letitia was Chief Risk Officer at Kleinwort Benson Private Bank with responsibility for Risk, Compliance, Legal, Internal Audit and Company Secretariat. She spent 11 years at RBS in various roles, but latterly as the Chief Risk Officer of the Wealth Division with responsibility for Risk and Compliance across several banks including Coutts UK and Coutts Switzerland. Letitia is also a qualified accountant and has a background in forensic accountancy.

**12. Jennifer Tippin** Group People and Productivity Director

**Appointed:** July 2017 (GEC)

**Skills and experience:** Jen was appointed as the Group People and Productivity Director in July 2017 and is responsible for several functions including people, property, sourcing and supply chain management, divestment and development and Group costs. Prior to this role, Jen was Group Customer Services and Managing Director, Business Banking. Jen joined the Group in 2005 having previously worked in the engineering and airline sector. Jen is a Non-Executive Director of Lloyds Bank Corporate Markets plc. In March 2020 Jen will join the Board of Morgan Sindall plc as a Non-Executive Director.

**13. Andrew Walton** Group Corporate Affairs Director

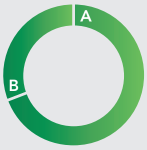
**Appointed:** September 2018 (GEC)

**Skills and experience:** Andrew joined the Group in September 2018, as Group Corporate Affairs Director, with responsibility for internal and external communications, reputation management and public affairs. Prior to joining the Group, Andrew was Senior Managing Director and Global Head of Financial Services for the strategic communications segment of FTI Consulting.

## Corporate governance report

# Our Board in 2019[1]

### Gender diversity

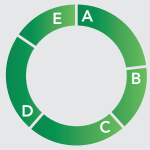



**A.** Male: 9
**B.** Female: 4

### Skills and experience
(Non-Executive Directors only)

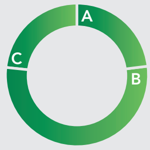
| Skill | Directors |
|---|---|
| Retail/Commercial Banking | 8 out of 10 |
| Financial markets/wholesale banking/ corporate clients | 8 out of 10 |
| Insurance | 6 out of 10 |
| Prudential and conduct risk in financial institutions | 10 out of 10 |
| Core technology operations | 5 out of 10 |
| Government/regulatory | 10 out of 10 |
| Consumer/marketing/distribution | 7 out of 10 |
| Strategic thinking | 10 out of 10 |
| Digital impact | 8 out of 10 |
| Major change programmes | 9 out of 10 |

### Board tenure




**A.** 0-2 years: 3
**B.** 2-4 years: 2
**C.** 4-6 years: 3
**D.** 6-8 years: 3
**E.** 8+ years: 2

### Age




**A.** 46-55: 3
**B.** 56-65: 7
**C.** 66-75: 3

1 Data as at 31 December 2019.

## Board and Committee composition and attendance at scheduled meetings in 2019[6]

| Board member | Board | Nomination and Governance Committee | Audit Committee | Board Risk Committee | Remuneration Committee | Responsible Business Committee |
|---|---|---|---|---|---|---|
| Lord Blackwell (C) | 11/11 | 7/7 (C) | – | 8/8 | 6/6 | 4/4 |
| António Horta-Osório | 11/11 | – | – | – | – | – |
| William Chalmers[1] | 3/3 | – | – | – | – | – |
| Juan Colombás | 11/11 | – | – | – | – | – |
| George Culmer[1] | 8/8 | – | – | – | – | – |
| Alan Dickinson[2] | 11/11 | 7/7 | 6/6 | 8/8 (C) | 6/6 | – |
| Anita Frew[2] | 11/11 | 7/7 | 6/6 | 8/8 | 6/6 | 3/4[4] |
| Simon Henry | 10/11[4] | – | 6/6 (C) | 7/8[4] | – | – |
| Sarah Legg[3] | – | – | – | – | – | – |
| Lord Lupton | 11/11 | – | 3/3 | 8/8 | – | 1/2[5] |
| Amanda Mackenzie | 11/11 | – | – | 8/8 | 3/3 | 4/4 |
| Nick Prettejohn | 11/11 | 5/5 | 6/6 | 8/8 | – | – |
| Stuart Sinclair | 11/11 | – | – | 8/8 | 6/6 (C) | 4/4 |
| Sara Weller | 11/11 | 7/7 | – | 7/8[4] | 6/6 | 4/4 (C) |

1 George Culmer retired from, and William Chalmers was appointed to, the Board on 1 August 2019.
2 Alan Dickinson succeeded Anita Frew as Senior Independent Director on 1 December 2019.
3 Sarah Legg joined the Board and respective Committees on 1 December 2019. There were no meetings in December 2019.
4 Unable to attend due to a scheduling clash with a prior business commitment.
5 Unable to attend due to a scheduling clash with another Group business commitment.
6 Where a Director is unable to attend a meeting s/he receives papers in advance and has the opportunity to provide comments to the Chairman of the Board or to the relevant Committee Chairman.
(C) Chairman

## Beyond Board meetings

Non-Executive Directors regularly meet with senior management and spend time increasing their understanding of the business through site visits, formal briefing sessions or more informal events including breakfast meetings with senior colleagues. These informal meetings allow Directors greater time to discuss business in an informal setting, ensuring that there is sufficient time for the Board to discuss matters of a material nature at Board meetings.

Non-Executive Directors see attendance at Board and Committee meetings as only one part of their role. In addition to the annual schedule of Board and Committee meetings, the Non-Executive Directors undertake a full programme of activities and engagements each year, please see pages 20 to 25 for more information.

Where further training or awareness is identified, such as new technology, regulations or sector advances, deep dives are held with the relevant field expert to provide overviews, chances to raise questions, and debate the impacts on business in an informal setting.

The Board held joint discussions with Scottish Widows Group Limited in April and Lloyds Bank Corporate Markets plc in September. These meetings are important in respect of both governance and the sharing of best practice. They also provide the opportunity for in-depth focus on both insurance and corporate markets matters. Performance and business updates are also provided, and, in the case of Lloyds Bank Corporate Markets plc, updates on key milestones in respect of the development of this new bank.

## How our Board works

# Meetings, activities and processes

### The right processes in place to deliver on our strategy

During the year, there were 11 scheduled Board meetings, with details of attendance shown on page 70. In addition to formal meetings, the Board meets as necessary to consider matters of a time-sensitive nature. The Chairman and the Chairmen of each Committee ensure Board and Committee meetings are structured to facilitate open discussion, debate and challenge.

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 Board appointments, internal control risk, financial reporting, governance and remuneration issues.

The management of all Committees is in keeping with the basis on which meetings of the Board are managed. Each of the Committees' structures facilitates open discussion and debate, with steps taken to ensure adequate time for members of the Committees to consider proposals which are put forward.

The Executive Directors make decisions within clearly defined parameters which are documented within the Corporate Governance Framework. However, where appropriate, any activities outside the ordinary course of business are brought to the full Board for their consideration, even if the matters fall within the agreed parameters. The Corporate Governance Framework helps to ensure that decisions are made by management with the correct authority. In the rare event of a Director being unable to attend a meeting, the Chairman of the respective meeting discusses the matters proposed with the Director concerned wherever possible, seeking their support and feedback accordingly. The Chairman subsequently represents those views at the meeting.

The Board recognises the need to be adaptable and flexible to respond to changing circumstances and emerging business priorities, whilst ensuring the continuing monitoring and oversight of core issues.

The Group has a comprehensive and continuous agenda setting and escalation process in place to ensure that 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 leads the process, assisted by the Group Chief Executive and Company Secretary. The process ensures that sufficient time is being set aside for strategic discussions and business critical items.

The process of escalating issues and agenda setting is reviewed at least annually as part of the Board effectiveness review with enhancements made to the process, where necessary, to ensure it remains effective. Details of the meeting process are provided below.

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 designated area on the secure electronic Board portal.

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

### Board meetings

**Start of the year**
- A yearly planner is prepared by the Company Secretary to map out the flow of key items of business to the Board
- Board venues are agreed and colleagues in the areas that the Board will visit are engaged at both senior management and operational level

**Agenda set**
- The Chairman holds monthly meetings to review the draft agenda and planner with the Company Secretary and Chief of Staff, as well as quarterly meetings with a wider group of central functions, to identify emerging issues
- The draft Board agenda is discussed with the Chairman and the Group Chief Executive and reviewed at GEC meetings
- Matters may be added to agendas in response to external events, Non-Executive Director requests, regulatory initiatives and the quarterly Board topic review meetings

**Papers compiled and distributed**
- Templates and guidelines are included within targeted training for authors of papers to ensure consistency and high quality of information
- Meeting packs are uploaded and communicated to all Directors via a secure electronic Board portal typically a week in advance of the meeting to ensure sufficient time to review the matters which are to be discussed and seek clarification or any additional information

**Before the meeting**
- Executive meetings are held ahead of all Board and Committee meetings to ensure matters being presented to the Board have been through a thorough discussion and escalation process
- Committee meetings are generally held prior to Board meetings, with the Chairman of each Committee then reporting matters discussed to the Board
- Non-Executive discussions and informal dinners are held prior to most Board meetings, some of which also include the Group Chief Executive

**Board meeting**
- Board meetings have certain standing items, such as a report from the Group Chief Executive and Chief Financial Officer on Group performance, reports from the Chairmen of Committees and principal subsidiaries and updates from certain GEC members
- The agenda includes free agenda discussion time
- Topics for deep dives or additional items are discussed when required and include business, governance and regulatory updates
- The Board makes full use of technology such as video conferencing, teleconferencing, a Board portal and tablets/devices in its meeting arrangements. This leads to greater flexibility, security and efficiency in Board paper distribution and meeting arrangements

**After the meeting**
- The Board has the chance to meet colleagues within the business and, if any additional meetings are required to provide more details, these are arranged
- Minutes and matters arising from the Board meeting are produced and circulated to the Directors for review and feedback
- Those responsible for matters arising are asked to provide updates to a subsequent meeting

How our Board works continued

# Key focus areas

## Discussions and decisions

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.

This page 72 and page 73 show the key focus areas of the Board during the year and highlight the link between those focus areas and our strategic objectives. Also listed are stakeholder groups central to the matters considered and decisions taken.

The agenda for each Board meeting is discussed in advance with the Chairman and Chief Executive Officer and reviewed at Group Executive Committee meetings and includes 30 minutes 'free agenda' discussion time. Regular updates are provided to the Board by the Chairmen of the Audit, Nomination and Governance, Remuneration, Responsible Business and Board Risk Committees as well as by the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer and the Chairman and the chairmen of the Lloyds Bank Corporate Markets plc and Scottish Widows Group Limited boards.

- Leading customer experience
- Digitising the Group
- Maximising Group capabilities
- Transforming ways of working

### CULTURE AND VALUES

**Reviewed and approved the Helping Britain Prosper Plan**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Community and Environment; Suppliers

**Discussed conduct, culture and values – culture dashboard and change management**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Colleagues; Regulatory and Government; Suppliers

**Received reports on responsible business including on climate change matters and sustainability**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Colleagues; Community and Environment; Shareholders; Suppliers; Regulatory and Government

**Reviewed and approved the Group's diversity policy**
Link to strategic priorities:
Link to stakeholder groups:
Colleagues

**Considered updates on workforce engagement**
Link to strategic priorities:
Link to stakeholder groups:
Colleagues

**Considered updates on proposed new Remuneration Policy**
Link to strategic priorities:
Link to stakeholder groups:
Colleagues; Regulatory and Government; Shareholders

### CUSTOMERS

**Discussed the Group's performance against customer dashboard**
Link to strategic priorities:
Link to stakeholder groups:
Customers

**Discussed improvements in customer outcomes from strategic transformation plan (GSR3)**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Regulatory and Government

**Discussed how the Group supports vulnerable customers and customers in financial difficulty**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Regulatory and Government

**Discussed the annual review of customer conduct framework and risk**
Link to stakeholder groups:
Customers; Regulatory and Government

**Deep dive on strong customer authentication**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Regulatory and Government

**Deep dive on Open Banking**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Regulatory and Government

**Discussed processes and outcomes for the fair treatment of customer complaints and remediation**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Regulatory and Government

**Deep dive on data ethics**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Regulatory and Government

### FINANCIAL

**Approved the 2019 budget**

**Discussed the regular finance report, forecasts and capital and liquidity positions**

**Reviewed and approved income statement, draft results and presentations to analysts**
Link to stakeholder groups:
Colleagues; Shareholders

**Reviewed and approved funding and liquidity plans and capital plan**
Link to stakeholder groups:
Regulatory and Government

**Approved the payment of final and interim dividends**
Link to stakeholder groups:
Shareholders

**Approved the launch of a share buyback programme and its subsequent curtailment as conditions changed**
Link to stakeholder groups:
Shareholders

**Approved the payment of quarterly dividends**
Link to stakeholder groups:
Shareholders

**Considered updates on structural hedging strategy & Group Corporate Treasury's regular management information report**
Link to stakeholder groups:
Regulatory and Government

**Received an annual update on pension scheme valuations**
Link to stakeholder groups:
Customers

**Discussed GSR3 and four year operating plan**
Link to strategic priorities:

**Reviewed and approved Basel Pillar 3 disclosures**
Link to stakeholder groups:
Regulatory and Government

**Reviewed and approved Annual Report and Form 20-F**
Link to stakeholder groups:
Regulatory and Government; Shareholders

**Reviewed and approved Group treasury plan 2020**
Link to stakeholder groups:
Regulatory and Government

## GOVERNANCE AND STAKEHOLDERS

**Considered an update on the implementation of the Group's ring-fencing model**
Link to stakeholder groups:
Customers; Regulatory and Government

**Discussed outcome of Board effectiveness review and agreed actions arising from it**
Link to stakeholder groups:
Shareholders

**Discussed Chairman's performance review**
Link to stakeholder groups:
Shareholders

**Approved AGM documentation and received update on voting**
Link to stakeholder groups:
Shareholders

**Reviewed and approved the corporate governance framework**
Link to stakeholder groups:
Shareholders

**Reviewed and approved various Group policies including the signing authorities, and Board and GEC dealing policy**
Link to stakeholder groups:
Colleagues; Regulatory and Government

**Considered updated Board skills matrix**
Link to stakeholder groups:
Shareholders

**Considered reviews of Chairman's fee (without Chairman present) and Non-Executive Directors' fees (with Non-Executive Directors abstaining)**

**Reviewed and approved going concern and viability statement**

**Discussed update on Banking Standards Board 2018 survey**
Link to stakeholder groups:
Colleagues; Regulatory and Government

**Approved Board and Board Committee appointments**

**Considered Board, Board Committee and Executive succession plans**
Link to stakeholder groups:
Colleagues; Shareholders

## REGULATORY

**Approved attestation of ring-fencing compliance**
Link to stakeholder groups:
Customers; Regulatory and Government

**Considered whistleblowing updates**
Link to stakeholder groups:
Colleagues; Customers; Regulatory and Government

**Considered regulatory updates**
Link to stakeholder groups:
Regulatory and Government

**Received updates on the Senior Manager and Certification Regime**
Link to stakeholder groups:
Regulatory and Government

**Discussed the FCA firm evaluation letter**
Link to stakeholder groups:
Regulatory and Government

**Held discussions with the PRA**
Link to stakeholder groups:
Regulatory and Government

## RISK MANAGEMENT

**Approved Group risk appetite**
Link to stakeholder groups:
Customers; Shareholders; Colleagues; Community and Environment; Regulatory and Government; Suppliers

**Considered cyber security updates**
Link to stakeholder groups:
Colleagues; Customers; Suppliers

**Considered key areas of conduct risk**
Link to stakeholder groups:
Colleagues; Customers; Regulatory and Government

**Reviewed and approved PRA stress testing results**
Link to stakeholder groups:
Customers; Shareholders; Regulatory and Government

**Reviewed and approved the risk management framework**
Link to stakeholder groups:
Customers; Shareholders; Colleagues; Regulatory and Government; Suppliers

**Approved annual review of Group ring-fencing policy**
Link to stakeholder groups:
Customers; Regulatory and Government

## STRATEGY

**Two strategy away days to review the progress in implementing the Group's strategy**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Shareholders; Colleagues; Community and Environment; Regulatory and Government; Suppliers

**Deep dive on data and machine intelligence programme**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Colleagues; Regulatory and Government

**Deep dive on Open Banking and on strong customer identification**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Regulatory and Government

**Deep dive on fintech**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Colleagues

**Considered and approved large transactions and contracts**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Shareholders; Suppliers

**Considered the Group's EU exit preparations**
Link to strategic priorities:
Link to stakeholder groups:
Customers; Shareholders; Colleagues; Community and Environment; Regulatory and Government; Suppliers

## Deep dive sessions

The Board regularly takes the opportunity to hold deep dive sessions with senior management outside formal Board meetings. The purpose of the sessions is to provide the Board with deeper insight into key areas of strategic focus, whilst providing Directors with a greater understanding and appreciation for the subject matter to help drive better quality of debate and enhance knowledge. The sessions are structured to allow plenty of opportunity for discussion and include presentations and videos.

Details of the deep dive sessions that were held in 2019 are set out in the key focus areas section on pages 72 and 73. In addition, detailed updates were received from, and joint discussions held with, Scottish Widows Group Limited and Lloyds Bank Corporate Markets plc.

# Governance in action

## Board oversight: culture

The Group aims to continually develop a values-led culture with the Board providing sponsorship of this approach. Our values and behaviours are the foundation of our culture, providing us with a clear framework to ensure we understand what is expected of each other every day. Despite many strengths, the Board recognises that the Group's culture needs to continually change to ensure the business can adapt rapidly to a changing environment while delivering the best outcomes for customers.

The Group's culture plan is driven by our three core values; putting customers first, keeping it simple and making a difference together and these are underpinned by our six drivers of culture: Vision and Values, Leaders and Line Managers, Communication and Colleague Voice, Enabling and Developing Colleagues, Reward and Recognition and Accountability and Empowerment. These are also reflected in divisional plans and align to the FCA's four key drivers of culture. Culture initiatives are designed and delivered collaboratively, with input from colleagues and various teams across the Group, including divisional culture leads, Inclusion and Diversity, Responsible Business and Group Corporate Affairs.

The Board provides oversight and direction of culture activities and believes that establishing the right culture is important to ensure we are building an environment where all colleagues feel included, empowered and inspired to do the right things for customers. During 2019, the Board assessed and monitored the Group's progress on culture through regular updates at Board meetings, which included:

- Regular updates on our Group strategic review, which incorporates our biggest ever investment in colleagues, with a significant focus on transforming the way we work and our culture
- Quarterly workforce engagement reports, which provide an update on culture initiatives and colleague feedback
- Specific bi-annual updates on culture initiatives

An understanding of the impact of the management initiatives is developed by reviewing a wide range of data and metrics, including the outputs from our colleague engagement survey, the Banking Standards Board assessment and other business metrics. Please see page 9 for our employee engagement index for 2019.

As a result of this oversight, our culture plan and associated activities are regularly refined and tailored to incorporate insight into our progress. By doing this, we are able to recognise areas of positive progress and understand where we still have more work to do so that we can focus on areas for improvement.

Culture highlights from 2019 include:

- Continued roll out and embedding of Your Best, our transformational approach to performance management and career development. As part of the roll out we undertook the biggest capability uplift for line managers ever seen across the Group
- Simplifying and improving our ways of working, through focusing on key colleague journeys
- Continued focus on developing the skills required for the future, with significant progress made towards achieving our commitment to deliver 4.4 million additional learning and development hours during 2018 to 2020
- Building resilience through a range of interventions for colleagues throughout the organisation, including the launch of an online portal providing access to a wide range of resources

The Group has a number of initiatives planned for 2020 to accelerate cultural change, in particular in relation to empathy and promoting simplicity.

## Q&A with Sara Weller

**The Group is committed to Helping Britain Prosper by supporting a thriving low carbon economy.**

**Sara Weller**
Non-Executive Director and Chairman, Responsible Business Committee

Q

**How does the Board oversee the Group's sustainability strategy?**

Given the strategic importance of our sustainability ambitions, our governance structure provides clear oversight and ownership of the sustainability strategy. The Board of Directors as a whole is responsible for sustainability and has oversight via the Responsible Business Committee, a sub-committee of the Board, chaired by me and which includes the Chairman, Lord Blackwell, and Deputy Chairman, Anita Frew, as members. The Responsible Business Committee regularly reports to the Board to enable the Board to discuss pertinent issues as whole. Day to day accountability for sustainability rests with executive management, in particular the Group Chief Executive. Further information in relation to the sustainability governance structure can be found on page 30.

Q

**How important is sustainability and the management of climate change risk to the Group?**

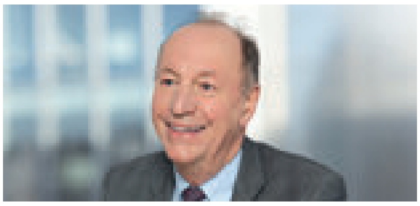
Sustainability and climate change has become a pressing priority for the country and beyond. Over the past year we have been working, right across the business, on the best ways for the Group to respond to these challenges, and have developed a sustainability strategy which is committed to supporting the UK's transition to a sustainable, low-carbon economy, and is fully aligned to the Paris Agreement and the UK's commitment to a net zero future by 2050. From our position at the heart of the UK economy, we are committed to supporting the UK successfully to engage with the challenges and opportunities presented by climate change and the carbon economy. We have identified and will manage material sustainability related risks across the Group, disclosing these in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. We have created a detailed implementation plan for the TCFD and the PRA supervisory expectations related to climate change. We have appointed Senior Management Function positions responsible for Climate Change risk, covering the three main legal entities, for example, for Lloyds Bank and Bank of Scotland this is the Chief Risk Officer.

Q

**Can you tell us about your personal highlights in 2019?**

There are so many matters on which great progress has been made in 2019. However, if I had to pick a couple of areas, I would choose highlights where colleagues have gone the extra mile and more to support individuals at the risk of disadvantage. Firstly our Digital Skills Academy, piloted in Manchester and now rolling out to other cities, starting with Bristol. Secondly, our work to provide support to Mental Health UK to allow them to set up the UK's first Money and Mental Health Advice line.

## Q&A with Stuart Sinclair



**2020 marks the beginning of a new policy period that must remain relevant for three years. This offered the opportunity for a fresh look.**

**Stuart Sinclair**
Non-Executive Director and Chairman, Remuneration Committee

Q

**How does the Board oversee the Group's Remuneration Policy and get assurance that it has been designed to align to the Group's purpose and values and is clearly linked to the successful delivery of the company's long-term strategy?**

This year, we were given an opportunity to take a step back and think about the remuneration philosophy for the Group and focus on what our main stakeholders would like us to consider. I personally have spent considerable time listening to a wide cross-section of our investor base, as well as receiving the input of stakeholders such as our recognised unions, regulators and the Work and Pensions Select Committee. With the insights from these discussions in mind, the Remuneration Committee has been able to discuss a great deal of material with management and independent advisers to gain comfort that the final proposals we have recommended to the Board are suitable and align to the Group's culture and values.

Q

**What has been your greatest challenge since becoming Remuneration Committee Chairman?**

The greatest challenge lay in crafting a new Remuneration Policy for the Group that would remain relevant for three years, while also being commercially sensible. To achieve this, Committee members spent time with a large cross section of investors and others (as noted in the Directors' Remuneration Report), while, as ever, being mindful of the need to set pay at a level which will continue to attract candidates who can run large, complex organisations. In this remuneration period, the task is made all the more challenging by the need to find senior people who have appreciation for technology and innovation generally and how it can improve customer experience while helping the cost structure.

It was also important, in this round, to build in as much optionality as we could, so that change in society's expectations or regulation or indeed the market for top talent could be accommodated within the new Policy. The various tests which have been engineered into the Policy, along with the continued expectation of Committee override and discretion, give the Committee some reassurance that a degree of future proofing has been built in.

Q

**In your opinion, what makes an effective Remuneration Committee to support the Board?**

Our role is to ask the right questions, get comfortable we have engaged with the right stakeholders and listened to them properly to give the Board assurance that the proposals we put forward are right for the Group. Composition of the Committee is important and we have a mix of male and female Non-Executive Directors with a wealth of financial and non-financial, executive and non-executive experience to bring to the table. Importantly, all Committee members also have a good understanding of what factors, both internal and external, have an impact on remuneration.

## Board oversight: operational resilience

The Board believes that operational resilience has become ever more important: maintaining the Group's most important services for our customers and the market in which we operate is critical and requires ongoing focus as the Group becomes more reliant on technology against a changing threat landscape.

Operational Resilience receives significant attention from the Board, primarily through the Board Risk Committee. The Board approves the list of the Group's most important business services annually, reviews a suite of operational resilience Board Risk Appetite Metrics on at least a quarterly basis and the operational resilience risk profile monthly, as it represents one of the Group's most important non-financial risks. Please see page 91 for a summary of operational resilience matters considered by the Board Risk Committee.

The Board also approved, and receives regular updates from the Group Chief Operating Officer, on progress against the Group's Operational Resilience strategy, and the operational resilience investment programmes that are delivering the strategy.

## Board oversight: transformation

The Board is responsible for the overall strategic direction of the Group and has been engaged with the Group's strategy to transform its business for success in a digital world through multiple touchpoints throughout the year. These have included:

- The annual cycle of two strategy away days to debate priorities and agree implementation plans
- A suite of formal Board metrics and qualitative reporting to monitor progress and risks
- Deep dives sessions on key areas (see pages 72 and 73 for more information)
- Customer insight sessions with workstream teams in research labs and other locations (see page 79 for more information)
- A range of informal interactions to feel the pulse

These touchpoints enable the Board to oversee the Group's transformation strategy, continually challenge and develop that strategy and take informed decisions on the critical issues relating to the Group's strategy.

## Key Board decisions

During the year, the Board covered a number of key focus areas and some examples of these decisions can be found on pages 21 to 25:

- Adopting a quarterly dividend
- Changing the Group's Remuneration Policy
- Adapting to climate change
- EU Exit preparations
- The acquisition of Tesco Bank's UK residential mortgage portfolio

## Workforce engagement

Please refer to page 22 for details of how the Board engages with the Group's workforce and why the Board considers these arrangements to be effective.

## Group Structure and Ring-Fencing Governance Arrangements

From 1 January 2019 UK legislation requires large UK banks to separate personal banking services such as current and savings accounts from riskier activities, such as investment banking, in other parts of their business. This is called ring-fencing. The Group has established a Group structure and governance arrangements which are appropriate for the Group and meet the regulatory requirements. Lloyds Bank plc and Bank of Scotland plc are the banks, within the Group, which have been included within the ring-fence (together, the Ring-Fenced Banks). The governance structure focuses on ensuring:

- Independent decision making by the Ring-Fenced Bank Boards – on any matters where there might be a conflict between the interests of the Ring-Fenced Banks and the interests of another part of the Group
- Risks affecting the Ring-Fenced Banks are considered and managed from the Ring-Fenced Banks' perspective – including maintenance of the capital adequacy and liquidity of the Ring-Fenced Banks
- Clear and effective governance at both Ring-Fenced Bank and Lloyds Banking Group plc level – including second and third lines of defence in respect of risk management

### Group Structure

The subsidiaries of the Group are structured into the following sub-groups under Lloyds Banking Group plc providing effective governance for the business undertaken in each sub group:

- Ring-Fenced Banks sub-group containing Lloyds Bank plc and Bank of Scotland plc (including the Halifax and MBNA businesses), serving both their UK personal and commercial customers
- Non Ring-Fenced bank sub-group - Lloyds Bank Corporate Markets plc (LBCM) - which provides products and services to Group customers that are not allowed within the ring-fence as well as serving Financial Service customers and holding the Group's subsidiaries and branches outside the UK
- Insurance sub-group under Scottish Widows Group Limited (including Scottish Widows Limited)
- Equity sub-group under LBG Equity Investments Limited, for which the principal subsidiary is Lloyds Development Capital Limited

### Board Structures

Since the Ring-Fenced Banks represent the core banking activity of the Group, all of the Directors of Lloyds Banking Group plc also sit on the Boards of the Ring-Fenced Banks, which are chaired by the Group Chairman. The ring-fencing governance structures have been operating since 1 January 2019. The Group Chief Executive is also Chief Executive of the Ring Fenced Banks. In addition, the Ring-Fenced Bank Boards have three additional independent Non-Executive Directors. These Ring-Fenced Bank only directors are independent of the management and the rest of the Group and play a critical role in the governance structure, with an enhanced role in managing any potential conflicts between the Ring-Fenced Banks and the Group. One of the Directors, Nigel Hinshelwood, acts as Senior Independent Director of the Ring-Fenced Banks and also chairs the cross-Group Information Technology and Cyber Security Advisory Forum.

Lloyds Bank Corporate Markets has its own Board as a separately constituted and regulated banking subsidiary, chaired by a Non-Executive Group Board member, Lord Lupton, and with its own independent Non-Executive Directors. Scottish Widows Group, which is regulated as an insurance group, similarly has its own Board with independent Non-Executive Directors, and is chaired by a Group Non-Executive Director, Nick Prettejohn. The Chief Executives and Functional Heads of these businesses have reporting lines to the Group executives, and the Group Board receives regular updates on their strategic development and performance.

## António Horta-Osório visits Glasgow

Group Chief Executive António Horta-Osório undertook a number of visits throughout the UK in 2019. During his regional visit to Glasgow in October 2019, António took the opportunity to spend time with our teams and customers, including holding a town hall, a recognition dinner to celebrate colleagues and all they are doing to Help Britain Prosper and embody the Group's values and a business breakfast with local Small and Medium-sized Enterprise and Corporate clients.

Across the two days António heard directly from colleagues about their work and their successes, passion, drive and commitment to improve the business for the benefit of customers and the Group.

Whilst meeting the Connect and Resolve teams in our Atlantic Quay building, António listened in to customer calls with the teams who support Schroders Personal Wealth and handle credit disputes. He also watched mobile messaging interactions with customers, seeing and hearing first-hand how we are meeting our customers' needs through a range of channels and products. This experience was part of the Reconnecting with Customers pilot programme, launched in July 2019 to bring senior leaders across the Group closer to our customers and customer-facing teams.

The Credit Disputes team shared with António the success it has had in improving the customer journey for credit card disputes. António was able to see the difference this transformation has made for customers by dialling into a live credit dispute call.

# Assessing our effectiveness

## Board evaluation

**How the Board performs and is evaluated**
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 of further development to enable the Board continuously to improve its own performance and the performance of the Group.

The Chairman of the Board, with the support of the Nomination and Governance Committee, leads the Board in considering and responding to the annual review of the Board's effectiveness, which includes a review of its Committees and individual Directors. Performance evaluation of the Chairman is carried out by the Non-Executive Directors, led by the Senior Independent Director, taking into account the views of the Executive Directors.

The Board is in the second year of its three year evaluation cycle. An external evaluation was conducted in 2018, facilitated by EgonZehnder[1], an external board review specialist, with an internal evaluation having been carried out in respect of 2019. The current expectation is that the 2020 evaluation will be conducted internally.

**2019 evaluation of the Board's performance**
The 2019 evaluation was conducted internally between October 2019 and January 2020 by the Company Secretary, and was overseen by the Nomination and Governance Committee.

The 2019 review sought the Directors' views on a range of topics including: strategy; planning and performance; risk and control; Board composition and size; balance of skills, experience and knowledge; diversity; culture; how members work together, and with executive management, to achieve objectives; the Board's calendar and agenda; the quality and timeliness of information; and support for Directors and Committees. The topics were selected by the Company Secretary and the Chairman of the Nomination and Governance Committee as being the most pertinent when considering the Board's effectiveness.

If Directors have concerns about the Company or a proposed action which cannot be resolved, their concerns are 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 2019 and up to the date of this report.

## Internal evaluation process

**October 2019**
Detailed questionnaire issued to all Directors by the Company Secretary

**October 2019 to January 2020**
Individual meetings held between each Director and the Company Secretary to discuss responses and opportunity for Directors to raise any other matters concerning the Board or its Committees.

**December 2019 to January 2020**
Report prepared by the Company Secretary based on the questionnaire results and matters raised in individual meetings.

**January 2020**
Draft report discussed by the Company Secretary with the Chairman.

Final report discussed at a meeting of the Board, following its consideration by the Nomination and Governance Committee.

**April 2020**
Actions to be recommended to the Board by the Nomination and Governance Committee to reflect the Board discussion in January.

Subsequently the Board will consider the recommendations and agree an action plan.

## Highlights from the 2019 review

The evaluation 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 and contributed effectively. The Board is also regarded as very able, collegiate and well-run, with an open and supportive culture and strong governance relating to risks and controls.

The key findings and areas for consideration include the following:

| | Findings | Areas for consideration |
|---|---|---|
| Ring-fencing governance | Ring-fencing governance requirements, with an increased number of participants at the Board, require individual Directors and the Chairman and Committee Chairmen to manage meetings, to ensure all Directors are able to contribute fully and effectively | Whilst ring-fencing governance has been embedded successfully, it is important to streamline governance processes further and ensure the Board's and its Committees' time is used to best effect |
| Strategy | The Board's detailed engagement in the formulation of strategy is seen as a key strength, with the strategy away days playing an important role in this | Continue to increase time allowed in Board meetings for expansive discussion of broader strategic issues and themes |
| Board papers and presentations | Board deep dives into particular topics and the continued use of more informal Board sessions to facilitate greater depth of discussion continue to be appreciated<br>Whilst the quality of Board papers was seen to have improved, there remain concerns about the length of Board papers and the inclusion of unnecessary detail | Board and Committee papers to be shorter in length and the amount of time spent in Board meetings on presentations to be reduced, to allow more time for open discussion and debate |

1 At the time of the 2018 review EgonZehnder provided certain Board and senior management level services from time to time, including in respect of succession planning as detailed on page 67 of the 2018 Annual Report and Accounts, otherwise EgonZehnder had no other connection with the Group.

How our Board works continued

## Progress against the 2018 external Board effectiveness review

During the year, work focused particularly on the Board becoming more outwardly focused and ensuring that the Board agenda was less rooted in regulatory compliance and risk mitigation. A summary of the Board's progress against the actions arising from the 2018 effectiveness review are set out below.

| | Recommendations from the 2018 evaluation | Actions taken during 2019 |
|---|---|---|
| Board focus | • Board agenda to become less rooted in regulatory compliance and risk mitigation<br>• Board to become more outwardly focused | • Added 30 minutes 'free agenda' discussion time to Board meetings<br>• June strategy session updated views of external environment (customer, technology, competition, society) to prepare for 2020 discussions on GSR4<br>• Executive Director performance reports continue to evolve towards flagging issues and priorities<br>• Regular competition reports to include more on the activities of new competitors<br>• Chairman to continue moving focus of agenda to give more time to business discussions |
| Size of Board | • Ensure size of Board and large attendance at Committee meetings does not inhibit debate | • Requirement for Board and Committee Chairmen to be more directive when required<br>• Commitments by individual Directors to self-discipline contributions<br>• Continued use of informal sessions to air issues that need more discussion |
| Board papers and agenda | • Further streamline meeting papers and agendas to enable more expansive discussion | • Continued to streamline length and time spent on 'taken as read' reports<br>• Further development and simplification of GSR3 reporting |
| Board skills and diversity | • Continue to evolve Board skills and diversity | • Chairman continued to share succession timetables and skills matrix for discussion in Nomination and Governance Committee and wider Board<br>• Reviewed wording of Board diversity objective during 2019 |
| Individual Non-Executive Director skills and experience | • Look at ways to better leverage individual Non-Executive Director skills and experience | • Chairman discussed and agreed potential focus areas with Non-Executive Directors during regular performance reviews<br>• Individual Non-Executive Directors encouraged to communicate topics they are engaging with to other Non-Executive Directors |

## Lord Blackwell's visit to Birmingham

As part of his programme of regional visits, Lord Blackwell spent time in Birmingham in September. He met colleagues from Lloyds Bank and Halifax branches, as well as spending time with colleagues from Brindley Place.

Lord Blackwell took part in the branch team talk with colleagues from the Lloyds Bank Branch. Topics covered the Group's joint venture with Schroders Personal Wealth, customer referrals and supporting our local communities. There were questions for Lord Blackwell covering the economic environment, digital technology, the Group's brands and its branch network.

Lord Blackwell was joined all day on this visit by Kendall Akhurst, a colleague from Group Transformation. As a strong advocate for, and member of, the Group's Access network, which supports colleagues with disabilities, Kendall was particularly interested in the visit to the Birmingham Disability Resource Centre (BDRC). The BDRC is one of the many charities the Group supports through its charitable Foundations and provides support for people with all kinds of disabilities. Lord Blackwell spent time hearing about the wide range of support BDRC has received from the Group and also from people who use the centre and their experience of the Journey to Work scheme, which aims to help people turn their lives around by building up their confidence and self-esteem to get back into work.

After the branch and charity visits, Lord Blackwell moved to Brindley Place where he hosted a recognition lunch for around 20 colleagues from Group Client Information Office and Commercial, discussing their successes and also what challenges they might be facing. He then spent time with teams from within those divisions and heard about work to investigate suspicious activity reports raised from branches, the cash management and payments model office, the automation journey for payments, including demonstrations of robotics and also how the Group is supporting business clients through their trade journey.

The visit continued with a Town Hall session for around 80 colleagues at which Lord Blackwell invited questions and answered a wide variety of questions covering topics such as resilience for colleagues and the Group, his own mentors and inspirations, the branch network, EU exit and leadership styles and skills.

The visit ended with a recognition dinner for 25 colleagues to celebrate how they have truly lived the Group's values and what they have done to embody the Group's purpose of Helping Britain Prosper.

# 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 the risk management and internal control systems, the Directors carried out a robust assessment of the emerging and principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity and reputation, the likelihood of a risk event occurring and the costs of control. The process for identification, evaluation and management of the emerging and principal risks faced by the Group is integrated into the Group's overall framework for risk governance. 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 Executive 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 internal control and risk management systems in relation to the financial reporting process is provided within the risk management report on pages 129 to 187. The Board concluded that the Group's risk management arrangements are adequate to provide assurance that the risk management systems put in place are suitable with regard to the Group's profile and strategy.

## 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 approve the CER findings which are reviewed and independently challenged by the Risk Division and Group Internal 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, which also receives reports of reviews undertaken by the Risk Division and Group Internal 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 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 a pathway to compliance with BCBS 239 risk data aggregation and risk reporting requirements and continues to actively manage enhancements.

## Lord Blackwell and Non-Executive Director visits to customer insight sessions

Lord Blackwell and a number of Non-Executive Directors attended multiple Customer Insight sessions during 2019.

Our customers' world is changing at pace so it is important to stay in touch with the reality of customers' daily lives, their changing needs and priorities.

Customer insight sessions are held monthly in research labs and other locations across the country to hear directly from customers about their lives and what is important to them. The discussions cover topics such as life priorities and money management providing a rich insight into evolving needs, attitudes and behaviours.

This insight is a valuable input into understanding how customers' lives are evolving to help develop the Group's strategic direction.

The Chairman and Non-Executive Directors were impressed by customers' openness and willingness to share their views. The sessions they attended gave a deep insight into customers' lives and needs and their ideas on how a bank can provide a leading customer experience.

Strategic report
Financial results
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Financial statements
Other information

## Complying with the UK Corporate Governance Code 2018

The UK Corporate Governance Code 2018 (the 'Code') applied to the financial year ended 31 December 2019. The Group confirms that it applied the principles and complied with all the provisions of the Code throughout the year except in relation to that part of provision 36 that provides that the remuneration committee should develop a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares. Whilst the Remuneration Committee has not introduced a formal post-employment shareholding policy, the existing reward structure ensures that Executive Directors will continue to meet the Group's shareholding requirements for a minimum of two years after leaving the Group. On this basis, the Group believes that it already complies with best practice and with the spirit of provision 36 notwithstanding the fact that a specific formal policy has not been introduced. Please refer to pages 100 and 108 for a more detailed explanation of the Group's approach to post-employment shareholding requirements.

The Code is publicly available at www.frc.org.uk. This page and the following page explain how we have applied the principles and related provisions of the Code during the year. The alphabetical references in the paragraphs below correspond to the principles, and related provisions, of the Code.

The Group has adopted the UK Finance Code for Financial Reporting Disclosure and its 2019 financial statements have been prepared in compliance with its principles.

### 1. Board Leadership and Company Purpose

| | Independent | Responsibilities |
|---|---|---|
| **Chairman**<br>Lord Blackwell | | Lord Blackwell leads the Board and promotes the highest standards of corporate governance. He leads in building an effective and complementary Board, and sets the Board's agenda. The Chairman also leads Board succession planning and ensures effective communication with shareholders. |
| **Executive Directors**<br>**Group Chief Executive**<br>António Horta-Osório | | António Horta-Osório manages and leads the Group on a day-to-day basis, making decisions on matters affecting the operation and performance of the Group's business and the delivery of the Board's approved strategy. He delegates aspects of his authority, as permitted under the Corporate Governance Framework, to other members of the Group Executive Committee. |
| **Chief Financial Officer**<br>William Chalmers[1] | | Under the leadership of the Group Chief Executive, William Chalmers, who joined the Board during the year, and Juan Colombás make and implement decisions in all matters affecting operations, performance and strategy. They provide specialist knowledge and experience to the Board. Together with António Horta-Osório, William Chalmers and Juan Colombás design, develop and implement strategic plans and deal with day-to-day operations of the Group. |
| **Chief Operating Officer**<br>Juan Colombás | | |
| **Non-Executive Directors**<br>**Deputy Chairman**<br>Anita Frew | ✓ | As Deputy Chairman, Anita Frew supports the Chairman in representing the Board, and acts as a spokesperson for the Group. She deputises for the Chairman and is available to the Board for consultation and advice. The Deputy Chairman may also represent the Group's interests to official enquiries and review bodies. Having spent nine years on the Board, Anita will retire at the forthcoming AGM. Anita's independence up to the point of her retirement is confirmed on page 81. |
| **Senior Independent Director**<br>Alan Dickinson | ✓ | As Senior Independent Director, Alan Dickinson is a sounding board for the Chairman and Group Chief Executive. He acts as a conduit for the views of other Non-Executive Directors and conducts the Chairman's annual performance appraisal. He is available to help resolve shareholders' concerns and attends meetings with major shareholders and financial analysts to understand issues and concerns. |
| Simon Henry | ✓ | The Non-Executive Directors challenge management constructively and help develop and set the Group's strategy. They actively participate in Board decision-making and scrutinise management performance.<br><br>The Non-Executive Directors satisfy themselves on the integrity of financial information and review the Group's risk exposures and controls. The Non-Executive Directors, through the Remuneration Committee, also determine the remuneration of Executive Directors. |
| Sarah Legg[2] | ✓ | |
| Lord Lupton | ✓ | |
| Amanda Mackenzie | ✓ | |
| Nick Prettejohn | ✓ | |
| Stuart Sinclair | ✓ | |
| Sara Weller | ✓ | |
| **Group Company Secretary**<br>Kate Cheetham | | Kate Cheetham was appointed Group Company Secretary during the course of the year, and in this role advises the Board on matters relating to governance, ensuring good information flows and comprehensive practical support is provided to Directors. She maintains the Group's Corporate Governance Framework and organises Directors' induction and training. The Company Secretary also communicates with shareholders as appropriate and ensures due regard is paid to their interests. Both the appointment and removal of the Group Company Secretary is a matter for the Board as a whole. |

1 William Chalmers joined the Board with effect from 1 August 2019.

2 Sarah Legg joined the Board with effect from 1 December 2019.

**A.** The Group is led by an effective, committed Board, which is collectively responsible for the long-term, sustainable success of the Group, ensuring due regard is paid to the interests of the Group's stakeholders, with its effectiveness assessed with an annual Board effectiveness review, discussed further on page 77 to 78. The Group's Corporate Governance Framework, which is reviewed annually by the Board, sets out the key decisions and matters reserved for the Board's approval, which includes matters relating to the Group's long-term strategy and priorities. Further details of the Corporate Governance Framework can be found online at www.lloydsbankinggroup.com/our-group/corporate-governance, and on page 71.

**B.** The Board assumes responsibility for establishing the purpose of the Company, setting its strategy, establishing its culture, and determining the values to be observed in achieving that strategy. Central to this is the Company's role as a trusted and responsible business, with the Board's Responsible Business Committee overseeing the Group's ambitions in this regard. The Group's approach to acting as a responsible business is discussed in detail on pages 26 to 35, and in the report of the Responsible Business Committee on page 93.

**C.** The Board retains ultimate responsibility for ensuring adequate resource is available to meet agreed objectives and strategy, and ensures such resources are responsibly and effectively deployed. The effective management of risk is central to the Company's strategy, supported by the Group's enterprise risk management framework, as discussed in the risk management report on pages 129 to 187.

**D.** The Board recognises that engaging with and acting on the needs of the Group's stakeholders is key to achieving the strategy and long-term objectives of the Company. Engagement with stakeholders, across the organisation and including that of the Board, is discussed further on pages 20 to 27, and in the Directors' statement of compliance with their duties under section 172 of the Companies Act 2006, also on pages 20 to 27.

**E.** All policy and practice relating to Group colleagues is developed and implemented in a way which is consistent with the Group's purpose and values, with the Board receiving regular updates on matters relevant to colleagues. The Board has appointed Anita Frew as its whistleblowing champion, with responsibility for overseeing the integrity, independence and effectiveness of the Group's whistleblowing procedures. In addition, the Audit Committee reviews reports on whistleblowing to ensure there are arrangements in place which colleagues can use in confidence to report relevant concerns, as discussed on page 88 and reports on such review to the Board.

## 2. Division of Responsibilities

**F.** The Chairman has overall responsibility for the leadership of the Board and for ensuring its effectiveness in all aspects of its operation. The responsibilities of the Chairman in this regard are formalised within the Corporate Governance Framework. Lord Blackwell was independent on appointment.

**G.** The balance of skills, experience, independence and knowledge on the Board is the responsibility of the Nomination and Governance Committee, and is reviewed annually or whenever appointments are considered. Having the right balance of skills and experience helps to ensure Directors discharge their duties effectively. The Nomination and Governance Committee monitors whether there are any relationships or circumstances which may affect a Director's independence. Following the most recent review of independence, the Committee concluded that all Non-Executive Directors are independent in character and judgement, as shown on page 82. As of 1 December 2019, Anita Frew had spent 9 years on the Board and will retire at the AGM in May. In relation to the period from 1 December 2019, being the ninth anniversary of Anita's appointment to the Board, to her retirement at the AGM in May, the Board considered and agreed that the period beyond nine years as a director did not impact on Anita's level of independence or the effectiveness of her contributions and her continuing treatment as an independent Non-Executive Director of the Company for that period. The decision was based on a number of factors including consideration of Anita's interests outside the Group and the continued challenge and oversight Anita provides in the role, whilst noting the benefits of enabling the phased transition of responsibilities to other Non-Executive Directors during this short period. More information on the annual Board effectiveness review can be found on pages 77 to 78 and information on the Board Diversity Policy can be found on page 83.

**H.** Non-Executive Directors are advised of time commitments prior to their appointment and are required to devote such time as is necessary to discharge their duties effectively. The time commitments of the Directors are considered by the Board on appointment and annually thereafter, and, following the most recent review, the Board is satisfied there are no directors whose time commitments are considered to be a matter for concern. External appointments, which may affect existing time commitments relevant to the Board, must be agreed with the Chairman, and prior Board approval must be obtained before taking on any new external appointments. The Board has not approved any significant external commitments during 2019. No Executive Director has taken up more than one Non-Executive Director role at a FTSE100 company or taken up the chairmanship of such a company. More information on Directors' attendance at meetings can be found on page 70.

**I.** The Chairman, supported by the Group Company Secretary, ensures that Board members receive appropriate and timely information. 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 discharge their duties.

## 3. Composition, Succession and Evaluation

**J.** The process for Board appointments is led by the Nomination and Governance Committee, which makes recommendations to the Board. A combination of open advertising and an external search consultancy is used for the appointment of the Chairman and Non-Executive Directors. More details about succession planning can be found on page 82 and 84. More information about the work of the Nomination and Governance Committee can be found on pages 82 to 84.

**K.** The Chairman leads the training and development of Directors and the Board regularly reviews and agrees with each Director their individual and combined training and development needs. 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, taking account of the specific role the Director has been appointed to fulfil and their skills and experience to date. Directors who take on or change roles during the year attend induction meetings in respect of those new roles. The Group Company Secretary maintains a training and development log for each Director.

At the 2020 AGM all Directors will seek re-election or election save for Anita Frew, who will be stepping down at the 2020 AGM. Being the first AGM since their respective appointments, William Chalmers and Sarah Legg will stand for election, together with Catherine Woods, who, as announced in October 2019, will join the Board on 1 March 2020. The Board believes that all Directors continue to be effective and committed to their roles.

**L.** An internally facilitated Board evaluation was completed in 2019, with an externally facilitated evaluation having taken place in 2018. Individual evaluation is carried out by the Chairman on behalf of the Board. Performance evaluation of the Chairman is carried out by the Non-Executive Directors, led by the Senior Independent Director, taking into account the views of the Executive Directors. More information on the Board effectiveness review can be found on pages 77 to 78, along with the findings, actions, and progress made during the year.

## 4. Audit, Risk and Internal Control

**M.** The Board has delegated a number of responsibilities to the Audit Committee, including oversight of financial reporting processes, the effectiveness of internal controls and the risk management framework, whistleblowing arrangements and the work undertaken by the external and internal auditors. The Audit Committee reports regularly to the Board on its activities, and its report for 2019, confirming how it has discharged its duties can be found on pages 85 to 88.

**N.** Requirements that the Annual Report is fair, balanced and understandable are considered throughout the drafting and reviewing process and the Board has concluded that the 2019 Annual Report meets this requirement. The Directors' and Auditors' Statements of Responsibility can be found on pages 97 and 196 respectively. Related information on the Company's business model and strategy can be found on pages 2 to 46.

**O.** The Board is responsible for the Group's risk management and internal controls systems, including the determination of the nature and extent of risk the Company is willing to take. Risk is further managed through the Board approved Risk Control Framework, as discussed in the risk management report on pages 129 to 187. The Audit Committee assumes further responsibility for the effectiveness of internal controls, with the Board Risk Committee assuming responsibility for the review of the risk culture of the Group, ensuring the correct 'tone from the top' in respect of risk management. The related Directors' Viability Statement can be found on pages 95 to 96 and confirmation that the business is a going concern can be found on page 96.

## 5. Remuneration

**P.** The Group is committed to offering all colleagues a reward package that is competitive, performance-driven and fair and its Remuneration Policy is designed to promote the long-term and sustainable success of the Company. The Directors' Remuneration Report on pages 98 to 128 provides further details regarding the remuneration of Directors. The current Remuneration Policy can be found in the 2016 Annual Report and Accounts and remains unchanged since last approved by shareholders at the 2017 AGM. A new Remuneration Policy will be proposed for approval by shareholders at the 2020 AGM.

**Q.** The Remuneration Committee seeks to ensure all remuneration policy, including that relevant to executive remuneration, is fair and transparent. The work of the Remuneration Committee during the year, including its review of the Remuneration Policy, is discussed further in its report on page 114.

**R.** The Remuneration Policy seeks to ensure all remuneration decisions made by Directors fully consider the wider circumstances as relevant to that decision, including, but not limited to, individual performance. The Remuneration Committee's decision making in respect of remuneration outcomes is discussed further in the Directors' Remuneration Report on pages 98 to 128 which includes additional confirmation of the use of remuneration consultants, including where any such consultant has another connection to the Company.

## Nomination and Governance Committee report

**Good succession planning and recognition of diversity is integral to maintaining a strong Board and supporting the development of the Executive population.**

**Lord Blackwell**
Chairman, Nomination and Governance Committee

### Dear Shareholder

I am pleased to report on the activity of the Nomination and Governance Committee (the 'Committee') during 2019.

### Board and GEC changes

As set out in my introduction to the Governance Report on page 65 there have been a number of changes to the Board and its Committees during the year, all of which have been overseen by the Committee.

During the year, the Committee undertook a thorough process to identify and assess candidates which resulted in the appointment of two new Group Non-Executive Directors: Sarah Legg was appointed to the Board on 1 December 2019 and Catherine Woods will join the Board on 1 March 2020. While selected on the basis of their strong banking experience and skills, these two appointments help meet our continuing commitment to gender diversity. Sarah's appointment also supports our objective of BAME diversity. Details of the selection process can be found on page 84.

The Committee oversaw the planned transition of the Senior Independent Director role from Anita Frew to Alan Dickinson with effect from 1 December 2019, ahead of Anita's planned retirement from the Board at the forthcoming AGM when Alan will also succeed her as Deputy Chairman. Alan's breadth and depth of experience make him ideally suited to the role of Deputy Chairman and Senior Independent Director.

Following our announcement in February 2019, William Chalmers joined the Board on 1 August 2019 as an Executive Director and Chief Finance Officer, succeeding George Culmer. As announced in October 2019, Juan Colombás plans to retire from the Group in July 2020, and I plan to retire as Group Chairman at or before the AGM in 2021, by which time I will have served 9 years on the Group Board. The Committee has initiated a search process for my successor under the leadership of the Senior Independent Director.

A number of changes have also been made to the membership of Board Committees during the year, reflecting Board changes and the ongoing review of Committee membership.

### Succession planning

As can be seen from these changes, the Committee continued to focus on succession planning at both a Board and Executive level, building on work undertaken in previous years.

The Committee continues to keep under review, on an ongoing basis, the structure, size and composition of the Board and its Committees, making recommendations to the Board as appropriate. Consideration was given to anticipated retirements from the Group Board over the next two years, together with the need to ensure the appropriate mix of knowledge, skills and experience, and diversity.

At an Executive level, the Committee considered the overall health of the Executive talent pipeline, together with detailed Executive succession planning aimed at supporting the development of executives for the Bank of the Future. Further detail on succession planning can be found on page 84.

### Board effectiveness and training

As highlighted in my introduction to the Governance Report on page 65, an internal Board effectiveness review, undertaken by the Company Secretary, was overseen by the Committee. The Committee also considered, and recommended to the Board, actions arising from the previous externally facilitated review undertaken by Egon Zehnder. Full details are provided on pages 77 to 78.

Annually, as part of the Board effectiveness review, the Committee also undertakes a review of its own effectiveness. The findings of this review, which were considered by the Committee at its meeting in January 2020, found that the Committee had met its key objectives and carried out its responsibilities effectively.

The Committee also oversees training undertaken by the Non-Executive Directors. Learning and engagement opportunities have been undertaken by all Non-Executive Directors in relation to material aspects of the Group's business.

### Independence and time commitments

Based on its assessment for 2019, the Committee is satisfied that, throughout the year, all Non-Executive Directors remained independent[1] as to both character and judgement. The Committee, and the Board gave specific consideration to Anita Frew's continuing independence as detailed on page 81.

In recommending Directors for re-election, the Committee reviews the performance of each Non-Executive Director and their ability to continue meeting the time commitments required, taking into consideration individual capabilities, skills and experiences and any relationships that have been disclosed. All Directors were considered to have appropriate roles. Details of conflicts of interest can be found on page 94.

### The Group's Corporate Governance Framework

The annual review of the Corporate Governance Framework was undertaken during the year with the inclusion of further enhancements to the ring-fenced banking governance arrangements which came into effect on 1 January 2019, together with various other minor amendments, and updates to committee terms of reference.

As part of its broader governance responsibilities, the Committee also considered regular updates on developments in corporate governance, including the initiation of HM Treasury's review of the financial services regulatory framework, provided ongoing oversight of the embedding of the ring-fenced banks' governance structure and considered correspondence with shareholders.

### UK Corporate Governance Code

As highlighted in last year's report and referred to in the Governance Report, the Financial Reporting Council's amended UK Corporate Governance Code (the 'Code'), came into effect from 1 January 2019, with requirements relating to the annual report applicable to the report and accounts for the year ended 31 December 2019. The Group applied the

1 The Chairman was independent on appointment in accordance with the Code. Following the Financial Reporting Council's Guidance on Board Effectiveness, the Chairman is not subject to the Code's independence test, other than on appointment.

Code. Our statement of compliance with the Code and a summary of the requirements of the Code can be found on pages 80 and 81.

## 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.

## Committee composition, skills and experience

To ensure a broad representation of experienced and independent Directors, membership of the Committee comprises the Chairman, Deputy Chairman, the Chairman of the Board Risk Committee (and Senior Independent Director since December 2019), the Chairman of our Insurance Subsidiary, and the Chairman of the Responsible Business Committee. In addition, as announced on 25 November 2019, Stuart Sinclair, Chairman of the Remuneration Committee, was appointed as a member of the Committee with effect from 1 December 2019.

The Group Chief Executive attends meetings as appropriate. Details of Committee memberships and meeting attendance can be found on page 70.

**Lord Blackwell**
Chairman, Nomination and Governance Committee

## The Board diversity policy

The Board Diversity Policy (the 'Policy') sets out the Board of Lloyds Banking Group's approach to diversity and provides a high level indication of the Board's approach to diversity in senior management roles which is governed in greater detail through the Group's policies. The Board places great emphasis on ensuring that its membership reflects diversity in its broadest sense. Consideration is given to the combination of demographics, skills, experience, race, age, gender, educational and professional background and other relevant personal attributes on the Board to provide the range of perspectives, insights and challenge needed to support good decision making.

New appointments are made on merit, taking account of the specific skills and experience, independence and knowledge needed to ensure a rounded Board and the diversity benefits each candidate can bring to the overall Board composition.

As part of the decision to appoint Sarah Legg and Catherine Woods to the Board, diversity was considered in its broadest sense. These appointments bring strong banking and asset management experience to the Group.

Objectives for achieving Board diversity may be set on a regular basis. In April (and then again in January 2020) the Board considered and approved updates to aspirations set out in the Board Diversity Policy relating to gender diversity and the number of senior roles held by Black, Asian and Minority Ethnic (BAME) executives.

On gender diversity the Board is committed to maintaining at least 3 female Board members and over time will expect female representation on the Board to match the 40 per cent target that the Group has set for senior executives. Reflecting these aspirations, the Board will aim to meet the Hampton-Alexander objective of 33 per cent female representation by, or as soon as possible after, the target date of 2020. Female representation on the Board is currently 31 per cent (based on four female Directors and nine male Directors).

The Group also set a target of 8 per cent of senior roles to be held by BAME executives by 2020. At Board level, the Group aims to meet the objectives of the Parker review for at least one BAME Board member by, or as soon as possible after, the target date of 2021. The appointment of Sarah Legg in 2019 supports this objective.

As noted, the Board places high emphasis on ensuring the development of diversity in senior management roles within the Group and supports and oversees the Group's objectives of achieving 40 per cent of senior roles held by female executives by 2020, and of 8 per cent of senior roles being held by BAME executives by 2020. This is underpinned by a range of policies within the Group to help provide mentoring and development opportunities for female and BAME executives and to ensure unbiased career progression opportunities. Progress on this objective is monitored by the Board and built into its assessment of executive performance. As at 31 December 2019, female representation within senior management and their direct reports was 31.1 per cent in total (29.4 per cent and 31.3 per cent respectively). Female representation across all senior roles was 36.8 per cent, and BAME representation in senior roles was 6.7 per cent.

A copy of the Policy is available on our website at www.lloydsbankinggroup.com/our-group/responsible-business and further information on the Board's broader approach to diversity and inclusion as part of its strategic priorities, and continued investment in being a leading inclusive employer, can be found on page 34.

Nomination and Governance Committee report continued

## Succession Planning

Effective 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. The Board is also committed to recognising and nurturing talent within the executive and management levels across the Group to ensure the Group creates opportunities to develop current and future leaders.

The role of succession planning in promoting diversity is recognised and the Group has a range of policies which promote the engagement of underrepresented groups within the business in order to build a diverse talent pipeline.

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. This has been a particular area of focus during 2019, with a number of changes to Board Committee membership, and the appointment of two new Non-Executive Directors, discussed further below.

Central to this is an ongoing assessment, led by the Chairman, of the collective Board's technical and governance skill set. From this the Chairman creates a Board skills matrix which is used to track the Board's strengths and identify any gaps in the desired collective skills profile of Board. Various factors are taken into consideration such as the Group's future strategic direction, and helping ensure due weight is given to diversity in its broadest sense. The skills matrix was considered in the appointment of Sarah Legg and Catherine Woods and the appointment of Alan Dickinson as Senior Independent Director and, in due course, also as Deputy Chairman.

Outcomes of the annual Board evaluation process are also taken into consideration.

During the year, the Committee also considered the adequacy of succession arrangements for key senior management roles, also taking into consideration the changing opportunities as the shape of the Group continues to evolve through delivery of the Group's strategy. The Chairman is responsible for developing and maintaining a succession plan for the Group Chief Executive who is, in turn, primarily responsible for developing and maintaining succession plans for key leadership positions in the senior executive team.

## Appointment Process - Assessment of new Non-Executive Directors

### Outcome

During the year the Committee led the search process for, and appointment of, new Non-Executive Directors which culminated in the appointment of Sarah Legg, who joined the Board on 1 December, and Catherine Woods who will join the Board on 1 March 2020.

### Key considerations

In establishing criteria for the new appointments, the Committee considered a number of factors including the collective Board's technical and governance skill set, anticipated retirements in 2020 and 2021 based on current FRC Code guidance, and support for the Group's diversity objectives.

**Step 1**

The Committee considered a number of search firms before appointing Heidrick & Struggles[1] to assist with the identification of potential candidates based on the Board's criteria.

**Step 2**

The Committee were provided with a list of potential candidates for consideration, from which a short list was identified.

**Step 3**

Interviews were then held between the candidates, the Chairman and the Senior Independent Director.

**Step 4**

Further meetings for selected candidates were held with other members of the Board.

**Step 5**

After further consideration, the Committee recommended to the Board the appointment of the preferred candidates.

**Step 6**

The Board formally approved the appointments, subject to any remaining checks and approvals required.

1 Aside from assisting with senior recruitment Heidrick & Struggles have no other connection to the Company, or individual Directors.

# Audit Committee report

## The Committee has delivered on its key responsibilities, ensuring oversight of financial reporting and the control environment.

**Simon Henry**
Chairman, Audit Committee

## Dear Shareholder

I am pleased to report on how the Group Audit Committee (the 'Committee') has discharged its responsibilities throughout 2019.

The Committee has continued to focus on the issues relevant to the Group's financial reporting, including consideration of key accounting judgements, and ensuring the integrity of financial reporting and related disclosures. The Committee has also spent a significant proportion of its time considering other related areas, including monitoring of the Group's internal control framework, to ensure it remains effective and fit for purpose. The key sources of information here remain the company's Financial Controllership, the Risk function, Internal Audit and External Audit. The Committee is hence receiving multiple, independent and objective reports, in support of assurance provided.

Assessing the final provisioning for the costs relating to Payment Protection Insurance redress has remained a significant area of judgement in the Group's financial reporting, with the Committee continuing to challenge management's assumptions used to calculate the Group's provision.

Reports from management were considered on the ongoing application of IFRS 9, including challenge of management judgements underpinning credit impairment provisions. The Committee also oversaw the successful implementation of IFRS 16, which was adopted by the Group on 1 January 2019, and received updates from the project to implement IFRS 17, which is expected to be effective for the 2022 financial year.

The potential for economic uncertainty arising from the exit of the UK from the European Union was considered in particular in respect of any potential impact on the Group's credit impairment provision.

The Committee continued to oversee the role of Group Internal Audit, with particular focus on the key risk themes across the Group, including the transformation programmes, which continue to play an increasingly important role in the Group's strategy.

The Committee also oversaw the establishment of a sub-committee to consider improvements in the Group's whistleblowing arrangements.

Looking ahead to 2020, beyond continued focus on financial reporting and related controls, the Committee will oversee the transition in January 2021 to Deloitte LLP as the Group's external auditor.

The Committee also expects to review ongoing developments in the Group's approach to climate change reporting, as this area continues to develop. The Committee will also consider the developments in Corporate Governance, external audit practice, and regulation of this industry, arising from reviews by Sir Donald Brydon and others. The Committee has already given initial consideration to the matters these reviews have raised, and will continue to contribute to the ongoing consultation processes.

**Simon Henry**
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 (including over financial reporting) and the risk management framework, whistleblowing arrangements and each of the internal and external audit processes, including the statutory audit of the consolidated financial statements and the independence of the statutory auditor.

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. 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. In satisfying its purpose, the Committee undertakes the functions detailed within Disclosure Guidance and Transparency Rule 7.1.3R.

During the year the Committee considered a number of issues relating to the Group's financial reporting. These issues are summarised on the following pages, including discussion of the conclusions the Committee reached, and the key factors considered in reaching conclusions, including a continuing focus on the judgements and assumptions used by management in its models. In addition, the Committee considered a number of other 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.

## Committee composition, skills, experience and operation

The Committee acts independently of the executive to ensure 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 with competence in the financial sector and their biographies can be found on pages 66 to 67.

Simon Henry is a Chartered Global Management Accountant and has extensive knowledge of financial markets, treasury, risk management and international accounting standards. He is a member having recent and relevant financial experience for the purposes of the UK Corporate Governance Code and is the Audit Committee financial expert for SEC purposes.

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. For details of how the Committee was run, see page 71.

Annually the Committee undertakes an effectiveness review. The review forms part of the Board evaluation process with Directors being asked to complete parts of the questionnaire relating to the Committees of which they were members. The findings of the review were considered by the Committee at its January 2020 meeting. On the basis of the evaluation the feedback was that the performance of the Committee continues to be effective.

Whilst the Committee's membership comprises the Non-Executive Directors noted on page 70, all Non-Executive Directors may attend meetings as agreed with the Chairman of the Committee. The Group Financial Controller, Chief Internal Auditor, the external auditor, the Group Chief Executive, the Chief Financial Officer, the Chief Risk Officer and the Chief Operating Officer also attend meetings as appropriate. Details of Committee membership and meeting attendance can be found on page 70.

## Financial Reporting

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

### Activities for the year

| | Key issues | Committee review and conclusion |
|---|---|---|
| Payment Protection Insurance (PPI) | Management judgement is used to determine the assumptions used to calculate the Group's PPI provision. Following the deadline for submission of claims in August 2019, the principal year-end assumptions used in the calculation are the extent to which customer enquiries convert to valid complaints, are then upheld, the average redress to be paid and expected future administration costs.<br><br>During 2019, the Group made provisions totalling £2,450 million in respect of PPI. | The Committee reviewed management's assumptions used to calculate the Group's provision for PPI redress and associated administration costs. The overall cost remains uncertain and the Committee considered management's use of sensitivities used to evaluate this uncertainty.<br><br>The Committee concluded that the provision for PPI redress and the Group's external disclosures were appropriate. The disclosures relating to PPI are set out in note 38: 'Other provisions' of the financial statements.<br><br>The Committee's consideration of PPI is discussed further on page 87. |
| Other conduct provisions | There were relatively few new conduct matters in 2019. The Group made provisions totalling £445 million in respect of other conduct matters, including £188 million for costs of identifying and rectifying certain arrears management fees and activities. | The Committee has considered management's assessment of the provisions required for other conduct matters and was satisfied that the provisions were appropriate. The disclosures relating to other conduct provisions are set out in note 38: 'Other provisions' of the financial statements. |
| Allowance for impairment on loans and advances | The Group's impairment provision is dependent on management's judgements on matters such as future interest rates, house prices and unemployment rates, as well as its assessment of a customer's current financial position and whether it has suffered a significant increase in credit risk.<br><br>The allowance for impairment losses on loans and advances to customers at 31 December 2019 was £3,259 million (2018: £3,150 million). | During the year, the Committee has challenged both the level of provision held by the Group, and the judgements and estimates used to calculate the provision. It regularly reviewed management's analysis of the Group's lending portfolios. As part of each of its reviews, the Committee considered management's assessment of the potential impact of the UK leaving the European Union. The Committee has also considered the disclosure recommendations published by The Taskforce on Disclosures about Expected Credit Losses in December 2019.<br><br>The Committee was satisfied that the impairment provisions and associated disclosures were appropriate. The disclosures relating to impairment provisions are set out in note 20: 'Allowance for impairment losses' and note 53: 'Financial risk management' of the financial statements. |
| Retirement benefit obligations | The value of the Group's defined benefit pension plan obligations is determined by making financial and demographic assumptions, both of which are significant estimates made by management. | The Committee reviewed the process used by management to determine an appropriate discount rate and considered the other critical assumptions underlying the calculation of the defined benefit liabilities, including those in respect of inflation and mortality.<br><br>The Committee was satisfied that management had used appropriate assumptions that reflected the Group's most recent experience and were consistent with market data and other information.<br><br>The Committee was also satisfied that the Group's disclosures made in respect of retirement benefit obligations are appropriate. The relevant disclosures are set out in note 36: 'Retirement benefit obligations' of the financial statements. The defined benefit obligation at 31 December 2019 was £45,241 million (31 December 2018: £41,092 million). |
| Recoverability of deferred tax asset | A deferred tax asset can be recognised only to the extent that it is more likely than not to be recoverable. The recoverability of the deferred tax asset in respect of carry forward losses requires consideration of the future levels of the Group's taxable profit and the legal entities in which the profit will arise. | The Committee considered management's assessment of forecast taxable profits based on the Group's operating plan, the split of these forecasts by legal entity and the Group's long-term financial and strategic plans.<br><br>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 37: 'Deferred tax' of the financial statements. The Group's net deferred tax asset at 31 December 2019 was £2,622 million (31 December 2018: £2,453 million). |
| Uncertain tax provisions | 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 Committee reviewed management's assessment of the Group's uncertain tax positions which took into account the views of the relevant tax authorities and any external advice it received.<br><br>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 48: 'Contingent liabilities, commitments and guarantees' of the financial statements. |

| | Key issues | Committee review and conclusion |
|---|---|---|
| Value-In-Force (VIF) asset and insurance liabilities | Determining the value of the VIF asset and insurance liabilities requires management to make significant estimates for both economic and non-economic actuarial assumptions. | The Committee considered updates from management and from the Group's Insurance Audit Committee summarising its activities, which included a review of the economic and non-economic assumptions made by management to determine the Group's VIF asset and insurance liabilities. The most significant assumptions were in respect of annuitant mortality, workplace pension persistency and expenses.<br>The Committee was satisfied that the assumptions used to calculate the VIF asset (2019: £5,558 million; 2018: £4,762 million) and liabilities arising from insurance contracts and participating investment contracts (2019: £111,449 million; 2018: £98,874 million) were appropriate. The disclosures are set out in note 25: 'Value of in-force business' and note 32: 'Liabilities arising from insurance contracts and participating investment contracts' of the financial statements. |
| Wealth management partnership | Determining the appropriate accounting for certain one-off transactions requires management to assess the facts and circumstances specific to each transaction. | During 2019, the Group entered into a wealth management partnership with Schroders plc. This involved the Group retaining a 50.1 per cent ownership interest in an entity into which it transferred assets under management and associated advisers from its existing business. Determining the appropriate accounting classification of the new activities required management judgement. The Committee reviewed the accounting proposed by management which determined that the entity should be accounted for as a joint venture and was satisfied that this was appropriate.<br>The relevant disclosures are set out in note 23 of the financial statements. |
| IFRS 16 Leases | The Committee has discussed the requirement of IFRS 16 which the Group adopted on 1 January 2019. | The Committee noted that the principal impact of the standard on the Group was to recognise property leases 'on-balance sheet' rather than as operating leases. The Committee was satisfied that the disclosures made in respect of IFRS 16 in the Group's financial statements were appropriate. |
| IFRS 17 Insurance contracts | IFRS 17 Insurance Contracts is expected to be effective for the year ending 31 December 2022. | The Committee received an update on the Group's IFRS 17 implementation project, which noted that, whilst the effective date of the standard is expected to be deferred, the Group will broadly maintain its existing timetable for elements of the programme that will improve processes. The Committee also noted the progress made to date on the IT development and actuarial models. The Committee was satisfied with the Group's progress and its disclosure included in note 56 to the financial statements setting out the impact of accounting standards that were not effective for the Group at 31 December 2019. |
| Viability statement | The Directors are required 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 viability statement must also disclose the basis for the Directors' conclusions and explain why the period chosen is appropriate. | The Committee assisted the Board in performing its assessment of the viability of the Company and the Group with input from management. The viability assessment, which was based on the Group's operating, capital and funding plans, 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.<br>The Committee was satisfied that the viability statement could be provided and advised the Board that three years was a suitable period of review. The viability statement is disclosed within the Directors' report on pages 95 to 96. |

## Payment Protection Insurance

The Group increased its provision for payment protection insurance (PPI) redress and associated administration costs by £2,450 million in the year ended 31 December 2019, bringing the total amount provided to £21,875 million. As in previous years, the Committee has reviewed management's assumptions used to calculate the Group's provision.

In the lead up to the 29 August 2019 deadline for the submission of claims (the Industry Deadline), the Group received a significant number of PPI Information Requests (PIRs). Management determined that the rate at which these enquiries convert to valid claims was a significant judgement in 2019, with the quality of PIRs deteriorating as the Industry Deadline approached.

The Committee reviewed management's assessment that the quality of the PIRs received in the period leading up to the deadline was low, with about one in ten PIRs leading to a valid claim, and its calculation that an additional provision of £1,800 million was required in the third quarter. At the year end, the Committee reviewed management's assessment that, based on actual experience in the fourth quarter of 2019, no further provision was required.

The overall cost associated with PPI remains uncertain and the Committee has considered management's use of sensitivities used to evaluate this uncertainty. At 31 December 2019, for every one per cent increase in the PIR conversion rate on the stock at the Industry Deadline, the Group would expect an additional charge of approximately £100 million.

## 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 section on pages 129 to 187. Specific related matters that the Committee considered for 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 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

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

**Risk weighted assets**
The Committee asked management to prepare a summary of the Group's end-to-end processes to calculate its risk-weighted assets, highlighting those areas that require management judgement and interpretation. Whilst no issues were identified, it was agreed further internal assurance work would be undertaken. The Committee also asked that a programme of targeted external assurance reviews be carried out; it will review the findings from both the internal and external reviews in 2020.

**Climate-related financial disclosure**
The Committee has received updates on the Group's plans to develop disclosures implementing the Taskforce on Climate-Related Financial Disclosure recommendations by 2022 and the Group's proposed current year Annual Report disclosure. Climate change disclosure will remain an area of focus for the Committee and it will continue to monitor its development during the coming year.

**Q1 and Q3 Interim Management Statements ('IMS')**
The Committee considered the processes and format of the Company's IMS reporting and concluded that improvements could be made, which resulted in simplification of IMS reporting in Q1 and Q3 for 2019.

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

- Monitored the effectiveness of Group Internal Audit and their audit programme through quarterly reports on the activities undertaken and a report from the Quality Assurance function within Group Internal Audit
- Monitored the progress of internal audit's coverage of key risk themes across the Group, including Transformation and Change, Cyber & Information Security, Data Management and IT, Business & Operational Resilience
- Approved the annual audit plan and budget, including resource and reviewed progress against the plan through the year
- Assessed Group Internal Audit's resources and skills (supplemented by externally sourced subject matter experts as required) as adequate to fulfil its mandate
- Monitored and assessed the independence of Group Internal Audit
- Considered the major findings of significant internal audits, and management's response

**Speak Up (the Group's whistleblowing service)**
The Committee received and considered reports from management on the Group's whistleblowing arrangements. The Committee reviewed the reports to ensure there are arrangements in place which colleagues can use in confidence to report concerns about inappropriate and unacceptable practices, and that there is proportionate and independent investigation of such matters or appropriate follow up. The Committee reported on its consideration of whistleblowing arrangements to the Board. The Committee also established an interim sub-committee to consider whistleblowing cases where allegations relate to Material Risk Takers or Senior Managers, and to oversee improvements being made to the Group's whistleblowing arrangements.

**Auditor independence and remuneration**
Both the Board and the external auditor have policies and procedures designed to protect the independence and objectivity of the external auditor. The Committee has received confirmation from Deloitte, the incoming auditor from 2021, that it is independent of the Group as at 1 January 2020. This will permit Deloitte to commence audit planning activities in the first half of 2020. In January 2020, the Committee amended its non-audit service policy to reflect revisions made by the Financial Reporting Council to its rules and to require Deloitte to comply with the policy. The main change related to due diligence services, which can no longer be provided to the Group by either PwC or Deloitte. In addition to detailing those services that the Committee prohibits the external auditor from providing to the Group, the policy pre-approves certain services provided the fee is below a threshold; all other permitted services must be specifically approved in advance by the Committee.

Prior to engagement of the auditor for a permitted service, the policy requires that senior management confirms whether the Committee has pre-approved the service or specific approval is required. The total amount of fees paid to the auditor for both audit and non-audit related services in 2019 is disclosed in note 12 to the financial statements.

**External auditor**
The Committee oversees the relationship with the external auditor (PwC) including its terms of engagement and remuneration, and monitors its independence and objectivity. Mark Hannam has been PwC's senior statutory audit partner for the Group and the Company since the beginning of 2016, and attends all meetings of the Committee. During 2019, the Committee reviewed PwC's audit plan, including the underlying methodology, and PwC's risk identification processes. In its assessment of PwC's performance and effectiveness, the Committee has considered: PwC's interactions with the Committee; the responses to a questionnaire issued to the Group's businesses, Finance, Risk and Internal Audit; and the FRC's Audit Quality Inspection Report published in July 2019. The Committee concluded that it was satisfied with the auditor's performance and recommended to the Board a proposal for the re-appointment of the auditor at the Company's AGM.

**Statutory Audit Services compliance**
The Company and the Group confirm 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 (the Order) for the year to 31 December 2019. PwC has been auditor to the Company and the Group since 1995, and will continue as auditor until the year ending 31 December 2020.

In October 2018, the Board, following a tender exercise and formal review to choose a new auditor and the recommendation of the Committee, approved the proposed appointment of Deloitte LLP. Subject to shareholder approval, Deloitte LLP will undertake the Group audit for the year ending 31 December 2021. The Company and the Group have no plans therefore as at the date of this report to conduct a tender exercise for external audit services.

# Board Risk Committee report

## The Group's resilience, through strategic change and continually emerging risks, has been a core consideration.

**Alan Dickinson**
Chairman, Board Risk Committee

## Dear Shareholder

I am pleased to report on how the Board Risk Committee (the 'Committee') has discharged its responsibilities throughout 2019.

During the year, the Committee again focused on a wide range of existing and emerging risks, using dedicated sub-committees and effective planning of the agenda to ensure that focus and attention was given to those risks which were considered to be of ongoing importance to the Group and its customers. The environment within which the Group operates remained subject to continually evolving risks with considerable degrees of change and uncertainty.

The Committee was concerned to oversee the successful delivery of significant regulatory change such as the embedding of ring-fenced banking, data risk and operational resilience. Operational resilience has been elevated to a primary risk category along with change and execution risk, recognising the extensive Group strategic change agenda. The Committee was pleased to see that good progress was made with the management of customer rectifications. The Committee also focused very closely on conduct risks and, in particular, the Group's management of customers in financial difficulty, including implementation of a revised operating model to improve customer outcomes. Each of these areas will be subject to ongoing focus in 2020.

Other areas of focus for the year ahead will include continued improvements in the Group's treatment of vulnerable customers, fraud and financial crime, consumer indebtedness, and continually evolving risks within IT and cyber – as part of the broader operational resilience agenda. The Committee will again consider impacts on the Group's broader risk profiles arising from delivery of the strategic change agenda. Inevitably, the external environment continues to provide challenges and potential impacts for the Group's risk profile which the Committee continues to closely monitor.

The Committee has concluded that the Group continues to have strong discipline in the management of both emerging and existing risks, and the Committee's work continues to support the Group in achieving its core aim of operating as a digitised, simple, low risk provider of financial services.

**Alan Dickinson**
Chairman, Board Risk Committee

## Committee purpose and responsibilities

The purpose of the 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 Group.

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 policies, 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 129 to 187. 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, experience and operation

The Committee is composed of 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.

All Non-Executive Directors are members of the Committee. The Chief Risk Officer has full access to the Committee and attends all meetings. The Chief Internal Auditor and members of the Executive also attend meetings, as appropriate.

Annually the Committee undertakes an effectiveness review. The review forms part of the Board evaluation process with Directors being asked to complete parts of the questionnaire relating to the Committees of which they were members. The findings of the review were considered by the Committee at its January 2020 meeting. On the basis of the evaluation, the feedback was that the performance of the Committee continues to be effective. Details of Committee membership and meeting attendance can be found on page 70.

As the most senior risk committee in the Group, the Committee interacts with other related risk committees, 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 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 on the following pages is a summary of these risks, with an outline of the material factors considered by the Committee, and the conclusions which were ultimately reached.

During 2019, the Committee continued to utilise established sub-committees to provide additional focus on areas such as IT resilience and cyber, and stress testing and recovery planning. The Committee receives regular updates from the Lloyds Bank Corporate Markets and Insurance business sub-groups, which summarise the key discussions and decisions taken at the relevant entities' risk committees. These sub-committees enable members of the Committee to dedicate additional time and resource to achieving a more in-depth understanding of the topics covered, and enable further review and challenge of the associated risks.

## Activities during the year

| | Key issues | Committee review and conclusion |
|---|---|---|
| **Conduct risk** | | |
| Rectifications | The Committee continues to focus closely on the Group's management of customer rectifications. | Throughout 2019 the Committee has considered reports on the Group's Rectifications portfolio performance, with particular interest in reducing the number of customers with outstanding remediations. The Committee has noted continued progress in the pace and quality of remediations, delivering a reduction in the number of customers awaiting redress and improvements in customer outcomes. The Committee has remained close to progress on material rectifications, including HBOS Reading.<br>**Conclusion:** Root cause analysis and read-across activities continue to improve and embed across the Group with good progress in reducing the volume of rectification programmes and customers impacted. This will remain a key focus for the Committee in 2020. |
| CiFD | The Committee continues to focus closely on the Group's management of conduct risks and issues associated with customers in financial difficulty. | During 2019, the Committee considered reports on the ongoing activity to improve the way we support customers experiencing financial difficulty.<br>The Committee held a deep dive into financial difficulty cases to provide deeper insight into root cause analysis and the actions being taken to improve customer outcomes. Other key focus areas included the initiatives being delivered and progressed through the Financial Wellbeing lab and implementation of a revised operating model to improve outcomes.<br>The Committee also noted the impact of a potential economic downturn and new regulatory requirements such as Persistent Debt.<br>**Conclusion:** Whilst progress has been made, further improvement in the Group's treatment of customers in financial difficulty will be a key focus area in 2020. |
| Complaints | The Committee continues to focus on ensuring the Group is resolving customer complaints in a timely and fair manner and eradicating the causes for complaints. | The Committee continues to focus on ensuring the Group has an effective framework for managing complaints including root cause analysis to establish lessons learned and help prevent similar issues in the future. Consideration has been given to complaint metric performance via Board Risk Appetites and quality as measured by the Financial Ombudsman Service.<br>**Conclusion:** The Group continues to make good progress in reducing the causes for customer complaints however focus needs to remain on reducing the time taken to resolve complaints in 2020 and to learn from root cause analysis. |
| Vulnerability | Vulnerable customers represent a significant proportion of the Group's customer base and continue to be an area of close focus with increasing regulatory focus. | The Committee recognises the importance of the Group's vulnerability strategy in delivering customer outcomes, against a backdrop of increasing regulatory focus and noted the Group's response to the FCA's consultation on Vulnerable Customers, considering the potential impact on the Group's strategy going forward.<br>The Committee considered the progress that continues to be made to implement the Group's vulnerability strategy, and the enhancements made to support the embedding of regulatory Framework and Guidance.<br>The Committee noted the actions in train, including defining solutions to allow vulnerability information to be recorded and shared, the continued development of vulnerability dashboards and enhancements to the control framework along with the proposals for an enhanced approach to investment prioritisation for vulnerability initiatives.<br>**Conclusion:** The Committee recognise the importance of this subject and the increasing regulatory focus. It will continue to require ongoing focus and investment to execute the Group's strategy in relation to vulnerable customers and meet external expectations. |
| Climate change | During the year the Committee has increased focus on climate change, sustainability and the potential impact to the Group and impact on our customers. | Climate change and sustainability have been added as top areas of ongoing focus and the Committee has increased consideration of the risks that may arise.<br>The Group is committed to delivering Taskforce on Climate-related Financial Disclosure Recommendations (TCFD) and is working to ensure that regulatory expectations with regards to managing the financial risks arising from climate change are met. A proactive approach is required to continue to anticipate the sustainability impact on client's business models.<br>**Conclusion:** The Committee will continue to closely monitor climate change and sustainability risks, looking at the impact on both the Group and our customers, and the delivery of TCFD and other commitments. |
| **Financial risk – covering Credit and Market risk** | | |
| Commercial credit quality | The Committee continues to review the Commercial lending portfolio through regular credit quality update papers, including reviews of key portfolio and sector trends observed and external threats to portfolio performance. | Detailed reviews allowed the Committee to assess the overall quality of the portfolio and new business written. Risk levels and credit exposure, including to material individual names, were monitored with reference to management information and risk appetite limits, as appropriate.<br>Key sector concentrations, including commercial real estate and the funds business, as well as those sectors more vulnerable to the wider economic backdrop or structural change, were also examined in greater detail, including construction, manufacturing and consumer related sectors, such as retail. Specific consideration was also given to the automotive sector, which continues to face into disruptors such as new technologies and changing consumer behaviours.<br>The Committee also considered the Group's approach to credit policies and individual transaction limits, and reviewed summary details of transactions and portfolio reviews that were assessed at the Group's most senior credit committee.<br>**Conclusion:** Overall Commercial Banking credit quality remained broadly stable. Origination quality has been maintained, supported by a consistent through-the-cycle approach to risk appetite. The portfolio continues to be monitored closely with consideration given to the macroeconomic outlook and emerging trends. |

| | Key issues | Committee review and conclusion |
|---|---|---|
| Customer indebtedness | The Committee reviewed the risks relating to retail lending indebtedness. | Consideration was given to the Group's lending controls, risk appetite monitoring and new lending indebtedness risk for the consumer unsecured, motor, retail secured and buy-to-let portfolios.<br>The Committee noted that lending controls, risks appetite metrics and segmented reporting for both indebtedness and affordability assessments are in place, and acknowledged the Group's continued actions closely to monitor and control higher risk and marginal indebtedness segments and reduce exposure over time. The Committee reviewed management action which had also been taken within retail secured lending, including buy-to-let, to protect against contagion risk from growth in consumer debt levels, and to ensure that customers' finances were resilient to stress.<br>**Conclusion:** The Committee was satisfied that the appropriate lending controls and monitoring are in place for affordability and indebtedness and noted progress made to strengthen these and improve visibility of customers' debt positions. |
| **Operational risk** | | |
| Operational resilience | Operational resilience is one of the Group's most important non-financial risks. Key focus in 2019 has been to continue to enhance the existing approach to operational resilience and strengthen the control environment, to improve the Group's ability to respond to incidents and continue delivering key services to our customers. | Key areas of focus for the Committee have included updates on the Group's operational resilience programmes, progress against the operational resilience strategy and continued regulatory engagement in advance of the publication of Bank of England's consultation paper.<br>Given the significance of the risk to the Group, the Committee is supported by the IT and Cyber Advisory Forum specifically focused on IT and cyber risks. The Committee has reviewed papers relating to Group operational resilience investment, proposals for considering Impact Tolerances and Advanced Intrusion Testing.<br>**Conclusion:** In 2019, operational resilience was classified as a primary risk. The Committee takes the operational resilience of its services very seriously and has drawn valuable insight from having independent advice and guidance. It has agreed risk appetite statements for critical services and will continue to strengthen these to reflect the increased focus on resilience. The Committee considers that governance of operational resilience risk is robust and that activities in plan will ensure the ongoing resilience of key services to the Group's customers. |
| Data risk | The Committee continues to focus on data governance, privacy and data ethics risks including oversight of the Group's compliance with the General Data Protection Regulation (GDPR), and the associated risks and controls. | Data risk continues to be an area of significant regulatory and media attention. The Committee has remained focused on ensuring effective controls are in place regarding the governance, privacy, ethics and management of our customers' data. Third party oversight controls continue to embed and mature following the successful implementation of GDPR. Compliance with the principles of the Basel Committee of Banking Supervision (BCBS) also remains a key area of focus.<br>**Conclusion:** The Group continues to enhance the controls required to identify and manage data risk. |
| People risk | The Committee recognises the importance of People risk management to ensure the Group has the right capabilities and culture as we build the Bank of the Future. | Throughout 2019, the Committee has continued to focus on the People risk profile, recognising the challenges faced with successfully delivering the Group's strategic agenda, alongside the regulatory change agenda. The Group recognises the increasing demands on colleagues and is focusing on the ongoing monitoring of colleague wellbeing and engagement, and on developing colleague skills to achieve capability enhancement for a digital era. Particular consideration is given to critical populations and high performing individuals to support the Group's core commitments. The Group has also made significant progress in evolving and refining the compliance control environment for the Senior Manager and Certification Regime (SMCR) and delivery of the SMCR extension was completed in 2019.<br>**Conclusion:** Regular monitoring continues to confirm that the People risk profile is managed effectively. The Committee ensures the necessary risk oversight as the Group continues to deliver simplified colleague processes and maximises colleague skills and potential to achieve the workforce of the future. |
| Change and execution risk | The Committee continues to focus on the risks associated with delivery and embedding of an extensive strategic change agenda, including both discretionary and regulatory change. | The Committee continues to focus on the risks associated with the extensive Group strategic change agenda, recognising the challenges faced in ensuring both successful delivery and embedding of change.<br>Change and execution risk has been elevated to a primary risk category to recognise the risk attached to the delivery of GSR3 and its impact on the enterprise wide risk profile.<br>The Group has matured in its ability to define, measure and report execution risk. The articulation and quantification of this risk continues to embed through regular reviews of the execution risk dashboard and its metrics, as well as the implementation of the change and execution risk library.<br>An area of focus has been on increasing understanding of the wider risk impacts of the initiatives that are driving investment funding decisions and the impact of GSR3 on the Group's risk profile. For instance, as GSR3 is transforming both ways of working and colleague journeys, there is a deeper understanding of the impact of those changes on People risk.<br>The Group continues to increase its use of agile delivery approaches and tools and our change oversight has been reviewed and refreshed to support this.<br>**Conclusion:** Change and execution risk will remain an area of focus for the Committee as the Group continues to increase its understanding of the change and execution risk associated with our transformation agenda and evolve its change delivery approaches. Further focus is required fully to reflect the enterprise wide impacts of our strategic agenda into business risk profiles and to leverage this awareness in key investment funding decisions. |

## Board Risk Committee report continued

| | Key issues | Committee review and conclusion |
|---|---|---|
| Macroeconomic environment | The Committee continues to consider key economic and political risks, particularly given the increasingly uncertain outlook. | The Committee continues to consider key economic and political risks. Consideration is focused on risks that may impact the Group's central economics forecast that is incorporated into the Group's four year operating plan. Continuation of the current global trade tensions, deterioration in the UK property market or UK productivity, or a global economic slowdown and low (or negative) interest rates could have an adverse impact on profitability, capital generation and the Group's credit risk profile.<br>**Conclusion:** The Committee will continue to closely monitor risks arising from economic uncertainty. The Committee will also focus on risks emerging due to slower economic growth and political challenges, as well as risks from wider global events. |
| EU Exit planning | Negotiations continue to determine the final terms of the UK's exit from the EU.<br>The prolonged uncertainty regarding the options, timing and the process itself could affect the outlook for the UK and global economy. | The key risks for the Group include volatility and possible discontinuities in financial markets, impact on our customers' trading performance, financial position and credit profile, and ability to continue to operate in line with current practice across borders.<br>When reviewing the possible impacts of the EU Exit, the Committee has given particular consideration to the Group's strong UK focus and UK-centric strategy. The Committee continues to closely monitor developments, with specific focus on the trading, financial, operational impacts for the Group, as well as the cyber, physical security and fraud risks, and the continued support of our customers.<br>**Conclusion:** The Group's EU exit contingency plans continue to be closely monitored by the Committee via specific regular updates, covering both operational status and external developments, a suite of early warning indicators and corresponding risk mitigation plans. |
| Money laundering | Financial Crime is a priority for the UK Government, law enforcement and regulators. The Committee continues to monitor the Group's management of financial crime risk in light of continued legislative change and regulatory scrutiny. | The Committee acknowledged the continued focus the Group places on the fight against financial crime and is playing an active part in developing and delivering on the strategic aims of HM Government's Economic Crime Reform programme, including designing and delivering improvements in the UK SARs (Suspicious Activity Reporting) regime. This is a multi-year programme delivering through a private and public partnership, and for which the Group is represented by the Chief Operating Officer attending the Home Office's Economic Crime Strategic Board.<br>The Committee also recognised significant strengthening of the Group's intelligence capability to inform assessment of risk, for example the work to understand exposure to allegations of money laundering through Baltic banks; and cash-based money laundering through instant deposit machines.<br>**Conclusion:** The Committee noted satisfaction with the standard of compliance documented in the MLRO report, and acknowledged the action plans in place across the Group to further enhance the Group's position. Additionally, the Committee acknowledged the strategic plans in place to further enhance and digitise the Group's financial crime control framework, designed to deliver more effective and agile controls whilst improving the customer experience. |
| Fraud | The Committee continues to closely monitor the Group's management of fraud risk, whilst minimising the impact of controls on genuine customer journeys. | The Committee considered the challenging and evolving nature of the fraud risk environment influenced by factors such as an increasing sophistication of fraud typologies and an uplift in industry reported gross fraud losses. The Committee noted the correlated impact on the Group's gross authorised fraud losses albeit our market share remains below our market share of transactions. Gross unauthorised fraud losses at both Industry and Group level rose during 2019. However, they remain within Group appetite and the Group's net losses remain stable year on year on a like-for-like basis.<br>Additionally, the Committee acknowledged the leading role the Group has played in the development of an industry code for authorised push payment fraud. The code was implemented in May 2019 and the Group has demonstrated compliance and good customer outcomes. Some operational improvements, expectations from the Financial Ombudsman's Service regarding the provision of warnings and the issue of funding cases where neither the financial institution nor the customer is to blame continue to be addressed.<br>**Conclusion:** The Committee noted the positive work undertaken in the detection and prevention of fraud and recognised the continuing efforts of the Group to protect the integrity of genuine customer journeys with strategic plans aimed at enhancing the fraud control environment of the Group which reflect the comprehensive nature of the challenge and require internal evolution and external engagements. |
| **Regular reporting categories** | | |
| Regulatory and legal risk | Managing regulatory risk continues to be a key focus within the Group due to the significant amount of highly complex and interdependent regulatory reform that we have managed in 2019, and will continue to manage in 2020. | The Committee has continued focus on ensuring effective controls and oversight to comply with existing regulatory obligations, as well as receiving regular updates on emerging regulatory and legal risks. There have been ongoing significant regulatory change and oversight programmes in which the Board has placed increased focus to ensure successful execution, including the Basel Committee on Banking Supervision (BCBS 239), IBOR Transition, EU Exit, product pricing, customers in financial difficulty, HBOS Reading and climate change.<br>In addition, a key area of focus for the Committee has been ensuring ring-fencing requirements have been fully embedded and the Committee has operated in line with its commitments to the PRA and continued to demonstrate independent decision making for the ring-fenced bank. Key topics have included reviews of the ring-fenced bank perimeter, management of legal entity conflicts and governance.<br>**Conclusion:** The Group continues to place significant focus on implementing complex regulatory changes, as well as ensuring effective horizon scanning of upcoming trends. The Committee has discussed the topics raised, and will continue to closely monitor compliance with regulatory requirements, including ring-fencing in 2020. Regulatory risk will remain a priority area of focus for the Committee in 2020. |

# Responsible Business Committee report

## We have a responsibility to help address some of the challenges faced by the UK. We manage this through our Helping Britain Prosper Plan.

**Sara Weller CBE**
Chairman, Responsible Business Committee

## Dear Shareholder

I am pleased to report on the activity of the Responsible Business Committee (the 'Committee'), during a busy 2019.

The Committee continues to oversee and track progress against the Group's Helping Britain Prosper Plan, including reviewing performance against strategic aims, focusing on digital skills, sustainability and our Charitable Foundations.

The Group made good progress against targets in the Helping Britain Prosper Plan. Some examples, set out later on this page, include the launch of a unique Resilience portal to support colleagues mental health.

The Group was recognised by Fortune magazine as a leading business worldwide for its work on both sustainability and mental health.

The Group continued to support its UK-wide Charitable Foundations, showcasing the work they do, including with domestic abuse and mental health charities.

The Committee regularly reviewed progress on our aim to have more women in senior roles. It also discussed the Group's opportunity and plans to advance the representation of colleagues from BAME backgrounds at all levels.

I would like to thank the thousands of colleagues across the entire Group for their hard work and extraordinary commitment to supporting Responsible Business activity in their daily work, as well as by volunteering over 246,000 hours of their time and helping to raise over £11 million to date for our charity of the year, Mental Health UK.

The following report gives more examples of our activity to Help Britain Prosper in 2019. I hope you find it both interesting and informative.

**Sara Weller**
Chairman, Responsible Business Committee

## How the Committee spent its time in 2019

The Committee continued to focus on the three material areas aligned to the Bank of the Future, with the aim of enabling people, businesses and communities to be ready for the future:

- **Digital Skills** The programme was reviewed regularly, with updates on the direction of and progress with the Lloyds Bank Academy which successfully launched a second location in Bristol. The Committee also considered 'future.now' launched by the Lord Mayor of London, bringing together organisations to boost digital skills in the UK
- The Group's **Sustainability** strategy made consistent progress in 2019. A number of targets were achieved ahead of plan such as the EV1000 initiative of supporting 1,000 electric vehicles which was achieved during the third quarter of 2019. The Committee continues to present challenge on the Group's strategy of developing new products and strategies to help and support customers in a sustainable way. The Company's sustainability strategy is available on the Group's website www.lloydsbankinggroup.com/our-group/responsible-business
- The relationship between the Group and the **Charitable Foundations** is a key area of focus and the Group worked closely with the Foundations to showcase the work they do. The Committee continues to review the work done to support the Charitable Foundations work in the charitable sector through strengthening skills-based volunteering across their-supported charities

In other activities, the Committee undertook an in-depth review of Inclusion and Diversity within the Group, focusing on BAME colleagues. This demonstrated some of the Group's strengths and uniqueness but also identified opportunities to strengthen further its approach to attracting and developing talent. The Committee looked closely at progress on mental health and resilience in conjunction with the launch of a Resilience portal for colleagues. This highlighted scientific research into human behaviours provided by medical professionals based on clinical data.

The Committee will continue to discuss and monitor the effectiveness of the portal.

At each meeting, updates have been provided on the performance against the metrics of the Helping Britain Prosper Plan on which a report is provided from page 27. This contains further information on the activities which the Committee keeps under review.

## Committee purpose and operation

The Committee supports the Board in overseeing the Group's performance as a Responsible Business by providing oversight of, and support for, the Group's strategy and plans for embedding responsible business as part of the Group's purpose to Help Britain Prosper. This Committee provides oversight and challenge on activities which impact the Group's trust and reputation and by considering and recommending to the Board for approval the Responsible Business Report and Helping Britain Prosper Plan.

The Committee's Chair reviews the forward agenda regularly to ensure that the focus of the Committee's work is on its key priorities and members have sufficient time at meetings to raise issues of concern and to engage in constructive dialogue with colleagues.

## Committee composition, attendance at meetings and effectiveness review

The Committee is composed of Non-Executive Directors.

Representatives from Group Internal Audit and the Chief Operating Office 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. The Committee will consider the output from the 2019 effectiveness review and whether amendments could be made to its current working arrangements.

Details of committee membership and meeting attendance can be found on page 70.

# Directors' report

## Corporate governance statement

The Corporate Governance report found on pages 65 to 93 together with the discussion of the composition of the Remuneration Committee on page 114 and this Directors' report, which form part of the Corporate Governance Report, fulfils the requirements of the Corporate Governance Statement for the purpose of the Financial Conduct Authority's Disclosure Guidance and Transparency Rules (DTR).

## Profit and dividends

The consolidated income statement shows a statutory profit before tax for the year ended 31 December 2019 of £4,393 million (2018: £5,960 million). The Directors have recommended a final dividend for 2019, which is subject to approval by the shareholders at the AGM, of 2.25 pence per share totalling £1,586 million. The final dividend will be paid on 27 May 2020.

The final dividend in respect of 2018 of 2.14 pence per ordinary share was paid to shareholders on 21 May 2019, and an interim dividend for 2019 of 1.12 pence per ordinary share was paid on 13 September 2019; these dividends totalled £2.312 billion. Further information on dividends is shown in note 45 on page 268 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.

William Chalmers and Sarah Legg have been appointed to the Board since the 2019 AGM and will therefore stand for election at the forthcoming AGM, together with Catherine Woods, who, as announced in October 2019, will join the Board on 1 March 2020. Anita Frew will retire at the AGM. In the interests of good governance and in accordance with the provisions of the UK Corporate Governance Code, all other Directors will retire, and those wishing to serve again will submit themselves for re-election at the forthcoming AGM.

Biographies of current Directors are set out on pages 66 to 67. Details of the Directors seeking election or re-election at the AGM are set out in the Notice of Meeting.

## Board composition changes

Changes to the composition of the Board since 1 January 2019 up to the date of this report are shown in the table below:

| | Joined the Board | Left the Board |
|---|---|---|
| William Chalmers | 1 August 2019 | |
| George Culmer | | 1 August 2019 |
| Sarah Legg | 1 December 2019 | |

## Directors' and Officers' liability insurance

Throughout 2019 the Group had appropriate insurance cover in place to protect Directors, including the 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 in the Directors' indemnities section.

## Capital Requirements (Country-by-Country Reporting)

As required under the Capital Requirements (Country-by-Country Reporting) Regulations 2013, the Group's related disclosures may be found online, at www.lloydsbankinggroup.com/globalassets/documents/investors/2018/2018_lbg_crdiv_country_by_country_disclosures.pdf

## 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. The deeds were in force during the whole of the financial year or from the date of appointment in respect of the Directors appointed in 2019. Deeds for existing Directors are available for inspection at the Company's registered office.

The Company has also granted deeds of indemnity by deed poll and by way of entering into individual deeds, which constitute '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, and to Group colleagues subject to the provisions of the Senior Managers and Certification Regime. Such deeds were in force during the financial year ended 31 December 2019 and remain in force as at the date of this report.

Qualifying pension scheme indemnities have also been granted to the Trustees of the Group's Pension Schemes, which were in force for the whole of the financial year and remain in force as at the date of this report.

## Change of control

The Company is not party to any significant agreements which take effect, alter or terminate upon a change of control of the Company following 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.

## 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, which include the Directors' ability to issue or buyback shares. The Directors were granted authorities to issue and allot shares and to buyback shares at the 2019 AGM. Shareholders will be asked to renew these authorities at the 2020 AGM. The authority in respect of purchase of the Company's ordinary shares is limited to 7,124,228,884 ordinary shares, equivalent to 10 per cent of the issued ordinary share capital of the Company as at the latest practicable date prior to publication of the 2019 AGM circular.

The Company undertook an ordinary share buyback programme, which was launched on 1 March 2019, until it was cancelled in September 2019 as a result of the additional PPI charges announced in September. The programme repurchased in aggregate 1,886,917,377 ordinary shares for an aggregate consideration of c.£1.1 billion (aggregate nominal value of the ordinary shares £188,691,737.70) as a means by which to return capital to shareholders, given the amount of surplus capital. The 2019 ordinary share buyback also assisted in the normalisation of ordinary dividends. All of the repurchased ordinary shares were cancelled, and together represented 2.69 per cent of the called up share capital of the Company at completion of the programme. Further information in relation to the 2019 ordinary share buyback programme is provided on page 63.

## Conflicts of interest

The Board has a comprehensive procedure for reviewing, and as permitted by the Companies Act 2006 and the Company's articles of association, approving actual and potential conflicts of interest. Directors have a duty to notify the Chairman and Company Secretary as soon as they become aware of actual or potential conflict situations. Changes to commitments of all Directors are reported to the Nomination and 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.

Stuart Sinclair is a Senior Independent Director at QBE UK Limited, a general insurance and reinsurance company. Lord Lupton is a senior advisor to Greenhill Europe, an investment bank focused on providing financial advice on significant mergers, acquisitions, restructurings, financings and capital raising to corporations, partnerships, institutions and governments. The Board has recognised that potential conflicts may arise as a result of these positions. The Board has authorised the potential conflicts and requires Mr. Sinclair and Lord Lupton to recuse themselves from discussions, should the need arise.

## 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.

## 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 | 36 to 39 |
| **Ordinary dividends** | Dividends on ordinary shares | 268 |
| **Directors' biographies** | Board of Directors | 66 to 67 |
| **Directors in 2019**[1] | Board of Directors | 66 to 67 |
| **Directors' emoluments** | Directors' remuneration report | 98 to 128 |
| **Internal control and financial risk management** | Financial reporting risk<br>Risk management<br>Financial instruments | 131<br>129 to 187<br>275 to 286 and 289 to 314 |
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1 George Culmer also served as a director during the year, retiring from the Company on 1 August 2019.

## 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 2019, 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] |
|---|---|---|
| BlackRock Inc. | 3,668,756,765[2] | 5.14% |
| Harris Associates L.P. | 3,551,514,571[3] | 4.99% |

1 Percentage provided was correct at the date of notification.

2 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 5 February 2020, which identifies beneficial ownership of 4,698,292,748 shares in the Company representing 6.7 per cent of the issued share capital in the Company. This variance is attributable to different notification and disclosure requirements between these regulatory regimes.

3 An indirect holding.

No further notifications have been received under Rule 5 of the DTR as at the date of this report.

## 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 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
- The 2017 Group Strategic Review, which sets out the Group's customer and business strategy for the three year period from 2018 to 2020 inclusive
- The Group's four year operating plan which comprises detailed customer, financial, capital and funding projections together with an assessment of relevant risk factors for the period from 2020 to 2023 inclusive

In particular, the assessment included consideration of the impact of the UK's exit from the EU on the economy and on the regulatory agenda, and the implications of alternative interest rate scenarios given volatility in interest rate markets.

Group, divisional and business unit operating plans covering a period of four years are produced and subject to rigorous stress testing 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 annual planning process comprises the following key stages:

- The Board reviews and revises the Group's strategy, risk appetite and objectives in the context of the operating environment and external market commitments
- The divisional teams develop their operating plans based on the Board's objectives ensuring that they are in line with the Group's strategy and risk appetite
- The financial projections and the underlying assumptions in respect of 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
- In addition, the Board obtains independent assurance from Risk Division over the alignment of the plan with Group strategy and the Board's risk appetite. This assessment performed by Risk Division also identifies the key risks to delivery of the Group's operating plan
- The planning process is also underpinned by a robust capital and funding stress testing framework. This framework allows the Group to assess compliance of the operating plan with the Group's risk appetite

- The scenarios used for stress testing are designed to be severe but plausible, and take account of the availability and likely effectiveness of mitigating actions that could be taken by management 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 79, is taken into account. Further information on stress testing and reverse stress testing is provided on page 137 to 138
- The final four year 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. The uncertain global economic and political environment, including the longer-term impact of the UK leaving the EU, together with the pace of regulatory change mean that the assumptions supporting the fourth year of the operating plan are likely to be less reliable. As a result, the Board considers that a three year period continues to present a reasonable degree of confidence over expected events and macroeconomic assumptions, whilst still providing an appropriate longer-term outlook, although the remaining period of the operating plan contains no information which would cause different conclusions to be reached over the longer-term viability of the Company and Group. 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 on pages 2 to 46
- Emerging risks are disclosed on pages 133 to 134
- 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 129 to 187
- The Group's approach to stress testing and reverse stress testing, including both regulatory and internal stresses, is described on page 137 to 138

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 2022.

## 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 45 and pages 175 to 180 and capital position on pages 166 to 175. Additionally, the Directors have considered the capital and funding projections of the Company and Group. Accordingly, the Directors conclude that the Company and the Group have adequate resources to continue in operational existence for a period of at least 12 months from the date of the approval of the financial statements and therefore it is appropriate to continue to adopt the going concern basis in preparing the accounts.

## Greenhouse gas emissions

The Group has voluntarily reported greenhouse gas emissions and environmental performance since 2009, and since 2013 this has been reported in line with the requirements of the Companies Act 2006. Our total emissions, in tonnes of $CO_2$ equivalent, are reported in the table below. Deloitte LLP has provided limited level ISAE 3000 (revised) and 3410 (ISAE 3410) assurance over selected non-financial indicators as noted by ✓. Their full, independent assurance statement is available online at www.lloydsbankinggroup.com/our-group/responsible-business

### 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 2018 to 30 September 2019, which is different to that of our Directors' report (January 2019 – December 2019). 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. 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 and purchase of electricity for own use, calculated using both the location and market based methodologies. Reported Scope 3 emissions relate to business travel and commuting undertaken by colleagues and emissions associated with waste and the extraction and distribution of each of our energy sources; electricity, gas and oil. In 2019 we have expanded Scope 3 emissions as part of our sustainability strategy to increase transparency of reporting of our carbon footprint, and to drive reductions in additional categories of emissions; these include Waste Emissions, Upstream Business Travel (the well to tank emissions of rail, air, road vehicles, hired vehicles); Hotels; Commuting; Tube; Taxis. A detailed definition of these emissions can be found in our 2019 Reporting Criteria online at www.lloydsbankinggroup.com/our-group/responsible-business

## Intensity ratio

### Legacy

| | Oct 2018 – Sept 2019 | Oct 2017 – Sept 2018 | Oct 2016 – Sept 2017 |
|---|---|---|---|
| GHG emissions ($CO_2e$) per £m of underlying income (Location Based)[1] | **11.5** | 13.0 | 15.5 |
| GHG emissions ($CO_2e$) per £m of underlying income (Market Based)[1] | **5.6** | 6.2 | 16.4 |

### Expanded

| | Oct 2018 – Sept 2019 | Oct 2017 – Sept 2018 | Oct 2016 – Sept 2017 |
|---|---|---|---|
| GHG emissions ($CO_2e$) per £m of underlying income (Location Based) – expanded scope[2] | **15.8** | 17.3 | – |
| GHG emissions ($CO_2e$) per £m of underlying income (Market Based) – expanded scope[2] | **9.9** | 10.5 | – |

1 Intensities have been restated for 2016-2017 and 2017-2018 to reflect changes to emissions data only, replacing estimated data with actuals; underlying income figures for those years have not changed.

2 Scope 3 emissions have been expanded to include additional elements within the Group's own operations including emissions from waste, colleague commuting and additional elements of business travel (including taxis, tube, well to tank emissions of business travel and hotels). We have disclosed these figures parallel to legacy scope numbers to allow fairer comparison to numbers previously disclosed and to demonstrate performance versus our previous targets.

This year, our overall location based carbon emissions were 207,768 $tCO_2e$; a 14.6 per cent decrease since 2018 and 63.1 per cent decrease against our 2009 baseline (legacy scope). Reductions achieved are attributable to an extensive energy optimisation programme and reductions in business travel, alongside decarbonisation of the UK electricity grid. In addition, there has been a reduction in property footprint and headcount.

Our market based emissions figure is equal to 101,042 $tCO_2e$ – a comparative decrease of 12.9 per cent year on year and 82.0 per cent decrease against 2009 baseline. Further reductions in market emissions are attributable to the purchase of renewable energy certificates for each of our operations outside of the UK equivalent to their consumption since January 2019. We continue to source solar, wind hydro and biomass Renewable Energy Guarantees of Origin (REGOs) equivalent to our total UK electricity consumption.

### $CO_2E$ emissions (tonnes) – Expanded scope

| $CO_2E$ Emissions Tonnes: | Oct 2018 – Sept 2019 | Oct 2017 – Sept 2018[1] | Oct 2016 – Sep 2017[1] |
|---|---|---|---|
| Total $CO_2e$ (market based) ✓ | **179,324** | 197,484 | n/a |
| Total $CO_2e$ (location based) ✓ | **286,051** | 324,816 | n/a |
| Total Scope 1 ✓ | **47,524** | 49,299 | 51,935 |
| Total Scope 2 (market based) ✓ | **387** | 1,951 | 178,711 |
| Total Scope 2 (location based) ✓ | **107,113** | 129,284 | 162,598 |
| Total Scope 3[2] ✓ | **131,414** | 146,233 | n/a |

### $CO_2E$ emissions (tonnes) – Legacy scope

| $CO_2E$ Emissions Tonnes: | Oct 2018 – Sept 2019 | Oct 2017 – Sept 2018[1] | Oct 2016 – Sept 2017[1] |
|---|---|---|---|
| Total $CO_2e$ (market based) ✓ | **101,042** | 115,961 | 303,065 |
| Total $CO_2e$ (location based) ✓ | **207,768** | 243,293 | 286,892 |
| Total Scope 3[2] ✓ | **53,131** | 64,710 | 72,876 |

1 Restated 2018/2017 and 2017/2016 emissions data to improve the accuracy of reporting, using actual data to replace estimates.

Emissions in tonnes $CO_2e$ in line with the GHG Protocol Corporate Standard (2004) including revised Scope 2 guidance (2015) which discloses a Market Based figure in addition to the Location Based figure.

The measure and reporting criteria for Scope 1, 2, 3 emissions is provided in the Lloyds Banking Group Reporting Criteria available online at www.lloydsbankinggroup.com/our-group/responsible-business

Scope 1 emissions include mobile and stationary combustion of fuel and operation of facilities.

Scope 2 emissions have been calculated in accordance with GHG Protocol guidelines, in both Location and Market Based methodologies.

2 Scope 3 emissions have been expanded to include additional elements within the Group's own operations including emissions from waste, colleague commuting and additional elements of business travel (including taxis, tube, well to tank emissions of business travel and hotels). We have also disclosed legacy scope numbers to allow fairer comparison to numbers previously disclosed and to demonstrate performance versus our previous targets.

✓ Indicator is subject to Limited ISAE 3000 (revised) and 3410 (ISAE 3410) assurance by Deloitte LLP for the 2019 Annual Responsible Business Reporting. Deloitte's 2019 assurance statement and the 2019 Reporting Criteria are available online at www.lloydsbankinggroup.com/our-group/responsible-business

**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 imported heat, steam or imported cooling and is not aware of any other material sources of omissions from our reporting.

## 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/investors/financial-performance. 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 as at the date of this report, and whose names and functions are listed on pages 66 to 67 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
- 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 the Group together with a description of the principal risks and uncertainties 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

Kate Cheetham

**Kate Cheetham, Company Secretary**

19 February 2020

Lloyds Banking Group plc
Registered in Scotland, No. SC095000

## Directors' remuneration report

# Remuneration Committee Chairman's statement

**Our latest policy provides direct alignment between remuneration and the purpose of the Group, and is designed to be fair and consistent. We have thought carefully about the simplest and clearest way to reward the right behaviours and outcomes.**

**Stuart Sinclair**
Chairman, Remuneration Committee

**Remuneration Content**



## Dear Shareholder

On behalf of the Board I am pleased to present the Directors' Remuneration Report for the year ended 31 December 2019 and the proposed Directors' Remuneration Policy (our Policy) for which we are seeking your support and approval at our Annual General Meeting in May 2020.

Our upcoming AGM marks the beginning of our next remuneration policy cycle, which will run until the end of 2022. This offered the opportunity to take a fresh look at how we incentivise and reward our colleagues, and what values and outcomes we wish to encourage.

The timing coincided with a great deal of public interest in matters of executive pay, fairness, employee engagement and the pay gap between those at the top of organisations compared to other colleagues. We have been active participants in these discussions, through meetings with shareholders, our unions, the Investment Association and some members of Parliament, as well as through an open dialogue with colleagues on a variety of topics related to their pay and benefits. These talks have had a material impact on the priorities and recommendations of the Remuneration Committee throughout the last year. In the pages which follow, the proposals which have emerged from these discussions are laid out in detail.

While we were pleased to receive over 90 per cent support for our Annual Report on Remuneration at the AGM in 2019, we heard during that process a continued desire for greater simplicity and transparency in our approach. To that end, we started to make changes early in 2019, without waiting for our full redesign to be finalised.

In November 2019, we announced our decision, subject to AGM approval, to reduce pension allowances for Executive Directors to 15 per cent of salary in a single step in 2020 with no offsetting adjustment in salary or other remuneration.

We are also making improvements to pensions for all the 50,000 colleagues who participate in Defined Contribution (DC) arrangements (the majority of our workforce) to make all members eligible for a maximum employer contribution of 15 per cent, and to increase the employer contribution for our lower paid colleagues by one per cent.

This represents a significant investment of approximately £20 million per annum in our colleagues and aligns the employer contributions available to the wider workforce with those of Executive Directors. At the same time, the Group supports the third largest private sector defined benefit (DB) scheme accruing benefits for a further 16,000 current colleagues.

We have listened to feedback and the external sentiment around executive remuneration. Some of the sentiments that resonated with me and my Committee were that executive remuneration should be re-evaluated in the context of colleagues as a whole; be truly variable, and not managed within a 'corridor' without being closely aligned with outcomes. We have tackled these sentiments head on with our proposals in the new Policy by reducing the new maximum opportunity for Executive Directors and by demonstrating with this year's outcomes that performance and conduct do have material consequences, resulting in lower total remuneration.

## Our new Policy

In approaching the refresh of the Directors' Remuneration Policy, my committee colleagues and I thought carefully about what behaviours and outcomes we wanted to see and how the remuneration structure could support them. We approached the review with the following core aims:

| | |
|---|---|
| Purpose | Remuneration should be linked to the Group's purpose of Helping Britain Prosper |
| Behaviours | Remuneration should reward and drive the right behaviours and outcomes and reflect both strategic (non-financial) and financial achievements |
| Simplicity | Remuneration should be designed in a manner that is clear for all stakeholders and reflects their expectations |
| Clarity | Remuneration should be easy to explain and be viewed as fair |

It was with these objectives in mind that we designed the new Policy detailed on page 115 and summarised on page 100. The key headlines are as follows:

- The maximum pension allowance for Executive Directors is reduced to 15 per cent of salary
- We are introducing a new long-term variable reward plan to align pay more closely to our business model of producing sustainable long-term returns
- As a result of the new Policy, the Group Chief Executive's fixed pay will reduce by 8 per cent and his maximum total remuneration opportunity by 29 per cent

Given the feedback we have received, we hope you will support the aims and the methods we outline, and vote accordingly at the AGM in May.

## Group performance and variable remuneration

For 2019, the performance of the Group was resilient in a challenging and uncertain economic environment. Despite a softening of margins and income, continued discipline in operating costs enabled the Group to maintain its significant investment in digitising and transforming the way we support customers, as well as to pay an increased dividend to shareholders. Financial results were however heavily impacted by the PPI provision of £2.45 billion; therefore a significant downward adjustment was made to the Group Performance Share pool to reflect this along with other conduct-related costs. The final 2019 Group Performance Share pool is £310.1 million, which is a reduction of 33 per cent compared to 2018. The vesting of the 2017 Executive Group Ownership Share was similarly affected by financial performance and shareholder returns, with a formulaic vesting outcome of 49.7 per cent. No discretion was used to change the vesting outcome.

The performance and strategic progress of the Group was however overshadowed by significant non-financial conduct issues during the latter part of the year, not least the findings of Sir Ross Cranston's review into how the Group has treated customers who were the victims of the HBOS Reading fraud. These issues are reflected in the variable reward outcomes for Executive Directors.

## Executive Director variable rewards decisions

As a result of the overall performance of the Group and the issues faced during 2019, the Group Chief Executive and Chief Operating Officer independently requested that they be withdrawn from consideration for Group Performance Share awards for 2019. The Committee exercised its discretion to accept this request and welcomed the judgement shown in volunteering it as a consequence of the non-financial conduct issues mentioned above. No downward adjustment has been made to the overall Group Performance Share pool as a result of these individual decisions, which was therefore distributed to other colleagues outside the executive team.

For the newly appointed Chief Financial Officer, overall performance for 2019 was assessed at 3.12 out of 5 with a corresponding Group Performance Share award of £195,528. An award of 250 per cent of salary will be awarded under the final Executive Group Ownership Share to the Group Chief Executive and 237.5 per cent for Chief Financial Officer. No Group Ownership Share award is being made to the Chief Operating Officer who has announced his retirement. Further details of awards are provided on pages 105 and 111.

### Executive Director total remuneration outcomes

The information below summarises Executive Director remuneration for the 2018 and 2019 performance years. Full details are provided in the Single total figure of remuneration table on page 103.

| Director | 2018 | 2019 | |
|---|---|---|---|
| António Horta Osório Group Chief Executive | £6.54m | **£4.73m** | ↓ 28% |
| Juan Colombás Chief Operating Officer | £3.42m | **£2.58m** | ↓ 25% |
| William Chalmers Chief Financial Officer 1 Aug 2019 | – | **£5.14m** | – |
| George Culmer Former Chief Financial Officer 1 Jan-1 Aug 2019 | £3.43m | **£1.95m** | – |

## How we have responded to your feedback

**Executive remuneration should be re-evaluated in the context of colleagues as a whole.**

- The proposed Policy for 2020 reduces the maximum total compensation opportunity for the Group Chief Executive by 29 per cent
- The Group Chief Executive's pension reduced from 46 per cent to 33 per cent of salary in 2018 and will now be 15 per cent with effect from 2020, a decrease of 67 per cent from 2018 to 2020
- The ratio of CEO pay to the medium employee has reduced by 24 per cent between 2018 and 2019
- We are very focused on addressing the pay gap from the bottom up and not just from the top down, in other words, by taking action to increase pay and pensions for more junior colleagues
- In 2019 we have continued our commitment for pay progression with higher pay awards for lower paid colleagues and colleagues paid lower within their pay range
- The pay budget for colleagues this year is 2.4 per cent, above the budget of 2 per cent for executives and we will once again make an award of free shares worth £200 to every permanent colleague in the Group. All these actions are intended to reduce the gap between executives and the wider workforce

**Variable pay should be truly variable and not managed within a corridor without being closely aligned with outcomes.**

- The Balanced Scorecard is made up of an appropriate balance of financial and non-financial measures. Targets are determined at the beginning of the year and my Committee and I discuss them thoroughly to ensure they are stretching
- When determining reward outcomes, other factors outside of the scorecard are considered. Scores directly correlate to reward outcomes and, as can be seen with this year's awards, there is clear pay for performance alignment
- GPS award outcomes for 2019 show that award outcomes are truly variable and that the structure of the plan ensures that performance and conduct will have a direct impact on remuneration

**Your remuneration structure is overly complex**

- We recognise that our process for determining short-term variable (GPS) outcomes has been perceived to be complex and the link between pay and performance is not easily understood
- We have taken steps to reduce complexity through reducing the number of measures in our Group Balanced Scorecard from 20 to 15 grouped under three equally weighted areas for 2019 and 2020. We believe this provides the optimum breadth of measures for a large and complex Group
- We've focused on simplifying the allocation to our overall Group Performance Share pool by agreeing to use a fixed 5 per cent of underlying profit as the starting position. The Committee will retain discretion to ensure that 5 per cent remains appropriate
- To support colleagues understanding of the approach to determine Group Performance Share awards across the Group, including for Executive Directors, we have used internal media channels to explain the process in a clear and transparent way and to emphasise the link between pay and performance

Together with my Committee members, I look forward to hearing your views on the remuneration arrangements outlined in the report and we hope the new Policy alongside the resolutions relating to remuneration will receive your support at the upcoming AGM.

On behalf of the Board

Stuart Sinclair

**Stuart Sinclair**
Chairman, Remuneration Committee

19 February 2020

Lloyds Banking Group plc
Registered in Scotland, No. SC095000

**Directors' remuneration report** continued

## Proposed Policy overview

Pages 100 to 103 provide an overview of the new proposed 2020 Policy. The full policy can be found on page 115.

Base Salary + Fixed Share Award + Pension + Benefits + Short Term Variable + Long Term Variable = Total Reward

| | | Current Policy | Proposed changes in Policy and why |
|---|---|---|---|
| FIXED | **Base Salary** | – Reflective of individual role, taking account of responsibilities, experience and pay in the wider Group.<br>– Typically reviewed annually, with increases effective 1 January. | **What:**<br>– We are changing the effective date of increases from 1 January to 1 April for new Executive Directors (EDs).<br>**Why:**<br>– Provides alignment to the award timeline for other colleagues in the Group, meeting our alignment principle. |
| FIXED | **Fixed Share Award** | – Ensures fixed remuneration is commensurate with role.<br>– Delivered in shares.<br>– Five year delivery with 20 per cent each year. | **What:**<br>– We are changing the release schedule from five to three years. All other aspects remain the same, including quantum.<br>**Why:**<br>– Provides alignment to the release schedule for other colleagues eligible for a Fixed Share Award in the Group meeting our alignment principle. |
| FIXED | **Pension** | – Contributions set as a percentage of base salary (cash salary only).<br>– Maximum allowance of 46 per cent for Group Chief Executive (GCE) and 25 per cent for other EDs and all future appointments. | **What:**<br>– We are reducing the maximum employer pension contribution available to all EDs to 15 per cent of base salary with no compensation for the reduction.<br>**Why:**<br>– We agree comparable pension contributions should be available to all colleagues, including EDs. |
| FIXED | **Benefits** | – Flexible benefit allowance of 4 per cent of base salary in line with other colleagues.<br>– Other benefits include private medical insurance and car allowance. | – No changes. |
| VARIABLE | **Short Term Variable** | **Group Performance Share (GPS)**<br>– Maximum opportunity of 140 per cent of salary for GCE and 100 per cent of salary for other EDs with normal target to 30 per cent of maximum.<br>– Performance adjustment including malus and clawback provisions apply.<br>– No award can be made if threshold performance is not met by the Group or the individual. | **What:**<br>– There will be no change in maximum opportunities, however expected value for performance in line with target will change to 50 per cent of maximum.<br>**Why:**<br>– We believe the GPS award is an effective short term variable reward opportunity.<br>– Simplifying the approach to target performance aligns the design structure to other colleagues and is clearer to articulate. The calibration of the 2020 scorecard has been set so that the payout outcome for achieving target performance is no less stretching. |
| VARIABLE | **Long Term Variable** | **Group Ownership Share (GOS)**<br>– Maximum opportunity of 400 per cent for the GCE and a maximum of 300 per cent of salary for other EDs.<br>– Vesting will be subject to the achievement of performance conditions measured over a period of three years.<br>– The Committee retains full discretion to amend the payout levels should the award not reflect business and/or individual performance.<br>– Award levels set at the time of grant under the rules of the 2016 Long-Term Incentive Plan approved at the AGM on 12 May 2016 and made in the form of conditional shares. | **What:**<br>– Introducing the Long Term Share Plan (LTSP), subject to approval at the 2020 AGM. An alternative reward structure to a traditional LTIP that has similarities with a restricted share awards.<br>– Maximum opportunities will significantly reduce from 400 per cent for the GCE and 300 per cent for other EDs to 200 per cent of base salary. The normal 'target' level of award will be 150 per cent of base salary. Please see page 101 for further explanation of how we determined the right maximum opportunities for the business.<br>– Remuneration Committee will grant awards based on a discretionary pre-grant test using the Balanced Scorecard to inform decision making.<br>– Vesting will be subject to a set of three financial underpins.<br>– Remuneration Committee retains full discretion to amend the vesting levels from that determined should they not reflect performance.<br>**Why:**<br>– The proposed structure provides greater alignment to the delivery of the strategic aims for the Group. Please see our Policy FAQs on pages 101 to 102 for further understanding of our rationale for the LTSP and how it is structured. |

**The Group's approach to shareholding requirements**
The Group currently operates a shareholding policy, please see page 108 for further details.

The Group considers it important to ensure Executive Directors continue to have a substantial shareholding after employment to continue to align their interests with shareholders over a longer time horizon than simply whilst in role. Our existing reward structures and the structure designed through the Long Term Share Plan, which, in line with regulatory requirements, mean that a substantial proportion of variable reward for Executive Directors and other senior employees takes the form of shares, deferred and held over a period of up to eight years. These structures achieve the outcomes intended from the introduction of a post-employment shareholding requirement and ensure that Executive Directors continue to meet their shareholding requirements for a minimum of two years after leaving the Group. On this basis, the Group already complies with best practice and therefore no formal post-employment shareholding policy is necessary.

# New Policy FAQs

## Long Term Share Plan

### Q Why did you decide the new Long Term Share Plan is more appropriate for your business compared to the traditional LTIP?

We believe this Policy cycle is the most opportune time to restructure our reward package and introduce the LTSP for the following core reasons.

**Lower and less volatile potential reward outcomes aligned to a stable long-term business model**
We believe that a reward package that has less volatile outcomes is more reflective of our objective of delivering stable and sustainable returns and will incentivise stewardship over longer timeframes.

**A simpler structure with one set of annual metrics**
In recent years we have received significant feedback on the complexity of our reward structures. Removing multiple scorecards and focusing on a single simplified Balanced Scorecard will give management clearer line of sight and greater alignment of interests to long-term company performance.

Amending the existing LTIP by reducing the number of measures was considered. However, we felt that this would not match the wider objectives of alignment to the Group's strategy and the experience of colleagues.

The use of a single Balanced Scorecard to inform both variable reward components provides clear line of sight to important annual and strategic measures, which can be tracked year on year through our disclosure.

**Promote fairness and consistency**
The structure supports reducing the gap between colleague and executive remuneration; the increase in certainty of award outcomes is offset by reduced opportunities.

**Performance against strategic goals will be assessed and Committee discretion will play an important role**
The Committee will have four opportunities to test performance, using a mixture of clear metrics and discretion, applied against a pre-determined approach.

- **Balanced Scorecard**
  Strategic decisions will, as now, be measured through the inclusion of both financial and non-financial performance metrics within the Balanced Scorecard
- **Individual assessment**
  As now, the Committee will determine if an Executive Director's personal performance justifies a variation in the assessment of performance or award values determined by the Balanced Scorecard, and will explain how this is determined
- **Pre-grant test**
  Committee discretion, incorporating an assessment of risk and conduct, will be applied where actual behaviours or outcomes are not adequately captured in the Balanced Scorecard assessment
- **Underpin assessment**
  The Committee will make an assessment against the three financial underpins. In addition, the Committee will consider applying a downward discretionary adjustment by asking itself whether there are any non-financial factors that should be considered at vesting

### Q What factors will the Committee take into account when exercising discretion?

When considering the use of discretion in conjunction with the underpin assessment, the Committee will consider the following key questions:

- Do the Group's financial results and capital position adequately reflect risk, conduct and any other non-financial considerations?
- Has the Group suffered a serious conduct event or has severe reputational damage arisen from the Group not living its values?
- Has the bank lived up to its ambition to be the Best Bank for Customers?

The Committee will explain its reasons for applying discretion in either direction, or for not doing so.

### Q How did you determine the new maximum opportunity for the Long Term Share Plan and did you consider shareholder guidelines that there should be at least a 50 per cent discount when moving to a restricted share model?

We are reducing the maximum opportunity for the Group Chief Executive's long-term awards by 50 per cent from 400 per cent to 200 per cent of base salary, and the normal 'target' level of award to 150 per cent of base salary. Unlike a number of restricted share schemes, our Long Term Share Plan will have a pre-grant test to determine the value of awards. As outlined, this will be based on the Balanced Scorecard (consistent with the short term variable award) with the expectation that the achievement of an overall outcome in line with target will lead to an award of 150 per cent of base salary.

Under the Group Ownership Share Plan Executive Directors were eligible to receive a maximum award of 300 per cent. We wanted consistency in award maximum for all other Executive Directors. This therefore marks a discount of 33 per cent but we are confident this is appropriate for the business given the use of a pre-grant test, underpins and the Committee's intention to use discretion where appropriate.

### Q Why did the Committee decide that the three underpins chosen for the plan are the most appropriate?

The pre-vest test against defined underpins after three years is an important feature to guard against the potential of 'rewards for failure.' After considerable debate, we are confident that focusing on capital strength, relative returns and a progressive and sustainable ordinary dividend aligns with our commitments to shareholders. Underpins will be measured over a three year period year period from grant and each underpin element will determine the vesting of 33 per cent of the original award.

The Committee will have discretion to consider any other events before confirming the vesting of awards using the questions outlined above.

## Balanced Scorecard

### Q How does the use of the Balanced Scorecard ensure that Executive Directors are rewarded for performance aligned to the strategic objectives of the Group?

The Balanced Scorecard is considered by non-executives and management to be a transparent and effective tool to drive and assess performance while meeting regulatory requirements. Each measure has pre-set underlying objectives determined by the Remuneration Committee at the start of the performance year. In the interest of transparency, the Committee can confirm that for 2020 there is no change[1] to the 15 measures in the 2019 Balanced Scorecard (fully disclosed on page 104) which the Committee consider provide sufficient breadth across the Group's core business objectives and the optimum balance to measure our performance as a simple, low-risk, customer-focused UK financial services provider, as highlighted below:

- **Customer measures (33%)**
  Providing a leading customer experience sits at the core of our strategy. The Group customer dashboard provides an assessment of how effectively we are serving customers across all brands, products and services, while other measures focused on complaint handling, customer perception, and trust in the Group, measure how effectively we are at being the best bank for customers
- **Colleagues and Conduct measures (33%)**
  Colleagues are critical to the delivery of the Group's long-term strategy and we confirmed our investment in training and development as part of transforming ways of working to drive better customer outcomes. Ensuring the way we operate is aligned with the Group's low-risk appetite, as well as in line with the Group's cultural aspiration, values and behaviours is key to our long-term success
- **Finance measures (33%)**
  Our financial measures assess the Group's ability to deliver a capital efficient, low cost and profitable bank

1 The measure in relation to external reputation has been expanded to now also include relationship with the Group's regulators.

**Directors' remuneration report** continued

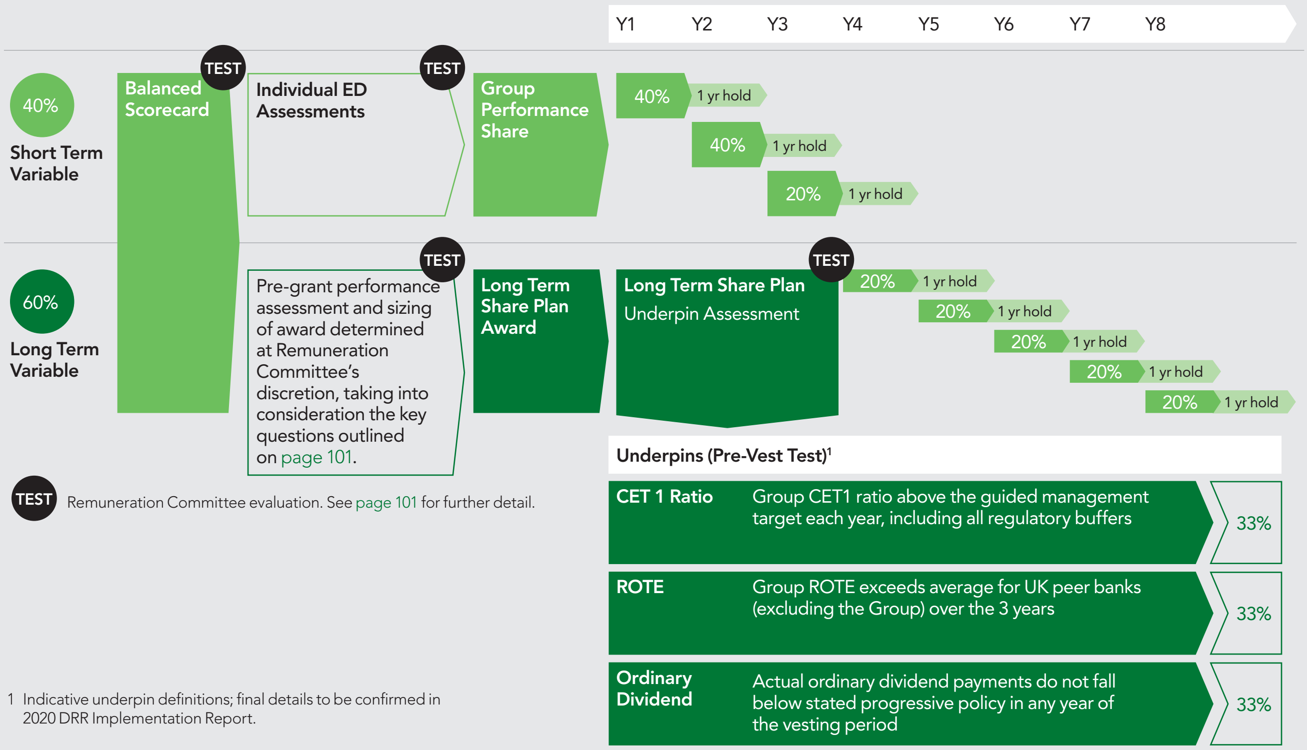
## Our new variable reward structure

The Group's purpose is to support our customers, colleagues and communities and to Help Britain Prosper. The Group's business model is to be a low risk UK bank and rewards for the executive management team in that business should reflect and encourage the steady creation of shareholder value over the long-term, best measured through the share price. The long-term sustainable success of the business is driven by meeting the needs of different stakeholders and our proposed move to Long Term (restricted) Share awards within our revised variable reward structure supports these strategic aims. We have set out why we believe the implementation of this new approach is now appropriate for the Group and aligns to our business model in our Policy FAQs on page 101.

The diagram below illustrates the performance inputs, underpin assessment and delivery of the Group's proposed short and long-term variable reward structures. The new structure has multiple test points to ensure the Remuneration Committee can use its discretion and make an evaluation beyond formulaic outcomes. Further details on the use of discretion are explained in full within the Policy on page 118.

Removing complex standalone LTIP metrics and instead using a simplified Balanced Scorecard will give management clearer line of sight and greater alignment of interest to long-term share price performance whilst the underpin and pre-vest test, combined with the long-term delivery of shares over up to eight years, ensure that long-term and multi-year performance assessment is not compromised.

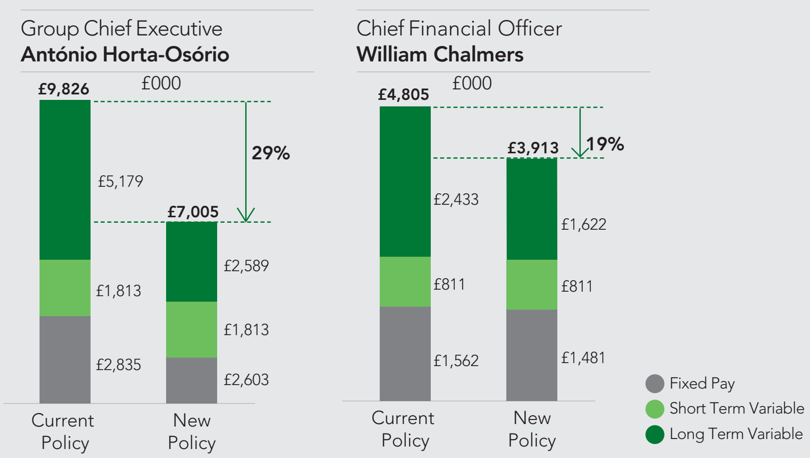
## How the new structure operates




1 Indicative underpin definitions; final details to be confirmed in 2020 DRR Implementation Report.

## How have the maximum opportunities for Executive Directors changed?

As a result of the proposed changes in policy, total variable opportunities will reduce from 540 per cent of salary to 340 per cent for the Group Chief Executive. This is a reduction of 29 per cent in maximum total compensation when reductions in fixed pay through the pension changes are taken into account. Other Executive Directors' total variable opportunities will reduce from 400 per cent to 300 per cent of salary resulting in a 19 per cent reduction in maximum total compensation.




In light of the Chief Operating Officer, Juan Colombás' retirement announcement in 2020, an illustration has not been provided here.

# 2019 Annual report on remuneration

## Executive Director Single Total Figure of Remuneration (audited)

| | António Horta-Osório | | Juan Colombás | | William Chalmers | | George Culmer | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| £000 | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 |
| Base Salary | 1,269 | 1,244 | 795 | 779 | 331 | – | 461 | 776 | 2,856 | 2,799 |
| Fixed Share Award | 1,050 | 900 | 497 | 497 | 252 | – | 298 | 504 | 2,097 | 1,901 |
| Benefits | 166 | 157 | 74 | 68 | 19 | – | 41 | 49 | 300 | 274 |
| Pension | 419 | 573 | 199 | 195 | 83 | – | 130 | 194 | 831 | 962 |
| **Total Fixed Pay** | 2,904 | 2,874 | 1,565 | 1,539 | 685 | – | 930 | 1,523 | 6,084 | 5,936 |
| Group Performance Share[1] | – | 1,178 | – | 527 | 81 | – | 113 | 527 | 194 | 2,232 |
| Group Ownership Share/ Long Term Incentive (LTIP)[2,3] | 1,821 | 2,490 | 1,011 | 1,355 | – | – | 911 | 1,374 | 3,743 | 5,219 |
| **Total Variable Pay** | 1,821 | 3,668 | 1,011 | 1,882 | 81 | – | 1,024 | 1,901 | 3,937 | 7,451 |
| Other Remuneration[4] | 2 | 2 | 1 | 1 | – | – | 1 | 1 | 4 | 4 |
| Buy out award[5] | – | – | – | – | 4,378 | – | – | – | 4,378 | – |
| **Total Remuneration** | 4,727 | 6,544 | 2,577 | 3,422 | 5,144 | – | 1,955 | 3,425 | 14,403 | 13,391 |

1 William Chalmers was awarded a full year Group Performance Share award of £195,528 which has been pro-rated to reflect five months as an Executive Director for the purpose of the table above. Awards for William Chalmers and George Culmer will be made in March 2020 in a combination of cash and shares. 40 per cent will be released in the first year following the award with £2,000 paid in cash, and the balance of the upfront 40 per cent delivered in shares; 50 per cent of which will be subject to holding until March 2021. The remaining 60 per cent is deferred into shares with 40 per cent vesting in 2021 and 20 per cent in 2022. 50 per cent of each release will be subject to a further 12-month holding in line with regulatory requirements.

2 The 2017 Group Ownership Share (GOS) vesting (see page 106) at 49.7 per cent and dividend equivalents awarded in shares were confirmed by the Remuneration Committee at its meeting on 18 February 2020. The total number of shares vesting were 2,643,386 and 425,413 shares delivered in respect of dividend equivalents for António Horta-Osório, 1,467,137 shares vesting and 236,113 shares delivered in respect of dividend equivalents for Juan Colombás and 1,322,490 shares vesting and 212,834 shares delivered in respect of dividend equivalents for George Culmer. This award was pro-rated to reflect George's leave date. William Chalmers was not granted a 2017 GOS award. The average share price between 1 October 2019 and 31 December 2019 (59.34 pence) has been used to indicate the value. The shares were awarded in 2017 based on a share price of 68.814 pence and as such no part of the reported value is attributable to share price appreciation.

3 LTIP and dividend equivalent figures for 2018 have been adjusted to reflect the share price on the date of vesting (62.9679 pence) instead of the average price (56.04 pence) reported in the 2018 report.

4 Other remuneration payments comprise income from all employee share plans, which arises through employer matching or discounting of employee purchases.

5 William Chalmers joined the Group on 3 June 2019 and was appointed as Chief Financial Officer on 1 August 2019 on the retirement of George Culmer. He was granted deferred cash of £2,046,097 and deferred share awards over 4,086,632 Shares, to replace unvested awards from his former employer, Morgan Stanley, that were forfeited as a result of him joining the Group. The deferred cash and the number of Shares over which the deferred share awards were granted was calculated using the USD:GBP exchange rate and the respective mid-market closing prices of Mr Chalmers' previous employer and the Group on 3 June 2019.

The awards are subject to a vesting schedule and retention periods that match the vesting schedule and retention periods of the awards forfeited and as a result, the awards vest in tranches until January 2022. The awards were granted pursuant to Listing Rule 9.4.2, and in accordance with the regulatory requirements for buy-outs and are subject to clawback. Clawback will also apply to any awards exercised prior to the first anniversary of employment.

## Pension and benefits (audited)

| Pension/Benefits £ | António Horta-Osório | Juan Colombás | William Chalmers | George Culmer |
|---|---|---|---|---|
| Cash allowance in lieu of pension contribution | 418,865 | 198,735 | 82,806 | 129,892 |
| Car or car allowance | 12,000 | 12,000 | 5,000 | 19,646 |
| Flexible benefits payments | 49,776 | 31,174 | 13,249 | 20,783 |
| Private medical insurance | 42,341 | 19,246 | 279 | 481 |
| Tax preparation | 24,000 | 9,000 | – | – |
| Transportation | 37,606 | 2,359 | – | – |

## Defined benefit pension arrangements (audited)

António Horta-Osório has a conditional unfunded pension commitment. This was a partial buy-out 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 benefit in the EFRBS accrued during the six years following commencement of employment, therefore ceasing to accrue as of 31 December 2016.

The EFRBS was subject to performance conditions and it provided for a percentage of the GCE's base salary or reference salary in the 12 months before retirement or leaving. No additional benefit is due in the event of early retirement. The rate of pension accrued in each year depended on share price conditions being met. In March 2019, the GCE asked that his defined benefit pension be based on a percentage of his pensionable salary in 2014. The total pension due is now fixed at 6 per cent of his 2014 reference salary of £1,220,000, or £73,200.

There are no other Executive Directors with defined benefit pension entitlements.

Under terms agreed when joining the Group, Juan Colombás is entitled to a conditional lump sum benefit of £718,996 either (i) on reaching normal retirement age of 65 unless he voluntarily resigns or is dismissed for cause, or (ii) on leaving due to long-term sickness or death.

## Calculating the 2019 Group Performance Share outcome (audited)

STEP 1 STEP 2 STEP 3 STEP 4

### Allocating Underlying Profit

- To simplify the approach to determining the Group Performance Share outcome for 2019, the Committee agreed that a fixed 5 per cent of Underlying Profit (UP)would be used as a starting position for the overall pool
- The threshold, below which no bonus is payable, remains set at 20 per cent below target UP
- For 2019, UP target was £8,637 million, actual UP was £8,349 million

£8,349m[1] x 5% = **£417.4m**

1 Underlying profit of £7,531 million, adjusted by £21 million for year-on-year Prudential Value Adjustment in line with regulatory requirement, £445 million for conduct and costs, and £352 million for Group Performance Share expenses in 2019.

STEP 1 STEP 2 STEP 3 STEP 4

### Measurement of performance against Balanced Scorecard objectives.

| | Strategic objectives | Measure | Performance Range/Outcome | Minimum: 1 | Maximum: 5 | Score |
|---|---|---|---|---|---|---|
| **Customer** 33% Leading customer experience | Satisfying our Customers | Customer dashboard | 64 | <30 | ≥85 | 3 |
| | Retaining and growing valuable customers | Segmented Customer Index | 3.75 | <2.0 | >4.5 | 3 |
| | Helping Britain Prosper | Deliver Helping Britain Prosper Plan targets | 20/22 metrics were rated green (90.9%) | <50% of Helping Britain Prosper Plan metrics are Green | ≥90% of Helping Britain Prosper Plan metrics are Green and none are Red | 4 |
| | Fewer complaints, better handled, driving better customer outcomes | Total FCA Complaints per '000 | 2.72 | >3.04 | ≤2.81 | 5 |
| | | FOS Change Rate (ex PPI) | 26% | >30% | ≤25% | 4 |
| | Building great relationships with external stakeholders | Reputation with External Stakeholders (Excluding Regulators) | 4.00 | <2.0 &/or >30% rated 1 | >4.5 & none rated 1 | 4 |
| **Colleagues & Conduct** 33% Transforming ways of working | Building a better culture | Colleague Culture & Engagement survey | 69 | <64 | >73 | 3 |
| | Building skills for the future | Colleagues successfully completing upskilling/ retraining | 3,193,087 | Cumulative hours <1,980,000 | Cumulative hours ≥2,640,000 | 5 |
| | Maintaining a low risk Bank | Board Risk Appetite | 7.4% | >10% | ≤4% | 3 |
| | Change delivered safely | Change Execution Risk | 92.2% green and 6.4% red | Green <75% and Red >15% | Green >92.5% and Red <5% | 4 |
| **Finance** 33% Maximising Group capabilities | Delivering a capital efficient, low cost, profitable Bank | Investment Performance | 11 | <5 | ≥14 | 4 |
| | | Cost:Income Ratio | 48.5% | >50.4% | ≤46.4% | 3 |
| | | Statutory Profit after tax | £3,006m | <4,241 | ≥5,831 | 1 |
| | | Common Equity Tier 1 | 77bps | <127bps | >200.bps | 1 |
| | | Statutory Return on Tangible Equity | 7.8% | <11.5% | ≥15.8% | 1 |

Overall 3.20/5

STEP 1 STEP 2 STEP 3 STEP 4

### Application of Group performance modifier

The modifier determined by Group Balanced Scorecard performance is applied to the proportion of UP allocated under Step 1.

| 2019 Balanced Scorecard Outcome | 1.00-1.49 | 1.5-1.79 | 1.8-2.09 | 2.1-2.39 | 2.4-2.69 | 2.7-2.99 | **3.0-3.29** | 3.3-3.59 | 3.6-3.89 | 3.9-4.19 | 4.2-4.49 | 4.5-4.79 | 4.8-5 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Group Balanced Scorecard Modifier | 0.00 | 0.55 | 0.70 | 0.80 | 0.90 | 0.95 | **1.00** | 1.05 | 1.10 | 1.15 | 1.20 | 1.25 | 1.30 |

Group Balanced Scorecard Modifier £417.4m x 1.00 = **£417.4m**

STEP 1 STEP 2 STEP 3 STEP 4

### Application of adjustments for risk, conduct and other factors.

The overall pool was reduced by £107.3 million to reflect the impact of conduct-related provisions and regulatory fines received during 2019. **£107.3m**

**Overall GPS pool** **£310.1m**

## Executive Directors' Group Performance Share outcome for 2019 (audited)

STEP 1 STEP 2 STEP 3 STEP 4

### Balanced Scorecard performance

Individual awards for Executive Directors are determined through the assessment of individual performance using the Group or their divisional balanced scorecard. Awards will not be made if the Group does not meet threshold financial performance or if an individual receives a score below 2.6 out of 5.

Group Chief Executive
**António Horta-Osório**

The Group Chief Executive's Balanced Scorecard assessment for 2019 reflects the Group's scorecard for which he has overall accountability.

For Group Balanced Scorecard please see **page 103**

Chief Operating Officer
**Juan Colombás**

**Chief Operating Office Scorecard rating**

| BSC category | Assessment |
|---|---|
| **Customer** | 3.00 |
| **Colleague & Conduct** | 3.63 |
| **Finance** | 4.33 |

Chief Financial Officer
**William Chalmers**

**Finance Division Scorecard rating**

| BSC category | Assessment |
|---|---|
| **Customer** | 3.00 |
| **Colleague & Conduct** | 3.29 |
| **Finance** | 2.71 |

Chief Financial Officer (Former)
**George Culmer**

**Finance Division Scorecard rating**

| BSC category | Assessment |
|---|---|
| **Customer** | 3.00 |
| **Colleague & Conduct** | 3.29 |
| **Finance** | 2.71 |

STEP 1 STEP 2 STEP 3 STEP 4

### Individual Performance Assessment and Committee Discretion

Personal contribution and how performance has been achieved through leadership approach may be considered where it diverges from scorecard outcomes. Judgement may be applied in deciding whether personal contribution should alter the mechanical outcome provided by balanced scorecard metrics.

Key considerations factored into assessing performance and overall rating include, but are not limited to, the following:

**Other performance considerations** (Group Chief Executive)

- Strong progress in executing the Group's strategic transformation programme, with significant investment in technology, people and improved customer propositions
- Further progress on the strategy for growing our Financial Planning & Retirement business with the successful launch of our Schroders Personal Wealth joint venture
- But acknowledged organisational failures in the Group's handling of some customers, including the victims of the historic HBOS Reading fraud

**Other performance considerations** (Chief Operating Officer)

- Strong leadership and oversight of the Group's strategic transformation programme, transforming the Group for success in a digital world
- Further investment and improvements delivered in the Group's operational resilience, resulting in a c.30% reduction in critical incident occurrences in 2019
- Acknowledged failures in the handling of those affected by the historic HBOS Reading fraud

The Group Chief Executive and Chief Operating Officer voluntarily requested to be withdrawn from consideration for a 2019 award.

**Other performance considerations** (Chief Financial Officer)

- Strong start to tenure as CFO, overseeing a challenging second half, marked by the substantial increase in PPI provision related to the deadline for claims submission
- Delivered costs and investments favourable to plan in 2019, maintaining cost efficiency versus peers
- Successful acquisition of the Tesco mortgage book finalised under William's stewardship

**Overall score 3.12/5**

**Other performance considerations** (Chief Financial Officer (Former))

- Prior to his retirement at the end of July, George oversaw delivery of a good financial performance in H1, with market leading efficiency and returns
- Balance sheet strength maintained with lower capital requirement
- Maintained prudent approach to growth and risk

**Overall score 3.12/5**

STEP 1 STEP 2 STEP 3 STEP 4

### GPS award commensurate with performance determined

Awards are initially based on pre-determined formulaic pay out ranges, commensurate with performance scores as follows:

| Individual Performance Score | 1.00 – 2.59 | Threshold | 2.60 – 2.69 | 2.70– 2.99 | Target | 3.00– 3.29 | 3.30– 3.59 | 3.60– 3.89 | 3.90– 4.19 | 4.20– 4.49 | 4.50– 4.79 | 4.80– 5.00 | Maximum |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Opportunity (% of maximum) | 0% | | 0.0% – 19.5% | 19.5% – 30.0% | | 30.0% – 40.5% | 40.5% – 51.0% | 51.0% – 61.5% | 61.5% – 72.0% | 72.0% – 82.5% | 82.5% – 93.0% | 93.0% – 100.0% | |

STEP 1 STEP 2 STEP 3 STEP 4

### Committee determine final award outcome

Judgement is applied by the Remuneration Committee to determine award levels within the formulaic pay-out ranges.

The Remuneration Committee exercised its overall discretion to accept the voluntary withdrawal of the Group Chief Executive and Chief Operating Officer from consideration for a 2019 GPS award. Accordingly, no award value was determined.

| Executive Directors | Balanced Scorecard | Final Individual Score | Award (% of max) | Group Funding Modifier[1] | **Final Award (% of max)** | GPS Maximum Opportunity (% of salary) | **Final Award (% of salary)** | **Final Award (£)** |
|---|---|---|---|---|---|---|---|---|
| António Horta-Osório | Group | – | – | – | – | 140% | – | – |
| Juan Colombás | Chief Operating Office | – | – | | – | 100% | – | – |
| William Chalmers[3] | Finance | 3.12 | 34.2% | 71.9% | **24.6%** | 100% | **24.6%** | **£195,528** |
| George Culmer[2] | Finance | 3.12 | 34.2% | | **24.6%** | 100% | **24.6%** | **£113,407** |

1 The overall GPS pool of £310.1 million was 28.1 per cent below the target pool of £431.2 million. Therefore, a downward adjustment of 28.1 per cent was applied to the award recommendations of William Chalmers and George Culmer.

2 Award pro-rated to reflect working days of employment.

3 GPS award reflects full year in line with hiring commitment.

## 2017 Executive Group Ownership Share (audited)

Group Ownership Share (GOS) Awards in the form of conditional rights to free shares in 2017 were made over shares with a value of 300 per cent of reference salary for the GCE and 275 per cent of salary for the former CFO and COO. These awards are vesting at 49.7 per cent, as detailed in the table below. The formulaic outcome reflects the Group's solid financial and strong strategic performance over the three years ended 31 December 2019, balanced against a challenging economic and political environment impacting negatively on share price performance. This has resulted in no vesting for the Total Shareholder Return component and lower than expected Economic Profit.

The Committee has an overarching discretion to reduce the level of award that will vest, regardless of whether the performance condition for partial or full vesting has been met. This qualitative judgement ensures that vesting is not simply driven by a formula that may give an unexpected or unintended remuneration outcome compared to Group performance and that share price performance can also be considered. The Committee agreed that no adjustment would be applied to the vesting outcome of 49.7 per cent.

Shares will vest on a pro–rata basis up to the seventh anniversary of the award grant and each set of vested shares will be subject to a further holding period. Further details on deferral and holding can be found on pages 110 to 111.

| Weighting | Measure | Threshold | Maximum | Actual | Vesting |
|---|---|---|---|---|---|
| 30% | **Absolute Total Shareholder Return** | 8% p.a. | 16% p.a. | **5.6% p.a.** | **0.00%** |
| 25% | **Economic Profit**[1] | £3,074m | £3,769m | **£3,138m** | **7.97%** |
| 10% | **Cost : Income Ratio**[2] | 47.2% | 45.7% | **45.9%** | **8.00%** |
| 10% | **Customer Complaint Handling**<br>FCA reportable complaints | 3.52 complaints per 1,000 | 3.18 complaints per 1,000 | **2.72** | **5.00%** |
| | Financial Ombudsman Service (FOS) uphold rate | =< 29% FOS uphold rate | =<25% FOS uphold rate | **26%** | **3.75%** |
| 10% | **Customer Satisfaction**<br>Group performance relative to market peers | 3rd | 1st | **1st** | **10.00%** |
| 7.5% | **Digital**<br>Active Customer Growth | 14.3m | 14.9m | **15.0m** | **7.50%** |
| 7.5% | **People**<br>Employee Engagement Index | 67 | 73 | **74** | **7.50%** |
| | | | | **Award (% maximum) vesting** | **49.70%** |

1 A measure of profit taking into account Expected Losses, tax and a charge for equity utilisation.

2 Adjusted to exclude remediation costs.

## Single Total Figure of Remuneration for Chairman and Non-Executive Directors (audited)

| | Fees £000 | | Benefits £000[2] | | Total £000 | |
|---|---|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 | **2019** | 2018 |
| **Chairman and current Non–Executive Directors** | | | | | | |
| Lord Blackwell | **758** | 743 | **12** | 12 | **770** | 755 |
| Alan Dickinson | **240** | 230 | **1** | – | **241** | 230 |
| Anita Frew | **356** | 380 | **1** | – | **357** | 380 |
| Simon Henry | **186** | 182 | **–** | – | **186** | 182 |
| Lord Lupton | **314** | 318 | **1** | – | **315** | 318 |
| Amanda Mackenzie OBE | **156** | 31 | **–** | – | **156** | 31 |
| Nick Prettejohn | **471** | 449 | **5** | – | **476** | 449 |
| Stuart Sinclair | **210** | 172 | **–** | – | **210** | 172 |
| Sara Weller CBE | **203** | 199 | **4** | – | **207** | 199 |
| Sarah Legg[1] | **6** | – | **–** | – | **6** | – |
| **Former Non–Executive Directors** | | | | – | | |
| Deborah McWhinney | **–** | 174 | **–** | – | **–** | 174 |

1 Appointed 1 December 2019.

2 The Chairman receives a car allowance of £12,000. Other benefits relate to reimbursement for expenses incurred in the course of duties.

## Payments for loss of office (audited)

George Culmer retired as Chief Financial Officer and an Executive Director with effect from 1 August 2019 and retired from the Group on 2 August 2019.

He received a payment of £79,595 in lieu of unused annual leave entitlement up to his Retirement Date. In accordance with contractual entitlements, George was entitled to a capped contribution of up to £10,000 (excluding VAT) towards legal fees incurred in connection with his retirement from the Company.

In accordance with retirement provisions, George has maintained outstanding deferred Group Performance Share awards under the 2016 GPS Plan (83,466 Shares), 2017 GPS Plan (176,108 Shares) and under the 2018 GPS Plan (501,341 Shares) which continue to be released on their scheduled release dates, subject to the relevant terms (including post-vesting holding periods, malus and, where applicable, clawback and deductions for national insurance and income tax). 2016 GPS shares released in September 2019.

A 2019 Group Performance Share award was made, pro-rated for the period of 2019 elapsed to George Culmer's retirement date, as described on page 105. This award is subject to deferral, holding periods, malus and clawback. Under the Executive Group Ownership Plan Rules (Executive GOS), George Culmer's outstanding 2017 and 2018 Executive GOS awards will be time pro-rated to his retirement date (2017 becomes 2,660,946 Shares and 2018 becomes 2,144,958 Shares). The awards remain subject to the performance measures which apply to the relevant awards and will continue to vest at the normal vesting dates and be released on their scheduled release dates, subject to the relevant terms (including post-vesting retention periods, malus and, where applicable, clawback and to deductions for national insurance and income tax).

No other payment for loss of office were made in 2019.

## Payments within the reporting year to past Directors (audited)

There were no payments made to past directors in 2019.

## External appointments

António Horta-Osório – During the year ended 31 December 2019, the GCE served as a Non- Executive Director of Exor, Fundação Champalimaud, Stichting INPAR Management/Enable and Sociedade Francisco Manuel dos Santos. The Group Chief Executive is entitled to retain the fees, which were £349,303 in total.

No other Executive Director served as a Non-Executive Director in 2019.

## Relative importance of spend on pay

The graphs illustrate the total remuneration of all Group employees compared with returns of capital to shareholders in the form of dividends and share buyback.

### Dividend[1]

£m


### Salaries and performance-based compensation £m

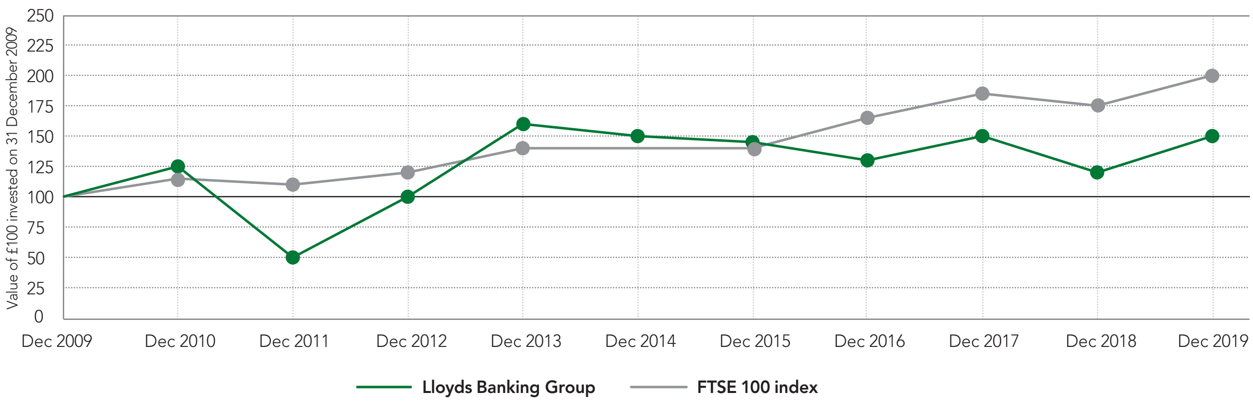

1 2019: Ordinary dividend in respect of the financial year ended 31 December 2019, partly paid in 2019 and partly to be paid in 2020.] 2018: Ordinary dividend in respect of the financial year ended 31 December 2018, partly paid in 2018 and partly to be paid in 2019 and intended share buyback.

## Comparison of returns to shareholders and GCE total remuneration

The chart below shows the historical total shareholder return (TSR) of Lloyds Banking Group plc compared with the FTSE 100 as required by the regulations.

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.

### TSR indices – Lloyds Banking Group and FTSE 100




| | CEO | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **GCE single figure of remuneration £000** | J E Daniels | 2,572 | 855 | – | – | – | – | – | – | – | – |
| | António Horta-Osório | – | 1,765 | 3,398 | 7,475 | 11,540 | 8,704 | 5,791 | 6,434 | 6,544 | **4,727** |
| **Annual bonus/ GPS payout (% of maximum opportunity)** | J E Daniels | 62% | 0% | – | – | – | – | – | – | – | – |
| | António Horta-Osório | – | – | 62% | 71% | 54% | 57% | 77% | 77% | 67.60% | – |
| **Long-term incentive vesting (% of maximum opportunity)** | J E Daniels | 0% | 0% | – | – | – | – | – | – | – | – |
| | António Horta-Osório | – | 0% | 0% | 54% | 97% | 94.18% | 55% | 66.30% | 68.70% | **49.7%** |
| **TSR component vesting (% of maximum)** | J E Daniels | 0% | 0% | – | – | – | – | – | – | – | |
| | António Horta-Osório | – | 0% | 0% | 25.30% | 30% | 30% | 0% | 0% | 0% | **0%** |

Notes: J E Daniels served as GCE until 28 February 2011; António Horta-Osório was appointed GCE from 1 March 2011. António Horta-Osório declined to take a bonus in 2011 and independently requested that he be withdrawn from consideration for a Group Performance Share award in 2019.

Directors' remuneration report continued

## Directors' share interests and share awards

### Directors' interests (audited)

| | Number of shares | | | Number of options | | Total shareholding[1] | | Value |
|---|---|---|---|---|---|---|---|---|
| | Owned outright | Unvested subject to continued employment | Unvested subject to performance | Unvested subject to continued employment | Vested unexercised | Total at 31 December 2019 | Total at 20 February 2020 | Expected value at 31 December 2019 (£000s)[2] |
| **Executive Directors** | | | | | | | | |
| António Horta-Osório | 20,817,507 | 1,509,516 | 19,729,182 | 53,618 | | 42,109,823 | 42,110,475[7] | 20,165 |
| Juan Colombás | 10,713,340 | 694,247 | 11,171,375 | 29,109 | | 22,608,071 | 22,608,639[7] | 10,645 |
| William Chalmers[3] | 705,398 | – | – | 3,268,460 | | 3,973,858 | 3,973,858 | 2,485 |
| George Culmer[4] | 16,626,666 | 677,449 | 6,854,490 | – | | 24,158,605 | 24,158,605 | 12,964 |
| **Non-Executive Directors** | | | | | | | | |
| Lord Blackwell | 150,000 | – | – | – | – | 150,000 | 150,000 | n/a |
| Alan Dickinson | 200,000 | – | – | – | – | 200,000 | 200,000 | n/a |
| Anita Frew | 450,000 | – | – | – | – | 450,000 | 450,000 | n/a |
| Simon Henry | 250,000 | – | – | – | – | 250,000 | 250,000 | n/a |
| Sarah Legg[5] | 0 | – | – | – | – | 0 | 0 | – |
| Lord Lupton | 1,000,000 | – | – | – | – | 1,000,000 | 1,000,000 | n/a |
| Amanda Mackenzie OBE | 63,567 | – | – | – | – | 63,567 | 63,567 | n/a |
| Nick Prettejohn[6] | 69,280 | – | – | – | – | 69,280 | 69,280 | n/a |
| Stuart Sinclair | 362,664 | – | – | – | – | 362,664 | 362,664 | n/a |
| Sara Weller CBE | 372,988 | – | – | – | – | 372,988 | 372,988 | n/a |

1 Including holdings of connected persons.

2 Awards subject to performance under the GOS had an expected value of 50 per cent of face value at grant (in line with the Remuneration Policy). Values are based on the 31 December 2019 closing price of 62.535 pence.

3 Appointed 1 August 2019.

4 Retired as Chief Financial Officer and an Executive Director with effect from 1 August 2019 and from the Group 2 August 2019. The number of shares in respect of which the GOS Awards (unvested subject to performance) vests, will be reduced to reflect the period from the start of the Performance Period to 2 August 2019, date of leaving, at the point of vest.

5 Appointed 1 December 2019.

6 In addition, Nick Prettejohn held 400 (6.475 per cent) preference shares at 1 January 2019 and 31 December 2019.

7 The changes in beneficial interests for António Horta-Osório (652 shares), Juan Colombás (568 shares) relate to 'partnership' and 'matching' shares acquired under the Lloyds Banking Group Share Incentive Plan between 31 December 2019 and 20 February 2020. There have been no other changes up to 20 February 2020.

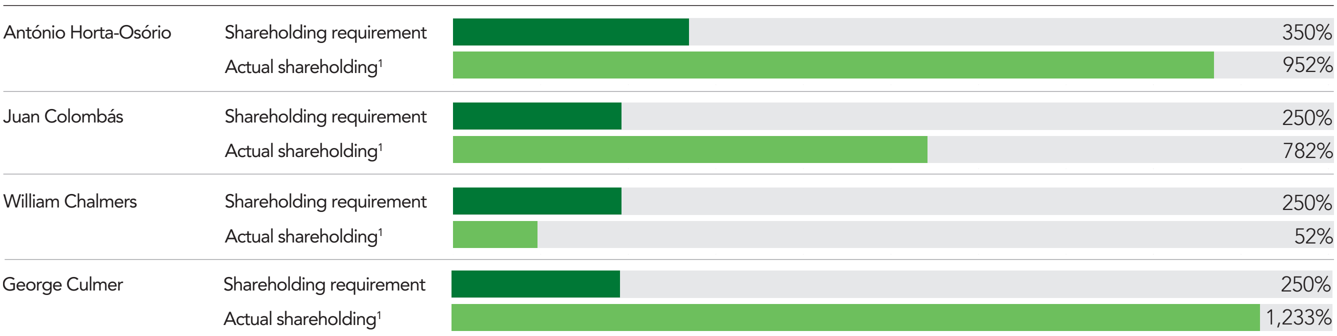
### Shareholding requirements (audited)

Executives are expected to build and maintain a company shareholding in direct proportion to their remuneration in order to align their interests to those of shareholders. The minimum shareholding requirements Executive Directors are expected to meet are as follows: 350 per cent of base salary for the GCE and 250 per cent of base salary for other Executive Directors. Newly appointed individuals will have three years from appointment to achieve the shareholding requirement. In the event that exceptional individual circumstances exist resulting in an Executive not being able to comply with the Policy, the Remuneration Committee will consider whether an exception should apply.

In addition to the Group's shareholding requirements, shares vesting are subject to holding periods in line with regulatory requirements.

For the year ending 31 December 2019, the GCE and COO continued to meet their shareholding requirements, as detailed within the illustration below. William currently holds 52 per cent of his salary in shares and will have until 2 June 2022 to achieve the requirement. At the time of his departure in August 2019, George Culmer held 1,233 per cent of his salary in shares.

The Group does not operate a formal post-employment shareholding policy. Existing reward structures and the Long Term Share Plan under the proposed new Policy have been designed in line with regulatory requirements and ensure that a substantial proportion of variable reward for Executive Directors and other senior employees takes the form of shares deferred and held over a period of up to eight years. These structures already ensure that Executive Directors continue to meet our shareholding requirements for a minimum of two years after leaving the Group.




1 Calculated using the average share price for the period 1 January 2019 to 31 December 2019 (58.07 pence). Includes ordinary shares acquired through the vesting of the deferred Group Performance Share plan, Fixed Share Awards as the shares have no performance conditions; American Deposit Receipts (ADRs) with each one ADR equating to four shares, Executive Share Awards which have vested but have not been exercised; shares held in the Share Incentive Plan (SIP) Trust, i.e. Free, Partnership, Matching and Dividend shares which are no longer subject to forfeiture, as defined in the SIP Rules. Shares held by Connected Persons, as defined by the Companies Act, but broadly meaning spouse or partner and children, may also be included.

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.

## Outstanding share plan interests (audited)

| | At 1 January 2019 | Granted/ awarded | Dividends awarded | Vested / released / exercised | Lapsed | At 31 December 2019 | Exercise price | Exercise periods From | To | Note |
|---|---|---|---|---|---|---|---|---|---|---|
| **António Horta-Osório** | | | | | | | | | | |
| LTIP 2016-2018 | **5,015,210** | – | 509,271 | 3,445,449 | 1,569,761 | **–** | | | | 1,2,3 |
| GOS 2017-2019 | **5,318,685** | – | – | – | – | **5,318,685** | | | | 3 |
| GOS 2018-2020 | **6,725,221** | – | – | – | – | **6,725,221** | | | | 3 |
| GOS 2019-2021 | | 7,685,276 | – | – | – | **7,685,276** | | | | 3, 4 |
| Deferred GPS awarded in 2018 | **1,166,466** | | | 777,644 | – | **388,822** | | | | 10 |
| Deferred GPS awarded in 2019 | | 1,494,258 | – | 373,564 | – | **1,120,694** | | | | 6 |
| 2016 Sharesave | **14,554** | – | – | – | – | **14,554** | 47.49p | 01/01/2020 | 30/06/2020 | |
| 2017 Sharesave | **21,728** | | – | – | – | **21,728** | 51.03p | 01/01/2021 | 30/06/2021 | |
| 2019 Sharesave | | 17,336 | – | – | – | **17,336** | 39.87p | 01/01/2023 | 30/06/2023 | |
| **Juan Colombás** | | | | | | | | | | |
| LTIP2016-2018 | **2,728,973** | – | 277,114 | 1,874,804 | 854,169 | **–** | | | | 1,2,3 |
| GOS 2017-2019 | **2,951,987** | | – | – | – | **2,951,987** | | | | 3 |
| GOS 2018-2020 | **3,807,302** | | – | – | – | **3,807,302** | | | | 3 |
| GOS 2019-2021 | | 4,412,086 | – | – | | **4,412,086** | | | | 3,4 |
| Deferred GPS awarded in 2018 | **528,320** | | | 352,212 | | **176,108** | | | | 10 |
| Deferred GPS awarded in 2019 | | 668,453 | | 167,112 | | **501,341** | | | | 6 |
| 2016 Sharesave | **29,109** | – | – | – | – | **29,109** | 47.49p | 01/01/2020 | 30/06/2020 | |
| **William Chalmers** | | | | | | | | | | |
| Share Buy-Out | | 818,172 | | 818,172 | | | | | | 7,8 |
| | | 1,457,748 | | | | **1,457,748** | | 28/01/2020 | 27/01/2025 | 7 |
| | | 1,124,627 | | | | **1,124,627** | | 28/01/2021 | 27/01/2026 | 7 |
| | | 686,085 | | | | **686,085** | | 28/01/2022 | 27/01/2027 | 7 |
| **George Culmer** | | | | | | | | | | |
| LTIP 2016-2018 | **2,767,409** | – | 281,017 | 1,901,209 | 866,200 | **–** | | | | 1,2,3 |
| GOS 2017-2019 | **2,993,565** | | – | – | – | **2,993,565** | | | | 3,5 |
| GOS 2018-2020 | **3,860,925** | | – | – | – | **3,860,925** | | | | 3,5 |
| Deferred GPS awarded in 2018 | **528,320** | | | 352,212 | | **176,108** | | | | 10 |
| Deferred GPS awarded in 2019 | | 668,453 | | 167,112 | | **501,341** | | | | 6 |
| 2016 Sharesave | **14,554** | – | – | 13,341 | 1,213 | – | 47.49p | | | 9 |

1. The shares awarded in March 2016 vested on 7 March 2019. The closing market price of the Group's ordinary shares on that date was 62.15 pence. Shares vested are subject to a further two-year holding period.
2. 2016 LTIP award was eligible to receive an amount equal in value to any dividends paid during the performance period. Dividend equivalents have been paid based on the number of shares vested and have been paid in shares. The dividend equivalent shares were paid on 7 March 2019. The closing market price of the Group's ordinary shares on that date was 62.15 pence. The dividend equivalent shares are not subject to any holding period.
3. All GOS have performance periods ending 31 December at the end of the three-year period. Awards were made in the form of conditional rights to free shares.
4. Awards (in the form of conditional rights to free shares) in 2019 were made over shares with a value of 300 per cent of salary for António Horta-Osório (7,685,276 shares with a face value of £3,733,200) and 275 per cent for Juan Colombás (4,412,086 shares with a face value of £2,143,215). No award was made to George Culmer. The share price used to calculate face value is the average price over the five days prior to grant (27 February to 5 March 2019), which was 63.052 pence. As regulations prohibit the payment of dividend equivalents on awards in 2018 and subsequent years, the number of shares awarded has been determined by applying a discount factor to the share price on award. An adjustment of 29.8 per cent was applied. Performance conditions for this award are set out in the table on page 110.
5. The number of Shares in respect of the 2017 and 2018 GOS Awards are stated in full and will be reduced to reflect the period from the start of the Performance Period to the date of leaving (2 August 2019) at the point of vest in accordance with the appropriate plan rules.
6. Part of GPS is deferred into shares (in the form of conditional rights to free shares). The face value of the share awards in respect of GPS granted in March 2019 was £942,160 (1,494,258 shares) for António Horta-Osório; £421,473 (668,453 shares) for Juan Colombás and £421,473 (668,453) for George Culmer. The share price used to calculate the face value is the average price over the five days prior to grant (27 February to 5 March 2019), which was 63.052 pence.
7. William Chalmers joined the Group on 3 June 2019 and was appointed as Chief Financial Officer on 1 August 2019 on the retirement of George Culmer. He was granted deferred cash of £2,046,097 and deferred share awards over 4,086,632 Shares, to replace unvested awards from his former employer, Morgan Stanley, that were forfeited as a result of him joining the Group. The deferred cash and the number of Shares over which the deferred share awards were granted was calculated using the USD:GBP exchange rate of 1.2664 and the respective mid-market closing prices of Mr Chalmers' previous employer and the Group on 3 June 2019 (57.05 pence) resulting in a face value of the awards of £4,377,521. The award is subject to vesting terms in line with those forfeited as set out above, and is on materially the same terms as the Executive Group Ownership Share (ExGOS), including the discretions as summarised on page 93 of the 2017 Annual Report, but as the award is a buy-out it is not subject to performance conditions and is not subject to time pro-rating in a good leaver circumstances. The award is subject to malus and clawback on the same terms as ExGOS awards, and in addition is subject to clawback in the event of resignation within one year of grant. The value of the award is not pensionable.
8. Options vested on 18 July 2019 and William Chalmers exercised on 1 August 2019. The closing market price of the Group's ordinary shares on that date was 52.84 pence. Mr Chalmers retained all the shares apart from 384,733 shares which were sold to meet income tax and National Insurance contributions. Shares are subject to a six month holding period from the date of vesting on 18 July 2019.
9. Mr Culmer had six months from his date of retirement to exercise his Sharesave options. Options were exercised on 7 November 2019 and savings made to date were used to buy shares. The closing market price of the Group's ordinary shares on that date was 57.20 pence.
10. Part of GPS is deferred into shares. The face value of the share awards in respect of GPS granted in March 2018 was £1,058,016 (1,555,288 shares) for António Horta-Osório; £479,200 (704,426 shares) for Juan Colombás and £479,200 (704,426) for George Culmer. The share price used to calculate the face value is the average price over the five days prior to grant (27 February to 5 March 2019), which was 63.052 pence.

**Directors' remuneration report** continued

### 2019 Group Ownership share performance measures (for awards made in March 2019) (audited)

Meeting threshold performance will result in 25 per cent vesting of each metric, relative to each weighting.

| Strategic priorities | Measure | Basis of payout range | Metric | Weighting |
|---|---|---|---|---|
| Creating the best customer experience | Customer satisfaction | Major Group average ranking over 2021 | Threshold: 3rd<br>Maximum: 1st | 10% |
| | Digital net promoter score | Set relative to 2021 targets | Threshold: 65.3<br>Maximum: 68.3 | 7.5% |
| | FCA total reportable[1] complaints and Financial Ombudsman Service (FOS) change rate[2] | Set relative to 2021 targets Average rates over 2021 | Threshold: 2.89 and ≤ 29%<br>Maximum: 2.61 and ≤ 25% | 10% |
| Becoming simpler and more efficient | Statutory economic profit[3] | Set relative to 2021 targets | Threshold: £2,210m<br>Maximum: £3,315m | 25% |
| | Cost:income ratio | Set relative to 2021 targets | Threshold: 45.9%<br>Maximum: 43.4% | 10% |
| Delivering sustainable growth | Absolute total shareholder return (TSR) | Growth in share price including dividends over 3-year period | Threshold: 8% p.a.<br>Maximum: 16% p.a. | 30% |
| Building the best team | Employee engagement index | Set relative to 2021 markets norms | Threshold: +5% vs. 2021 UK Norm<br>Maximum: +2% vs. 2021 UK High Performing Norm | 7.5% |

1 FCA reportable complaints per 1,000 accounts.

2 FOS uphold rate.

3 A measure of profit taking into account Expected Losses, tax and a charge for equity utilisation.

## Implementation of the policy in 2020

The 2020 Remuneration Policy is subject to approval at the Annual General Meeting in May 2020. We propose to implement the Policy in the following ways subject to shareholder approval. A final 2020 Group Ownership Share award will be granted under the existing Remuneration Policy prior to the AGM when the 2020 Remuneration Policy is intended to come into effect.

| | | |
|---|---|---|
| **Base Salary** | The Group has applied a total pay budget of 2.4 per cent including a minimum pay award of £500 for eligible colleagues. Focussing on lower paid colleagues and colleagues paid lower in their pay range, the Group's pay approach ensures over 63 per cent of colleague will receive a pay award of 2.5 per cent or more. The pay budget for senior executives is set below the budget for the wider colleague at 2 per cent. | It was agreed that a salary increase of 2 per cent would apply for the Group Chief Executive (GCE) and Chief Financial Officer (CFO). Following confirmation that the Chief Operating Officer (COO) is due to retire in 2020, his salary is due to remain in line with 2019.<br>Salaries will therefore be as follows:<br>GCE: £1,294,674 (with effect from 1 January 2020)<br>COO: £794,938<br>CFO: £810,837 (with effect from 1 April 2020) |
| **Fixed Share Award** | Awards remain unchanged from 2019 as follows:<br>GCE: £1,050,000<br>COO: £497,000<br>CFO: £504,000 | Subject to approval shares will be released in equal tranches over three years. (See page 116 for further details). |
| **Pension** | With effect from 1 January 2020, pension allowances will be reduced for all Executive Directors to 15 per cent of base salary. Any new Executive Director appointments in 2020 will also attract a maximum allowance of 15 per cent of base salary. | Over 50,000 colleagues participate in the Group's Defined Contribution (DC) Pension scheme. We therefore believe the DC pension provisions provide an accurate reflection of the pension rate available to the majority of the workforce. With effect from July 2020 the maximum employer contribution for all colleagues will be 15 per cent of base salary and Executive Directors will be aligned to the majority of the workforce. |
| **Benefits** | Benefits remain unchanged from 2019. Executive Directors receive a flexible benefit allowance in line with colleagues, (4 per cent of base salary). This can be used to select benefits including life assurance and critical illness cover. Other benefits include car allowance, transportation tax preparation and private medical cover. | |
| **Group Performance Share** | The approach to determining the Group's Group Performance Share outcome for 2020 will remain aligned to the approach from 2019. A fixed five per cent of adjusted Underlying Profit (UP) will be used as a starting position for the overall pool. This remains within the maximum plan limit of 10 per cent of UP and a financial performance threshold will be set at 20 per cent below the Group's underlying profit target, at which no award will be payable.<br>A measurement of the Group's performance will be assessed against Balanced Scorecard objectives and receive a score from 1 to 5. The Group Balanced Scorecard must exceed a threshold score of 1.5, below which no award will be payable.<br>The fixed 5 per cent of UP will be adjusted by a scorecard modifier commensurate with the Group Balanced Scorecard performance score. Adjustments for conduct and risk factors will also be considered when determining the final overall pool.<br>Individual maximum opportunities for Executive Directors remain unchanged from 2019 at 140 per cent of base salary for the GCE and 100 per cent of base salary for other Executive Directors.<br>Individual awards will be based on pre-determined formulaic pay out ranges commensurate with performance and will be determined by the Remuneration Committee through the assessment of a balanced scorecard and an individual performance assessment. The Committee will determine if an Executive Director's personal performance justifies a variation up or down in the rating or award values determined by the scorecard, and will explain how this is determined. The Group Chief Executive's individual performance will be measured through the Group Balanced Scorecard, the Chief Operating Officer will be measured through the Chief Operating Office scorecard and the Chief Financial Officer will be measured through the Finance Division scorecard. | The 2020 scorecards will provide a balanced view across 15 financial, operational and strategic measures equally weighted between Financial, Customer and Colleague and Conduct measures. Target will be assessed against a rating scale of 1 to 5.<br>The Committee considers the specific targets that apply to 2020 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.<br>For the 2020 performance year, any Group Performance Share opportunity will be awarded in March 2021 in a combination of cash (up to 50 per cent) and shares. 40 per cent will be released in the first year following the award with £2,000 paid in cash, and the balance of the upfront 40 per cent delivered in shares; 50 per cent of which will be subject to holding until March 2022. The remaining 60 per cent is deferred into shares with 40 per cent vesting in 2022 and 20 per cent in 2023. 50 per cent of each release will be subject to a further 12-month holding in line with regulatory requirements.<br>The Committee may consider the application of malus and clawback as outlined in the performance adjustment section. |

### Group Ownership Share

A Group Ownership Share award will be granted in relation to 2019 performance under the terms of the current Remuneration Policy. On the basis of the new Long Term Share Plan being approved by shareholders at the 2020 AGM, no further Group Ownership Share awards would then be made.

The maximum Group Ownership Share award for Executive Directors is 300 per cent of salary and the Remuneration Committee has the ability to grant an award up to 400 per cent of salary for exceptional circumstances for the Group Chief Executive. Following confirmation that the Chief Operating Officer (COO) is due to retire in 2020, no award will be made.

Awards in 2020 are being made as follows:
GCE: 250 per cent of base salary
COO: No award
CFO: 237.5 per cent of base salary

As regulations prohibit the payment of dividend equivalents on awards, the number of shares subject to the award has been determined by applying a discount factor to the share price on grant, as previously disclosed. The Committee approved an adjustment of 29.03 per cent for colleagues who are senior managers, including the Executive Directors.

Awards will be subject to a three-year performance period with vesting between the third and seventh anniversary of award, on a pro-rata basis. Any shares released are subject to a further holding period in line with regulatory requirements and market practice. Meeting threshold performance will result in 25 per cent vesting of each metric, relative to each weighting.

Awards made in 2020 will vest based on the Group's performance against the financial and strategic measures, set out below. In line with the current Remuneration Policy, the Committee has full discretion to amend payout levels should the award not reflect business and/or individual performance. Business performance includes, but is not limited to, consideration of returns to shareholders.

There are no changes to proposed financial and strategic measures to provide consistency with the 2019 plan and continued alignment to the key strategic priorities as set out in the third Group Strategic Review.

The Committee may consider the application of malus and clawback as outlined in the performance adjustment section.

### Group Ownership Share continued

| Strategic priorities | Measure | Basis of payout range | Metric | Weighting |
|---|---|---|---|---|
| Creating the best customer experience | Customer satisfaction | Major Group average ranking over 2022 | Threshold: 3rd<br>Maximum: 1st | 10% |
| | Digital net promoter score | Set relative to 2022 targets | Threshold: 65.3<br>Maximum: 68.3 | 7.5% |
| | FCA total reportable complaints and Financial Ombudsman Service (FOS) change rate | Set relative to 2022 targets<br>Average rates over 2022 | Threshold: 2.65<br>Maximum: 2.52<br>Threshold: 30%<br>Maximum: 25% | 10% |
| Becoming simpler and more efficient | Statutory economic profit[1] | Set relative to 2022 targets | Threshold: £1,965m<br>Maximum: £2,948 | 15% |
| | Cost:income ratio | Set relative to 2022 targets | Threshold: 46.4%<br>Maximum: 43.9% | 10% |
| Delivering sustainable growth | Absolute total shareholder return (TSR) | Growth in share price including dividends over 3-year period | Threshold: 8%<br>Maximum: 16% | 40% |
| Building the best team | Employee engagement index | Set relative to 2022 markets norms | Threshold: +5% vs UK norm<br>Maximum: +2% vs UK High Performing Norm | 7.5% |

1 A measure of profit taking into account expected losses, tax and a charge for equity utilisation.

### Performance adjustment

Performance adjustment is determined by the Remuneration Committee and/or Board Risk Committee and may result in a reduction of up to 100 per cent of the GPS and/or GOS opportunity for the relevant period. It can be applied on a collective or individual basis. When considering collective adjustment, the Senior Independent Performance Adjustment and Conduct Committee (SIPACC) submits a report to the Remuneration Committee and Board Risk Committee regarding any adjustments required to balanced scorecards or the overall GPS and/or GOS outcome to reflect in-year or prior year risk matters.

The application of malus will generally be considered when:

– there is reasonable evidence of employee misbehaviour 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 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.

Judgement on individual performance adjustment is informed by 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. Individual adjustment may be applied through adjustments to balanced scorecard assessments and/or through reducing the GPS and/or GOS outcome.

Awards are subject to clawback for a period of up to seven years after the date of award which may be extended to 10 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.

## Chairman and Non-Executive Director fees in 2019

The annual fee for the Chairman was increased by 2 per cent to £772,855, in line with the overall salary budget for the executive population. The annual Non-Executive Director fees were increased by 2 per cent, in line with the base salary increase awarded to the senior management of the Group. These changes took effect from 1 January 2020.

| | **2020** | 2019 |
|---|---|---|
| Basic Non-Executive Director fee | **£81,200** | £79,600 |
| Deputy Chairman | **£106,000** | £104,000 |
| Senior Independent Director | **£63,600** | £62,400 |
| Audit Committee Chairmanship | **£74,300** | £72,800 |
| Remuneration Committee Chairmanship | **£74,300** | £72,800 |
| Risk Committee Chairmanship | **£74,300** | £72,800 |
| Responsible Business Committee Chairmanship | **£42,400** | £41,600 |
| IT Forum Chairmanship | **£42,400** | £41,600 |
| Audit Committee Membership | **£34,000** | £33,300 |
| Remuneration Committee Membership | **£34,000** | £33,300 |
| Risk Committee Membership | **£34,000** | £33,300 |
| Responsible Business Committee Membership[1] | **£15,900** | £15,600 |
| Nomination and Governance Committee Membership | **£15,900** | £15,600 |

1 New members only.

Non-Executive Directors may receive more than one of the above fees.

## Percentage change in remuneration levels

Figures for 'All employees' are calculated using figures for all colleagues eligible for the GPS 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 2019, 66,216 colleagues were included in this category.

| | **% change in base salary (2018 to 2019)** | **% change in GPS (2018 to 2019)** | **% change in benefits (2018 to 2019)** |
|---|---|---|---|
| GCE (salary increase effective 1 January 2020) | 2.0% | (100%)[1] | 2.0% |
| All employees | 2.4%[2] | (31.7%)[2] | 2.4%[2] |

1 Reflects the increase in base salary from 1 January 2019 against which the award is determined.
2 Adjusted for movements in colleagues numbers and other impacts to ensure a like-for-like comparison. Salary increases effective 1 April 2020.

## Gender Pay

**We have further reduced our gender pay gap in 2019 resulting in a 1.9 per cent improvement since 2017.**
At Lloyds Banking Group we are committed to promoting a diverse and inclusive working environment. Our focus is on improving the gender pay and bonus gaps by increasing the proportion of women in senior roles. In doing so, the gender gaps will reduce over time. We are committed to attracting and retaining the best talent and we are pleased that our 2019 mean gender pay and bonus gaps have reduced further this year.

The reduction in the pay gap can be attributed to an improvement in female representation across the Bank, with an increase in the proportion of female colleagues in senior roles. The proportion of women in the upper pay quartile for the Group has increased. We are pleased to see that our efforts have started to decrease our gender pay gap, however we are aware that there continue to be more men in senior roles. Addressing female representation across the Bank will take time and we are committed to achieving our gender targets that will have an impact on our pay gaps in future years. Further information is available at: www.lloydsbankinggroup.com/globalassets/our-group/responsible-business/reporting-centre/lloyds-banking-group-gender-pay-gap-report-2019.pdf

### Mean Pay Gap
%


### Mean Bonus Gap
%

## CEO pay ratio

| Year | Methodology | Total Compensation P25 (Lower Quartile) | Total Compensation P50 (Median) | Total Compensation P75 (Upper Quartile) | Fixed pay P25 (Lower Quartile) | Fixed pay P50 (Median) | Fixed pay P75 (Upper Quartile) |
|---|---|---|---|---|---|---|---|
| **2019** | **A** | 179:1 | **128:1** | 71:1 | 114:1 | **82:1** | 47:1 |
| **2018** | **A** | 237:1 | **169:1** | 93:1 | 113:1 | **81:1** | 48:1 |
| **2017** | **A** | 245:1 | **177:1** | 97:1 | 113:1 | **82:1** | 48:1 |
| Y-o-Y (2018 vs 2019) | | | **(24%)** | | | **1%** | |

**Notes to the calculation:**
- The 2019 total remuneration for the colleagues identified at P25, P50 and P75 are as follows: £26,419, £36,975, £66,944
- The 2019 base salary for the colleagues identified at P25, P50 and P75 are as follows: £22,227, £31,671, £50,431
- The P25, P50 and P75 colleagues were determined on 12 February 2020 based on calculating total remuneration for all UK employees for the 2019 financial year. Payroll data from 1 January 2019 to 31 December 2019 and variable remuneration outcomes approved in February 2020 were used
- Methodology option A has been used and was selected on the basis that it provided the most accurate means of identifying the median, lower and upper quartile colleagues
- Colleague total remuneration has been calculated in line with the single total figure of remuneration. The single total figure of remuneration calculated for each of the 62,364 UK colleagues includes full time equivalent base pay, Group Performance Share awards for the 2019 performance year, vesting Group Ownership Share awards (for eligible colleagues), core benefits, pension, overtime and shift payments, travel/relocation payments (for eligible colleagues) and private medical benefit
- The average share price between 1 October 2019 and 31 December 2019 (59.34 pence) has been used to indicate the value of vesting Group Ownership Share awards
- The colleague identified at P50 did not receive a separate car benefit and does not participate in the long-term incentive plan. As a result, the ratio does not provide a direct comparison to the total remuneration of the Group Chief Executive
- Each of the three individuals identified was a full-time employee during the year
- Due to operational constraints, inflationary adjustments to defined benefit pensions are excluded
- All other data has been calculated in line with the methodology for the single total figure of remuneration for the Group Chief Executive

The median ratio has decreased 24 per cent year-on-year. The reduction is largely attributed to the Group Chief Executive's request to withdraw from consideration by the Remuneration Committee (the Committee) for a Group Performance Share award for 2019. Volatility in variable reward outcomes has contributed to the year-on-year changes in the ratio.

The Committee is thoughtful of the volatility in pay ratios due to variable reward outcomes. Although the pay ratio is used as a useful reference point to inform policy-setting, the Committee takes into account a number of other factors to assess colleague pay progression.

For the majority of colleagues, year-on-year changes in remuneration are principally driven by pay increases. We are committed to reducing the pay gap between executives and wider colleagues and continue to remain focused on addressing the gap from the bottom up and not just from the top down. To support this, the Group has a commitment to pay progression and a continued focus on ensuring higher pay awards for colleagues who are lower paid, or paid lower within their pay range.

For 2020, the pay budget has been set at 2.4 per cent, with over 63 per cent of colleagues at lower grades receiving a pay award of 2.5 per cent or over. The pay budget for senior colleagues was set lower, at 2 per cent.

A minimum pay award of £500 will apply for all eligible colleagues and pay awards of up to 3.5 per cent for the lowest paid colleagues. We are proud to be an accredited Living Wage employer since 2015, and from April 2020 we will go further and raise the minimum salary for all full-time colleagues to £18,200, reflecting a rate of £10 per hour. For some colleagues this will result in an increase of up to 3.94 per cent and is 22 per cent greater than the National Living Wage and 70 pence greater than current National Living Wage Foundation's UK wide real Living Wage.

We believe our approach to pay progression has contributed to the reduction of the 2019 median pay ratio and supports reducing the gap between executive and wider colleague pay over time. For example, the colleague who is now at P25 for 2019 received a 2.69 per cent pay increase which brought them up from P24 to that level.

## Remuneration Committee

The Committee comprises six Non-Executive Directors; Stuart Sinclair (Chair), Lord Blackwell, Alan Dickinson, Anita Frew, Sara Weller and Amanda Mackenzie; to provide a balanced and independent view on remuneration matters. Stuart Sinclair has been Chair of the Committee since 1 September 2018 and has been a member of the Committee since January 2016. For further details of Committee membership and attendance at meetings, please see page 70.

The purpose of the Committee is to set the remuneration for all Executive Directors and the Chairman, including pension rights and any compensation payments. It recommends and monitors the level and structure of remuneration for senior management and material risk takers. It also considers, agrees and recommends 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, purpose and values and the long-term interests of the Group, and recognises the interests of relevant stakeholders, including the wider workforce. The Committee's operation is designed to ensure that no conflicts of interest arise, and in particular, the Committee ensures that no individual is present when matters relating to their own remuneration are discussed.

Mercer was appointed by the Committee in 2016 following a competitive tender process and was retained for 2019. The Committee is of the view that Mercer provides independent remuneration advice to the Committee and does not have any connections with the Group or any director that may impair its independence. The broader Mercer company provides unrelated advice on accounting and investments. During the year the Committee requested advice and independent research on market and best practice in relation to fixed and variable reward structures to support formulating the Policy. Mercer attended Committee meetings upon invitation and fees payable for the provision of services in 2019 were £31,630.

### How the Remuneration Committee spent its time in 2019 and compliance with the 2018 Corporate Governance Code

#### Executives

**Key highlights:**
Assurance that the new Policy supports the delivery of the Group's purpose and long-term goals while rewarding the right behaviours in line with the Group's culture and values.

**Oversight and approval**

- Review of 2018 performance and remuneration for EDs and senior management. Particularly focused on discussing and challenging performance outcomes and the direct implications of risk and conduct on reward outcomes
- Comfortable that the Directors' Remuneration Policy worked effectively in 2019, ensuring that there was true alignment between pay and performance notwithstanding that there were areas of development to consider when designing the new Policy
- The 2019 executive pay budget was set in the context of the wider colleague pay budget. Pay increases were approved on the basis that they were lower than pay increases for wider colleagues. The implications of pay increases on future CEO pay ratios and the Group's approach to pay progression was considered
- Code Provision 40. When designing the new Directors' Remuneration Policy, the Committee has aimed to design clear and transparent remuneration structures that reduce complexity and promote behaviours that support the Group's purpose, values and culture. Risk and conduct has been considered to avoid rewarding for failure and the range of possible values of rewards EDs can potentially receive have been reviewed. Please see pages 98 to 102 for examples of how we have considered the key principles of Provision 40 in 2019

#### Colleagues and Wider Workforce

**Key highlights:**
Delivery of the Group's new performance management approach 'Your Best' and colleague understanding of the link between performance and reward.

**Oversight**

- 2020 Colleague Pension Policy and how the changes support the Group's culture.
- When finalising the changes to the Group's DC employer pension offering including the reduction to ED pensions, the potential impact on pay ratios including gender pay were considered
- Received a quarterly report on key colleague and wider workforce reward activity including in-year spend on colleague pay increases and a review of the Group Remuneration Policy for third party suppliers sharing enhancements to the assessment framework used to ensure third party reward polices align to the Group's own principles
- Constructive engagement with the Group's recognised Unions, particularly on the deployment of the Group Performance Share model with the introduction of 'Your Best', the improvements to the DC pension scheme for all colleagues, the broader reward package the Group offers and 2019 discussions on pay budgets. Together the Unions are recognised across a bargaining unit of circa. 95 per cent of colleagues and continue to play a valuable role in representing colleagues across the Group
- To support colleagues to better understand the approach to determining GPS awards across the Group, including Executive Directors, the Committee gained insight into how the Group has used internal media channels to explain the process in a clear and transparent way and to emphasise the link between pay and performance

#### Additional Stakeholders

**Key highlights:**
Consideration of a balanced range of opinions from stakeholders on remuneration matters.

**Oversight and engagement**

- Regular updates on corporate governance and institutional remuneration principles changes
- The regulators were invited to attend committee meetings in 2019 and gain greater understanding of Committee debates in relation to performance and reward outcomes
- The Chair attended the Work and Pensions Select Committee and reiterated intentions to focus on purpose and behaviour when designing the Policy in its entirety whilst also gaining further insight into external sentiment felt in relation to executive pensions

## Statement of voting at Annual General Meeting

The table below sets out the voting outcome at the Annual General Meeting in May 2019 in relation to the annual report on remuneration and the Remuneration Policy, last voted on in 2017.

| | 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) |
| 2018 annual report on remuneration (advisory vote) | 43,322 | 91.95% | 3,790 | 8.05% | 1,006 |
| Directors' remuneration policy (binding vote in 2017) | 47,673 | 98.03% | 959 | 1.97% | 535 |

# 2020 Remuneration Policy

Approval for this Remuneration Policy will be sought at the AGM on 21 May 2020 and, if approved, will take effect from that date.

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. Information on how the Policy will be implemented in 2020 is included in the annual report on remuneration.

The objective of the Policy 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 Group's purpose of Helping Britain Prosper and the strategic aim of becoming the best bank for customers whilst delivering long-term superior and sustainable returns to shareholders. It fosters performance in line with the Group's values and behaviours, encourages effective risk disciplines and is in line with relevant regulations and codes of best practice.

### Decision making process for determining the Policy and consideration of stakeholder views

In formulating the Policy, the Remuneration Committee has consulted extensively with a number of stakeholders including institutional shareholders and the Group's main regulators, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). A formal consultation on the remuneration of Executive Directors was not undertaken with colleagues. However, constructive engagement with the Group's recognised Unions took place on key elements of the reward package and the unions continue to play a valuable role in representing colleagues across the Group. The Committee also increased its level of oversight on remuneration matters for colleagues and the wider workforce in 2019, receiving overviews and analysis on key reward matters on a quarterly basis to support decisions in relation to executive remuneration.

The Chairman of the Remuneration Committee alongside senior management consulted with shareholders extensively and the proposed amendments to the Policy were deliberated by the Remuneration Committee at three separate committee meetings. Throughout the process, the Committee Chair kept an open dialogue with key stakeholders to provide updates on amendments and additional points of consideration within the Policy following their feedback. The final Policy is proposed on the basis that it has been widely consulted on with stakeholders and has been designed to align to the Group's culture, values and purpose whilst also remaining aligned to wider stakeholder interests.

No Executive Director has been involved in the determination of their own remuneration but has remained well informed to ensure alignment between executive and wider colleague remuneration structures. To manage conflicts of interests effectively, Executive Directors were asked to step out of committee meetings and relevant paperwork was also redacted for individuals if required. The Committee has also considered gender pay and CEO pay ratio analysis when finalising policy proposals.

### Directors' Remuneration Policy and Group Remuneration Policy alignment

There is no significant difference between the Policy for Executive Directors and that for other colleagues. If a significant difference for any individual were proposed, this would be subject to approval by the Remuneration Committee (within regulatory requirements). The table below summarises how the Policy applies across the Group.

| | | Executive Directors | Group Executive Committee | Other Material Risk Takers | Other Employees |
|---|---|---|---|---|---|
| Fixed | Base salary | ✓ | ✓ | ✓ | ✓ |
| | Fixed share award[1] | ✓ | ✓ | ✓ | ✓ |
| | Pension and benefits | ✓ | ✓ | ✓ | ✓ |
| Variable | Short-term incentive | ✓ | ✓ | ✓ | ✓ |
| | Long term incentive[1] | ✓ | ✓ | ✓ | ✓ |

1 Eligibility based on seniority and / or role.

## Base salary

| | |
|---|---|
| **Purpose and link to strategy** | To support the recruitment and retention of Executive Directors of the calibre required to develop and deliver the Group's strategic priorities. Base salary reflects the role of the individual, taking account of market competitiveness, responsibilities and experience, and pay in the Group as a whole. |
| **Operation** | Base salaries are typically reviewed annually with any increases normally taking effect from 1 January for existing Executive Directors and 1 April for future appointments. When determining and reviewing base salary levels, the Committee takes into account base salary increases for employees throughout the Group and ensures that decisions are made within the following two parameters:<br>– An objective assessment of the individual's responsibilities and the size and scope of their role, using objective job-sizing methodologies.<br>– Pay for comparable roles in comparable publicly listed financial services groups of a similar size.<br>Salary may be paid in sterling or other currency and at an exchange rate determined by the Committee. |
| **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. Where increases are awarded in excess of the wider employee population, the Committee will provide an explanation in the relevant annual report on remuneration. |
| **Performance measures** | N/A |
| **Changes** | The effective date will change from January to April each year for future Executive Directors to align delivery with the rest of the workforce. |

## 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 entirely in Lloyds Banking Group shares, released over three years with 33 per cent being released each year following the year of award. The Committee can, however, decide to deliver some or all of it in the form of cash. |
| **Maximum potential** | The maximum award is 100 per cent of base salary. |
| **Performance measures** | N/A |
| **Changes** | Delivery of vested shares will change from five to three years to align the delivery schedule with other colleagues eligible to receive a Fixed Share Award. |

## Pension

| | |
|---|---|
| **Purpose and link to strategy** | To provide cost effective and market competitive retirement benefits, supporting 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.<br>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 all Executive Directors is 15 per cent of base salary. All future appointments as Executive Directors will also attract a maximum allowance of 15 per cent of base salary in line with the majority of the workforce. Maximum allowance may be increased or decreased in order to remain aligned. |
| **Performance measures** | N/A |
| **Changes** | Maximum employer pension contribution available has been reduced to 15 per cent of cash salary with no compensation for the reduction to align to the maximum employer pension contribution available to colleagues on the defined contribution pension scheme. |

## Benefits

| | |
|---|---|
| **Purpose and link to strategy** | To provide flexible benefits as part of a competitive remuneration package. |
| **Operation** | Benefits may include those currently provided and disclosed in the annual report on remuneration.<br>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.<br>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.<br>When determining and reviewing the level of benefits provided, the Committee ensures that decisions are made within the following two parameters:<br>– An objective assessment of the individual's responsibilities and the size and scope of their role, using objective job-sizing methodologies.<br>– Benefits for comparable roles in comparable publicly listed financial services groups of a similar size. |
| **Maximum potential** | The Committee will only make increases in the benefits currently provided which it believes are consistent with the two parameters above. Executive Directors receive a flexible benefits allowance, in line with all other colleagues. The flexible benefits allowance does not currently exceed 4 per cent of base salary. |
| **Performance measures** | N/A |
| **Changes** | No change to Policy |

## All-employee plans

| | |
|---|---|
| **Purpose and link to strategy** | Executive Directors are eligible to participate in HMRC-approved share plans which promote share ownership by giving employees an opportunity to invest in Group shares. |
| **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. The monthly savings limits for Save As You Earn (SAYE) is currently £500. The maximum value of shares that may be purchased under the Share Incentive Plan (SIP) in any year is currently £1,800 with a two-for-one match. Currently a three-for-two match is operated up to a maximum colleague investment of £30 per month.<br>The maximum value of free shares that may be awarded in any year is £3,600. |
| **Performance measures** | N/A |
| **Changes** | No change to policy |

## Group Performance Share plan

| | |
|---|---|
| **Purpose and link to strategy** | To incentivise and reward the achievement of the Group's annual financial and strategic targets whilst supporting the delivery of long-term superior and sustainable returns. |
| **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 Group Performance Share may be delivered partly in cash, shares, notes or other debt instruments including contingent convertible bonds. Where all or part of any award is deferred, the Committee may adjust these 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.<br><br>Where an award or a deferred award is in shares or other share-linked instrument, the number of shares to be awarded may be calculated using a fair value or based on discount to market value, as appropriate.<br><br>The Committee applies its judgement to determine the payout level commensurate with business and/or individual performance or other factors as determined by the Committee. The Committee may reduce the level of 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. Awards may be subject to malus and clawback for a period of up to seven years after the date of award which may be extended to 10 years where there is an ongoing internal or regulatory investigation. |
| **Maximum potential** | The maximum Group Performance Share 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.<br><br>Measures consist of both financial and non-financial measures and the weighting of these measures will be determined annually by the Committee. The weightings of the performance measures for the 2020 financial year are set out for 2019 on page 110. All assessments of performance are ultimately subject to the Committee's judgement, but no award will be made if threshold performance (as determined by the Committee) is not met for financial measures or the individual receives a score of 2.6 out of 5 or below. The normal 'target' level of the Group Performance Share is 50 per cent of maximum opportunity.<br><br>The Committee is committed to providing transparency in its decision making in respect of Group Performance Share awards and will disclose historic measures and target information together with information relating to how the Group has performed against those targets in the annual report on remuneration for the relevant year except to the extent that this information is deemed to be commercially sensitive, in which case it will be disclosed once it is deemed not to be sensitive. |
| **Changes** | The normal 'target' level of the Group Performance Share has changed to 50 per cent of maximum opportunity from 30 per cent. |

## Long Term Share plan

| | |
|---|---|
| **Purpose and link to strategy** | Long term variable reward opportunity to align executive management incentives and behaviours to the Group's objectives of delivering long-term superior and sustainable returns. The Long Term Share Plan will incentive stewardship over a long time horizon and promote good governance through a simple alignment with the interest of shareholders. |
| **Operation** | From 2021, awards will be granted under the rules of the 2020 Long-Term Share Plan, subject to shareholder approval at the AGM on 21 May 2020. Awards are made in the form of conditional shares and 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. The number of shares to be awarded may be calculated using a fair value or based on a discount to market value, as appropriate.<br><br>Vesting will be subject to an assessment of underpin thresholds being maintained measured over a period of three years, or such longer period, as determined by the Committee.<br><br>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.<br><br>Awards may be subject to malus and clawback for a period of up to seven years after the date of award which may be extended to 10 years where there is an ongoing internal or regulatory investigation. |
| **Maximum potential** | The maximum Long Term Share Plan opportunity is 200 per cent of base salary for all Executive Directors including the GCE. |
| **Performance measures** | An award may be granted by the Remuneration Committee taking into account an assessment of performance of the Company, any Member of the Group or business unit or team, and/or the performance, conduct or capability of the Participant, on such basis as the Committee determine. The normal 'target' level of the Long Term Share award is 150 per cent of base salary.<br><br>No further performance conditions will apply. However vesting will be subject to the underpins and Remuneration Committee discretion as described above. |
| **Changes** | The Long Term Share Plan replaces the Executive Group Ownership Share Plan. |

## Deferral of variable remuneration and holding periods

| | |
|---|---|
| **Operation** | The Group Performance Share and Long Term Share 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 for seven years with pro rata vesting between the third and seventh year, and at least 50 per cent of total variable remuneration is paid in shares or other equity linked instruments subject to a holding period in line with current regulatory requirements).<br>A proportion of the aggregate variable remuneration may vest immediately on award. The remaining proportion of the variable remuneration is then deferred in line with regulatory requirements. |
| **Changes** | No change in deferral requirements. |

Further information on which performance measures were chosen and how performance targets and underpin thresholds are set are disclosed in the relevant sections throughout the report.

## Discretion in relation to variable rewards

The Committee retains discretion with regards to these plans. This relates to:

- The timing, size and type of awards and holding periods, subject to policy maxima, and the annual setting of targets
- Where qualitative performance measures or underpins are used and performance against those measures or underpins is not commensurate with the Group's overall financial or strategic performance over the performance period
- Where qualitative underpin thresholds are used and performance against those underpins is not commensurate with the Group's overall financial performance over the underpin period
- Adjustment of targets and measures if events occur which cause it to determine that it is appropriate to do so. The Committee also retains the right to change performance measures and the weighting of measures, including following feedback from regulators, shareholders and/or other stakeholders; and amending the plan rules in accordance with their terms and or amending the basis of operation (including but not limited to the approach in respect of dividend equivalents) including in light of any change to regulatory requirements or guidance or feedback from regulators
- To exercise discretion in accordance with the rules, including in relation to whether or not malus or clawback provisions would apply, in connection with recruitment, or terminations of employment, or corporate events affecting the Company
- Adjustments required in certain circumstances (e.g. rights issues, corporate restructuring events and special dividends)
- The exercise of the Committee's discretion will be disclosed in accordance with regulatory requirements

## Legacy awards and restrictions on payments

Awards in respect of the Group Performance Share and under the long-term incentive Group Ownership share will be granted in 2020 under the terms of the Directors' remuneration policy approved by shareholders on 11 May 2017 (the "2017 Policy"). No further awards would be made under the long-term incentive Group Ownership share (or the terms of the 2017 Policy) unless the new Long Term Share Plan 2020 was not approved by shareholders. The Committee reserves the right to make any remuneration payments/awards and any payments/awards for loss of office, notwithstanding that they are not in line with the policy set out above where the terms of the payment/award were agreed (i) before the 2017 policy came into effect; (ii) pursuant to the 2017 policy; or (iii) at a time when the relevant individual was not a Director of the Group and, in the opinion of the Committee, the payment/award was not in consideration for the individual becoming a Director of the Group. Such payments/awards will have been set out in the annual report on remuneration for the relevant year. They include awards and payments made under previous approved remuneration policy and payments in relation to deferred Group Performance Share awards and long-term incentive' Group Ownership share awards granted in 2018, 2019 and, as referred to above, 2020.

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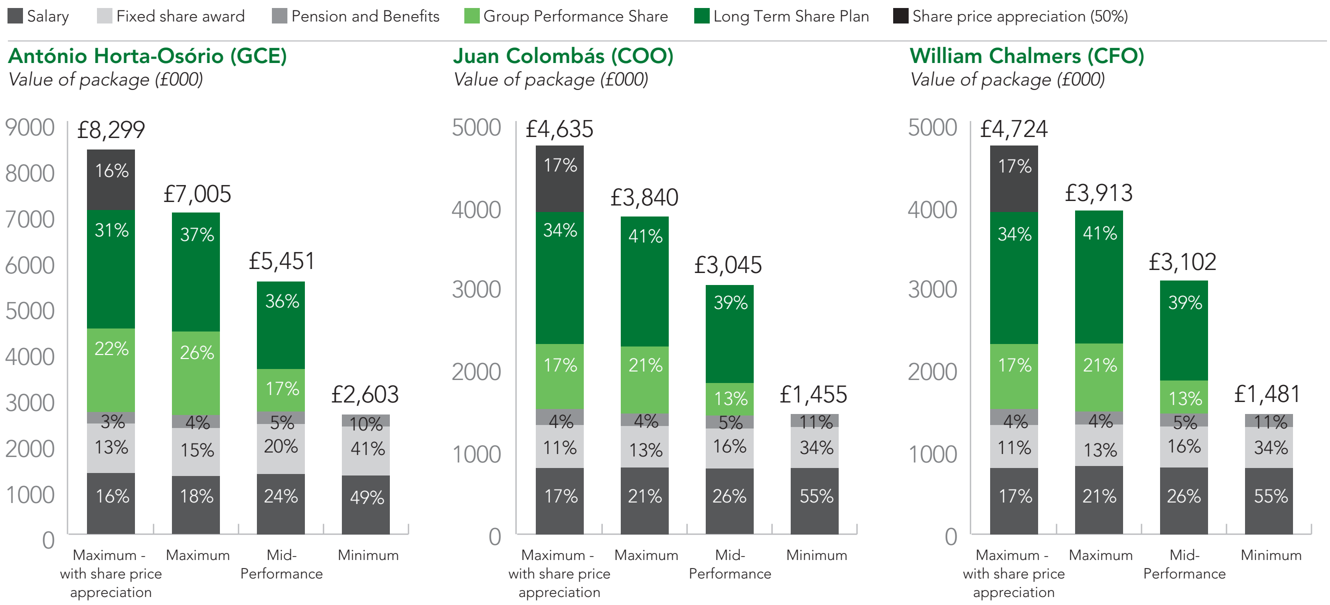
## Illustration of application of remuneration policy

The charts below illustrate possible remuneration outcomes under the following three scenarios:

1. The maximum that may be paid, assuming full Group Performance Share payout and full vesting under the new Long Term Share plan. For the Long Term Share Plan, an indication of the maximum remuneration receivable assumes a share price appreciation of 50 per cent during the period in which the award is subject to underpins. The basis of the calculation of the share price appreciation is that the share price embedded in the calculation for the 'maximum' bar chart is assumed to increase by 50 per cent across the performance period.
2. The expected value of remuneration for performance midway between threshold and maximum, assuming 50 per cent of maximum Group Performance Share opportunity and a Long Term Share award granted at 150 per cent of salary. It is also assumed that the Long Term Share Award will vest in full.
3. The minimum that may be paid, where only the fixed element is paid (base salary, benefits, pension and the fixed share award).

Amounts are based on based salaries as at 1 January 2020 for the Group Chief Executive and Chief Operating Officer and 1 April 2020 for the Chief Financial Officer. Implementation of the Policy in 2020 is set out in the annual report on remuneration.




## Approach to recruitment and appointment to the Board

In determining appropriate remuneration arrangements on hiring a new Executive Director, the Committee will take into account all relevant factors. This may include the experience and calibre of the individual, local market practice, the existing remuneration arrangements for other executives and the business circumstances. The Committee will seek to ensure that arrangements are in the best interests of both the Group and its shareholders and will seek not to pay more than is necessary.

The Committee may make awards on hiring an external candidate to 'buy-out' remuneration arrangements forfeited on leaving a previous employer. In doing so the Committee will take account of relevant factors including any performance conditions attached to these awards, the form in which they were granted (e.g. cash or shares), the currency of the awards, and the timeframe of awards. Any such award made will be made in accordance with the PRA's Rulebook and made on a comparable basis to those forfeited and subject to malus and clawback at the request of the previous employer as required by the PRA rules.

The package will normally be aligned with the remuneration policy as described in the policy report. However, the Committee retains the discretion to make appropriate remuneration decisions outside the standard policy to facilitate the recruitment of an individual of the calibre required and in exceptional cases.

This may, for example, include the following circumstances:

- An interim recruit, appointed to fill an Executive Director role on a short-term basis
- Exceptional circumstances requiring the Chairman to take on an executive function on a short-term basis
- An Executive Director recruited at a time in the year when it would be inappropriate to provide a Group Performance Share or Long Term Share award for that year, for example, where there may be insufficient time to assess performance. In this situation the Committee may feel it appropriate to transfer the quantum in respect of the months employed during the year to the subsequent year so that reward is provided on a fair basis
- An Executive Director recruited from a business or location where benefits are provided that do not fall into the definition of 'variable remuneration forfeited' but where the Committee considers it reasonable to buy-out these benefits
- Transitional arrangements for overseas hires, which might include relocation expenses and accommodation

The maximum level of variable remuneration (excluding buy-out awards) that may be awarded to new Executive Directors is equal to 200 per cent of fixed remuneration, including any discount permitted by the European Banking Authority. In making any such remuneration decisions, the Committee will apply any appropriate performance measures in line with those applied to other Executive Directors.

A full explanation will be provided of any buy-out award or discretionary payment.

## 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.

| | Notice to be given by the Group | Date of service agreement |
|---|---|---|
| Lord Blackwell | 6 months | 31 March 2014 |
| António Horta-Osório | 12 months | 3 November 2010 |
| William Chalmers | 12 months | 3 June 2019 |
| Juan Colombás | 12 months | 30 November 2010 |

Under his contract (dated 3 November 2010), António Horta-Osório (GCE) is entitled to an amount equivalent to base salary and pension allowance as a payment in lieu of notice if notice to terminate is given by the Group. If notice to terminate is given by the GCE, he is entitled to an amount equivalent to base salary if the Group chooses to make a payment in lieu of notice. Such payments in lieu will be made in monthly instalments subject to mitigation. He is also entitled to six months' notice from the Group in the event of his long-term incapacity. As part of a buy-out of a pension forfeited on joining from Santander, the GCE is also entitled to the provision of a conditional unfunded pension commitment, subject to performance conditions as described further in the annual report on remuneration. In the event of long-term incapacity, if the GCE does not perform his duties for a period of at least 26 weeks (in aggregate over a 12 month period), the Group shall be entitled to terminate his employment by giving six months' notice. In all other respects, the terms of the GCE's contract in relation to payments for loss of office match those set out below for new directors.

Under terms agreed when joining the Group, Juan Colombás is entitled to a conditional lump sum benefit, payable either (i) on reaching normal retirement age unless he voluntarily resigns or is dismissed for cause, or (ii) on leaving due to long-term sickness or death, as described further in the annual report on remuneration.

The service contracts and letters of appointment are available for inspection at the Company's registered office.

## Notice periods

Newly-appointed Executive Directors will be employed on contracts that include the following provisions:

- The individual will be required to give six months' notice if they wish to leave and the Group will give 12 months' notice other than for material misconduct or neglect or other circumstances where the individual may be summarily dismissed by written notice. In exceptional circumstances, new joiners will be offered a longer notice period (typically reducing to 12 months within two years of joining)
- In the event of long-term incapacity, if the Executive Director does not perform their duties for a period of at least 26 weeks (in aggregate over a 12 month period), the Group shall be entitled to terminate the executive's employment by giving three months' notice
- At any time after notice to terminate is given by either the Group or the Executive Director, the Group may require the Executive Director to take leave for some or all of the notice period
- At any time, at its absolute discretion, the Group may elect to terminate the individual's employment by paying to the Executive Director, in lieu of the notice period, an amount equivalent to base salary, subject to mitigation as described more fully in the termination payments section of this report

## Termination payments

It is the Group's policy that where compensation on termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured. Where it is appropriate to make a bonus payment ( known as Group Performance Share) to the individual, this should relate to the period of actual service, rather than the full notice period. Any Group Performance Share payment will be determined on the basis of performance as for all continuing employees and will remain subject to performance adjustment (malus and clawback) and deferral. Generally, on termination of employment, Group Performance Share awards, in flight Group Ownership Share awards, Long Term Share Plan awards and other rights to payments will lapse except where termination falls within one of the reasons set out below. In the event of redundancy, the individual may receive a payment in line with statutory entitlements at that time. If an Executive Director is dismissed for gross misconduct, the Executive Director will receive normal contractual entitlements until the date of termination and all deferred Group Performance Share, Group Ownership Share and Long Term Share Plan awards will lapse.

| | Base salary | Fixed share award | Pension, benefits and other fixed remuneration |
|---|---|---|---|
| Resignation | In the case of resignation to take up new employment, paid until date of termination (including any period of leave required by the Group). In the case of resignation for other reasons, base salary will be paid in monthly instalments for the notice period (or any balance of it), offset by earnings from new employment during this period. | Awards continue and are released at the normal time and the number of shares subject to the award in the current year will be reduced to reflect the date of termination. | Paid until date of termination including any period of leave required by the Group (subject to individual benefit scheme rules). |
| Redundancy or termination by mutual agreement | Paid until date of termination (including any period of leave required by the Group). In respect of the balance of any notice period, base salary will be paid in monthly instalments, offset by earnings from new employment during this period. | Awards will normally continue and be released at the normal time and the number of shares subject to the award in the current year will be reduced to reflect the date of termination unless, in the case of mutual agreement, the Committee determines that exceptional circumstances apply in which case shares may be released on termination. | Paid until date of termination including any period of leave required by the Group (subject to individual benefit scheme rules). |
| Retirement/ill health, injury, permanent disability/death | Paid until date of retirement/death. For ill health, injury or permanent disability which results in the loss of employment, paid for the applicable notice period (including any period of leave required by the Group). | Awards will normally continue and be released at the normal time and the number of shares subject to the award in the current year will be reduced to reflect the date of termination except for (i) death where shares are released on the date of termination; or (ii) in the case of permanent disability the Committee determines that exceptional circumstances apply in which case shares may be released on the date of termination. | Paid until date of death/ retirement (subject to individual benefit scheme rules). For ill health, injury, permanent disability, paid for the notice period including any period of leave required by the Group (subject to individual benefit scheme rules). |
| Change of control or merger | N/A | Awards will be payable on the date of the Change of Control and the number of shares subject to the award will be reduced to reflect the shorter accrual period. The Committee may decide that vested awards will be exchanged for (and future awards made over) shares in the acquiring company or other relevant company. | N/A |
| Other reason where the Committee determines that the executive should be treated as a good leaver | Paid until date of termination (including any period of leave required by the Group). In respect of the balance of any notice period, base salary will be paid in monthly instalments, offset by earnings from new employment during this period. | Awards continue and are released at the normal time and the number of shares subject to the award in the current year will be reduced to reflect the date of termination. | Paid until date of termination including any period of leave required by the Group (subject to individual benefit scheme rules). |

## Directors' remuneration report continued

| | Group Performance Share (Annual bonus plan)[1] | Long Term Share Plan (Long term variable reward plan)[2] | Chairman and Non-Executive Director fees[3] |
|---|---|---|---|
| Resignation | Unvested deferred Group Performance Share awards are forfeited and in-year Group Performance Share awards are accrued until the date of termination (or the commencement of garden leave if earlier) unless the Committee determines otherwise (in exceptional circumstances), in which case such awards are subject to deferral, malus and clawback. | Awards lapse on date of leaving (or on notice of leaving) unless the Committee determines otherwise in exceptional circumstances that they will vest on the original vesting date (or exceptionally on the date of leaving). Where award is to vest it will be subject to the underpins and time pro-rating (for months worked in underpin period). Malus and clawback will apply. | Paid until date of leaving Board. |
| Redundancy or termination by mutual agreement | For cases of redundancy, unvested deferred Group Performance Share awards are retained and in-year Group Performance Share awards are accrued until the date of termination (or the commencement of garden leave if earlier). Such awards would be subject to deferral, malus and clawback. For termination by mutual agreement, the same approach as for resignation would apply. | Awards vest on the original vesting date (or exceptionally on the date of leaving). Vesting is subject to the underpins and time pro-rating (for months worked in underpin period). Malus and clawback will apply. | Paid until date of leaving Board. |
| Retirement/ill health, injury, permanent disability | Unvested deferred Group Performance Share awards are retained and in-year Group Performance Share awards are accrued until the date of termination (or the commencement of garden leave if earlier). Such awards would be subject to deferral, malus and clawback. | Awards vest on the original vesting date (or exceptionally on the date of leaving). Vesting is subject to the underpins and time pro-rating (for months worked in underpin period). Malus and clawback will apply. | Paid until date of leaving Board. |
| Death | Unvested deferred Group Performance Share awards are retained and in-year Group Performance Share awards are accrued until the date of termination. Deferred Group Performance Share awards vest on death in cash, unless the Committee determines otherwise. | Awards vest in full on the date of death unless in exceptional circumstances the Remuneration Committee determines that the underpins or pre-vest test do not support full vesting. | Paid until date of leaving Board. |
| Change of control or merger[2] | In-year Group Performance Share accrued up until date of change of control or merger (current year). Where there is a Corporate Event, deferred Group Performance Share awards vest to the extent and timing determined by the Committee in its absolute discretion. | Awards vest on date of event. Vesting is subject to the underpins and time pro-rating (for months worked in underpin period unless determined otherwise). Malus and clawback will normally apply. Instead of vesting, awards may be exchanged for equivalent awards over the shares of the acquiring company or another company or equivalent cash based awards. | Paid until date of leaving Board. |
| Other reason where the Committee determines that the executive should be treated as a good leaver | Unvested deferred Group Performance Share awards are retained and in-year Group Performance Share awards are accrued until the date of termination (or the commencement of garden leave if earlier). Deferred Group Performance Share awards vest in line with normal timeframes and are subject to malus and clawback. The Committee may allow awards to vest early if it considers it appropriate. | Awards vest on the original vesting date (or exceptionally on the date of leaving). Vesting is subject to the underpins and time pro-rating (for months worked in underpin period). Malus and clawback will apply. | Paid until date of leaving Board. |

1 If any Group Performance Share is to be paid to the Executive Director for the current year, this will be determined on the basis of performance for the period of actual service, rather than the full notice period (and so excluding any period of leave required by the Group).

2 Reference to change of control or merger includes a compromise or arrangement under section 899 of the Companies Act 2006 or equivalent. Fixed share awards may also be released/exchanged in the event of a resolution for the voluntary winding up of the Company; a demerger, delisting, distribution (other than an ordinary dividend) or other transaction, which, in the opinion of the Committee, might affect the current or future value of any award; or a reverse takeover, merger by way of a dual listed company or other significant corporate event, as determined by the Committee. In the event of a demerger, special dividend or other transaction which would in the Committee's opinion affect the value of awards, the Committee may allow a deferred Group Performance Share award or a long term incentive award to vest to the extent relevant performance conditions are met to that date and if the Committee so determined, on a time pro-rated basis (unless determined otherwise) to reflect the number of months of the underpin period worked.

3 The Chairman is entitled to six months' notice.

4 The terms applicable on a cessation of employment to Group Ownership Share Awards are as shown on page 97 of the 2017 Remuneration Policy.

On termination, the Executive Director will be entitled to payment for any accrued but untaken holiday calculated by reference to base salary and fixed share award.

The cost of legal, tax or other advice incurred by an Executive Director in connection with the termination of their employment and/or the cost of support in seeking alternative employment may be met up to a maximum of £100,000. Additional payments may be made where required to settle legal disputes, or as consideration for new or amended post-employment restrictions.

Where an Executive Director is in receipt of expatriate or relocation expenses at the time of termination (as at the date of the AGM no current Executive Directors are in receipt of such expenses), the cost of actual expenses incurred may continue to be reimbursed for up to 12 months after termination or, at the Group's discretion, a one-off payment may be made to cover the costs of premature cancellation. The cost of repatriation may also be covered.

## Remuneration policy table for Chairman and Non-Executive Directors

The table below sets out the remuneration policy for Non-Executive Directors (NEDs).

### Chairman and Non-Executive Director fees and benefits

| | |
|---|---|
| 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.<br>The GCE and the Chairman are responsible for evaluating and making recommendations to the Board in relation to the fees of the NEDs.<br>When determining and reviewing fee and benefit levels, the Committee ensures that decisions are made within the following parameters:<br>– The individual's skills and experience.<br>– An objective assessment of the individual's responsibilities and the size and scope of their role, using objective sizing methodologies.<br>– Fees and benefits for comparable roles in comparable publicly listed financial services groups of a similar size.<br>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.<br>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.<br>Additional fees are also paid to the senior independent director and to the deputy chairman to reflect additional responsibilities.<br>Any increases normally take effect from 1 January of a given year.<br>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.<br>NEDs are reimbursed for expenses incurred in the course of their duties, such as travel and accommodation expenses, on a grossed-up basis (where applicable). |
| Maximum potential | The Committee will make no increase in fees or benefits currently provided which it believes is inconsistent with the parameters above. |
| Performance metrics | N/A |
| Changes | No change to policy. |

### Letters of appointment

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.

### Date of letter of appointment

| NED | Date of letter of appointment | Date of appointment |
|---|---|---|
| Alan Dickinson | 26 June 2014 | 8 September 2014 |
| Anita Frew | 17 November 2010 | 1 December 2010 |
| Simon Henry | 1 May 2014 | 26 June 2014 |
| Nick Prettejohn | 1 April 2014 | 23 June 2014 |
| Stuart Sinclair | 26 November 2015 | 04 January 2016 |
| Sara Weller | 31 January 2012 | 01 February 2012 |
| Lord Lupton | 2 March 2017 | 01 June 2017 |
| Amanda Mackenzie | 17 April 2018 | 01 October 2018 |
| Sarah Legg | 21 October 2019 | 01 December 2019 |

All Directors are subject to annual re-election by shareholders.

The service contracts and letters of appointments are available for inspection at the Company's registered office.

# Other remuneration disclosures

This section discloses the remuneration awards made by the Group to Material Risk Takers (MRTs) in respect of the 2019 performance year. Additional information summarising the Group's remuneration policies, structure and governance is also provided. These disclosures should be read in conjunction with the disclosures for Executive Directors contained in the Directors' Remuneration Report (DRR) on pages 98 to 114 and the Directors' Remuneration Policy (DRP) on pages 115 to 123. Together these disclosures comply with the requirements of Article 450 of the Capital Requirements Regulation (EU) No. 575/2013 (CRR). The remuneration principles and practices detailed in the DRR apply to MRTs and non-MRTs in the same way as to Executive Directors (other than where stated in this disclosure).

The Group has applied the EBA Delegated Regulation (EU) No 604/2014 to determine which colleagues should be identified as MRTs. MRTs are colleagues who are considered to have a material impact on the Group's risk profile, and include, but are not limited to:

- Senior management, Executive Directors, members and attendees of the Group Executive Committee (GEC) and their respective executive level direct reports
- Non-Executive Directors
- Approved persons performing significant influence functions (SIFs) and/or all colleagues performing a senior management function
- Other highly remunerated individuals whose activities could have a material impact on the Group's risk profile

## Decision making process for remuneration policy

The Group has a strong belief in aligning the remuneration delivered to the Group's executives with the successful performance of the business and, through this, the delivery of long-term, superior and sustainable returns to shareholders. It has continued to seek the views of shareholders and other key stakeholders with regard to remuneration policy and seeks to motivate, incentivise and retain talent while being mindful of the economic outlook.

The overarching purpose of the Remuneration Committee is to consider, agree and recommend to the Board an overall remuneration policy and philosophy for the Group that is defined by, supports and is closely aligned to its long-term business strategy, business objectives, risk appetite and values and recognises the interests of relevant stakeholders. The remuneration policy governs all aspects of remuneration and applies in its entirety to all divisions, business units and companies in the Group, including wholly-owned overseas businesses and all colleagues, contractors and temporary staff. The Committee reviews the policy annually and Committee pays particular attention to the top management population, including the highest paid colleagues in each division, those colleagues who perform senior management functions for the Group and MRTs. During 2019 the Committee had 5 scheduled meetings. Further details on the operation of the Remuneration Committee and independent advise received during the year can be found on page 114 of the DRR.

The Group has a robust governance framework, with the Remuneration Committee reviewing all compensation decisions for Executive Directors, senior management, senior risk and compliance officers, high earners and any other MRTs. This approach to governance is cascaded through the Group with the Group People Committee having oversight for all other colleagues.

## Governance and risk management

An essential component of the approach to remuneration is the governance process that underpins it. This ensures that the policy is robustly applied and risk is managed appropriately.

In addition to setting the overall remuneration policy and philosophy for the Group, the Remuneration Committee ensures that colleagues who could have a material impact on the Group's risk profile are provided with appropriate incentives and reward to encourage them to enhance the performance of the Group and that they are recognised for their individual contribution to the success of the organisation, whilst ensuring that there is no reward for excessive risk taking. The Remuneration Committee works closely with the Risk Committee in ensuring the Group Performance Share (GPS) plan outcome is moderated. The two Committees determine whether the proposed GPS outcome and performance assessments adequately reflect the risk appetite and framework of the Group; whether it took account of current and future risks; and whether any further adjustment is required or merited. The Group and the Remuneration Committee are determined to ensure that the aggregate of the variable remuneration for all colleagues is appropriate and balanced with the interests of shareholders and all other stakeholders.

The Remuneration Committee's terms of reference are available from the Company Secretary and are displayed on the Group's website, www.lloydsbankinggroup.com/our-group/corporate-governance. These terms are reviewed each year to ensure compliance with the remuneration regulations and were last updated in November 2018.

## Link between pay and performance

The Group's approach to reward is intended to provide a clear link between remuneration and delivery of its key strategic objectives, supporting the aim of becoming the best bank for customers, and through that, for shareholders. To this end, the performance management process has been developed, with the close participation of the Group's Risk team, to ensure there is a clear alignment between award outcomes and individual performance, growth and development, whilst also reflecting divisional achievement.

The use of a balanced scorecard approach to measure performance enables the Remuneration Committee to assess the performance of the Group and its senior executives in a consistent and performance-driven way. The Group's remuneration policy supports the business values and strategy, based on building long-term relationships with customers and colleagues and managing the financial consequences of business decisions across the entire economic cycle.

Further detail can be found in the DRR and the DRP. In particular, see pages 104 to 106, 110 to 111 and 117.

## Design and structure of remuneration

When establishing the remuneration policy and associated frameworks, the Group is required to take into account its size, organisation and the nature, scope and complexity of its activities. For the purpose of remuneration regulation, Lloyds Bank plc is treated as a proportionality level I firm and therefore subject to the more onerous remuneration rules.

Remuneration is delivered via a combination of fixed and variable remuneration. Fixed remuneration reflects the role, responsibility and experience of a colleague. Variable remuneration is based on an assessment of individual, business area and Group performance. The mix of variable and fixed remuneration is driven by seniority, grade and role. Taking into account the expected value of awards, the performance-related elements of pay make up a considerable proportion of the total remuneration package for MRTs, whilst maintaining an appropriate balance between the fixed and variable elements. The maximum ratio of variable to fixed remuneration for MRTs is 200 per cent, which has been approved by shareholders (98.77 per cent of votes cast) at the AGM on 15 May 2014.

Remuneration for control functions is set in relation to benchmark market data to ensure that it is possible to attract and retain staff with the appropriate knowledge, experience and skills. An appropriate balance between fixed and variable compensation supports this approach. Generally, control function staff receive a higher proportion of fixed remuneration than other colleagues and the aggregate ratio of fixed to variable remuneration for all control function staff does not exceed 100 per cent. Particular attention is paid to ensure remuneration for control function staff is linked to the performance of their function and independent from the business areas they control.

The table below summarises the different remuneration elements for MRTs (this includes control function staff) and non-MRTs.

| | | |
|---|---|---|
| **Base salary** | Base salaries are reviewed annually, taking into account individual performance and market information. Further information on base salaries can be found on page 115 of the DRP. | **Applies to:**<br>– Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports<br>– Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function<br>– Other MRTs<br>– Non-MRTs |
| **Fees** | Non-Executive Director fees are reviewed periodically by the Board. Further information on fees can be found on page 112 of the DRR and page 123 of the DRP. | **Applies to:**<br>– Non-Executive Directors (NEDs) |
| **Fixed share award** | The fixed share award, made annually, delivers Lloyds Banking Group shares over a period of five years. With effect from 2020 fixed share awards will be delivered over a period of three years (subject to shareholder approval for Executive Directors). Its purpose is to ensure that total fixed remuneration is commensurate with the role, responsibilities and experience of the individual; provides a competitive reward package; and is appropriately balanced with variable remuneration, in line with regulatory requirements. The fixed share award can be amended or withdrawn in the following circumstances:<br>– to reflect a change in role;<br>– to reflect a Group leave policy (e.g. parental leave or sickness absence);<br>– termination of employment with the Group;<br>– if the award would be inconsistent with any applicable legal, regulatory or tax requirements or market practice.<br>Further information on fixed share awards can be found on page 116 of the DRP. | **Applies to:**<br>– Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports<br>– Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function1<br>– Other MRTs[1]<br>– Non-MRTs[1] |
| **Benefits** | Core benefits for UK-based colleagues include pension, private medical insurance, life insurance and other benefits that may be selected through the Group's flexible benefits plan. Further information on benefits and all-employee share plans can be found on page 116 of the DRP. Benefits can be amended or withdrawn in the following circumstances:<br>– to reflect a change to colleague contractual terms;<br>– to reflect a change of grade;<br>– termination of employment with the Group;<br>– to reflect a change of Reward Strategy/benefit provision;<br>– if the award would be inconsistent with any statutory or tax requirements.<br>Details of NEDs' benefits are set out on page 123 of the DRP. | **Applies to:**<br>– Non-Executive Directors (NEDs)<br>– Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports<br>– Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function<br>– Other MRTs<br>– Non-MRTs |
| **Short-term variable remuneration arrangements** | The Group Performance Share (GPS) plan is an annual discretionary bonus plan. The plan is designed to reflect specific goals linked to the performance of the Group. The majority of colleagues and all MRTs participate in the GPS plan. Individual GPS awards are based upon individual contribution, overall Group financial results and performance conversations over the past financial year. The Group's total risk-adjusted GPS outcome is determined by the Remuneration Committee annually as a percentage of the Group's underlying profit, modified for:<br>– Group Balanced Scorecard performance<br>– Collective and discretionary adjustments to reflect risk matters and/or other factors.<br>The Group applies deferral arrangements to GPS and variable pay awards made to colleagues. GPS awards for MRTs are subject to deferral and a holding period in line with regulatory requirements and market practice.<br>Further information on the GPS plan can be found on pages 110 to 111 of the DRR as well as page 117 of the DRP. | **Applies to:**<br>– Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports<br>– Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function<br>– Other MRTs<br>– Non-MRTs |

1 Eligibility based on seniority, grade and role.

| | | |
|---|---|---|
| **Group Ownership Share Plan** | The Group Ownership Share (GOS) plan is an important tool for aligning the Group's reward strategy to the long-term performance of the business. Through the application of carefully considered, stretching target measures, the Group can ensure that awards are forfeited or restricted where performance does not meet the desired level.<br><br>The GOS pays out in shares based on performance against Group financial and other non-financial strategic targets measured over a three-year period. Shares are released over a minimum three to five-year period and are then subject to a holding period (MRTs only) in line with regulatory requirements and market practice.<br><br>Further information on the current GOS plan can be found on pages 110 and 111 of the DRR. Subject to shareholder approval, it is proposed that the GOS plan be replaced with a Long Term Share Plan (LTSP) for Executive Directors with effect from 2020. The LTSP will share similarities to a restricted share plan with vesting subject to a set of three financial underpins and a further discretion for the Committee to amend the underpin vesting outcome. Shares will continue to be released over a minimum three to five-year period and subject to holding. Further details of the proposed LTSP for Executive Directors can be found on page 117 of the DRP. | **Applies to:**<br>– Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports<br>– Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function1<br>– Other MRTs[1]<br>– Non-MRTs[1] |
| **Deferral, vesting and performance adjustment** | At least 40 per cent of MRTs' variable remuneration above certain thresholds is deferred into Lloyds Banking Group Shares. For all MRTs, variable remuneration is deferred in line with the regulatory requirements for three, five or seven years, (depending on MRT category). At least 50 per cent of each release is subject to a 12 month holding period.<br>For all colleagues, any deferred variable remuneration amount is subject to performance adjustment (malus) in accordance with the Group's Deferral and Performance Adjustment Policy. | MRTs' vested variable remuneration (including variable remuneration subject to a holding period) can be recovered from colleagues up to seven years after the date of award in the case of a material or severe risk event (clawback). This period may be extended to ten years where there is an ongoing internal or regulatory investigation. Clawback is used alongside other performance adjustment processes.<br><br>Further information on deferral, vesting and performance adjustment can be found in the DRR on pages 110 and 111 and 118 of the DRP. |
| **Guaranteed variable remuneration** | Guarantees, such as sign-on awards, may only be offered in exceptional circumstances to new hires for the first year of service and in accordance with regulatory requirements. Any awards made to new hires to compensate them for unvested variable remuneration they forfeit on leaving their previous employment ('buy-out awards') will be subject to appropriate retention, deferral, performance and clawback arrangements in accordance with applicable regulatory requirements.<br><br>Retention awards may be made to existing colleagues in limited circumstances and are subject to prior regulatory approval in line with applicable regulatory requirements. | **Applies to:**<br>– Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports<br>– Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function<br>– Other MRTs<br>– Non-MRTs |
| **Shareholding requirement** | Executive Directors: see DRR page 108.<br><br>All other MRTs and non-MRTs: 25 per cent to 100 per cent of the aggregate of base salary and fixed share award depending on grade. | **Applies to:**<br>– Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports<br>– Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function2<br>– Other MRTs[2]<br>– Non-MRTs[2] |
| **Termination payments** | Executive Directors and GEC members: see page 96 of the 2016 DRR.<br><br>All other termination payments comply with the Group's contractual, legal and regulatory requirements and are made in such a way as to ensure they do not reward failure or misconduct and reflect performance over time. | **Applies to:**<br>– Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports<br>– Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function<br>– Other MRTs<br>– Non-MRTs |

1 Eligibility based on seniority, grade and role.

2 Requirement based on seniority and grade.

## Table 1 Analysis of high earners by band

| Number of Material Risk Takers paid €1 million[1,2] or more | 2019 Material Risk Takers[3,4] | 2018 Material Risk Takers[4] |
|---|---|---|
| €1.0m – €1.5m | 30 | 30 |
| €1.5m – €2.0m | 5 | 8 |
| €2.0m – €2.5m | 0 | 7 |
| €2.5m – €3.0m | 4 | 1 |
| €3.0m – €3.5m | 3 | 2 |
| €3.5m – €4.0m | 0 | 4 |
| €4.0m – €4.5m | 0 | 0 |
| €4.5m – €5.0m | 0 | 0 |
| €5.0m – €6.0m | 1 | 0 |
| €6.0m – €7.0m | 0 | 0 |
| €7.0m – €8.0m | 0 | 1 |

1 Converted to Euros using the exchange rate €1 = £0.8518 (average exchange rate 1 December 2019 – 31 December 2019 based on the European Commission Budget exchange rates). The exchange rate used for 2018 was €1 = £0.89135.

2 Values for LTIP/Group Ownership Share awards based on expected value at grant pre the application of the EBA discount factor. (50 per cent of granted LTIP/GOS before apply EBA discount required Inclusive of uplift in response to prohibition of dividend equivalents).

3 Total number of Material Risk Takers earning more than €1m has decreased from 53 in 2018 to 43 in 2019.

4 2019 and 2018 data has been calculated using methodology consistent with EBA guidelines.

## Table 2 Aggregate remuneration expenditure (Material Risk Takers)

### Analysis of aggregate remuneration expenditure by division[1]

| | Retail and Community Banking £m | Commercial Banking £m | Insurance & Wealth £m | Chief Operating Office and Group Functions[1] £m | Total £m |
|---|---|---|---|---|---|
| Aggregate remuneration expenditure | 18.0 | 47.2 | 9.02 | 83.6 | 157.8 |

1 Chief Operating Office and Group Functions comprises People and Productivity, Group Transformation, Chief Information Office and Chief Security Office, Business Risk, Finance, Legal, Strategy, Group Corporate Affairs, Group Internal Audit, Company Secretariat, Responsible Business and Inclusion and Diversity.

## Table 3 Fixed and variable remuneration (Material Risk Takers)

### Analysis of remuneration between fixed and variable amounts

| | Remuneration £m | Awarded in relation to the 2019 performance year | | | | |
|---|---|---|---|---|---|---|
| | | Management body | | | | |
| | | Executive Directors | Non-Executive Directors | Senior Management[2] | Other MRTs | 2019 Total |
| | Number of employees | 4 | 19 | 120 | 149 | 292 |
| Fixed Remuneration £m | Total fixed remuneration | 6.9 | – | 49.3 | 41 | 97.2 |
| | Of which: Cash based | 4.8 | – | 44.9 | 39.2 | 88.9 |
| | Of which: Shares[1] | 2.1 | – | 4.4 | 1.8 | 8.3 |
| Variable Remuneration £m | Total variable remuneration | 2.8 | – | 32.9 | 24.9 | 60.6 |
| | Of which: Upfront cash based | 0 | – | 0.2 | 0.3 | 0.5 |
| | Of which: Share based[3] | 2.8 | – | 32.7 | 24.6 | 60.1 |
| | Of which: Deferred | | | | | |
| | Vested | 0.1 | – | 10.2 | 12.9 | 23.2 |
| | Unvested | 2.7 | – | 22.5 | 11.7 | 36.9 |
| | **Total remuneration** | 9.7 | – | 82.2 | 65.9 | 157.8 |

1 Released over a five year period.

2 Senior Management are defined as Group Executive Committee (GEC) members/attendees (excluding Group Executive Directors and Non-Executive Directors) and their direct reports (excluding those direct reports who do not materially influence the risk profile of any in-scope group firm).

3 Values for LTIP/Group Ownership Share awards based on expected value at the date of grant pre the application of the EBA discount factor.

## Table 4 Total outstanding deferred variable remuneration

| | Remuneration £m | Total outstanding deferred variable remuneration at 31 December 2019 | | | | |
|---|---|---|---|---|---|---|
| | | Management body | | | | |
| | | Executive Directors | Non-Executive Directors | Senior Management | Other MRTs | 2019 Total |
| Variable Remuneration £m | Number of employees | 4 | 19 | 120 | 149 | 292 |
| | Total outstanding deferred variable remuneration | 27.3 | – | 128.3 | 60.5 | 216.1 |
| | Of which: Vested | 4.6 | – | 18.3 | 10.6 | 33.5 |
| | Of which: Unvested | 22.7 | – | 110 | 49.9 | 182.6 |

## Table 5 Other payments awarded in relation to the 2019 performance year

| | Guaranteed bonuses | | Sign-on awards | | Severance payments | |
|---|---|---|---|---|---|---|
| | Number of awards made | Total £m | Number of awards made | Total £m | Number of awards made | Total £m |
| Management body | – | – | – | – | – | – |
| Senior management | 1 | 0.172 | – | – | – | – |
| Other Material Risk Takers | – | – | – | – | – | – |

## Table 6 Deferred remuneration

**Analysis of deferred remuneration at 31 December 2019**

| Remuneration £m | Total amount of outstanding deferred[1] and retained[2] remuneration | Of which: Total amount of outstanding remuneration exposed to ex-post explicit and/or implicit adjustment | Total amount of amendment during the year due to ex-post explicit adjustments | Total amount of deferred remuneration paid out in the performance year |
|---|---|---|---|---|
| Management body[3] | 27.3 | 27.3 | – | 5.9 |
| Senior management | 128.3 | 128.3 | – | 25.4 |
| Other Material Risk Takers | 60.5 | 60.5 | – | 18.4 |

1 Deferred in this context refers only to any unvested remuneration.

2 Retained refers to any variable remuneration for which the deferral period has ended but which is still subject to a holding period before release.

3 Reference to the 'Management Body' relates to Executive Directors only. Non-Executive Directors are not eligible to receive variable remuneration.

## 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.



Further information on risk management can be found:



The Group supports the recommendations made in the report 'Enhancing the Risk Disclosures of Banks' issued by the Enhanced Disclosure Task Force of the Financial Stability Board in October 2012.

## Green Resource Engineering

A designer and manufacturer of cooling systems has delivered a £1.1 million export order to South Korea thanks to support from Lloyds Bank. Green Resource Engineering (GRE) in Devon, won the contract to supply the country's largest smart energy supplier, marking the first time GRE has exported directly to South Korea.

GRE's exporting activity is set to boost annual turnover by 20 per cent, from £2.5 million to more than £3 million, and increase its head count by 10 per cent.

Jobs will be created in the workshop and purchasing departments, alongside additional graduate engineering roles.

**www.lloydsbankinggroup.com/our-group/responsible-business/**

# Risk management

## Risk management is at the heart of our strategy to become the best bank for customers.

## Our mission is to protect our customers, shareholders, colleagues and the Group, whilst enabling sustainable growth in targeted segments. This is achieved through informed risk decisions and robust risk management, supported by a consistent risk-focused culture.

The risk overview (pages 40 to 46) provides a summary of risk management within the Group. It highlights the important role of risk as a strategic differentiator, key areas of focus for risk during 2019, and the role of risk management in enhancing the customer experience, along with an overview of the Group's enterprise risk management framework, and the principal risks faced by the Group.

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 and a full analysis of the principal risk categories (pages 138 to 187), the framework by which risks are identified, managed, mitigated and monitored.

Each principal risk category is described and managed using the following standard headings: definition, 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 current and emerging risks, support sustainable growth within the Group's risk appetite, and to drive and inform good risk reward decision-making.

To meet ring-fencing requirements from 1 January 2019, core UK retail financial services and ancillary retail activities have been ring-fenced from other activities of the Group. The Group enterprise risk management framework and Group risk appetite apply across the Group and are supplemented by risk management frameworks and risk appetites for the sub-groups to meet sub-group specific needs. In each case these operate within the Group parameters. The Group's corporate governance framework applies across Lloyds Banking Group plc, Lloyds Bank plc, Bank of Scotland plc and HBOS plc. It is tailored where needed to meet the entity specific needs of Lloyds Bank plc and Bank of Scotland plc, and supplementary corporate governance frameworks are in place to address sub-group specific requirements of the other sub-groups (Lloyds Bank Corporate Markets, Insurance and Lloyds Banking Group Equity Investments).

The Group's enterprise risk management framework (ERMF) (see risk overview, page 40) is structured to align with the industry-accepted internal control framework standards.

The ERMF applies to every area of the business and covers all types of risk. It is reviewed, updated and approved by the Board at least annually to reflect any changes in the nature of our business and external regulations, law, corporate governance and industry best practice. The ERMF 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:

- approval of the ERMF and Board risk appetite
- approval of Group-wide risk principles and policies
- the cascade of delegated authority (for example to Board sub-committees and the Group Chief Executive)
- effective oversight of risk management consistent with 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' in delivering our Group strategy.

Group strategy and risk appetite are developed in tandem. Business planning aims to optimise value within our risk appetite parameters and deliver on our promise to Help Britain Prosper.

The Group's risk appetite statement details the risk parameters within which the Group operates. The statement forms part of our control framework and is embedded into our policies, authorities and limits, to guide decision-making and risk management. The Board is responsible for approving the Group's risk appetite statement at least annually. Group Board-level metrics are cascaded into more detailed business appetite metrics and limits.

Group risk appetite headlines are outlined within Our Principal Risks section on pages 42 to 46.

## Governance frameworks

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 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 regulation, 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 Group-wide risk issues at Group Executive Committee level, ensures that escalated issues are promptly addressed and remediation plans are initiated where required.

Line managers are directly accountable for identifying and managing risks in their individual businesses, ensuring that business decisions strike an appropriate balance between risk and reward and are 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.

The risk committee governance framework is outlined on page 135.

## Three lines of defence model

The ERMF 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, headed by the Chief Risk Officer, 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.

It also has a key role in promoting the implementation of a strategic approach to risk management reflecting the risk appetite and ERMF agreed by the Board that encompasses:

- overseeing embedding of 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
- a constructive dialogue with the first line through provision of advice, development of common methodologies, understanding, education, training, and development of new risk management tools

The primary role of Group Internal Audit (third line) is to help the Board and senior executive management protect the assets, reputation and sustainability of the Group. Group Internal Audit is led by the Group Chief Internal Auditor. Group Internal Audit provides independent assurance to the Audit Committee and the Board through performing reviews and engaging with committees and senior executive management, providing opinion and challenge on risk and the state of the control environment. Group Internal Audit is a single independent internal audit function, reporting to the Board Audit Committee of the Group and the Board Audit Committee of the key subsidiaries.

## Risk and control cycle from identification to reporting

To allow senior management to make informed risk decisions, the business follows a continuous risk management approach which includes producing appropriate, accurate and focused risk reporting. The risk and control cycle sets out how this should be approached, with the appropriate controls and processes in place. This cycle, from identification to reporting, ensures consistency and is intended to manage and mitigate the risks impacting the Group.

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 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.

Identified risks are 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 tolerances. There is a clear process for escalation of risks and risk events.

All business areas complete a Control Effectiveness Review (CER) annually, reviewing the effectiveness of their internal controls and putting in place a programme of enhancements where appropriate. The CER reports are approved at divisional risk committees or directly by the relevant member of the Group Executive Committee to confirm the accuracy of the assessment. This key process is overseen and independently challenged by Risk division, reviewed by Group Internal Audit against the findings of its assurance activities, and reported to the Board. No significant failings or weaknesses were identified during the 2019 review.

## Risk culture

Based on the Group's conservative business model, prudent approach to risk management, and guided by the Board, the senior management articulates the core risk values to which the Group aspires, and sets the tone at the top, with a strong focus on building and sustaining long-term relationships with customers, through the economic cycle. The Group's Code of Responsibility reinforces colleagues' accountability for the risks they take and their responsibility to prioritise their customers' needs.

## Risk 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.

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.

## Financial reporting risk management systems and internal controls

The Group maintains risk management systems and internal controls relating to the financial reporting process which are designed to:

- ensure that accounting policies are appropriately and consistently applied, transactions are recorded accurately, and undertaken in accordance with delegated authorities, that assets are safeguarded and liabilities are properly stated
- 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
- enable certifications by the Senior Accounting Officer relating to maintenance of appropriate tax accounting and in accordance with the 2009 Finance Act
- ensure that disclosures are made on a timely basis in accordance with statutory and regulatory requirements (for example UK Finance Code for Financial Reporting Disclosure and the US Sarbanes Oxley Act)
- ensure ongoing monitoring to assess the impact of emerging regulation and legislation on financial, prudential regulatory and tax reporting
- ensure an accurate view of the Group's performance to allow the Board and senior management to appropriately manage the affairs and strategy of the business as a whole and each of its sub-groups

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 85 to 88.

## Risk decision-making and reporting

Risk analysis and reporting enables better understanding of risks and returns, supporting the identification of opportunities as well as better management of 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 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 of the aggregate risk profile and has direct access to the Chairman and members of Board Risk Committee.

**Risk management** continued

## 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 through its risk-weighted assets. Details of the business activities for each division are provided in the Financial Performance Overview on pages 37 to 39.

| | Retail £bn | Commercial Banking £bn | Insurance and Wealth[1] £bn | Central items[2] £bn | Group £bn |
|---|---|---|---|---|---|
| **Risk-weighted assets (RWAs)** | | | | | |
| – Credit risk | 78.7 | 66.3 | 0.7 | 14.3 | 160.0 |
| – Counterparty credit risk[3] | – | 4.7 | – | 1.2 | 5.9 |
| – Market risk | – | 1.8 | – | – | 1.8 |
| – Operational risk | 19.7 | 4.6 | 0.6 | 0.6 | 25.5 |
| **Total (excluding threshold)** | 98.4 | 77.4 | 1.3 | 16.1 | 193.2 |
| – Threshold[4] | – | – | – | 10.2 | 10.2 |
| **Total** | 98.4 | 77.4 | 1.3 | 26.3 | 203.4 |

1 As a separate regulated business, Insurance (excluding Wealth) maintains its own solvency requirements, including appropriate management buffers, and reports directly to the Insurance Board. Insurance does not hold any RWAs as its assets are removed from the Group's regulatory capital calculations. However, in accordance with capital rules part of the Group's equity investment in Insurance is included in the calculation of threshold RWAs, while the remainder is taken as a deduction from common equity tier 1 (CET1) capital.

2 Central items include assets held outside the main operating divisions, including the assets of Group Corporate Treasury which holds the Group's liquidity portfolio, and other supporting functions.

3 Exposures relating to the default fund of a central counterparty and credit valuation adjustment risk are included in counterparty credit risk.

4 Threshold RWAs reflect the proportion 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 42 to 46). The Group's emerging risks are shown overleaf. Full analysis of the Group's risk categories is on pages 138 to 187.

# 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:** The financial sector continues to experience increasing regulation from various bodies, including government and regulators.<br>Regulatory rules and laws from both the UK and overseas may affect the Group's operation, placing pressure on expert resource and investment priorities. | – We work closely with regulatory authorities and industry bodies to ensure that the Group can identify and respond to the evolving regulatory and legal landscape.<br>– We actively implement programmes to deliver legal, regulatory and mandatory change requirements. |
| **Climate:** The key risks are financial, derived from both physical risks (climate and weather-related events) and transition risks resulting from the process of adjustment towards a low carbon economy. Climate change extends across multiple risk types e.g. credit, market, conduct and operational. For example, physical and transition risks could result in the impairment of asset values, may impact the creditworthiness of our clients, and the products and services our customers require.<br>The focus on these risks by key stakeholders including businesses, clients, shareholders, governments and regulators is increasing, aligned to the evolving societal, regulatory and political landscape.<br>There also remains a risk that campaign groups or other bodies could seek to take legal or other action against the Group and/or the financial services industry for investing in or lending to organisations that they deem to be responsible for, or contributing to, climate change. | – Our risk management approach to climate change is outlined in the Strategic Report (page 30) and reflects our commitment to adopting the framework set out by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).<br>– The Group Chief Risk Officer (CRO) has assumed responsibility for identifying and managing the risks arising from climate change, alongside the CROs for key legal entities.<br>– We are integrating risk management of financial risks posed by climate change in our existing enterprise risk management framework, including our policies, risk appetite and controls.<br>– We continue to support customers and clients in managing the financial risks from the UK's transition to a low carbon economy. |
| **Cyber:** Increases in the volume and sophistication of cyber-attacks alongside the growth in connected devices continues to heighten the potential for cyber-enabled crime.<br>Increases in geopolitical tensions increase the indirect threat of a sophisticated attack on the Group. The capability of organised crime groups is growing rapidly, which along with the commoditisation of cyber-crime increases the likelihood that the Group or one of its suppliers will be the direct target of a sophisticated attack. This increases the risk of the Group's exposure through its supply chain. | – Continued investment in and focus on the Group's Cyber programme to ensure confidentiality and integrity of data and availability of systems. Key areas of focus relate to access controls, network security, disruptive technology, and denial of service capability.<br>– Embedding of Group Cyber control framework aligned to industry recognised cyber security framework (National Institute of Standards and Technology, NIST).<br>– Three year cyber strategy to deliver an industry-leading approach across the Group and to embed innovation in our approach to cyber.<br>– Increased business and colleague engagement through education and awareness, phishing testing and cultural MI. Cyber risk is governed through all key risk committees and there are quarterly reviews of all cyber risks. |
| **Political uncertainties including EU trade deal:** Following the UK's exit from the EU, significant negotiation is now required on the terms of the future trade agreement. As a result, the possibility of a limited or no deal at the end of the transition period remains and could manifest in prolonged business uncertainty across the UK, including in the financial services sector. This continued lack of clarity over the UK's relationship with the EU and other foreign countries, and ongoing challenges in the Eurozone, including weak growth, raise additional uncertainty for the UK's economic outlook. There also remains the possibility of a further referendum on Scottish independence. | – Engagement with politicians, regulators, officials, media, trade and other bodies to monitor external developments and reassure our commitment to Helping Britain Prosper.<br>– Entities established in the EU ensure continuity of certain business activities; contingency planning in relation to wider areas of impact.<br>– Group Corporate Treasury tracking market conditions closely and actively managing the Group's balance sheet.<br>– Credit applications and sector reviews include assessment of EU related risks. Initiatives in place to help clients effectively identify and mitigate or manage such risks. |
| **Competition:** Adoption of technological trends is accelerating with customer preferences increasingly shaped by tech giants and other challengers who are able to exploit their own infrastructure and are impacted by different market dynamics. Regulation is focusing on lowering barriers for new entrants, which could have an adverse impact on our market position.<br>Operational complexity has the potential to restrict our speed of response to market trends. Inability to leverage data and innovate could lead to loss of market share as challengers capitalise on Open Banking. Timely delivery of GSR3 objectives remains key to addressing the competitive challenges facing the Group. | – The Group is transforming the business to improve customer experience by digitising customer journeys and leveraging branches for complex needs, in response to customers' evolving needs and expectations.<br>– The Group will deepen insight into customer segments, their perception of brands and what they value.<br>– Agility will be increased by consolidating platforms and building new architecture aligned with customer journeys.<br>– The Group is responsive to changing customer behaviour/business models and adjusts its risk management approach as appropriate.<br>– GSR3 is designed to support the Group to strengthen its competitive position. |
| **Data:** Advancements in new technologies and new services, an increasing external threat landscape, and changing regulatory requirements increase the need for the Group to effectively govern, manage, and protect its data (or the data shared with third-party suppliers). Failure to manage data risk effectively can result in unethical decisions, poor customer outcomes, loss of value to the Group and mistrust. | – The Group's strategy is to introduce advanced data management practices, based on Group-wide standards, data-first culture and modern enterprise data platforms, supported by a simplified modern IT architecture.<br>– The Group has implemented Open Banking and actively monitors implications for our customers, including protection from fraud.<br>– The Group is making a significant investment to improve data privacy, including the security of data and oversight of third-parties. |

## Risk management continued

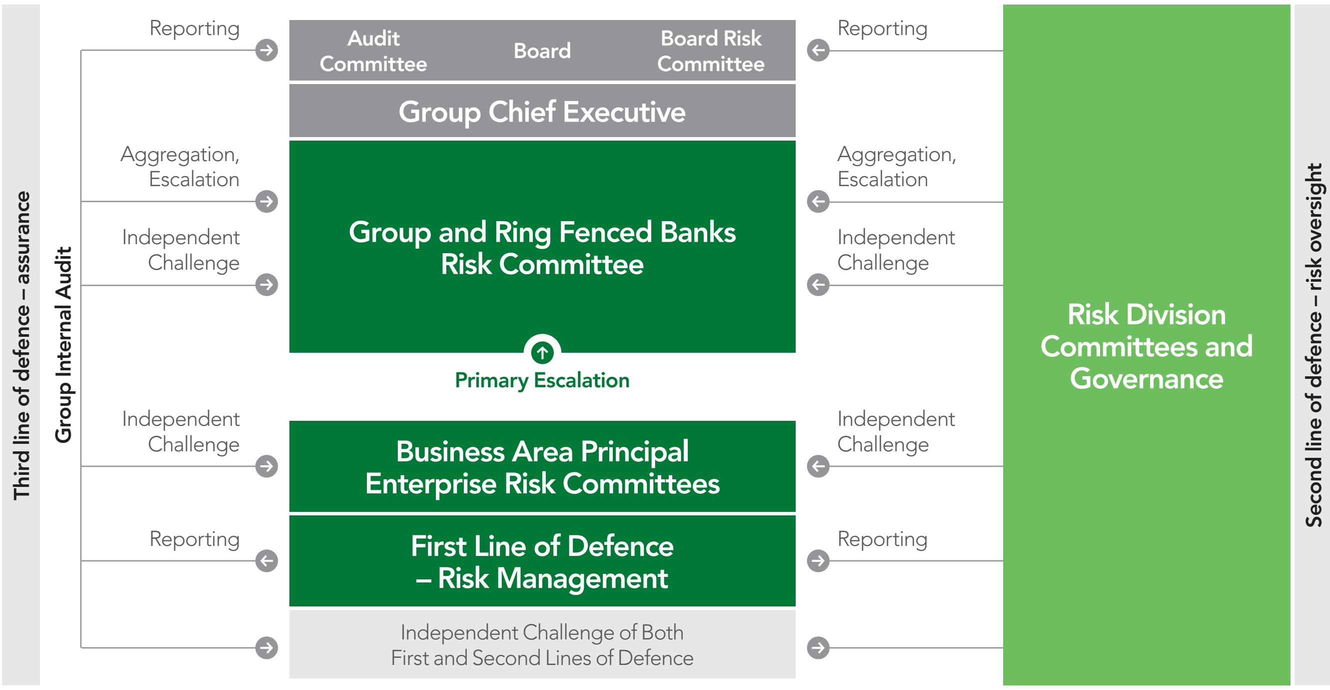
| Risk | Key mitigating actions |
|---|---|
| **Macroeconomic headwinds:** The UK economic outlook remains uncertain, since it is unclear how businesses will respond to the uncertainty relating to ongoing negotiations of international trade agreements, especially with the EU.<br>Markets have priced continued low UK interest rates, but rapid growth in labour costs resulting from low unemployment and weak productivity growth could boost inflation more than anticipated, pushing interest rate expectations upward. These factors, combined with current levels of consumer indebtedness, could lead to downward pressure on credit quality.<br>Internationally, growing protectionism remains a significant risk to stability of the global economy. Notwithstanding the recent first agreement on trade between the US and China, the fundamental nature of the disagreement suggests that roll-back of tariffs applied so far will prove difficult and further escalation is eminently possible. US tariffs on Europe may also increase.<br>More widely, concerns remain that elevated government indebtedness in advanced economies and limited headroom for conventional monetary policy could render the next global downturn more prolonged and lead to a sustained period of stagflation. These circumstances may spur the wider adoption of less conventional monetary policies such as negative interest rates. | – High levels of liquidity provided by central banks has boosted asset values and reduced spreads across a wide range of assets, but creates vulnerability to a sharp correction if the global economy turns down.<br>– Wide array of risks considered in setting strategic plans.<br>– Capital and liquidity are reviewed regularly through committees, ensuring compliance with risk appetite and regulatory requirements.<br>– The Group has a robust through the cycle credit risk appetite, including appropriate product, sector and single name concentration parameters, robust sector appetite statements and policies, as well as affordability and indebtedness controls at origination. In addition to ongoing focused monitoring, portfolio deep dives are conducted and regular larger exposure reviews. Enhancements have been made to our use of early warning indicators, including sector-specific indicators. |
| **Geopolitical:** Current geopolitical uncertainties or political upheavals could further impede the global economic recovery, heighten instability and impact markets. Terrorist activity including cyber-attacks also has the potential to trigger changes in the economic outlook, market risk pricing and funding conditions. Additionally, the more recent coronavirus outbreak and related global health issues could potentially impact economies and markets. | – Risk appetite criteria limit single counterparty exposures complemented by a UK-focused strategy.<br>– The Chief Security Office develops and maintains a framework for external incidents, including financial stability, to ensure the incident response team convenes and acts as a rapid reaction group, should an external crisis occur.<br>– The Chief Security Office also maintains the operational resilience framework to embed resilience activities across the Group and limit the impact of internal or external events.<br>– Hedging of market risk considers, inter alia, potential shocks as a result of geopolitical events. |
| **Financial services transformation impact on customers:** The risk that transformation of the financial services industry and the Group does not adequately consider vulnerable customers. As technology and innovation move at increasing pace, the more vulnerable customers could be at a disadvantage.<br>The increase in execution only propositions due to digitisation may lead to increased conduct risk where customers (including vulnerable customers) choose unsuitable products. Our approach to customer segmentation will need to ensure conduct and reputational risks are well managed.<br>Further, there is a risk of systematic, unintended consequences within decision-making undertaken by machine learning which could occur on a large scale in a short period of time, creating new operational risks that affect financial and non-financial outcomes, for example credit portfolio anomalies or conduct impacts. This is relevant for the Group at present as the delivery of GSR3 utilises new technologies. | – Group vulnerability strategy and associated actions being developed through the value stream operating model.<br>– Digital principles are being agreed across the Group, primarily aimed at preventing material conduct residual risk and giving customers an optimal, informative and fair buying journey to mitigate the increased risks.<br>– Emerging customer risks, including those pertaining to vulnerable customers, are managed through customer segmentation strategy governance throughout the change lifecycle.<br>– Technology risks, including those related to machine learning, are escalated and discussed through governance to ensure ongoing monitoring of any emerging unintended consequences. |
| **Transition from IBORs to Alternative Risk Free Reference Rates:** Widely used benchmark rates, such as the London Interbank Offered Rate ('LIBOR'), have been subject to increasing regulatory scrutiny, with regulators signalling the need to use alternative benchmark rates. As a result, existing benchmark rates may be discontinued or the basis on which they are calculated may change.<br>Uncertainty as to the nature of such potential changes may adversely affect the value of a broad array of financial products, including any LIBOR-based securities, loans and derivatives. This may impact the availability and cost of hedging instruments and borrowings.<br>Any changes could have important implications for our customers, for example: necessitating amendments to existing documents and contracts; and differential in performance of benchmark rates and financial products which reference them. | – The Group is working closely with the Bank of England initiated Working Group on Sterling Risk-Free Reference Rates on the transition away from LIBOR in the UK.<br>– Maintaining close engagement with the FCA on potential impacts.<br>– Working closely with industry bodies to understand and manage the impact of benchmark transition in other geographies.<br>– Transition programme established and the appointment of an IBOR Transition Director as accountable executive.<br>– Developed a communication strategy for our customers to ensure they understand the risks or outcomes they might face from transition.<br>– Developing an implementation plan for new products and a transition plan for legacy products, taking into account market developments and lead times for product, process and system changes<br>– Implementing an internal communication strategy to ensure that all staff are aware and have the tools and training required. |

## 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 Group Executive Committee and Board. Conversely, strategic direction and guidance is cascaded down from the Board and Group Executive Committee.

Company Secretariat supports senior and Board-level committees, and supports the Chairs in agenda planning. This gives a further line of escalation outside the three lines of defence.

Table 1.2: **Risk governance structure**




### Group Chief Executive Committees

- Group Executive Committee (GEC)
- Group and Ring-Fenced Banks Risk Committees (GRC)
- Group and Ring-Fenced Banks Asset and Liability Committees (GALCO)
- Group and Ring-Fenced Banks Customer First Committees
- Group and Ring-Fenced Banks Cost Management Committees
- Group and Ring-Fenced Banks Conduct Review Committees
- Group and Ring-Fenced Banks People Committees
- Group and Ring-Fenced Banks Sustainability Committees
- Senior Independent Performance Adjustment and Conduct Committees
- Group and Ring-Fenced Banks Strategic Review 3 Committees

### Business area principal Enterprise Risk Committees

- Commercial Banking Risk Committee
- Retail Bank Risk Committee
- Insurance and Wealth Risk Committee
- Group Transformation Risk Committee
- Finance Risk Committee
- People and Productivity Risk Committee
- Group Corporate Affairs Risk Committee
- Group People Risk Committee
- Responsible Business and Inclusion and Diversity Risk Committee

### Risk Division Committees and Governance

- Credit Risk Committees
- Group Market Risk Committee
- Group Conduct, Compliance and Operational Risk Committee
- Group Fraud and Financial Crime Prevention Committee
- Group Financial Risk Committee
- Group Capital Risk Committee
- Group Model Governance Committee
- Ring-Fenced Bank Perimeter Oversight Committee

## 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 70 to 93, for further information on Board committees.

The divisional and functional risk committees review and recommend divisional and functional risk appetite and monitor local risk profile and adherence to appetite.

### Table 1.3: Executive and Risk Committees

The Group Chief Executive is supported by the following:

| Committees | Risk focus |
|---|---|
| Group Executive Committee (GEC) | Assists the Group Chief Executive in exercising their authority in relation to material matters having strategic, cross-business area or Group-wide implications. |
| Group and Ring-Fenced Banks Risk Committees (GRC) | Responsible for the development, implementation and effectiveness of the Group's enterprise risk management framework, the clear articulation of the Group's risk appetite and monitoring and reviewing of the Group's aggregate risk exposures and concentrations of risk. |
| Group and Ring-Fenced Banks Asset and Liability Committees (GALCO) | Responsible for the strategic direction of the Group's assets and liabilities and the profit and loss implications of balance sheet management actions. The committee reviews and determines the appropriate allocation of capital, funding and liquidity, and market risk resources and makes appropriate trade-offs between risk and reward. |
| Group and Ring-Fenced Banks Customer First Committees | Provides a Group-wide perspective of customer experience and the governing body of customer plans and targets including governing targets and plans, oversight of customer outcomes and experience, and learning through best practice externally and leveraging Group memberships and partnerships. |
| Group and Ring-Fenced Banks Cost Management Committees | Leads and shapes the Group's approach to cost management, ensuring appropriate governance and process over Group-wide cost management activities and effective control of the Group's cost base. |
| Group and Ring-Fenced Banks Conduct Review Committees | Provides senior management oversight, challenge and accountability in connection with the Group's engagement with conduct review matters as agreed with the Group Chief Executive. |
| Group and Ring-Fenced Banks People Committees | Oversees the Group's people and colleague policies, the remuneration policy and Group-wide remuneration matters, oversees compliance with Senior Manager and Certification Regime (SM&CR) and other regulatory requirements, monitors colleague engagement surveys, progress of the Group towards its culture targets and oversees the implementation of action plans. |
| Group and Ring-Fenced Banks Sustainability Committees | Recommends and implements the strategy and plans for delivering the Group's aspiration to be viewed as a trusted responsible business as part of the purpose of Helping Britain Prosper. |
| Senior Independent Performance Adjustment and Conduct Committees | Responsible for providing recommendations regarding performance adjustment, including the individual risk-adjustment process and risk-adjusted performance assessment, and making final decisions on behalf of the Group on the appropriate course of action relating to conduct breaches, under the formal scope of the SM&CR. |
| Group and Ring-Fenced Banks Strategic Review 3 Committees | Responsible for monitoring the progress of transformation across the Group, acting as a clearing house to resolve issues and facilitate resolution of issues where necessary and to drive the execution of the Group's transformation agenda as agreed by the Group Chief Executive. |
| The Group Risk Committee is supported through escalation and ongoing reporting by business area risk committees, cross-divisional committees addressing specific matters of Group-wide significance and the following second line of defence Risk committees which ensure effective oversight of risk management: | |
| Credit Risk Committees | Review material credit risk, both current and emerging, and adherence to agreed risk appetite; provide insight into the performance of material credit portfolios against expectation, forecast, metrics, portfolio controls to ensure they remain within agreed credit risk appetite; provide assurance that new business is being written within agreed credit risk appetite; ensure credit risk exposures causing concerns and any risks or issues are identified as early as possible so that remedial action may be taken; review information on credit impairment levels and allowance for expected credit losses; review information on the performance of credit risk models; and the reporting of monitoring activities relating to residual value risk. |
| Group Market Risk Committee | Reviews and recommends market risk appetites. Monitors and oversees market risk exposures across the Group and adherence to Board risk appetite. Approves the framework and designation of books between the Trading Book and the Banking Book for regulatory purposes.<br>Responsible for reviewing and proposing changes to the market risk management framework, and for reviewing adequacy of data quality for managing market risks. |

| Committees | Risk focus |
|---|---|
| Group Conduct, Compliance and Operational Risk Committee | Acts as a Risk community forum to independently challenge and oversee the Group-wide risk and control environment, using read-across and lessons learned from the three lines of defence to ensure that the Group-wide risk profile adapts to emerging risks, trends and themes, and the control environment is sustainable to deliver the Bank of the Future. |
| Group Fraud and Financial Crime Prevention Committee | The Fraud and Financial Crime Prevention Committee brings together accountable stakeholders and subject matter experts to ensure that the development and application of fraud and financial crime risk management complies with the Group's Strategic Aims, Group Corporate Responsibility, Group risk appetite and Group Fraud and Financial Crime (Anti-Money Laundering, Anti-bribery and Sanctions) policies. It provides direction and appropriate focus on priorities to enhance the Group's fraud and financial crime risk management capabilities in line with business and customer objectives whilst aligning to the Group's target operating model. |
| Group Financial Risk Committee | Responsible for overseeing, reviewing, challenging and recommending to senior executives and Board committees on internal and regulatory stress tests, Internal Capital Adequacy Assessment Process, Individual Liquidity Adequacy Assessment Process, Pillar 3 disclosures, Recovery and Resolution Plans, and other analysis as required. |
| Group Capital Risk Committee | Responsible for providing oversight of all relevant capital matters within the Group, Ring Fenced bank and material subsidiaries, including the Group's latest capital position and plans, risk appetite proposals, Pillar 2 development updates relating to ICAAP, Recovery and Resolution and the impact from regulatory reforms and accounting developments specific to capital. |
| Group Model Governance Committee | Responsible for approving the model governance framework, the associated policy and related principles and procedures; reviewing and approving models, model changes, model extensions and capital post model adjustments; recommending those models which require GRC approval to GRC; approving summary of model performance, approving any appropriate corrective actions; and supporting approval of risk appetite performance and escalating as required. |
| Ring Fenced Bank Perimeter Oversight Committee | The Committee escalates perimeter control breaches to the Ring-Fenced Banks' Board and the Ring-Fenced Banks' Board Risk Committee. |

# Capital stress testing

## Overview

Stress testing is recognised as a key risk management tool by the Boards, senior management, the businesses and the Risk and Finance functions of all parts of the Group and its legal entities. It is fully embedded in the planning process of the Group and its legal entities as a key activity in medium-term planning, and senior management is actively involved in stress testing activities via a strict governance process.

Scenario stress testing is used for:

Risk Identification:

- Understand key vulnerabilities of the Group and its key legal entities under adverse economic conditions

Risk Appetite:

- Assess the results of the stress test against the risk appetite of all parts of the Group to ensure the Group and its legal entities are managed within their risk parameters
- Inform the setting of risk appetite by assessing the underlying risks under stress conditions

Strategic and Capital Planning:

- Allow senior management and the Boards of the Group and its applicable legal entities to adjust strategies if the plan does not meet risk appetite in a stressed scenario
- 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 Prudential Regulation Authority (PRA) and management buffers (see capital risk on pages 166 to 175) of the Group and its separately regulated legal entities

Risk Mitigation:

- Drive the development of potential actions and contingency plans to mitigate the impact of adverse scenarios. Stress testing also links directly to the recovery planning process of the Group and its legal entities

## Regulatory stress tests

In 2019, the Group participated in both the Annual Cyclical Scenario (ACS) UK stress test and the Biennial Exploratory Scenario (BES) run by the Bank of England (BoE). Despite the severity of the ACS stress, the Group exceeded the capital and leverage hurdles on a transitional basis, after the application of management actions and as a consequence was not required to take any capital actions. The BoE continues to review the outputs of the BES exercise.

## Internal stress tests

On at least an annual basis, the Group conducts macroeconomic stress tests of the operating plan, which are supplemented with higher-level refreshes if necessary. The exercise aims to highlight the key vulnerabilities of the Group's and its legal entities' business plans to adverse changes in the economic environment, and to ensure that there are adequate financial resources in the event of a downturn.

## Reverse stress testing

Reverse stress testing is used to explore the vulnerabilities of the Group's and its key legal entities' strategies and plans to extreme adverse events that would cause the businesses to fail. Where this identifies plausible scenarios with an unacceptably high risk, the Group or its entities will adopt measures to prevent or mitigate that and reflect these in strategic plans.

## Other stress testing activity

The Group's stress testing programme also involves undertaking assessments of liquidity scenarios, market risk sensitivities and scenarios, and business specific scenarios (see the principal risk categories on pages 138 to 187 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. From 2020 onwards, climate change risk stress testing will be considered as part of the implementation of the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).

## Methodology

The stress tests at all levels must comply with all regulatory requirements, achieved through the comprehensive construction of macroeconomic scenarios and a rigorous divisional, functional, risk and executive review and challenge process, supported by analysis and insight into impacts on customers and business drivers.

The engagement of all required business, Risk and Finance teams is built into the preparation process, so that the appropriate analysis of each risk category'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.

## Governance

Clear accountabilities and responsibilities for stress testing are assigned to senior management and the Risk and Finance functions throughout the Group and its key legal entities. This is formalised through the Group Business Planning and Stress Testing Policy and Procedure, which are reviewed at least annually.

The Group Financial Risk Committee (GFRC), chaired by the Chief Risk Officer and attended by the Chief Financial 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 and Ring-Fenced Bank's stress tests. Lloyds Bank Corporate Markets (LBCM) Risk Committee performs a similar function within the scope of LBCM.

The review and challenge of the Group's and Ring-Fenced Bank's detailed stress forecasts, the key assumptions behind these, and the methodology used to translate the economic assumptions into stressed outputs conclude with the divisional Finance Directors', appropriate Risk Directors' and Managing Directors' sign-off. The outputs are then presented to GFRC and Board Risk Committee for review and challenge, before being approved by the Board. There is a similar process within LBCM for the governance of the LBCM-specific results.

## Full analysis of risk categories

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 on pages 139 to 187.

Risk categories recognised by the Group are periodically reviewed to ensure that they reflect the Group risk profile in light of internal and external factors, such as the Group strategy and the regulatory environment in which it operates. There have been no changes to the risk categories during 2019.

| Principal risk categories | Secondary risk categories | | |
|---|---|---|---|
| **Change/Execution risk**<br>Page 139 | – Change/Execution | | |
| **Data risk**<br>Page 139 | – Data | | |
| **Operational resilience risk**<br>Page 140 | – Operational resilience | | |
| **Strategic risk**<br>Page 141 | – Strategic | | |
| **Credit risk**<br>Page 141 | – Retail credit | – Commercial credit | |
| **Regulatory and legal risk**<br>Page 162 | – Regulatory compliance | – Legal | |
| **Conduct risk**<br>Page 163 | – Conduct | | |
| **Operational risk**<br>Page 163 | – Business process<br>– Cyber and information security<br>– External service provision<br>– Financial crime | – Financial reporting<br>– Fraud<br>– Internal service provision<br>– IT systems | – Physical security/health and safety<br>– Sourcing |
| **People risk**<br>Page 165 | – People | | |
| **Insurance underwriting risk**<br>Page 165 | – Insurance underwriting | | |
| **Capital risk**<br>Page 166 | – Capital | | |
| **Funding and liquidity risk**<br>Page 175 | – Funding and liquidity | | |
| **Governance risk**<br>Page 181 | – Governance | | |
| **Market risk**<br>Page 182 | – Trading book<br>– Banking book | – Pensions<br>– Insurance | |
| **Model risk**<br>Page 187 | – Model | | |

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 category.

## Change and execution risk

### Definition

Change and execution is defined as the risk that, in delivering its change agenda, the Group fails to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operation within the Group's risk appetite.

### Exposures

Change and execution risks arise when the Group undertakes activities which require products, processes, people, systems or controls to change. These changes can be as a result of external drivers (for example, a new piece of regulation that requires the Group to put in place a new process or reporting) and internal drivers (such as the strategic transformation that is outlined in our GSR3).

### Measurement

The Group currently measures change and execution risk against a defined risk appetite metric which is a combination of lead, quality and delivery indicators across the investment portfolio. These indicators are reported through defined internal governance structures in the form of a monthly execution risk dashboard. An associated measure, based on the aggregate performance of the dashboard is included in the Group Balanced Scorecard.

### Mitigation

The Group takes a range of mitigating actions with respect to change and execution risk. These include the following:

- The Board establishes a Group-wide risk appetite and metric for change and execution risk
- Ensuring compliance with the Change policy and associated policies and procedures, which set out the principles and key controls that apply across the business and are aligned to the Group risk appetite
- Businesses assess the potential impacts of undertaking any change activity on their ability to execute effectively, and the potential consequences for the existing risk profiles
- The implementation of effective governance and control frameworks to ensure adequate controls are in place to manage the change activity and act to mitigate the change and execution risks identified. These controls are monitored in line with the Change policy and any additional monitoring that is deemed necessary
- Events related to change activities are escalated and managed appropriately in line with risk framework guidance

### Monitoring

Change and execution risks from across the Group are monitored and reported through to Board and Group Governance Committees in accordance with the Group's enterprise risk management framework and aligned to our GSR3 activities. Risk exposures are discussed monthly through established governance through to Group Transformation Risk Committee with upwards reporting to Board Risk and Executive Committees. In addition, oversight, challenge and reporting are completed at Risk division level to provide oversight of management of risks and the effectiveness of controls, recommending follow up remedial action if required. All material change and execution risk events are escalated in accordance with the formal Group Operational Risk policy and Change policy.

## Data risk

### Definition

Data risk is defined as the risk of the Group failing to effectively govern, manage and control its data (including data processed by third party suppliers), leading to unethical decisions, poor customer outcomes, loss of value to the Group and mistrust.

### Exposures

Data risk is present in all aspects of the business where data is processed, both within the Group and by third parties including colleague and contractor, prospective and existing customer, client lifecycle and insight processes. Data risk manifests

- When personal data is not gathered legally, for a legitimate purpose, or is not managed/protected from misuse and/or processed in a way that complies with General Data Protection Regulations (GDPR) and other data privacy regulatory obligations
- When data quality (accuracy, completeness, consistency, uniqueness, validity and timeliness) is not managed, resulting in data used in systems, processes and products not being fit for the intended purpose
- When data records are not created, retained, protected and destroyed appropriately and when data records cannot be retrieved in a timely manner
- When data governance fails to provide robust oversight of data decision-making and the control mechanisms to ensure strategies and management instructions are implemented effectively
- When data standards are not maintained across core data, data management risks are not managed and data related issues are not remediated as a result of poor data management resulting in inaccurate, incomplete data that is not available at the right time, to the right people, to enable business decisions to be made, and regulatory reporting requirements to be fulfilled
- When critical data mapping and data information standards are not followed impacting compliance, traceability and understanding of data

### Measurement

Data risk is measured through a series of quantitative and qualitative indicators, aligned to key sources of data risk for the Group covering data governance, data management and data privacy and ethics. In addition to risk appetite measures and limits, data risks and controls are monitored and governed on a monthly basis through divisional risk committees. Significant issues are escalated to Group Risk Committee.

### Mitigation

Data risk is a key component of the Group's enterprise risk management framework, where the focus is on the end to end management of data risk. This ensures that risks are identified, measured, managed, monitored and reported using the risk and control self-assessment process. Significant investment has been made to enhance the maturity of data risk management in recent years. In addition to the General Data Protection programme which delivered the necessary infrastructure to achieve compliance with the new regulations in May 2018, a number of other large investments and remediation projects include:

- Enhancing capability by investing in professional training for data privacy managers
- Enhancing assurance over of suppliers
- Delivered enhanced controls and processes for data retention and destruction, deleting large volumes of historic over-retained data
- Delivering increased level of data maturity against the Data Management Capability Assessment Model
- Where required, these projects have also delivered enhancements to colleague and client training, vetting procedures and access controls processes

### Monitoring

Data risk is governed through divisional risk committees and significant issues are escalated to Group Risk Committee, in accordance with the Group's enterprise risk management framework. Risk exposures are discussed at divisional risk committees, where oversight, challenge and reporting are completed to assess the effectiveness of controls. Remedial action is recommended, if required. All material data risk events are escalated in accordance with the Group Operational Risk policy and Data risk policies to the respective divisional Managing Directors and Conduct, Compliance and Operational Risk, including, where personal data is concerned, the Group Data Protection Officer. In addition, Group-wide data risk issues and the top data risks that Group faces are discussed at Group Data Committee.

A number of activities support the close monitoring of data risk including:

- Design and monitoring of data risk appetite metrics, including key risk indicators and key performance indicators
- Monitoring and reporting of progress against the Data Capability Assessment Model
- Monitoring of significant data related issues
- Identification and effective mitigation of data risk when planning and implementing transformation or business change
- Implementation of effective controls to mitigate data risk, including data privacy, ethics, data management and records management
- Effective monitoring and testing of compliance with data privacy and data management regulatory requirements. For example GDPR and Basel Committee on Banking Supervision (BCBS 239) requirements
- Horizon scanning for changes in the external environment, including but not limited to changes to laws, rules and regulations

# Operational resilience risk

## Definition

Operational resilience risk is defined as the risk that the Group fails to design resilience into business operations, underlying infrastructure and controls (people, process, technology) so that it is able to withstand external or internal events which could impact the continuation of operations, and/or fails to respond in a way which meets customer and stakeholder expectations and needs when the continuity of operations is compromised.

## Exposures

Ineffective operational resilience risk management could lead to vital services not being available to customers, and in extreme circumstances, bank failure could result. The Group has in place a transparent and effective operating model to identify and monitor critical business processes from a customer, Group and financial industry perspective. The failure to adequately build resilience into a critical business process may occur in a variety of ways, including:

- The Group being overly reliant on one location to deliver a critical business process
- The Group not having an adequate succession plan in place for designated subject matter experts
- The Group being overly reliant on a supplier which fails to provide a service
- A weakness in the Group's cyber or security defences leaving it vulnerable to an attack
- The Group failing to upgrade its IT systems and leaving them vulnerable to failure
- Operational resilience and damage to physical assets including: terrorist acts, other acts of war or hostility, geopolitical, pandemic or other such events

Effective operational resilience ensures the Group designs resilience into its systems, is able to withstand and/or recover from a significant unexpected event occurring and can continue to provide services to its customers. A significant outage could result in customers being unable to access accounts or conduct transactions, which as well as presenting significant reputational risk for the Group would negatively impact the Group's purpose of Helping Britain Prosper. Operational resilience is also an area of continued regulatory and industry focus, similar in importance to financial resilience.

Failure to manage operational resilience effectively could impact the following other risk categories:

- Regulatory compliance – non-compliance with new/existing operational resilience regulations, for example, through failure to identify emerging regulation or not embedding regulatory requirements within the Group's policies, processes and procedures
- Operational risk – being unable to safely provide customers with business services
- Conduct risk – an operational resilience failure may render the Group liable to fines from the FCA for poor conduct
- Market risk – the Group being unable to provide key services could have ramifications for the wider market and could impact share price

## Measurement

Operational resilience risk is managed across the Group through the Group's enterprise risk management framework and Operational risk policies. The Group's enterprise risk management framework includes a risk and control self-assessment process, risk impact likelihood matrix, key risk and control indicators, risk appetite, a robust incident management and escalation process, scenario analysis and an operational losses process. Board risk appetite metrics are in place and are well understood. These specific measures are subject to ongoing monitoring and reporting, including a mandatory review of thresholds on at least an annual basis. To strengthen the management of operational resilience risk, the Group mobilised an operational resilience enhancement programme which is designed to focus on end to end resilience and the management of key risks to critical processes.

## Mitigation

The Group has increased its focus on operational resilience and has updated its operational resilience strategy to reflect changing priorities of both customers and regulators. The Group is carefully considering the publication of the consultation paper by the FCA, PRA and Bank of England (December 2019). Focus will be given to ensure that the Group's strategy and approach to operational resilience aligns with industry thinking and expectation. At the core of its approach to operational resilience are the Group's critical business processes which drive all activity, including further mapping of the processes to identify any additional resilience requirements such as impact tolerances in the event of a service outage. The Group continues to develop playbooks that guide our response to a range of interruptions from internal and external threats and tests these through scenario-based testing and exercising.

The Group's strategic review considers the changing risk management requirements, adapting the change delivery model to be more agile and develop the people skills and capabilities needed to be a 'Bank of the Future'. The Group continues to review and invest in its control environment to ensure it addresses the risks it faces. Risks are reported and discussed at local governance forums and escalated to executive management and Board as appropriate. The Group employs a range of risk management strategies, including: avoidance, mitigation, transfer (including insurance) and acceptance. Where there is a reliance on third-party suppliers to provide services, the Group's sourcing policy ensures that outsourcing initiatives follow a defined process including due diligence, risk evaluation and ongoing assurance.

Mitigating actions to the principal operational resilience risk are:

- **Cyber:** the threat landscape associated with cyber risk continues to evolve and there is significant regulatory attention on this subject. The Board continues to invest heavily to protect the Group from cyber-attacks. Investment continues to focus on improving the Group's approach to identity and access management, improving capability to detect and respond to cyber-attacks and improved ability to manage vulnerabilities across the estate
- **IT resilience:** the Group continues to optimise its approach to IT and operational resilience by investing in technology improvements and enhancing the resilience of systems that support the Group's critical business processes, primarily through the technology resilience programme, with independent verification of progress on an annual basis. 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 resilience
- **People:** the Group acknowledges the risks associated to the failure to maintain appropriately skilled and available colleagues. The Group continues to optimise its approach to ensure that where applicable, colleagues are capable of supporting a critical business process. Key controls and processes are regularly reported to committee(s) and alignment to the Group Strategic Review is closely monitored
- **Property:** the Group's property portfolio remains a key focus in ensuring resilience requirements are appropriately maintained. Processes are in place to identify key buildings where a critical business process is performed. Depending on criticality, a number of mitigating controls are in place to manage the risk of severe critical business process disruption. The Group remains committed to investment in the upkeep of the property portfolio, primarily through the Group Property upkeep investment programme

- **Sourcing:** the threat landscape associated with third party suppliers and the critical services they provide continues to receive a significant amount of regulatory attention. The Group acknowledges the importance demonstrating control and responsibility for those critical business services which could cause significant harm to our customers. Risks and controls are regularly reported through committee(s) and is further supported via the mobilisation of the Sourcing enterprise programme

## Monitoring

Monitoring and reporting of operational resilience risk is undertaken at Board, Group, entity and divisional committees. Each committee monitors key risks, control effectiveness, key risk and control indicators, events, operational losses, risk appetite metrics and the results of independent testing conducted by the Risk division and/or Group Internal Audit.

The Group maintains a formal approach to operational resilience risk event escalation, whereby material events are identified, captured and escalated. Root causes are determined, and action plans put in place to ensure an optimum level of control to keep customers and the business safe, reduce costs, and improve efficiency.

# Strategic risk

## Definition

The risks which result from strategic plans which do not adequately reflect trends in external factors, ineffective business strategy execution, or failure to respond in a timely manner to external environments or changes in stakeholder behaviours and expectations.

## Exposures

The Group faces significant risks due to the changing regulatory and competitive environments in the financial services sector, with an increased pace, scale and complexity of change. Customers, shareholders and employees expectations continue to evolve, with indications that current societal trends may accelerate, impacting the Group's ability to respond accordingly, and negatively impacting the Group's relevance in society.

## Measurement

The Group assesses and monitors the impact of the strategic risk implications of new business, product entries and other strategic initiatives, as part of the business planning processes and stress testing scenarios.

## Mitigation

The Group has a number of mitigating actions to manage strategic risk, including:

- Continued digitisation of customer journeys, thereby enabling the delivery of market leading customer experiences that are seamless, accessible and personal
- Robust operating and contingency planning to ensure potential impacts of strategic initiatives and external drivers are mitigated
- Continued focus on increasing the efficiency of the Group's operations to ensure investment capacity, responsiveness and effectiveness to respond to external trends
- Development of a compelling colleague proposition to continue to attract talent to the Group

## Monitoring

A review of the Group's emerging and strategic risks, which includes the risks to the current strategic review and the mitigating actions, is undertaken on an annual basis and the findings are reported to the Group and Board Risk Committees.

# Credit Risk

## Definition

Credit risk is defined as the risk that parties with whom the Group has contracted fail to meet their financial obligations (both on and off-balance sheet).

## 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 289.

In terms of loans and advances, (for example mortgages, term loans and overdrafts) and contingent liabilities (for example credit instruments such as guarantees and documentary letters of credit), credit risk arises both from amounts advanced and commitments to extend credit to a customer or bank. With respect to commitments to extend credit, the Group is also potentially exposed to an additional loss up to an amount equal to the total unutilised commitments. However, the likely amount of loss may be less than the total unutilised commitments, as most retail and certain commercial lending commitments may be cancelled based on regular assessment of the prevailing creditworthiness of customers. Most commercial term commitments are also contingent upon customers maintaining specific credit standards.

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 2019 is shown on page 161. 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 289.

Additionally, credit risk arises from leasing arrangements where the Group is the lessor. Note 2(J) on page 210 provides details on the Group's approach to the treatment of leases.

Credit risk exposures in the Insurance and Wealth division relate mostly to bond and loan assets which, together with some related swaps, are used to fund annuity commitments within Shareholder funds; plus balances held in liquidity funds to manage Insurance division's liquidity requirements, and exposure to reinsurers.

The investments held in the Group's defined benefit pension schemes also expose the Group to credit risk. Note 36 on page 253 provides further information on the defined benefit pension 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 occur for a number of reasons which may include: the borrower is in financial difficulty, because the terms required to refinance are outside acceptable appetite at the time or the customer is unable to refinance externally due to a lack of market liquidity. 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 exposures are minimised through intensive account management and, where appropriate, are classed as impaired and/or forborne.

## Measurement

The process for credit risk identification, measurement, and control is integrated into the Board-approved framework for credit risk appetite and governance.

Credit risk is measured from different perspectives using a range of appropriate modelling and scoring techniques at a number of levels of granularity, including total balance sheet, individual portfolio, pertinent concentrations and individual customer – for both new business and existing lending. Key metrics, such as total exposure, risk-weighted assets, new business quality, concentration risk and portfolio performance, are reported monthly to Risk Committees.

Measures such as expected credit loss (ECL), risk-weighted assets, observed credit performance, predicted credit quality (usually from predictive credit scoring models), collateral cover and quality, and other credit drivers (such as cash flow, affordability, leverage and indebtedness) are used to enable effective risk measurement across the Group.

In addition, stress testing and scenario analysis are used to estimate impairment losses and capital demand forecasts for both regulatory and internal purposes and to assist in the formulation of credit risk appetite.

As part of the 'three lines of defence' model, Risk division is the second line of defence providing oversight and independent challenge to key risk decisions taken by business management. Risk division also tests the effectiveness of credit risk management and internal credit risk controls. This includes ensuring that the control and monitoring of higher risk and vulnerable portfolios and sectors is appropriate and confirming that appropriate loss allowances for impairment are in place. Output from these reviews helps to inform credit risk appetite and credit policy.

As the third line of defence, Group Internal Audit undertakes regular risk-based reviews to assess the effectiveness of Credit risk management and controls.

## 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, credit risk policies and credit risk appetite statements. These are subject to regular review and governance, with any changes subject to an approval process. Risk teams monitor credit performance trends and the outlook. Risk teams also test the adequacy of and adherence to credit risk policies and processes throughout the Group. This includes tracking portfolio performance against an agreed set of credit risk appetite tolerances.

**Robust models and controls:** see model risk on page 187.

**Limitations on concentration risk:** there are portfolio controls on certain industries, sectors and products to reflect risk appetite as well as individual, customer and bank limit risk tolerances. Credit policies and appetite statements are aligned to the Group's risk appetite and restrict exposure to higher risk countries and potentially vulnerable sectors and asset classes. Note 18 on page 235 provides an analysis of loans and advances to customers by industry (for commercial customers) and product (for retail customers). Exposures are monitored to prevent both 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 minimum policy and/or guideline requirements. The Group's largest credit limits are regularly monitored by the Board Risk Committee and reported in accordance with regulatory requirements.

**Defined country risk management framework:** the Board sets a broad maximum country risk appetite. Within this, the Executive Credit Approval Committee approves the Group country risk framework and sovereign limits on an annual basis. Risk based appetite for all countries is set within the independent Risk division, taking into account economic, financial, political and social factors as well as the approved business and strategic plans of the Group.

**Specialist expertise:** credit quality is managed and controlled by a number of specialist units within the business and Risk division, which provide for example: intensive management and control; security perfection; maintenance of customer and facility records; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market segments and product ranges offered by the Group.

**Stress testing:** the Group's credit portfolios are subject to regular stress testing. In addition to the Group led, PRA, EBA and other regulatory stress tests, exercises focused on individual divisions and portfolios are also performed. For further information on stress testing process, methodology and governance see page 137.

**Frequent and robust Credit risk oversight and assurance:** oversight and assurance of credit risk is undertaken by independent credit risk oversight functions operating within the Risk division which are part of the Group's second line of defence. Their primary objective is to provide reasonable and independent oversight that credit risk is being effectively managed and to ensure that appropriate controls are in place and being adhered to. Group Internal Audit also provides assurance to the Board Audit Committee on the effectiveness of credit risk management controls across the Group's activities.

### Collateral

The principal types of acceptable collateral include:

- residential and commercial properties
- charges over business assets such as premises, inventory and accounts receivable
- financial instruments such as debt securities
- vehicles
- cash
- guarantees received from third-parties

The Group maintains appetite parameters on the acceptability of specific classes of collateral.

For non-mortgage retail lending to small businesses, collateral may include second charges over residential property and the assignment of life cover.

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. However, 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 financial counterparties are typically collateralised under a Credit Support Annex (CSA) in conjunction with the International Swaps and Derivatives Association (ISDA) Master Agreement. Derivative transactions with non-financial customers are not usually supported by a CSA.

The requirement for collateral and the type to be taken at origination will be based upon the nature of the transaction and the credit quality, size and structure of the borrower. For non-retail exposures if required, the Group will often seek that any collateral include a first charge over land and buildings owned and occupied by the business, a debenture over the assets of a company or limited liability partnership, personal guarantees, limited in amount, from the directors of a company or limited liability partnership and key man insurance. The Group maintains policies setting out which types of collateral valuation are acceptable, maximum loan to value (LTV) ratios and other criteria that are to be considered when reviewing an application. Other than for project finance, object finance and income-producing real estate where charges over the subject assets are required, 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 or counterparty's financial commitment, rather than reliance on the disposal of any security provided.

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 primarily 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.

The Group requires collateral to be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. In certain circumstances, for Retail residential mortgages this may include the use of automated valuation models based on market data, subject to accuracy criteria and LTV limits. Where third-parties are used for collateral valuations, they are subject to regular monitoring and review. Collateral values are subject to review, which will vary according to the type of lending, collateral involved and account performance. Such reviews are undertaken to confirm that the value recorded remains appropriate and whether revaluation is required, considering for example, account performance, market conditions and any information available that may indicate that the value of the collateral has materially declined. In such instances, the Group may seek additional collateral and/or other amendments to the terms of the facility. The Group adjusts estimated market values to take account of the costs of realisation and any discount associated with the realisation of the collateral when estimating credit losses.

The Group considers risk concentrations by collateral providers and collateral type 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.

The Group seeks to avoid correlation or wrong-way risk where possible. Under the Group's repurchase (repo) policy, the issuer of the collateral and the repo counterparty should be neither the same nor connected. The same rule applies for derivatives. 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- or better may be considered to have no adverse correlation between the counterparty domiciled in that country and the country of risk (issuer of securities).

Refer to note 53 on page 289 for further information on collateral.

### Additional mitigation for Retail 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 internal data and information held by Credit Reference Agencies (CRA).

The Group also assesses the affordability and sustainability of lending for each borrower. For secured lending this includes use of an appropriate stressed interest rate scenario. Affordability assessments for all lending are compliant with relevant regulatory and conduct guidelines. The Group takes reasonable steps to validate information used in the assessment of a customer's income and expenditure.

In addition, the Group has in place quantitative limits such as maximum limits for individual customer products, 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 policy limits above which the Group will typically reject borrowing applications. The Group also applies certain criteria that are applicable to specific products for example applications for buy-to-let mortgages.

For UK mortgages, the Group's policy permits owner occupier applications with a maximum loan to value (LTV) of 95 per cent. This can increase to 100 per cent for specific products where additional security is provided by a supporter of the applicant and held on deposit by the Group. Applications with an LTV above 90 per cent are subject to enhanced underwriting criteria, including higher scorecard cut-offs and loan size restrictions.

Buy-to-let mortgages within Retail are limited to a maximum loan size of £1,000,000 and 75 per cent LTV. Buy-to-let applications must pass a minimum rental cover ratio of 125 per cent under stressed interest rates, after applicable tax liabilities. Portfolio landlords (customers with four or more mortgaged buy-to-let properties) are subject to additional controls including evaluation of overall portfolio resilience.

The Group's policy is to reject any application for a lending product where a customer is registered as bankrupt or insolvent, or has a recent County Court Judgment or financial default registered at a CRA used by the Group above de minimis thresholds. In addition, the Group typically rejects applicants where total unsecured debt, debt-to-income ratios, or other indicators of financial difficulty exceed policy limits.

Where credit acceptance scorecards are used, new models, model changes and monitoring of model effectiveness are independently reviewed and 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 certain relationship managers have limited delegated sanctioning authority, credit risk in commercial customer portfolios is 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 and Divisional risk appetite. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities and risk based recommended maximum limit parameters. Approval requirements for each decision are based on a number of factors including, but not limited to, the transaction amount, the customer's aggregate facilities, credit policy, risk appetite, credit risk ratings and the nature and term of the risk. The Group's credit risk appetite criteria for counterparty and customer loan Underwriting is generally the same as that for loans intended to be held to maturity. All hard loan/bond Underwriting must be sanctioned by Risk division. A pre-approved credit matrix may be used for 'best efforts' underwriting.

**Counterparty credit 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 derivatives and securities financing 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 relevant counterparty to cover the aggregate of all settlement risk arising from the Group's market transactions on any single day. Where possible, the Group uses Continuous Linked Settlement in order to reduce FX settlement risk.

## Master netting agreements

It is credit policy that a Group approved master netting agreement must be used for all derivative and traded product transactions and must be in place prior to trading, with separate documentation required for each Group entity providing facilities. This requirement extends to trades with clients and the counterparties used for the Bank's own hedging activities, which may also include clearing trades with Central Counterparties (CCPs). Any exceptions must be approved by the appropriate credit sanctioner. 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. However, within relevant jurisdictions and for appropriate counterparty types, master nettings agreements do reduce the credit risk to the extent that, if an event of default occurs, all trades with the counterparty may be 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, securitisations (including Significant Risk Transfer transactions), purchases of credit default swaps and purchase of credit insurance as a means of mitigating or reducing credit risk and/or risk concentration, 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 behaviours and characteristics by which those portfolios are managed and monitored. This entails the production and analysis of regular portfolio monitoring reports for review by senior management. Risk division in turn produces an aggregated view of credit risk across the Group, including reports on material credit exposures, concentrations, concerns and other management information, which is presented to the divisional risk committees, Group Risk Committee and the Board Risk Committee.

## Models

The performance of all models used in credit risk is monitored in line with the Group's model governance framework – see model risk on page 187.

## Intensive care of customers in financial difficulty

The Group operates a number of solutions to assist borrowers who are experiencing financial stress. The material elements of these solutions through which the Group has granted a concession, whether temporarily or permanently, are set out below.

### Forbearance

The Group's aim in offering forbearance and other assistance to customers in financial distress is to benefit both the customer and the Group by supporting its customers and acting in their best interests by, where possible, bringing customer facilities back into a sustainable position.

The Group offers a range of tools and assistance to support 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 appropriate and sustainable for both the customer and the Group.

Forbearance measures consist of concessions towards a debtor that is experiencing or about to experience difficulties in meeting its financial commitments. This can include modification of the previous terms and conditions of a contract or a total or partial refinancing of a troubled debt contract, either of which would not have been required had the debtor not been experiencing financial difficulties.

The provision and review of such assistance is controlled through the application of an appropriate policy framework and associated controls. Regular review of the assistance offered to customers is undertaken to confirm that it remains appropriate, alongside monitoring of customers' performance and the level of payments received.

The Group classifies accounts as forborne at the time a customer in financial difficulty is granted a concession. Non-performing exposures can be reclassified as Performing Forborne after a minimum 12 month cure period, providing there are no past due amounts or concerns regarding the full repayment of the exposure. A minimum of a further 24 months must pass from the date the forborne exposure was reclassified as Performing Forborne before the account can exit forbearance. If conditions to exit forbearance are not met at the end of this probation period, the exposure shall continue to be identified as forborne until all the conditions are met.

The Group's treatment of loan renegotiations is included in the impairment policy in note 2(H) on page 209.

### Customers receiving support from UK government sponsored programmes

To assist customers in financial distress, the Group participates in UK government sponsored programmes for households, including the Income Support for Mortgage Interest programme, under which the government pays the Group all or part of the interest on the mortgage on behalf of the customer. This is provided as a government loan which the customer must repay.

## The Group credit risk portfolio in 2019

### Overview

- Credit quality remains strong despite an uncertain environment
- The Group's loan portfolios continue to be well positioned, reflecting the Group's effective risk management and continue to benefit from a low interest rate environment
- The net asset quality ratio increased to 29 basis points (2018: 21 basis points) as did the impairment charge to £1,291 million (2018: £937 million). This was primarily driven by material charges against two corporate cases in Commercial Banking, along with some weakening in used car prices in Retail
- Stage 2 loans as a proportion of total loans and advances to customers reduced by 0.1 percentage points to 7.7 per cent (31 December 2018: 7.8 per cent). Stage 2 loans and advances were broadly flat at £38.4 billion
- Stage 2 expected credit loss allowances as a percentage of drawn balances (coverage) decreased to 3.7 per cent (31 December 2018: 4.1 per cent), largely driven by a reduction in expected credit loss (ECL) allowances in SME due to an enhanced approach to loan amortisation within the IFRS 9 model and a number of other model refinements
- Stage 3 loans as a proportion of total loans and advances to customers fell to 1.8 per cent (31 December 2018: 1.9 per cent), with Stage 3 loans and advances down £0.5 billion to £8.8 billion. Coverage of Stage 3 assets reduced by 1.8 percentage points to 22.5 per cent, largely as a result of a the improved performance of mortgage cases in long-term default , and a change in the mix of Commercial assets due to a combination of write-offs and the transfer in of cases with lower likelihood of net loss

### Low risk culture and prudent risk appetite

- The Group continues to take a prudent approach to credit risk, with robust credit quality and affordability controls at origination and a prudent through the cycle credit risk appetite
- Although not immune, credit portfolios are well positioned against an uncertain economic outlook and potential market volatility
- The Group continues to grow lending to targeted segments in line with strategy, without relaxing credit criteria
- The Group's effective risk management seeks to ensure early identification and management of customers and counterparties who may be showing signs of distress
- Sector concentrations within the portfolios are closely monitored and controlled, with mitigating actions taken where appropriate. Sector and product caps limit exposure to certain higher risk and vulnerable sectors and asset classes

Table 1.4: **Group impairment charge (underlying basis)**

| | Loans and advances to customers £m | Financial assets at fair value through other comprehensive income £m | Undrawn balances £m | 2019 Total £m | 2018[1] £m |
|---|---|---|---|---|---|
| Retail | 1,063 | – | (25) | 1,038 | 861 |
| Commercial Banking | 297 | (1) | 10 | 306 | 71 |
| Insurance and Wealth | – | – | – | – | 1 |
| Central Items | (53) | – | – | (53) | 4 |
| **Total impairment charge** | 1,307 | (1) | (15) | 1,291 | 937 |
| Asset quality ratio | | | | 0.29% | 0.21% |
| Gross asset quality ratio | | | | 0.37% | 0.28% |

1 Prior period segmental comparatives restated. See note 4 on page 217.

### Group loans and advances to customers

The following pages contain analysis of the Group's loans and advances to customers by sub-portfolio. Loans and advances to customers are categorised into the following stages:

Stage 1 assets comprise of newly originated assets (unless purchased or originated credit impaired), as well as those which have not experienced a significant increase in credit risk. These assets carry an expected credit loss allowance equivalent to the expected credit losses that result from those default events that are possible within 12 months of the reporting date (12 month expected credit losses).

Stage 2 assets are those which have experienced a significant increase in credit risk since origination. These assets carry an expected credit loss allowance equivalent to the expected credit losses arising over the lifetime of the asset (lifetime expected credit losses).

Stage 3 assets have either defaulted or are otherwise considered to be credit impaired. These assets carry a lifetime expected credit loss.

Purchased or originated credit impaired assets (POCI) are those that have been originated or acquired in a credit impaired state. This includes within the definition of credit impaired the purchase of a financial asset at a deep discount that reflects impaired credit losses.

### Credit risk basis of presentation

The analyses which follow have been presented on two bases; the statutory basis which is consistent with the presentation in the Group's accounts and the underlying basis which is used for internal management purposes. Reconciliations between the two bases have been provided.

In the following statutory basis tables, purchased or originated credit-impaired (POCI) assets include a fixed pool of mortgages that were purchased as part of the HBOS acquisition at a deep discount to face value reflecting credit losses incurred from the point of origination to the date of acquisition. The residual ECL allowance and resulting low coverage ratio on POCI assets reflects further deterioration in the creditworthiness from the date of acquisition. Over time, these POCI assets will run off as the loans redeem, pay down or losses are crystallised.

The Group uses the underlying basis to monitor the creditworthiness of the lending portfolio and related ECL allowances because it provides a better indication of the credit performance of the POCI assets purchased as part of the HBOS acquisition. The underlying basis assumes that the lending assets acquired as part of a business combination were originated by the Group and are classified as either Stage 1, 2 or 3 according to the change in credit risk over the period since origination. Underlying ECL allowances have been calculated accordingly.

Table 1.5: **Group loans and advances to customers (statutory basis)**

| | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Stage 3 as % of total % |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| Retail | **344,218** | **305,502** | **22,518** | **2,484** | **13,714** | **0.7** |
| Commercial Banking | **96,763** | **87,323** | **5,993** | **3,447** | **–** | **3.6** |
| Insurance and Wealth | **862** | **753** | **32** | **77** | **–** | **8.9** |
| Central items | **56,404** | **56,397** | **–** | **7** | **–** | **–** |
| **Total gross lending** | **498,247** | **449,975** | **28,543** | **6,015** | **13,714** | **1.2** |
| Expected credit loss allowance on drawn balances | **(3,259)** | **(675)** | **(995)** | **(1,447)** | **(142)** | |
| **Net balance sheet carrying value** | **494,988** | **449,300** | **27,548** | **4,568** | **13,572** | |
| **Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)**[1] | **0.7** | **0.2** | **3.8** | **25.0** | **1.0** | |
| At 31 December 2018[2] | | | | | | |
| Retail | 341,682 | 305,160 | 18,741 | 2,390 | 15,391 | 0.7 |
| Commercial Banking | 101,824 | 92,002 | 6,592 | 3,230 | – | 3.2 |
| Insurance and Wealth | 865 | 804 | 6 | 55 | – | 6.4 |
| Central items | 43,637 | 43,565 | 6 | 66 | – | 0.2 |
| Total gross lending | 488,008 | 441,531 | 25,345 | 5,741 | 15,391 | 1.2 |
| Expected credit loss allowance on drawn balances | (3,150) | (525) | (994) | (1,553) | (78) | |
| Net balance sheet carrying value | 484,858 | 441,006 | 24,351 | 4,188 | 15,313 | |
| Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)[1] | 0.7 | 0.1 | 4.2 | 28.4 | 0.5 | |

1 Stage 3 ECL allowances as a percentage of drawn balances are calculated excluding loans in recoveries in Retail of £205 million (31 December 2018: £250 million).

2 Prior period segmental comparatives restated. See note 4 on page 217.

Table 1.6: **Group loans and advances to customers (underlying basis)**

| | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Stage 3 as % of total % |
|---|---|---|---|---|---|
| **At 31 December 2019**[1] | | | | | |
| Retail | **344,776** | **307,138** | **32,415** | **5,223** | **1.5** |
| Commercial Banking | **96,763** | **87,323** | **5,993** | **3,447** | **3.6** |
| Insurance and Wealth | **862** | **753** | **32** | **77** | **8.9** |
| Central items | **56,404** | **56,397** | **–** | **7** | **–** |
| **Total gross lending** | **498,805** | **451,611** | **38,440** | **8,754** | **1.8** |
| Expected credit loss allowance on drawn balances | **(3,965)** | **(702)** | **(1,346)** | **(1,917)** | |
| **Net balance sheet carrying value** | **494,840** | **450,909** | **37,094** | **6,837** | |
| **Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)**[2] | **0.8** | **0.2** | **3.7** | **22.5** | |
| At 31 December 2018[1,3] | | | | | |
| Retail | 342,559 | 305,048 | 31,647 | 5,864 | 1.7 |
| Commercial Banking | 101,824 | 92,002 | 6,592 | 3,230 | 3.2 |
| Insurance and Wealth | 865 | 804 | 6 | 55 | 6.4 |
| Central items | 43,637 | 43,565 | 6 | 66 | 0.2 |
| Total gross lending | 488,885 | 441,419 | 38,251 | 9,215 | 1.9 |
| Expected credit loss allowance on drawn balances | (4,236) | (556) | (1,506) | (2,174) | |
| Net balance sheet carrying value | 484,649 | 440,863 | 36,745 | 7,041 | |
| Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)[2] | 0.9 | 0.2 | 4.1 | 24.3 | |

1 These balances exclude the impact of the HBOS and MBNA acquisition related adjustments.

2 Stage 3 ECL allowances as a percentage of drawn balances are calculated excluding loans in recoveries in Retail of £205 million (31 December 2018: £250 million).

3 Prior period segmental comparatives restated. See note 4 on page 217.

Risk management continued

## Table 1.7: Group's total expected credit loss allowance (statutory basis)

| | At 31 Dec 2019 £m | At 31 Dec 2018 £m |
|---|---|---|
| Customer related balances | | |
| Drawn | 3,259 | 3,150 |
| Undrawn | 177 | 193 |
| | 3,436 | 3,343 |
| Other assets | 19 | 19 |
| **Total expected credit loss allowance** | 3,455 | 3,362 |

## Table 1.8: Group's total expected credit loss allowance (underlying basis)

| | At 31 Dec 2019 £m | At 31 Dec 2018 £m |
|---|---|---|
| Customer related balances | | |
| Drawn | 3,965 | 4,236 |
| Undrawn | 177 | 193 |
| | 4,142 | 4,429 |
| Other assets | 19 | 19 |
| **Total expected credit loss allowance** | 4,161 | 4,448 |

## Table 1.9: Reconciliation between statutory and underlying basis of Group gross loans and advances to customers

| | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m |
|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | |
| Underlying basis | 498,805 | 451,611 | 38,440 | 8,754 | – |
| Purchased or originated credit-impaired assets | – | (1,718) | (9,903) | (2,740) | 14,361 |
| Acquisition fair value adjustment | (558) | 82 | 6 | 1 | (647) |
| | (558) | (1,636) | (9,897) | (2,739) | 13,714 |
| **Statutory basis** | 498,247 | 449,975 | 28,543 | 6,015 | 13,714 |
| At 31 December 2018 | | | | | |
| Underlying basis | 488,885 | 441,419 | 38,251 | 9,215 | – |
| Purchased or originated credit-impaired assets | – | – | (12,917) | (3,476) | 16,393 |
| Acquisition fair value adjustment | (877) | 112 | 11 | 2 | (1,002) |
| | (877) | 112 | (12,906) | (3,474) | 15,391 |
| Statutory basis | 488,008 | 441,531 | 25,345 | 5,741 | 15,391 |

## Table 1.10: Reconciliation between statutory and underlying basis of Group expected credit loss allowances on drawn balances

| | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m |
|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | |
| Underlying basis | **3,965** | **702** | **1,346** | **1,917** | **–** |
| Purchased or originated credit-impaired assets | **–** | **–** | **(334)** | **(455)** | **789** |
| Acquisition fair value adjustment | **(706)** | **(27)** | **(17)** | **(15)** | **(647)** |
| | **(706)** | **(27)** | **(351)** | **(470)** | **142** |
| **Statutory basis** | **3,259** | **675** | **995** | **1,447** | **142** |
| At 31 December 2018 | | | | | |
| Underlying basis | 4,236 | 556 | 1,506 | 2,174 | – |
| Purchased or originated credit-impaired assets | – | – | (481) | (599) | 1,080 |
| Acquisition fair value adjustment | (1,086) | (31) | (31) | (22) | (1,002) |
| | (1,086) | (31) | (512) | (621) | 78 |
| Statutory basis | 3,150 | 525 | 994 | 1,553 | 78 |

## Table 1.11: Group expected credit loss allowances (drawn and undrawn) as a percentage of loans and advances to customers (statutory basis)

| | Total | | Stage 1 | | Stage 2 | | Stage 3 | | Purchased or originated credit-impaired | |
|---|---|---|---|---|---|---|---|---|---|---|
| | £m | As % of drawn balances % | £m | As % of drawn balances % | £m | As % of drawn balances % | £m | As % of drawn balances[1] % | £m | As % of drawn balances % |
| **At 31 December 2019** | | | | | | | | | | |
| Retail | **2,090** | **0.6** | **639** | **0.2** | **819** | **3.6** | **490** | **21.5** | **142** | **1.0** |
| Commercial Banking | **1,313** | **1.4** | **115** | **0.1** | **252** | **4.2** | **946** | **27.4** | **–** | **–** |
| Insurance and Wealth | **17** | **2.0** | **6** | **0.8** | **1** | **3.1** | **10** | **13.0** | **–** | **–** |
| Central items | **16** | **–** | **10** | **–** | **–** | **–** | **6** | **85.7** | **–** | **–** |
| **Total** | **3,436** | **0.7** | **770** | **0.2** | **1,072** | **3.8** | **1,452** | **25.0** | **142** | **1.0** |
| At 31 December 2018[2] | | | | | | | | | | |
| Retail | 1,768 | 0.5 | 493 | 0.2 | 713 | 3.8 | 484 | 22.6 | 78 | 0.5 |
| Commercial Banking | 1,486 | 1.5 | 111 | 0.1 | 338 | 5.1 | 1,037 | 32.1 | – | – |
| Insurance and Wealth | 18 | 2.1 | 6 | 0.7 | 1 | 16.7 | 11 | 20.0 | – | – |
| Central items | 71 | 0.2 | 38 | 0.1 | 6 | 100.0 | 27 | 40.9 | – | – |
| Total | 3,343 | 0.7 | 648 | 0.1 | 1,058 | 4.2 | 1,559 | 28.4 | 78 | 0.5 |

1 Stage 3 ECL allowances as a percentage of drawn balances are calculated excluding loans in recoveries in Retail of £205 million (31 December 2018: £250 million).

2 Prior period segmental comparatives restated. See note 4 on page 217.

Risk management continued

## Table 1.12: Group expected credit loss allowances (drawn and undrawn) as a percentage of loans and advances to customers (underlying basis)

| | Total | | Stage 1 | | Stage 2 | | Stage 3 | |
|---|---|---|---|---|---|---|---|---|
| | £m | As % of drawn balances % | £m | As % of drawn balances % | £m | As % of drawn balances % | £m | As % of drawn balances[2] % |
| **At 31 December 2019[1]** | | | | | | | | |
| Retail | **2,796** | **0.8** | **666** | **0.2** | **1,170** | **3.6** | **960** | **19.1** |
| Commercial Banking | **1,313** | **1.4** | **115** | **0.1** | **252** | **4.2** | **946** | **27.4** |
| Insurance and Wealth | **17** | **2.0** | **6** | **0.8** | **1** | **3.1** | **10** | **13.0** |
| Central items | **16** | **–** | **10** | **–** | **–** | **–** | **6** | **85.7** |
| **Total** | **4,142** | **0.8** | **797** | **0.2** | **1,423** | **3.7** | **1,922** | **22.5** |
| At 31 December 2018[3] | | | | | | | | |
| Retail | 2,854 | 0.8 | 524 | 0.2 | 1,225 | 3.9 | 1,105 | 19.7 |
| Commercial Banking | 1,486 | 1.5 | 111 | 0.1 | 338 | 5.1 | 1,037 | 32.1 |
| Insurance and Wealth | 18 | 2.1 | 6 | 0.7 | 1 | 16.7 | 11 | 20.0 |
| Central items | 71 | 0.2 | 38 | 0.1 | 6 | 100.0 | 27 | 40.9 |
| Total | 4,429 | 0.9 | 679 | 0.2 | 1,570 | 4.1 | 2,180 | 24.3 |

1 Balances exclude the impact of the HBOS and MBNA related acquisition adjustments.

2 Stage 3 ECL allowances as a percentage of drawn balances are calculated excluding loans in recoveries in Retail of £205 million (31 December 2018: £250 million).

3 Prior period segmental comparatives restated. See note4 on page 217.

## Table 1.13: Group Stage 2 loans and advances to customers (statutory basis)

| | Total | | | Up to date | | | | | | 1-30 days past due | | | Over 30 days past due | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | PD movements | | | Other[1] | | | | | | | | |
| | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % |
| **At 31 December 2019** | | | | | | | | | | | | | | | |
| Retail | **22,518** | **819** | **3.6** | **13,359** | **341** | **2.6** | **4,959** | **238** | **4.8** | **2,373** | **130** | **5.5** | **1,827** | **110** | **6.0** |
| Commercial Banking | **5,993** | **252** | **4.2** | **3,911** | **179** | **4.6** | **1,700** | **64** | **3.8** | **117** | **8** | **6.8** | **265** | **1** | **0.4** |
| Insurance and Wealth | **32** | **1** | **3.1** | **–** | **–** | **–** | **28** | **1** | **3.6** | **1** | **–** | **–** | **3** | **–** | **–** |
| Central items | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| **Total** | **28,543** | **1,072** | **3.8** | **17,270** | **520** | **3.0** | **6,687** | **303** | **4.5** | **2,491** | **138** | **5.5** | **2,095** | **111** | **5.3** |
| At 31 December 2018 | | | | | | | | | | | | | | | |
| Retail | 18,741 | 713 | 3.8 | 10,017 | 248 | 2.5 | 4,488 | 250 | 5.6 | 2,441 | 113 | 4.6 | 1,795 | 102 | 5.7 |
| Commercial Banking | 6,592 | 338 | 5.1 | 4,169 | 177 | 4.2 | 1,851 | 110 | 5.9 | 455 | 42 | 9.2 | 117 | 9 | 7.7 |
| Insurance and Wealth | 6 | 1 | 16.7 | 3 | – | – | 1 | – | – | – | – | – | 2 | 1 | 50.0 |
| Central items | 6 | 6 | 100.0 | – | – | – | 6 | 6 | 100.0 | – | – | – | – | – | – |
| Total | 25,345 | 1,058 | 4.2 | 14,189 | 425 | 3.0 | 6,346 | 366 | 5.8 | 2,896 | 155 | 5.4 | 1,914 | 112 | 5.9 |

1 Includes forbearance, client and product-specific indicators not reflected within quantitative PD assessments.

Table 1.14: **Group Stage 2 loans and advances to customers (underlying basis)**

| | Total | | | Up to date | | | | | | 1-30 days past due | | | Over 30 days past due | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | PD movements | | | Other[1] | | | | | | | | |
| | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % |
| **At 31 December 2019** | | | | | | | | | | | | | | | |
| Retail | **32,415** | **1,170** | **3.6** | **18,607** | **461** | **2.5** | **6,096** | **304** | **5.0** | **4,014** | **184** | **4.6** | **3,698** | **221** | **6.0** |
| Commercial Banking | **5,993** | **252** | **4.2** | **3,911** | **179** | **4.6** | **1,700** | **64** | **3.8** | **117** | **8** | **6.8** | **265** | **1** | **0.4** |
| Insurance and Wealth | **32** | **1** | **3.1** | **–** | **–** | **–** | **28** | **1** | **3.6** | **1** | **–** | **–** | **3** | **–** | **–** |
| Central items | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| **Total** | **38,440** | **1,423** | **3.7** | **22,518** | **640** | **2.8** | **7,824** | **369** | **4.7** | **4,132** | **192** | **4.6** | **3,966** | **222** | **5.6** |
| At 31 December 2018 | | | | | | | | | | | | | | | |
| Retail | 31,647 | 1,225 | 3.9 | 16,928 | 397 | 2.3 | 6,097 | 372 | 6.1 | 4,472 | 182 | 4.1 | 4,150 | 274 | 6.6 |
| Commercial Banking | 6,592 | 338 | 5.1 | 4,169 | 177 | 4.2 | 1,851 | 110 | 5.9 | 455 | 42 | 9.2 | 117 | 9 | 7.7 |
| Insurance and Wealth | 6 | 1 | 16.7 | 3 | – | – | 1 | – | – | – | – | – | 2 | 1 | 50.0 |
| Central items | 6 | 6 | 100.0 | – | – | – | 6 | 6 | 100.0 | – | – | – | – | – | – |
| Total | 38,251 | 1,570 | 4.1 | 21,100 | 574 | 2.7 | 7,955 | 488 | 6.1 | 4,927 | 224 | 4.5 | 4,269 | 284 | 6.7 |

1 Includes forbearance, client and product-specific indicators not reflected within quantitative PD assessments.

The Group's assessment of a significant increase in credit risk, and resulting categorisation of Stage 2, includes customers moving into early arrears as well as a broader assessment that an up to date customer has experienced a level of deterioration in credit risk since origination. A more sophisticated assessment is required for up to date customers, which varies across divisions and product type. This assessment incorporates specific triggers such as a significant proportionate increase in probability of default relative to that at origination, recent arrears, forbearance activity, internal watch lists and external bureau flags. Up to date exposures in Stage 2 are likely to show lower levels of expected credit loss (ECL) allowance relative to those that have already moved into arrears given that an arrears status typically reflects a stronger indication of future default and greater likelihood of credit losses.

## Additional information

The measurement of ECL reflects an unbiased probability-weighted range of possible future economic outcomes. The Group achieves this by selecting four economic scenarios to reflect the range of outcomes; the central scenario reflects the Group's base case assumptions used for medium term planning purposes, an upside and a downside scenario are also selected together with a severe downside scenario. The base case, upside and downside scenarios carry a 30 per cent weighting; the severe downside is weighted at 10 per cent. The table below shows the decomposition of the final probability-weighted ECL for each forward-looking economic scenario. The stage allocation for an asset is based on the overall scenario probability-weighted PD and, hence, the Stage 2 allocation is constant across all the scenarios.

The table below shows the ECL calculated under each scenario on both an underlying and a statutory basis.

| | Probability-weighted £m | Upside £m | Base Case £m | Downside £m | Severe Downside £m |
|---|---|---|---|---|---|
| **Statutory basis** | | | | | |
| Secured | **569** | **317** | **464** | **653** | **1,389** |
| Other Retail | **1,521** | **1,443** | **1,492** | **1,564** | **1,712** |
| Commercial | **1,315** | **1,211** | **1,258** | **1,382** | **1,597** |
| Other | **50** | **50** | **50** | **50** | **50** |
| **At 31 December 2019** | **3,455** | **3,021** | **3,264** | **3,649** | **4,748** |

| | Probability-weighted £m | Upside £m | Base Case £m | Downside £m | Severe Downside £m |
|---|---|---|---|---|---|
| **Underlying basis** | | | | | |
| Secured | **1,216** | **964** | **1,111** | **1,300** | **2,036** |
| Other Retail | **1,580** | **1,502** | **1,551** | **1,623** | **1,771** |
| Commercial | **1,315** | **1,211** | **1,258** | **1,382** | **1,597** |
| Other | **50** | **50** | **50** | **50** | **50** |
| **At 31 December 2019** | **4,161** | **3,727** | **3,970** | **4,355** | **5,454** |

**Risk management** continued

The table below shows the Group's underlying ECL allowances for the upside and downside scenarios using a 100 per cent weighting, which means that both stage allocation and the ECL are based on the single scenario only. All non-modelled provisions, including management judgement remain unchanged.

| | Upside £m | Downside £m |
|---|---|---|
| ECL allowances | **3,707** | **4,383** |

## Retail

- The credit quality of the Retail portfolios remains strong and continues to benefit from robust credit risk management, including affordability and indebtedness controls at origination and a prudent approach to risk appetite. The economic environment continues to benefit from high employment rates, positive real wage growth and household indebtedness remaining below pre-crisis levels
  - New business quality remains strong
  - The flow of loans entering arrears remains at low levels
  - Stage 3 loans and advances as a per cent of total decreased slightly to 1.5 per cent (31 December 2018: 1.7 per cent)
- Loans and advances increased to £345 billion (31 December 2018: £343 billion)
- The impairment charge increased to £1,038 million in 2019 compared to £861 million in the same period in 2018, driven by a number of items including some weakening in used car prices, provisioning methodology refinements and lower cash recoveries following prior year debt sales, partially offset by releases following a reassessment of cases in long-term default and repossession and improvements in the Secured portfolio
- ECL allowance as a percentage of drawn balances for Stage 3 decreased to 19.1 per cent (31 December 2018: 19.7 per cent) following a reassessment of Secured cases in long-term default. Coverage for Stage 2 is also broadly stable at 3.6 per cent (31 December 2018: 3.9 per cent)

### Portfolios

- Secured credit quality remains strong, with flow to arrears stable at low levels. Total secured loans and advances are broadly flat at £289.8 billion (31 December 2018: £289.2 billion), with an improved asset risk mix

  The average indexed loan to value (LTV) remained broadly stable at 44.9 per cent (31 December 2018: 44.3 per cent) and the proportion of balances with an LTV of greater than 90 per cent remained broadly flat at 2.5 per cent (31 December 2018: 2.4 per cent). The average LTV of new business increased to 64.3 per cent (31 December 2018: 62.5 per cent). The Group entered into a risk transfer transaction of £1 billion worth of higher LTV new business in 2019, which was awarded Transaction of the Year at the 2019 SCI Capital Relief Trades Awards

  The impairment release of £167 million in 2019 compared to a charge of £38 million in 2018. This reflects provision releases due to improved credit quality of the portfolio and a reassessment of Secured cases in long-term default. Total expected credit loss allowance as a percentage of loans and advances (coverage) reduced slightly to 0.4 per cent (31 December 2018: 0.5 per cent)
- Unsecured loans and advances remained broadly flat at £28.3 billion. The impairment charge increased by £265 million to £948 million for 2019 (2018: £683 million), due to provisioning methodology refinements, including the alignment of credit card methodologies, and lower cash recoveries following prior year debt sales. The total coverage was 3.8 per cent (31 December 2018: 3.5 per cent)
- The motor finance portfolio continued to grow in 2019, with loans and advances increasing by 7.0 per cent to £16.0 billion (31 December 2018: £14.9 billion). The portfolio continues to benefit from a prudent approach to residual values at origination and provisions through the loan lifecycle. Residual value provisions, which are included in ECL allowances for Stage 1 and Stage 2, have increased to £201 million at 31 December 2019 (31 December 2018: £99 million). This is due to an anticipated increase in residual value deficits following some weakening in used car prices, a change in approach relating to the recognition of voluntary terminations and book growth. As a result of this, the impairment charge increased to £203 million for 2019 (2018: £113 million) and coverage for the portfolio increased to 2.4 per cent (31 December 2018: 1.9 per cent)
- Other loans and advances increased by £0.2 billon to £10.6 billion. The impairment charge was £54 million for 2019 (2018: £27 million). This increase is partly due to the non-repeat of prior year IFRS 9 methodology refinements in Business Banking. Total coverage remained flat at 1.2 per cent (31 December 2018: 1.2 per cent)

Table 1.15: **Retail impairment charge (underlying basis)**

| | 2019 £m | 2018 £m | Change % |
|---|---|---|---|
| Secured | **(167)** | 38 | |
| Unsecured[1] | **948** | 683 | (39) |
| UK Motor Finance | **203** | 113 | (80) |
| Other[2,3] | **54** | 27 | (100) |
| **Total impairment charge** | **1,038** | 861 | (21) |
| Asset quality ratio | **0.30%** | 0.25% | 5bp |

1 Unsecured includes Credit cards, Loans and Overdrafts.

2 Other includes Business Banking, Europe and Retail run-off.

3 Prior period segmental comparatives restated. See note 4 on page 217.

Table 1.16: **Retail loans and advances to customers (statutory basis)**

| | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Stage 3 as % of total % |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| Secured | **289,198** | **257,043** | **16,935** | **1,506** | **13,714** | **0.5** |
| Unsecured[1] | **28,411** | **24,921** | **2,812** | **678** | **–** | **2.4** |
| UK Motor Finance | **15,976** | **13,884** | **1,942** | **150** | **–** | **0.9** |
| Other[2] | **10,633** | **9,654** | **829** | **150** | **–** | **1.4** |
| **Total gross lending** | **344,218** | **305,502** | **22,518** | **2,484** | **13,714** | **0.7** |
| Expected credit loss allowance on drawn balances | **(1,961)** | **(563)** | **(766)** | **(490)** | **(142)** | |
| **Net balance sheet carrying value** | **342,257** | **304,939** | **21,752** | **1,994** | **13,572** | |
| **Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)[3]** | **0.6** | **0.2** | **3.6** | **21.5** | **1.0** | |
| At 31 December 2018 | | | | | | |
| Secured | 288,235 | 257,797 | 13,654 | 1,393 | 15,391 | 0.5 |
| Unsecured[1] | 28,115 | 24,705 | 2,707 | 703 | – | 2.5 |
| UK Motor Finance | 14,933 | 13,224 | 1,580 | 129 | – | 0.9 |
| Other[2] | 10,399 | 9,434 | 800 | 165 | – | 1.6 |
| Total gross lending | 341,682 | 305,160 | 18,741 | 2,390 | 15,391 | 0.7 |
| Expected credit loss allowance on drawn balances | (1,613) | (389) | (662) | (484) | (78) | |
| Net balance sheet carrying value | 340,069 | 304,771 | 18,079 | 1,906 | 15,313 | |
| Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)[3] | 0.5 | 0.2 | 3.8 | 22.6 | 0.5 | |

1 Unsecured includes Credit cards, Loans and Overdrafts.

2 Other includes Business Banking, Europe and Retail run-off.

3 Stage 3 ECL allowances as a percentage of drawn balances are calculated excluding loans in recoveries for unsecured of £184 million (31 December 2018: £233 million) and £21 million (31 December 2018: £17 million) for Business Banking in Other.

Risk management continued

## Table 1.17: Retail loans and advances to customers (underlying basis)

| | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Stage 3 as % of total % |
|---|---|---|---|---|---|
| **At 31 December 2019**[1] | | | | | |
| Secured | **289,845** | **258,760** | **26,838** | **4,247** | **1.5** |
| Unsecured[2] | **28,322** | **24,840** | **2,806** | **676** | **2.4** |
| UK Motor Finance | **15,976** | **13,884** | **1,942** | **150** | **0.9** |
| Other[3] | **10,633** | **9,654** | **829** | **150** | **1.4** |
| **Total gross lending** | **344,776** | **307,138** | **32,415** | **5,223** | **1.5** |
| Expected credit loss allowance on drawn balances | **(2,667)** | **(590)** | **(1,117)** | **(960)** | |
| **Net balance sheet carrying value** | **342,109** | **306,548** | **31,298** | **4,263** | |
| **Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)**[4] | **0.8** | **0.2** | **3.6** | **19.1** | |
| | | | | | |
| At 31 December 2018[1] | | | | | |
| Secured | 289,237 | 257,797 | 26,571 | 4,869 | 1.7 |
| Unsecured[2] | 27,990 | 24,593 | 2,696 | 701 | 2.5 |
| UK Motor Finance | 14,933 | 13,224 | 1,580 | 129 | 0.9 |
| Other[3] | 10,399 | 9,434 | 800 | 165 | 1.6 |
| Total gross lending | 342,559 | 305,048 | 31,647 | 5,864 | 1.7 |
| Expected credit loss allowance on drawn balances | (2,698) | (420) | (1,173) | (1,105) | |
| Net balance sheet carrying value | 339,861 | 304,628 | 30,474 | 4,759 | |
| Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)[4] | 0.8 | 0.2 | 3.9 | 19.7 | |

1 Balances exclude the impact of the HBOS and MBNA acquisition related adjustments.

2 Unsecured includes Credit cards, Loans and Overdrafts.

3 Other includes Business Banking, Europe and Retail run-off.

4 Stage 3 ECL allowances as a percentage of drawn balances are calculated excluding loans in recoveries for unsecured of £184 million (31 December 2018: £233 million) and £21 million (31 December 2018: £17 million) for Business Banking in Other.

## Table 1.18: Reconciliation between statutory and underlying basis of Retail gross loans and advances to customers

| | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m |
|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | |
| Underlying basis | **344,776** | **307,138** | **32,415** | **5,223** | **–** |
| Purchased or originated credit-impaired assets | **–** | **(1,718)** | **(9,903)** | **(2,740)** | **14,361** |
| Acquisition fair value adjustment | **(558)** | **82** | **6** | **1** | **(647)** |
| | **(558)** | **(1,636)** | **(9,897)** | **(2,739)** | **13,714** |
| **Statutory basis** | **344,218** | **305,502** | **22,518** | **2,484** | **13,714** |
| | | | | | |
| At 31 December 2018 | | | | | |
| Underlying basis | 342,559 | 305,048 | 31,647 | 5,864 | – |
| Purchased or originated credit-impaired assets | – | – | (12,917) | (3,476) | 16,393 |
| Acquisition fair value adjustment | (877) | 112 | 11 | 2 | (1,002) |
| | (877) | 112 | (12,906) | (3,474) | 15,391 |
| Statutory basis | 341,682 | 305,160 | 18,741 | 2,390 | 15,391 |

## Table 1.19: Reconciliation between statutory and underlying basis of Retail expected credit loss allowances on drawn balances

| At 31 December 2019 | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m |
|---|---|---|---|---|---|
| **Expected credit losses on drawn balances** | | | | | |
| Underlying basis | **2,667** | **590** | **1,117** | **960** | **–** |
| Purchased or originated credit-impaired assets | **–** | **–** | **(334)** | **(455)** | **789** |
| Pre-acquisition ECL allowances | **(706)** | **(27)** | **(17)** | **(15)** | **(647)** |
| | **(706)** | **(27)** | **(351)** | **(470)** | **142** |
| **Statutory basis** | **1,961** | **563** | **766** | **490** | **142** |
| At 31 December 2018 | | | | | |
| **Expected credit losses on drawn balances** | | | | | |
| Underlying basis | 2,698 | 420 | 1,173 | 1,105 | – |
| Purchased or originated credit-impaired assets | – | – | (481) | (599) | 1,080 |
| Pre-acquisition ECL allowances | (1,085) | (31) | (30) | (22) | (1,002) |
| | (1,085) | (31) | (511) | (621) | 78 |
| Statutory basis | 1,613 | 389 | 662 | 484 | 78 |

## Table 1.20: Retail expected credit loss allowances (drawn and undrawn) as a percentage of loans and advances to customers (statutory basis)

| | Total | | Stage 1 | | Stage 2 | | Stage 3 | | Purchased or originated credit-impaired | |
|---|---|---|---|---|---|---|---|---|---|---|
| | £m | As % of drawn balances % | £m | As % of drawn balances % | £m | As % of drawn balances % | £m | As % of drawn balances[1] % | £m | As % of drawn balances % |
| **At 31 December 2019** | | | | | | | | | | |
| Secured | **569** | **0.2** | **24** | **–** | **281** | **1.7** | **122** | **8.1** | **142** | **1.0** |
| Unsecured[2] | **1,007** | **3.6** | **363** | **1.5** | **411** | **14.6** | **233** | **47.2** | **–** | **–** |
| UK Motor Finance[3] | **387** | **2.4** | **216** | **1.6** | **87** | **4.5** | **84** | **56.0** | **–** | **–** |
| Other[4] | **127** | **1.2** | **36** | **0.4** | **40** | **4.8** | **51** | **39.5** | **–** | **–** |
| **Total** | **2,090** | **0.6** | **639** | **0.2** | **819** | **3.6** | **490** | **21.5** | **142** | **1.0** |
| At 31 December 2018 | | | | | | | | | | |
| Secured | 460 | 0.2 | 38 | – | 226 | 1.7 | 118 | 8.5 | 78 | 0.5 |
| Unsecured[2] | 896 | 3.2 | 287 | 1.2 | 379 | 14.0 | 230 | 48.9 | – | – |
| UK Motor Finance[3] | 290 | 1.9 | 127 | 1.0 | 78 | 4.9 | 85 | 65.9 | – | – |
| Other[4] | 122 | 1.2 | 41 | 0.4 | 30 | 3.8 | 51 | 34.5 | – | – |
| Total | 1,768 | 0.5 | 493 | 0.2 | 713 | 3.8 | 484 | 22.6 | 78 | 0.5 |

1 Stage 3 ECL allowances as a percentage of drawn balances are calculated excluding loans in recoveries for unsecured of £184 million (31 December 2018: £233 million) and £21 million (31 December 2018: £17 million) for Business Banking within other.

2 Unsecured includes Credit cards, Loans and Overdrafts.

3 UK Motor Finance for Stages 1 and 2 include £201 million (31 December 2018: £99 million) relating to provisions against residual values of vehicles subject to finance leasing agreements. These provisions are included within the calculation of coverage ratios.

4 Other includes Business Banking, Europe and Retail run-off.

Risk management continued

## Table 1.21: Retail expected credit loss allowances (drawn and undrawn) as a percentage of loans and advances to customers (underlying basis)

| | Total | | Stage 1 | | Stage 2 | | Stage 3 | |
|---|---|---|---|---|---|---|---|---|
| | £m | As % of drawn balances % | £m | As % of drawn balances % | £m | As % of drawn balances % | £m | As % of drawn balances[1] % |
| **At 31 December 2019[2]** | | | | | | | | |
| Secured | **1,216** | **0.4** | **26** | **–** | **614** | **2.3** | **576** | **13.6** |
| Unsecured[3] | **1,066** | **3.8** | **388** | **1.6** | **429** | **15.3** | **249** | **50.6** |
| UK Motor Finance[4] | **387** | **2.4** | **216** | **1.6** | **87** | **4.5** | **84** | **56.0** |
| Other[5] | **127** | **1.2** | **36** | **0.4** | **40** | **4.8** | **51** | **39.5** |
| **Total** | **2,796** | **0.8** | **666** | **0.2** | **1,170** | **3.6** | **960** | **19.1** |
| At 31 December 2018[2] | | | | | | | | |
| Secured | 1,462 | 0.5 | 38 | – | 707 | 2.7 | 717 | 14.7 |
| Unsecured[3] | 980 | 3.5 | 318 | 1.3 | 410 | 15.2 | 252 | 53.8 |
| UK Motor Finance[4] | 290 | 1.9 | 127 | 1.0 | 78 | 4.9 | 85 | 65.9 |
| Other[5] | 122 | 1.2 | 41 | 0.4 | 30 | 3.8 | 51 | 34.5 |
| Total | 2,854 | 0.8 | 524 | 0.2 | 1,225 | 3.9 | 1,105 | 19.7 |

1 Stage 3 ECL allowances as a percentage of drawn balances are calculated excluding loans in recoveries for unsecured of £184 million (31 December 2018: £233 million) and £21 million (31 December 2018: £17 million) for Business Banking within other.

2 These balances exclude the impact of the HBOS and MBNA acquisition related adjustments.

3 Unsecured includes Credit cards, Loans and Overdrafts.

4 UK Motor Finance for Stages 1 and 2 include £201 million (31 December 2018: £99 million) relating to provisions against residual values of vehicles subject to finance leasing agreements. These provisions are included within the calculation of coverage ratios.

5 Other includes Business Banking, Europe and Retail run-off.

## Table 1.22: Retail Stage 2 loans and advances to customers (statutory basis)

| | Total | | | Up to date | | | | | | 1-30 days past due | | | Over 30 days past due | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | PD movement | | | Other[1] | | | | | | | | |
| | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % |
| **At 31 December 2019** | | | | | | | | | | | | | | | |
| Secured | **16,935** | **281** | **1.7** | **10,846** | **83** | **0.8** | **2,593** | **107** | **4.1** | **1,876** | **33** | **1.8** | **1,620** | **58** | **3.6** |
| Unsecured[2] | **2,812** | **411** | **14.6** | **1,661** | **217** | **13.1** | **772** | **90** | **11.7** | **282** | **67** | **23.8** | **97** | **37** | **38.1** |
| UK Motor Finance | **1,942** | **87** | **4.5** | **543** | **27** | **5.0** | **1,232** | **30** | **2.4** | **135** | **21** | **15.6** | **32** | **9** | **28.1** |
| Other[3] | **829** | **40** | **4.8** | **309** | **14** | **4.5** | **362** | **11** | **3.0** | **80** | **9** | **11.3** | **78** | **6** | **7.7** |
| **Total** | **22,518** | **819** | **3.6** | **13,359** | **341** | **2.6** | **4,959** | **238** | **4.8** | **2,373** | **130** | **5.5** | **1,827** | **110** | **6.0** |
| At 31 December 2018 | | | | | | | | | | | | | | | |
| Secured | 13,654 | 226 | 1.7 | 8,318 | 62 | 0.7 | 1,800 | 77 | 4.3 | 1,955 | 30 | 1.5 | 1,581 | 57 | 3.6 |
| Unsecured[2] | 2,707 | 379 | 14.0 | 998 | 149 | 14.9 | 1,357 | 144 | 10.6 | 258 | 53 | 20.5 | 94 | 33 | 35.1 |
| UK Motor Finance | 1,580 | 78 | 4.9 | 488 | 26 | 5.3 | 915 | 21 | 2.3 | 146 | 23 | 15.8 | 31 | 8 | 25.8 |
| Other[3] | 800 | 30 | 3.8 | 213 | 11 | 5.2 | 416 | 8 | 1.9 | 82 | 7 | 8.5 | 89 | 4 | 4.5 |
| Total | 18,741 | 713 | 3.8 | 10,017 | 248 | 2.5 | 4,488 | 250 | 5.6 | 2,441 | 113 | 4.6 | 1,795 | 102 | 5.7 |

1 Includes forbearance and product-specific indicators not reflected within quantitative PD assessments.

2 Unsecured includes Credit cards, Loans and Overdrafts.

3 Other includes Business Banking, Europe and Retail run-off.

Table 1.23: **Retail Stage 2 loans and advances to customers (underlying basis)**

| | Total | | | Up to date | | | | | | 1-30 days past due | | | Over 30 days past due | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | PD movement | | | Other[1] | | | | | | | | |
| | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % |
| **At 31 December 2019**[2] | | | | | | | | | | | | | | | |
| Secured | **26,838** | **614** | **2.3** | **16,100** | **192** | **1.2** | **3,730** | **171** | **4.6** | **3,517** | **84** | **2.4** | **3,491** | **167** | **4.8** |
| Unsecured[3] | **2,806** | **429** | **15.3** | **1,656** | **228** | **13.8** | **771** | **92** | **11.9** | **282** | **70** | **24.8** | **97** | **39** | **40.2** |
| UK Motor Finance | **1,942** | **87** | **4.5** | **543** | **27** | **5.0** | **1,232** | **30** | **2.4** | **135** | **21** | **15.6** | **32** | **9** | **28.1** |
| Other[4] | **829** | **40** | **4.8** | **308** | **14** | **4.5** | **363** | **11** | **3.0** | **80** | **9** | **11.3** | **78** | **6** | **7.7** |
| **Total** | **32,415** | **1,170** | **3.6** | **18,607** | **461** | **2.5** | **6,096** | **304** | **5.0** | **4,014** | **184** | **4.6** | **3,698** | **221** | **6.0** |
| At 31 December 2018[2] | | | | | | | | | | | | | | | |
| Secured | 26,571 | 707 | 2.7 | 15,228 | 211 | 1.4 | 3,419 | 172 | 5.0 | 3,987 | 97 | 2.4 | 3,937 | 227 | 5.8 |
| Unsecured[3] | 2,696 | 410 | 15.2 | 998 | 149 | 14.9 | 1,348 | 171 | 12.7 | 257 | 55 | 21.4 | 93 | 35 | 37.6 |
| UK Motor Finance | 1,580 | 78 | 4.9 | 489 | 26 | 5.3 | 914 | 21 | 2.3 | 146 | 23 | 15.8 | 31 | 8 | 25.8 |
| Other[4] | 800 | 30 | 3.8 | 213 | 11 | 5.2 | 416 | 8 | 1.9 | 82 | 7 | 8.5 | 89 | 4 | 4.5 |
| Total | 31,647 | 1,225 | 3.9 | 16,928 | 397 | 2.3 | 6,097 | 372 | 6.1 | 4,472 | 182 | 4.1 | 4,150 | 274 | 6.6 |

1 Includes forbearance and product-specific indicators not reflected within quantitative PD assessments.

2 Balances exclude the impact of the HBOS and MBNA acquisition related adjustments.

3 Unsecured includes Credit cards, Loans and Overdrafts.

4 Other includes Business Banking, Europe and Retail run-off.

Table 1.24: **Retail secured loans and advances to customers (statutory basis)**

| | **At 31 Dec 2019 £m** | At 31 Dec 2018 £m |
|---|---|---|
| Mainstream | **227,975** | 223,230 |
| Buy-to-let | **49,086** | 51,322 |
| Specialist | **12,137** | 13,683 |
| **Total** | **289,198** | 288,235 |

Table 1.25: **Mortgages greater than three months in arrears (excluding repossessions, underlying basis)**

| | Number of cases | | Total mortgage accounts % | | Value of loans[1] | | Total mortgage balances | |
|---|---|---|---|---|---|---|---|---|
| At 31 December | **2019 Cases** | 2018 Cases | **2019 %** | 2018 % | **2019 £m** | 2018 £m | **2019 %** | 2018 % |
| Mainstream | **24,393** | 30,106 | **1.3** | 1.5 | **2,619** | 3,262 | **1.1** | 1.5 |
| Buy-to-let | **3,863** | 4,544 | **0.9** | 1.0 | **502** | 576 | **1.0** | 1.1 |
| Specialist | **6,059** | 7,966 | **6.6** | 7.8 | **998** | 1,282 | **8.2** | 9.3 |
| Total | **34,315** | 42,616 | **1.4** | 1.7 | **4,119** | 5,120 | **1.4** | 1.8 |

1 Value of loans represents total gross book value of mortgages more than three months in arrears; the balances exclude the impact of the HBOS acquisition adjustments.

The stock of repossessions increased to approximately 1,150 cases at 31 December 2019 compared to approximately 750 cases at 31 December 2018.

The increase is due to the resumption of business as usual litigation activity which had been partially suspended whilst changes were made to the Group's handling of mortgages arrears.

Risk management continued

## Table 1.26: Period end and average LTVs across the Retail mortgage portfolios (underlying basis)

| | Mainstream % | Buy-to-let % | Specialist % | Total % |
|---|---|---|---|---|
| **At 31 December 2019[1]** | | | | |
| Less than 60% | **51.8** | **54.1** | **62.7** | **52.7** |
| 60% to 70% | **16.4** | **25.1** | **17.5** | **18.0** |
| 70% to 80% | **16.9** | **18.0** | **11.7** | **16.8** |
| 80% to 90% | **12.0** | **2.0** | **4.1** | **10.0** |
| 90% to 100% | **2.6** | **0.4** | **1.2** | **2.1** |
| Greater than 100% | **0.3** | **0.4** | **2.8** | **0.4** |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** |
| Average loan to value[2]: | | | | |
| Stock of residential mortgages | **43.6** | **52.3** | **44.0** | **44.9** |
| New residential lending | **65.2** | **58.2** | **n/a** | **64.3** |

| | Mainstream % | Buy-to-let % | Specialist % | Total % |
|---|---|---|---|---|
| At 31 December 2018[1] | | | | |
| Less than 60% | 54.1 | 53.5 | 60.9 | 54.3 |
| 60% to 70% | 16.7 | 24.9 | 16.4 | 18.1 |
| 70% to 80% | 15.9 | 16.6 | 12.0 | 15.9 |
| 80% to 90% | 10.8 | 3.7 | 6.1 | 9.3 |
| 90% to 100% | 2.2 | 0.8 | 1.7 | 1.9 |
| Greater than 100% | 0.3 | 0.5 | 2.9 | 0.5 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 |
| Average loan to value[2]: | | | | |
| Stock of residential mortgages | 42.6 | 52.6 | 45.3 | 44.3 |
| New residential lending | 63.1 | 58.6 | n/a | 62.5 |

1 2019 LTVs (loan to value) use Markit's 2019 Halifax House Price Index; 2018 LTVs have been restated on the same basis.

2 Average loan to value is calculated as total loans and advances as a percentage of the total indexed collateral of these loans and advances; the balances exclude the impact of the HBOS acquisition adjustments.

### Interest only mortgages

The Group provides interest only mortgages to owner occupier mortgage customers whereby only payments of interest are made for the term of the mortgage with the customer responsible for repaying the principal outstanding at the end of the loan term. At 31 December 2019, owner occupier interest only balances as a proportion of total owner occupier balances had reduced to 23.9 per cent (31 December 2018: 26.7 per cent). The average indexed loan to value remained at 41.2 per cent (31 December 2018: 41.2 per cent).

For existing interest only mortgages, a contact strategy is in place during the term of the mortgage to ensure that customers are aware of their obligations to repay the principal upon maturity of the loan.

Treatment strategies are in place to help customers anticipate and plan for repayment of capital at maturity and support those who may have difficulty in repaying the principal amount. A dedicated specialist team supports customers who have passed their contractual maturity date and are unable to fully repay the principal. A range of treatments are offered to customers based on their individual circumstances to create fair and sustainable outcomes.

Table 1.27: **Analysis of owner occupier interest only mortgages (statutory basis)**

| | At 31 Dec 2019 Total | At 31 Dec 2018 Total |
|---|---|---|
| Interest only balances (£m) | **57,437** | 63,138 |
| Stage 1% | **75.6** | 79.1 |
| Stage 2% | **10.0** | 6.6 |
| Stage 3% | **1.2** | 1.0 |
| Purchased or originated credit impaired % | **13.2** | 13.3 |
| | | |
| Average loan to value (%)[1] | **41.2** | 41.2 |
| | | |
| Maturity profile (£m) | | |
| Due | **1,459** | 1,144 |
| 1 year | **1,968** | 2,405 |
| 2-5 years | **9,852** | 10,229 |
| 6-10 years | **18,606** | 18,562 |
| >11 years | **25,552** | 30,798 |
| | | |
| Past term interest only balances (£m)[2] | **1,677** | 1,635 |
| Stage 1% | **0.9** | 2.8 |
| Stage 2% | **23.9** | 16.8 |
| Stage 3% | **21.8** | 17.9 |
| Purchased or originated credit impaired % | **53.4** | 62.5 |
| | | |
| Average loan to value (%)[1] | **35.7** | 34.9 |
| Negative equity (%) | **2.8** | 2.8 |

1 2019 interest only LTVs (loan to value) use Markit's 2019 Halifax House Price Index; 2018 LTVs have been restated on the same basis.

2 Balances where all interest only elements have moved past term. Some may subsequently have had a term extension, so are no longer classed as due.

## Retail forbearance

The basis of disclosure for forbearance is aligned to definitions used in the European Banking Authority's FINREP reporting. On an underlying basis, total forbearance for the major retail portfolios has improved by £665 million to £6.5 billion driven primarily by a reduction in customers where arrears are written on to the loan balance (capitalisations). On a statutory basis the equivalent total forbearance position improved by £546 million to £6.2 billion.

Following the MBNA integration into Lloyds Banking Group systems the December 2019 disclosure includes £129 million of MBNA forbearance, with December 2018 re-stated to include £128 million of MBNA forbearance (underlying basis).

The main customer treatments included are: repair, where arrears are written on to the loan balance and the arrears position cancelled; instances where there are suspensions of interest and/or capital repayments; past term interest only mortgages; and refinance personal loans.

As a percentage of loans and advances, forbearance loans improved to 1.9 per cent at 31 December 2019 (31 December 2018: 2.2 per cent).

As at 31 December 2019, 98.8 per cent of forbearance loans are captured in Stage 2 or Stage 3 for IFRS 9 and hold provision on a lifetime basis (31 December 2018: 98.0 per cent).

Total expected credit losses (ECL) as a proportion of loans and advances which are forborne has decreased to 9.3 per cent (31 December 2018: 9.9 per cent).

Risk management continued

## Table 1.28: Retail forborne loans and advances (statutory basis) (audited)

| | Total £m | Of which Stage 2 £m | Of which Stage 3 £m | Of which purchased or originated credit impaired £m | Expected credit losses as a % of total loans and advances which are forborne[1] % |
|---|---|---|---|---|---|
| **At 31 December 2019[2]** | | | | | |
| Secured | **5,559** | **1,156** | **736** | **3,659** | **2.1** |
| Unsecured[2] | **540** | **168** | **305** | **–** | **31.2** |
| UK Motor Finance | **63** | **35** | **26** | **–** | **30.4** |
| **Total** | **6,162** | **1,359** | **1,067** | **3,659** | **5.0** |
| At 31 December 2018[2] | | | | | |
| Secured | 6,089 | 1,136 | 642 | 4,241 | 1.6 |
| Unsecured[2] | 563 | 204 | 289 | – | 30.3 |
| UK Motor Finance | 56 | 30 | 25 | – | 34.8 |
| Total | 6,708 | 1,370 | 956 | 4,241 | 4.3 |

1 Expected credit loss allowance as a percentage of total loans and advances which are forborne is calculated excluding loans in recoveries for Unsecured (31 December 2019: £82 million; 31 December 2018: £107 million).

2 2019 balances include MBNA, 2018 balances have been restated on the same basis.

## Table 1.29: Retail forborne loans and advances (underlying basis)

| | Total £m | Of which Stage 2 £m | Of which Stage 3 £m | Expected credit losses as a % of total loans and advances which are forborne[1] % |
|---|---|---|---|---|
| **At 31 December 2019[2]** | | | | |
| Secured | **5,857** | **3,467** | **2,379** | **7.1** |
| Unsecured[3] | **540** | **168** | **305** | **31.2** |
| UK Motor Finance | **63** | **35** | **26** | **30.4** |
| **Total** | **6,460** | **3,670** | **2,710** | **9.3** |
| At 31 December 2018[2] | | | | |
| Secured | 6,506 | 3,838 | 2,598 | 8.0 |
| Unsecured[3] | 563 | 204 | 290 | 30.3 |
| UK Motor Finance | 56 | 30 | 25 | 34.8 |
| Total | 7,125 | 4,072 | 2,913 | 9.9 |

1 Expected credit losses as a percentage of total loans and advances which are forborne are calculated excluding loans in recoveries for Unsecured (31 December 2019: £82 million; 31 December 2018: £107 million).

2 Balances exclude the impact of HBOS and MBNA acquisition related adjustments.

3 2019 balances include MBNA, 2018 balances have been restated on the same basis.

## Commercial Banking

- Despite the challenging environment, the overall credit quality of the portfolio and new business remains good. The portfolio continues to benefit from effective risk management and low interest rates. Notwithstanding the current competitive market conditions, the Group is maintaining its prudent, well-defined and controlled through the cycle credit risk appetite
- The possibility of a no-deal exit from the European Union remains given the timelines for striking a trade deal. Developments continue to be monitored proactively and various initiatives are in place to mitigate 'No Deal' risk to ensure portfolio quality is maintained whilst supporting the Group's purpose of Helping Britain Prosper
- There are headwinds in a number of sectors including agriculture, construction, manufacturing and consumer related sectors such as retail. Performance and monitoring of vulnerable sectors remains a key focus at this stage of the credit cycle
- Dynamic internal and external key performance indicators are monitored closely to help identify early signs of deterioration.
- Portfolios remain well positioned and are subject to ongoing risk mitigation actions as appropriate. Monitoring indicates no material deterioration in the credit quality of the portfolio
- Net impairment charge of £306 million compared with a net charge of £71 million in 2018 is largely as a result of gross charges on two corporate cases, rather than any material deterioration in the underlying portfolio. These were partially offset by a net release in Stage 1 and 2 ECL, driven by enhancements to model methodology and data, including the approach to modelling loan amortisation. The impact of this was weighted toward the SME portfolio. Excluding the two large corporate cases, gross charges in 2019 were lower than 2018
- The size and nature of the commercial portfolio results in some volatility as cases move between stages. Stage 3 loans as a proportion of total loans and advances to customers has increased to 3.6 per cent (31 December 2018: 3.2 per cent). Stage 3 ECL allowance as a percentage of Stage 3 drawn balances has reduced to 27.4 per cent (31 December 2018: 32.1 per cent), predominantly due to the change in mix of assets due to write-offs and the transfer in of a small number of larger, individually assessed names with lower likelihood of net loss
- Stage 2 loans as a proportion of total loans and advances to customers remained broadly stable at 6.2 per cent (31 December 2018: 6.5 per cent). Stage 2 ECL allowances as a percentage of Stage 2 drawn balances were lower at 4.2 per cent (31 December 2018: 5.1 per cent) with the reduction weighted toward SME mainly due to enhanced approach to loan amortisation within the IFRS 9 model and a number of other model refinements

## Portfolios

- The SME and Mid Markets portfolios are domestically focused and reflect both our prudent credit risk appetite and the underlying performance of the UK economy
- The Global Corporates business continues to have a predominance of UK based, and to a lesser extent, US and European-based multi-national investment grade clients. The portfolio remains of good quality and is well positioned for the current economic outlook
- Through clearly defined sector strategies, Financial Institutions serves predominantly investment grade counterparties with whom relationships are either client driven or held to support the Group's funding, liquidity or general hedging requirements. Overall performance of the portfolio remains good
- The commercial real estate business within the Group's Mid Markets and Global Corporates 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. Credit quality remains good with minimal impairments and stressed loans. Recognising this is a cyclical sector, appropriate caps are in place to control exposure and business propositions continue to be written in line with a prudent, through the cycle risk appetite with conservative LTVs, strong quality of income and proven management teams

Table 1.30: **Commercial Banking impairment charge**

| | **2019 £m** | 2018[1] £m | Change % |
|---|---|---|---|
| SME | **(65)** | 64 | |
| Other | **371** | 7 | |
| **Total impairment charge** | **306** | 71 | (331) |
| Asset quality ratio | **0.30%** | 0.06% | *24bp* |

1 Prior period segmental comparatives restated. See note 4 on page 217.

Table 1.31: **Commercial Banking loans and advances to customers**

| | **Total £m** | **Stage 1 £m** | **Stage 2 £m** | **Stage 3 £m** | **Stage 3 as % of total %** |
|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | |
| SME | **30,698** | **27,455** | **2,523** | **720** | **2.3** |
| Other | **66,065** | **59,868** | **3,470** | **2,727** | **4.1** |
| **Total gross lending** | **96,763** | **87,323** | **5,993** | **3,447** | **3.6** |
| Expected credit loss allowance on drawn balances | **(1,265)** | **(96)** | **(228)** | **(941)** | |
| **Net balance sheet carrying value** | **95,498** | **87,227** | **5,765** | **2,506** | |
| **Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%)** | **1.4** | **0.1** | **4.2** | **27.4** | |
| At 31 December 2018[1] | | | | | |
| SME | 30,296 | 26,099 | 3,484 | 713 | 2.4 |
| Other[1] | 71,528 | 65,903 | 3,108 | 2,517 | 3.5 |
| Total gross lending | 101,824 | 92,002 | 6,592 | 3,230 | 3.2 |
| Expected credit loss allowance on drawn balances | (1,449) | (93) | (325) | (1,031) | |
| Net balance sheet carrying value | 100,375 | 91,909 | 6,267 | 2,199 | |
| Expected credit loss allowances (drawn and undrawn) as a percentage of gross lending (%) | 1.5 | 0.1 | 5.1 | 32.1 | |

1 Prior period segmental comparatives restated. See note 4 on page 217.

Table 1.32: **Commercial Banking expected credit loss allowances (drawn and undrawn) as a percentage of loans and advances to customers**

| | **Total** | | **Stage 1** | | **Stage 2** | | **Stage 3** | |
|---|---|---|---|---|---|---|---|---|
| | **£m** | **As % of drawn balances %** | **£m** | **As % of drawn balances %** | **£m** | **As % of drawn balances %** | **£m** | **As % of drawn balances %** |
| **At 31 December 2019** | | | | | | | | |
| SME | **273** | **0.9** | **45** | **0.2** | **127** | **5.0** | **101** | **14.0** |
| Other | **1,040** | **1.6** | **70** | **0.1** | **125** | **3.6** | **845** | **31.0** |
| **Total** | **1,313** | **1.4** | **115** | **0.1** | **252** | **4.2** | **946** | **27.4** |
| At 31 December 2018[1] | | | | | | | | |
| SME | 384 | 1.3 | 40 | 0.2 | 231 | 6.6 | 113 | 15.8 |
| Other | 1,102 | 1.5 | 71 | 0.1 | 107 | 3.4 | 924 | 36.7 |
| Total | 1,486 | 1.5 | 111 | 0.1 | 338 | 5.1 | 1,037 | 32.1 |

1 Prior period segmental comparatives restated. See note 4 on page 217.

Risk management continued

Table 1.33: **Commercial Banking Stage 2 loans and advances to customers**

| | Total | | | Up to date | | | | | | 1-30 days past due | | | Over 30 days past due | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | PD movement | | | Other[1] | | | | | | | | |
| | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % | Gross lending £m | ECL £m | As % of gross lending % |
| **At 31 December 2019** | | | | | | | | | | | | | | | |
| SME | **2,523** | **127** | **5.0** | **2,030** | **104** | **5.1** | **410** | **17** | **4.1** | **56** | **6** | **10.7** | **27** | **–** | **–** |
| Other | **3,470** | **125** | **3.6** | **1,881** | **75** | **4.0** | **1,290** | **47** | **3.6** | **61** | **2** | **3.3** | **238** | **1** | **0.4** |
| **Total** | **5,993** | **252** | **4.2** | **3,911** | **179** | **4.6** | **1,700** | **64** | **3.8** | **117** | **8** | **6.8** | **265** | **1** | **0.4** |
| At 31 December 2018 | | | | | | | | | | | | | | | |
| SME | 3,484 | 231 | 6.6 | 2,376 | 116 | 4.9 | 661 | 65 | 9.8 | 383 | 41 | 10.7 | 64 | 9 | 14.1 |
| Other | 3,108 | 107 | 3.4 | 1,793 | 61 | 3.4 | 1,190 | 45 | 3.8 | 72 | 1 | 1.4 | 53 | – | – |
| Total | 6,592 | 338 | 5.1 | 4,169 | 177 | 4.2 | 1,851 | 110 | 5.9 | 455 | 42 | 9.2 | 117 | 9 | 7.7 |

1 Includes client-specific indicators not reflected within quantitative PD assessments.

## 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). Exposures to social housing providers is also excluded
- Focus remains on the UK market, on good quality customers, with a proven track record in real estate and where cash flows are robust
- Commercial Banking UK Direct Real Estate gross lending stood at £13.6 billion at 31 December 2019 (net of exposures subject to protection through Significant Risk Transfer securitisations). The Group has a further £0.47 billion of UK Direct Real Estate exposure in Business Banking within Retail
- Approximately 60 per cent of loans and advances to UK Direct Real Estate relate to commercial real estate with the remainder related to residential real estate. The portfolio continues to be heavily weighted towards investment real estate (c.90 per cent) over development
- The LTV profile of the UK Direct Real Estate portfolio in Commercial Banking remains robust
- Both investment and development lending is subject to specific credit risk appetite criteria. Development lending criteria includes maximum loan to gross development value and maximum loan to cost, with funding typically only released against completed work as confirmed by the Group's monitoring quantity surveyor

Table 1.34: **LTV – UK Direct Real Estate**

| | At 31 December 2019[1,2] | | | | At 31 December 2018[1,2] | | | |
|---|---|---|---|---|---|---|---|---|
| | Stage 1/2 £m | Stage 3 £m | Total £m | % | Stage 1/2 £m | Stage 3 £m | Total £m | % |
| Investment Exposures > £1m | | | | | | | | |
| Less than 60% | **6,136** | **89** | **6,225** | **79.2** | 8,838 | 101 | 8,939 | 79.8 |
| 60% to 70% | **917** | **14** | **931** | **11.8** | 1,190 | 7 | 1,197 | 10.7 |
| 70% to 80% | **117** | **7** | **124** | **1.6** | 267 | 41 | 308 | 2.7 |
| 80% to 100% | **138** | **38** | **176** | **2.2** | 79 | 11 | 90 | 0.8 |
| 100% to 120% | **26** | **37** | **63** | **0.8** | 27 | 25 | 52 | 0.5 |
| 120% to 140% | **4** | **12** | **16** | **0.2** | – | 1 | 1 | – |
| Greater than 140% | **18** | **1** | **19** | **0.2** | 18 | 46 | 64 | 0.6 |
| Unsecured[3] | **311** | **–** | **311** | **4.0** | 520 | 31 | 551 | 4.9 |
| **Total Investment >£1m** | **7,667** | **198** | **7,865** | **100.0** | 10,939 | 263 | 11,202 | 100.0 |
| Investment <£1m[4] | **3,455** | **88** | **3,543** | | 3,679 | 105 | 3,784 | |
| **Total Investment** | **11,122** | **286** | **11,408** | | 14,618 | 368 | 14,986 | |
| Development | **1,805** | **58** | **1,863** | | 1,698 | 111 | 1,809 | |
| **Total** | **12,927** | **344** | **13,271** | | 16,316 | 479 | 16,795 | |

1 Excludes Commercial Banking UK Direct Real Estate exposures subject to protection through Significant Risk Transfer transactions.

2 Excludes Islands Commercial UK Direct Real Estate of £0.35 billion (31 December 2018: £0.45 billion).

3 Predominantly Investment grade corporate CRE lending where the Group is relying on the corporate covenant.

4 December 2019 <£1m investment exposures have an LTV profile broadly similar to the >£1m investment exposures.

## Commercial Banking forbearance

### Table 1.35: Commercial Banking forborne loans and advances (audited)

| | Total £m | Of which Stage 3 £m |
|---|---|---|
| **At 31 December 2019** | | |
| **Type of forbearance** | | |
| Refinancing | **70** | **41** |
| Modification | **4,216** | **3,322** |
| **Total** | **4,286** | **3,363** |
| At 31 December 2018 | | |
| Type of forbearance | | |
| Refinancing | 38 | 29 |
| Modification | 3,834 | 2,949 |
| Total | 3,872 | 2,978 |

### Table 1.36: Derivative credit risk exposures

| | 2019 | 2019 Traded over the counter | | | 2018 | 2018 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 | **–** | **8** | **421,143** | **421,151** | – | 45 | 385,680 | 385,725 |
| Interest rate | **199,986** | **6,211,948** | **250,392** | **6,662,326** | 128,221 | 4,950,912 | 689,882 | 5,769,015 |
| Equity and other | **4,820** | **–** | **6,594** | **11,414** | 9,247 | – | 5,898 | 15,145 |
| Credit | **–** | **–** | **16,959** | **16,959** | – | – | 13,757 | 13,757 |
| **Total** | **204,806** | **6,211,956** | **695,088** | **7,111,850** | 137,468 | 4,950,957 | 1,095,217 | 6,183,642 |
| *Fair values* | | | | | | | | |
| Assets | | **1,820** | **24,499** | | | 144 | 23,448 | |
| Liabilities | | **(1,794)** | **(23,928)** | | | (150) | (21,222) | |
| **Net asset** | | **26** | **571** | | | (6) | 2,226 | |

The total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2019 and 31 December 2018 is shown in the table above. 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 289.

### Environmental risk management

As appropriate, the Group considers the management of the environmental impact of its lending activities. The Group-wide credit risk principles require all credit risk to be incurred with due regard to environmental legislation and the Group's Code of Responsibility. The Group's external sector statements determine the appetite for many activities that impact the environment. The Group seeks to reduce detrimental impacts and support clients as they improve their own environmental footprint. Further detail is provided in the Responsible Business section (see pages 26 to 34).

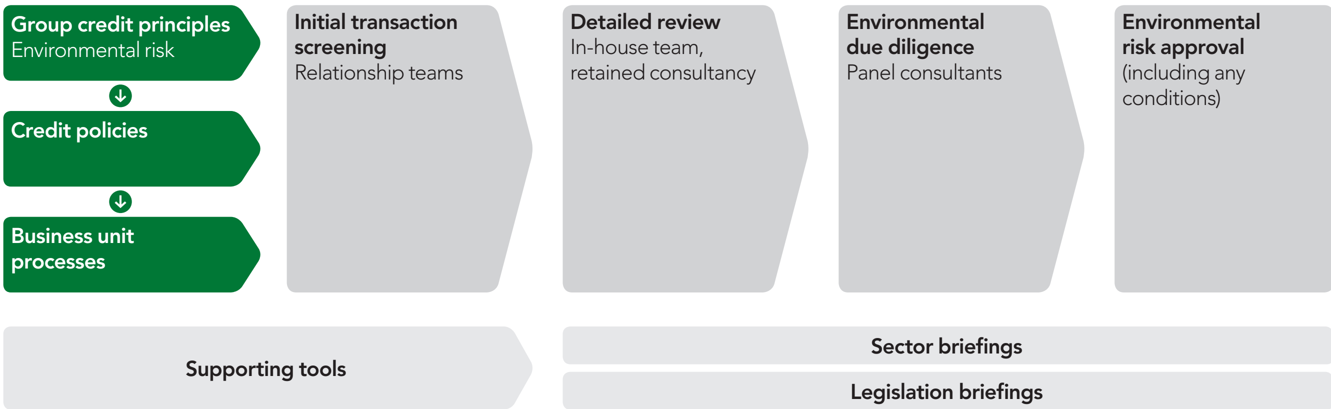
The Group's business areas and sub-groups are each exposed to different types and levels of climate-related risk in their operations. For example, the general insurance function regularly uses weather, climate and environmental models and data to assess its insurance risk from covered perils such as windstorm and flood. A team of specialist scientists are employed within underwriting to do this work and they also regularly monitor the state of climate science to assess the need to include its potential impacts within pricing and solvency.

The Group has been a signatory to the Equator Principles since 2008 and has adopted and applied the expanded scope of Equator Principles III and committed itself to adoption of Equator Principles 4 during 2020. 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. The Group has also been a signatory to the UN Principles for Responsible Investment (UNPRI) since 2012, which incorporate ESG (environmental, social and governance) risk considerations in asset management. Scottish Widows is responsible for the annual UNPRI reporting process.

Within Commercial Banking, an electronic Environmental Risk Screening Tool is the primary mechanism for assessing environmental risk for lending transactions. This system provides screening of location specific and sector based risks that may be present in a transaction. Where a risk is identified, the transaction is referred to the Group's expert in-house environmental risk team for further review and assessment. Where required, the Group's panel of environmental consultants provide additional expert support.

We provide colleague training on environmental risk management as part of the standard suite of Commercial Banking credit risk courses. To support this training, a range of online resources are available to colleagues, including environmental risk theory, procedural guidance, and information on environmental legislation and sector-specific environmental impacts. We also continue to partner with the Cambridge Institute for Sustainability Leadership to provide high quality training to executives and colleagues focused on risk management, product development and in client-facing roles.

Table 1.37: **Environmental risk management approach**




## Regulatory and legal risk

### Definition

Regulatory and legal risk is defined as the risk of financial penalties, regulatory censure, criminal or civil enforcement action or customer detriment as a result of failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements.

### Exposures

Whilst the Group has a zero risk appetite for material regulatory breaches or material legal incidents, the Group remains exposed to them, driven by significant ongoing and new legislation, regulation and court proceedings in the UK and overseas which in each case needs to be interpreted, implemented and embedded into day-to-day operational and business practices across the Group.

### Measurement

Regulatory and legal risks are measured against a defined risk appetite metric, which is an assessment of material regulatory breaches and material legal incidents.

### Mitigation

The Group undertakes a range of key mitigating actions to manage regulatory and legal risk. These include the following:

- The Board has established a Group-wide risk appetite and metric 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 identify, assess and implement policy and regulatory requirements and establish local controls, processes, procedures and resources to ensure appropriate governance and compliance
- Business units regularly produce management information to assist in the identification of issues and test management controls are working effectively
- Risk and Legal departments provide oversight, proactive support and constructive challenge to the business in identifying and managing regulatory and legal issues
- Risk department conducts thematic reviews of regulatory compliance and provides oversight of regulatory compliance assessments across businesses and divisions where appropriate
- Business units, with the support of divisional and Group-level teams, conduct ongoing horizon scanning to identify and address changes in regulatory and legal requirements
- The Group engages with regulatory authorities and industry bodies on forthcoming regulatory changes, market reviews and investigations, ensuring programmes are established to deliver new regulation and legislation

### Monitoring

Material risks are managed through the relevant divisional-level committees, with review and escalation through Group level committees where appropriate, including the escalation of any material regulatory breaches or material legal incidents.

# Conduct risk

## Definition

Conduct risk is defined as the risk of customer detriment across the customer lifecycle including: failures in product management, distribution and servicing activities; from other risks materialising, or other activities which could undermine the integrity of the market or distort competition, leading to unfair customer outcomes, regulatory censure, reputational damage or financial loss.

## Exposures

The Group faces significant conduct risks, which affect all aspects of the Group's operations and all types of customers.

Conduct risks can impact directly or indirectly on our customers and could materialise from a number of areas across the Group, including:

- Business and strategic planning that does not sufficiently consider customer needs
- Ineffective management and monitoring of products and their distribution (including the sales process)
- Unclear, unfair, misleading or untimely customer communications
- A culture that is not sufficiently customer-centric
- Poor governance of colleagues' incentives and rewards and approval of schemes which drive unfair customer outcomes
- Ineffective management and oversight of legacy conduct issues
- Ineffective management of customers' complaints or claims
- Outsourcing of customer service and product delivery to third-parties that do not have the same level of control, oversight and culture as the Group

There is a high level of scrutiny regarding financial institutions' treatment of customers, including those in vulnerable circumstances, from regulatory bodies, the media, politicians and consumer groups.

There continues to be a significant focus on market misconduct, resulting from previous issues such as London Inter-bank Offered Rate (LIBOR) and foreign exchange (FX).

Due to the level of enhanced focus on conduct, there is a risk that certain aspects of the Group's current or legacy business may be determined by the Financial Conduct Authority, other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, in a manner that fails to deliver fair and reasonable customer treatment, or is inconsistent with market integrity or competition requirements.

## Measurement

To articulate its conduct risk appetite, the Group has sought more granularity through the use of suitable Conduct Risk Appetite Metrics (CRAMs) and tolerances that indicate where it may be operating outside its conduct risk appetite. These include Board-level conduct risk metrics covering an assessment of overall CRAMs performance, out of appetite CRAMs, Financial Ombudsman Service (FoS) change rates and complaints.

CRAMs have been designed for services and product families offered by the Group and are measured by a consistent set of common metrics. These contain a range of product design, sales and process metrics to provide a more holistic view of conduct risks; some products also have a suite of additional bespoke metrics.

Each of the tolerances for the metrics are agreed for the individual product or service and are regularly tracked. At a consolidated level these metrics are part of the Board risk appetite. The Group has, and continues to, evolve its approach to conduct risk measurements, including those supporting customer vulnerability, process delivery and customer journeys.

## Mitigation

The Group takes a range of mitigating actions with respect to conduct risk and remains focused on delivering a leading customer experience. The Group's ongoing commitment to good customer outcomes sets the tone from the top and supports the development of the right customer-centric culture – strengthening links between actions to support conduct, culture and customer and enabling more effective control management. Actions to encourage good conduct include:

- Conduct risk appetite established at Group and business area level, with metrics included in the Group risk appetite to ensure ongoing focus
- Simplified and enhanced conduct policies and procedures in place to ensure appropriate controls and processes that deliver fair customer outcomes, and support market integrity and competition requirements
- Customer needs considered through divisional customer plans, with integral conduct lens, reviewed and challenged by Group Customer First Committee (GCFC)
- Cultural transformation: achieving our values-led culture through a focus on our behaviours to ensure we are transforming our Group culture for success in a digital world. This is supported by strong direction and tone from senior executives and the Board
- Continuous embedding of the customer vulnerability framework. Development and continued oversight of the implementation of the vulnerability strategy continues through the Group Customer Vulnerability Committee (GCVC) operating at a senior level to prioritise change, drive implementation and ensure consistency across the Group. The Group is also in the third year of its partnership with Macmillan to support customers with cancer, has launched specialist support for those impacted by financial and domestic abuse and has signed up to standards supporting customers with mental health problems
- Enhanced product governance framework to ensure products continue to offer customers fair value, and consistently meet their needs throughout their product life cycle; reviewed and challenged by Group Product Governance Committee (GPGC)
- Enhanced complaints management through effectively responding to, and learning from, root causes of complaint volumes and FoS change rates
- Review and oversight of thematic conduct agenda items at senior committees, ensuring holistic consideration of key Group-wide conduct risks
- Robust recruitment and training, with a continued focus on how the Group manages colleagues' performance with clear customer accountabilities
- Ongoing engagement with third-parties involved in serving the Group's customers to ensure consistent delivery
- Monitoring and testing of customer outcomes to ensure the Group delivers fair outcomes for customers whilst making continuous improvements to products, services and processes
- Continued focus on market conduct and member of the Fixed Income, Currencies and Commodities Markets Standard Board
- Adoption of robust change delivery methodology to enable prioritisation and delivery of initiatives to address conduct challenges
- Continued focus on proactive identification and mitigation of conduct risk in the GSR3
- Active engagement with regulatory bodies and other stakeholders to develop understanding of concerns related to customer treatment, effective competition and market integrity, to ensure that the Group's strategic conduct focus continues to meet evolving stakeholder expectations

## Monitoring

Monitoring and reporting is undertaken at Board, Group, entity and divisional committees. As part of the reporting of CRAMs, a robust outcomes testing regime is in place to determine whether the Group is delivering fair outcomes for customers.

GCFC acts as the guardian of customer experience and has responsibility for monitoring and reviewing plans and actions to improve it, providing oversight of customer outcomes and customer experience and providing challenge to divisions to make changes to support the delivery of the Group's vision and foster a customer-centric culture.

# 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.

**Risk management** continued

## Exposures

The principal operational risks to the Group which could result in customer detriment, unfair customer outcomes, financial loss, disruption and/or reputational damage are:

- A cyber-attack
- Failure of IT systems, due to volume of change, and/or aged infrastructure
- Internal and/or external fraud or financial crime
- Failure to ensure compliance with increasingly complex and detailed regulation including anti-money laundering, anti-bribery, counter-terrorist financing, and financial sanctions and prohibitions laws and regulations

A number of these risks could increase where there is a reliance on third-party suppliers to provide services to the Group or its customers.

## Measurement

Operational risk is managed across the Group through an operational risk framework and operational risk policies. The operational risk framework includes a risk and control self-assessment process, risk impact likelihood matrix, key risk and control indicators, risk appetite, a robust operational event management and escalation process, scenario analysis and an operational losses process.

Table 1.38 below shows high level loss and event trends for the Group using Basel II categories. Based on data captured on the Group's Risk and Control Self-Assessment, in 2019 the highest frequency of events occurred in external fraud (67.89 per cent) and execution, delivery and process management (18.04 per cent). Clients, products and business practices accounted for 72.70 per cent of losses by value, driven by legacy issues where impacts materialised in 2019 (excluding PPI).

Table 1.38: **Operational risk events by risk category (losses greater than or equal to £10,000), excluding PPI[1]**

| | % of total volume | | % of total losses | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| Business disruption and system failures | **0.78** | 1.46 | **2.45** | 3.53 |
| Clients, products and business practices | **12.84** | 12.30 | **72.70** | 65.12 |
| Damage to physical assets | **0.15** | 1.64 | **0.03** | 0.21 |
| Employee practices and workplace safety | **0.10** | 0.06 | **0.01** | – |
| Execution, delivery and process management | **18.04** | 21.21 | **20.60** | 25.96 |
| External fraud | **67.89** | 62.98 | **4.16** | 5.05 |
| Internal fraud | **0.20** | 0.35 | **0.05** | 0.13 |
| **Total** | **100.00** | 100.00 | **100.00** | 100.00 |

1 2018 breakdowns have been restated to reflect a number of events that have been reclassified following an internal review.

Operational risk losses and scenario analysis is used to inform the Internal Capital Adequacy Assessment Process (ICAAP). The Group calculates its minimum (Pillar I) operational risk capital requirements using The Standardised Approach (TSA). Pillar II is calculated using internal and external loss data and extreme but plausible scenarios that may occur in the next 12 months.

## Mitigation

The Group's strategic review considers the changing risk management requirements, adapting the change delivery model to be more agile and develop the people skills and capabilities needed to be a 'Bank of the Future'. 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 and Board as appropriate to ensure the correct level of visibility and engagement. The Group employs a range of risk management strategies, including: avoidance, mitigation, transfer (including insurance) and acceptance. Where there is a reliance on third-party suppliers to provide services, the Group's sourcing policy ensures that outsourcing initiatives follow a defined process including due diligence, risk evaluation and ongoing assurance.

Mitigating actions to the principal operational risks are:

- The threat landscape associated with cyber risk continues to evolve and there is significant regulatory attention on this subject. The Board continues to invest heavily to protect the Group from malicious cyber-attacks. Investment continues to focus on improving the Group's approach to identity and access management, improving capability to detect and respond to cyber-attacks and improved ability to manage vulnerabilities across the estate
- The Group continues to optimise its approach to IT by investing in technology improvements; focusing on simplification of IT architecture; and decommissioning legacy systems in order to maintain reliable banking services for its customers. IT risk mitigation programmes are in place to continually improve customers' experience, which receive considerable time and focus at Board and Board Risk Committees
- The Group adopts a risk based approach to mitigate the internal and external fraud risks it faces, reflecting the current and emerging fraud risks within the market. Fraud risk appetite metrics holistically cover the impacts of fraud in terms of losses to the Group, costs of fraud systems and operations, and customer experience of actual and attempted fraud. Oversight of the appropriateness and performance of these metrics is undertaken regularly through business area and Group-level committees. This approach drives a continual programme of prioritised 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. Group-wide 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 requirements. The Group's fraud awareness programme remains a key component of its fraud control environment, and awareness of fraud risk is supported by mandatory training for all colleagues. The Group also plays an active role with other financial institutions, industry bodies, and enforcement agencies in identifying and combatting fraud
- The Group continues to lead and support industry wide activity to help address fraud, such as leadership on the design and implementation of the industry code for Authorised Push Payment (APP) fraud, in addition to making more bespoke commitments with key partners, such as the City of London Police. Such initiatives support the continued enhancement of the Group's control framework, whilst contributing to the raising of standards across the industry. The Group also continues to make material annual investments in both technology and colleague development to help mitigate this growing area of risk
- The Group has adopted policies and procedures designed to detect and prevent the use of its banking network for money laundering, terrorist financing, bribery, tax evasion, human trafficking, modern-day slavery and wildlife trafficking, and activities prohibited by legal and regulatory sanctions. Against a background of increasingly complex and detailed laws and regulations, and of increased criminal and terrorist activity, the Group regularly reviews and assesses its policies, procedures and organisational arrangements to keep them current, effective and consistent across markets and jurisdictions. 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, reporting of suspicions of money laundering or terrorist financing to the applicable regulatory authorities, and interaction between the Group's Financial Intelligence Unit and external agencies and other financial institutions. 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 of 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 of operational risk is undertaken at Board, Group, entity and divisional committees. Each committee monitors key risks, control effectiveness, key risk and control indicators, events, operational losses, risk appetite metrics and the results of independent testing conducted by Risk and/or Internal Audit.

The Group maintains a formal approach to operational risk event escalation, whereby material events are identified, captured and escalated. Root causes of events are determined, and action plans put in place to ensure an optimum level of control to keep customers and the business safe, reduce costs, and improve efficiency.

The insurance programme is monitored and reviewed regularly, with recommendations being made to the Group's senior management annually prior to each renewal. Insurers are monitored on an ongoing basis, to ensure counterparty risk is minimised. A process is in place to manage any insurer rating changes or insolvencies.

# People risk

## Definition

The risk that the Group fails to provide an appropriate colleague and customer-centric culture, supported by robust reward and wellbeing policies and processes; effective leadership to manage colleague resources; effective talent and succession management; and robust control to ensure all colleague-related requirements are met.

## 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, particularly in the context of increasing volumes of organisational, political and external market change and increasing digitisation. The Group is exposed to the following key people risks:

- Failure to recruit, develop and retain colleagues, including ineffective management of succession planning or failure to identify appropriate talent pipeline
- The increasing digitisation of the business is changing the capability mix required and may impact our ability to attract and retain talent
- Senior Managers and Certification Regime (SM&CR) and additional regulatory constraints on remuneration structures may impact the Group's ability to attract and retain talent
- Failure to manage capacity, colleagues having excessive demands placed on them resulting in wellbeing issues and business objectives not being met
- Failure to meet all colleague-related legal and regulatory requirements
- Ineffective leadership, poor communication, weak performance, inappropriate remuneration policies
- Colleague engagement may continue to be challenged by ongoing media attention on culture within the banking sector, conduct and ethical considerations
- Inadequately designed people processes that are not resilient to withstand unexpected events

## 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 wellbeing. 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:

- 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
- Continued focus on the Group's culture by developing and delivering initiatives that reinforce the appropriate behaviours which generate the best possible long-term outcomes for customers and colleagues
- Managing organisational capability and capacity through divisional people strategies to ensure there are the right skills and resources to meet our customers' needs and deliver our strategic plan
- Maintain effective remuneration arrangements to ensure they promote an appropriate culture and colleague behaviours that meet customer needs and regulatory expectations
- Ensuring colleague wellbeing strategies and support are in place to meet colleague needs, and that the skills and capability growth required to build a workforce for the 'Bank of the Future' are achieved
- 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
- Ongoing consultation with the Group's recognised unions on changes which impact their members
- Reviewing and enhancing people processes to ensure they are fit for purpose and operationally resilient

## Monitoring

Monitoring and reporting is undertaken at Board, Group, entity and divisional committees. Key people risk metrics are reported and discussed monthly at the Group People Risk Committee with escalation to Group Risk and Executive Committees and the Board where required.

All material people risk events are escalated in accordance with the Group Operational Risk Policy.

# Insurance underwriting risk

## Definition

Insurance underwriting risk is defined as the risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions in earnings and/or value.

## Exposures

The major source of insurance underwriting risk within the Group is the Insurance business.

Longevity and persistency are key risks within the life and pensions business. Longevity risk arises from the annuity portfolios where policyholders' future cash flows 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 with the Insurance business growth in the annuity market. Persistency assumptions are set to give a best estimate, however customer behaviour may result in increased cancellations or cessation of contributions.

The Group's defined benefit pension schemes also expose the Group to longevity risk. For further information please refer to the defined benefit pension schemes component of the market risk section and note 36 to the financial statements.

Property insurance risk is a key risk within the General Insurance business, through Home Insurance. Exposures can arise, for example, in extreme weather conditions such as flooding, when property damage claims are higher than expected.

## Measurement

Insurance underwriting 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 underwriting risk exposures are assessed and aggregated on a range of stresses including risk measures based on 1-in-200 year stresses for the Insurance business' regulatory capital assessments and other supporting measures where appropriate, including those set out in note 33 to the financial statements.

## Mitigation

Insurance underwriting risk in the Insurance business is mitigated in a number of ways:

- 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
- Longevity risk transfer and hedging solutions are considered on a regular basis and since 2017 we have reinsured £3.1 billion of annuitant longevity. A team of longevity and pricing experts has been built to support the annuity proposition
- 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

## Monitoring

Insurance underwriting risks in the Insurance business are monitored by Insurance senior executive committees and ultimately the Insurance Board. Significant risks from the Insurance business and the defined benefit pension schemes are reviewed by the Group Executive and Group Risk Committees and Board.

Insurance underwriting 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 underwriting risk is evaluated and significant divergences from experience or movements in risk exposures are investigated and remedial action taken.

# Capital risk

## Definition

Capital risk is defined as the risk that the Group has a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across the Group.

## Exposures

A capital risk exposure arises when the Group has insufficient capital resources to support its strategic objectives and plans, and to meet both regulatory and 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 needs to be held either at Group level, Ring-Fenced Bank (RFB) sub-group level or at a regulated entity level. The Group's capital management approach is focused on maintaining sufficient capital resources across all regulated levels of its structure in order to prevent such exposures while optimising value for shareholders.

## Measurement

The Group maintains capital levels commensurate with a prudent level of solvency and aims to deliver consistent and high quality returns to shareholders. To support this the capital risk appetite is calibrated by taking into consideration both an internal view of the amount of capital the Group should hold as well as recognising external regulatory requirements.

The Group measures both its capital requirements and the amount of capital resources it holds to meet those requirements through applying the regulatory framework defined by the Capital Requirements Directive and Regulation (CRD IV), as amended by provisions of the revised Capital Requirements Regulation (CRR II) that came into force in June 2019. Directive requirements are implemented in the UK by the Prudential Regulation Authority (PRA) and supplemented through additional regulation under the PRA Rulebook. Further details of the regulatory capital and leverage frameworks that the Group is subject to, including the means by which its capital and leverage requirements and capital resources are calculated, will be provided in the Group's Pillar 3 Report.

The minimum amount of total capital, under Pillar 1 of the regulatory framework, is set at 8 per cent of total 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 2A of the regulatory framework, the aggregate of which is referred to as the Group's Total Capital Requirement (TCR), and a number of regulatory capital buffers as described below.

Additional minimum requirements under Pillar 2A are set by the PRA as a firm-specific Individual Capital Requirement (ICR) reflecting a point in time estimate, which may change over time, of the minimum amount of capital that is needed by the Group to cover 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 in the banking book (IRRBB). The Group's Pillar 2A capital requirement at 31 December 2019 was 4.6 per cent of risk-weighted assets, of which 2.6 per cent must be met by CET1 capital.

The Group is also required to hold a number of regulatory capital buffers which are required to be met with CET1 capital.

Systemic buffers are designed to hold systemically important banks to higher capital standards, so that they can withstand a greater level of stress before requiring resolution.

- Although the Group is not currently classified as a global systemically important institution (G-SII) under the Capital Requirements Directive, it has been classified as an 'other' systemically important institution (O-SII) by the PRA. The O-SII buffer is set to zero in the UK
- The systemic risk buffer (SRB) came into force for UK ring-fenced banks during 2019, with the PRA setting a buffer of 2.0 per cent of risk-weighted assets for the RFB sub-group. The size of the buffer applied to the RFB sub-group is dependent upon its total assets. The SRB equates to 1.7 per cent of risk-weighted assets at Group level, with the difference reflecting the risk-weighted assets of the Group that are not in the Ring-Fenced Bank sub-group and for which the SRB does not therefore apply

The capital conservation buffer (CCB) is a standard buffer of 2.5 per cent of risk-weighted assets designed to provide for losses in the event of stress.

The countercyclical capital buffer (CCYB) 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 applied by the Bank of England's Financial Policy Committee (FPC) for the individual countries where the Group has relevant credit exposures. The CCYB rate for the UK is currently set at 1.0 per cent and will increase to 2.0 per cent from December 2020 following a review by the FPC of the appropriate level to set in the current standard risk environment. As a result of this change the PRA will consult in 2020 on a reduction in Pillar 2A capital requirements by 50 per cent of the relevant bank specific increase in the CCYB, which would leave overall loss absorbing capacity (MREL) broadly unchanged, but increase the Group's requirement plus buffers for CET1 by c.65 basis points.

The FPC regularly considers the adequacy of the UK CCYB rate in light of the evolution of the overall risk environment. As at 31 December 2019 non-zero buffer rates also currently apply for Bulgaria, the Czech Republic, Denmark, France, Hong Kong, Iceland, Ireland, Lithuania, Norway, Slovakia and Sweden. During 2020 Belgium, Germany, and Luxembourg will implement non-zero buffer rates. The Group's overall countercyclical capital buffer at 31 December 2019 was 0.9 per cent of risk-weighted assets which reflects the concentration of exposures of the Group to the UK.

As part of the capital planning process, forecast capital positions are subjected to wide ranging programme of stress testing to determine the adequacy of the Group's capital resources against the minimum requirements, including the ICR. The PRA considers outputs from both the Group's internal stress tests and the annual Bank of England stress test, in conjunction with the Group's other regulatory capital buffers and non-stress related elements, as part of the process for informing the setting of a bank-specific capital buffer for the Group, known as the PRA Buffer. The PRA requires this buffer to remain confidential between the Group and the PRA.

All buffers are required to be met with CET1 capital. Usage of the PRA Buffer would trigger a dialogue between the Group and the PRA to agree what action is required whereas a breach of the CRD IV combined buffer (all other regulatory buffers, as referenced above) would give rise to mandatory restrictions upon any discretionary capital distributions.

In addition to the risk-based capital framework outlined above, the Group is also subject to minimum capital requirements under the UK Leverage Ratio Framework. The leverage ratio is calculated by dividing fully loaded tier 1 capital resources by the leverage exposure which is a defined measure of on-balance sheet assets and off-balance sheet items.

The minimum leverage ratio requirement under the UK Leverage Ratio Framework is 3.25 per cent. This is supplemented by a time-varying countercyclical leverage buffer (CCLB) which is determined by multiplying the leverage exposure measure by 35 per cent of the countercyclical capital buffer (CCYB) rate. As at 31 December 2019 the CCLB for the Group was 0.3 per cent. This is set to increase in proportion to the increase in the countercyclical capital buffer following the FPC's decision to increase the UK CCYB rate to 2.0 per cent with effect from December 2020. An additional leverage ratio buffer (ALRB) of 0.7 per cent applies to the Ring-Fenced Bank sub-group and is determined by multiplying the Ring-Fenced Bank sub-group leverage exposure measure by 35 per cent of the SRB. This equates to 0.6 per cent of the total leverage exposure measure at Group level.

At least 75 per cent of the 3.25 per cent minimum leverage ratio requirement as well as 100 per cent of regulatory leverage buffers must be met by CET1 capital.

The leverage ratio framework does not currently give rise to higher regulatory capital requirements for the Group than the risk-based capital framework.

## Mitigation

The Group has a capital management framework that includes the setting of capital risk appetite. Close monitoring of capital and leverage ratios is undertaken to ensure the Group meets regulatory requirements and risk appetite levels and deploys its capital resources efficiently. Comprehensive stress testing analyses take place to evidence capital adequacy.

The Group maintains a recovery plan which sets out a range of potential mitigating actions that could be taken in response to a stress. For example, the Group is able to accumulate additional capital through the retention of profits over time, which can be enhanced through reducing or cancelling dividend payments and share buybacks, by raising new equity via, for example, a rights issue or debt exchange and by raising additional tier 1 or tier 2 capital securities. 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.

## Monitoring

The Group's capital is actively managed and monitoring capital ratios is a key factor in the Group's planning processes and stress testing, which separately cover the Ring-Fenced Bank sub-group and key individual banking entities. Multi-year base case 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 plan whilst shorter term forecasts are more frequently undertaken to understand and respond to variations of the Group's actual performance against the plan. The Group's capital plan is tested for capital adequacy using a range of stress scenarios and sensitivities covering adverse economic conditions as well as other adverse factors that could impact the Group.

The Group's capital plan also considers the impact of IFRS 9 which has the potential to increase bank capital volatility. Under stress this is primarily a result of provisioning for assets that are not in default at an earlier stage than would have been the case under IAS 39.

In the short to medium term the IFRS 9 transitional arrangements for capital, which the Group has adopted, will provide some stability in capital requirements against the increased provisioning, measurement uncertainty and volatility introduced by IFRS 9.

For the Bank of England Annual Cyclical Scenario stress test, the Bank of England has taken action to avoid an unwarranted de facto increase in capital requirements that could result from the interaction of IFRS 9. The stress hurdle rates for banks participating in the exercise are adjusted to recognise the additional resilience provided by the earlier provisions taken under IFRS 9. The Bank of England is considering options for a more enduring treatment of IFRS9 provisions in the capital framework and alternative options will be explored further during the 2020 Bank of England ACS stress test.

Regular reporting of actual and base case and stress scenario projected ratios for Group, the Ring-Fenced Bank sub-group and key legal entities is undertaken, including submissions to the Group Capital Risk Committee (GCRC), Group Financial Risk Committee (GFRC), Group Asset and Liability Committee (GALCO), Group Risk Committee (GRC), Board Risk Committee (BRC) and the Board. Capital policies and procedures are well established and subject to independent oversight.

The regulatory framework within which the Group operates continues to evolve and further detail on this will be provided in the Group's Pillar 3 report. The Group continues to monitor these developments very closely, analysing the potential capital impacts to ensure that, through organic capital generation and management actions, the Group continues to maintain a strong capital position that exceeds both minimum regulatory requirements and the Group's risk appetite and is consistent with market expectations.

## Target capital ratios

The Board's view of the ongoing level of CET1 capital required by the Group to grow the business, meet regulatory requirements and cover uncertainties continues to be c.12.5 per cent plus a management buffer of c.1 per cent.

This takes into account, amongst other things:

- the minimum Pillar 1 CET1 capital requirement of 4.5 per cent of risk-weighted assets
- the Group's Pillar 2A set by the PRA. During the year the PRA reduced the Group's Pillar 2A requirement from 4.7 per cent to 4.6 per cent of risk-weighted assets at 31 December 2019, of which 2.6 per cent must be met by CET1 capital
- the capital conservation buffer (CCB) requirement of 2.5 per cent of risk-weighted assets
- the Group's current countercyclical capital buffer (CCYB) requirement of 0.9 per cent of risk-weighted assets, which is set to increase following the FPC's decision to increase the UK CCYB rate from 1.0 per cent to 2.0 per cent, effective from December 2020. In conjunction the PRA will consult during 2020 on a proposed reduction in Pillar 2A capital requirements by 50 per cent of this increase in the CCYB, equivalent to reducing the Pillar 2A CET1 requirement by 28 per cent of the increase.
- the Ring-Fenced Bank sub-group's systemic risk buffer (SRB) of 2.0 per cent of risk-weighted assets, which equates to 1.7 per cent of risk weighted assets at Group level

- the Group's PRA Buffer, which the PRA sets after taking account of the results of the annual PRA stress test and other information, as well as outputs from the Group's internal stress tests. The PRA requires the PRA Buffer itself to remain confidential between the Group and the PRA

## Dividend policy

The Group has established a policy to pay a progressive and sustainable ordinary dividend. Any growth in the ordinary dividend will be decided by the Board in light of the circumstances at the time.

The Board also gives due consideration to the return of capital through the use of special dividends or share buybacks. 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 by its nature there can be no guarantee that any return of surplus capital will be appropriate.

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 Group's financial and operating performance.

Distributable reserves are determined as required by the Companies Act 2006 by reference to a company's individual financial statements. At 31 December 2019 Lloyds Banking Group plc ('the Company') had accumulated distributable reserves of approximately £10 billion. 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.

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 its ability to sustain dividend payments, is therefore dependent upon the continued receipt of dividends from its main operating subsidiaries, including Lloyds Bank plc (the Ring-Fenced Bank), Lloyds Bank Corporate Markets plc (the non-ring-fenced bank), LBG Equity Investments Limited and Scottish Widows Group Limited (the insurance business). The principal operating subsidiary is Lloyds Bank plc which, at 31 December 2019, had a consolidated CET1 capital ratio of 14.3 per cent (31 December 2018: 14.9 per cent). A number of Group subsidiaries, principally those with banking and insurance activities, are subject to regulatory capital requirements which require minimum amounts of capital to be maintained relative to their size and risk. The Group actively manages the capital of its subsidiaries, which includes monitoring the regulatory capital ratios for its banking and insurance subsidiaries and, on a consolidated basis, the RFB sub-group against approved risk appetite levels. The Group operates a formal capital management policy which requires all subsidiary entities to remit surplus capital to their parent companies.

In May 2019 the Group announced that it will move to the payment of quarterly dividends in 2020, with the first quarterly dividend in respect of the period to 31 March 2020 payable in June 2020. The new approach will result in three equal interim ordinary dividend payments for the first three quarters of the year followed by, subject to performance, a larger final dividend for the fourth quarter of the year. The first three quarterly payments, payable in June, September and December will be equal to 20 per cent of the previous year's total ordinary dividend per share. The fourth quarter payment will be announced with the full year results, with the amount continuing to deliver a full year dividend payment that reflects the Group's financial performance and objective of a progressive and sustainable ordinary dividend.

## Minimum requirement for own funds and eligible liabilities (MREL)

In 2015, the Financial Stability Board established an international standard for the total loss absorbing capacity (TLAC) of global systemically important banks (G-SIBs). The standard, which applies from 1 January 2019, is designed to enhance the resilience of the global financial system by ensuring that failing G-SIBs have sufficient capital to absorb losses and recapitalise under resolution, whilst continuing to provide critical banking services.

At EU level, G-SIBs are subject to the minimum requirements for own funds and eligible liabilities (MREL) that came into force in June 2019 following the implementation of CRR II. The MREL framework reflects the European implementation of the global TLAC standard. The purpose of MREL is to require firms to maintain sufficient own funds and eligible liabilities that are capable of credibly bearing losses or recapitalising a bank whilst in resolution. MREL requirements can be satisfied by a combination of regulatory capital and certain unsecured liabilities (which must be subordinate to a firm's operating liabilities).

In the UK the Bank of England has implemented the requirements of the TLAC standard through a statement of policy on MREL (the MREL SoP).

As the Group is not classified as a G-SIB it is not directly subject to the CRR II MREL requirements. However the Group is subject to the Bank of England's MREL SoP and must therefore maintain a minimum level of MREL resources from 1 January 2020. The Group operates a single point of entry (SPE) resolution strategy, with Lloyds Banking Group plc as the designated resolution entity.

Applying the Bank of England's MREL SoP to current minimum capital requirements, the Group's indicative MREL requirement, excluding regulatory capital and leverage buffers, is as follows:

- From 1 January 2020, the higher of 2 times Pillar 1 plus Pillar 2A, equivalent to 20.6 per cent of risk-weighted assets, or 6.5 per cent of the UK leverage ratio exposure measure
- From 1 January 2022, the higher of 2 times Pillar 1 plus 2 times Pillar 2A, equivalent to 25.2 per cent of risk-weighted assets, or 6.5 per cent of the UK leverage ratio exposure measure

In addition, CET1 capital cannot be used to meet both MREL requirements and capital or leverage buffers.

The Bank of England will review the calibration of MREL in 2020 before setting final end-state requirements to be met from 2022. This review will take into consideration any changes to the capital framework, including the finalisation of the Basel III reforms.

Internal MREL requirements will also apply to the Group's material sub-groups and entities, including the RFB sub-group, Lloyds Bank plc, Bank of Scotland plc and Lloyds Bank Corporate Markets plc, from 1 January 2020.

## Analysis of capital position

The Group's pro forma CET1 capital build amounted to 207 basis points before PPI, and to 86 basis points after the in-year PPI charge, reflecting:

- Underlying capital build (198 basis points), including the dividend paid up by the Insurance business in February 2020 in relation to its 2019 earnings (18 basis points)
- Other movements (20 basis points), reflecting market movements and the continued optimisation of Commercial Banking risk-weighted assets, net of additional pension contributions and model updates
- Offset by a reduction of 121 basis points relating to the in-year PPI charge and 11 basis points relating to the impact of changes arising from the implementation of IFRS 16 on risk-weighted assets

The Group's capital position also benefitted by 34 basis points as a result of the cancellation of the remaining c.£650 million of the 2019 buyback programme, as announced in September 2019. The Group used 9 basis points of capital for the acquisition of the Tesco UK prime residential mortgage portfolio.

Overall the Group's CET1 capital ratio is 15.0 per cent on a pro forma basis before ordinary dividends and 13.8 per cent on a pro forma basis after ordinary dividends (31 December 2018: 13.9 per cent pro forma, after ordinary dividends and incorporating the effects of the share buyback announced in February 2019).

Excluding the Insurance dividend paid in February 2020 the Group's actual CET1 ratio is 13.6 per cent after ordinary dividends (31 December 2018: 14.6 per cent).

The accrual for foreseeable dividends reflects the recommended final ordinary dividend of 2.25 pence per share.

The transitional total capital ratio, after ordinary dividends, reduced to 21.3 per cent (21.5 per cent on a pro forma basis), largely reflecting the reduction in CET1 capital and the net reduction in AT1 capital instruments, partially offset by the reduction in risk-weighted assets.

The UK leverage ratio, after ordinary dividends, reduced from 5.6 per cent on a pro forma basis to 5.2 per cent on a pro forma basis, largely reflecting the reduction in the fully loaded tier 1 capital position, partially offset by a reduction in the exposure measure.

## Total capital requirement

The Group's total capital requirement (TCR) as at 31 December 2019, being the aggregate of the Group's Pillar 1 and current Pillar 2A capital requirements, was £25,608 million (31 December 2018: £26,124 million).

## Capital resources

An analysis of the Group's capital position as at 31 December 2019 is presented in the following section on both a CRD IV transitional arrangements basis and a CRD IV fully loaded basis, as amended by provisions of the revised Capital Requirements Regulation (CRR II) that came into force in June 2019. In addition the Group's capital position reflects the application of the transitional arrangements for IFRS 9.

Risk management continued

## Table 1.39: Capital resources (audited)

The table below summarises the consolidated capital position of the Group. The Group's Pillar 3 Report will provide a comprehensive analysis of the own funds of the Group.

| | Transitional | | Fully loaded | |
|---|---|---|---|---|
| | At 31 Dec 2019 £m | At 31 Dec 2018 £m | At 31 Dec 2019 £m | At 31 Dec 2018 £m |
| **Common equity tier 1** | | | | |
| Shareholders' equity per balance sheet | **41,697** | 43,434 | **41,697** | 43,434 |
| Adjustment to retained earnings for foreseeable dividends | **(1,586)** | (1,523) | **(1,586)** | (1,523) |
| Deconsolidation adjustments[1] | **2,337** | 2,273 | **2,337** | 2,273 |
| Adjustment for own credit | **26** | (280) | **26** | (280) |
| Cash flow hedging reserve | **(1,504)** | (1,051) | **(1,504)** | (1,051) |
| Other adjustments | **247** | (19) | **247** | (19) |
| | **41,217** | 42,834 | **41,217** | 42,834 |
| **less: deductions from common equity tier 1** | | | | |
| Goodwill and other intangible assets | **(4,179)** | (3,667) | **(4,179)** | (3,667) |
| Prudent valuation adjustment | **(509)** | (529) | **(509)** | (529) |
| Excess of expected losses over impairment provisions and value adjustments | **(243)** | (27) | **(243)** | (27) |
| Removal of defined benefit pension surplus | **(531)** | (994) | **(531)** | (994) |
| Securitisation deductions | **(185)** | (191) | **(185)** | (191) |
| Significant investments[1] | **(4,626)** | (4,222) | **(4,626)** | (4,222) |
| Deferred tax assets | **(3,200)** | (3,037) | **(3,200)** | (3,037) |
| **Common equity tier 1 capital** | **27,744** | 30,167 | **27,744** | 30,167 |
| **Additional tier 1** | | | | |
| Other equity instruments | **5,881** | 6,466 | **5,881** | 6,466 |
| Preference shares and preferred securities[2] | **4,127** | 4,008 | **–** | – |
| Transitional limit and other adjustments | **(2,474)** | (1,804) | **–** | – |
| | **7,534** | 8,670 | **5,881** | 6,466 |
| **less: deductions from tier 1** | | | | |
| Significant investments[1] | **(1,286)** | (1,298) | **–** | – |
| **Total tier 1 capital** | **33,992** | 37,539 | **33,625** | 36,633 |
| **Tier 2** | | | | |
| Other subordinated liabilities[2] | **13,003** | 13,648 | **13,003** | 13,648 |
| Deconsolidation of instruments issued by insurance entities[1] | **(1,796)** | (1,767) | **(1,796)** | (1,767) |
| Adjustments for transitional limit and non-eligible instruments | **2,278** | 1,504 | **(2,204)** | (1,266) |
| Amortisation and other adjustments | **(3,101)** | (2,717) | **(3,101)** | (2,717) |
| | **10,384** | 10,668 | **5,902** | 7,898 |
| **less: deductions from tier 2** | | | | |
| Significant investments[1] | **(960)** | (973) | **(2,246)** | (2,271) |
| **Total capital resources** | **43,416** | 47,234 | **37,281** | 42,260 |
| **Risk-weighted assets (unaudited)** | **203,431** | 206,366 | **203,431** | 206,366 |
| Common equity tier 1 capital ratio[3] | **13.6%** | 14.6% | **13.6%** | 14.6% |
| Tier 1 capital ratio | **16.7%** | 18.2% | **16.5%** | 17.8% |
| Total capital ratio | **21.3%** | 22.9% | **18.3%** | 20.5% |

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 (via 'significant investments' in the table above) and the remaining amount is risk-weighted, forming part of threshold risk-weighted assets.

2 Preference shares, preferred securities and other subordinated liabilities are categorised as subordinated liabilities in the balance sheet.

3 The common equity tier 1 ratio is 13.8 per cent on a pro forma basis reflecting the dividend paid up by the Insurance business in February 2020 in relation to its 2019 earnings (31 December 2018: 13.9 per cent pro forma, incorporating the effects of the share buyback announced in February 2019).

## Movements in capital resources

The key difference between the transitional capital calculation as at 31 December 2019 and the fully loaded equivalent is primarily related to capital securities that previously qualified as tier 1 or tier 2 capital, but that do not fully qualify under the regulation, which can be included in additional tier 1 (AT1) or tier 2 capital (as applicable) up to specified limits which reduce by 10 per cent per annum until 2022. In addition, following revisions to eligibility criteria for capital instruments under CRR II, certain tier 1 capital instruments of the Group that will transition to tier 2 capital by 2022 will cease to qualify as regulatory capital in June 2025. The key movements on a transitional basis are set out in the table below.

Table 1.40: **Movements in capital resources**

| | Common Equity tier 1 £m | Additional Tier 1 £m | Tier 2 £m | Total capital £m |
|---|---|---|---|---|
| At 31 December 2018 | 30,167 | 7,372 | 9,695 | 47,234 |
| Banking profit attributable to ordinary shareholders[1] | **2,228** | **–** | **–** | **2,228** |
| Movement in foreseeable dividends[2] | **(63)** | **–** | **–** | **(63)** |
| Dividends paid out on ordinary shares during the year | **(2,312)** | **–** | **–** | **(2,312)** |
| Dividends received from the Insurance business[1] | **450** | **–** | **–** | **450** |
| Share buyback completed | **(1,095)** | **–** | **–** | **(1,095)** |
| IFRS 9 transitional adjustment to retained earnings | **(49)** | **–** | **–** | **(49)** |
| Movement in treasury shares and employee share schemes | **233** | **–** | **–** | **233** |
| Pension movements: | | | | |
| Removal of defined benefit pension surplus | **463** | **–** | **–** | **463** |
| Movement through other comprehensive income | **(1,117)** | **–** | **–** | **(1,117)** |
| Fair value through other comprehensive income reserve | **(142)** | **–** | **–** | **(142)** |
| Prudent valuation adjustment | **20** | **–** | **–** | **20** |
| Deferred tax asset | **(163)** | **–** | **–** | **(163)** |
| Goodwill and other intangible assets | **(512)** | **–** | **–** | **(512)** |
| Excess of expected losses over impairment provisions and value adjustments | **(216)** | **–** | **–** | **(216)** |
| Significant investments | **(404)** | **12** | **13** | **(379)** |
| Movements in other equity, subordinated debt and other tier 2 items: | | | | |
| Repurchases, redemptions and other | **–** | **(2,032)** | **(284)** | **(2,316)** |
| Issuances | **–** | **896** | **–** | **896** |
| Other movements | **256** | **–** | **–** | **256** |
| **At 31 December 2019** | **27,744** | **6,248** | **9,424** | **43,416** |

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 are recognised through CET1 capital. The £450 million of dividends received from Insurance during the year include £350 million in respect of their 2018 full year ordinary dividend and £100 million in respect of their 2019 interim ordinary dividend.

2 Reflects the accrual for the 2019 full year ordinary dividend and the reversal of the accrual for the 2018 full year ordinary dividend which was paid during the year.

CET1 capital resources have reduced by £2,423 million over the year, primarily reflecting:

- the interim dividend paid in September 2019 and the accrual for the 2019 full year ordinary dividend
- the extent of the 2019 share buyback programme completed during the year prior to the cancellation of the remaining 2019 buyback programme in September 2019
- the impact of additional pension contributions made during the year
- the increase in other intangible assets, excess expected losses and significant investments in financial sector entities
- offset in part by profit generation during the year (net of PPI provision charges), the receipt of dividends paid by the Insurance business during the year and movements in treasury shares and employee share schemes

AT1 capital resources have reduced by £1,124 million over the year, primarily reflecting a redemption during the year and the annual reduction in the transitional limit applied to grandfathered AT1 capital instruments, offset in part by the issuance of new capital instruments.

Tier 2 capital resources have reduced by £271 million over the year, largely reflecting the amortisation of dated instruments and a reduction in eligible provisions, partially offset by the transitioning of grandfathered AT1 instruments to tier 2.

Risk management continued

## Table 1.41: Minimum requirement for own funds and eligible liabilities (MREL)

An analysis of the Group's current transitional MREL position is provided below.

| | Transitional[2] | |
|---|---|---|
| | At 31 Dec 2019 £m | At 31 Dec 2018 £m |
| Total capital resources (transitional basis) | 43,416 | 47,234 |
| Ineligible AT1 and tier 2 instruments[1] | (874) | (613) |
| Amortised portion of eligible tier 2 instruments issued by Lloyds Banking Group plc | 24 | – |
| Senior unsecured securities issued by Lloyds Banking Group plc | 23,554 | 20,213 |
| **Total MREL resources[2]** | 66,120 | 66,834 |
| **Risk-weighted assets** | 203,431 | 206,366 |
| **MREL ratio[3]** | 32.5% | 32.4% |
| **Leverage exposure measure** | 654,387 | 663,277 |
| **MREL leverage ratio** | 10.1% | 10.1% |

1 Instruments with less than one year to maturity or governed under non-EEA law without a contractual bail-in clause.

2 Until 2022, externally issued regulatory capital in operating entities can count towards the Group's MREL to the extent that such capital would count towards the Group's consolidated capital resources.

3 The MREL ratio is 32.6 per cent on a pro forma basis upon recognition of the dividend paid up by the Insurance business in February 2020 in relation to its 2019 earnings (31 December 2018: 32.6 per cent pro forma).

During 2019, the Group issued externally £3.5 billion (sterling equivalent) of senior unsecured securities from Lloyds Banking Group plc which, while not included in total capital, are eligible to meet MREL requirements. Combined with previous issuances made over the last few years the Group remains comfortably positioned to meet MREL requirements from 1 January 2020 and, as at 31 December 2019, had a transitional MREL ratio of 32.5 per cent of risk-weighted assets.

Total MREL resources reduced by £714 million, largely as a result of the reduction in total capital resources, offset in part by the increase in senior unsecured securities following the issuances made during the year.

## Table 1.42: Risk-weighted assets

| | At 31 Dec 2019 £m | At 31 Dec 2018 £m |
|---|---|---|
| Foundation Internal Ratings Based (IRB) Approach | 53,842 | 60,555 |
| Retail IRB Approach | 63,208 | 59,522 |
| Other IRB Approach | 18,544 | 15,666 |
| **IRB Approach** | 135,594 | 135,743 |
| Standardised (STA) Approach | 24,420 | 25,757 |
| **Credit risk** | 160,014 | 161,500 |
| Counterparty credit risk | 5,083 | 5,718 |
| Contributions to the default funds of central counterparties | 210 | 830 |
| Credit valuation adjustment risk | 584 | 702 |
| Operational risk | 25,482 | 25,505 |
| Market risk | 1,790 | 2,085 |
| **Underlying risk-weighted assets** | 193,163 | 196,340 |
| Threshold risk-weighted assets[1] | 10,268 | 10,026 |
| **Total risk-weighted assets** | 203,431 | 206,366 |

1 Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of being deducted from CET1 capital. Significant investments primarily arise from investment in the Group's Insurance business.

Table 1.43: **Risk-weighted assets movement by key driver**

| | Credit risk IRB £m | Credit risk STA £m | Credit risk total[1] £m | Counterparty credit risk[2] £m | Market risk £m | Operational risk £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Total risk-weighted assets as at 31 December 2018** | | | | | | | 206,366 |
| Less threshold risk-weighted assets[3] | | | | | | | (10,026) |
| **Risk-weighted assets as at 31 December 2018** | 135,743 | 25,757 | 161,500 | 7,250 | 2,085 | 25,505 | 196,340 |
| Asset size | **(2,707)** | **(1,184)** | **(3,891)** | **(257)** | **(110)** | **–** | **(4,258)** |
| Asset quality | **2,190** | **(682)** | **1,508** | **(672)** | **–** | **–** | **836** |
| Model updates | **2,284** | **–** | **2,284** | **–** | **(110)** | **–** | **2,174** |
| Methodology and policy | **(1,083)** | **(747)** | **(1,830)** | **(339)** | **4** | **–** | **(2,165)** |
| Acquisitions and disposals | **–** | **1,326** | **1,326** | **–** | **–** | **–** | **1,326** |
| Movements in risk levels (market risk only) | **–** | **–** | **–** | **–** | **(79)** | **–** | **(79)** |
| Foreign exchange movements | **(833)** | **(50)** | **(883)** | **(105)** | **–** | **–** | **(988)** |
| Other | **–** | **–** | **–** | **–** | **–** | **(23)** | **(23)** |
| **Risk-weighted assets as at 31 December 2019** | **135,594** | **24,420** | **160,014** | **5,877** | **1,790** | **25,482** | **193,163** |
| Threshold risk-weighted assets[3] | | | | | | | **10,268** |
| **Risk-weighted assets as at 31 December 2019** | | | | | | | **203,431** |

1 Credit risk includes securitisation risk-weighted assets.

2 Counterparty credit risk includes movements in contributions to the default funds of central counterparties and movements in credit valuation adjustment risk.

3 Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of being deducted from CET1 capital. Significant investments primarily arise from investments in the Group's Insurance business.

The risk-weighted assets movement table provides analysis of the movement 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, risk-weighted assets:

- Asset size reduction of £3.9 billion, largely driven by commercial portfolio management, includes changes in book size (both drawn and undrawn balances) and composition, excluding acquisitions and disposals
- Asset quality increase of £1.5 billion includes increases in the valuation of equity investments as well as movements due to changes in borrower risk, including changes in the macro-economic environment
- Model updates increase in risk-weighted assets of £2.3 billion which relates to changes to the Retail mortgage models
- Methodology and policy changes reduced risk-weighted assets by £1.8 billion principally as a result of securitisation activity, partially offset by the introduction of IFRS 16
- Acquisition and disposals increase of £1.3 billion reflects the purchase of the Tesco Bank UK prime residential mortgage portfolio

Counterparty credit risk, risk-weighted assets reduced by £1.4 billion due to reduced contributions to the default fund of a central counterparty, movement in CVA and a reduction in asset size.

Market risk, risk-weighted assets reductions of £0.3 billion were driven by refinements to internal models, a change in the business model following ring-fencing and movement in risk levels.

## Leverage ratio

### Analysis of leverage movements

The Group's fully loaded UK leverage ratio reduced to 5.1 per cent, primarily driven by the reduction in tier 1 capital. This was partially offset by the £8.9 billion reduction in the leverage exposure measure which largely reflected the reduction in the derivatives exposure measure and off-balance sheet items.

On a pro forma basis the UK leverage ratio reduced to 5.2 per cent from 5.6 per cent pro forma at 31 December 2018.

The derivatives exposure measure, representing derivative financial instruments per the balance sheet net of deconsolidation and derivatives adjustments, reduced by £3.6 billion during the period, predominantly reflecting a move from a collateralised-to-market to a settled-to-market approach for swaps transacted through a central counterparty.

The SFT exposure measure, representing SFT assets per the balance sheet net of deconsolidation and other SFT adjustments, reduced by £0.6 billion during the period, largely reflecting a reduction in volumes.

Off-balance sheet items reduced by £3.2 billion during the period, reflecting an overall reduction in corporate facilities driven by commercial portfolio management, offset in part by new residential mortgage offers placed.

The average UK leverage ratio of 5.0 per cent over the quarter largely reflected a higher average exposure measure compared to the position at 31 December 2019, with the reductions in the derivative exposure measure and off-balance sheet items described above largely occurring towards the end of the quarter.

Risk management continued

Table 1.44: **Leverage ratio**

| | Fully loaded | |
|---|---|---|
| | At 31 Dec 2019 £m | At 31 Dec 2018 £m |
| **Total tier 1 capital for leverage ratio** | | |
| Common equity tier 1 capital | 27,744 | 30,167 |
| Additional tier 1 capital | 5,881 | 6,466 |
| **Total tier 1 capital** | 33,625 | 36,633 |
| **Exposure measure** | | |
| **Statutory balance sheet assets** | | |
| Derivative financial instruments | 26,369 | 23,595 |
| Securities financing transactions | 67,424 | 69,301 |
| Loans and advances and other assets | 740,100 | 704,702 |
| **Total assets** | 833,893 | 797,598 |
| **Qualifying central bank claims** | (49,590) | (50,105) |
| **Deconsolidation adjustments**[1] | | |
| Derivative financial instruments | (1,293) | (1,376) |
| Securities financing transactions | (334) | (487) |
| Loans and advances and other assets | (167,410) | (130,048) |
| **Total deconsolidation adjustments** | (169,037) | (131,911) |
| **Derivatives adjustments** | | |
| Adjustments for regulatory netting | (11,298) | (8,828) |
| Adjustments for cash collateral | (12,551) | (10,536) |
| Net written credit protection | 458 | 539 |
| Regulatory potential future exposure | 16,337 | 18,250 |
| **Total derivatives adjustments** | (7,054) | (575) |
| **Securities financing transactions adjustments** | 1,164 | 40 |
| **Off-balance sheet items** | 53,191 | 56,393 |
| **Regulatory deductions and other adjustments** | (8,180) | (8,163) |
| **Total exposure measure**[2] | 654,387 | 663,277 |
| **Average exposure measure**[3] | 667,433 | |
| **UK Leverage ratio**[2,4] | 5.1% | 5.5% |
| **Average UK leverage ratio**[3] | 5.0% | |
| **CRD IV exposure measure**[5] | 703,977 | 713,382 |
| **CRD IV leverage ratio**[5] | 4.8% | 5.1% |

1 Deconsolidation adjustments relate to the deconsolidation of certain Group entities that fall outside the scope of the Group's regulatory capital consolidation, being primarily the Group's Insurance business.

2 Calculated in accordance with the UK Leverage Ratio Framework which requires qualifying central bank claims to be excluded from the leverage exposure measure.

3 The average UK leverage ratio is based on the average of the month end tier 1 capital position and average exposure measure over the quarter (1 October 2019 to 31 December 2019). The average of 5.0 per cent compares to 4.9 per cent at the start and 5.1 per cent at the end of the quarter.

4 The UK leverage ratio is 5.2 per cent on a pro forma basis upon recognition of the dividend paid up by the Insurance business in February 2020 in relation to its 2019 earnings (31 December 2018: 5.6 per cent pro forma).

5 Calculated in accordance with CRD IV rules which include central bank claims within the leverage exposure measure.

Table 1.45 : **Application of IFRS 9 on a full impact basis for capital and leverage**

| | IFRS 9 full impact | |
|---|---|---|
| | At 31 Dec 2019 | At 31 Dec 2018 |
| Common equity tier 1 (£m) | **27,002** | 29,592 |
| Transitional tier 1 (£m) | **33,249** | 36,964 |
| Transitional total capital (£m) | **43,153** | 47,195 |
| Total risk-weighted assets (£m) | **203,083** | 206,614 |
| Common equity tier 1 ratio (%) | **13.3%** | 14.3% |
| Transitional tier 1 ratio (%) | **16.4%** | 17.9% |
| Transitional total capital ratio (%) | **21.2%** | 22.8% |
| UK leverage ratio exposure measure (£m) | **653,643** | 663,182 |
| UK leverage ratio (%) | **5.0%** | 5.4% |

The Group has opted to apply paragraph 4 of CRR Article 473a (the 'transitional rules') which allows for additional capital relief in respect of any post 1 January 2018 increase in Stage 1 and Stage 2 IFRS 9 expected credit loss provisions (net of regulatory expected losses) during the transition period. As at 31 December 2019 no additional capital relief has been recognised.

## Stress testing

The Group undertakes a wide-ranging programme of stress testing providing a comprehensive view of the potential impacts arising from the risks to which the Group and its key legal entities are exposed. One of the most important uses of stress testing is to assess the resilience of the operational and strategic plans of the Group and its legal entities to adverse economic conditions and other key vulnerabilities. As part of this programme the Group conducted a macroeconomic stress test of the four year operating plan in the first quarter of 2019.

The Group also participates in the UK wide Annual Cyclical Scenario stress tests run by the Bank of England. In the 2019 Bank of England stress test the Group exceeded the capital and leverage hurdles on a transitional basis after the application of management actions and was not required to take any action as a result of the test.

## G-SIB indicators

Although the Group is not currently classified as a Global Systemically Important Bank (G-SIB), by virtue of the Group's leverage exposure measure exceeding €200 billion the Group is required to report G-SIB indicator metrics to the PRA. The Group's indicator metrics used within the 2019 Basel G-SIBs annual exercise will be disclosed from April 2020 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.

Scottish Widows Limited (SW Ltd) holds the only with-profit fund managed by the Group. Each insurance company within the Group is regulated by the PRA.

The Solvency II regime for insurers and insurance groups came into force from 1 January 2016. The insurance businesses are required to calculate solvency capital requirements and available capital on a risk-based approach. The Insurance business of the Group calculates regulatory capital on the basis of an internal model, which was approved by the PRA on 5 December 2015, with the latest major change to the model approved in December 2019.

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.

All minimum regulatory requirements of the insurance companies have been met during the year.

# 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. Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due.

## Exposure

Liquidity exposure represents the potential stressed outflows in any future period less expected inflows. The Group considers liquidity exposure 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 maturities with behavioural overlays as appropriate. Note 53 on page 289 sets out an analysis of assets and liabilities by relevant maturity grouping. The Group undertakes quantitative and qualitative analysis of the behavioural aspects of its assets and liabilities in order to reflect their expected behaviour.

## Mitigation

The Group manages and monitors liquidity risks and ensures that liquidity risk management systems and arrangements are adequate with regard to the internal risk appetite, Group strategy and regulatory requirements. Liquidity policies and procedures are subject to independent internal oversight by Risk. Overseas branches and subsidiaries of the Group may also be required to meet the liquidity requirements of the entity's domestic country. Management of liquidity requirements is performed by the overseas branch or subsidiary in line with Group policy. Liquidity risk of the Insurance business is actively managed and monitored within the Insurance business. The Group plans funding requirements over the life of the funding plan, combining business as usual and stressed conditions. The Group manages its liquidity position both with regard to its internal risk appetite and the Liquidity Coverage Ratio (LCR) as required by the PRA and Capital Requirements Directive and Regulation (CRD IV) liquidity requirements.

The Group's funding and liquidity position is underpinned by its significant customer deposit base, and is supported by strong relationships across customer segments. The Group has consistently observed that in aggregate the retail deposit base provides a stable source of funding. Funding concentration by counterparty, currency and tenor is monitored on an ongoing basis and where concentrations do exist, these are managed as part of the planning process and limited by internal funding and liquidity risk monitoring framework, with analysis regularly provided to senior management.

To assist in managing the balance sheet, the Group operates a Liquidity Transfer Pricing (LTP) process which: allocates relevant interest expenses from the centre to the Group's banking businesses within the internal management accounts; helps drive the correct inputs to customer pricing; and is consistent with regulatory requirements. LTP makes extensive use of behavioural maturity profiles, taking account of expected customer loan prepayments and stability of customer deposits, modelled on historic data.

The Group can monetise liquid assets quickly, either through the repurchase agreements (repo) market or through outright sale. In addition, the Group has pre-positioned a substantial amount of assets at the Bank of England's Discount Window Facility which can be used to access additional liquidity in a time of stress. The Group considers diversification across geography, currency, markets and tenor when assessing appropriate holdings of liquid assets. The Group's liquid asset buffer is available for deployment at immediate notice, subject to complying with regulatory requirements.

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, for example, a significant weather event. Liquidity risk is actively managed and monitored within the Insurance business to ensure that it remains within approved risk appetite, so that even under stress conditions, there is sufficient liquidity to meet obligations.

## Monitoring

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. This captures regulatory metrics as well as metrics the Group considers relevant for its liquidity profile. These are a mixture of quantitative and qualitative measures, including: daily variation of customer balances; changes in maturity profiles; funding concentrations; changes in LCR outflows; credit default swap (CDS) spreads; and basis risks.

The Group carries out internal stress testing of its liquidity and potential cash flow mismatch position over both short (up to one month) and longer-term horizons against a range of scenarios forming an important part of the internal risk appetite. The scenarios and assumptions are reviewed at least annually to ensure that they continue to be relevant to the nature of the business including reflecting emerging horizon risks to the Group. For further information on the Group's 2019 liquidity stress testing results refer to page 179.

The Group maintains a Contingency Funding Framework as part of the wider Recovery 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 2019

The Group has maintained its strong funding and liquidity position with a stable loan to deposit ratio of 107 per cent.

During 2019, the Group repaid its Funding for Lending Scheme (FLS) contractual maturities of £12.1 billion and early repaid £4.5 billion of its Term Funding Scheme (TFS) drawings, representing all of its 2020 TFS maturities. This has reduced the balance of FLS outstanding to £1 billion and the balance of TFS to £15.4 billion as at 31 December 2019.

The Group's liquidity coverage ratio (LCR) was 137 per cent (based on a monthly rolling average over the previous 12 months) as at 31 December 2019 calculated on a consolidated basis based on the EU Delegated Act. Following the implementation of structural reform, liquidity risk is managed at a legal entity level with the Group consolidated LCR representing the composite of the ring-fenced bank and non ring-fenced bank entities.

The Group's credit ratings continue to reflect its robust balance sheet, resilient underlying profitability and bail-in capital position. There were no changes to the ratings over 2019, although in November, Moody's revised the Group's and Lloyds Bank plc's outlooks to negative due to concern relating to the UK's exit from the European Union. In March Fitch placed the majority of UK banks, including the Group's entities, on Ratings Watch Negative before stabilising the ratings in December given the reduced risk of a no-deal exit from the EU.

Table 1.46: **Group funding position**

| | At 31 Dec 2019 £bn | At 31 Dec 2018 £bn | Change % |
|---|---|---|---|
| **Funding requirement** | | | |
| Loans and advances to customers[1] | **440.4** | 444.4 | (1) |
| Loans and advances to banks[2] | **8.1** | 5.9 | 37 |
| Debt securities at amortised cost | **3.9** | 4.0 | (3) |
| Reverse repurchase agreements | **–** | – | – |
| Financial assets at fair value through other comprehensive income – non-LCR eligible[3] | **0.1** | 0.8 | (88) |
| Cash and balances at central bank – non-LCR eligible[4] | **5.7** | 5.8 | (2) |
| **Funded assets** | **458.2** | 460.9 | – |
| Other assets[5] | **251.7** | 212.9 | 18 |
| | **709.9** | 673.8 | 5 |
| **On balance sheet LCR eligible liquid assets** | | | |
| Reverse repurchase agreements | **56.2** | 40.9 | 37 |
| Cash and balances at central banks[4] | **49.4** | 48.9 | 1 |
| Debt securities at amortised cost | **1.6** | 1.2 | 33 |
| Financial assets at fair value through other comprehensive income | **25.0** | 24.0 | 4 |
| Trading and fair value through profit and loss | **4.0** | 11.9 | (66) |
| Repurchase agreements | **(12.2)** | (3.1) | |
| | **124.0** | 123.8 | – |
| **Total Group assets** | **833.9** | 797.6 | 5 |
| Less: other liabilities[5] | **(230.6)** | (187.9) | 23 |
| **Funding requirement** | **603.3** | 609.7 | (1) |
| **Funded by** | | | |
| Customer deposits[6] | **411.8** | 416.3 | (1) |
| Wholesale funding[7] | **128.3** | 123.3 | 4 |
| | **540.1** | 539.6 | – |
| Term funding scheme | **15.4** | 19.9 | (23) |
| Total equity | **47.8** | 50.2 | (5) |
| **Total funding** | **603.3** | 609.7 | (1) |

1 Excludes reverse repos of £54.6 billion (31 December 2018: £40.5 billion).

2 Excludes £0.1 billion (31 December 2018: £nil) of loans and advances to banks within the Insurance business and £1.6 billion (31 December 2018: £0.4 billion) of reverse repurchase agreements.

3 Non-LCR eligible liquid assets comprise a diversified pool of highly rated unencumbered collateral (including retained issuance).

4 Cash 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 Excludes repos of £9.5 billion (31 December 2018: £1.8 billion).

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.

**Risk management** continued

## Table 1.47 Reconciliation of Group funding to the balance sheet (audited)

| | Included in funding analysis £bn | Repos and cash collateral received by Insurance £bn | Fair value and other accounting methods £bn | Balance sheet £bn |
|---|---|---|---|---|
| **At 31 December 2019** | | | | |
| Deposits from banks | 9.6 | 18.7 | (0.1) | 28.2 |
| Debt securities in issue | 102.1 | – | (4.4) | 97.7 |
| Subordinated liabilities | 16.6 | – | 0.5 | 17.1 |
| **Total wholesale funding** | 128.3 | 18.7 | | |
| Customer deposits | 411.8 | 9.5 | – | 421.3 |
| **Total** | 540.1 | 28.2 | | |
| At 31 December 2018 | | | | |
| Deposits from banks | 8.3 | 22.1 | (0.1) | 30.3 |
| Debt securities in issue | 97.1 | – | (5.9) | 91.2 |
| Subordinated liabilities | 17.9 | – | (0.2) | 17.7 |
| Total wholesale funding | 123.3 | 22.1 | | |
| Customer deposits | 416.3 | 1.8 | – | 418.1 |
| Total | 539.6 | 23.9 | | |

## Table 1.48: Analysis of 2019 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 2019 £bn | Total at 31 Dec 2018 £bn |
|---|---|---|---|---|---|---|---|---|---|---|
| Deposits from banks | 7.3 | 1.3 | 0.3 | 0.1 | 0.1 | 0.2 | 0.3 | – | 9.6 | 8.3 |
| Debt securities in issue: | | | | | | | | | | |
| Certificates of deposit | 1.2 | 2.6 | 2.8 | 2.4 | 1.2 | 0.4 | – | – | 10.6 | 12.0 |
| Commercial paper | 1.3 | 3.5 | 2.8 | 0.9 | 0.4 | – | – | – | 8.9 | 8.0 |
| Medium-term notes | 1.0 | 0.8 | 1.8 | 1.2 | 0.2 | 6.6 | 19.3 | 17.1 | 48.0 | 45.4 |
| Covered bonds | 0.8 | 1.3 | – | 2.9 | – | 6.1 | 10.6 | 7.0 | 28.7 | 27.1 |
| Securitisation | 0.4 | – | 1.1 | 0.9 | 0.4 | 1.7 | 1.4 | – | 5.9 | 4.6 |
| | 4.7 | 8.2 | 8.5 | 8.3 | 2.2 | 14.8 | 31.3 | 24.1 | 102.1 | 97.1 |
| Subordinated liabilities | – | 1.2 | – | 1.0 | 0.1 | 0.5 | 4.3 | 9.5 | 16.6 | 17.9 |
| **Total wholesale funding**[1] | 12.0 | 10.7 | 8.8 | 9.4 | 2.4 | 15.5 | 35.9 | 33.6 | 128.3 | 123.3 |

1 The Group's definition of wholesale funding aligns with that used by other international market participants; including interbank deposits, debt securities and subordinated liabilities.

## Table 1.49: Total wholesale funding by currency (audited)

| | Sterling £bn | US Dollar £bn | Euro £bn | Other currencies £bn | Total £bn |
|---|---|---|---|---|---|
| **At 31 December 2019** | 28.7 | 49.6 | 40.9 | 9.1 | 128.3 |
| At 31 December 2018 | 25.8 | 45.2 | 42.8 | 9.5 | 123.3 |

## Table 1.50: Analysis of 2019 term issuance (audited)

| | Sterling £bn | US Dollar £bn | Euro £bn | Other currencies £bn | Total £bn |
|---|---|---|---|---|---|
| Securitisation | 1.6 | 0.4 | – | – | 2.0 |
| Medium-term notes | 0.5 | 3.2 | 1.8 | 1.1 | 6.6 |
| Covered bonds | 2.0 | 0.8 | 2.8 | – | 5.6 |
| Private placements[1] | 0.1 | 0.3 | 0.9 | – | 1.3 |
| Subordinated liabilities[2] | 0.5 | 0.4 | – | – | 0.9 |
| **Total issuance** | 4.7 | 5.1 | 5.5 | 1.1 | 16.4 |

1 Private placements include structured bonds.

2 Consists of AT1 issuances.

The Group continues to access wholesale funding markets across a wide range of products, currencies and investors to maintain a stable and diverse source of funds. In 2019, the Group has continued with this approach to funding, including capital and funding from the holding company, Lloyds Banking Group plc, as needed to transition towards final UK Minimum Requirements for Own Funds and Eligible Liabilities (MREL). The Group will continue to issue funding trades from Lloyds Bank plc, the ring-fenced bank operating company, across senior unsecured, covered bonds, ABS and RMBS. In 2019, the Group launched an operating company funding programme for LBCM, the non-ring-fenced bank, and have since issued a number of trades for this entity including an inaugural five year £500 million senior unsecured public benchmark transaction. The maturity of the Funding for Lending and Term Funding Schemes are fully factored into the Group's funding plans.

## Liquidity Portfolio

At 31 December 2019, the banking business had £118.3 billion of highly liquid unencumbered LCR eligible assets (31 December 2018: £129.4 billion), of which £115.7 billion is LCR level 1 eligible (31 December 2018: £128.6 billion) and £2.6 billion is LCR level 2 eligible (31 December 2018: £0.8 billion). These assets are available to meet cash and collateral outflows and regulatory requirements. Total LCR eligible liquid assets represent over five times the Group's money market funding less than one year to maturity (excluding derivative collateral margins and settlement accounts) and thus provide a substantial buffer in the event of market dislocation. The Insurance business manages a separate liquidity portfolio to mitigate insurance liquidity risk.

### Table 1.51: LCR eligible assets

| | At 31 Dec 2019 £bn | At 31 Dec 2018 £bn | Change % | Average 2019 £bn | Average 2018 £bn |
|---|---|---|---|---|---|
| **Level 1** | | | | | |
| Cash and central bank reserves | **49.4** | 48.9 | 1 | **50.9** | 58.1 |
| High quality government/MDB/agency bonds[1] | **63.9** | 78.7 | (19) | **76.4** | 66.2 |
| High quality covered bonds | **2.4** | 1.0 | | **1.9** | 0.8 |
| **Total** | **115.7** | 128.6 | (10) | **129.2** | 125.1 |
| Level 2[2] | **2.6** | 0.8 | | **1.5** | 0.8 |
| **Total LCR eligible assets** | **118.3** | 129.4 | (9) | **130.7** | 125.9 |

1 Designated multilateral development bank (MDB).

2 Includes Level 2A and Level 2B.

### Table 1.52: LCR eligible assets by currency

| | Sterling £bn | US Dollar £bn | Euro £bn | Other currencies £bn | Total £bn |
|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | |
| Level 1 | **91.5** | **11.7** | **12.5** | **–** | **115.7** |
| Level 2 | **1.7** | **0.5** | **0.4** | **–** | **2.6** |
| **Total** | **93.2** | **12.2** | **12.9** | **–** | **118.3** |
| At 31 December 2018 | | | | | |
| Level 1 | 98.2 | 19.8 | 10.6 | – | 128.6 |
| Level 2 | 0.4 | 0.4 | – | – | 0.8 |
| **Total** | 98.6 | 20.2 | 10.6 | – | 129.4 |

The banking business also has a significant amount of non-LCR eligible liquid assets which are eligible for use in a range of central bank or similar facilities. Future use of such facilities will be based on prudent liquidity management and economic considerations, having regard for external market conditions.

## Stress testing results

Internal liquidity stress testing results at 31 December 2019 showed that the banking business had liquidity resources representing 158 per cent of modelled outflows over a three month period from all wholesale funding sources, retail and corporate deposits, intraday requirements and rating dependent contracts under the Group's most severe liquidity stress scenario.

This scenario includes a two notch downgrade of the Group's current long-term debt rating and accompanying one notch short-term downgrade implemented instantaneously by all major rating agencies.

## 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 Board and the Group Asset and Liability Committee (GALCO) monitor and manage total balance sheet encumbrance using a number of risk appetite metrics. At 31 December 2019, the Group had £60.6 billion (31 December 2018: £53.4 billion) of externally encumbered on-balance sheet assets with counterparties other than central banks. The increase in encumbered assets was primarily driven by an increase in covered bond issuance. The Group also had £639.5 billion (31 December 2018: £584.3 billion) of unencumbered on-balance sheet assets, and £133.7 billion (31 December 2018: £159.8 billion) of pre-positioned and encumbered assets held with central banks, the reduction in the latter was primarily driven by a decrease in encumbrance relating to FLS and TFS maturities in the year. 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.

Risk management continued

Table 1.53: **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 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Securitisations £m | Covered bond £m | Other £m | Total £m | £m | Readily realisable[1] £m | Other realisable assets[2] £m | Cannot be used[3] £m | Total £m | Total £m |
| **At 31 December 2019** | | | | | | | | | | |
| Cash and balances at central banks | – | – | – | – | – | 49,270 | – | 5,860 | 55,130 | 55,130 |
| Financial assets at fair value through profit or loss | 51 | – | 4,834 | 4,885 | – | 2,469 | – | 152,835 | 155,304 | 160,189 |
| Derivative financial instruments | – | – | – | – | – | – | – | 26,369 | 26,369 | 26,369 |
| Financial assets at amortised cost: | | | | | | | | | | |
| Loans and advances to banks | – | – | 1 | 1 | – | 1,858 | 3,851 | 4,065 | 9,774 | 9,775 |
| Loans and advances to customers | 7,319 | 33,161 | 7,109 | 47,589 | 133,732 | 14,087 | 171,370 | 128,210 | 313,667 | 494,988 |
| Debt securities | – | – | 553 | 553 | – | 3,200 | – | 1,791 | 4,991 | 5,544 |
| | 7,319 | 33,161 | 7,663 | 48,143 | 133,732 | 19,145 | 175,221 | 134,066 | 328,432 | 510,307 |
| Financial assets at fair value through other comprehensive income | – | – | 7,617 | 7,617 | – | 16,919 | – | 556 | 17,475 | 25,092 |
| Other[4] | – | – | – | – | – | – | 514 | 56,292 | 56,806 | 56,806 |
| **Total assets** | 7,370 | 33,161 | 20,114 | 60,645 | 133,732 | 87,803 | 175,735 | 375,978 | 639,516 | 833,893 |
| **At 31 December 2018** | | | | | | | | | | |
| Cash and balances at central banks | – | – | – | – | – | 49,645 | – | 5,018 | 54,663 | 54,663 |
| Trading and other financial assets at fair value through profit or loss | 54 | – | 2,646 | 2,700 | – | 5,190 | – | 150,639 | 155,829 | 158,529 |
| Derivative financial instruments | – | – | – | – | – | – | – | 23,595 | 23,595 | 23,595 |
| Financial assets at amortised cost: | | | | | | | | | | |
| Loans and advances to banks | – | – | 12 | 12 | – | 1,223 | 2,555 | 2,493 | 6,271 | 6,283 |
| Loans and advances to customers | 5,774 | 29,041 | 6,012 | 40,827 | 159,822 | 12,098 | 155,278 | 116,833 | 284,209 | 484,858 |
| Debt securities | – | – | 2,627 | 2,627 | – | 2,581 | 4 | 26 | 2,611 | 5,238 |
| | 5,774 | 29,041 | 8,651 | 43,466 | 159,822 | 15,902 | 157,837 | 119,352 | 293,091 | 496,379 |
| Financial assets at fair value through other comprehensive income: | – | – | 7,278 | 7,278 | – | 17,114 | – | 423 | 17,537 | 24,815 |
| Other[4] | – | – | – | – | – | 56 | 612 | 38,949 | 39,617 | 39,617 |
| **Total assets** | 5,828 | 29,041 | 18,575 | 53,444 | 159,822 | 87,907 | 158,449 | 337,976 | 584,332 | 797,598 |

1 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.

2 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.

3 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 segregated in order to meet the Financial Resilience requirements of the PRA's Supervisory Statement 9/6 'Operational Continuity in Resolution'; assets pledged to facilitate the use of intra-day payment and settlement systems; and reverse repos and derivatives balance sheet ledger items.

4 Other comprises: items in the course of collection from banks; investment properties; goodwill; value in-force business; other intangible assets; tangible fixed assets; current tax recoverable; deferred tax assets; retirement benefit assets; investments in joint ventures and associates; assets arising from reinsurance contracts held 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. 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.

## 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.

### 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, both within the UK and across the multiple jurisdictions within which it operates, with which it must comply.

### 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 enterprise risk management framework (ERMF) 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 managemen
- Supporting a consistent approach to Group-wide behaviour and risk decision-making through a Group policy framework which helps everyone understand their responsibilities by clearly articulating and communicating rules, standards, boundaries and risk appetite measures which can be controlled, enforced and monitored

Under the banner of the ERMF, training modules are in place to support all colleagues in understanding and fulfilling their risk responsibilities.

The Group's Code of Responsibility embodies its 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 code in all aspects of their roles.

Effective implementation of the ERMF mutually reinforces and is reinforced by the Group's risk culture, which is embedded in its approach to recruitment, selection, training, performance management and reward.

### Monitoring

A review of the Group's ERMF, 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.

For further information on corporate governance see pages 70 to 93.

# 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 prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and/or value.

## Balance sheet linkages

The information provided in table 1.54 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.

Table 1.54: **Market risk linkage to the balance sheet**

| | | Banking | | | |
|---|---|---|---|---|---|
| 2019 | Total £m | Trading book only £m | Non-trading £m | Insurance £m | Primary market risk factor |
| **Assets** | | | | | |
| Cash and balances at central banks | 55,130 | – | 55,130 | – | Interest rate |
| Financial assets at fair value through profit or loss | 160,189 | 17,982 | 5,352 | 136,855 | Interest rate, foreign exchange, credit spread |
| Derivative financial instruments | 26,369 | 18,885 | 5,119 | 2,365 | Interest rate, foreign exchange, credit spread |
| Financial assets at amortised cost | | | | | |
| Loans and advances to banks | 9,775 | – | 9,710 | 65 | Interest rate |
| Loans and advances to customers | 494,988 | – | 494,948 | 40 | Interest rate |
| Debt securities | 5,544 | – | 5,544 | – | Interest rate, credit spread |
| | 510,307 | – | 510,202 | 105 | |
| Financial assets at fair value through other comprehensive income | 25,092 | – | 25,092 | – | Interest rate, foreign exchange, credit spread |
| Value of in-force business | 5,558 | – | – | 5,558 | Equity |
| Other assets | 51,248 | – | 22,410 | 28,838 | Interest rate |
| Total assets | 833,893 | 36,867 | 623,305 | 173,721 | |
| **Liabilities** | | | | | |
| Deposit from banks | 28,179 | – | 28,179 | – | Interest rate |
| Customer deposits | 421,320 | – | 421,320 | – | Interest rate |
| Financial liabilities at fair value through profit or loss | 21,486 | 13,955 | 7,531 | – | Interest rate, foreign exchange |
| Derivative financial instruments | 25,779 | 15,654 | 7,719 | 2,406 | Interest rate, foreign exchange, credit spread |
| Debt securities in issue | 97,689 | – | 97,689 | – | Interest rate, credit spread |
| Liabilities arising from insurance and investment contracts | 148,908 | – | – | 148,908 | Credit spread |
| Subordinated liabilities | 17,130 | – | 15,335 | 1,795 | Interest rate, foreign exchange |
| Other liabilities | 25,596 | – | 10,678 | 14,918 | Interest rate |
| **Total liabilities** | 786,087 | 29,609 | 588,451 | 168,027 | |

The defined benefit pension schemes' assets and liabilities are included under Other assets and Other liabilities in this table and note 36 on page 253 provides further information.

The Group's trading book assets and liabilities are originated 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 meet the requirements as set out in the Capital Requirements Regulation, article 104. Further information on these activities can be found under the Trading portfolios section on page 187.

Derivative assets and liabilities are held by the Group 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. 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 243).

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 asset swapped and held at fair value through other comprehensive income with the remainder held as financial assets at fair value through profit and loss. Further information on these balances can be found under funding and liquidity risk on page 175.

The majority of debt issuance originates from the Group's capital and funding activities and the interest rate risk of the debt issued is hedged by swapping them into a floating rate.

The non-trading book primarily consists of customer on-balance sheet activities and the Group's capital and funding activities, which expose it to the risk of adverse movements in market prices, predominantly interest rates, credit spreads, exchange rates and equity prices, as described in further detail within the Banking activities section (page 183).

## Measurement

In addition to measuring single factors, Group risk appetite is calibrated primarily to five multi-risk Group economic 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 Group risk appetite is cascaded first to the Group Asset and Liability Committee (GALCO), chaired by the Chief Financial Officer, 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 metrics are reviewed regularly by senior management to inform effective decision-making.

## Mitigation

GALCO is responsible for approving and monitoring group market risks, management techniques, market risk measures, behavioural assumptions, and the market risk policy. Various mitigation activities are assessed and undertaken across the Group to manage portfolios and seek to ensure they remain within approved limits. The mitigation actions will vary dependent on exposure but will, in general, look to reduce risk in a cost effective manner by offsetting balance sheet exposures and externalising to the financial markets dependent on market liquidity. The market risk 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.

## 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 Board 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 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.

## Banking activities

### Exposures

The Group's banking activities expose it to the risk of adverse movements in market prices, predominantly interest rates, credit spreads, exchange rates and equity prices. 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, liability or instrument.

### Interest rate risk

Yield curve 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 1.54) and off-balance sheet positions.

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 two rates widens or tightens.

Optionality risk arises predominantly from embedded optionality within assets, liabilities or off-balance sheet items where either the Group or the customer can affect the size or timing of cash flows. One example of this is mortgage prepayment risk where the customer owns an option allowing them to prepay when it is economical to do so. This can result in customer balances amortising more quickly or slowly than anticipated due to customers' response to changes in economic conditions.

### 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 289). In addition, the Group incurs foreign exchange risk through non-functional currency flows from services provided by customer-facing divisions, the Group's debt and capital management programmes and is exposed to volatility in its CET1 ratio, due to the impact of changes in foreign exchange rates on the retranslation of non-sterling-denominated RWAs.

### Equity risk

Equity risk arises primarily from three different sources;

- the Group's private equity investments held by Lloyds Development Capital within the Equities sub-group
- the Group's strategic equity holdings, for example Visa Inc Preference Shares, now held in the Equities sub-group
- a small exposure to Lloyds Banking Group share price through deferred shares and deferred options granted to employees as part of their benefits package

### Credit spread risk

Credit spread risk arises largely from (i) the liquid asset portfolio held in the management of Group liquidity, comprising of government, supranational and other eligible assets; (ii) the Credit Valuation Adjustment (CVA) and Debit Valuation Adjustment (DVA) sensitivity to credit spreads; (iii) a number of the Group's structured medium-term notes where we have elected to fair value the notes through the profit and loss account; and (iv) banking book assets held at fair value in Commercial Banking under IFRS9.

## Measurement

Interest rate risk exposure is monitored monthly using, primarily:

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). The market value sensitivities are calculated on a static balance sheet using principal cash flows excluding interest, commercial margins and other spread components and are therefore discounted at the risk free zero-coupon rate.

Interest income sensitivity: this measures the 12 month impact on future net interest income arising from various economic scenarios. These include instantaneous 25, 100 and 200 basis point parallel shifts in all yield curves and the five Group economic scenarios (subject to an appropriate floor). These scenarios are reviewed every year and are designed to replicate severe but plausible economic events, capturing risks that would not be evident through the use of parallel shocks alone such as basis risk and steepening or flattening of the yield curve. An additional negative rates scenario is also used for information purposes where all floors are removed; however this is not measured against the limit framework.

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 changing rates. In addition a dynamic balance sheet is used which includes the run-off of current assets and liabilities and the addition of planned new business.

Reported sensitivities are not necessarily predictive of future performance as they do not capture additional management actions that would likely be taken in response to an immediate, large, movement in interest rates. These actions could reduce the net interest income sensitivity, help mitigate any adverse impacts or they may result in changes to total income that are not captured in the net interest income.

Structural hedge limits: the structural hedging programme managing interest rate risk in the banking book relies on a number of assumptions made around customer behaviour. A material mismatch between assumptions and reality could lead to a deterioration in earnings. In order to monitor this risk a number of metrics are in place to enhance understanding of risks within 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. The Group is aware that any assumptions based model is open to challenge. A full behavioural review is performed annually, or in response to changing market conditions, to ensure the assumptions remain appropriate and the model itself is subject to annual re-validation, as required under the Group Model Governance Policy. The key behavioural assumptions are:

- embedded optionality within products
- the duration of balances that are contractually repayable on demand, such as current accounts and overdrafts, together with net free reserves of the Group
- the re-pricing behaviour of managed rate liabilities namely variable rate savings

Table 1.55 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 rates.

### Table 1.55: Group Banking activities: market value sensitivity

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | **13.6** | **(13.6)** | **52.7** | **(47.4)** | 29.1 | (29.5) | 113.7 | (122.4) |
| US Dollar | **(5.6)** | **5.8** | **(21.3)** | **24.3** | (7.8) | 7.8 | (30.6) | 31.9 |
| Euro | **(7.2)** | **2.3** | **(27.0)** | **11.1** | (3.0) | 1.7 | (11.2) | 7.2 |
| Other | **0.2** | **(0.2)** | **0.8** | **(0.8)** | (0.1) | 0.1 | (0.4) | 0.5 |
| **Total** | **1.0** | **(5.7)** | **5.2** | **(12.8)** | 18.2 | (19.9) | 71.5 | (82.8) |

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

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 1.56 below shows supplementary value sensitivity to a steepening and flattening (c.100 basis points around the 3 year point) in the yield curve. This ensures there are no unintended consequences to managing risk to parallel shifts in rates.

### Table 1.56: Group Banking activities: market value sensitivity to a steepening and flattening of the yield curve

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | Steepener £m | Flattener £m | Steepener £m | Flattener £m |
| Sterling | **46.6** | **(47.5)** | 38.3 | (36.5) |
| US Dollar | **(13.2)** | **15.3** | 6.5 | (5.7) |
| Euro | **(15.5)** | **9.7** | (6.8) | 3.6 |
| Other | **0.4** | **(0.4)** | (0.1) | 0.1 |
| **Total** | **18.3** | **(22.9)** | 37.9 | (38.5) |

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 1.57: **Group Banking activities: net interest income sensitivity**

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | **109.4** | **(147.9)** | **430.8** | **(702.8)** | 76.2 | (125.4) | 341.6 | (538.6) |

Income sensitivity is measured over a rolling 12 month basis.

The increase in the net interest income sensitivity to a downwards 100bps shock reflects additional margin compression risk within retail savings and a reduction in the size of the structural hedge.

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 risk type.

### 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 the 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. The hedges are externalised to the market by derivative desks within GCT and Commercial Banking Markets. The Group mitigates income statement volatility through hedge accounting. This reduces the accounting volatility arising from the Group's economic hedging activities by utilising both LIBOR and bank base rate assets. Any hedge accounting ineffectiveness that leads to accounting volatility is continuously monitored.

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 structural hedge consists of longer-term fixed rate assets or interest rate swaps and the amount and duration of the hedging activity is reviewed regularly by GALCO.

Whilst the bank faces margin compression in low rate environments, 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 Asset and Liability Committees (ALCOs).

Net investment foreign exchange exposures are managed centrally by GCT, by hedging non-sterling 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. The Group makes use of both accounting and economic foreign exchange exposures, as an offset against the impact of changes in foreign exchange rates on the value of non-sterling-denominated RWAs. This involves the holding of a structurally open currency position; sensitivity is minimised where, for a given currency, the ratio of the structural open position to RWAs equals the CET1 ratio. Continually evaluating this structural open currency position against evolving non-sterling-denominated RWAs, mitigates volatility in the Group's CET1 ratio.

### Monitoring

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 their assets and liabilities. The liability discount rate exposes the Group 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. Scheme membership exposes the Group to longevity risk.

For further information on defined benefit pension scheme assets and liabilities please refer to note 36 on page 253.

### Measurement

Management of the schemes' 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 Group will be liable for meeting any funding deficit that may arise. As part of the triennial valuation process, the Group will agree with the Trustees a funding strategy to eliminate the deficit over an appropriate period.

Longevity risk is measured using both 1-in-20 year stresses (risk appetite) and 1-in-200 year stresses (regulatory capital).

### Mitigation

The Group takes an active involvement in agreeing mitigation strategies with the schemes' Trustees. An interest rate and inflation hedging programme is in place to reduce liability risk. The schemes have also reduced equity allocation and invested the proceeds in credit assets. The Trustees have put in place a longevity swap to mitigate longevity risk. The merits of longevity risk transfer and hedging solutions are reviewed regularly.

### Monitoring

In addition to the wider risk management framework, governance of the schemes includes two specialist pensions committees.

The surplus, or deficit, in the schemes is tracked monthly along with various single factor and scenario stresses which consider the assets and liabilities holistically. Key metrics are monitored monthly including the Group's capital resources of the scheme, the performance against risk appetite triggers, and the performance of the hedged asset and liability matching positions.

## 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 243). Equity risk also arises in the with-profits funds but is less material
- Credit spread risk mainly arises from annuities where policyholders' future cash flows are guaranteed at retirement. Exposure arises if the market value of the assets which are held to back these liabilities, mainly corporate bonds and loans, do not perform in line with expectations
- 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 arises 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 techniques including stress, reverse stress and scenario testing, as well as stochastic modelling.

Risk measures include 1-in-200 year stresses used for regulatory capital assessments and single factor stresses for profit before tax.

Table 1.58 demonstrates the impact of the Group's UK Recession scenario on the Insurance business' portfolio (with no diversification benefit, but after the impact of Group consolidation on interest rate and credit spreads). The amounts include movements in assets, liabilities and the value of in-force business in respect of insurance contracts and participating investment contracts.

Table 1.58: **Insurance business: profit before tax sensitivities**

| | Increase (reduction) in profit before tax | |
|---|---|---|
| | **2019 £m** | 2018 £m |
| Interest rates – decrease 100 basis points | **116** | 297 |
| Inflation – increase 50 basis points | **30** | 93 |
| Credit spreads – 100% widening | **(859)** | (823) |
| Equity – 30% fall | **(68)** | (38) |
| Property – 25% fall | **(47)** | (50) |
| **Total** | **(828)** | (521) |

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 premium, as applied to profit before tax are set out in note 33 on page 252.

One of the consequences of preparations for the formation of the Ring Fenced Bank was to reduce the impact of some stresses within the Insurance business, though Group exposures may not have materially changed. Examples of this include centralisation of defined benefit pension schemes, and the transfer of specific hedging programmes from the corporate centre to the business unit where the exposure emanated.

### Mitigation

Equity and credit spread risks are closely monitored and, where appropriate, asset liability matching is undertaken to mitigate risk. Unit matching has been used since 2018 to reduce the sensitivity of equity movements by matching unit-linked liabilities on a best-estimate view. Hedging strategies are also in place to reduce exposure from unit-linked funds and 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 and 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 does not engage in any 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 (Value at Risk; diversified across risk factors) was £0.9 million for 31 December 2019 compared to £0.8 million for 31 December 2018.

Trading market risk measures are applied to all of the Group's regulatory trading books and they include daily VaR (table 1.59), sensitivity based measures, and stress testing calculations.

### Measurement

The Group internally uses VaR as the primary risk measure for all trading book positions.

Table 1.59 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 2019 and year end 2018.

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, but does not reflect any diversification between Lloyds Bank Corporate Markets and any other entities. 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 1.59: **Trading portfolios: VaR (1-day 95 per cent confidence level) (audited)**

| | At 31 December 2019 | | | | At 31 December 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Close £m | Average £m | Maximum £m | Minimum £m | Close £m | Average £m | Maximum £m | Minimum £m |
| Interest rate risk | 0.6 | 0.8 | 1.6 | 0.4 | 0.6 | 0.7 | 1.8 | 0.4 |
| Foreign exchange risk | 0.1 | 0.1 | 0.3 | 0.0 | 0.1 | 0.1 | 2.1 | – |
| Equity risk | – | – | – | – | – | – | – | – |
| Credit spread risk | 0.1 | 0.2 | 0.3 | 0.1 | 0.2 | 0.2 | 0.7 | 0.1 |
| Inflation risk | 0.4 | 0.2 | 0.6 | 0.1 | 0.3 | 0.3 | 0.7 | 0.2 |
| All risk factors before diversification | 1.2 | 1.3 | 2.2 | 0.9 | 1.2 | 1.3 | 3.0 | 0.9 |
| Portfolio diversification | (0.4) | (0.4) | | | (0.4) | (0.5) | | |
| **Total VaR** | 0.8 | 0.9 | 1.6 | 0.5 | 0.8 | 0.8 | 2.1 | 0.4 |

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 a 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 actual profit and loss. The 1-day 99 per cent VaR chart for Lloyds Banking Group can be found in the Group's Pillar 3 Report.

### Mitigation

The level of exposure is controlled by establishing and communicating the approved risk limits and controls through policies and procedures that define the responsibility and authority for risk taking. Market risk limits are clearly and consistently communicated to the business. Any new or emerging risks are brought within risk reporting and defined 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.

# Model risk

## Definition

Model risk is defined as the risk of financial loss, regulatory censure, reputational damage or customer detriment, as a result of deficiencies in the development, application or ongoing operation of models and rating systems.

Models are defined as quantitative methods that process input data into quantitative outputs, or qualitative outputs (including ordinal letter output) which have a quantitative measure associated with them. Model Governance Policy is restricted to specific categories of application of models, principally financial risk, treasury and valuation, with certain exclusions, such as prescribed calculations and project appraisal calculations.

## Exposures

There are over 300 models in the Group performing a variety of functions including:

- capital calculation
- credit decisioning, including fraud
- pricing models
- impairment calculation
- stress testing and forecasting
- market risk measurement

As a result of the wide scope and breadth of coverage, there is exposure to model risk across a number of the Group's principal risk categories.

## Measurement

The Group risk appetite framework is the key component for measuring the Group's model risk. Reported monthly to the Group Risk Committee and Board, focus is placed on the performance of the Group's most material models.

## Mitigation

The model risk management framework, established by and with continued oversight from an independent team in the Risk division, provides the foundation for managing and mitigating model risk within the Group. Accountability is cascaded from the Board and senior management via the Group enterprise risk management framework.

This provides the basis for the Group Model Governance Policy, which defines the mandatory requirements for models across the Group, including:

- the scope of models covered by the policy
- model materiality
- roles and responsibilities, including ownership, independent oversight and approval
- key principles and controls regarding data integrity, development, validation, implementation, ongoing maintenance and revalidation, monitoring, and the process for non-compliance

The model owner takes responsibility for ensuring the fitness for purpose of the models and rating systems, supported and challenged by the independent specialist Group function.

The above ensures all models in scope of policy, including those involved in regulatory capital calculation, are developed consistently and are of sufficient quality to support business decisions and meet regulatory requirements.

## Monitoring

The Group Model Governance Committee is the primary body for overseeing model risk. Policy requires that key performance indicators are monitored for every model to ensure they remain fit for purpose and all issues are escalated appropriately. Material model issues are reported to Group and Board Risk Committees monthly with more detailed papers as necessary to focus on key issues.

## Financial statements

# Independent auditors' report to the members of Lloyds Banking Group plc

## Report on the audit of the financial statements

## Opinion

In our opinion, the financial statements of Lloyds Banking Group plc (the Group) and the 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 2019 and of the Group's profit and the Group's and the parent company's cash flows for the year then ended;
– have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
– have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the "Annual Report"), which comprise: consolidated and parent company balance sheets as at 31 December 2019; 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; and 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 description of the significant accounting policies.

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.

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

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Other than those disclosed in note 12 to the financial statements, we have provided no non-audit services to the Group or the parent company in the period from 1 January 2019 to 31 December 2019.

## Our audit approach

### Overview

– Overall Group materiality: £360 million (2018: £360 million), based on 5 per cent of profit adjusted to remove the effects of certain items which were considered to have a disproportionate impact.
– Overall parent company materiality: £360 million (2018: £360 million), based on 1 per cent of total assets but limited to the overall Group materiality.
– 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 components and other qualitative factors (including history of misstatement through fraud or error).
– We performed audit procedures over components 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 performed other procedures including testing entity level controls, information technology general controls and analytical review procedures to address the risk of material misstatement in the residual components.

The key audit matters which in our professional judgement were of most significance in the audit and involved the greatest allocation of our efforts and resources:

– Allowance for Expected Credit Losses (ECL) (Group)
– Payment Protection Insurance (PPI) (Group)
– Insurance actuarial assumptions (Group)
– Defined benefit obligation (Group)
– Valuation of certain level 3 financial instruments (Group)
– Hedge accounting (Group)
– Privileged access to IT systems (Group and parent company)

These items were discussed with the Audit Committee as part of our audit plan communicated in May 2019 and supplemented with updates in January 2020. These were the key audit matters for discussion at the conclusion of our audit.

### The scope of our audit

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

## Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of banking laws and regulations such as, but not limited to, regulations relating to consumer credit and unethical and prohibited business practices, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006, Consumer Credit Act 1974 and Banking Reform Act 2013. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting manual journal entries to manipulate financial performance, management bias through judgements and assumptions in significant accounting estimates and significant one-off or unusual transactions. The Group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the Group engagement team and/or component auditors included:

- Discussions with management and those charged with governance including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- Evaluation and testing of the operating effectiveness of management's entity level controls designed to prevent and detect irregularities, in particular their code of conduct and whistleblowing helpline;
- Assessment of matters reported on the Group's whistleblowing helpline and the results of management's investigation of such matters;
- Performing testing over period end adjustments;
- Incorporating unpredictability into the nature, timing and/or extent of our testing;
- Reviewing key correspondence with the FCA and PRA;
- Challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to the allowance for ECL; the provision for PPI; insurance actuarial assumptions; the defined benefit obligation; the valuation of certain level 3 financial instruments; and hedge accounting (see related key audit matters below); and
- Identifying and testing journal entries, in particular any manual journal entries posted by infrequent users or senior management, posted on unusual days, posted with descriptions indicating a higher level of risk, or posted late with a favourable impact on financial performance.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

## Key audit matters

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

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| *Allowance for Expected Credit Losses (ECL)*<br>*Group*<br>*Refer to page 85 (Audit Committee report), page 206 (Note 2: Accounting policies), page 214 (Note 3: Critical accounting judgements and estimates) and page 238 (Note 20: Allowance for impairment losses).*<br>The determination of the allowance for ECL is a judgemental area. A number of judgements and assumptions are outlined in the financial statements, including the definition of significant increases in credit risk and the application of forward looking information.<br>*Group economics*<br>The Group's economics team develops future economic scenarios. The base case economic scenario is determined through the application of judgement, and the outer scenarios are generated and selected through the use of a statistical model. The four economic scenarios represent distinct parts of the loss distribution which is developed based on historical experience. The scenarios, together with their weightings, are provided to the Retail and Commercial Banking divisions for incorporation into the calculation of the allowance for ECL. | *Group economics*<br>We understood management's process and tested key controls relating to the generation, selection and weighting of economic scenarios. We engaged our internal economic experts and actuarial modelling specialists to assist us as we considered:<br>– The approach to the determination of the base case economic scenario;<br>– The identification and use of appropriate external economic data;<br>– The approach to the generation and selection of economic scenarios representing the upside, downside and severe downside;<br>– The operation of the Group's internally developed statistical model; and<br>– The review, challenge and approval of the economic scenarios by the Group's governance processes.<br>We found the key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.<br>We critically assessed the assumptions adopted in the base case economic scenario by comparing them to our independent view of the economic outlook and market consensus data. We investigated any economic variables outside of our thresholds. We also assessed the risk of bias in the forecasts, as well as the existence of contrary evidence.<br>We independently re-performed the Group's model and performed testing to evaluate the level of non-linearity captured in the allowance for ECL. We also assessed the appropriateness of the weightings adopted.<br>Based on the evidence obtained, we consider that the economic scenarios adopted reflect an unbiased, probability weighted view, that appropriately captures the impact of non-linearity. |

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| *Retail*<br>The allowance for ECL relating to loans and advances in the Retail division is determined on a collective basis, with the use of impairment models. These models use a number of key assumptions including probability of default, loss given default (including propensity for possession and forced sale discounts for mortgages) and valuation of recoveries. Management also apply overlays where they believe the model calculated assumptions and allowances are not appropriate, either due to emerging trends or the model limitations. An example of this is an overlay to the impairment model output for the UK mortgages portfolio relating to ECL on past term interest only exposures. Our work therefore focused on the appropriateness of modelling methodologies adopted and significant judgements made in determining overlays as well as the measurement of those overlays. | *Retail*<br>We understood management's process and tested key controls around the determination of the allowance for ECL, including controls relating to:<br>– Appropriateness of modelling methodologies and monitoring of model performance;<br>– Periodic model review, validation and approval;<br>– The identification of credit impairment events; and<br>– The review, challenge and approval of the allowances for ECL, including the impairment model outputs, key management judgements and overlays applied.<br>We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.<br>We understood and assessed the appropriateness of the impairment models developed and used by management. This included assessing and challenging the appropriateness of key modelling judgements (e.g. criteria used to determine significant increase in credit risk) and quantifying the impact of the use of proxies and simplifications, assessing whether these were appropriate. For selected portfolios, we created our own independent models covering certain parts of the model calculation which enabled us to re-perform management's calculation and challenge their outputs.<br>We tested the completeness and accuracy of key data inputs, sourced from underlying systems that are applied in the calculation. We tested the reconciliation of loans and advances between underlying source systems and the ECL models.<br>We performed testing over the measurement of the overlays in place, focusing on the larger overlays and those which we considered to represent the greatest level of audit risk (e.g. overlays relating to past term interest-only exposures). We assessed the appropriateness of methodologies used to determine and quantify the overlays required and the reasonableness of key assumptions.<br>Based on our knowledge and understanding of the weaknesses and limitations in management's models and industry emerging risks, we critically assessed the completeness of the overlays proposed by management.<br>We used credit risk modelling specialists to support the audit team in the performance of these audit procedures. |
| *Commercial Banking*<br>The allowance for ECL relating to credit impaired loans and advances (referred to herein also as being in Stage 3) in the Commercial Banking division is primarily estimated on an individual basis. Judgement is required to determine when a loan is considered to be credit impaired, and then to estimate the expected future cash flows related to that loan under multiple weighted scenario outcomes. An allowance for ECL is determined for Commercial Banking loans and advances which are not classified as being credit impaired at the reporting date (referred to as being in Stages 1 and 2) using impairment models based on key assumptions including probability of default and loss given default. Management apply overlays to the modelled output to address methodology and data limitations, or risks not captured by the model. | *Commercial Banking*<br>We understood management's process and evaluated and tested key controls around the determination of the allowance for ECL.<br>For the Stage 1 and 2 allowance, we focused on:<br>– The identification and assessment of the completeness and accuracy of critical data applied in the ECL calculation.<br>– The governance over the ECL determination, including the validation of the ECL methodology, assumptions and inputs, and the annual model performance validation; and<br>– The review, challenge and approval processes in place to assess the overall reasonableness of the allowance for ECL.<br>For the Stage 3 allowance, we focused on:<br>– The controls in place for the identification of credit impaired loans and subsequent transfer of these cases to the credit loss assessment team; and<br>– The review, challenge and approval processes that are in place to assess the overall reasonableness of the allowance for ECL.<br>We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.<br>We performed the following procedures over the Stage 1 and 2 allowance for ECL:<br>– We critically assessed whether the methodology applied in the calculation is compliant with IFRS 9;<br>– We tested the formulae applied within the calculation, including the appropriateness, and application of, the quantitative and qualitative criteria used to assess significant increases in credit risk;<br>– We tested the completeness and accuracy of key data inputs, sourced from underlying systems that are applied in the calculation;<br>– We tested the reconciliation of loans and advances between underlying source systems and the allowance models; and<br>– We critically assessed the impact of identified model limitations and the completeness of overlays applied by management. |

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| | We performed the following procedures to test the completeness of credit impaired assets requiring a Stage 3 allowance for ECL:<br>– We critically assessed the criteria for determining whether a credit impairment event had occurred; and<br>– We tested a risk based sample of Stage 1 and 2 loans, utilising industry and insolvency specialists to support the audit team in identifying sectors or types of borrowers with an elevated risk of weaker financial performance or distress. For each risk based sample, as well as an additional haphazardly selected sample of Stage 1 and 2 loans, we independently assessed whether there was evidence indicating a credit impairment event (e.g. a customer experiencing financial difficulty or in breach of covenant) and therefore whether they were appropriately categorised.<br>For a sample of Stage 3 credit impaired loans, we:<br>– Evaluated the basis on which the allowance was determined, and the evidence supporting the analysis performed by management;<br>– We independently challenged whether the key assumptions used, such as the recovery strategies, collateral rights and ranges of potential outcomes, were appropriate, given the borrower's circumstances;<br>– Re-performed management's allowance calculation, assessing supporting evidence in relation to key inputs on a case by case basis, that included expected future cash flows, discount rates, valuations of collateral held, and the weightings applied to scenario outcomes; and<br>– Where relevant, specifically considered whether valuations were up to date, and consistent with the strategy being followed in respect of the particular borrower and assessed the sensitivity to key assumptions used.<br>Based on the evidence assessed, we found the methodologies, modelled assumptions and data used within the allowance for ECL assessment to be appropriate and in line with the requirements of IFRS 9. |
| *Payment Protection Insurance (PPI)*<br>*Group*<br>*Refer to page 85 (Audit Committee report), page 206 (Note 2: Accounting policies), page 214 (Note 3: Critical accounting judgements and estimates) and page 260 (Note 38: Other provisions).*<br>Provisions reflecting the Group's best estimate of present obligations relating to anticipated customer redress payments, operational costs and regulatory costs as a result of PPI continues to be significant and therefore represent a key audit matter.<br>Determining the measurement of provisions requires a number of assumptions which are made using a significant degree of management judgement. Key assumptions include the conversion ratio of PPI information requests to complaints, related redress costs and operational costs. | Our work focused on the valuation of conduct provisions relating to PPI policies.<br>We understood and tested the key controls around the appropriateness of the model calculation.<br>We found that these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.<br>The provision is based on assumptions determined using management judgement with reference to historic experience. We understood and challenged the provisioning methodologies and underlying assumptions, including whether historic information was an appropriate indicator of future experience. For example, we challenged management on how many complaints eligible for redress would arise from the information requests which had been received.<br>We independently recalculated the provision and compared our results to management's model output. We performed sensitivity analysis on the assumptions used within the model to inform our risk assessment of which were significant. We performed sample testing over the data used to inform the key assumptions within the model.<br>We considered regulatory developments and reviewed the Group's correspondence with the FCA and PRA, discussing the content of any correspondence considered to be pertinent to our audit with management. We also met with each regulator.<br>Given the inherent uncertainty in the estimation of the PPI provision and its judgemental nature, we evaluated the disclosures made in the financial statements. In particular, we focused on challenging management around whether the disclosures were sufficiently clear in highlighting significant uncertainties and the sensitivity of the provision to changes in the underlying assumptions.<br>Based on the procedures performed and evidence obtained, we found management's assumptions to be appropriate. |

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| *Insurance actuarial assumptions*<br>*Group*<br>*Refer to page 85 (Audit Committee report), page 206 (Note 2: Accounting policies), page 214 (Note 3: Critical accounting judgments and estimates) and pages 243, 249 and 252 (Notes 25, 32 and 33).*<br>A number of significant assumptions about future experience contribute as key inputs into the valuation of the Group's insurance contracts, participating investment contracts ('insurance contract liabilities') and the value of in-force business asset.<br>Some of the economic and non-economic actuarial assumptions used in valuing the insurance contract liabilities and the value of in-force business asset are highly judgemental in nature, 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), maintenance expenses (future expenses incurred to maintain existing policies to maturity), credit default and illiquidity premium (adjustments made to the discount rate). | We understood and tested key controls relating to the governance and processes for setting actuarial assumptions.<br>We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.<br>Our actuarial specialists assessed the reasonableness of the actuarial assumptions, including considering and challenging management's rationale for judgements applied and any reliance placed on industry information. Where appropriate, assumptions were benchmarked by comparing to the Group's peers in the insurance market whilst overlaying an understanding of the specific policy features of the Group's business.<br>For persistency, we considered the appropriateness of assumptions set by management in light of actual experience and regulatory changes. For example, we considered how the assumptions reflected expected persistency experience following the increase in the minimum contribution rate for auto-enrolment business.<br>For longevity, we assessed the appropriateness of how the Group's own experience and industry data were used in setting future assumptions and we compared resulting life expectancies to benchmarking data.<br>For maintenance expenses, we assessed the appropriateness of the judgements in respect of costs deemed to be non-attributable to the long-term insurance business and the resulting allocation of attributable costs to product types which then form the basis of the per-policy costs assumptions.<br>For credit default and illiquidity premium, we assessed the appropriateness of the methodology against our knowledge and experience with regulatory requirements and industry practice. We challenged whether the asset mix used in the illiquidity premium calculation remained an appropriate proxy to a market consistent portfolio by comparing the proportion of illiquid assets held to those held by other similar companies.<br>Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models and overlays to modelled outputs to be appropriate. |
| *Defined benefit obligation*<br>*Group*<br>*Refer to page 85 (Audit Committee report), page 206 (Note 2: Accounting policies), page 214 (Note 3: Critical accounting judgements and estimates) and page 253 (Note 36: Retirement benefit obligations).*<br>The valuation of the retirement benefit obligations in the Group are determined with reference to various actuarial assumptions including discount rate, rate of inflation and mortality rates. Due to the size of these schemes, small changes in these assumptions can have a material impact on the estimated defined benefit obligation. | We understood and tested key controls over the pensions process involving the use of members data, formulation of assumptions and the financial reporting process. We tested the controls for determining the actuarial assumptions and the approval of those assumptions by senior management.<br>We engaged our actuarial experts, met with management and communicated with their actuaries 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.<br>We performed testing over the members data used in calculating the obligation through a combination of substantive testing and consideration of member-related controls at the administrators. Where material, we also considered the treatment of curtailments, settlements, past service costs, remeasurements, benefits paid and any other movement in obligations during the year.<br>From the evidence obtained, we found the data and assumptions used by management in the actuarial valuations for pension obligations to be appropriate.<br>We read and assessed the disclosures made in the financial statements, including disclosures of the assumptions, and found them to be appropriate. |
| *Valuation of certain level 3 financial instruments*<br>*Group*<br>*Refer to page 206 (Note 2: Accounting policies), page 214 (Note 3: Critical accounting judgements and estimates) and pages 275 and 289 (Notes 50 and 53).*<br>Within its Level 3 financial instruments, the Group holds two portfolios (Loans and advances to customers of £8.2bn and £1.6bn of debt securities) which are each concentrations of similar, non-traded assets. They are classified as Level 3 instruments as their valuation is subjective and determined using bespoke models which rely on a range of unobservable inputs. | We understood management's process and evaluated and tested the key controls around the financial instrument's valuation processes including the independent price verification and valuation governance controls.<br>We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.<br>With the support of our valuation's specialists, we performed the following further testing:<br>– Evaluating the appropriateness of management's valuation methodologies and testing their application;<br>– Evaluating key inputs and assumptions, with reference to matters including historic performance, market information and perspectives, servicer and trustee reports and investment prospectuses; and<br>– Assessing the reasonableness of the valuations and performing sensitivity analyses over them.<br>Based on the evidence obtained, we determined the methodologies, inputs and assumptions to be appropriate. |

Strategic report
Financial results
Governance
Risk management
Financial statements
Other information

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| *Hedge accounting*<br>*Group*<br>*Refer to page 206 (Note 2: Accounting policies) and page 289 (Note 53: Financial risk management).*<br>The Group enters into derivative contracts in order to manage and economically hedge risks such as interest and foreign exchange rate risk. These arrangements create accounting mismatches which are addressed through designating instruments into fair value or cash flow hedge accounting relationships.<br>The Group's application of hedge accounting, including determining effectiveness, is largely manual in nature, which increases the risk of errors and hence the risk that financial reporting is not compliant with IFRS requirements. | We understood and tested key controls over the designation and ongoing management of hedge accounting relationships, including testing of hedge effectiveness as well as the hedging strategy and related documentation prior to the implementation of new hedges.<br>We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.<br>Our testing included the following:<br>– Examining selected hedge documentation to assess whether it complies with the requirements of IFRS;<br>– Testing the key year-end reconciliations between underlying source systems and the models used to manage hedging relationships;<br>– Independently assessing whether management have captured and are monitoring all material sources of ineffectiveness, including any impact of reference rate reform;<br>– Re-performing a sample of hedge effectiveness calculations; and<br>– Testing a sample of manual adjustments posted to record ineffectiveness.<br>Based on the evidence obtained, we determined the application of hedge accounting to be appropriate and compliant with the requirements of IFRS. |
| *Privileged access to IT systems*<br>*Group and parent company*<br>*Refer to page 85 (Audit Committee report).*<br>The Group's financial reporting processes are reliant on automated processes, controls and data managed by IT systems.<br>For the purposes of our audit, we validate the design, implementation and operating effectiveness of those automated and IT dependent controls that support the in-scope financial statement line items. We also review the supporting IT General Computer Controls (ITGCs) that provide assurance over the effective operation of these controls as well as those controls that manage the integrity of relevant data repositories for the full financial reporting period.<br>As part of our audit work in prior periods, we identified control matters in relation to the management of IT privileged access to IT platforms supporting applications in-scope for financial reporting. While there is an ongoing programme of activities to address such control matters across the IT estate, the fact that these were open during the period meant there was a risk that automated functionality, reports and data from the systems were not reliable. | We tested the design and operating effectiveness of those key controls identified that manage IT privileged access across the in-scope IT platforms. Specifically, we tested controls over:<br>– The completeness and accuracy of the Access Controls Lists from IT platforms that are used by downstream IT security processes;<br>– The onboarding and management of IT privileged accounts through the privileged access break-glass tool (including static IT privileged accounts);<br>– The monitoring of security events on IT platforms by the Security Operations Centre; and<br>– Approval, recertification and timely removal of access from IT systems.<br>As part of our review, we identified a number of IT privileged accounts that had not been onboarded to the privileged access restriction tool during the period.<br>Consequently, we performed an assessment of each of the areas within our audit approach where we place reliance on automated functionality and data within IT systems. In each case we identified a combination of mitigating controls, performed additional audit procedures and assessed other mitigating factors in order to respond to the impact on our overall audit approach. |

## How we tailored the audit scope

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

The Group is structured into three segments being Retail, Commercial Banking, and Insurance and Wealth. Each of the segments comprises a number of components. The consolidated financial statements are a consolidation of the components.

In establishing the overall approach to the Group audit, we determined the type of work that is required to be performed over the components 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 their audit work 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 significant and elevated risk areas and formal clearance meetings.

Any components which were considered individually financially significant in the context of the Group's consolidated financial statements (defined as components that represent more than or equal to 10% of the total assets of the consolidated Group) were considered full scope components. We considered the individual financial significance of other components in relation to primary statement account balances. We considered the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). Any component which was not already included as a full scope 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 components which, in our judgement, did not present 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 components which were neither inconsequential nor individually financially significant were subject to procedures which addressed the risk of material misstatement including testing of entity level controls, information technology general controls and Group and component level analytical review procedures.

Certain account balances were audited centrally by the Group engagement team.

Components within the scope of our audit contributed 98 per cent of Group total assets and 86 per cent of Group total income.

## Materiality

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

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

| | Group financial statements | Parent company financial statements |
|---|---|---|
| Overall materiality | £360 million (2018: £360 million). | £360 million (2018: £360 million). |
| How we determined it | 5 per cent of the adjusted profit before tax. Profit was adjusted to remove the effects of certain items which were considered to have a disproportionate impact. | 1 per cent of total assets but limited to the overall Group materiality. |
| Rationale for benchmark applied | Our starting point was 5 per cent of profit before tax, a generally accepted auditing practice. Profit before tax was adjusted to remove the disproportionate effect of regulatory provisions as they are considered not to reflect the long term performance of the Group. | We have selected total assets as an appropriate benchmark for parent company materiality. Profit based benchmarks are not considered the most appropriate for parent company materiality as the Group is not required to disclose a parent company income statement. Where the calculated parent company materiality from total assets exceeds the Group overall materiality level, the parent company overall materiality has been restricted to equal the Group overall materiality level. |

For each component in the scope of the Group audit, we allocated a materiality that is less than the overall Group materiality. The range of materiality allocated across components was between £50 million and £100 million. Certain components were audited to a local statutory audit materiality that was also less than the allocated materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £18 million (Group and parent company audit) (2018: £15 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

## Going concern

In accordance with ISAs (UK) we report as follows:

| Reporting obligation | Outcome |
|---|---|
| We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group's and the parent company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements. | We have nothing material to add or to draw attention to.<br><br>However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and parent company's ability to continue as a going concern. For example, the terms of the United Kingdom's withdrawal from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the Group's trade, customers, suppliers and the wider economy. |
| We are required to report if the directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit. | We have nothing to report. |

## Reporting on other information

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

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

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

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06), ISAs (UK) and the Listing Rules of the FCA require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

### Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2019 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and parent company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

### The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

– The directors' confirmation on page 95 of the Annual Report 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;

– The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated; and

– The directors' explanation on page 95 of the Annual Report 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 to report having performed a review of the directors' statement that they have carried out a robust assessment of the principal risks facing the Group and 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 UK Corporate Governance Code (the "Code"); and considering whether the statements are consistent with the knowledge and understanding of the Group and parent company and their environment obtained in the course of the audit. (Listing Rules)

### Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

– The statement given by the directors, on page 97, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and parent company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and parent company obtained in the course of performing our audit;

– The section of the Annual Report on page 85 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; and

– The directors' statement relating to the parent company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

### Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

## Responsibilities for the financial statements and the audit

### Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 97, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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

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

### Use of this report

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

# Other required reporting

## Companies Act 2006 exception reporting

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

– we have not received all the information and explanations we require for our audit; or
– adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
– certain disclosures of directors' remuneration specified by law are not made; or
– the 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.

## Appointment

Following the recommendation of the Audit Committee, we were appointed by the directors on 25 December 1995 to audit the financial statements for the year ended 31 December 1995 and subsequent financial periods. The period of total uninterrupted engagement is 25 years, covering the years ended 31 December 1995 to 31 December 2019. The audit was tendered in 2014 and we were re-appointed with effect from 1 January 2016. There will be a mandatory rotation for the 2021 audit and we will cease to be auditor of the Group.

**Mark Hannam (Senior Statutory Auditor)**
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
19 February 2020

# Consolidated income statement

for the year ended 31 December

| | Note | 2019 £ million | 2018† £ million | 2017† £ million |
|---|---|---|---|---|
| Interest and similar income | | **16,861** | 16,349 | 16,006 |
| Interest and similar expense | | **(6,681)** | (2,953) | (5,094) |
| **Net interest income** | 5 | **10,180** | 13,396 | 10,912 |
| Fee and commission income | | **2,756** | 2,848 | 2,965 |
| Fee and commission expense | | **(1,350)** | (1,386) | (1,382) |
| Net fee and commission income | 6 | **1,406** | 1,462 | 1,583 |
| Net trading income | 7 | **18,288** | (3,876) | 11,817 |
| Insurance premium income | 8 | **9,574** | 9,189 | 7,930 |
| Other operating income | 9 | **2,908** | 1,920 | 1,995 |
| **Other income** | | **32,176** | 8,695 | 23,325 |
| **Total income** | | **42,356** | 22,091 | 34,237 |
| Insurance claims | 10 | **(23,997)** | (3,465) | (15,578) |
| **Total income, net of insurance claims** | | **18,359** | 18,626 | 18,659 |
| Regulatory provisions | | **(2,895)** | (1,350) | (2,515) |
| Other operating expenses | | **(9,775)** | (10,379) | (10,181) |
| Total operating expenses | 11 | **(12,670)** | (11,729) | (12,696) |
| **Trading surplus** | | **5,689** | 6,897 | 5,963 |
| Impairment | 13 | **(1,296)** | (937) | (688) |
| **Profit before tax** | | **4,393** | 5,960 | 5,275 |
| Tax expense | 14 | **(1,387)** | (1,454) | (1,626) |
| **Profit for the year** | | **3,006** | 4,506 | 3,649 |
| | | | | |
| Profit attributable to ordinary shareholders | | **2,459** | 3,975 | 3,144 |
| Profit attributable to other equity holders[1] | | **466** | 433 | 415 |
| Profit attributable to equity holders | | **2,925** | 4,408 | 3,559 |
| Profit attributable to non-controlling interests | | **81** | 98 | 90 |
| **Profit for the year** | | **3,006** | 4,506 | 3,649 |
| | | | | |
| Basic earnings per share | 15 | **3.5p** | 5.5p | 4.4p |
| Diluted earnings per share | 15 | **3.4p** | 5.5p | 4.3p |

† Restated, see note 1.

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated statement of comprehensive income

for the year ended 31 December

| | 2019 £ million | 2018[1] £ million | 2017[1] £ million |
|---|---|---|---|
| **Profit for the year** | **3,006** | 4,506 | 3,649 |
| **Other comprehensive income** | | | |
| *Items that will not subsequently be reclassified to profit or loss:* | | | |
| Post-retirement defined benefit scheme remeasurements: | | | |
| Remeasurements before tax | **(1,433)** | 167 | 628 |
| Tax | **316** | (47) | (146) |
| | **(1,117)** | 120 | 482 |
| Movements in revaluation reserve in respect of equity shares held at fair value through other comprehensive income: | | | |
| Change in fair value | **–** | (97) | |
| Tax | **12** | 22 | |
| | **12** | (75) | |
| Gains and losses attributable to own credit risk: | | | |
| (Losses) gains before tax | **(419)** | 533 | (55) |
| Tax | **113** | (144) | 15 |
| | **(306)** | 389 | (40) |
| Share of other comprehensive income of associates and joint ventures | **–** | 8 | – |
| *Items that may subsequently be reclassified to profit or loss:* | | | |
| Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income: | | | |
| Change in fair value | **(30)** | (37) | |
| Income statement transfers in respect of disposals | **(196)** | (275) | |
| Impairment recognised in the income statement | **(1)** | – | |
| Tax | **71** | 119 | |
| | **(156)** | (193) | |
| Movements in revaluation reserve in respect of available for sale financial assets: | | | |
| Change in fair value | | | 303 |
| Income statement transfers in respect of disposals | | | (446) |
| Income statement transfers in respect of impairment | | | 6 |
| Tax | | | 63 |
| | | | (74) |
| Movement in cash flow hedging reserve: | | | |
| Effective portion of changes in fair value taken to other comprehensive income | **1,209** | 234 | (363) |
| Net income statement transfers | **(608)** | (701) | (651) |
| Tax | **(148)** | 113 | 283 |
| | **453** | (354) | (731) |
| Currency translation differences (tax: nil) | **(12)** | (8) | (32) |
| **Other comprehensive income for the year, net of tax** | **(1,126)** | (113) | (395) |
| **Total comprehensive income for the year** | **1,880** | 4,393 | 3,254 |
| Total comprehensive income attributable to ordinary shareholders | **1,333** | 3,862 | 2,749 |
| Total comprehensive income attributable to other equity holders | **466** | 433 | 415 |
| Total comprehensive income attributable to equity holders | **1,799** | 4,295 | 3,164 |
| Total comprehensive income attributable to non-controlling interests | **81** | 98 | 90 |
| **Total comprehensive income for the year** | **1,880** | 4,393 | 3,254 |

1 Restated, see note 1.

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated balance sheet

at 31 December

| | Note | 2019 £ million | 2018 £ million |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | | 55,130 | 54,663 |
| Items in the course of collection from banks | | 313 | 647 |
| Financial assets at fair value through profit or loss | 16 | 160,189 | 158,529 |
| Derivative financial instruments | 17 | 26,369 | 23,595 |
| Loans and advances to banks | | 9,775 | 6,283 |
| Loans and advances to customers | | 494,988 | 484,858 |
| Debt securities | | 5,544 | 5,238 |
| Financial assets at amortised cost | 18 | 510,307 | 496,379 |
| Financial assets at fair value through other comprehensive income | 21 | 25,092 | 24,815 |
| Investments in joint ventures and associates | 22 | 304 | 91 |
| Goodwill | 24 | 2,324 | 2,310 |
| Value of in-force business | 25 | 5,558 | 4,762 |
| Other intangible assets | 26 | 3,808 | 3,347 |
| Property, plant and equipment | 27 | 13,104 | 12,300 |
| Current tax recoverable | | 7 | 5 |
| Deferred tax assets | 37 | 2,666 | 2,453 |
| Retirement benefit assets | 36 | 681 | 1,267 |
| Assets arising from reinsurance contracts held | | 23,567 | 7,860 |
| Other assets | 28 | 4,474 | 4,575 |
| **Total assets** | | 833,893 | 797,598 |

The accompanying notes are an integral part of the consolidated financial statements.

| **Equity and liabilities** | Note | **2019 £ million** | 2018 £ million |
|---|---|---|---|
| **Liabilities** | | | |
| Deposits from banks | | **28,179** | 30,320 |
| Customer deposits | | **421,320** | 418,066 |
| Items in course of transmission to banks | | **373** | 636 |
| Financial liabilities at fair value through profit or loss | 29 | **21,486** | 30,547 |
| Derivative financial instruments | 17 | **25,779** | 21,373 |
| Notes in circulation | | **1,079** | 1,104 |
| Debt securities in issue | 30 | **97,689** | 91,168 |
| Liabilities arising from insurance contracts and participating investment contracts | 32 | **111,449** | 98,874 |
| Liabilities arising from non-participating investment contracts | 34 | **37,459** | 13,853 |
| Other liabilities | 35 | **20,333** | 19,633 |
| Retirement benefit obligations | 36 | **257** | 245 |
| Current tax liabilities | | **187** | 377 |
| Deferred tax liabilities | 37 | **44** | – |
| Other provisions | 38 | **3,323** | 3,547 |
| Subordinated liabilities | 39 | **17,130** | 17,656 |
| **Total liabilities** | | **786,087** | 747,399 |
| **Equity** | | | |
| Share capital | 40 | **7,005** | 7,116 |
| Share premium account | 41 | **17,751** | 17,719 |
| Other reserves | 42 | **13,695** | 13,210 |
| Retained profits | 43 | **3,246** | 5,389 |
| **Shareholders' equity** | | **41,697** | 43,434 |
| Other equity instruments | 44 | **5,906** | 6,491 |
| Total equity excluding non-controlling interests | | **47,603** | 49,925 |
| Non-controlling interests | | **203** | 274 |
| **Total equity** | | **47,806** | 50,199 |
| **Total equity and liabilities** | | **833,893** | 797,598 |

The accompanying notes are an integral part of the consolidated financial statements.

The directors approved the consolidated financial statements on 19 February 2020.

**Lord Blackwell**
Chairman

**António Horta-Osório**
Group Chief Executive

**William Chalmers**
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 2019** | **24,835** | **13,210** | **5,389** | **43,434** | **6,491** | **274** | **50,199** |
| **Comprehensive income** | | | | | | | |
| Profit for the year | – | – | 2,925 | 2,925 | – | 81 | 3,006 |
| Other comprehensive income | | | | | | | |
| Post-retirement defined benefit scheme remeasurements, net of tax | – | – | (1,117) | (1,117) | – | – | (1,117) |
| Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income, net of tax: | | | | | | | |
| Debt securities | – | (156) | – | (156) | – | – | (156) |
| Equity shares | – | 12 | – | 12 | – | – | 12 |
| Gains and losses attributable to own credit risk, net of tax | – | – | (306) | (306) | – | – | (306) |
| Movements in cash flow hedging reserve, net of tax | – | 453 | – | 453 | – | – | 453 |
| Currency translation differences (tax: £nil) | – | (12) | – | (12) | – | – | (12) |
| Total other comprehensive income | – | 297 | (1,423) | (1,126) | – | – | (1,126) |
| **Total comprehensive income** | – | 297 | 1,502 | 1,799 | – | 81 | 1,880 |
| **Transactions with owners** | | | | | | | |
| Dividends | – | – | (2,312) | (2,312) | – | (138) | (2,450) |
| Distributions on other equity instruments | – | – | (466) | (466) | – | – | (466) |
| Issue of ordinary shares | 107 | – | – | 107 | – | – | 107 |
| Share buyback | (189) | 189 | (1,095) | (1,095) | – | – | (1,095) |
| Redemption of preference shares | 3 | (3) | – | – | – | – | – |
| Issue of other equity instruments (note 44) | – | – | (3) | (3) | 896 | – | 893 |
| Redemptions of other equity instruments (note 44) | – | – | – | – | (1,481) | – | (1,481) |
| Movement in treasury shares | – | – | (3) | (3) | – | – | (3) |
| Value of employee services: | | | | | | | |
| Share option schemes | – | – | 71 | 71 | – | – | 71 |
| Other employee award schemes | – | – | 165 | 165 | – | – | 165 |
| Changes in non-controlling interests | – | – | – | – | – | (14) | (14) |
| **Total transactions with owners** | (79) | 186 | (3,643) | (3,536) | (585) | (152) | (4,273) |
| Realised gains and losses on equity shares held at fair value through other comprehensive income | – | 2 | (2) | – | – | – | – |
| **At 31 December 2019** | **24,756** | **13,695** | **3,246** | **41,697** | **5,906** | **203** | **47,806** |

Further details of movements in the Group's share capital, reserves and other equity instruments are provided in notes 40, 41, 42, 43 and 44.

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 | Other equity instruments £ million | Non-controlling interests £ million | Total £ million |
| **Balance at 31 December 2017** | 24,831 | 13,815 | 4,905 | 43,551 | 5,355 | 237 | 49,143 |
| Adjustment on adoption of IFRS 9 and IFRS 15 | – | (262) | (929) | (1,191) | – | – | (1,191) |
| **Balance at 1 January 2018** | 24,831 | 13,553 | 3,976 | 42,360 | 5,355 | 237 | 47,952 |
| **Comprehensive income** | | | | | | | |
| Profit for the year[1] | – | – | 4,408 | 4,408 | – | 98 | 4,506 |
| Other comprehensive income | | | | | | | |
| Post-retirement defined benefit scheme remeasurements, net of tax | – | – | 120 | 120 | – | – | 120 |
| Share of other comprehensive income of associates and joint ventures | – | – | 8 | 8 | – | – | 8 |
| Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income, net of tax: | | | | | | | |
| Debt securities | – | (193) | – | (193) | – | – | (193) |
| Equity shares | – | (75) | – | (75) | – | – | (75) |
| Gains and losses attributable to own credit risk, net of tax | – | – | 389 | 389 | – | – | 389 |
| Movements in cash flow hedging reserve, net of tax | – | (354) | – | (354) | – | – | (354) |
| Currency translation differences (tax: £nil) | – | (8) | – | (8) | – | – | (8) |
| Total other comprehensive income | – | (630) | 517 | (113) | – | – | (113) |
| **Total comprehensive income** | – | (630) | 4,925 | 4,295 | – | 98 | 4,393 |
| **Transactions with owners** | | | | | | | |
| Dividends | – | – | (2,240) | (2,240) | – | (61) | (2,301) |
| Distributions on other equity instruments[1] | – | – | (433) | (433) | – | – | (433) |
| Issue of ordinary shares | 162 | – | – | 162 | – | – | 162 |
| Share buyback | (158) | 158 | (1,005) | (1,005) | – | – | (1,005) |
| Issue of other equity instruments | – | – | (5) | (5) | 1,136 | – | 1,131 |
| Movement in treasury shares | – | – | 40 | 40 | – | – | 40 |
| Value of employee services: | | | | | | | |
| Share option schemes | – | – | 53 | 53 | – | – | 53 |
| Other employee award schemes | – | – | 207 | 207 | – | – | 207 |
| **Total transactions with owners** | 4 | 158 | (3,383) | (3,221) | 1,136 | (61) | (2,146) |
| Realised gains and losses on equity shares held at fair value through other comprehensive income | – | 129 | (129) | – | – | – | – |
| **At 31 December 2018** | 24,835 | 13,210 | 5,389 | 43,434 | 6,491 | 274 | 50,199 |

1 Restated, see note 1.

The accompanying notes are an integral part of the consolidated financial statements.

# 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 2017** | 24,768 | 14,652 | 3,600 | 43,020 | 5,355 | 440 | 48,815 |
| **Comprehensive income** | | | | | | | |
| Profit for the year[1] | – | – | 3,559 | 3,559 | – | 90 | 3,649 |
| Other comprehensive income | | | | | | | |
| Post-retirement defined benefit scheme remeasurements, net of tax | – | – | 482 | 482 | – | – | 482 |
| Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax | – | (74) | – | (74) | – | – | (74) |
| Gains and losses attributable to own credit risk, net of tax | – | – | (40) | (40) | – | – | (40) |
| Movements in cash flow hedging reserve, net of tax | – | (731) | – | (731) | – | – | (731) |
| Currency translation differences (tax: £nil) | – | (32) | – | (32) | – | – | (32) |
| Total other comprehensive income | – | (837) | 442 | (395) | – | – | (395) |
| **Total comprehensive income** | – | (837) | 4,001 | 3,164 | – | 90 | 3,254 |
| **Transactions with owners** | | | | | | | |
| Dividends | – | – | (2,284) | (2,284) | – | (51) | (2,335) |
| Distributions on other equity instruments[1] | – | – | (415) | (415) | – | – | (415) |
| Issue of ordinary shares | 63 | – | – | 63 | – | – | 63 |
| Movement in treasury shares | – | – | (411) | (411) | – | – | (411) |
| Value of employee services: | | | | | | | |
| Share option schemes | – | – | 82 | 82 | – | – | 82 |
| Other employee award schemes | – | – | 332 | 332 | – | – | 332 |
| Changes in non-controlling interests | – | – | – | – | – | (242) | (242) |
| **Total transactions with owners** | 63 | – | (2,696) | (2,633) | – | (293) | (2,926) |
| **Balance at 31 December 2017** | 24,831 | 13,815 | 4,905 | 43,551 | 5,355 | 237 | 49,143 |

1 Restated, see note 1.

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated cash flow statement

for the year ended 31 December

| | Note | 2019 £ million | 2018 £ million | 2017 £ million |
|---|---|---|---|---|
| **Profit before tax** | | **4,393** | 5,960 | 5,275 |
| Adjustments for: | | | | |
| Change in operating assets | 54(A) | **(11,049)** | (4,472) | (15,492) |
| Change in operating liabilities | 54(B) | **3,642** | (8,673) | (4,282) |
| Non-cash and other items | 54(C) | **15,573** | (2,892) | 12,332 |
| Tax paid | | **(1,278)** | (1,030) | (1,028) |
| **Net cash provided by (used in) operating activities** | | **11,281** | (11,107) | (3,195) |
| **Cash flows from investing activities** | | | | |
| Purchase of financial assets | | **(9,730)** | (12,657) | (7,862) |
| Proceeds from sale and maturity of financial assets | | **9,631** | 26,806 | 18,675 |
| Purchase of fixed assets | | **(3,442)** | (3,514) | (3,655) |
| Proceeds from sale of fixed assets | | **1,432** | 1,334 | 1,444 |
| Acquisition of businesses, net of cash acquired | 54(E) | **(21)** | (49) | (1,923) |
| Disposal of businesses, net of cash disposed | 54(F) | **–** | 1 | 129 |
| **Net cash (used in) provided by investing activities** | | **(2,130)** | 11,921 | 6,808 |
| **Cash flows from financing activities** | | | | |
| Dividends paid to ordinary shareholders | | **(2,312)** | (2,240) | (2,284) |
| Distributions on other equity instruments | | **(466)** | (433) | (415) |
| Dividends paid to non-controlling interests | | **(138)** | (61) | (51) |
| Interest paid on subordinated liabilities | | **(1,178)** | (1,268) | (1,275) |
| Proceeds from issue of subordinated liabilities | | **–** | 1,729 | – |
| Proceeds from issue of other equity instruments | | **893** | 1,131 | – |
| Proceeds from issue of ordinary shares | | **36** | 102 | 14 |
| Share buyback | | **(1,095)** | (1,005) | – |
| Repayment of subordinated liabilities | | **(818)** | (2,256) | (1,008) |
| Redemption of other equity instruments | | **(1,481)** | – | – |
| **Net cash used in financing activities** | | **(6,559)** | (4,301) | (5,019) |
| Effects of exchange rate changes on cash and cash equivalents | | **(5)** | 3 | – |
| Change in cash and cash equivalents | | **2,587** | (3,484) | (1,406) |
| Cash and cash equivalents at beginning of year | | **55,224** | 58,708 | 62,388 |
| **Cash and cash equivalents at end of year** | 54(D) | **57,811** | 55,224 | 60,982 |
| Adjustment on adoption of IFRS 9 | | | | (2,274) |
| **Cash and cash equivalents at 1 January 2018** | | | | 58,708 |

The accompanying notes are an integral part of the consolidated financial statements.

# Notes to the consolidated financial statements

for the year ended 31 December

## Note 1: Basis of preparation

The consolidated financial statements of Lloyds Banking Group plc and its subsidiary undertakings (the Group) 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. On adoption of IFRS 9 in 2018, the Group elected to continue applying hedge accounting under IAS 39. 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, financial assets measured at fair value through other comprehensive income, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts. As stated on page 96, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

The Group adopted IFRS 16 *Leases* from 1 January 2019. IFRS 16 replaces IAS 17 *Leases* and addresses the classification and measurement of all leases. The Group's accounting as a lessor under IFRS 16 is substantially unchanged from its approach under IAS 17; however for lessee accounting there is no longer a distinction between the accounting for finance and operating leases. For all assets the lessee recognises a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use. Assets and liabilities arising from a lease are initially measured on a present value basis. The lease payments are discounted using the interest rate implicit in the lease, if that rate can be determined, or the lessee's incremental borrowing rate. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. Payments associated with leases with a lease term of 12 months or less and leases of low-value assets are recognised as an expense in profit or loss on a straight-line basis.

The Group elected to apply the standard retrospectively with the cumulative effect of initial application being recognised at 1 January 2019, comparatives have therefore not been restated. There was no impact on shareholders' equity. Further details of the impact of adoption of IFRS 16 are provided in note 55.

The Group has also implemented the amendments to IAS 12 *Income Taxes* with effect from 1 January 2019 and as a result tax relief on distributions on other equity instruments, previously taken directly to retained profits, is reported within tax expense in the income statement. Comparatives have been restated. Adoption of these amendments to IAS 12 has resulted in a reduction in tax expense and an increase in profit for the year in 2019 of £115 million (2018: £106 million; 2017: £102 million) for the Group and £89 million (2018: £82 million; 2017: £79 million) for the Company. There is no impact on shareholders' equity or on earnings per share.

The Group has early adopted the hedge accounting amendments *Interest Rate Benchmark Reform*, issued by the IASB as a response to issues arising from the planned replacement of interest rate benchmarks in a number of jurisdictions. The amendments confirm that entities applying hedge accounting can continue to assume that the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of the uncertainties of the interest rate benchmark reform. Comparatives have not been restated. Further details are provided in note 53.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2019 and which have not been applied in preparing these financial statements are given in note 56.

## 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 332 to 337.

### (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 and the movement in these interests in interest expense.

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

## Note 2: Accounting policies continued

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 (P) 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. Joint control is the contractually agreed sharing of control of an arrangement and only exists when decisions about the relevant activities require the unanimous consent of the parties sharing control. 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.

## (B) Goodwill

Goodwill arises on business combinations and 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. 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

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: up to 7 years for capitalised software; 10 to 15 years for brands and other intangibles.

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

### (1) Net interest income

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 to the gross carrying amount of the financial asset (before adjusting for expected credit losses) or to the amortised cost of the financial liability, including 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. Interest income from non-credit impaired financial assets is recognised by applying the effective interest rate to the gross carrying amount of the asset; for credit impaired financial assets, the effective interest rate is applied to the net carrying amount after deducting the allowance for expected credit losses. Impairment policies are set out in (H) below.

### (2) Fee and commission income and expense

Fees and commissions receivable which are not an integral part of the effective interest rate are recognised as income as the Group fulfils its performance obligations. The Group's principal performance obligations arising from contracts with customers are in respect of value added current accounts, credit cards and debit cards. These fees are received, and the Group's provides the service, monthly; the fees are recognised in income on this basis. The Group also receives certain fees in respect of its asset finance business where the performance obligations are typically fulfilled towards the end of the customer contract; these fees are recognised in income on this basis. Where it is unlikely that the loan commitments will be drawn, loan commitment fees are recognised in fee and commission income over the life of the facility, rather than as an adjustment to the effective interest rate for loans expected to be drawn. Incremental costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

### (3) Other

Dividend income is recognised when the right to receive payment is established.

Revenue recognition policies specific to trading income are set out in E(3) below, life insurance and general insurance business are detailed below (see (M) below); those relating to leases are set out in (J)(1) below.

## (E) Financial assets and liabilities

On initial recognition, financial assets are classified as measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss, depending on the Group's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest. The Group assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. Financial assets with embedded derivatives are considered in their entirety when considering their cash flow characteristics. The Group reclassifies financial assets when and only when its business model for managing those assets changes. A reclassification will only take place when the change is significant to the Group's operations and will occur at a portfolio level and not for individual instruments; reclassifications are expected to be rare. Equity investments are measured at fair value through profit or loss unless the Group elects at initial recognition to account for the instruments at fair value through other comprehensive income. For these instruments, principally strategic investments, dividends are recognised in profit or loss but fair value gains and losses are not subsequently reclassified to profit or loss following derecognition of the investment.

## Note 2: Accounting policies continued

The Group initially recognises loans and advances, 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 the obligation is discharged, cancelled or expires.

### (1) Financial instruments measured at amortised cost

Financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Where the contractual cash flows introduce exposure to risks or volatility unrelated to a basic lending arrangement such as changes in equity prices or commodity prices, the payments do not comprise solely principal and interest. Financial assets measured at amortised cost are predominantly loans and advances to customers and banks together with certain debt securities used by the Group to manage its liquidity. Loans and advances are initially recognised when cash is advanced to the borrower at fair value inclusive of transaction costs. Interest income is accounted for using the effective interest method (see (D) above).

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.

### (2) Financial assets measured at fair value through other comprehensive income

Financial assets that are held to collect contractual cash flows and for subsequent sale, where the assets' cash flows represent solely payments of principal and interest, are recognised in the balance sheet at their fair value, inclusive of transaction costs. Interest calculated using the effective interest method and foreign exchange gains and losses on assets denominated in foreign currencies are recognised in the income statement. All other gains and losses arising from changes in fair value are recognised directly in other comprehensive income, until the financial asset is either sold or matures, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement other than in respect of equity shares, for which the cumulative revaluation amount is transferred directly to retained profits. The Group recognises a charge for expected credit losses in the income statement (see (H) below). As the asset is measured at fair value, the charge does not adjust the carrying value of the asset, it is reflected in other comprehensive income.

### (3) Financial instruments measured at fair value through profit or loss

Financial assets are classified at fair value through profit or loss where they do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income or where they are designated at fair value through profit or loss to reduce an accounting mismatch. All derivatives are carried at fair value through profit or loss.

The assets backing the insurance and investment contracts issued by the Group do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income as they are managed on a fair value basis and accordingly are measured at fair value through profit or loss. Similarly, trading securities, which 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, do not meet these criteria and are also measured at fair value through profit or loss. Financial assets measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses together with interest coupons and dividend income are recognised in the income statement within net trading income.

Financial liabilities are measured at fair value through profit or loss where they are trading liabilities or where they are designated at fair value through profit or loss in order to reduce an accounting mismatch; where the liabilities are part of a group of liabilities (or assets and liabilities) which is managed, and its performance evaluated, on a fair value basis; or where the 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. Financial liabilities measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses are recognised in the income statement within net trading income in the period in which they occur, except that gains and losses attributable to changes in own credit risk are recognised in other comprehensive income.

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. The fair values of derivative financial instruments are adjusted where appropriate to reflect credit risk (via credit valuation adjustments (CVAs), debit valuation adjustments (DVAs) and funding valuation adjustments (FVAs)), market liquidity and other risks.

### (4) Borrowings

Borrowings (which include deposits from banks, customer deposits, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense. 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 carrying value of the liability and the fair value of the new equity is recognised in profit or loss.

### (5) 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 advances measured at amortised cost 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 advance measured at amortised cost or customer deposit.

## Note 2: Accounting policies continued

## (F) Derivative financial instruments and hedge accounting

As permitted by IFRS 9, the Group continues to apply the requirements of IAS 39 to its hedging relationships. All derivatives are recognised at their fair value. Derivatives are carried on the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to 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 all derivative instruments, other than those in effective cash flow and net investment hedging relationships, are recognised immediately in the income statement. As noted in (2) and (3) below, the change in fair value of a derivative in an effective cash flow or net investment hedging relationship is allocated between the income statement and other comprehensive income.

Derivatives embedded in a financial asset are not considered separately; the financial asset is considered in its entirety when determining whether its cash flows are solely payments of principal and interest. Derivatives embedded in financial liabilities 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.

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 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. Note 17 provides details of the types of derivatives held by the Group and presents separately those designated in hedge relationships. In respect of interest rate benchmark reform, the Group assumes that the interest rate benchmark on which the hedged cash flows and/or the hedged risk are based, or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform. The Group does not discontinue a hedging relationship during the period of uncertainty arising from the interest rate benchmark reform solely because the actual results of the hedge are not highly effective.

### (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 a financial asset at fair value through other comprehensive income. 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 hedging 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

The impairment charge in the income statement includes the change in expected credit losses and certain fraud costs. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts. Expected credit losses are calculated as an unbiased and probability-weighted estimate using an appropriate probability of default, adjusted to take into account a range of possible future economic scenarios, and applying this to the estimated exposure of the Group at the point of default after taking into account the value of any collateral held, repayments, or other mitigants of loss and including the impact of discounting using the effective interest rate.

At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk since origination, allowance (or provision) is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk since initial recognition are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3. Some Stage 3 assets, mainly in Commercial Banking, are subject to individual rather than collective assessment. Such cases are subject to a risk-based impairment sanctioning process, and these are reviewed and updated at least quarterly, or more frequently if there is a significant change in the credit profile.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses. In determining whether there has been a significant increase in credit risk, the Group uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings together with qualitative indicators such as watchlists and other indicators of historical delinquency, credit weakness or financial difficulty. However, unless identified at an earlier stage, the

## Note 2: Accounting policies continued

credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since initial recognition, the asset is transferred back to Stage 1.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. Default is considered to have occurred when there is evidence that the customer is experiencing financial difficulty which is likely to affect significantly the ability to repay the amount due. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The Group uses this 90 day backstop for all its products except for UK mortgages. For UK mortgages, the Group uses a backstop of 180 days past due as mortgage exposures more than 90 days past due, but less than 180 days, typically show high cure rates and this aligns with the Group's risk management practices.

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. In the latter circumstances, the loan will remain classified as either Stage 2 or Stage 3 until the credit risk has improved such that it no longer represents a significant increase since origination (for a return to Stage 1), or the loan is no longer credit impaired (for a return to Stage 2). Renegotiation may also lead to the loan and associated allowance being derecognised and a new loan being recognised initially at fair value.

Purchased or originated credit-impaired financial assets (POCI) include financial assets that are purchased or originated at a deep discount that reflects incurred credit losses. At initial recognition, POCI assets do not carry an impairment allowance; instead, lifetime expected credit losses are incorporated into the calculation of the effective interest rate. All changes in lifetime expected credit losses subsequent to the assets' initial recognition are recognised as an impairment charge.

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 continuing attempts to recover are 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.

### (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: the shorter of 50 years and the remaining period of the lease for freehold/long and short leasehold premises; the shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease for leasehold improvements; 10 to 20 years for fixtures and furnishings; and 2 to 8 years for other equipment and motor vehicles.

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.

### (J) Leases

Under IFRS 16, a lessor is required to determine whether a lease is a finance or operating lease. A lessee is not required to make this determination.

#### (1) 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 allowances for expected credit losses, 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 property, plant and equipment 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.

#### (2) As lessee

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Assets and liabilities arising from a lease are initially measured on a present value basis. The lease payments are discounted using the interest rate implicit in the lease, if that rate can be determined, or the Group's incremental borrowing rate appropriate for the right-of-use asset arising from the lease.

Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of twelve months or less. Low-value assets comprise IT equipment and small items of office furniture.

### (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.

## Note 2: Accounting policies continued

### (1) Pension schemes

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.

Scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. The Group's income statement charge includes the current service cost of providing pension benefits, past service costs, net interest expense (income), and plan administration costs that are not deducted from the return on plan assets. Past service costs, which represents the change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment, are recognised when the plan amendment or curtailment occurs. Net interest expense (income) is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or asset.

Remeasurements, comprising actuarial gains and losses, the return on plan assets (excluding amounts included in net interest expense (income) and net of the cost of managing the plan assets), and the effect of changes to the asset ceiling (if applicable) are reflected immediately in the balance sheet with a charge or credit recognised in other comprehensive income in the period in which they occur. Remeasurements recognised in other comprehensive income are reflected immediately in retained profits and will not subsequently be reclassified to profit or loss.

The Group's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes. 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.

### (2) 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.

## (L) Taxation

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it. The tax consequences of the Group's dividend payments (including distributions on other equity instruments), if any, are charged or credited to the statement in which the profit distributed originally arose.

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or other relevant tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are re-measured as required to reflect current information.

For the Group's long-term insurance businesses, the tax expense is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on the shareholders' returns. This allocation is based on an assessment of the rates of tax which will be applied to the returns under the current UK tax rules.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences but not recognised for taxable temporary differences arising on investments in subsidiaries where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax liabilities are not recognised on temporary differences that arise from goodwill which is not deductible for tax purposes.

Deferred tax assets are recognised to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilised, and are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are not recognised in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. Deferred tax is not discounted.

## (M) 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 and UK established practice.

Products sold by the life insurance business are classified into three categories:

## Note 2: Accounting policies continued

– Insurance contracts – these contracts transfer significant insurance risk and may also transfer financial risk. The Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. These contracts may or may not include discretionary participation features.
– Investment contracts containing a discretionary participation feature (participating investment contracts) – these contracts do not transfer significant insurance risk, but contain a contractual right which gives the holder the right to receive, in addition to the guaranteed benefits, further additional discretionary benefits or bonuses that are likely to be a significant proportion of the total contractual benefits and the amount and timing of which is at the discretion of the Group, within the constraints of the terms and conditions of the instrument and based upon the performance of specified assets.
– Non-participating investment contracts – these contracts do not transfer significant insurance risk or contain a discretionary participation feature.

The general insurance business issues only insurance contracts.

## (1) Life insurance business

### (i) Accounting for insurance and participating investment contracts

#### Premiums and claims

Premiums received in respect of insurance and participating investment contracts are recognised as revenue when due except for unit-linked contracts on which premiums are recognised as revenue when received. Claims are recorded as an expense on the earlier of the maturity date or the date on which the claim is notified.

#### Liabilities

Changes in the value of liabilities are recognised in the income statement through insurance claims.

– *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).

– *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.

– *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. 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 its recoverability is reviewed 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.

## Note 2: Accounting policies continued

### (2) General insurance business

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included in insurance premium income, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred in the balance sheet within liabilities arising from insurance contracts and participating investment contracts on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of the contract and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date. Claims liabilities are not discounted.

### (3) Liability adequacy test

At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities net of related deferred cost assets and value of in-force business. In performing these tests current best estimates of discounted future contractual cash flows and claims handling and policy administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the income statement, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from liability adequacy tests.

### (4) Reinsurance

Contracts entered into by the Group with reinsurers under which the Group is compensated for benefits payable on one or more contracts issued by the Group are recognised as assets arising from reinsurance contracts held. Where the underlying contracts issued by the Group are classified as insurance contracts and the reinsurance contract transfers significant insurance risk on those contracts to the reinsurer, the assets arising from reinsurance contracts held are classified as insurance contracts. Where the underlying contracts issued by the Group are classified as non-participating investment contracts and the reinsurance contract transfers financial risk on those contracts to the reinsurer, the assets arising from reinsurance contracts held are classified as non-participating investment contracts.

#### Assets arising from reinsurance contracts held – Classified as insurance contracts

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured contracts and in accordance with the terms of each reinsurance contract and are regularly reviewed for impairment. Premiums payable for reinsurance contracts are recognised as an expense when due within insurance premium income. Changes in the reinsurance recoverable assets are recognised in the income statement through insurance claims.

#### Assets arising from reinsurance contracts held – Classified as non-participating investment contracts

These contracts are accounted for as financial assets whose value is contractually linked to the fair values of financial assets within the reinsurers' investment funds. Investment returns (including movements in fair value and investment income) allocated to these contracts are recognised in insurance claims. Deposits and withdrawals are not accounted for through the income statement but are accounted for directly in the balance sheet as adjustments to the assets arising from reinsurance contracts held.

## (N) 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). 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 non-monetary financial assets measured at fair value through other comprehensive income, 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; and 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.

## (O) 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.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

Provision is made for expected credit losses in respect of irrevocable undrawn loan commitments and financial guarantee contracts (see (H) above).

## (P) Share capital

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. Dividends paid on the Group's ordinary shares are recognised as a reduction in equity in the period in which they are paid.

## Note 2: Accounting policies continued

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; if these shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

### (Q) 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 judgements and estimates

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 expected credit losses

The Group recognises an allowance for expected credit losses for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets measured at fair value through other comprehensive income and certain loan commitment and financial guarantee contracts. At 31 December 2019 the Group's expected credit loss allowance was £3,455 million (31 December 2018: £3,362 million), of which £3,278 million (31 December 2018: £3,169 million) was in respect of drawn balances.

The calculation of the Group's expected credit loss (ECL) allowances and provisions against loan commitments and guarantees under IFRS 9 requires the Group to make a number of judgements, assumptions and estimates. The most significant are set out below.

#### Definition of default

The probability of default (PD) of an exposure, both over a 12 month period and over its lifetime, is a key input to the measurement of the ECL allowance. Default has occurred when there is evidence that the customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due. The definition of default adopted by the Group is described in note 2(H) Impairment of financial assets. The Group has rebutted the presumption in IFRS 9 that default occurs no later than when a payment is 90 days past due for UK mortgages. As a result, at 31 December 2019, approximately £0.6 billion of UK mortgages (31 December 2018: £0.6 billion) were classified as Stage 2 rather than Stage 3; the impact on the Group's ECL allowance was not material.

#### Lifetime of an exposure

The PD of a financial asset is dependent on its expected life. A range of approaches, segmented by product type, has been adopted by the Group to estimate a product's expected life. These include using the full contractual life and taking into account behavioural factors such as early repayments and refinancing. For non-revolving retail assets, the Group has assumed the expected life for each product to be the time taken for all significant losses to be observed. For retail revolving products, the Group has considered the losses beyond the contractual term over which the Group is exposed to credit risk. For commercial overdraft facilities, the average behavioural life has been used. Changes to the assumed expected lives of the Group's assets could impact the ECL allowance recognised by the Group.

#### Significant increase in credit risk

Performing assets are classified as either Stage 1 or Stage 2. An ECL allowance equivalent to 12 months expected losses is established against assets in Stage 1; assets classified as Stage 2 carry an ECL allowance equivalent to lifetime expected losses. Assets are transferred from Stage 1 to Stage 2 when there has been a significant increase in credit risk (SICR) since initial recognition.

The Group uses a quantitative test together with qualitative indicators to determine whether there has been a SICR for an asset. For retail, a deterioration in the Retail Master Scale of four grades for credit cards, personal loans or overdrafts, three grades for personal mortgages, or two grades for UK motor finance accounts is treated as a SICR. For Commercial a doubling of PD with a minimum increase in PD of 1 per cent and a resulting change in the underlying grade is treated as a SICR. All financial assets are assumed to have suffered a SICR if they are more than 30 days past due.

The setting of precise trigger points combined with risk indicators requires judgement. The use of different trigger points may have a material impact upon the size of the ECL allowance. The Group monitors the effectiveness of SICR criteria on an ongoing basis.

#### Post-model adjustments

Limitations in the Group's impairment models or input data may be identified through the on-going assessment and validation of the output of the models. In these circumstances, management make appropriate adjustments to the Group's allowance for impairment losses to ensure the overall provision adequately reflects all material risks. These adjustments are generally determined taking into account the particular attributes of the exposure which have not been adequately captured by the primary impairment models.

At 31 December 2019, significant post-model adjustments included within the allowance for expected credit losses amounted to £161 million (2018: £195 million), less than 5 percent of overall provisions. This comprises increases for the additional end of term risk on interest only mortgages of £132 million (2018: £114 million); mortgage accounts in long term default of £33 million (2018: £47 million); the extension of modelled lifetime on Retail revolving products of £36 million (2018: £34 million); and a decrease from the temporary effects of bureau data changes which artificially inflate PDs, and the resulting ECL, of £40 million; (2018: Nil).

#### Forward looking information

The measurement of expected credit losses is required to reflect an unbiased probability-weighted range of possible future outcomes. In order to do this, the Group has developed an economic model to project a wide range of key impairment drivers using information derived mainly from external sources. These drivers include factors such as the unemployment rate, the house price index, commercial property prices and corporate credit spreads. The model-generated economic scenarios for the six years beyond 2019 are mapped to industry-wide historical loss data by portfolio. Combined losses across portfolios are used to rank the scenarios by severity of loss. Alongside a defined central scenario three further scenarios are generated by averaging a group of individual scenarios around specified points along the loss distribution to reflect the range of outcomes. The central scenario reflects the Group's base case assumptions used for medium-term planning purposes, an upside and a downside scenario are also produced together with a severe downside scenario. Rare occurrences of adverse economic events can lead to relatively large credit losses which means that typically the most likely outcome is less than the probability-weighted outcome of the range of possible future events. To allow for this a relatively unlikely severe downside scenario is therefore included. At 31 December 2018 and 2019, the base case, upside and downside scenarios each carry a 30 per cent weighting; the severe downside scenario is weighted

## Note 3: Critical accounting judgements and estimates continued

at 10 per cent. The choice of alternative scenarios and scenario weights is a combination of quantitative analysis and judgemental assessment to ensure that the full range of possible outcomes and material non-linearity of losses are captured. A committee under the chairmanship of the Chief Economist meets quarterly, to review and, if appropriate, recommend changes to the economic scenarios to the Chief Financial Officer and Chief Risk Officer. Findings dealing with all aspects of the expected credit loss calculation are presented to the Group Audit Committee.

For each major product grouping models have been developed which utilise historical credit loss data to produce PDs for each scenario; an overall weighted average PD is used to assist in determining the staging of financial assets and related ECL.

The key UK economic assumptions made by the Group averaged over a five-year period are shown below:

| | At 31 December 2019 | | | | At 31 December 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| Economic assumptions | Base case % | Upside % | Downside % | Severe downside % | Base case % | Upside % | Downside % | Severe downside % |
| Interest rate | **1.25** | **2.04** | **0.49** | **0.11** | 1.25 | 2.34 | 1.30 | 0.71 |
| Unemployment rate | **4.3** | **3.9** | **5.8** | **7.2** | 4.5 | 3.9 | 5.3 | 6.9 |
| House price growth | **1.3** | **5.0** | **(2.6)** | **(7.1)** | 2.5 | 6.1 | (4.8) | (7.5) |
| Commercial real estate price growth | **(0.2)** | **1.8** | **(3.8)** | **(7.1)** | 0.4 | 5.3 | (4.7) | (6.4) |

The Group's base-case economic scenario has changed little over the year and reflects a broadly stable outlook for the economy. Although there remains considerable uncertainty about the economic consequences of the UK's exit from the European Union, the Group considers that at this stage the range of possible economic outcomes is adequately reflected in its choice and weighting of scenarios. The averages shown above do not fully reflect the peak to trough changes in the stated assumptions over the period. The tables below illustrate the variability of the assumptions from the start of the scenario period to the peak and trough.

| | At 31 December 2019 | | | | At 31 December 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| Economic assumptions – start to peak | Base case % | Upside % | Downside % | Severe downside % | Base case % | Upside % | Downside % | Severe downside % |
| Interest rate | **1.75** | **2.56** | **0.75** | **0.75** | 1.75 | 4.00 | 1.75 | 1.25 |
| Unemployment rate | **4.6** | **4.6** | **6.9** | **8.3** | 4.8 | 4.3 | 6.3 | 8.6 |
| House price growth | **6.0** | **26.3** | **(1.9)** | **(2.3)** | 13.7 | 34.9 | 0.6 | (1.6) |
| Commercial real estate price growth | **0.1** | **10.4** | **(0.6)** | **(1.1)** | 0.1 | 26.9 | (0.5) | (0.5) |

| | At 31 December 2019 | | | | At 31 December 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| Economic assumptions – start to trough | Base case % | Upside % | Downside % | Severe downside % | Base case % | Upside % | Downside % | Severe downside % |
| Interest rate | **0.75** | **0.75** | **0.35** | **0.01** | 0.75 | 0.75 | 0.75 | 0.25 |
| Unemployment rate | **3.8** | **3.4** | **3.9** | **3.9** | 4.1 | 3.5 | 4.3 | 4.2 |
| House price growth | **(1.9)** | **(0.8)** | **(14.8)** | **(33.1)** | 0.4 | 2.3 | (26.5) | (33.5) |
| Commercial real estate price growth | **(0.9)** | **0.3** | **(17.5)** | **(30.9)** | (0.1) | 0.0 | (23.8) | (33.8) |

The table below shows the extent to which a higher ECL allowance has been recognised to take account of forward looking information from the weighted multiple economic scenarios. The most significant difference between these bases arises on UK mortgages as the probability weighted ECL includes the impact of house price movements on the loss given default. For other portfolios adjustment is made only for the probability of default. All non-modelled provisions, including post model adjustments, are based on the probability weighted modelled ECL across all scenarios.

| | At 31 December 2019 | | | At 31 December 2018 | | |
|---|---|---|---|---|---|---|
| Impact of multiple economic scenarios | Base case £m | Probability weighted £m | Difference £m | Base case £m | Probability weighted £m | Difference £m |
| UK mortgages | **464** | **569** | **105** | 253 | 460 | 207 |
| Other Retail | **1,492** | **1,521** | **29** | 1,294 | 1,308 | 14 |
| Commercial Banking | **1,258** | **1,315** | **57** | 1,472 | 1,513 | 41 |
| Other | **50** | **50** | **–** | 81 | 81 | – |
| | **3,264** | **3,455** | **191** | 3,100 | 3,362 | 262 |

The table below shows the Group's ECL for the upside and downside scenarios using a 100 per cent weighting, with stage allocation based on each specific scenario.

| | At 31 December 2019 | | At 31 December 2018 | |
|---|---|---|---|---|
| | Upside £m | Downside £m | Upside £m | Downside £m |
| ECL allowance | **3,001** | **3,677** | 2,775 | 3,573 |

The impact of changes in the UK unemployment rate and House Price Index (HPI) have also been assessed. Although such changes would not be observed in isolation, as economic indicators tend to be correlated in a coherent scenario, this gives insight into the sensitivity of the Group's ECL to changes in these two critical economic factors. The assessment has been made against the base case with the reported staging unchanged. The changes to HPI and the unemployment rate have been phased in to the forward-looking economic outlook over three years.

## Note 3: Critical accounting judgements and estimates continued

The table below shows the impact on the Group's ECL resulting from a decrease/increase in Loss Given Default for a 10 percentage point (pp) increase/decrease in the UK House Price Index (HPI).

| | At 31 December 2019 | | At 31 December 2018 | |
|---|---|---|---|---|
| | 10pp increase in HPI | 10pp decrease in HPI | 10pp increase in HPI | 10pp decrease in HPI |
| ECL impact, £m | **(110)** | **147** | (114) | 154 |

The table below shows the impact on the Group's ECL resulting from a decrease/increase for a 1 percentage point (pp) increase/decrease in the UK unemployment rate.

| | At 31 December 2019 | | At 31 December 2018 | |
|---|---|---|---|---|
| | 1pp increase in unemployment | 1pp decrease in unemployment | 1pp increase in unemployment | 1pp decrease in unemployment |
| ECL impact, £m | **141** | **(143)** | 172 | (155) |

### Valuation of assets and liabilities arising from insurance business

At 31 December 2019, the Group recognised a value of in-force business asset of £5,311 million (2018: £4,491 million) and an acquired value of in-force business asset of £247 million (2018: £271 million).

The value of in-force business asset represents the estimated present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. The valuation of this asset requires assumptions to be made about future economic and operating conditions which are inherently uncertain and changes could significantly affect the value attributed to this asset. The methodology used to value this asset and the key assumptions that have been made in determining the carrying value of the value of in-force business asset at 31 December 2019 are set out in note 25.

At 31 December 2019, the Group carried total liabilities arising from insurance contracts and participating investment contracts of £111,449 million (2018: £98,874 million). Elements of the valuations of liabilities arising from insurance contracts and participating investment contracts require management to estimate future investment returns, future mortality rates, future expenses and future policyholder behaviour. These estimates are subject to significant uncertainty. The methodology used to value these liabilities and the key assumptions that have been made in determining their carrying value are set out in note 32.

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 33.

### Defined benefit pension scheme obligations

The net asset recognised in the balance sheet at 31 December 2019 in respect of the Group's defined benefit pension scheme obligations was £550 million (comprising an asset of £681 million and a liability of £131 million) (2018: a net asset of £1,146 million comprising an asset of £1,267 million and a liability of £121 million). The Group's accounting policy for its defined benefit pension scheme obligations is set out in note 2(K).

The accounting valuation 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 in the currency and with a term consistent with the defined benefit pension schemes' obligations. The average duration of the schemes' obligations is approximately 18 years. The market for bonds with a similar 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 life expectancy of the members. The Group considers latest market practice and actual experience in determining the appropriate assumptions for both current mortality expectations and the rate of future mortality improvement. 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 part (v) of note 36.

### Recoverability of deferred tax assets

At 31 December 2019 the Group carried deferred tax assets on its balance sheet of £2,666 million (2018: £2,453 million) principally relating to tax losses carried forward. Further information on the Group's deferred tax assets and uncertain tax positions is provided in notes 37 and 48 respectively.

Estimation of income taxes includes the assessment of recoverability of deferred tax assets. Deferred tax assets are only recognised to the extent they are considered more likely than not to be recoverable based on existing tax laws and forecasts of future taxable profits against which the underlying tax deductions can be utilised. The Group has recognised a deferred tax asset of £3,611 million (2018: £3,778 million) in respect of UK trading losses carried forward. Substantially all of these losses have arisen in Bank of Scotland plc and Lloyds Bank plc, and they will be utilised as taxable profits arise in those legal entities in future periods.

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 strategic report, as well as the risks associated with future regulatory change. Under current law there is no expiry date for UK trading losses not yet utilised, although (since Finance Act 2016) banking losses that arose before 1 April 2015 can only be used against 25 per cent of taxable profits arising after 1 April 2016, and they cannot be used to reduce the surcharge on banking profits. This restriction in utilisation means that the value of the deferred tax asset is only expected to be fully recovered by 2039. It is possible that future tax law changes could materially affect the value of these losses ultimately realised by the Group.

As disclosed in note 37, deferred tax assets totalling £428 million (2018: £584 million) have not been recognised in respect of certain capital and trading losses carried forward, unrelieved foreign tax credits and other tax deductions, as there are currently no expected future taxable profits against which these assets can be utilised.

## Note 3: Critical accounting judgements and estimates continued

### Regulatory provisions

At 31 December 2019, the Group carried provisions of £2,408 million (2018: £2,385 million) against the cost of making redress payments to customers and the related administration costs in connection with historical regulatory breaches.

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 and estimate. It will often be necessary to form a view on matters which are inherently uncertain, such as the scope of reviews required by regulators, and to estimate 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 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.

More detail on the nature of the assumptions that have been made and key sensitivities is set out in note 38.

### Fair value of financial instruments

At 31 December 2019, the carrying value of the Group's financial instrument assets held at fair value was £211,650 million (2018: £206,939 million), and its financial instrument liabilities held at fair value was £47,265 million (2018: £51,920 million).

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 minimal estimates are made in determining fair value. 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.

The valuation techniques for level 2 and level 3 financial instruments involve management judgement and estimates the extent of which depends on the complexity of the instrument and the availability of market observable information. 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. 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 also 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 187.

## 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 (GEC) 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 GEC 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 and 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 the following are excluded in arriving at underlying profit:

- market volatility and asset sales, including the effects of certain asset sales, the volatility relating to the Group's own debt and hedging arrangements and that arising in the insurance businesses;
- the unwind of acquisition-related fair value adjustments and the amortisation of purchased intangible assets;
- restructuring costs, principally comprising severance costs, the costs of integrating newly acquired businesses, the costs of regulatory reform and the rationalisation of the non-branch property portfolio; and
- payment protection insurance.

For the purposes of the underlying income statement, operating lease depreciation (net of gains on disposal of operating lease assets) is shown as an adjustment to total income.

During 2019, the Group transferred Cardnet, its card payment acceptance service, from Retail into Commercial Banking and also transferred certain equity business from Commercial Banking into Central items. Comparative figures have been restated accordingly.

The Group's activities are organised into three financial reporting segments: Retail; Commercial Banking; and Insurance and Wealth.

Retail offers a broad range of financial service products, including current accounts, savings, mortgages, motor finance and unsecured consumer lending to personal and small business customers.

Commercial Banking provides a range of products and services such as lending, transactional banking, working capital management, risk management and debt capital markets services to SMEs, corporates and financial institutions.

Insurance and Wealth offers insurance, investment and wealth management products and services.

Other includes income and expenditure not attributed to divisions, including the costs of certain central and head office functions and the Group's private equity business, Lloyds Development Capital.

Inter-segment services are generally recharged at cost, although some attract a margin. In particular a profit margin is charged on the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds.

For the majority of those derivative contracts entered into by business units for risk management purposes, the business unit recognises the net interest income or expense on an accrual accounting basis and transfers the remainder of the movement in the fair value of the derivative to the central function 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 function. 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.

Notes to the consolidated financial statements continued

## Note 4: Segmental analysis continued

| | Retail £m | Commercial Banking £m | Insurance and Wealth £m | Other £m | Underlying basis total £m |
|---|---|---|---|---|---|
| **Year ended 31 December 2019** | | | | | |
| Net interest income | 8,807 | 2,918 | 112 | 540 | 12,377 |
| Other income, net of insurance claims | 2,014 | 1,422 | 2,021 | 275 | 5,732 |
| **Total underlying income, net of insurance claims** | 10,821 | 4,340 | 2,133 | 815 | 18,109 |
| Operating lease depreciation[1] | (946) | (21) | – | – | (967) |
| Net income | 9,875 | 4,319 | 2,133 | 815 | 17,142 |
| Operating costs | (4,760) | (2,081) | (982) | (52) | (7,875) |
| Remediation | (238) | (155) | (50) | (2) | (445) |
| Total costs | (4,998) | (2,236) | (1,032) | (54) | (8,320) |
| Impairment (charge) credit | (1,038) | (306) | – | 53 | (1,291) |
| **Underlying profit** | 3,839 | 1,777 | 1,101 | 814 | 7,531 |
| External income | 13,109 | 3,394 | 1,740 | (134) | 18,109 |
| Inter-segment income (expense) | (2,288) | 946 | 393 | 949 | – |
| **Segment underlying income, net of insurance claims** | 10,821 | 4,340 | 2,133 | 815 | 18,109 |
| **Segment external assets** | 350,585 | 145,060 | 175,869 | 162,379 | 833,893 |
| **Segment customer deposits** | 252,056 | 145,122 | 13,677 | 10,465 | 421,320 |
| **Segment external liabilities** | 259,964 | 183,390 | 182,333 | 160,400 | 786,087 |
| **Analysis of segment underlying other income, net of insurance claims:** | | | | | |
| Current accounts | 518 | 136 | 5 | – | 659 |
| Credit and debit card fees | 652 | 330 | – | – | 982 |
| Commercial banking and treasury fees | – | 248 | – | – | 248 |
| Unit trust and insurance broking | 9 | – | 197 | – | 206 |
| Private banking and asset management | – | 4 | 65 | – | 69 |
| Factoring | – | 103 | – | – | 103 |
| Other fees and commissions | 54 | 249 | 156 | 30 | 489 |
| Fees and commissions receivable | 1,233 | 1,070 | 423 | 30 | 2,756 |
| Fees and commissions payable | (571) | (321) | (405) | (53) | (1,350) |
| Net fee and commission income | 662 | 749 | 18 | (23) | 1,406 |
| Operating lease rental income | 1,225 | 25 | – | – | 1,250 |
| Rental income from investment properties | – | – | 191 | – | 191 |
| Gains less losses on disposal of financial assets at fair value through other comprehensive income | – | (5) | – | 201 | 196 |
| Lease termination income | – | 12 | – | – | 12 |
| Trading income | 47 | 812 | – | 278 | 1,137 |
| Insurance and other, net of insurance claims | 206 | 72 | 2,216 | (954) | 1,540 |
| Other external income, net of insurance claims | 1,478 | 916 | 2,407 | (475) | 4,326 |
| Inter-segment other income | (126) | (243) | (404) | 773 | – |
| Segment other income, net of insurance claims | 2,014 | 1,422 | 2,021 | 275 | 5,732 |
| Other segment items reflected in income statement above: | | | | | |
| Depreciation and amortisation | 1,712 | 315 | 181 | 452 | 2,660 |
| Increase in value of in-force business | – | – | 825 | – | 825 |
| Defined benefit scheme charges | 108 | 43 | 19 | 75 | 245 |
| Other segment items: | | | | | |
| Additions to fixed assets | 2,208 | 260 | 174 | 1,007 | 3,649 |
| Investments in joint ventures and associates at end of year | 4 | – | – | 300 | 304 |

1 Net of profits on disposal of operating lease assets of £41 million.

## Note 4: Segmental analysis continued

| | Retail £m | Commercial Banking £m | Insurance and Wealth £m | Other £m | Underlying basis total £m |
|---|---|---|---|---|---|
| Year ended 31 December 2018[1] | | | | | |
| Net interest income | 9,060 | 3,013 | 123 | 518 | 12,714 |
| Other income, net of insurance claims | 2,097 | 1,670 | 1,865 | 378 | 6,010 |
| Total underlying income, net of insurance claims | 11,157 | 4,683 | 1,988 | 896 | 18,724 |
| Operating lease depreciation[2] | (921) | (35) | – | – | (956) |
| Net income | 10,236 | 4,648 | 1,988 | 896 | 17,768 |
| Operating costs | (4,897) | (2,191) | (1,021) | (56) | (8,165) |
| Remediation | (267) | (203) | (39) | (91) | (600) |
| Total costs | (5,164) | (2,394) | (1,060) | (147) | (8,765) |
| Impairment (charge) credit | (861) | (71) | (1) | (4) | (937) |
| Underlying profit | 4,211 | 2,183 | 927 | 745 | 8,066 |
| External income | 13,022 | 4,889 | 1,895 | (1,082) | 18,724 |
| Inter-segment income (expense) | (1,865) | (206) | 93 | 1,978 | – |
| Segment underlying income, net of insurance claims | 11,157 | 4,683 | 1,988 | 896 | 18,724 |
| Segment external assets | 349,412 | 165,030 | 140,487 | 142,669 | 797,598 |
| Segment customer deposits | 252,808 | 148,635 | 14,063 | 2,560 | 418,066 |
| Segment external liabilities | 259,778 | 191,687 | 147,673 | 148,261 | 747,399 |
| Analysis of segment underlying other income, net of insurance claims | | | | | |
| Current accounts | 503 | 142 | 5 | – | 650 |
| Credit and debit card fees | 660 | 332 | 1 | – | 993 |
| Commercial banking and treasury fees | – | 305 | – | – | 305 |
| Unit trust and insurance broking | 13 | – | 208 | – | 221 |
| Private banking and asset management | – | 5 | 92 | – | 97 |
| Factoring | – | 83 | – | – | 83 |
| Other fees and commissions | 52 | 253 | 163 | 31 | 499 |
| Fees and commissions receivable | 1,228 | 1,120 | 469 | 31 | 2,848 |
| Fees and commissions payable | (601) | (311) | (418) | (56) | (1,386) |
| Net fee and commission income | 627 | 809 | 51 | (25) | 1,462 |
| Operating lease rental income | 1,305 | 38 | – | – | 1,343 |
| Rental income from investment properties | – | – | 197 | – | 197 |
| Gains less losses on disposal of financial assets at fair value through other comprehensive income | – | – | – | 275 | 275 |
| Lease termination income | – | 7 | – | – | 7 |
| Net trading income, excluding insurance | 71 | 711 | – | 282 | 1,064 |
| Insurance and other, net of insurance claims | 247 | 356 | 2,146 | (1,087) | 1,662 |
| Other external income, net of insurance claims | 1,623 | 1,112 | 2,343 | (530) | 4,548 |
| Inter-segment other income | (153) | (251) | (529) | 933 | – |
| Segment other income, net of insurance claims | 2,097 | 1,670 | 1,865 | 378 | 6,010 |
| Other segment items reflected in income statement above: | | | | | |
| Depreciation and amortisation | 1,573 | 278 | 154 | 400 | 2,405 |
| Decrease in value of in-force business | – | – | (55) | – | (55) |
| Defined benefit scheme charges | 121 | 49 | 20 | 215 | 405 |
| Other segment items: | | | | | |
| Additions to fixed assets | 2,092 | 208 | 223 | 991 | 3,514 |
| Investments in joint ventures and associates at end of year | 4 | – | – | 87 | 91 |

1 Restated, see page 217.

2 Net of profits on disposal of operating lease assets of £60 million.

Notes to the consolidated financial statements continued

## Note 4: Segmental analysis continued

| | Retail £m | Commercial Banking £m | Insurance and Wealth £m | Other £m | Underlying basis total £m |
|---|---|---|---|---|---|
| Year ended 31 December 2017[1] | | | | | |
| Net interest income | 8,695 | 3,040 | 133 | 452 | 12,320 |
| Other income, net of insurance claims | 2,150 | 1,803 | 1,846 | 406 | 6,205 |
| Total underlying income, net of insurance claims | 10,845 | 4,843 | 1,979 | 858 | 18,525 |
| Operating lease depreciation[2] | (947) | (105) | – | (1) | (1,053) |
| Net income | 9,898 | 4,738 | 1,979 | 857 | 17,472 |
| Operating costs | (4,847) | (2,249) | (1,040) | (48) | (8,184) |
| Remediation | (633) | (173) | (40) | (19) | (865) |
| Total costs | (5,480) | (2,422) | (1,080) | (67) | (9,049) |
| Impairment (charge) credit | (710) | (95) | – | 10 | (795) |
| Underlying profit | 3,708 | 2,221 | 899 | 800 | 7,628 |
| External income | 12,606 | 3,181 | 1,883 | 855 | 18,525 |
| Inter-segment income (expense) | (1,761) | 1,662 | 96 | 3 | – |
| Segment underlying income, net of insurance claims | 10,845 | 4,843 | 1,979 | 858 | 18,525 |
| Segment external assets | 350,051 | 177,763 | 151,986 | 132,309 | 812,109 |
| Segment customer deposits | 253,127 | 148,313 | 13,770 | 2,914 | 418,124 |
| Segment external liabilities | 258,246 | 224,918 | 157,824 | 121,978 | 762,966 |
| Analysis of segment underlying other income, net of insurance claims: | | | | | |
| Current accounts | 572 | 135 | 5 | – | 712 |
| Credit and debit card fees | 640 | 312 | 1 | – | 953 |
| Commercial banking and treasury fees | – | 321 | – | – | 321 |
| Unit trust and insurance broking | 10 | – | 214 | – | 224 |
| Private banking and asset management | – | 5 | 93 | – | 98 |
| Factoring | – | 91 | – | – | 91 |
| Other fees and commissions | 95 | 273 | 184 | 14 | 566 |
| Fees and commissions receivable | 1,317 | 1,137 | 497 | 14 | 2,965 |
| Fees and commissions payable | (636) | (287) | (380) | (79) | (1,382) |
| Net fee and commission income | 681 | 850 | 117 | (65) | 1,583 |
| Operating lease rental income | 1,281 | 63 | – | – | 1,344 |
| Rental income from investment properties | – | 1 | 212 | – | 213 |
| Gains less losses on disposal of available-for-sale financial assets | – | 5 | (3) | 444 | 446 |
| Lease termination income | – | 74 | – | – | 74 |
| Trading income | 26 | 481 | – | (89) | 418 |
| Insurance and other, net of insurance claims | 6 | (6) | 2,223 | (96) | 2,127 |
| Other external income, net of insurance claims | 1,313 | 618 | 2,432 | 259 | 4,622 |
| Inter-segment other income | 156 | 335 | (703) | 212 | – |
| Segment other income, net of insurance claims | 2,150 | 1,803 | 1,846 | 406 | 6,205 |
| Other segment items reflected in income statement above: | | | | | |
| Depreciation and amortisation | 1,547 | 322 | 197 | 304 | 2,370 |
| Increase in value of in-force business | – | – | (165) | – | (165) |
| Defined benefit scheme charges | 149 | 53 | 25 | 132 | 359 |
| Other segment items: | | | | | |
| Additions to fixed assets | 2,431 | 130 | 274 | 820 | 3,655 |
| Investments in joint ventures and associates at end of year | 12 | – | – | 53 | 65 |

1 Restated see page 217.

2 Net of profits on disposal of operating lease assets of £32 million.

## 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.

| | Lloyds Banking Group statutory £m | Removal of: Volatility and other items[1] £m | Removal of: Insurance gross up[2] £m | Removal of: PPI £m | Underlying basis £m |
|---|---|---|---|---|---|
| **Year ended 31 December 2019** | | | | | |
| Net interest income | **10,180** | **379** | **1,818** | **–** | **12,377** |
| Other income, net of insurance claims | **8,179** | **(426)** | **(2,021)** | **–** | **5,732** |
| **Total income, net of insurance claims** | **18,359** | **(47)** | **(203)** | **–** | **18,109** |
| Operating lease depreciation[3] | | **(967)** | **–** | **–** | **(967)** |
| Net income | **18,359** | **(1,014)** | **(203)** | **–** | **17,142** |
| Operating expenses | **(12,670)** | **1,697** | **203** | **2,450** | **(8,320)** |
| Impairment | **(1,296)** | **5** | **–** | **–** | **(1,291)** |
| **Profit before tax** | **4,393** | **688** | **–** | **2,450** | **7,531** |

| | Lloyds Banking Group statutory £m | Removal of: Volatility and other items[4] £m | Removal of: Insurance gross up[2] £m | Removal of: PPI £m | Underlying basis £m |
|---|---|---|---|---|---|
| Year ended 31 December 2018 | | | | | |
| Net interest income | 13,396 | 152 | (834) | – | 12,714 |
| Other income, net of insurance claims | 5,230 | 107 | 673 | – | 6,010 |
| Total income, net of insurance claims | 18,626 | 259 | (161) | – | 18,724 |
| Operating lease depreciation[3] | | (956) | – | – | (956) |
| Net income | 18,626 | (697) | (161) | – | 17,768 |
| Operating expenses | (11,729) | 2,053 | 161 | 750 | (8,765) |
| Impairment | (937) | – | – | – | (937) |
| Profit before tax | 5,960 | 1,356 | – | 750 | 8,066 |

| | Lloyds Banking Group statutory £m | Removal of: Volatility and other items[5] £m | Removal of: Insurance gross up[2] £m | Removal of: PPI £m | Underlying basis £m |
|---|---|---|---|---|---|
| Year ended 31 December 2017 | | | | | |
| Net interest income | 10,912 | 228 | 1,180 | – | 12,320 |
| Other income, net of insurance claims | 7,747 | (186) | (1,356) | – | 6,205 |
| Total income, net of insurance claims | 18,659 | 42 | (176) | – | 18,525 |
| Operating lease depreciation[3] | | (1,053) | – | – | (1,053) |
| Net income | 18,659 | (1,011) | (176) | – | 17,472 |
| Operating expenses | (12,696) | 1,821 | 176 | 1,650 | (9,049) |
| Impairment | (688) | (107) | – | – | (795) |
| Profit before tax | 5,275 | 703 | – | 1,650 | 7,628 |

1 In the year ended 31 December 2019 this comprises the effects of asset sales (gains of £214 million); volatility and other items (losses of £88 million); the amortisation of purchased intangibles (£68 million); restructuring (£471 million, comprising severance related costs, the integration of Zurich's UK workplace pensions and savings business and costs associated with establishing the Schroders Personal Wealth joint venture); and the fair value unwind and other items (losses of £275 million).

2 The Group's insurance businesses' income statements include income and expenditure which are attributable to the policyholders of the Group's long-term assurance funds. These items have no impact in total upon the profit attributable to equity shareholders and, in order to provide a clearer representation of the underlying trends within the business, these items are shown net within the underlying results.

3 Net of profits on disposal of operating lease assets of £41 million (2018: £60 million; 2017: £32 million).

4 Comprises the effects of asset sales (loss of £145 million); volatility and other items (gains of £95 million); the amortisation of purchased intangibles (£108 million); restructuring (£879 million, comprising severance related costs, the rationalisation of the non-branch property portfolio, the work on implementing the ring-fencing requirements and the integration of MBNA and Zurich's UK workplace pensions and savings business); and the fair value unwind and other items (losses of £319 million).

5 Comprises the effects of asset sales (gain of £30 million); volatile items (gain of £263 million); liability management (loss of £14 million); the amortisation of purchased intangibles (£91 million); restructuring costs (£621 million, principally comprising costs relating to the Simplification programme; the rationalisation of the non-branch property portfolio, the work on implementing the ring-fencing requirements and the integration of MBNA); and the fair value unwind and other items (loss of £270 million).

## Geographical areas

Following the reduction in the Group's non-UK activities, an analysis between UK and non-UK activities is no longer provided.

Notes to the consolidated financial statements continued

## Note 5: Net interest income

| | Weighted average effective interest rate | | | | | |
|---|---|---|---|---|---|---|
| | 2019 % | 2018 % | 2017 % | 2019 £m | 2018 £m | 2017 £m |
| Interest and similar income: | | | | | | |
| Loans and advances to customers | **3.17** | 3.17 | 3.16 | **15,790** | 15,078 | 14,712 |
| Loans and advances to banks | **0.78** | 0.84 | 0.40 | **514** | 565 | 271 |
| Debt securities held at amortised cost | **2.23** | 1.60 | 1.29 | **122** | 66 | 43 |
| Interest receivable on financial assets held at amortised cost | **2.89** | 2.87 | 2.81 | **16,426** | 15,709 | 15,026 |
| Financial assets at fair value through other comprehensive income | **1.64** | 1.98 | | **435** | 640 | |
| Available-for-sale financial assets | | | 1.96 | | | 980 |
| **Total interest and similar income**[1] | **2.83** | 2.82 | 2.73 | **16,861** | 16,349 | 16,006 |
| Interest and similar expense: | | | | | | |
| Deposits from banks, excluding liabilities under sale and repurchase transactions | **0.86** | 1.39 | 1.18 | **(96)** | (117) | (80) |
| Customer deposits, excluding liabilities under sale and repurchase transactions | **0.59** | 0.53 | 0.49 | **(2,015)** | (1,812) | (1,721) |
| Debt securities in issue[2] | **1.24** | 0.27 | 0.37 | **(1,204)** | (234) | (266) |
| Subordinated liabilities | **6.79** | 7.63 | 7.93 | **(1,201)** | (1,388) | (1,481) |
| Lease liabilities | **2.49** | 2.46 | 2.38 | **(42)** | (1) | (1) |
| Liabilities under sale and repurchase agreements | **1.12** | 0.96 | 0.58 | **(301)** | (245) | (110) |
| Interest payable on liabilities held at amortised cost | **0.98** | 0.79 | 0.79 | **(4,859)** | (3,797) | (3,659) |
| Amounts payable to unitholders in consolidated open-ended investment vehicles[4] | **13.64** | (6.07) | 9.15 | **(1,822)** | 844 | (1,435) |
| **Total interest and similar expense**[3] | **1.31** | 0.60 | 1.06 | **(6,681)** | (2,953) | (5,094) |
| **Net interest income** | | | | **10,180** | 13,396 | 10,912 |

1 Includes £26 million (2018: £31 million; 2017: £12 million) of interest income on liabilities with negative interest rates and £45 million (2018: £46 million; 2017: £49 million) in respect of interest income on finance leases.

2 The impact of the Group's hedging arrangements is included on this line; excluding this impact the weighted average effective interest rate in respect of debt securities in issue would be 2.57 per cent (2018: 2.68 per cent; 2017: 2.43 per cent).

3 Includes £119 million (2018: £10 million; 2017: £50 million) of interest expense on assets with negative interest rates.

4 Where a collective investment vehicle is consolidated the interests of parties other than the Group are reported in other liabilities and the movement in these interests in interest expense.

Included within interest and similar income is £198 million (2018: £227 million; 2017: £179 million) in respect of credit-impaired financial assets. Net interest income also includes a credit of £608 million (2018: credit of £701 million; 2017: credit of £651 million) transferred from the cash flow hedging reserve (see note 42).

## Note 6: Net fee and commission income

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Fee and commission income: | | | |
| Current accounts | **659** | 650 | 712 |
| Credit and debit card fees | **982** | 993 | 953 |
| Commercial banking and treasury fees | **248** | 305 | 321 |
| Unit trust and insurance broking | **206** | 221 | 224 |
| Private banking and asset management | **69** | 97 | 98 |
| Factoring | **103** | 83 | 91 |
| Other fees and commissions | **489** | 499 | 566 |
| Total fee and commission income | **2,756** | 2,848 | 2,965 |
| Fee and commission expense | **(1,350)** | (1,386) | (1,382) |
| **Net fee and commission income** | **1,406** | 1,462 | 1,583 |

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.

At 31 December 2019, the Group held on its balance sheet £293 million (31 December 2018: £282 million) in respect of services provided to customers and £140 million (31 December 2018: £168 million) in respect of amounts received from customers for services to be provided after the balance sheet date. Current unsatisfied performance obligations amount to £270 million (31 December 2018: £314 million); the Group expects to receive substantially all of this revenue by 2022.

Income recognised during the year ended 31 December 2019 included £54 million in respect of amounts included in the contract liability balance at 31 December 2018 and £9 million in respect of amounts from performance obligations satisfied in previous years.

The most significant performance obligations undertaken by the Group are in respect of current accounts, the provision of other banking services for commercial customers, credit and debit card services and investment management services.

## Note 6: Net fee and commission income continued

In respect of current accounts, the Group receives fees for the provision of bank account and transaction services such as ATM services, fund transfers, overdraft facilities and other value-added offerings.

For commercial customers, alongside its provision of current accounts, the Group provides other corporate banking services including factoring and commitments to provide loan financing. Loan commitment fees are included in fees and commissions where the loan is not expected to be drawn down by the customer.

The Group receives interchange and merchant fees, together with fees for overseas use and cash advances, for provision of card services to cardholders and merchants.

Investment management services principally comprise the management and administration of policyholders' funds in accordance with investment mandates. Fees are generally based on the value of the assets under management.

## Note 7: Net trading income

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Foreign exchange translation (losses) gains | (255) | 342 | (174) |
| Gains on foreign exchange trading transactions | 677 | 580 | 517 |
| Total foreign exchange | 422 | 922 | 343 |
| Investment property (losses) gains (note 27) | (108) | 139 | 230 |
| Securities and other gains (losses) (see below) | 17,974 | (4,937) | 11,244 |
| **Net trading income** | 18,288 | (3,876) | 11,817 |

Securities and other gains comprise net gains (losses) arising on assets and liabilities held at fair value through profit or loss as follows:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Net income arising on assets and liabilities mandatorily held at fair value through profit or loss: | | | |
| Financial instruments held for trading | 120 | (8) | 404 |
| Other financial instruments mandatorily held at fair value through profit or loss: | | | |
| Debt securities, loans and advances | 3,509 | (26) | 1,122 |
| Equity shares | 14,559 | (4,747) | 9,862 |
| | 18,188 | (4,781) | 11,388 |
| Net (expense) income arising on assets and liabilities designated at fair value through profit or loss | (214) | (156) | (144) |
| **Securities and other gains** | 17,974 | (4,937) | 11,244 |

## Note 8: Insurance premium income

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Life insurance** | | | |
| Gross premiums: | | | |
| Life and pensions | 6,827 | 6,612 | 6,273 |
| Annuities | 2,483 | 2,178 | 1,082 |
| | 9,310 | 8,790 | 7,355 |
| Ceded reinsurance premiums | (378) | (271) | (168) |
| Net earned premiums | 8,932 | 8,519 | 7,187 |
| **Non-life insurance** | | | |
| Net earned premiums | 642 | 670 | 743 |
| **Total net earned premiums** | 9,574 | 9,189 | 7,930 |

## Note 9: Other operating income

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Operating lease rental income | 1,250 | 1,343 | 1,344 |
| Rental income from investment properties (note 27) | 191 | 197 | 213 |
| Gains less losses on disposal of financial assets at fair value through other comprehensive income (2017: available-for-sale financial assets) (note 42) | 196 | 275 | 446 |
| Movement in value of in-force business (note 25) | 825 | (55) | (165) |
| Gain related to establishment of joint venture (note 23) | 244 | – | – |
| Share of results of joint ventures and associates (note 22) | 6 | 9 | 6 |
| Other | 196 | 151 | 151 |
| **Total other operating income** | 2,908 | 1,920 | 1,995 |

Notes to the consolidated financial statements continued

## Note 10: Insurance claims

| Insurance claims comprise: | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Life insurance and participating investment contracts** | | | |
| Claims and surrenders | **(8,684)** | (8,735) | (8,898) |
| Change in insurance and participating investment contracts (note 32) | **(12,633)** | 4,565 | (9,067) |
| Change in non-participating investment contracts | **(2,664)** | 628 | 2,836 |
| | **(23,981)** | (3,542) | (15,129) |
| Reinsurers' share | **290** | 404 | 35 |
| | **(23,691)** | (3,138) | (15,094) |
| Change in unallocated surplus | **(19)** | 8 | (147) |
| **Total life insurance and participating investment contracts** | **(23,710)** | (3,130) | (15,241) |
| **Non-life insurance** | | | |
| Total non-life insurance claims, net of reinsurance | **(287)** | (335) | (337) |
| **Total insurance claims** | **(23,997)** | (3,465) | (15,578) |
| Life insurance and participating investment contracts gross claims and surrenders can also be analysed as follows: | | | |
| Deaths | **(674)** | (721) | (675) |
| Maturities | **(1,122)** | (1,198) | (1,280) |
| Surrenders | **(5,523)** | (5,548) | (5,674) |
| Annuities | **(1,104)** | (1,032) | (985) |
| Other | **(261)** | (236) | (284) |
| **Total life insurance gross claims and surrenders** | **(8,684)** | (8,735) | (8,898) |

## Note 11: Operating expenses

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Staff costs: | | | |
| Salaries | **2,539** | 2,482 | 2,679 |
| Performance-based compensation | **380** | 509 | 473 |
| Social security costs | **325** | 343 | 361 |
| Pensions and other post-retirement benefit schemes (note 36) | **532** | 705 | 625 |
| Restructuring costs | **92** | 249 | 24 |
| Other staff costs | **383** | 474 | 448 |
| | **4,251** | 4,762 | 4,610 |
| Premises and equipment: | | | |
| Rent and rates | **93** | 370 | 365 |
| Repairs and maintenance | **187** | 190 | 231 |
| Other | **211** | 169 | 134 |
| | **491** | 729 | 730 |
| Other expenses: | | | |
| Communications and data processing | **1,038** | 1,121 | 882 |
| Advertising and promotion | **170** | 197 | 208 |
| Professional fees | **226** | 287 | 328 |
| UK bank levy | **224** | 225 | 231 |
| Other | **715** | 653 | 814 |
| | **2,373** | 2,483 | 2,463 |
| Depreciation and amortisation: | | | |
| Depreciation of property, plant and equipment (note 27) | **2,064** | 1,852 | 1,944 |
| Amortisation of acquired value of in-force non-participating investment contracts (note 25) | **30** | 40 | 34 |
| Amortisation of other intangible assets (note 26) | **566** | 513 | 392 |
| | **2,660** | 2,405 | 2,370 |
| Goodwill impairment | **–** | – | 8 |
| Total operating expenses, excluding regulatory provisions | **9,775** | 10,379 | 10,181 |
| Regulatory provisions: | | | |
| Payment protection insurance provision (note 38) | **2,450** | 750 | 1,650 |
| Other regulatory provisions (note 38) | **445** | 600 | 865 |
| | **2,895** | 1,350 | 2,515 |
| **Total operating expenses** | **12,670** | 11,729 | 12,696 |

## 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.

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Performance-based compensation expense comprises: | | | |
| Awards made in respect of the year ended 31 December | **244** | 362 | 334 |
| Awards made in respect of earlier years | **136** | 147 | 139 |
| | **380** | 509 | 473 |

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Performance-based compensation expense deferred until later years comprises: | | | |
| Awards made in respect of the year ended 31 December | **113** | 152 | 127 |
| Awards made in respect of earlier years | **36** | 37 | 35 |
| | **149** | 189 | 162 |

Performance-based awards expensed in 2019 include cash awards amounting to £89 million (2018: £137 million; 2017: £102 million).

### Average headcount

The average number of persons on a headcount basis employed by the Group during the year was as follows:

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| UK | **69,321** | 71,857 | 75,150 |
| Overseas | **762** | 769 | 794 |
| **Total** | **70,083** | 72,626 | 75,944 |

## Note 12: Auditors' remuneration

Fees payable to the Company's auditors by the Group are as follows:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Fees payable for the audit of the Company's current year annual report | **1.5** | 1.5 | 1.5 |
| Fees payable for other services: | | | |
| Audit of the Company's subsidiaries pursuant to legislation | **20.2** | 19.1 | 18.6 |
| Other services supplied pursuant to legislation | **3.5** | 2.9 | 3.0 |
| Total audit fees | **25.2** | 23.5 | 23.1 |
| Other services – audit related fees | **1.0** | 1.2 | 1.2 |
| Total audit and audit related fees | **26.2** | 24.7 | 24.3 |
| Other non-audit fees: | | | |
| Services relating to corporate finance transactions | **–** | – | 1.2 |
| Other services | **0.7** | 2.0 | 2.4 |
| Total other non-audit fees | **0.7** | 2.0 | 3.6 |
| **Total fees payable to the Company's auditors by the Group** | **26.9** | 26.7 | 27.9 |

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 costs incurred in connection with client asset assurance and with the Sarbanes-Oxley Act requirements associated with the audit of the Group's financial statements filed on its Form 20-F.

**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 debt prospectuses required by the listing rules.

**Other non-audit fees:** This category includes due diligence relating to corporate finance, including venture capital transactions and other assurance services. The auditors are not engaged to provide tax 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.

**Notes to the consolidated financial statements** continued

## Note 12: Auditors' remuneration continued

The Group has procedures that are designed to ensure auditor independence, including prohibiting certain non-audit services. All audit and non-audit assignments must be pre-approved by the audit committee on an individual engagement basis; for certain types of non-audit engagements where the fee is 'de minimis' the audit committee has pre-approved all assignments subject to confirmation by management. 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:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Audits of Group pension schemes | 0.1 | 0.1 | 0.1 |
| Audits of the unconsolidated Open Ended Investment Companies managed by the Group | 0.4 | 0.3 | 0.3 |
| Reviews of the financial position of corporate and other borrowers | 0.2 | 0.4 | 0.2 |
| Acquisition due diligence and other work performed in respect of potential venture capital investments | – | – | 0.1 |

## Note 13: Impairment

| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| **Year ended 31 December 2019** | | | | | |
| Impact of transfers between stages | (17) | 89 | 532 | – | 604 |
| Other changes in credit quality | 4 | 1 | 899 | (106) | 798 |
| Additions (repayments) | 94 | (39) | (84) | (87) | (116) |
| Methodology, model and assumption changes | 33 | (27) | 8 | – | 14 |
| Other items | (4) | – | – | – | (4) |
| | 127 | (65) | 823 | (193) | 692 |
| **Total impairment** | 110 | 24 | 1,355 | (193) | 1,296 |
| | | | | | |
| In respect of: | | | | | |
| Loans and advances to banks | – | – | – | – | – |
| Loans and advances to customers | 139 | 10 | 1,351 | (193) | 1,307 |
| Financial assets at amortised cost | 139 | 10 | 1,351 | (193) | 1,307 |
| Other assets | – | – | 5 | – | 5 |
| Impairment charge on drawn balances | 139 | 10 | 1,356 | (193) | 1,312 |
| Loan commitments and financial guarantees | (28) | 14 | (1) | – | (15) |
| Financial assets at fair value through other comprehensive income | (1) | – | – | – | (1) |
| **Total impairment** | 110 | 24 | 1,355 | (193) | 1,296 |

| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| **Year ended 31 December 2018** | | | | | |
| Impact of transfers between stages | (12) | 51 | 446 | – | 485 |
| Other changes in credit quality | (20) | (47) | 541 | 69 | 543 |
| Additions (repayments) | 18 | (82) | 43 | (69) | (90) |
| Methodology, model and assumption changes | (71) | (21) | 72 | – | (20) |
| Other items | (13) | – | 32 | – | 19 |
| | (86) | (150) | 688 | – | 452 |
| **Total impairment** | (98) | (99) | 1,134 | – | 937 |
| | | | | | |
| In respect of: | | | | | |
| Loans and advances to banks | 1 | – | – | – | 1 |
| Loans and advances to customers | (66) | (51) | 1,139 | – | 1,022 |
| Financial assets at amortised cost | (65) | (51) | 1,139 | – | 1,023 |
| Other assets | – | – | 1 | – | 1 |
| Impairment charge on drawn balances | (65) | (51) | 1,140 | – | 1,024 |
| Loan commitments and financial guarantees | (19) | (48) | (6) | – | (73) |
| Financial assets at fair value through other comprehensive income | (14) | – | – | – | (14) |
| **Total impairment** | (98) | (99) | 1,134 | – | 937 |

## Note 13: Impairment continued

The Group's impairment charge comprises the following items:

### Transfers between stages

The net impact on the impairment charge of transfers between stages.

### Other changes in credit quality

Changes in loss allowance as a result of movements in risk parameters that reflect changes in customer quality, but which have not resulted in a transfer to a different stage. This also contains the impact on the impairment charge as a result of write-offs and recoveries, where the related loss allowances are reassessed to reflect ultimate realisable or recoverable value.

### Additions (repayments)

Expected loss allowances are recognised on origination of new loans or further drawdowns of existing facilities. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

### Methodology, model and assumption changes

Increase or decrease in impairment charge as a result of adjustments to the models used for expected credit loss calculations; either as changes to the model inputs or to the underlying assumptions, as well as the impact of changing the models used.

| | 2017 £m |
|---|---|
| Impairment losses on loans and receivables: | |
| Loans and advances to customers | 697 |
| Debt securities classified as loans and receivables | (6) |
| Total impairment losses on loans and receivables | 691 |
| Impairment of available-for-sale financial assets | 6 |
| Other credit risk provisions | (9) |
| **Total impairment charged to the income statement** | 688 |

Movements in the Group's impairment allowances are shown in note 20.

## Note 14: Tax expense

### (A) Analysis of tax expense for the year

| | 2019 £m | 2018[1] £m | 2017[1] £m |
|---|---|---|---|
| UK corporation tax: | | | |
| Current tax on profit for the year | (1,389) | (1,280) | (1,240) |
| Adjustments in respect of prior years | 96 | 11 | 122 |
| | (1,293) | (1,269) | (1,118) |
| Foreign tax: | | | |
| Current tax on profit for the year | (70) | (34) | (40) |
| Adjustments in respect of prior years | 2 | 5 | 10 |
| | (68) | (29) | (30) |
| Current tax expense | (1,361) | (1,298) | (1,148) |
| Deferred tax: | | | |
| Current year | (165) | (127) | (430) |
| Adjustments in respect of prior years | 139 | (29) | (48) |
| Deferred tax expense | (26) | (156) | (478) |
| **Tax expense** | (1,387) | (1,454) | (1,626) |

The income tax expense is made up as follows:

| | 2019 £m | 2018[1] £m | 2017[1] £m |
|---|---|---|---|
| Tax (expense) credit attributable to policyholders | (148) | 14 | (82) |
| Shareholder tax expense | (1,239) | (1,468) | (1,544) |
| **Tax expense** | (1,387) | (1,454) | (1,626) |

1 Restated, see note 1.

## Note 14: Tax expense continued

### (B) Factors affecting the tax expense for the year

The UK corporation tax rate for the year was 19.0 per cent (2018: 19.0 per cent; 2017: 19.25 per cent). An explanation of the relationship between tax expense and accounting profit is set out below:

| | 2019 £m | 2018[1] £m | 2017[1] £m |
|---|---|---|---|
| Profit before tax | 4,393 | 5,960 | 5,275 |
| UK corporation tax thereon | (835) | (1,132) | (1,015) |
| Impact of surcharge on banking profits | (364) | (409) | (429) |
| Non-deductible costs: conduct charges | (370) | (101) | (352) |
| Non-deductible costs: bank levy | (43) | (43) | (44) |
| Other non-deductible costs | (121) | (90) | (59) |
| Non-taxable income | 40 | 87 | 72 |
| Tax relief on coupons on other equity instruments | 89 | 83 | 79 |
| Tax-exempt gains on disposals | 102 | 124 | 128 |
| Recognition (derecognition) of losses that arose in prior years | 18 | (9) | – |
| Remeasurement of deferred tax due to rate changes | (6) | 32 | (9) |
| Differences in overseas tax rates | (14) | 6 | (15) |
| Policyholder tax | (67) | (62) | (66) |
| Policyholder deferred tax asset in respect of life assurance expenses | (53) | 73 | – |
| Adjustments in respect of prior years | 237 | (13) | 85 |
| Tax effect of share of results of joint ventures | – | – | (1) |
| **Tax expense** | (1,387) | (1,454) | (1,626) |

1 Restated, see note 1.

## Note 15: Earnings per share

| | 2019 £m | 2018[1] £m | 2017[1] £m |
|---|---|---|---|
| Profit attributable to equity shareholders – basic and diluted | 2,459 | 3,975 | 3,144 |

1 Restated, see note 1.

| | 2019 million | 2018 million | 2017 million |
|---|---|---|---|
| Weighted average number of ordinary shares in issue – basic | 70,603 | 71,638 | 71,710 |
| Adjustment for share options and awards | 682 | 641 | 683 |
| Weighted average number of ordinary shares in issue – diluted | 71,285 | 72,279 | 72,393 |
| Basic earnings per share | 3.5p | 5.5p | 4.4p |
| Diluted earnings per share | 3.4p | 5.5p | 4.3p |

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 25 million (2018: 38 million; 2017: 57 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.

There were 24 million anti-dilutive share options and awards excluded from the calculation of diluted earnings per share (2018: none; 2017: none).

## Note 16: Financial assets at fair value through profit or loss

These assets are comprised as follows:

| | 31 December 2019 | | | 31 December 2018 | | |
|---|---|---|---|---|---|---|
| | Trading assets £m | Other financial assets mandatorily at fair value through profit or loss £m | Total £m | Trading assets £m | Other financial assets mandatorily at fair value through profit or loss £m | Total £m |
| Loans and advances to customers | **10,422** | **10,654** | **21,076** | 26,886 | 10,964 | 37,850 |
| Loans and advances to banks | **513** | **1,886** | **2,399** | 848 | 2,178 | 3,026 |
| Debt securities: | | | | | | |
| Government securities | **6,791** | **12,063** | **18,854** | 7,192 | 10,903 | 18,095 |
| Other public sector securities | **–** | **2,126** | **2,126** | – | 2,064 | 2,064 |
| Bank and building society certificates of deposit | **–** | **984** | **984** | – | 1,105 | 1,105 |
| Asset-backed securities: | | | | | | |
| Mortgage-backed securities | **6** | **462** | **468** | 10 | 215 | 225 |
| Other asset-backed securities | **17** | **241** | **258** | 63 | 286 | 349 |
| Corporate and other debt securities | **233** | **17,983** | **18,216** | 247 | 18,063 | 18,310 |
| | **7,047** | **33,859** | **40,906** | 7,512 | 32,636 | 40,148 |
| Equity shares | **–** | **95,789** | **95,789** | – | 77,485 | 77,485 |
| Treasury and other bills | **–** | **19** | **19** | – | 20 | 20 |
| **Total** | **17,982** | **142,207** | **160,189** | 35,246 | 123,283 | 158,529 |

Other financial assets at fair value through profit or loss include assets backing insurance contracts and investment contracts of £136,855 million (31 December 2018: £116,903 million). Included within these assets are investments in unconsolidated structured entities of £38,177 million (31 December 2018: £26,028 million), see note 49.

For amounts included above which are subject to repurchase and reverse repurchase agreements see note 53.

Notes to the consolidated financial statements continued

## Note 17: Derivative financial instruments

The fair values and notional amounts of derivative instruments are set out in the following table:

| | 31 December 2019 | | | 31 December 2018 | | |
|---|---|---|---|---|---|---|
| | 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 | 44,095 | 681 | 616 | 41,571 | 746 | 549 |
| Currency swaps | 349,606 | 3,857 | 5,425 | 311,491 | 4,566 | 3,709 |
| Options purchased | 8,310 | 452 | – | 10,202 | 485 | – |
| Options written | 9,557 | – | 499 | 11,393 | – | 495 |
| | 411,568 | 4,990 | 6,540 | 374,657 | 5,797 | 4,753 |
| Interest rate contracts: | | | | | | |
| Interest rate swaps | 5,245,703 | 17,318 | 15,213 | 4,381,271 | 13,624 | 12,629 |
| Forward rate agreements | 555,742 | 7 | 13 | 494,430 | – | 2 |
| Options purchased | 27,158 | 2,468 | – | 30,724 | 2,107 | – |
| Options written | 23,610 | – | 2,216 | 26,463 | – | 1,997 |
| Futures | 199,884 | 17 | 22 | 128,211 | 16 | 4 |
| | 6,052,097 | 19,810 | 17,464 | 5,061,099 | 15,747 | 14,632 |
| Credit derivatives | 16,959 | 83 | 167 | 13,757 | 99 | 181 |
| Equity and other contracts | 11,414 | 250 | 503 | 15,145 | 389 | 699 |
| **Total derivative assets/liabilities – trading and other** | 6,492,038 | 25,133 | 24,674 | 5,464,658 | 22,032 | 20,265 |
| Hedging | | | | | | |
| Derivatives designated as fair value hedges: | | | | | | |
| Currency swaps | 34 | 8 | – | 490 | 3 | 29 |
| Interest rate swaps | 183,489 | 798 | 229 | 150,971 | 947 | 187 |
| | 183,523 | 806 | 229 | 151,461 | 950 | 216 |
| Derivatives designated as cash flow hedges: | | | | | | |
| Interest rate swaps | 426,740 | 355 | 743 | 556,945 | 358 | 844 |
| Currency swaps | 9,549 | 75 | 133 | 10,578 | 255 | 48 |
| | 436,289 | 430 | 876 | 567,523 | 613 | 892 |
| **Total derivative assets/liabilities – hedging** | 619,812 | 1,236 | 1,105 | 718,984 | 1,563 | 1,108 |
| **Total recognised derivative assets/liabilities** | 7,111,850 | 26,369 | 25,779 | 6,183,642 | 23,595 | 21,373 |

The notional amount of the contract does not represent the Group's 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; a large proportion of the Group's derivatives are held through exchanges such as London Clearing House and are collateralised through those exchanges. Further details are provided in note 53 Credit risk.

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.

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.
- 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.

## Note 17: Derivative financial instruments continued

Details of the Group's hedging instruments are set out below:

| 31 December 2019 | Maturity Up to 1 month £m | 1-3 months £m | 3-12 months £m | 1-5 years £m | Over 5 years £m | Total £m |
|---|---|---|---|---|---|---|
| **Fair value hedges** | | | | | | |
| **Interest rate** | | | | | | |
| Cross currency swap | | | | | | |
| Notional | – | – | – | – | 34 | 34 |
| Average fixed interest rate | – | – | – | – | 1.28% | |
| Average EUR/GBP exchange rate | – | – | – | – | 1.38 | |
| Average USD/GBP exchange rate | – | – | – | – | – | |
| Average NOK/GBP exchange rate | – | – | – | – | – | |
| Interest rate swap | | | | | | |
| Notional | 331 | 9,305 | 37,948 | 106,339 | 29,566 | 183,489 |
| Average fixed interest rate | 2.58% | 1.74% | 1.22% | 1.71% | 2.81% | |
| **Cash flow hedges** | | | | | | |
| **Foreign exchange** | | | | | | |
| Currency swap | | | | | | |
| Notional | – | 413 | 1,611 | 2,389 | 5,136 | 9,549 |
| Average EUR/GBP exchange rate | – | – | – | 1.05 | 1.05 | |
| Average USD/GBP exchange rate | – | 1.29 | 1.30 | 1.31 | – | |
| **Interest rate** | | | | | | |
| Interest rate swap | | | | | | |
| Notional | 9,675 | 23,589 | 58,447 | 209,108 | 125,921 | 426,740 |
| Average fixed interest rate | 1.05% | 1.22% | 1.29% | 1.47% | 2.39% | |

**Notes to the consolidated financial statements** continued

## Note 17: Derivative financial instruments continued

| | Maturity | | | | | |
|---|---|---|---|---|---|---|
| 31 December 2018 | Up to 1 month £m | 1-3 months £m | 3-12 months £m | 1-5 years £m | Over 5 years £m | Total £m |
| **Fair value hedges** | | | | | | |
| **Interest rate** | | | | | | |
| Cross currency swap | | | | | | |
| Notional | – | 36 | – | 283 | 171 | 490 |
| Average fixed interest rate | – | 4.82% | – | 5.88% | 4.44% | |
| Average EUR/USD exchange rate | – | – | – | 1.13 | – | |
| Average USD/GBP exchange rate | – | – | – | 1.30 | – | |
| Average NOK/GBP exchange rate | – | 9.22 | – | 9.19 | 9.03 | |
| Interest rate swap | | | | | | |
| Notional | 393 | 417 | 32,876 | 86,451 | 30,834 | 150,971 |
| Average fixed interest rate | 1.38% | 2.06% | 1.65% | 1.75% | 2.98% | |
| **Cash flow hedges** | | | | | | |
| **Foreign exchange** | | | | | | |
| Currency swap | | | | | | |
| Notional | 67 | 47 | 2,234 | 2,111 | 6,119 | 10,578 |
| Average USD/EUR exchange rate | 1.15 | – | 1.13 | 1.10 | 1.07 | |
| Average USD/GBP exchange rate | – | 1.32 | 1.34 | 1.27 | 1.28 | |
| **Interest rate** | | | | | | |
| Interest rate swap | | | | | | |
| Notional | 4,874 | 11,204 | 66,312 | 292,712 | 181,843 | 556,945 |
| Average fixed interest rate | 1.47% | 1.03% | 0.99% | 1.46% | 1.85% | |

The carrying amounts of the Group's hedging instruments are as follows:

| | Carrying amount of the hedging instrument | | | |
|---|---|---|---|---|
| **31 December 2019** | **Contract/notional amount £m** | **Assets £m** | **Liabilities £m** | **Changes in fair value used for calculating hedge ineffectiveness (YTD) £m** |
| **Fair value hedges** | | | | |
| **Interest rate** | | | | |
| Currency swaps | **34** | **8** | **–** | **2** |
| Interest rate swaps | **183,489** | **798** | **229** | **1,142** |
| **Cash flow hedges** | | | | |
| **Foreign exchange** | | | | |
| Currency swaps | **9,549** | **75** | **133** | **(185)** |
| **Interest rate** | | | | |
| Interest rate swaps | **426,740** | **355** | **743** | **992** |

| | Carrying amount of the hedging instrument | | | |
|---|---|---|---|---|
| 31 December 2018 | Contract/notional amount £m | Assets £m | Liabilities £m | Changes in fair value used for calculating hedge ineffectiveness (YTD) £m |
| **Fair value hedges** | | | | |
| **Interest rate** | | | | |
| Currency swaps | 490 | 3 | 29 | (10) |
| Interest rate swaps | 150,971 | 947 | 187 | 104 |
| **Cash flow hedges** | | | | |
| **Foreign exchange** | | | | |
| Currency swaps | 10,578 | 255 | 48 | 229 |
| **Interest rate** | | | | |
| Interest rate swaps | 556,945 | 358 | 844 | (781) |

All amounts are held within Derivative financial instruments.

## Note 17: Derivative financial instruments continued

The Group's hedged items are as follows:

| 31 December 2019 | Carrying amount of the hedged item Assets £m | Carrying amount of the hedged item Liabilities £m | Accumulated amount of fair value adjustment on the hedged item Assets £m | Accumulated amount of fair value adjustment on the hedged item Liabilities £m | Change in fair value of hedged item for ineffectiveness assessment (YTD) £m | Cash flow hedge reserve Continuing hedges £m | Cash flow hedge reserve Discontinued hedges £m |
|---|---|---|---|---|---|---|---|
| **Fair value hedges** | | | | | | | |
| **Interest rate** | | | | | | | |
| Fixed rate mortgages[1] | 83,818 | – | 154 | – | (73) | | |
| Fixed rate issuance[2] | – | 70,353 | – | 3,058 | (1,333) | | |
| Fixed rate bonds[3] | 21,354 | – | 660 | – | 405 | | |
| **Cash flow hedges** | | | | | | | |
| **Foreign exchange** | | | | | | | |
| Foreign currency issuance[2] | | | | | 72 | (2) | 179 |
| Customer deposits[4] | | | | | 116 | 18 | (48) |
| **Interest rate** | | | | | | | |
| Customer loans[1] | | | | | (680) | 1,248 | 336 |
| Central bank balances[5] | | | | | (263) | 128 | 163 |
| Customer deposits[4] | | | | | – | (31) | 5 |

| 31 December 2018 | Carrying amount of the hedged item Assets £m | Carrying amount of the hedged item Liabilities £m | Accumulated amount of fair value adjustment on the hedged item Assets £m | Accumulated amount of fair value adjustment on the hedged item Liabilities £m | Change in fair value of hedged item for ineffectiveness assessment (YTD) £m | Cash flow hedge reserve Continuing hedges £m | Cash flow hedge reserve Discontinued hedges £m |
|---|---|---|---|---|---|---|---|
| **Fair value hedges** | | | | | | | |
| **Interest rate** | | | | | | | |
| Fixed rate mortgages[1] | 53,136 | – | (45) | – | (173) | | |
| Fixed rate issuance[2] | – | 63,746 | – | 1,598 | 807 | | |
| Fixed rate bonds[3] | 23,285 | – | 232 | – | (666) | | |
| **Cash flow hedges** | | | | | | | |
| **Foreign exchange** | | | | | | | |
| Foreign currency issuance[2] | | | | | (165) | 114 | 327 |
| Customer deposits[4] | | | | | (62) | 70 | (78) |
| **Interest rate** | | | | | | | |
| Customer loans[1] | | | | | 456 | 867 | 60 |
| Central bank balances[5] | | | | | (16) | 30 | 20 |
| Customer deposits[4] | | | | | (118) | (9) | (6) |

1 Included within loans and advances to customers.

2 Included within debt securities in issue.

3 Included within financial assets at fair value through other comprehensive income.

4 Included within customer deposits.

5 Included within cash and balances at central banks.

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for hedged items that have ceased to be adjusted for hedging gains and losses is a liability of £692 million (2018: liability of £170 million).

## Notes to the consolidated financial statements continued

# Note 17: Derivative financial instruments continued

Gains and losses arising from hedge accounting are summarised as follows:

| 31 December 2019 | Gain (loss) recognised in other comprehensive income £m | Hedge ineffectiveness recognised in the income statement[1] £m | Amounts reclassified from reserves to income statement as: Hedged cashflows will no longer occur £m | Hedged item affected income statement £m | Income statement line item that includes reclassified amount |
|---|---|---|---|---|---|
| **Fair value hedges** | | | | | |
| **Interest rate** | | | | | |
| Fixed rate mortgages | | **186** | | | |
| Fixed rate issuance | | **(32)** | | | |
| Fixed rate bonds | | **(11)** | | | |
| **Cash flow hedges** | | | | | |
| **Foreign exchange** | | | | | |
| Foreign currency issuance | **(265)** | **–** | **(101)** | **(92)** | Interest expense |
| Customer deposits | **(22)** | **–** | **–** | **7** | Interest expense |
| **Interest rate** | | | | | |
| Customer loans | **651** | **98** | **–** | **(362)** | Interest income |
| Central bank balances | **237** | **36** | **–** | **(66)** | Interest income |
| Customer deposits | **–** | **–** | **–** | **6** | Interest expense |

| 31 December 2018 | Gain (loss) recognised in other comprehensive income £m | Hedge ineffectiveness recognised in the income statement[1] £m | Amounts reclassified from reserves to income statement as: Hedged item affected income statement £m | Income statement line item that includes reclassified amount |
|---|---|---|---|---|
| **Fair value hedges** | | | | |
| **Interest rate** | | | | |
| Fixed rate mortgages | | 106 | | |
| Fixed rate issuance | | (17) | | |
| Fixed rate bonds | | (27) | | |
| **Cash flow hedges** | | | | |
| **Foreign exchange** | | | | |
| Foreign currency issuance | 85 | – | (81) | Interest expense |
| Customer deposits | (22) | (2) | (32) | Interest expense |
| **Interest rate** | | | | |
| Customer loans | (418) | (17) | (467) | Interest income |
| Central bank balances | (63) | (5) | (52) | Interest income |
| Customer deposits | (49) | (1) | (69) | Interest expense |

1 Hedge ineffectiveness is included in the income statement within net trading income.

There was a gain of £101 million (2018: nil) reclassified from the cash flow hedging reserve for which hedge accounting had previously been used but for which the hedged future cash flows are no longer expected to occur.

# Note 18: Financial assets at amortised cost

## Year ended 31 December 2019

| Loans and advances to banks | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2019 | 6,282 | 3 | – | – | 6,285 |
| Exchange and other adjustments[1] | (218) | – | – | – | (218) |
| Additions (repayments) | 3,713 | (3) | – | – | 3,710 |
| **At 31 December 2019** | 9,777 | – | – | – | 9,777 |
| **Allowance for impairment losses** | (2) | – | – | – | (2) |
| **Total loans and advances to banks** | 9,775 | – | – | – | 9,775 |

| Loans and advances to customers | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2019 | 441,531 | 25,345 | 5,741 | 15,391 | 488,008 |
| Exchange and other adjustments[1] | (498) | (34) | 47 | 283 | (202) |
| Additions (repayments) | 13,554 | (2,558) | (858) | (1,934) | 8,204 |
| Transfers to Stage 1 | 6,318 | (6,286) | (32) | | – |
| Transfers to Stage 2 | (13,084) | 13,516 | (432) | | – |
| Transfers to Stage 3 | (1,540) | (1,440) | 2,980 | | – |
| | (8,306) | 5,790 | 2,516 | | – |
| Recoveries | – | – | 397 | 28 | 425 |
| Acquisition of portfolios[2] | 3,694 | – | – | – | 3,694 |
| Financial assets that have been written off during the year | | | (1,828) | (54) | (1,882) |
| **At 31 December 2019** | 449,975 | 28,543 | 6,015 | 13,714 | 498,247 |
| **Allowance for impairment losses** | (675) | (995) | (1,447) | (142) | (3,259) |
| **Total loans and advances to customers** | 449,300 | 27,548 | 4,568 | 13,572 | 494,988 |

| Debt securities | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2019 | 5,238 | – | 6 | – | 5,244 |
| Exchange and other adjustments[1] | (94) | – | (2) | – | (96) |
| Additions (repayments) | 400 | – | – | – | 400 |
| Financial assets that have been written off during the year | | | (1) | – | (1) |
| **At 31 December 2019** | 5,544 | – | 3 | – | 5,547 |
| **Allowance for impairment losses** | – | – | (3) | – | (3) |
| **Total debt securities** | 5,544 | – | – | – | 5,544 |
| **Total financial assets at amortised cost** | 464,619 | 27,548 | 4,568 | 13,572 | 510,307 |

Movements in Retail mortgage balances were as follows:

| Retail mortgages | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2019 | 257,797 | 13,654 | 1,393 | 15,391 | 288,235 |
| Exchange and other adjustments[1] | (1) | – | 2 | 283 | 284 |
| Additions (repayments) | 799 | (1,432) | (416) | (1,934) | (2,983) |
| Transfers to Stage 1 | 3,060 | (3,057) | (3) | | – |
| Transfers to Stage 2 | (7,879) | 8,242 | (363) | | – |
| Transfers to Stage 3 | (427) | (472) | 899 | | – |
| | (5,246) | 4,713 | 533 | | – |
| Recoveries | – | – | 29 | 28 | 57 |
| Acquisition of portfolios[2] | 3,694 | – | – | – | 3,694 |
| Financial assets that have been written off during the year | | | (35) | (54) | (89) |
| **At 31 December 2019** | 257,043 | 16,935 | 1,506 | 13,714 | 289,198 |
| **Allowance for impairment losses** | (23) | (281) | (122) | (142) | (568) |
| **Total loans and advances to customers** | 257,020 | 16,654 | 1,384 | 13,572 | 288,630 |

1 Exchange and other adjustments includes certain adjustments, prescribed by IFRS 9, in respect of purchased or originated credit-impaired financial assets.

2 Acquisition of portfolios in 2019 relates to the purchase, completed in September 2019, of Tesco Bank's UK residential mortgage portfolio.

## Note 18: Financial assets at amortised cost continued

Year ended 31 December 2018

| Loans and advances to banks | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2018 | 4,245 | 2 | – | – | 4,247 |
| Exchange and other adjustments | (29) | 1 | – | – | (28) |
| Additions (repayments) | 2,066 | – | – | – | 2,066 |
| **At 31 December 2018** | 6,282 | 3 | – | – | 6,285 |
| **Allowance for impairment losses** | (2) | – | – | – | (2) |
| **Total loans and advances to banks** | 6,280 | 3 | – | – | 6,283 |

| Loans and advances to customers | | | | | |
|---|---|---|---|---|---|
| At 1 January 2018 | 403,881 | 37,245 | 5,140 | 17,973 | 464,239 |
| Exchange and other adjustments | 958 | 32 | – | – | 990 |
| Additions (repayments) | 34,942 | (2,187) | (2,074) | (2,609) | 28,072 |
| Transfers to Stage 1 | 19,524 | (19,501) | (23) | | – |
| Transfers to Stage 2 | (15,743) | 15,996 | (253) | | – |
| Transfers to Stage 3 | (2,031) | (2,220) | 4,251 | | – |
| | 1,750 | (5,725) | 3,975 | | – |
| Recoveries | – | – | 553 | 27 | 580 |
| Disposal of businesses | – | (4,020) | (277) | – | (4,297) |
| Financial assets that have been written off during the year | | | (1,576) | – | (1,576) |
| **At 31 December 2018** | 441,531 | 25,345 | 5,741 | 15,391 | 488,008 |
| **Allowance for impairment losses** | (525) | (994) | (1,553) | (78) | (3,150) |
| **Total loans and advances to customers** | 441,006 | 24,351 | 4,188 | 15,313 | 484,858 |

| Debt securities | | | | | |
|---|---|---|---|---|---|
| At 1 January 2018 | 3,291 | – | 49 | – | 3,340 |
| Exchange and other adjustments | 77 | – | (14) | – | 63 |
| Additions (repayments) | 1,870 | – | – | – | 1,870 |
| Financial assets that have been written off during the year | | | (29) | – | (29) |
| **At 31 December 2018** | 5,238 | – | 6 | – | 5,244 |
| **Allowance for impairment losses** | – | – | (6) | – | (6) |
| **Total debt securities** | 5,238 | – | – | – | 5,238 |
| | | | | | |
| **Total financial assets at amortised cost** | 452,524 | 24,354 | 4,188 | 15,313 | 496,379 |

Movements on Retail mortgage balances were as follows:

| Retail mortgages | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2018 | 251,707 | 20,109 | 1,232 | 17,973 | 291,021 |
| Additions (repayments) | 989 | (938) | (239) | (2,609) | (2,797) |
| Transfers to Stage 1 | 10,814 | (10,805) | (9) | | – |
| Transfers to Stage 2 | (5,396) | 5,691 | (295) | | – |
| Transfers to Stage 3 | (317) | (403) | 720 | | – |
| | 5,101 | (5,517) | 416 | | – |
| Recoveries | – | – | 3 | 27 | 30 |
| Financial assets that have been written off during the year | | | (19) | – | (19) |
| **At 31 December 2018** | 257,797 | 13,654 | 1,393 | 15,391 | 288,235 |
| **Allowance for impairment losses** | (37) | (226) | (118) | (78) | (459) |
| **Total loans and advances to customers** | 257,760 | 13,428 | 1,275 | 15,313 | 287,776 |

## Note 18: Financial assets at amortised cost continued

The movement tables are compiled by comparing the position at 31 December to that at the beginning of the year. Transfers between stages are deemed to have taken place at the start of the reporting period, with all other movements shown in the stage in which the asset is held at 31 December, with the exception of those held within Purchased or originated credit-impaired, which are not transferrable.

Additions (repayments) comprise new loans originated and repayments of outstanding balances throughout the reporting period. Loans which are written off in the period are first transferred to Stage 3 before acquiring a full allowance and subsequent write-off.

## Note 19: Finance lease receivables

The Group's finance lease receivables are classified as loans and advances to customers and accounted for at amortised cost. The balance is analysed as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| Gross investment in finance leases, receivable: | | |
| Not later than 1 year | 490 | 458 |
| Later than 1 year and not later than 2 years | 347 | 516 |
| Later than 2 years and not later than 3 years | 181 | 456 |
| Later than 3 years and not later than 4 years | 145 | 201 |
| Later than 4 years and not later than 5 years | 208 | 178 |
| Later than 5 years | 883 | 1,104 |
| | 2,254 | 2,913 |
| Unearned future finance income on finance leases | (563) | (1,068) |
| Rentals received in advance | (20) | (23) |
| **Net investment in finance leases** | 1,671 | 1,822 |

The net investment in finance leases represents amounts recoverable as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| Not later than 1 year | 406 | 303 |
| Later than 1 year and not later than 2 years | 326 | 407 |
| Later than 2 years and not later than 3 years | 130 | 353 |
| Later than 3 years and not later than 4 years | 103 | 154 |
| Later than 4 years and not later than 5 years | 171 | 130 |
| Later than 5 years | 535 | 475 |
| **Net investment in finance leases** | 1,671 | 1,822 |

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. There was an allowance for uncollectable finance lease receivables included in the allowance for impairment losses of £12 million (2018: £1 million).

Notes to the consolidated financial statements continued

# Note 20: Allowance for impairment losses

## Analysis of movement in the allowance for impairment losses by Stage

| Year ended 31 December 2019 | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| *In respect of drawn balances* | | | | | |
| At 1 January 2019 | 527 | 994 | 1,570 | 78 | 3,169 |
| Exchange and other adjustments | 11 | (9) | 23 | 283 | 308 |
| Transfers to Stage 1 | 229 | (222) | (7) | | – |
| Transfers to Stage 2 | (53) | 92 | (39) | | – |
| Transfers to Stage 3 | (15) | (140) | 155 | | – |
| Impact of transfers between stages | (175) | 353 | 420 | | 598 |
| | (14) | 83 | 529 | | 598 |
| Other items charged to the income statement | 153 | (73) | 827 | (193) | 714 |
| Charge to the income statement (note 13) | 139 | 10 | 1,356 | (193) | 1,312 |
| Advances written off | | | (1,829) | (54) | (1,883) |
| Recoveries of advances written off in previous years | | | 397 | 28 | 425 |
| Discount unwind | | | (53) | – | (53) |
| **At 31 December 2019** | 677 | 995 | 1,464 | 142 | 3,278 |
| *In respect of undrawn balances* | | | | | |
| At January 2019 | 123 | 64 | 6 | – | 193 |
| Exchange and other adjustments | – | (1) | – | – | (1) |
| Transfers to Stage 1 | 19 | (19) | – | | – |
| Transfers to Stage 2 | (4) | 4 | – | | – |
| Transfers to Stage 3 | (1) | (3) | 4 | | – |
| Impact of transfers between stages | (17) | 24 | (1) | | 6 |
| | (3) | 6 | 3 | | 6 |
| Other items charged to the income statement | (25) | 8 | (4) | – | (21) |
| Charge to the income statement (note 13) | (28) | 14 | (1) | – | (15) |
| **At 31 December 2019** | 95 | 77 | 5 | – | 177 |
| **Total at 31 December 2019** | 772 | 1,072 | 1,469 | 142 | 3,455 |
| *In respect of:* | | | | | |
| Loans and advances to banks | 2 | – | – | – | 2 |
| Loans and advances to customers: | | | | | |
| Retail mortgages | 23 | 281 | 122 | 142 | 568 |
| Other | 652 | 714 | 1,325 | – | 2,691 |
| | 675 | 995 | 1,447 | 142 | 3,259 |
| Debt securities | – | – | 3 | – | 3 |
| Financial assets at amortised cost | 677 | 995 | 1,450 | 142 | 3,264 |
| Other assets | – | – | 14 | – | 14 |
| Provisions in relation to loan commitments and financial guarantees | 95 | 77 | 5 | – | 177 |
| **Total** | 772 | 1,072 | 1,469 | 142 | 3,455 |
| Expected credit loss in respect of financial assets at fair value through other comprehensive income (memorandum item) | – | – | – | – | – |

Exchange and other adjustments include certain adjustments, prescribed by IFRS 9, in respect of purchased or originated credit-impaired financial assets.

## Note 20: Allowance for impairment losses continued

Movements in the Group's allowance for impairment losses in respect of Retail mortgages were as follows:

| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| Balance at 1 January 2019 | 37 | 226 | 118 | 78 | 459 |
| Exchange and other adjustments | – | – | – | 283 | 283 |
| Transfers to Stage 1 | 17 | (17) | – | | – |
| Transfers to Stage 2 | (13) | 33 | (20) | | – |
| Transfers to Stage 3 | (5) | (21) | 26 | | – |
| Impact of transfers between stages | (15) | 105 | 39 | | 129 |
| | (16) | 100 | 45 | | 129 |
| Other items charged to the income statement | 3 | (45) | (59) | (193) | (294) |
| Charge to the income statement | (13) | 55 | (14) | (193) | (165) |
| Advances written off | | | (35) | (54) | (89) |
| Recoveries of advances written off in previous years | | | 29 | 28 | 57 |
| Discount unwind | | | 24 | – | 24 |
| **At 31 December 2019** | **24** | **281** | **122** | **142** | **569** |

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## Note 20: Allowance for impairment losses continued

| Year ended 31 December 2018 | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| *In respect of drawn balances* | | | | | |
| Balance at 1 January 2018 | 590 | 1,147 | 1,491 | 32 | 3,260 |
| Exchange and other adjustments | 2 | – | 133 | – | 135 |
| Transfers to Stage 1 | 304 | (299) | (5) | | – |
| Transfers to Stage 2 | (46) | 85 | (39) | | – |
| Transfers to Stage 3 | (32) | (131) | 163 | | – |
| Impact of transfers between stages | (233) | 401 | 325 | | 493 |
| | (7) | 56 | 444 | | 493 |
| Other items charged to the income statement | (58) | (107) | 696 | – | 531 |
| Charge to the income statement (note 13) | (65) | (51) | 1,140 | – | 1,024 |
| Advances written off | | | (1,605) | – | (1,605) |
| Disposal of businesses | – | (102) | (79) | – | (181) |
| Recoveries of advances written off in previous years | | | 553 | 27 | 580 |
| Discount unwind | | | (63) | 19 | (44) |
| At 31 December 2018 | 527 | 994 | 1,570 | 78 | 3,169 |
| *In respect of undrawn balances* | | | | | |
| Balance at 1 January 2018 | 147 | 126 | – | – | 273 |
| Exchange and other adjustments | (5) | (14) | 12 | – | (7) |
| Transfers to Stage 1 | 28 | (28) | – | | – |
| Transfers to Stage 2 | (6) | 6 | – | | – |
| Transfers to Stage 3 | (2) | (5) | 7 | | – |
| Impact of transfers between stages | (25) | 22 | (5) | | (8) |
| | (5) | (5) | 2 | | (8) |
| Other items charged to the income statement | (14) | (43) | (8) | – | (65) |
| Charge to the income statement (note 13) | (19) | (48) | (6) | – | (73) |
| At 31 December 2018 | 123 | 64 | 6 | – | 193 |
| **Total at 31 December 2018** | 650 | 1,058 | 1,576 | 78 | 3,362 |
| *In respect of:* | | | | | |
| Loans and advances to banks | 2 | – | – | – | 2 |
| Loans and advances to customers: | | | | | |
| Retail mortgages (see below) | 37 | 226 | 118 | 78 | 459 |
| Other | 488 | 768 | 1,435 | – | 2,691 |
| | 525 | 994 | 1,553 | 78 | 3,150 |
| Debt securities | – | – | 6 | – | 6 |
| Financial assets at amortised cost | 527 | 994 | 1,559 | 78 | 3,158 |
| Other assets | – | – | 11 | – | 11 |
| Provisions in relation to loan commitments and financial guarantees | 123 | 64 | 6 | – | 193 |
| **Total** | 650 | 1,058 | 1,576 | 78 | 3,362 |
| Expected credit loss in respect of financial assets at fair value through other comprehensive income (memorandum item): | 1 | – | – | – | 1 |

## Note 20: Allowance for impairment losses continued

Movements in the Group's allowance for impairment losses in respect of Retail mortgages were as follows:

| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|
| Balance at 1 January 2018 | 30 | 236 | 86 | 32 | 384 |
| Exchange and other adjustments | – | 1 | 1 | – | 2 |
| Transfers to Stage 1 | 72 | (71) | (1) | | – |
| Transfers to Stage 2 | (3) | 15 | (12) | | – |
| Transfers to Stage 3 | (3) | (17) | 20 | | – |
| Impact of transfers between stages | (48) | 82 | 40 | | 74 |
| | 18 | 9 | 47 | | 74 |
| Other items charged to the income statement | (11) | (20) | (5) | – | (36) |
| Charge to the income statement | 7 | (11) | 42 | – | 38 |
| Advances written off | | | (19) | – | (19) |
| Recoveries of advances written off in previous years | | | 3 | 27 | 30 |
| Discount unwind | | | 5 | 19 | 24 |
| At 31 December 2018 | 37 | 226 | 118 | 78 | 459 |

The Group income statement charge comprises:

| | 2019 £m | 2018 £m |
|---|---|---|
| Drawn balances | **1,312** | 1,024 |
| Undrawn balances | **(15)** | (73) |
| Financial assets at fair value through other comprehensive income | **(1)** | (14) |
| **Total** | **1,296** | 937 |

The movement tables are compiled by comparing the position at 31 December to that at the beginning of the year. Transfers between stages are deemed to have taken place at the start of the reporting period, with all other movements shown in the stage in which the asset is held at 31 December, with the exception of those held within Purchased or originated credit-impaired, which are not transferrable. As assets are transferred between stages, the resulting change in expected credit loss of £598 million (2018: £493 million) for drawn balances, and £6 million (2018: £8 million) for undrawn balances, is presented separately as Impacts of transfers between stages, in the stage in which the expected credit loss is recognised at the end of the reporting period.

Other items charged to the income statement include the movements in the expected credit loss as a result of new loans originated and repayments of outstanding balances throughout the reporting period. Loans which are written off in the period are first transferred to Stage 3 before acquiring a full allowance and subsequent write-off. Consequently, recoveries on assets previously written-off also occur in Stage 3 only.

## Note 21: Financial assets at fair value through other comprehensive income

| | 2019 £m | 2018 £m |
|---|---|---|
| Debt securities: | | |
| Government securities | **13,098** | 18,971 |
| Bank and building society certificates of deposit | **–** | 118 |
| Asset-backed securities: | | |
| Mortgage-backed securities | **121** | 120 |
| Other asset-backed securities | **60** | 131 |
| Corporate and other debt securities | **11,051** | 5,151 |
| | **24,330** | 24,491 |
| Treasury and other bills | **535** | 303 |
| Equity shares | **227** | 21 |
| **Total financial assets at fair value through other comprehensive income** | **25,092** | 24,815 |

All assets were assessed at Stage 1 at 31 December 2018 and 2019.

# Note 22: Investments in joint ventures and associates

The Group's share of results of, and investments in, equity accounted joint ventures and associates comprises:

| | Joint ventures | | | Associates | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2019 £m | 2018 £m | 2017 £m | 2019 £m | 2018 £m | 2017 £m | 2019 £m | 2018 £m | 2017 £m |
| Share of income statement amounts: | | | | | | | | | |
| Income | **66** | 8 | (5) | **(1)** | – | 4 | **65** | 8 | (1) |
| Expenses | **(59)** | 1 | – | **–** | – | – | **(59)** | 1 | – |
| Impairment | **–** | – | 7 | **–** | – | – | **–** | – | 7 |
| Profit (loss) before tax | **7** | 9 | 2 | **(1)** | – | 4 | **6** | 9 | 6 |
| Tax | **–** | – | – | **–** | – | – | **–** | – | – |
| **Share of post-tax results** | **7** | 9 | 2 | **(1)** | – | 4 | **6** | 9 | 6 |
| Share of other comprehensive income | **–** | 8 | – | **–** | – | – | **–** | 8 | – |
| Share of total comprehensive income | **7** | 17 | 2 | **(1)** | – | 4 | **6** | 17 | 6 |
| Share of balance sheet amounts: | | | | | | | | | |
| Current assets | **347** | 27 | | **5** | 15 | | **352** | 42 | |
| Non-current assets | **158** | 54 | | **6** | 17 | | **164** | 71 | |
| Current liabilities | **(35)** | (2) | | **–** | (20) | | **(35)** | (22) | |
| Non-current liabilities | **(177)** | – | | **–** | – | | **(177)** | – | |
| **Share of net assets at 31 December** | **293** | 79 | | **11** | 12 | | **304** | 91 | |
| Movement in investments over the year: | | | | | | | | | |
| At 1 January | **79** | 64 | | **12** | 1 | | **91** | 65 | |
| Exchange and other adjustments | **–** | – | | **–** | 1 | | **–** | 1 | |
| Acquisitions | **1** | – | | **–** | – | | **1** | – | |
| Establishment of joint venture (note 23) | **208** | – | | **–** | – | | **208** | – | |
| Additional investments | **–** | 12 | | **–** | 11 | | **–** | 23 | |
| Disposals | **–** | – | | **–** | (1) | | **–** | (1) | |
| Share of post-tax results | **7** | 9 | | **(1)** | – | | **6** | 9 | |
| Share of other comprehensive income | **–** | 8 | | **–** | – | | **–** | 8 | |
| Dividends paid | **(2)** | (14) | | **–** | – | | **(2)** | (14) | |
| **Share of net assets at 31 December** | **293** | 79 | | **11** | 12 | | **304** | 91 | |

The Group's unrecognised share of losses of associates for the year was £nil (2018: £4 million; 2017; £nil). For entities making losses, subsequent profits earned are not recognised until previously unrecognised losses are extinguished. The Group's unrecognised share of losses net of unrecognised profits on a cumulative basis of associates is £17 million (2018: £17 million; 2017 £17 million) and of joint ventures is £3 million (2018: £3 million; 2017: £29 million).

Where entities have statutory accounts drawn up to a date other than 31 December management accounts are used when accounting for them by the Group.

# Note 23: Acquisitions

## Acquisition of workplace pensions business

On 1 July 2019, following the receipt of regulatory and legal approvals, the Group completed the acquisition of the UK workplace pensions and savings business of the Zurich Insurance Group. The total fair value of the purchase consideration in the year was £20 million, settled in cash.

The acquisition is intended to enhance Scottish Widows' offering and broaden its participation in the financial planning and retirement segment whilst delivering a modern, flexible workplace savings platform.

The table below sets out the fair value of the identifiable assets and liabilities acquired.

| | Book value as at 1 July 2019 £m | Fair value adjustments £m | Fair value as at 1 July 2019 £m |
|---|---|---|---|
| **Assets** | | | |
| Financial assets at fair value through profit or loss | **7,350** | **–** | **7,350** |
| Loans and advances to banks | **17** | **–** | **17** |
| Value of in-force business | **–** | **6** | **6** |
| Assets arising from reinsurance contracts held | **13,616** | **–** | **13,616** |
| Other assets | **6** | **–** | **6** |
| **Total assets** | **20,989** | **6** | **20,995** |
| **Liabilities** | | | |
| Liabilities arising from non-participating investment contracts | **20,981** | **–** | **20,981** |
| Other liabilities | **8** | **–** | **8** |
| **Total liabilities** | **20,989** | **–** | **20,989** |
| **Provisional fair value of net assets acquired** | **–** | **6** | **6** |
| **Goodwill arising on acquisition** | | | **14** |
| **Total consideration** | | | **20** |

## Note 23: Acquisitions continued

The post-acquisition total income of the acquired business, which is included in the Group statutory consolidated income statement for the year ended 31 December 2019, is £22 million; the business also contributed profit before tax of £2 million for the same period.

Had the acquisition date been 1 January 2019, the Group's consolidated total income would have been £18 million higher at £42,374 million and the Group's consolidated profit before tax would have been £3 million lower at £4,390 million.

The carrying value of the goodwill arising on acquisition of £14 million has been reviewed at 31 December 2019, with appropriate assumptions made as to the future performance of the acquired business, and no adjustments are considered necessary.

### Wealth management partnership

Following agreement with Schroders to enter into a partnership to create a new wealth management proposition, during 2019 the Group transferred approximately £13 billion of assets under management from its UK wealth management business and £12 billion of investment funds administered by its existing Authorised Corporate Director business into Scottish Widows Schroder Wealth Holdings Limited.

In connection with this partnership, the Group sold a 49.9 per cent interest in Scottish Widows Schroder Wealth Holdings Limited to Schroders Administration Limited in exchange for a 19.9 per cent interest in Schroder Wealth Holdings Limited, the holding company of Schroders plc's existing UK wealth management business, valued at £202 million.

Following disposal of the 49.9 per cent interest, the Group accounts for its remaining 50.1 per cent interest in Scottish Widows Schroder Wealth Holdings Limited as a joint venture, which was recorded at a fair value upon initial recognition of £208 million.

The Group recognised a gain arising from these transactions of £244 million, net of a charge of £70 million for an onerous contract provision in relation to the services that it is now obligated to provide to the joint venture; this amount is recognised within other operating income.

## Note 24: Goodwill

| | 2019 £m | 2018 £m |
|---|---|---|
| **At 1 January** | **2,310** | 2,310 |
| Acquisition of businesses (note 23) | **14** | – |
| **At 31 December** | **2,324** | 2,310 |
| Cost[1] | **2,664** | 2,664 |
| Accumulated impairment losses | **(340)** | (354) |
| **At 31 December** | **2,324** | 2,310 |

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 £2,324 million (2018: £2,310 million), £1,836 million, or 79 per cent of the total (2018: £1,836 million, 79 per cent of the total) has been allocated to Scottish Widows in the Group's Insurance and Wealth division; £302 million, or 13 per cent of the total (2018: £302 million, or 13 per cent of the total) has been allocated to Cards in the Group's Retail division; and £170 million, or 7 per cent of the total (2018: £170 million, 7 per cent of the total) to Motor Finance in the Group's Retail 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 three-year period, the related run-off of existing business in force and a discount rate of 8 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. New business cash flows beyond the three-year period have been extrapolated using a steady 2 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 Motor 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 four-year period and a discount rate of 14 per cent. The cash flows beyond the four-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 Motor Finance participates. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of Motor Finance to fall below the balance sheet carrying value.

The recoverable amount of the goodwill relating to the Cards business has 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 10 per cent. The cash flows beyond the five year period assume no growth. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of the Cards business to fall below the balance sheet carrying value.

## Note 25: Value of in-force business

### Key assumptions

The impact of reasonably possible changes in the key assumptions made in respect of the Group's life insurance business, which include the impact on the value of in force business, are disclosed in note 33.

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 32.

## Note 25: Value of in-force business continued

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. In determining the market premium for illiquidity, a range of inputs are considered which reflect actual asset allocation and relevant observable market data. The illiquidity premium is estimated to be 91 basis points at 31 December 2019 (2018: 128 basis points).

The risk-free rate is derived from the relevant swap curve with a deduction for credit risk.

The table below shows the resulting range of yields and other key assumptions at 31 December:

| | 2019 % | 2018 % |
|---|---|---|
| Risk-free rate (value of in-force non-annuity business)[1] | **0.00 to 3.90** | 0.00 to 4.05 |
| Risk-free rate (value of in-force annuity business)[1] | **0.91 to 4.81** | 1.28 to 5.33 |
| Risk-free rate (financial options and guarantees)[1] | **0.00 to 3.90** | 0.00 to 4.05 |
| Retail price inflation | **3.11** | 3.43 |
| Expense inflation | **3.41** | 3.75 |

1 All risk-free rates are quoted as the range of rates implied by the relevant forward 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 32 and the effect of changes in key assumptions is given in note 33.

The gross value of in-force business asset in the consolidated balance sheet is as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| Acquired value of in-force non-participating investment contracts | **247** | 271 |
| Value of in-force insurance and participating investment contracts | **5,311** | 4,491 |
| **Total value of in-force business** | **5,558** | 4,762 |

The movement in the acquired value of in-force non-participating investment contracts over the year is as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | **271** | 306 |
| Acquisition of business | **6** | 5 |
| Amortisation (note 11) | **(30)** | (40) |
| **At 31 December** | **247** | 271 |

The acquired value of in-force non-participating investment contracts includes £150 million (2018: £167 million) in relation to OEIC business.

## Note 25: Value of in-force business continued

### Movement in value of in-force business

The movement in the value of in-force insurance and participating investment contracts over the year is as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | **4,491** | 4,533 |
| Exchange and other adjustments | **(5)** | 13 |
| Movements in the year: | | |
| New business | **696** | 675 |
| Existing business: | | |
| Expected return | **(274)** | (304) |
| Experience variances | **(43)** | (122) |
| Assumption changes | **102** | (67) |
| Economic variance | **344** | (237) |
| Movement in the value of in-force business (note 9) | **825** | (55) |
| **At 31 December** | **5,311** | 4,491 |

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 makes 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 year from those included in assumptions used to calculate new and existing business returns.

## 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 2018 | 596 | 2,770 | 1,017 | 538 | 2,940 | 7,861 |
| Additions | – | – | – | – | 1,046 | 1,046 |
| Disposals | – | – | (15) | – | (55) | (70) |
| At 31 December 2018 | 596 | 2,770 | 1,002 | 538 | 3,931 | 8,837 |
| Exchange and other adjustments | **–** | **–** | **–** | **–** | **4** | **4** |
| Additions | **–** | **–** | **–** | **–** | **1,033** | **1,033** |
| Disposals | **–** | **–** | **–** | **–** | **(10)** | **(10)** |
| **At 31 December 2019** | **596** | **2,770** | **1,002** | **538** | **4,958** | **9,864** |
| Accumulated amortisation: | | | | | | |
| At 1 January 2018 | 193 | 2,770 | 355 | 519 | 1,189 | 5,026 |
| Charge for the year | 23 | – | 71 | 19 | 400 | 513 |
| Disposals | – | – | (15) | – | (34) | (49) |
| At 31 December 2018 | 216 | 2,770 | 411 | 538 | 1,555 | 5,490 |
| Exchange and other adjustments | **–** | **–** | **–** | **–** | **4** | **4** |
| Charge for the year | **–** | **–** | **70** | **–** | **496** | **566** |
| Disposals | **–** | **–** | **–** | **–** | **(4)** | **(4)** |
| **At 31 December 2019** | **216** | **2,770** | **481** | **538** | **2,051** | **6,056** |
| **Balance sheet amount at 31 December 2019** | **380** | **–** | **521** | **–** | **2,907** | **3,808** |
| Balance sheet amount at 31 December 2018 | 380 | – | 591 | – | 2,376 | 3,347 |

Brands of £380 million (31 December 2018: £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 purchased credit card relationships represent the benefit of recurring income generated from portfolios of credit cards purchased. The balance sheet amount at 31 December 2019 is expected to be amortised over its remaining useful life of eight years.

## Note 27: Property, plant and equipment

| | Investment properties £m | Premises £m | Equipment £m | Operating lease assets £m | Right-of-use asset[1] £m | Total £m |
|---|---|---|---|---|---|---|
| Cost or valuation: | | | | | | |
| At 1 January 2018 | 3,699 | 1,791 | 5,068 | 6,528 | | 17,086 |
| Exchange and other adjustments | – | – | (6) | 11 | | 5 |
| Additions | – | 72 | 519 | 1,755 | | 2,346 |
| Expenditure on investment properties (see below) | 143 | – | – | – | | 143 |
| Change in fair value of investment properties (note 7) | 139 | – | – | – | | 139 |
| Disposals | (211) | (647) | (574) | (1,540) | | (2,972) |
| At 31 December 2018 | 3,770 | 1,216 | 5,007 | 6,754 | | 16,747 |
| Adjustment on adoption of IFRS 16 (note 55) | – | – | – | – | 1,716 | 1,716 |
| **Balance at 1 January 2019** | **3,770** | **1,216** | **5,007** | **6,754** | **1,716** | **18,463** |
| Exchange and other adjustments | **16** | **3** | **5** | **(4)** | **–** | **20** |
| Additions | **–** | **121** | **522** | **1,693** | **196** | **2,532** |
| Expenditure on investment properties (see below) | **73** | **–** | **–** | **–** | **–** | **73** |
| Change in fair value of investment properties (note 7) | **(108)** | **–** | **–** | **–** | **–** | **(108)** |
| Disposals | **(198)** | **(245)** | **(238)** | **(1,694)** | **(27)** | **(2,402)** |
| **At 31 December 2019** | **3,553** | **1,095** | **5,296** | **6,749** | **1,885** | **18,578** |
| Accumulated depreciation and impairment: | | | | | | |
| At 1 January 2018 | – | 728 | 2,125 | 1,506 | | 4,359 |
| Exchange and other adjustments | – | 1 | (8) | 6 | | (1) |
| Depreciation charge for the year | – | 121 | 715 | 1,016 | | 1,852 |
| Disposals | – | (634) | (534) | (595) | | (1,763) |
| At 31 December 2018 | – | 216 | 2,298 | 1,933 | | 4,447 |
| Exchange and other adjustments | **–** | **–** | **(1)** | **(36)** | **1** | **(36)** |
| Depreciation charge for the year | **–** | **125** | **715** | **1,008** | **216** | **2,064** |
| Disposals | **–** | **(225)** | **(180)** | **(595)** | **(1)** | **(1,001)** |
| **At 31 December 2019** | **–** | **116** | **2,832** | **2,310** | **216** | **5,474** |
| **Balance sheet amount at 31 December 2019** | **3,553** | **979** | **2,464** | **4,439** | **1,669** | **13,104** |
| Balance sheet amount at 31 December 2018 | 3,770 | 1,000 | 2,709 | 4,821 | – | 12,300 |

1 Primarily premises.

Expenditure on investment properties is comprised as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| Acquisitions of new properties | **21** | 81 |
| Additional expenditure on existing properties | **52** | 62 |
| | **73** | 143 |

Rental income of £191 million (2018: £197 million) and direct operating expenses arising from properties that generate rental income of £32 million (2018: £23 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 £7 million (2018: £33 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:

| | 2019 £m | 2018 £m |
|---|---|---|
| Receivable within 1 year | **978** | 1,095 |
| 1 to 2 years | **620** | 681 |
| 2 to 3 years | **312** | 332 |
| 3 to 4 years | **102** | 113 |
| 4 to 5 years | **12** | 30 |
| Over 5 years | **2** | 6 |
| **Total future minimum rentals receivable** | **2,026** | 2,257 |

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements.

## Note 28: Other assets

| | 2019 £m | 2018 £m |
|---|---|---|
| Deferred acquisition and origination costs | **83** | 90 |
| Settlement balances | **654** | 743 |
| Other assets and prepayments | **3,737** | 3,742 |
| **Total other assets** | **4,474** | 4,575 |

## Note 29: Financial liabilities at fair value through profit or loss

| | 2019 £m | 2018 £m |
|---|---|---|
| Liabilities designated at fair value through profit or loss: | | |
| Debt securities in issue | **7,531** | 7,085 |
| Other | **–** | 11 |
| | **7,531** | 7,096 |
| Trading liabilities: | | |
| Liabilities in respect of securities sold under repurchase agreements | **11,048** | 21,595 |
| Other deposits | **98** | 242 |
| Short positions in securities | **2,809** | 1,614 |
| | **13,955** | 23,451 |
| **Financial liabilities at fair value through profit or loss** | **21,486** | 30,547 |

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 2019 was £14,365 million, which was £6,834 million higher than the balance sheet carrying value (2018: £15,435 million, which was £8,350 million higher than the balance sheet carrying value). At 31 December 2019 there was a cumulative £33 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 an increase of £419 million arose in 2019 and a decrease of £533 million arose in 2018.

For the fair value of collateral pledged in respect of repurchase agreements see note 53.

## Note 30: Debt securities in issue

| | 2019 £m | 2018 £m |
|---|---|---|
| Medium-term notes issued | **41,291** | 37,490 |
| Covered bonds (note 31) | **29,821** | 28,194 |
| Certificates of deposit issued | **10,598** | 12,020 |
| Securitisation notes (note 31) | **7,288** | 5,426 |
| Commercial paper | **8,691** | 8,038 |
| **Total debt securities in issue** | **97,689** | 91,168 |

# Note 31: Securitisations and covered bonds

## Securitisation programmes

Loans and advances to customers and debt securities carried at amortised cost 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 30.

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Loans and advances securitised £m** | **Notes in issue £m** | Loans and advances securitised £m | Notes in issue £m |
| **Securitisation programmes** | | | | |
| UK residential mortgages | **25,815** | **23,505** | 25,018 | 22,485 |
| Commercial loans | **5,116** | **6,037** | 5,746 | 6,577 |
| Credit card receivables | **8,164** | **5,767** | 8,060 | 5,263 |
| Motor vehicle finance | **3,450** | **3,462** | 2,850 | 2,855 |
| | **42,545** | **38,771** | 41,674 | 37,180 |
| Less held by the Group | | **(31,436)** | | (31,701) |
| **Total securitisation programmes (notes 29 and 30)[1]** | | **7,335** | | 5,479 |
| **Covered bond programmes** | | | | |
| Residential mortgage-backed | **37,579** | **29,321** | 34,963 | 27,694 |
| Social housing loan-backed | **1,552** | **600** | 1,839 | 1,200 |
| | **39,131** | **29,921** | 36,802 | 28,894 |
| Less held by the Group | | **(100)** | | (700) |
| **Total covered bond programmes (note 30)** | | **29,821** | | 28,194 |
| **Total securitisation and covered bond programmes** | | **37,156** | | 33,673 |

1 Includes £47 million (2018: £53 million) of securitisation notes held at fair value through profit or loss.

Cash deposits of £4,703 million (2018: £4,102 million) which support the debt securities issued by the structured entities, the term advances related to covered bonds and other legal obligations are held by the Group. Additionally, the Group had certain contractual arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2019 these obligations had not been triggered; the maximum exposure under these facilities was £56 million (2018: £88 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 in respect of its securitisation issuances 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 provided financial or other support by voluntarily offering to repurchase assets from any of its public securitisation programmes during 2019 (2018: none).

# Note 32: Liabilities arising from insurance contracts and participating investment contracts

Insurance contract and participating investment contract liabilities are comprised as follows:

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Gross £m | Reinsurance[1] £m | Net £m | Gross £m | Reinsurance[1] £m | Net £m |
| Life insurance (see (1) below): | | | | | | |
| Insurance contracts | 96,812 | (715) | 96,097 | 84,366 | (716) | 83,650 |
| Participating investment contracts | 14,063 | – | 14,063 | 13,912 | – | 13,912 |
| | 110,875 | (715) | 110,160 | 98,278 | (716) | 97,562 |
| Non-life insurance contracts (see (2) below): | | | | | | |
| Unearned premiums | 333 | (14) | 319 | 342 | (13) | 329 |
| Claims outstanding | 241 | – | 241 | 254 | – | 254 |
| | 574 | (14) | 560 | 596 | (13) | 583 |
| **Total** | 111,449 | (729) | 110,720 | 98,874 | (729) | 98,145 |

1 Reinsurance balances are reported within assets.

## (1) Life insurance

The movement in life insurance contract and participating investment contract liabilities over the year can be analysed as follows:

| | Insurance contracts £m | Participating investment contracts £m | Gross £m | Reinsurance £m | Net £m |
|---|---|---|---|---|---|
| At 1 January 2018 | 86,949 | 15,881 | 102,830 | (563) | 102,267 |
| New business | 5,476 | 31 | 5,507 | (42) | 5,465 |
| Changes in existing business | (8,072) | (2,000) | (10,072) | (111) | (10,183) |
| Change in liabilities charged to the income statement | (2,596) | (1,969) | (4,565) | (153) | (4,718) |
| Exchange and other adjustments | 13 | – | 13 | – | 13 |
| At 31 December 2018 | 84,366 | 13,912 | 98,278 | (716) | 97,562 |
| New business | 5,684 | 37 | 5,721 | (45) | 5,676 |
| Changes in existing business | 6,798 | 114 | 6,912 | 46 | 6,958 |
| Change in liabilities charged to the income statement (note 10) | 12,482 | 151 | 12,633 | 1 | 12,634 |
| Exchange and other adjustments | (36) | – | (36) | – | (36) |
| **At 31 December 2019** | 96,812 | 14,063 | 110,875 | (715) | 110,160 |

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:

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | With-profit fund £m | Non-profit fund £m | Total £m | With-profit fund £m | Non-profit fund £m | Total £m |
| Insurance contracts | 8,018 | 88,794 | 96,812 | 7,851 | 76,515 | 84,366 |
| Participating investment contracts | 7,222 | 6,841 | 14,063 | 7,438 | 6,474 | 13,912 |
| **Total** | 15,240 | 95,635 | 110,875 | 15,289 | 82,989 | 98,278 |

## With-profit fund realistic liabilities

### (i) Business description

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.

## Note 32: Liabilities arising from insurance contracts and participating investment contracts continued

### (iii) Assumptions

Key assumptions used in the calculation of with-profit liabilities, and the processes for determining these, are:

#### Investment returns and discount rates

With-profit fund liabilities are valued on a market-consistent basis, 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.

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 2019 of £2.6 billion (2018: £2.5 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, 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 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:

## Note 32: Liabilities arising from insurance contracts and participating investment contracts continued

### Interest rates

The rates of interest used are determined 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, 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 2019 resulted in the following key impacts on profit before tax:

– Change in persistency assumptions (£67 million decrease).

– Change in the assumption in respect of current and future mortality and morbidity rates (£164 million increase).

– Change in expenses assumptions (£208 million increase).

Included within change in expenses assumptions are the impacts associated with exiting the Standard Life Aberdeen investment management agreement.

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.

### (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 £64 million (2018: £39 million) in respect of those guarantees.

## (2) Non-life insurance

For non-life insurance contracts, the methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product. Assumptions are intended to be neutral estimates of the most likely or expected outcome. There has been no significant change in the assumptions and methodologies used for setting reserves.

The movements in non-life insurance contract liabilities and reinsurance assets over the year have been as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| **Provisions for unearned premiums** | | |
| Gross provision at 1 January | **342** | 358 |
| Increase in the year | **663** | 681 |
| Release in the year | **(672)** | (697) |
| Change in provision for unearned premiums charged to income statement | **(9)** | (16) |
| Gross provision at 31 December | **333** | 342 |
| Reinsurers' share | **(14)** | (13) |
| **Net provision at 31 December** | **319** | 329 |

These provisions represent the liability for short-term insurance contracts for which the Group's obligations are not expired at the year end.

| | 2019 £m | 2018 £m |
|---|---|---|
| **Claims outstanding** | | |
| Gross claims outstanding at 1 January | **254** | 225 |
| Cash paid for claims settled in the year | **(300)** | (306) |
| Increase/(decrease) in liabilities charged to the income statement [1] | **287** | 335 |
| | **(13)** | 29 |
| **Gross claims outstanding at 31 December** | **241** | 254 |
| Reinsurers' share | **–** | – |
| **Net claims outstanding at 31 December** | **241** | 254 |
| Notified claims | **128** | 170 |
| Incurred but not reported | **113** | 84 |
| **Net claims outstanding at 31 December** | **241** | 254 |

1 Of which an increase of £335 million (2018: £367 million) was in respect of current year claims and a decrease of £48 million (2018: a decrease of £32 million) was in respect of prior year claims.

## Note 33: 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.

| | | 2019 | | 2018 | |
|---|---|---|---|---|---|
| | 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 | 19 | 16 | 22 | 18 |
| Annuitant mortality[2] | 5% reduction | (293) | (243) | (234) | (194) |
| Lapse rates[3] | 10% reduction | 107 | 89 | 89 | 74 |
| Future maintenance and investment expenses[4] | 10% reduction | 299 | 248 | 262 | 217 |
| Risk-free rate[5] | 0.25% reduction | 33 | 28 | 76 | 63 |
| Guaranteed annuity option take up[6] | 5% addition | (1) | (1) | (3) | (2) |
| Equity investment volatility[7] | 1% addition | (2) | (1) | (5) | (4) |
| Widening of credit default spreads on corporate bonds[8] | 0.25% addition | (424) | (352) | (364) | (303) |
| Increase in illiquidity premia[9] | 0.10% addition | 191 | 159 | 153 | 127 |

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 34: Liabilities arising from non-participating investment contracts

The movement in liabilities arising from non-participating investment contracts may be analysed as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | 13,853 | 15,447 |
| Acquisition of business (note 23) | 20,981 | – |
| New business | 1,810 | 668 |
| Changes in existing business | 815 | (2,262) |
| **At 31 December** | **37,459** | 13,853 |

The balances above are shown gross of reinsurance. As at 31 December 2019, related reinsurance balances were £21 million (2018: £20 million); reinsurance balances are reported within assets. Liabilities arising from non-participating investment contracts are categorised as level 2. See note 50 for details of levels in the fair value hierarchy.

## Note 35: Other liabilities

| | 2019 £m | 2018 £m |
|---|---|---|
| Settlement balances | 760 | 485 |
| Unitholders' interest in Open Ended Investment Companies[1] | 11,928 | 12,933 |
| Unallocated surplus within insurance businesses | 400 | 382 |
| Lease liabilities | 1,844 | 46 |
| Other creditors and accruals | 5,401 | 5,787 |
| **Total other liabilities** | **20,333** | 19,633 |

1 Where a collective investment vehicle is consolidated the interests of parties other than the Group are reported at fair value in other liabilities.

## Note 35: Other liabilities continued

The maturity of the Group's lease liabilities was as follows:

| | 2019 £m | 2018 £m |
|---|---|---|
| Not later than 1 year | **241** | 10 |
| Later than 1 year and not later than 2 years | **222** | 9 |
| Later than 2 years and not later than 3 years | **207** | 7 |
| Later than 3 years and not later than 4 years | **170** | 6 |
| Later than 4 years and not later than 5 years | **145** | 2 |
| Later than 5 years | **859** | 12 |
| | **1,844** | 46 |

The Group adopted IFRS 16 *Leases* from 1 January 2019, see note 1.

## Note 36: Retirement benefit obligations

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Charge to the income statement** | | | |
| Defined benefit pension schemes | **241** | 401 | 362 |
| Other post-retirement benefit schemes | **4** | 4 | 7 |
| Total defined benefit schemes | **245** | 405 | 369 |
| Defined contribution pension schemes | **287** | 300 | 256 |
| **Total charge to the income statement (note 11)** | **532** | 705 | 625 |

| | 2019 £m | 2018 £m |
|---|---|---|
| **Amounts recognised in the balance sheet** | | |
| Retirement benefit assets | **681** | 1,267 |
| Retirement benefit obligations | **(257)** | (245) |
| **Total amounts recognised in the balance sheet** | **424** | 1,022 |

The total amount recognised in the balance sheet relates to:

| | 2019 £m | 2018 £m |
|---|---|---|
| Defined benefit pension schemes | **550** | 1,146 |
| Other post-retirement benefit schemes | **(126)** | (124) |
| **Total amounts recognised in the balance sheet** | **424** | 1,022 |

## 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 main section of the Lloyds Bank Pension Schemes No. 1, the Lloyds Bank Pension Scheme No. 2 and the HBOS Final Salary Pension Scheme. At 31 December 2019, these schemes represented 94 per cent of the Group's total gross defined benefit pension assets (2018: 94 per cent). 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 2019 is generally 55 although certain categories of member are deemed to have a contractual right to retire at 50.

The Group operates both funded and unfunded pension arrangements; the majority, including the three most significant schemes, are funded schemes in the UK. All of these UK funded schemes are operated as separate legal entities under trust law, are in compliance with the Pensions Act 2004 and 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 funding valuation process. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the Scheme's regulations.

A valuation to determine the funding status of each scheme is carried out 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 between the employer and the scheme Trustee and sent to the Pensions Regulator for review. 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 most recent triennial funding valuation of the Group's three main schemes, based on the position as at 31 December 2016, showed an aggregate funding deficit of £7.3 billion (a funding level of 85.6 per cent) compared to a £5.2 billion deficit (a funding level of 85.9 per cent) for the previous valuation as at 30 June 2014. In the light of this funding deficit, and in contemplation of the changes that the Group had made as a result of its Structural Reform Programme, the Group agreed a recovery plan with the trustees. Under the plan, deficit contributions of £618 million were paid during 2019, and these will rise to £798 million in 2020, £1,287 million in 2021 and £1,305 million per annum from 2022 to 2024. Contributions in the later years will be subject to review and renegotiation at subsequent funding valuations. The next funding valuation is due to be completed by March 2021 with an effective date of 31 December 2019. The deficit contributions are in addition to the regular contributions to meet benefits accruing over the year, and to cover the expenses of running the scheme. The Group currently expects to pay contributions of approximately £1,200 million to its defined benefit schemes in 2020.

## Note 36: 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 in the form of interests in limited liability partnerships for each of the two schemes which hold assets to provide security for the Group's obligations to the two schemes. At 31 December 2019, the limited liability partnerships held assets of approximately £6.7 billion. The limited liability partnerships are consolidated fully in the Group's balance sheet.

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 2019 these held assets of approximately £4.8 billion in aggregate. 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 2019.

The last funding valuations of other Group schemes were carried out on a number of different dates. In order to report the position under IAS 19 as at 31 December 2019 the most recent valuation results for all schemes have been updated by qualified independent actuaries. The funding valuations use a more prudent approach to setting the discount rate and more conservative longevity assumptions than the IAS 19 valuations.

In July 2018 a decision was sought from the High Court in respect of the requirement to equalise the Guaranteed Minimum Pension (GMP) benefits accrued between 1990 and 1997 from contracting out of the State Earnings Related Pension Scheme. In its judgment handed down on 26 October 2018 the High Court confirmed the requirement to treat men and women equally with respect to these benefits and a range of methods that the Trustee is entitled to adopt to achieve equalisation. The Group recognised a past service cost of £108 million in respect of equalisation in 2018 and, following agreement of the detailed implementation approach with the Trustee, a further £33 million has been recognised in 2019.

### (ii) Amounts in the financial statements

| | 2019 £m | 2018 £m |
|---|---|---|
| **Amount included in the balance sheet** | | |
| Present value of funded obligations | **(45,241)** | (41,092) |
| Fair value of scheme assets | **45,791** | 42,238 |
| **Net amount recognised in the balance sheet** | **550** | 1,146 |

| | 2019 £m | 2018 £m |
|---|---|---|
| **Net amount recognised in the balance sheet** | | |
| At 1 January | **1,146** | 509 |
| Net defined benefit pension charge | **(241)** | (401) |
| Actuarial gains (losses) on defined benefit obligation | **(4,958)** | 1,707 |
| Return on plan assets | **3,531** | (1,558) |
| Employer contributions | **1,062** | 863 |
| Exchange and other adjustments | **10** | 26 |
| **At 31 December** | **550** | 1,146 |

| | 2019 £m | 2018 £m |
|---|---|---|
| **Movements in the defined benefit obligation** | | |
| At 1 January | **(41,092)** | (44,384) |
| Current service cost | **(201)** | (261) |
| Interest expense | **(1,172)** | (1,130) |
| Remeasurements: | | |
| Actuarial losses – experience | **(29)** | (439) |
| Actuarial (losses) gains – demographic assumptions | **471** | (201) |
| Actuarial gains (losses) – financial assumptions | **(5,400)** | 2,347 |
| Benefits paid | **2,174** | 3,079 |
| Past service cost | **(44)** | (108) |
| Curtailments | **–** | (12) |
| Settlements | **17** | 17 |
| Exchange and other adjustments | **35** | – |
| **At 31 December** | **(45,241)** | (41,092) |

| | 2019 £m | 2018 £m |
|---|---|---|
| **Analysis of the defined benefit obligation:** | | |
| Active members | **(6,413)** | (6,448) |
| Deferred members | **(16,058)** | (14,208) |
| Pensioners | **(21,032)** | (18,885) |
| Dependants | **(1,738)** | (1,551) |
| | **(45,241)** | (41,092) |

## Note 36: Retirement benefit obligations continued

| | 2019 £m | 2018 £m |
|---|---|---|
| **Changes in the fair value of scheme assets** | | |
| At 1 January | **42,238** | 44,893 |
| Return on plan assets excluding amounts included in interest income | **3,531** | (1,558) |
| Interest income | **1,220** | 1,152 |
| Employer contributions | **1,062** | 863 |
| Benefits paid | **(2,174)** | (3,079) |
| Settlements | **(18)** | (18) |
| Administrative costs paid | **(43)** | (41) |
| Exchange and other adjustments | **(25)** | 26 |
| **At 31 December** | **45,791** | 42,238 |

The expense recognised in the income statement for the year ended 31 December comprises:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Current service cost | **201** | 261 | 295 |
| Net interest amount | **(48)** | (22) | (1) |
| Past service credits and curtailments | **–** | 12 | 10 |
| Settlements | **1** | 1 | 3 |
| Past service cost – plan amendments | **44** | 108 | 14 |
| Plan administration costs incurred during the year | **43** | 41 | 41 |
| **Total defined benefit pension expense** | **241** | 401 | 362 |

### (iii) Composition of scheme assets

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Quoted £m | Unquoted £m | Total £m | Quoted £m | Unquoted £m | Total £m |
| Equity instruments | **555** | **39** | **594** | 637 | 222 | 859 |
| Debt instruments[1]: | | | | | | |
| Fixed interest government bonds | **8,893** | **–** | **8,893** | 7,449 | – | 7,449 |
| Index-linked government bonds | **18,207** | **–** | **18,207** | 16,477 | – | 16,477 |
| Corporate and other debt securities | **10,588** | **–** | **10,588** | 8,813 | – | 8,813 |
| Asset-backed securities | **–** | **–** | **–** | 138 | – | 138 |
| | **37,688** | **–** | **37,688** | 32,877 | – | 32,877 |
| Property | **–** | **158** | **158** | – | 556 | 556 |
| Pooled investment vehicles | **4,773** | **10,585** | **15,358** | 4,578 | 10,494 | 15,072 |
| Money market instruments, cash, derivatives and other assets and liabilities | **204** | **(8,211)** | **(8,007)** | (283) | (6,843) | (7,126) |
| **At 31 December** | **43,220** | **2,571** | **45,791** | 37,809 | 4,429 | 42,238 |

1 Of the total debt instruments, £33,134 million (31 December 2018: £29,033 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:

| | 2019 £m | 2018 £m |
|---|---|---|
| Equity funds | **2,429** | 2,329 |
| Hedge and mutual funds | **2,886** | 2,487 |
| Liquidity funds | **1,126** | 2,329 |
| Bond and debt funds | **971** | 313 |
| Other | **7,946** | 7,614 |
| **At 31 December** | **15,358** | 15,072 |

The Trustee's approach to investment is focused on acting in the members' best financial interests, with the integration of ESG (*Environmental, Social and Governance*) considerations into investment management processes and practices. This policy is reviewed annually (or more frequently as required) and has been shared with the schemes' investment managers for implementation.

## Note 36: Retirement benefit obligations continued

### (iv) Assumptions

The principal actuarial and financial assumptions used in valuations of the defined benefit pension schemes were as follows:

| | 2019 % | 2018 % |
|---|---|---|
| Discount rate | **2.05** | 2.90 |
| Rate of inflation: | | |
| Retail Prices Index | **2.94** | 3.20 |
| Consumer Price Index | **1.99** | 2.15 |
| Rate of salary increases | **0.00** | 0.00 |
| Weighted-average rate of increase for pensions in payment | **2.57** | 2.73 |

| | 2019 Years | 2018 Years |
|---|---|---|
| Life expectancy for member aged 60, on the valuation date: | | |
| Men | **27.5** | 27.8 |
| Women | **29.2** | 29.4 |
| Life expectancy for member aged 60, 15 years after the valuation date: | | |
| Men | **28.5** | 28.8 |
| Women | **30.3** | 30.6 |

The mortality assumptions used in the UK 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 2019 is assumed to live for, on average, 27.5 years for a male and 29.2 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years' time at age 60.

### (v) 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 materially 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 materially offset by an increase in the value of bond holdings and through the use of derivatives.

**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 asset 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.

#### 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 asset, 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.

## Note 36: Retirement benefit obligations continued

| | Effect of reasonably possible alternative assumptions | | | |
|---|---|---|---|---|
| | Increase (decrease) in the income statement charge | | (Increase) decrease in the net defined benefit pension scheme surplus | |
| | **2019 £m** | 2018 £m | **2019 £m** | 2018 £m |
| Inflation (including pension increases):[1] | | | | |
| Increase of 0.1 per cent | **12** | 14 | **467** | 410 |
| Decrease of 0.1 per cent | **(12)** | (14) | **(460)** | (395) |
| Discount rate:[2] | | | | |
| Increase of 0.1 per cent | **(20)** | (27) | **(763)** | (670) |
| Decrease of 0.1 per cent | **21** | 25 | **784** | 686 |
| Expected life expectancy of members: | | | | |
| Increase of one year | **40** | 43 | **1,636** | 1,299 |
| Decrease of one year | **(39)** | (42) | **(1,575)** | (1,257) |

1 At 31 December 2019, the assumed rate of RPI inflation is 2.94 per cent and CPI inflation 1.99 per cent (2018: RPI 3.20 per cent and CPI 2.15 per cent).

2 At 31 December 2019, the assumed discount rate is 2.05 per cent (2018: 2.90 per cent).

### Sensitivity analysis method and assumptions

The sensitivity analysis above reflects the impact on the liabilities of 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.

On 28 January 2020, the main schemes entered into a £10 billion longevity insurance arrangement to hedge around 20 per cent of the schemes' exposure to unexpected increases in life expectancy. This arrangement will form part of the schemes' investment portfolio and will provide income to the schemes in the event that pensions are paid out for longer than expected. The transaction is structured as a pass-through with Scottish Widows as the insurer, and onwards reinsurance to Pacific Life Re Limited.

At 31 December 2019 the asset-liability matching strategy mitigated around 106 per cent of the liability sensitivity to interest rate movements and around 103 per cent of the liability sensitivity to inflation movements. In addition a small amount of interest rate sensitivity arises through holdings of corporate and other debt securities.

### Maturity profile of defined benefit obligation

The following table provides information on the weighted average duration of the defined benefit pension obligations and the distribution and timing of benefit payments:

| | **2019 Years** | 2018 Years |
|---|---|---|
| Duration of the defined benefit obligation | **18** | 18 |
| | **2019 £m** | 2018 £m |
| Maturity analysis of benefits expected to be paid: | | |
| Within 12 months | **1,274** | 1,225 |
| Between 1 and 2 years | **1,373** | 1,299 |
| Between 2 and 5 years | **4,455** | 4,303 |
| Between 5 and 10 years | **8,426** | 8,305 |
| Between 10 and 15 years | **9,229** | 9,416 |
| Between 15 and 25 years | **17,400** | 18,417 |
| Between 25 and 35 years | **13,999** | 15,631 |
| Between 35 and 45 years | **8,291** | 9,924 |
| In more than 45 years | **3,160** | 4,270 |

## Note 36: Retirement benefit obligations continued

### Maturity analysis method and assumptions

The projected benefit payments are based on the assumptions underlying the assessment of the obligations, including allowance for expected future inflation. They are shown in their undiscounted form and therefore appear large relative to the discounted assessment of the defined benefit obligations recognised in the Group's balance sheet. They are in respect of benefits that have been accrued prior to the respective year-end date only and make no allowance for any benefits that may have been accrued subsequently.

### Defined contribution schemes

The Group operates a number of defined contribution pension schemes in the UK and overseas, principally Your Tomorrow and the defined contribution sections of the Lloyds Bank Pension Scheme No. 1.

During the year ended 31 December 2019 the charge to the income statement in respect of defined contribution schemes was £287 million (2018: £300 million; 2017: £256 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 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 2019 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 6.54 per cent (2018: 6.81 per cent).

Movements in the other post-retirement benefits obligation:

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | **(124)** | (144) |
| Actuarial (losses) gains | **(6)** | 18 |
| Insurance premiums paid | **7** | 5 |
| Charge for the year | **(4)** | (4) |
| Exchange and other adjustments | **1** | 1 |
| **At 31 December** | **(126)** | (124) |

## Note 37: Deferred tax

The Group's deferred tax assets and liabilities are as follows:

| Statutory position | 2019 £m | 2018 £m | Tax disclosure | 2019 £m | 2018 £m |
|---|---|---|---|---|---|
| Deferred tax assets | **2,666** | 2,453 | Deferred tax assets | **4,917** | 4,731 |
| Deferred tax liabilities | **(44)** | – | Deferred tax liabilities | **(2,295)** | (2,278) |
| **Asset at 31 December** | **2,622** | 2,453 | **Asset at 31 December** | **2,622** | 2,453 |

The statutory position reflects the deferred tax assets and liabilities as disclosed in the consolidated balance sheet and takes into account the ability of the Group to net assets and liabilities where there is a legally enforceable right of offset. The tax disclosure of deferred tax assets and liabilities ties to the amounts outlined in the tables below which splits the deferred tax assets and liabilities by type, before such netting.

As a result of legislation enacted in 2016, the UK corporation tax rate will reduce from 19 per cent to 17 per cent on 1 April 2020. The Group measures its deferred tax assets and liabilities at the value expected to be recoverable or payable in future periods, and re-measures them at each reporting date based on the most recent estimates of utilisation or settlement, including the impact of bank surcharge where appropriate. The deferred tax impact of this re-measurement to 17 per cent in 2019 is a charge of £6 million in the income statement and a credit of £5 million in other comprehensive income.

During the December 2019 election campaign, the UK government stated its intention to maintain the corporation tax rate at 19 per cent on 1 April 2020. Had this rate change been substantively enacted at 31 December 2019, the effect would have been to increase net deferred tax assets by £294 million.

On 29 October 2018, the UK government announced its intention to restrict the use of capital tax losses to 50 per cent of any future gains arising. Had this restriction been substantively enacted at 31 December 2019, the effect would have been to reduce net deferred tax assets by £50 million.

## Note 37: Deferred tax continued

Movements in deferred tax liabilities and assets (before taking into consideration the offsetting of balances within the same taxing jurisdiction) can be summarised as follows:

| Deferred tax assets | Tax losses £m | Property, plant and equipment £m | Pension liabilities £m | Provisions £m | Share-based payments £m | Derivatives £m | Other temporary differences £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| At 1 January 2018 | 4,034 | 743 | 90 | 380 | 51 | – | 16 | 5,314 |
| (Charge) credit to the income statement | (256) | (100) | 64 | (45) | (6) | – | (5) | (348) |
| (Charge) credit to other comprehensive income | – | – | (92) | (138) | – | – | – | (230) |
| Other (charge) credit to equity | – | – | – | – | (5) | – | – | (5) |
| At 31 December 2018 | 3,778 | 643 | 62 | 197 | 40 | – | 11 | 4,731 |
| (Charge) credit to the income statement | **(167)** | **(1)** | **(83)** | **(87)** | **4** | **149** | **174** | **(11)** |
| (Charge) credit to other comprehensive income | **–** | **–** | **74** | **116** | **–** | **–** | **–** | **190** |
| Other (charge) credit to equity | **–** | **–** | **–** | **–** | **7** | **–** | **–** | **7** |
| **At 31 December 2019** | **3,611** | **642** | **53** | **226** | **51** | **149** | **185** | **4,917** |

| Deferred tax liabilities | Long-term assurance business £m | Acquisition fair value £m | Pension assets £m | Derivatives £m | Asset revaluations[1] £m | Other temporary differences £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 1 January 2018 | (799) | (879) | (181) | (499) | (207) | (140) | (2,705) |
| (Charge) credit to the income statement | 162 | 142 | (67) | (19) | (33) | 7 | 192 |
| (Charge) credit to other comprehensive income | – | – | (25) | 113 | 141 | – | 229 |
| Exchange and other adjustments | – | – | – | – | – | 6 | 6 |
| At 31 December 2018 | (637) | (737) | (273) | (405) | (99) | (127) | (2,278) |
| (Charge) credit to the income statement | **(193)** | **221** | **59** | **(48)** | **(19)** | **(35)** | **(15)** |
| (Charge) credit to other comprehensive income | **–** | **–** | **64** | **(148)** | **83** | **–** | **(1)** |
| Exchange and other adjustments | **–** | **–** | **–** | **–** | **–** | **(1)** | **(1)** |
| **At 31 December 2019** | **(830)** | **(516)** | **(150)** | **(601)** | **(35)** | **(163)** | **(2,295)** |

1 Financial assets at fair value through other comprehensive income.

### Deferred tax not recognised

Deferred tax of £24 million (2018: £90 million) has been recognised in respect of the future tax benefit of some expenses of the life assurance business carried forward. The deferred tax asset not recognised in respect of the remaining expenses is approximately £254 million (2018: £371 million), and these expenses can be carried forward indefinitely. The unrecognised deferred tax asset has reduced in 2019, as a significant amount of brought forward expenses have been utilised in the last year.

Deferred tax assets of approximately £48 million (2018: £78 million) have not been recognised in respect of £280 million of UK tax losses and other temporary differences which can only be used to offset future capital gains. UK capital losses can be carried forward indefinitely.

In addition, no deferred tax asset is recognised in respect of unrelieved foreign tax credits of £46 million (2018: £46 million), as there are no expected future taxable profits against which the credits can be utilised. These credits can be carried forward indefinitely.

No deferred tax has been recognised in respect of foreign trade losses where it is not more likely than not that we will be able to utilise them in future periods. Of the asset not recognised, £35 million (2018: £36 million) relates to losses that will expire if not used within 20 years, and £45 million (2018: £53 million) relates to losses with no expiry date.

As a result of parent company exemptions on dividends from subsidiaries and on capital gains on disposal there are no significant taxable temporary differences associated with investments in subsidiaries, branches, associates and joint arrangements.

Notes to the consolidated financial statements continued

## Note 38: Other provisions

| | Provisions for financial commitments and guarantees £m | Payment protection insurance £m | Other regulatory provisions £m | Other £m | Total £m |
|---|---|---|---|---|---|
| At 31 December 2018 | 193 | 1,524 | 861 | 969 | 3,547 |
| Adjustment on adoption of IFRS 16 (note 55) | | | | (97) | (97) |
| **Balance at 1 January 2019** | | | | **872** | **3,450** |
| Exchange and other adjustments | (1) | 367 | – | (39) | 327 |
| Provisions applied | – | (2,461) | (778) | (593) | (3,832) |
| Charge for the year | (15) | 2,450 | 445 | 498 | 3,378 |
| **At 31 December 2019** | **177** | **1,880** | **528** | **738** | **3,323** |

## Provisions for financial commitments and guarantees

Provisions are recognised for expected credit losses on undrawn loan commitments and financial guarantees. See also note 20.

## Payment protection insurance (excluding MBNA)

The Group increased the provision for PPI costs by a further £2,450 million in the year ended 31 December 2019, bringing the total amount provided to £21,875 million.

The charge in 2019 was largely due to the significant increase in PPI information requests (PIRs) leading up to the deadline for submission of claims on 29 August 2019, and also reflects costs relating to complaints received from the Official Receiver as well as administration costs. An initial review of around 60 per cent of the five million PIRs received in the run-up to the PPI deadline has been undertaken, with the conversion rate remaining low, and consistent with the provision assumption of around 10 per cent. The Group has reached final agreement with the Official Receiver.

At 31 December 2019, a provision of £1,578 million remained unutilised relating to complaints and associated administration costs excluding amounts relating to MBNA. Total cash payments were £2,201 million during the year ended to 31 December 2019.

### Sensitivities

The total amount provided for PPI represents the Group's best estimate of the likely future cost. A number of risks and uncertainties remain including processing the remaining PIRs and outstanding complaints. The cost could differ from the Group's estimates and the assumptions underpinning them, and could result in a further provision being required. These may also be impacted by any further regulatory changes and potential additional remediation arising from the continuous improvement of the Group's operational practices.

For every one per cent increase in PIR conversion rate on the stock as at the industry deadline, the Group would expect an additional charge of approximately £100 million.

## Payment protection insurance (MBNA)

MBNA increased its PPI provision by £367 million in the year ended 31 December 2019 but the Group's exposure continues to remain capped at £240 million under the terms of the sale and purchase agreement.

## Note 38 Other provisions continued

## Other provisions for 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 in connection with its past conduct and claims brought by or on behalf of current and former employees, customers, investors and other third parties and is subject to legal proceedings and other legal actions. Where significant, provisions are held against the costs expected to be incurred in relation to these matters and matters arising from related internal reviews. During the year ended 31 December 2019 the Group charged a further £445 million in respect of legal actions and other regulatory matters, and the unutilised balance at 31 December 2019 was £528 million (31 December 2018: £861 million). The most significant items are as follows.

### Arrears handling related activities

The Group has provided an additional £188 million in the year ended 31 December 2019 for the costs of identifying and rectifying certain arrears management fees and activities, taking the total provided to date to £981 million. The Group has put in place a number of actions to improve its handling of customers in these areas and has made good progress in reimbursing arrears fees to impacted customers.

### Packaged bank accounts

The Group had provided a total of £795 million up to 31 December 2018 in respect of complaints relating to alleged mis-selling of packaged bank accounts, with no further amounts provided during the year ended 31 December 2019. A number of risks and uncertainties remain, particularly with respect to future volumes.

### Customer claims in relation to insurance branch business in Germany

The Group continues to receive claims in Germany from customers relating to policies issued by Clerical Medical Investment Group Limited (subsequently renamed Scottish Widows Limited), with smaller numbers received from customers in Austria and Italy. The industry-wide issue regarding notification of contractual 'cooling off' periods continued to lead to an increasing number of claims in 2016 and 2017. Whilst complaint volumes have declined, new litigation claim volumes per month have remained fairly constant throughout 2019. Up to 31 December 2019 the Group had provided a total of £656 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 be known only once all relevant claims have been resolved.

### HBOS Reading – review

The Group has now completed its compensation assessment for all 71 business customers within the customer review, with more than 98 per cent of these offers to individuals accepted. In total, more than £100 million in compensation has been offered to victims of the HBOS Reading fraud prior to the publication of Sir Ross Cranston's independent quality assurance review of the customer review, of which £94 million has so far been accepted, in addition to £9 million for ex-gratia payments and £6 million for the re-imbursements of legal fees. Sir Ross's review was concluded on 10 December 2019 and made a number of recommendations, including a re-assessment of direct and consequential losses by an independent panel. The Group has committed to implementing Sir Ross's recommendations in full. In addition, further ex gratia payments of £35,000 have been made to 200 individuals in recognition of the additional delay which will be caused whilst the Group takes steps to implement Sir Ross's recommendations. It is not possible to estimate at this stage what the financial impact will be.

### HBOS Reading – FCA investigation

The FCA's investigation into the events surrounding the discovery of misconduct within the Reading-based Impaired Assets team of HBOS has concluded. The Group has settled the matter with the FCA and paid a fine of £45.5 million, as per the FCA's final notice dated 21 June 2019.

### Other

Following the sale of TSB Banking Group plc, the Group raised a provision of £665 million in relation to various ongoing commitments; £117 million of this provision remained unutilised at 31 December 2019.

Provisions are made for staff and other costs related to Group restructuring initiatives at the point at which the Group becomes committed to the expenditure. At 31 December 2019 provisions of £129 million (31 December 2018: £191 million) were held.

The Group carries provisions of £118 million (2018: £122 million) for indemnities and other matters relating to legacy business disposals in prior years.

Notes to the consolidated financial statements continued

## Note 39: Subordinated liabilities

The movement in subordinated liabilities during the year was as follows:

| | Preference shares £m | Preferred securities £m | Undated subordinated liabilities £m | Dated subordinated liabilities £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2018 | 813 | 3,690 | 565 | 12,854 | 17,922 |
| Issued during the year | – | – | – | 1,729 | 1,729 |
| Repurchases and redemptions during the year[1] | – | (614) | – | (1,642) | (2,256) |
| Foreign exchange movements | 18 | 131 | 20 | 377 | 546 |
| Other movements (all non-cash) | (28) | (2) | 3 | (258) | (285) |
| At 31 December 2018 | 803 | 3,205 | 588 | 13,060 | 17,656 |
| Repurchases and redemptions during the year[1] | **(3)** | **(49)** | **(53)** | **(713)** | **(818)** |
| Foreign exchange movements | **(12)** | **(83)** | **(36)** | **(402)** | **(533)** |
| Other movements (all non-cash) | **114** | **152** | **18** | **541** | **825** |
| **At 31 December 2019** | **902** | **3,225** | **517** | **12,486** | **17,130** |

1 The repurchases and redemptions resulted in cash outflows of £818 million (2018: £2,256 million).

| | |
|---|---|
| Issued during 2018 | |
| *Dated subordinated liabilities* | £m |
| 1.75% Subordinated Fixed Rate Notes 2028 callable 2023 | 664 |
| 4.344% Subordinated Fixed Rate Notes callable 2048 | 1,065 |
| | 1,729 |
| **Repurchases and redemptions during 2019** | |
| *Preference shares* | **£m** |
| 6.3673% Non-cumulative Fixed to Floating Rate Preference Shares callable 2019 | **3** |
| *Preferred securities* | **£m** |
| 13% Step-up Perpetual Capital Securities callable 2019 | **49** |
| *Undated subordinated liabilities* | **£m** |
| 6.5% Undated Subordinated Step-up Notes callable 2019 | **1** |
| 7.375% Undated Subordinated Guaranteed Bonds | **52** |
| | **53** |
| *Dated subordinated liabilities* | **£m** |
| 10.375% Subordinated Fixed to Fixed Rate Notes 2024 callable 2019 | **135** |
| 9.375% Subordinated Bonds 2021 | **328** |
| 6.375% Subordinated Instruments 2019 | **250** |
| | **713** |
| Repurchases and redemptions during 2018 | |
| *Preferred securities* | **£m** |
| 6.461% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities | 600 |
| Undated Perpetual Preferred Securities | 14 |
| | 614 |
| *Dated subordinated liabilities* | **£m** |
| 10.5% Subordinated Bonds callable 2018 | 150 |
| 6.75% Subordinated Fixed Rate Notes callable 2018 | 1,492 |
| | 1,642 |

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 Group has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during 2019 (2018: none).

# Note 40: 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

| | 2019 Number of shares | 2018 Number of shares | 2017 Number of shares | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|---|---|---|
| **Ordinary shares of 10p (formerly 25p) each** | | | | | | |
| At 1 January | **71,163,592,264** | 71,972,949,589 | 71,373,735,357 | **7,116** | 7,197 | 7,138 |
| Issued under employee share schemes | **775,882,951** | 768,551,098 | 518,293,181 | **78** | 77 | 51 |
| Share buyback programme (note 42) | **(1,886,917,377)** | (1,577,908,423) | – | **(189)** | (158) | – |
| Redesignation of limited voting ordinary shares (see below) | **–** | – | 80,921,051 | **–** | – | 8 |
| **At 31 December** | **70,052,557,838** | **71,163,592,264** | **71,972,949,589** | **7,005** | **7,116** | **7,197** |
| **Limited voting ordinary shares of 10p (formerly 25p) each** | | | | | | |
| At 1 January | **–** | – | 80,921,051 | **–** | – | 8 |
| Redesignation to ordinary shares | **–** | – | (80,921,051) | **–** | – | (8) |
| **At 31 December** | **–** | – | – | **–** | – | – |
| **Total issued share capital** | | | | **7,005** | **7,116** | **7,197** |

### Share issuances

In 2019, 776 million shares (2018: 769 million shares; 2017: 518 million shares) were issued in respect of employee share schemes.

## (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);

– 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 95.

The directors have authority to allot and issue ordinary and preference shares and to make market purchases of ordinary and preference shares as granted at the annual general meeting on 16 May 2019. 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, who held 100 per cent of the total ordinary share capital at 31 December 2019, 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 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

At the annual general meeting on 11 May 2017, the Company's shareholders approved the redesignation of the 80,921,051 limited voting ordinary shares held by the Lloyds Bank Foundations as ordinary shares of 10 pence each. The redesignation took effect on 1 July 2017 and the redesignated shares now rank equally with the existing issued ordinary shares of the Company.

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 in effect as at 31 December 2019 provide that such annual donations will cease in certain circumstances, including the Company providing nine years' notice. Such notice has been given to the Lloyds TSB Foundation for Scotland.

### Preference shares

The Company has in issue various classes of preference shares which are all classified as liabilities under accounting standards and which are included in note 39.

## Note 41: Share premium account

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| At 1 January | **17,719** | 17,634 | 17,622 |
| Issued under employee share schemes | **29** | 85 | 12 |
| Redemption of preference shares[1] | **3** | – | – |
| **At 31 December** | **17,751** | 17,719 | 17,634 |

1 During the year ended 31 December 2019, the Company redeemed all of its outstanding 6.3673% Non-cumulative Fixed to Floating Rate Preference Shares at their combined sterling par value of £3 million. These preference shares had been accounted for as subordinated liabilities. On redemption an amount of £3 million was transferred from the distributable merger reserve to the share premium account.

## Note 42: Other reserves

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Other reserves comprise: | | | |
| Merger reserve | **7,763** | 7,766 | 7,766 |
| Capital redemption reserve | **4,462** | 4,273 | 4,115 |
| Revaluation reserve in respect of debt securities held at fair value through other comprehensive income | **123** | 279 | |
| Revaluation reserve in respect of equity shares held at fair value through other comprehensive income | **19** | 5 | |
| Revaluation reserve in respect of available-for-sale financial assets | | | 685 |
| Cash flow hedging reserve | **1,504** | 1,051 | 1,405 |
| Foreign currency translation reserve | **(176)** | (164) | (156) |
| **At 31 December** | **13,695** | 13,210 | 13,815 |

The merger reserve primarily comprises the premium on shares issued in January 2009 as part of the recapitalisation of the Group and the acquisition of HBOS plc.

The capital redemption reserve represents transfers from distributable reserve in accordance with companies' legislation upon the redemption of ordinary and preference share capital.

The revaluation reserves in respect of debt securities and equity shares held at fair value through other comprehensive income represent the cumulative after tax unrealised change in the fair value of financial assets so classified since initial recognition; or in the case of financial assets obtained on acquisitions of businesses, since the date of acquisition.

The cash flow hedging reserve represents the cumulative after tax gains and losses on effective cash flow hedging instruments that will be reclassified to the income statement in the periods in which the hedged item affects profit or loss.

The foreign currency translation reserve represents the cumulative after-tax gains and losses on the translation of foreign operations and exchange differences arising on financial instruments designated as hedges of the Group's net investment in foreign operations.

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Merger reserve** | | | |
| At 1 January | **7,766** | 7,766 | 7,766 |
| Redemption of preference shares (note 41) | **(3)** | – | – |
| **At 31 December** | **7,763** | 7,766 | 7,766 |

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Capital redemption reserve** | | | |
| At 1 January | **4,273** | 4,115 | 4,115 |
| Shares cancelled under share buyback programmes (see below) | **189** | 158 | – |
| **At 31 December** | **4,462** | 4,273 | 4,115 |

On 20 February 2019 the Group announced the launch of a share buyback programme to repurchase outstanding ordinary shares and the programme commenced on 1 March 2019; the Group bought back and cancelled 1,887 million shares under the programme, for a total consideration, including expenses, of £1,095 million. Upon cancellation £189 million, being the nominal value of the shares repurchased, was transferred to the capital redemption reserve.

Under a similar programme in 2018, the Group bought back and cancelled 1,578 million shares for a total consideration, including expenses, of £1,005 million; £158 million was transferred to the capital redemption reserve.

## Note 42: Other reserves continued

| | 2019 £m | 2018 £m |
|---|---|---|
| **Revaluation reserve in respect of debt securities held at fair value through other comprehensive income** | | |
| At 1 January | **279** | 472 |
| Change in fair value | **(30)** | (37) |
| Deferred tax | **10** | 35 |
| | **(20)** | (2) |
| Income statement transfer in respect of disposals (note 9) | **(196)** | (275) |
| Deferred tax | **61** | 84 |
| | **(135)** | (191) |
| Impairment recognised in the income statement | **(1)** | – |
| **At 31 December** | **123** | 279 |

| | 2019 £m | 2018 £m |
|---|---|---|
| **Revaluation reserve in respect of equity shares held at fair value through other comprehensive income** | | |
| At 1 January | **5** | (49) |
| Change in fair value | **–** | (97) |
| Deferred tax | **12** | 22 |
| | **12** | (75) |
| Realised gains and losses transferred to retained profits | **14** | 151 |
| Deferred tax | **(12)** | (22) |
| | **2** | 129 |
| **At 31 December** | **19** | 5 |

Notes to the consolidated financial statements continued

## Note 42: Other reserves continued

Movements in other reserves were as follows:

| | 2017 £m |
|---|---|
| **Revaluation reserve in respect of available-for-sale financial assets** | |
| At 1 January | 759 |
| Change in fair value of available-for-sale financial assets | 303 |
| Deferred tax | (26) |
| Current tax | (4) |
| | 273 |
| Income statement transfers: | |
| Disposals (note 9) | (446) |
| Deferred tax | 93 |
| Current tax | – |
| | (353) |
| Impairment | 6 |
| Deferred tax | – |
| | 6 |
| **At 31 December** | 685 |

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Cash flow hedging reserve** | | | |
| At 1 January | **1,051** | 1,405 | 2,136 |
| Change in fair value of hedging derivatives | **1,209** | 234 | (363) |
| Deferred tax | **(303)** | (69) | 121 |
| | **906** | 165 | (242) |
| Income statement transfers | **(608)** | (701) | (651) |
| Deferred tax | **155** | 182 | 162 |
| | **(453)** | (519) | (489) |
| **At 31 December** | **1,504** | 1,051 | 1,405 |

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Foreign currency translation reserve** | | | |
| At 1 January | **(164)** | (156) | (124) |
| Currency translation differences arising in the year | **(12)** | (8) | (21) |
| Foreign currency gains on net investment hedges (tax: £nil) | **–** | – | (11) |
| **At 31 December** | **(176)** | (164) | (156) |

## Note 43: Retained profits

| | 2019 £m | 2018[1] £m | 2017[1] £m |
|---|---|---|---|
| At 31 December 2017 | | 4,905 | |
| Adjustment on adoption of IFRS 9 and IFRS 15 | | (929) | |
| At 1 January | **5,389** | 3,976 | 3,600 |
| Profit for the year | **2,925** | 4,408 | 3,559 |
| Dividends paid[2] | **(2,312)** | (2,240) | (2,284) |
| Issue costs of other equity instruments (net of tax) (note 44) | **(3)** | (5) | – |
| Distributions on other equity instruments | **(466)** | (433) | (415) |
| Share buyback programmes (note 42) | **(1,095)** | (1,005) | – |
| Realised gains and losses on equity shares held at fair value through other comprehensive income | **(2)** | (129) | |
| Post-retirement defined benefit scheme remeasurements | **(1,117)** | 120 | 482 |
| Share of other comprehensive income of associates and joint ventures | **–** | 8 | – |
| Gains and losses attributable to own credit risk (net of tax)[3] | **(306)** | 389 | (40) |
| Movement in treasury shares | **(3)** | 40 | (411) |
| Value of employee services: | | | |
| Share option schemes | **71** | 53 | 82 |
| Other employee award schemes | **165** | 207 | 332 |
| **At 31 December** | **3,246** | 5,389 | 4,905 |

1 Restated, see note 1.

2 Net of a credit in respect of unclaimed dividends written-back in accordance with the Company's Articles of Association in 2017.

3 During 2017 the Group derecognised, on redemption, financial liabilities on which cumulative fair value movements relating to own credit of £3 million net of tax, had been recognised directly in retained profits.

Retained profits are stated after deducting £575 million (2018: £499 million; 2017: £611 million) representing 902 million (2018: 909 million; 2017: 861 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 168.

## Note 44: Other equity instruments

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| At 1 January | **6,491** | 5,355 | 5,355 |
| Issued in the year: | | | |
| US dollar notes ($1,500 million nominal) | **–** | 1,136 | – |
| US dollar notes ($500 million nominal) | **396** | – | – |
| Sterling notes (£500 million nominal) | **500** | – | – |
| Redemption | **(1,481)** | – | – |
| At 31 December | **5,906** | 6,491 | 5,355 |

During the year ended 31 December 2019 the Group issued £500 million of sterling and £396 million (US$500 million) of US dollar Additional Tier 1 (AT1) securities; issue costs of £3 million, net of tax, were charged to retained profits.

On 27 June 2019 the Group redeemed, at par, £1,481 million of Additional Tier 1 securities at their first call date.

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 a conversion event being triggered.
- 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 period, or on any fifth anniversary after the first call date or period. 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 45: 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 2.25 pence per share (2018: 2.14 pence per share; 2017: 2.05 pence per share) representing a total dividend of £1,586 million (2018: £1,523 million; 2017: £1,475 million), which will be paid on 27 May 2020. The financial statements do not reflect recommended dividends.

Dividends paid during the year were as follows:

| | 2019 pence per share | 2018 pence per share | 2017 pence per share | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|---|---|---|
| Recommended by directors at previous year end: | | | | | | |
| Final dividend | **2.14** | 2.05 | 1.70 | **1,523** | 1,475 | 1,212 |
| Special dividend | **–** | – | 0.50 | **–** | – | 356 |
| Interim dividend paid in the year | **1.12** | 1.07 | 1.00 | **789** | 765 | 720 |
| | **3.26** | 3.12 | 3.20 | **2,312** | 2,240 | 2,288 |

The cash cost of the dividends paid in the year was £2,312 million (2018: £2,240 million; 2017: £2,284 million), in 2017 this was net of a credit in respect of unclaimed dividends written-back in accordance with the Company's Articles of Association.

In May 2019 the Group announced that it will move to the payment of quarterly dividends in 2020, with the first quarterly dividend in respect of the first quarter of 2020 payable in June 2020. The new approach will be to adopt three equal interim ordinary dividend payments for the first three quarters of the year followed by, subject to performance, a larger final dividend for the fourth quarter of the year. The first three quarterly payments, payable in June, September and December will be 20 per cent of the previous year's total ordinary dividend per share. The fourth quarter payment will be announced with the full year results. The final dividend will continue to be paid in May, following approval at the AGM. The Group believes that this approach will provide a more regular flow of dividend income to all shareholders whilst accelerating the receipt of payments.

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 2019: 6,508,529 shares, 31 December 2018: 5,538,164 shares, waived rights to all dividends), the HBOS Share Incentive Plan Trust (holding at 31 December 2019: 445,625 shares, 31 December 2018: 445,625 shares, waived rights to all dividends), the Lloyds Banking Group Employee Share Ownership Trust (holding at 31 December 2019: 11,656,155 shares, 31 December 2018: 5,679,119 shares, on which it waived rights to all dividends) and Lloyds Group Holdings (Jersey) Limited (holding at 31 December 2019: nil, 31 December 2018: 42,846 shares, waived rights to all but a nominal amount of one penny in total).

## Note 46: Share-based payments

### Charge to the income statement

The charge to the income statement is set out below:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Deferred bonus plan | **261** | 325 | 313 |
| Executive and SAYE plans: | | | |
| Options granted in the year | **16** | 14 | 17 |
| Options granted in prior years | **59** | 71 | 81 |
| | **75** | 85 | 98 |
| Share plans: | | | |
| Shares granted in the year | **17** | 16 | 17 |
| Shares granted in prior years | **20** | 17 | 9 |
| | **37** | 33 | 26 |
| **Total charge to the income statement** | **373** | 443 | 437 |

During the year ended 31 December 2019 the Group operated the following share-based payment schemes, all of which are equity settled.

### Group Performance Share plan

The Group operates a Group Performance Share plan that is equity settled. Bonuses in respect of employee performance in 2019 have been recognised in the charge in line with the proportion of the deferral period completed.

## Note 46: Share-based payments continued

## Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) schemes to save up to £500 per month and, at the expiry of a fixed term of three 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:

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | Number of options | Weighted average exercise price (pence) | Number of options | Weighted average exercise price (pence) |
| Outstanding at 1 January | 802,994,918 | 49.30 | 860,867,088 | 51.34 |
| Granted | 487,654,212 | 39.87 | 188,866,162 | 47.92 |
| Exercised | (27,303,963) | 51.23 | (135,721,404) | 59.00 |
| Forfeited | (15,830,204) | 48.69 | (22,909,999) | 49.85 |
| Cancelled | (130,068,149) | 49.03 | (78,073,042) | 50.66 |
| Expired | (49,352,741) | 58.74 | (10,033,887) | 55.20 |
| **Outstanding at 31 December** | 1,068,094,073 | 44.55 | 802,994,918 | 49.30 |
| **Exercisable at 31 December** | 227,139 | 60.70 | 68,378 | 60.02 |

The weighted average share price at the time that the options were exercised during 2019 was £0.59 (2018: £0.67). The weighted average remaining contractual life of options outstanding at the end of the year was 2.22 years (2018: 2.16 years).

The weighted average fair value of SAYE options granted during 2019 was £0.10 (2018: £0.13). The fair values of the SAYE options have been determined using a standard Black-Scholes model.

## 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 (to compensate new recruits for any lost share awards), and also to make grants to key individuals for retention purposes. In some instances, grants may be made subject to individual performance conditions.

Participants are not entitled to any dividends paid during the vesting period.

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | Number of options | Weighted average exercise price (pence) | Number of options | Weighted average exercise price (pence) |
| Outstanding at 1 January | 10,263,028 | Nil | 14,523,989 | Nil |
| Granted | 2,336,171 | Nil | 3,914,599 | Nil |
| Exercised | (4,455,481) | Nil | (6,854,043) | Nil |
| Vested | (69,005) | Nil | (148,109) | Nil |
| Forfeited | (39,250) | Nil | (662,985) | Nil |
| Lapsed | (400,825) | Nil | (510,423) | Nil |
| **Outstanding at 31 December** | 7,634,638 | Nil | 10,263,028 | Nil |
| **Exercisable at 31 December** | 2,683,267 | Nil | 3,305,442 | Nil |

The weighted average fair value of options granted in the year was £0.59 (2018: £0.55). 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 2019 was £0.60 (2018: £0.65). The weighted average remaining contractual life of options outstanding at the end of the year was 3.8 years (2018: 5.2 years).

## Note 46: Share-based payments continued

## Other share plans

### Lloyds Banking Group Executive Share Ownership Plan

The plan, 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.

At the end of the performance period for the 2016 grant, the targets had not been fully met and therefore these awards vested in 2019 at a rate of 68.7 per cent.

| | 2019 Number of shares | 2018 Number of shares |
|---|---|---|
| Outstanding at 1 January | **417,385,636** | 370,804,915 |
| Granted | **174,490,843** | 160,586,201 |
| Vested | **(88,318,950)** | (73,270,301) |
| Forfeited | **(55,029,439)** | (48,108,870) |
| Dividend award | **11,376,655** | 7,373,691 |
| **Outstanding at 31 December** | **459,904,745** | 417,385,636 |

Awards in respect of the 2017 grant vested in 2020 at a rate of 49.7 per cent. For the 2017 grant, participants are entitled to any dividends paid during the vesting period. 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, will be paid, based on the number of shares that vest. The Remuneration Committee can 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.

The weighted average fair value of awards granted in the year was £0.45 (2018: £0.48).

### CFO Buyout

William Chalmers joined the Group on 3 June 2019 and was appointed as Chief Financial Officer on 1 August 2019 on the retirement of George Culmer. He was granted deferred share awards over 4,086,632 shares, to replace unvested awards from his former employer, Morgan Stanley, that were forfeited as a result of him joining the Group.

| | 2019 Number of shares |
|---|---|
| Outstanding at 1 January | **–** |
| Granted | **4,086,632** |
| Exercised | **(818,172)** |
| **Outstanding at 31 December** | **3,268,460** |

The weighted average fair value of awards granted in the year was £0.55.

The fair value calculations at 31 December 2019 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 | CFO Buyout |
|---|---|---|---|---|
| Weighted average risk-free interest rate | **0.36%** | **0.62%** | **0.83%** | **0.64%** |
| Weighted average expected life | **3.2 years** | **1.3 years** | **3.7 years** | **1.4 years** |
| Weighted average expected volatility | **20%** | **23%** | **27%** | **19%** |
| Weighted average expected dividend yield | **4.0%** | **4.0%** | **4.0%** | **4.0%** |
| Weighted average share price | **£0.53** | **£0.62** | **£0.63** | **£0.58** |
| Weighted average exercise price | **£0.40** | **Nil** | **Nil** | **Nil** |

Expected volatility is a measure of the amount by which the Group's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option. The historical volatility is compared to the implied volatility generated from market traded options in the Group's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

## Share Incentive Plan

### Free Shares

An award of shares may be made annually to employees up to a maximum of £3,600. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition. If an employee leaves the Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited.

On 9 May 2019, the Group made an award of £200 (2018: £200) of shares to all eligible employees. The number of shares awarded was 22,422,337 (2018: 21,513,300), with an average fair value of £0.62 (2018: £0.67) based on the market price at the date of award.

### Matching shares

The Group undertakes to match shares purchased by employees up to the value of £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, all of the matching shares are forfeited. Similarly if the employees sell their purchased shares within three years, their matching shares are forfeited.

## Note 46: Share-based payments continued

The number of shares awarded relating to matching shares in 2019 was 37,346,812 (2018: 34,174,161), with an average fair value of £0.56 (2018: £0.63), 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 2019 was 8,239,332 (2018: 8,965,562).

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.

## Note 47: 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:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Compensation** | | | |
| Salaries and other short-term benefits | **15** | 14 | 13 |
| Post-employment benefits | **–** | – | – |
| Share-based payments | **15** | 18 | 22 |
| **Total compensation** | **30** | 32 | 35 |

Aggregate contributions in respect of key management personnel to defined contribution pension schemes were £nil (2018: £nil; 2017: £0.05 million).

| | 2019 million | 2018 million | 2017 million |
|---|---|---|---|
| **Share option plans** | | | |
| At 1 January | **–** | 1 | 3 |
| Granted, including certain adjustments (includes entitlements of appointed key management personnel) | **–** | – | – |
| Exercised/lapsed (includes entitlements of former key management personnel) | **–** | (1) | (2) |
| **At 31 December** | **–** | – | 1 |

| | 2019 million | 2018 million | 2017 million |
|---|---|---|---|
| **Share plans** | | | |
| At 1 January | **84** | 82 | 65 |
| Granted, including certain adjustments (includes entitlements of appointed key management personnel) | **46** | 39 | 37 |
| Exercised/lapsed (includes entitlements of former key management personnel) | **(29)** | (37) | (20) |
| **At 31 December** | **101** | 84 | 82 |

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:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Loans** | | | |
| At 1 January | **2** | 2 | 4 |
| Advanced (includes loans of appointed key management personnel) | **1** | 1 | 1 |
| Repayments (includes loans of former key management personnel) | **(1)** | (1) | (3) |
| **At 31 December** | **2** | 2 | 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 6.45 per cent and 24.20 per cent in 2019 (2018: 6.70 per cent and 24.20 per cent; 2017: 6.45 per cent and 23.95 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2018 and 2017: £nil).

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| **Deposits** | | | |
| At 1 January | **20** | 20 | 12 |
| Placed (includes deposits of appointed key management personnel) | **44** | 33 | 41 |
| Withdrawn (includes deposits of former key management personnel) | **(41)** | (33) | (33) |
| **At 31 December** | **23** | 20 | 20 |

## Note 47: Related party transactions continued

Deposits placed by key management personnel attracted interest rates of up to 3.0 per cent (2018: 3.5 per cent; 2017: 4.0 per cent).

At 31 December 2019, the Group did not provide any guarantees in respect of key management personnel (2018 and 2017: none).

At 31 December 2019, 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 £0.6 million with four directors and two connected persons (2018: £0.5 million with three directors and three connected persons; 2017: £0.01 million with three directors and two connected persons).

### Subsidiaries

Details of the Group's subsidiaries and related undertakings are provided on pages 332 to 337. In accordance with IFRS 10 Consolidated financial statements, transactions and balances with subsidiaries have been eliminated on consolidation.

### Pension funds

The Group provides banking and some investment management services to certain of its pension funds. At 31 December 2019, customer deposits of £169 million (2018: £225 million) and investment and insurance contract liabilities of £127 million (2018: £79 million) related to the Group's pension funds.

### Collective investment vehicles

The Group manages 141 (2018: 131) collective investment vehicles, such as Open Ended Investment Companies (OEICs) and of these 75 (2018: 82) are consolidated. The Group invested £804 million (2018: £620 million) and redeemed £1,771 million (2018: £404 million) in the unconsolidated collective investment vehicles during the year and had investments, at fair value, of £3,417 million (2018: £2,513 million) at 31 December. The Group earned fees of £127 million from the unconsolidated collective investment vehicles during 2019 (2018: £128 million).

### Joint ventures and associates

At 31 December 2019 there were loans and advances to customers of £75 million (2018: £57 million) outstanding and balances within customer deposits of £5 million (2018: £2 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 2019, these companies had total assets of approximately £4,761 million (2018: £4,091 million), total liabilities of approximately £5,322 million (2018: £4,616 million) and for the year ended 31 December 2019 had turnover of approximately £4,286 million (2018: £4,522 million) and made a loss of approximately £190 million (2018: net loss of £125 million). In addition, the Group has provided £1,266 million (2018: £1,141 million) of financing to these companies on which it received £86 million (2018: £49 million) of interest income in the year.

As discussed in note 23, in October 2019, the Group established a wealth management joint venture with Schroders. The Group subsequently transferred approximately £12 billion of managed assets at fair value.

## Note 48: Contingent liabilities, commitments and guarantees

### Interchange fees

With respect to multi-lateral interchange fees (MIFs), the Group is not involved in the ongoing litigation (as described below) which involves card schemes such as Visa and Mastercard. However, the Group is a member/licensee of Visa and Mastercard and other card schemes. The litigation in question is as follows:

- litigation brought by retailers against both Visa and Mastercard continues in the English Courts (and includes appeals heard by the Supreme Court, judgment awaited); and
- litigation brought on behalf of UK consumers in the English Courts against Mastercard.

Any impact on the Group of the litigation against Visa and Mastercard remains uncertain at this time. Insofar as Visa is required to pay damages to retailers for interchange fees set prior to June 2016, contractual arrangements to allocate liability have been agreed between various UK banks (including the Group) and Visa Inc, as part of Visa Inc's acquisition of Visa Europe in 2016. These arrangements cap the maximum amount of liability to which the Group may be subject, and this cap is set at the cash consideration received by the Group for the sale of its stake in Visa Europe to Visa Inc in 2016.

### 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 Swiss Competition Commission concluded its investigation against Lloyds Bank plc in June 2019. The Group continues to cooperate with various other government and regulatory authorities, including 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 and the Australian BBSW Reference Rate. Certain of the plaintiffs' claims have been dismissed by the US Federal Court for Southern District of New York (subject to appeals).

Certain Group companies are also named as defendants in (i) UK based claims; and (ii) two Dutch class actions, raising LIBOR manipulation allegations. A number of the claims against the Group in relation to the alleged mis-sale of interest rate hedging products also include allegations of LIBOR manipulation.

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.

### UK shareholder litigation

In August 2014, the Group and a number of former directors were named as defendants in a claim by a number of claimants who held shares in Lloyds TSB Group plc (LTSB) prior to the acquisition of HBOS plc, alleging breaches of duties in relation to information provided to shareholders in connection with the acquisition and the recapitalisation of LTSB. Judgment was delivered on 15 November 2019. The Group and former directors successfully defended the claims. The claimants have sought permission to appeal. It is currently not possible to determine the ultimate impact on the Group (if any).

### Tax authorities

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 which allow the offset of such losses denies the claim for group relief of losses. If HMRC's position is found to be correct, management estimate that this would result in an increase in current tax liabilities of

## Note 48: Contingent liabilities, commitments and guarantees continued

approximately £800 million (including interest) and a reduction in the Group's deferred tax asset of approximately £250 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 (including the tax treatment of certain costs arising from the divestment of TSB Banking Group plc), none of which is expected to have a material impact on the financial position of the Group.

### Mortgage arrears handling activities – FCA investigation

On 26 May 2016, the Group was informed that an enforcement team at the FCA had commenced an investigation in connection with the Group's mortgage arrears handling activities. It is not currently possible to make a reliable assessment of any liability resulting from the investigation including any financial penalty.

### 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. In these circumstances, specific disclosure in relation to a contingent liability will be made where material. 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.

### Contingent liabilities, commitments and guarantees arising from the banking business

| | 2019 £m | 2018 £m |
|---|---|---|
| **Contingent liabilities** | | |
| Acceptances and endorsements | **74** | 194 |
| Other: | | |
| Other items serving as direct credit substitutes | **366** | 632 |
| Performance bonds and other transaction-related contingencies | **2,454** | 2,425 |
| | **2,820** | 3,057 |
| **Total contingent liabilities** | **2,894** | 3,251 |

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.

| | 2019 £m | 2018 £m |
|---|---|---|
| **Commitments and guarantees** | | |
| Documentary credits and other short-term trade-related transactions | **–** | 1 |
| Forward asset purchases and forward deposits placed | **189** | 731 |
| Undrawn formal standby facilities, credit lines and other commitments to lend: | | |
| Less than 1 year original maturity: | | |
| Mortgage offers made | **12,684** | 11,594 |
| Other commitments and guarantees | **85,735** | 85,060 |
| | **98,419** | 96,654 |
| 1 year or over original maturity | **34,945** | 37,712 |
| **Total commitments and guarantees** | **133,553** | 135,098 |

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £63,504 million (2018: £64,884 million) was irrevocable.

### Capital commitments

Excluding commitments in respect of investment property (note 27), capital expenditure contracted but not provided for at 31 December 2019 amounted to £405 million (2018: £378 million). Of this amount, £400 million (2018: £369 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 49: 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 31 for securitisations and covered bond vehicles, note 36 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 31, which are used for securitisation and covered bond programmes, the Group sponsors an active asset-backed conduit, Cancara, which invests in client receivables and debt securities. The total consolidated exposure of Cancara at 31 December 2019 was £3,735 million (2018: £5,122 million), comprising £3,670 million of loans and advances (2018: £5,012 million) and £65 million of debt securities (2018: £110 million).

All lending assets and debt securities 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. During 2019 there have continued to be planned drawdowns on certain liquidity facilities for balance sheet management purposes, supporting the programme to provide funding alongside the proceeds of the asset-backed commercial paper issuance. The Group could be asked to provide support under the contractual terms of these arrangements including, for example, if Cancara experienced a shortfall in external funding, which may occur in the event of market disruption.

The external assets in Cancara are consolidated in the Group's financial statements.

### (B) Consolidated collective investment vehicles and limited partnerships

The assets 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 2019, the total carrying value of these consolidated collective investment vehicle assets and liabilities held by the Group was £68,724 million (2018: £62,648 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 £38,177 million at 31 December 2019 (2018: £26,028 million), included within financial assets designated at fair value through profit and loss (see note 16). These investments include both those entities managed by third parties and those managed by the Group. At 31 December 2019, the total asset value of these unconsolidated structured entities, including the portion in which the Group has no interest, was £2,363 billion (2018: £2,435 billion).

Given the nature of these investments, 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 2019, are reported in note 6.

# 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.

| | | Mandatorily held at fair value through profit or loss | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Derivatives designated as hedging instruments £m | Held for trading £m | Other £m | Designated at fair value through profit or loss £m | At fair value through other comprehensive income £m | Held at amortised cost £m | Insurance contracts £m | Total £m |
| **At 31 December 2019** | | | | | | | | |
| **Financial assets** | | | | | | | | |
| Cash and balances at central banks | – | – | – | – | – | 55,130 | – | 55,130 |
| Items in the course of collection from banks | – | – | – | – | – | 313 | – | 313 |
| Financial assets at fair value through profit or loss | – | 17,982 | 142,207 | – | – | – | – | 160,189 |
| Derivative financial instruments | 1,236 | 25,133 | – | – | – | – | – | 26,369 |
| Loans and advances to banks | – | – | – | – | – | 9,775 | – | 9,775 |
| Loans and advances to customers | – | – | – | – | – | 494,988 | – | 494,988 |
| Debt securities | – | – | – | – | – | 5,544 | – | 5,544 |
| Financial assets at amortised cost | – | – | – | – | – | 510,307 | – | 510,307 |
| Financial assets at fair value through other comprehensive income | – | – | – | – | 25,092 | – | – | 25,092 |
| Assets arising from reinsurance contracts held | – | – | – | – | – | – | 23,567 | 23,567 |
| **Total financial assets** | **1,236** | **43,115** | **142,207** | **–** | **25,092** | **565,750** | **23,567** | **800,967** |
| **Financial liabilities** | | | | | | | | |
| Deposits from banks | – | – | – | – | – | 28,179 | – | 28,179 |
| Customer deposits | – | – | – | – | – | 421,320 | – | 421,320 |
| Items in course of transmission to banks | – | – | – | – | – | 373 | – | 373 |
| Financial liabilities at fair value through profit or loss | – | 13,955 | – | 7,531 | – | – | – | 21,486 |
| Derivative financial instruments | 1,105 | 24,674 | – | – | – | – | – | 25,779 |
| Notes in circulation | – | – | – | – | – | 1,079 | – | 1,079 |
| Debt securities in issue | – | – | – | – | – | 97,689 | – | 97,689 |
| Liabilities arising from insurance contracts and participating investment contracts | – | – | – | – | – | – | 111,449 | 111,449 |
| Liabilities arising from non-participating investment contracts | – | – | – | – | – | – | 37,459 | 37,459 |
| Other | – | – | – | – | – | 1,844 | 400 | 2,244 |
| Subordinated liabilities | – | – | – | – | – | 17,130 | – | 17,130 |
| **Total financial liabilities** | **1,105** | **38,629** | **–** | **7,531** | **–** | **567,614** | **149,308** | **764,187** |

**Notes to the consolidated financial statements** continued

## Note 50: Financial instruments continued

| | Derivatives designated as hedging instruments £m | Mandatorily held at fair value through profit or loss: Held for trading £m | Mandatorily held at fair value through profit or loss: Other £m | Designated at fair value through profit or loss £m | At fair value through other comprehensive income £m | Held at amortised cost £m | Insurance contracts £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| **At 31 December 2018** | | | | | | | | |
| **Financial assets** | | | | | | | | |
| Cash and balances at central banks | – | – | – | – | – | 54,663 | – | 54,663 |
| Items in the course of collection from banks | – | – | – | – | – | 647 | – | 647 |
| Financial assets at fair value through profit or loss | – | 35,246 | 123,283 | – | – | – | – | 158,529 |
| Derivative financial instruments | 1,563 | 22,032 | – | – | – | – | – | 23,595 |
| Loans and advances to banks | – | – | – | – | – | 6,283 | – | 6,283 |
| Loans and advances to customers | – | – | – | – | – | 484,858 | – | 484,858 |
| Debt securities | – | – | – | – | – | 5,238 | – | 5,238 |
| Financial assets at amortised cost | – | – | – | – | – | 496,379 | – | 496,379 |
| Financial assets at fair value through other comprehensive income | – | – | – | – | 24,815 | – | – | 24,815 |
| Assets arising from reinsurance contracts held | – | – | – | – | – | – | 7,860 | 7,860 |
| **Total financial assets** | 1,563 | 57,278 | 123,283 | – | 24,815 | 551,689 | 7,860 | 766,488 |
| **Financial liabilities** | | | | | | | | |
| Deposits from banks | – | – | – | – | – | 30,320 | – | 30,320 |
| Customer deposits | – | – | – | – | – | 418,066 | – | 418,066 |
| Items in course of transmission to banks | – | – | – | – | – | 636 | – | 636 |
| Financial liabilities at fair value through profit or loss | – | 23,451 | – | 7,096 | – | – | – | 30,547 |
| Derivative financial instruments | 1,108 | 20,265 | – | – | – | – | – | 21,373 |
| Notes in circulation | – | – | – | – | – | 1,104 | – | 1,104 |
| Debt securities in issue | – | – | – | – | – | 91,168 | – | 91,168 |
| Liabilities arising from insurance contracts and participating investment contracts | – | – | – | – | – | – | 98,874 | 98,874 |
| Liabilities arising from non-participating investment contracts | – | – | – | – | – | – | 13,853 | 13,853 |
| Other | – | – | – | – | – | 46 | 382 | 428 |
| Subordinated liabilities | – | – | – | – | – | 17,656 | – | 17,656 |
| **Total financial liabilities** | 1,108 | 43,716 | – | 7,096 | – | 558,996 | 113,109 | 724,025 |

## 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 measures valuation adjustments for its derivative exposures on the same basis as the derivatives are managed.

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, assets arising from reinsurance contracts held, 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.

# Note 50: Financial instruments continued

## (3) Financial assets and liabilities carried at fair value

## (A) Financial assets, excluding derivatives

### Valuation hierarchy

At 31 December 2019, the Group's financial assets carried at fair value, excluding derivatives, totalled £185,281 million (31 December 2018: £183,344 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 277). 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 2019** | | | | |
| Financial assets at fair value through profit or loss | | | | |
| Loans and advances to customers | – | 10,164 | 10,912 | 21,076 |
| Loans and advances to banks | 18 | 2,381 | – | 2,399 |
| Debt securities: | | | | |
| Government securities | 18,618 | 236 | – | 18,854 |
| Other public sector securities | – | 2,071 | 55 | 2,126 |
| Bank and building society certificates of deposit | 52 | 932 | – | 984 |
| Asset-backed securities: | | | | |
| Mortgage-backed securities | – | 468 | – | 468 |
| Other asset-backed securities | – | 158 | 100 | 258 |
| Corporate and other debt securities | – | 16,381 | 1,835 | 18,216 |
| | 18,670 | 20,246 | 1,990 | 40,906 |
| Treasury and other bills | 19 | – | – | 19 |
| Equity shares | 93,766 | 17 | 2,006 | 95,789 |
| Total financial assets at fair value through profit or loss | 112,473 | 32,808 | 14,908 | 160,189 |
| Financial assets at fair value through other comprehensive income | | | | |
| Debt securities: | | | | |
| Government securities | 12,860 | 238 | – | 13,098 |
| Bank and building society certificates of deposit | – | – | – | – |
| Asset-backed securities: | | | | |
| Mortgage-backed securities | – | – | 121 | 121 |
| Other asset-backed securities | – | – | 60 | 60 |
| Corporate and other debt securities | 16 | 11,035 | – | 11,051 |
| | 12,876 | 11,273 | 181 | 24,330 |
| Treasury and other bills | 535 | – | – | 535 |
| Equity shares | – | – | 227 | 227 |
| Total financial assets at fair value through other comprehensive income | 13,411 | 11,273 | 408 | 25,092 |
| **Total financial assets carried at fair value, excluding derivatives** | **125,884** | **44,081** | **15,316** | **185,281** |

## Note 50: Financial instruments continued

| | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| At 31 December 2018 | | | | |
| Financial assets at fair value through profit or loss | | | | |
| Loans and advances to customers | – | 27,285 | 10,565 | 37,850 |
| Loans and advances to banks | – | 3,026 | – | 3,026 |
| Debt securities: | | | | |
| Government securities | 17,926 | 169 | – | 18,095 |
| Other public sector securities | – | 2,064 | – | 2,064 |
| Bank and building society certificates of deposit | 84 | 1,021 | – | 1,105 |
| Asset-backed securities: | | | | |
| Mortgage-backed securities | – | 219 | 6 | 225 |
| Other asset-backed securities | – | 231 | 118 | 349 |
| Corporate and other debt securities | – | 16,840 | 1,470 | 18,310 |
| | 18,010 | 20,544 | 1,594 | 40,148 |
| Treasury and other bills | 20 | – | – | 20 |
| Equity shares | 75,701 | 26 | 1,758 | 77,485 |
| Total financial assets at fair value through profit or loss | 93,731 | 50,881 | 13,917 | 158,529 |
| Financial assets at fair value through other comprehensive income | | | | |
| Debt securities: | | | | |
| Government securities | 18,847 | 124 | – | 18,971 |
| Bank and building society certificates of deposit | – | 118 | – | 118 |
| Asset-backed securities: | | | | |
| Mortgage-backed securities | – | – | 120 | 120 |
| Other asset-backed securities | – | 5 | 126 | 131 |
| Corporate and other debt securities | 32 | 5,119 | – | 5,151 |
| | 18,879 | 5,366 | 246 | 24,491 |
| Treasury and other bills | 303 | – | – | 303 |
| Equity shares | – | – | 21 | 21 |
| Total financial assets at fair value through other comprehensive income | 19,182 | 5,366 | 267 | 24,815 |
| **Total financial assets carried at fair value, excluding derivatives** | 112,913 | 56,247 | 14,184 | 183,344 |

### Movements in Level 3 portfolio

The table below analyses movements in level 3 financial assets, excluding derivatives, carried at fair value (recurring measurement).

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Financial assets at fair value through profit or loss £m** | **Financial assets at fair value through other comprehensive income £m** | **Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m** | Financial assets at fair value through profit or loss £m | Financial assets at fair value through other comprehensive income £m | Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m |
| At 1 January | **13,917** | **267** | **14,184** | 14,152 | 302 | 14,454 |
| Exchange and other adjustments | **(85)** | **(10)** | **(95)** | 87 | (2) | 85 |
| Gains recognised in the income statement within other income | **794** | **–** | **794** | 439 | – | 439 |
| (Losses) gains recognised in other comprehensive income within the revaluation reserve in respect of financial assets at fair value through other comprehensive income | **–** | **12** | **12** | – | (4) | (4) |
| Purchases/increases to customer loans | **2,579** | **207** | **2,786** | 2,480 | 2 | 2,482 |
| Sales | **(2,807)** | **(87)** | **(2,894)** | (3,593) | (95) | (3,688) |
| Transfers into the level 3 portfolio | **644** | **19** | **663** | 815 | 348 | 1,163 |
| Transfers out of the level 3 portfolio | **(134)** | **–** | **(134)** | (463) | (284) | (747) |
| **At 31 December** | **14,908** | **408** | **15,316** | 13,917 | 267 | 14,184 |
| Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December | **269** | **–** | **269** | (104) | – | (104) |

## Note 50: Financial instruments continued

### Valuation methodology for financial assets, excluding derivatives

#### Loans and advances to customers and banks

The fair value of these assets is determined using discounted cash flow techniques. The discount rates are derived from market observable interest rates, a risk margin that reflects loan credit ratings and an incremental illiquidity premium based on historical spreads at origination on similar loans.

#### 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.

## (B) Financial liabilities, excluding derivatives

### Valuation hierarchy

At 31 December 2019, the Group's financial liabilities carried at fair value, excluding derivatives, comprised its financial liabilities at fair value through profit or loss and totalled £21,486 million (31 December 2018: £30,547 million). The table below analyses these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on page 277). 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 2019** | | | | |
| Financial liabilities at fair value through profit or loss | | | | |
| Liabilities designated at fair value through profit or loss | **–** | **7,483** | **48** | **7,531** |
| Trading liabilities: | | | | |
| Liabilities in respect of securities sold under repurchase agreements | **–** | **11,048** | **–** | **11,048** |
| Other deposits | **–** | **98** | **–** | **98** |
| Short positions in securities | **2,781** | **28** | **–** | **2,809** |
| | **2,781** | **11,174** | **–** | **13,955** |
| **Total financial liabilities carried at fair value, excluding derivatives** | **2,781** | **18,657** | **48** | **21,486** |
| At 31 December 2018 | | | | |
| Financial liabilities at fair value through profit or loss | | | | |
| Liabilities designated at fair value through profit or loss | – | 7,085 | 11 | 7,096 |
| Trading liabilities: | | | | |
| Liabilities in respect of securities sold under repurchase agreements | – | 21,595 | – | 21,595 |
| Other deposits | – | 242 | – | 242 |
| Short positions in securities | 1,464 | 150 | – | 1,614 |
| | 1,464 | 21,987 | – | 23,451 |
| **Total financial liabilities carried at fair value, excluding derivatives** | 1,464 | 29,072 | 11 | 30,547 |

## Note 50: Financial instruments continued

The table below analyses movements in the level 3 financial liabilities portfolio, excluding derivatives.

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | 11 | – |
| Losses (gains) recognised in the income statement within other income | – | – |
| Redemptions | (5) | – |
| Transfers into the level 3 portfolio | 52 | 11 |
| Transfers out of the level 3 portfolio | (10) | – |
| **At 31 December** | **48** | 11 |
| Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December | – | – |

### 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 and the resulting gain or loss is recognised in other comprehensive income.

At 31 December 2019, the own credit adjustment arising from the fair valuation of £7,531 million (2018: £7,085 million) of the Group's debt securities in issue designated at fair value through profit or loss resulted in a loss of £419 million (2018: gain of £533 million), before tax, recognised in other comprehensive income.

#### 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 2019, such assets totalled £26,369 million (31 December 2018: £23,595 million) and liabilities totalled £25,779 million (31 December 2018: £21,373 million). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 277). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Level 1 £m | Level 2 £m | Level 3 £m | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
| Derivative assets | 50 | 25,456 | 863 | 26,369 | 93 | 22,575 | 927 | 23,595 |
| Derivative liabilities | (54) | (24,358) | (1,367) | (25,779) | (132) | (20,525) | (716) | (21,373) |

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.

Certain unobservable inputs used to calculate CVA, FVA, and own credit adjustments, are not significant in determining the classification of the derivative and debt instruments. Consequently, these inputs do not form part of the Level 3 sensitivities presented.

Notes to the consolidated financial statements continued

## Note 50: Financial instruments continued

The table below analyses movements in level 3 derivative assets and liabilities carried at fair value.

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | Derivative assets £m | Derivative liabilities £m | Derivative assets £m | Derivative liabilities £m |
| At 1 January | 927 | (716) | 1,056 | (804) |
| Exchange and other adjustments | (27) | 4 | 7 | (5) |
| Losses (gains) recognised in the income statement within other income | 81 | (75) | (84) | 49 |
| Purchases (additions) | 4 | (4) | – | (68) |
| (Sales) redemptions | (19) | 47 | (52) | 112 |
| Transfers into the level 3 portfolio | 415 | (959) | – | – |
| Transfers out of the level 3 portfolio | (518) | 336 | – | – |
| **At 31 December** | 863 | (1,367) | 927 | (716) |
| 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 | (14) | 18 | (424) | 82 |

### 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 2018 and 2019:

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | 562 | 521 |
| Income statement charge (credit) | (134) | 47 |
| Transfers | (5) | (6) |
| **At 31 December** | 423 | 562 |

Represented by:

| | 2019 £m | 2018 £m |
|---|---|---|
| Credit Valuation Adjustment | 278 | 409 |
| Debit Valuation Adjustment | (27) | (79) |
| Funding Valuation Adjustment | 172 | 232 |
| | 423 | 562 |

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 £60 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 (although no such adjustment was required at 31 December 2019).

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.

## Note 50: Financial instruments continued

A one per cent rise in the CDS spread would lead to an increase in the DVA of £99 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 £63 million fall in the overall valuation adjustment to £188 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 £21 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 2019, the Group's derivative trading business held mid to bid-offer valuation adjustments of £80 million (2018: £80 million).

## (D) Sensitivity of level 3 valuations

| | | | At 31 December 2019 | | | At 31 December 2018 | | |
|---|---|---|---|---|---|---|---|---|
| | | | | 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 |
| **Financial assets at fair value through profit or loss** | | | | | | | | |
| Loans and advances to customers | Discounted cash flows | Interest rate spreads (bps) 47bps/108bps | **10,912** | **401** | **(384)** | 10,565 | 380 | (371) |
| Debt securities | Discounted cash flows | Credit spreads (bps) (1bps/2bps) | **61** | **1** | **(1)** | 274 | 92 | (21) |
| Equity and venture capital investments | Market approach | Earnings multiple (1.5//15.4) | **1,948** | **89** | **(89)** | 1,657 | 54 | (55) |
| | Underlying asset/net asset value (incl. property prices)[3] | n/a | **935** | **89** | **(113)** | 523 | 48 | (57) |
| Unlisted equities, debt securities and property partnerships in the life funds | Underlying asset/net asset value (incl. property prices), broker quotes or discounted cash flows[3] | n/a | **1,052** | **19** | **(41)** | 898 | 2 | (45) |
| | | | **14,908** | | | 13,917 | | |
| **Financial assets at fair value through other comprehensive income** | | | | | | | | |
| Asset-backed securities | Lead manager or broker quote/consensus pricing | n/a | **181** | **6** | **(6)** | 246 | 3 | (5) |
| Equity and venture capital investments | Underlying asset/net asset value (incl. property prices)[3] | n/a | **227** | **7** | **(6)** | 21 | 2 | (2) |
| | | | **408** | | | 267 | | |
| **Derivative financial assets** | | | | | | | | |
| Interest rate derivatives | Option pricing model | Interest rate volatility (14%/115%) | **863** | **5** | **(6)** | 927 | 7 | (5) |
| | | | **863** | | | 927 | | |
| **Level 3 financial assets carried at fair value** | | | **16,179** | | | 15,111 | | |
| **Financial liabilities at fair value through profit or loss** | Discounted cash flows | Interest rate spreads (+/–50bps) | **48** | **1** | **(1)** | 11 | – | – |
| **Derivative financial liabilities** | | | | | | | | |
| Interest rate derivatives | Option pricing model | Interest rate volatility (14%/115%) | **1,367** | **–** | **–** | 716 | – | – |
| | | | **1,367** | | | 716 | | |
| **Level 3 financial liabilities carried at fair value** | | | **1,415** | | | 727 | | |

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 swaptions in the Group's derivative portfolios which 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 10 per cent to 128 per cent (2018: 19 per cent to 80 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.

## (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 277). Financial assets carried at amortised cost 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 2019** | | | | | |
| Financial assets at amortised cost: | | | | | |
| Loans and advances to customers: Stage 1 | **449,300** | **450,465** | **–** | **54,600** | **395,865** |
| Loans and advances to customers: Stage 2 | **27,548** | **28,259** | **–** | **–** | **28,259** |
| Loans and advances to customers: Stage 3 | **4,568** | **3,508** | **–** | **–** | **3,508** |
| Loans and advances to customers: purchased or originated credit-impaired | **13,572** | **13,572** | **–** | **–** | **13,572** |
| Loans and advances to customers | **494,988** | **495,804** | **–** | **54,600** | **441,204** |
| Loans and advances to banks | **9,775** | **9,773** | **–** | **1,555** | **8,218** |
| Debt securities | **5,544** | **5,537** | **–** | **5,526** | **11** |
| Reverse repos included in above amounts: | | | | | |
| Loans and advances to customers | **54,600** | **54,600** | **–** | **54,600** | **–** |
| Loans and advances to banks | **1,555** | **1,555** | **–** | **1,555** | **–** |
| At 31 December 2018 | | | | | |
| Financial assets at amortised cost: | | | | | |
| Loans and advances to customers: Stage 1 | 441,006 | 440,542 | – | 40,483 | 400,059 |
| Loans and advances to customers: Stage 2 | 24,351 | 25,516 | – | – | 25,516 |
| Loans and advances to customers: Stage 3 | 4,188 | 3,289 | – | – | 3,289 |
| Loans and advances to customers: purchased or originated credit-impaired | 15,313 | 15,313 | – | – | 15,313 |
| Loans and advances to customers | 484,858 | 484,660 | – | 40,483 | 444,177 |
| Loans and advances to banks | 6,283 | 6,286 | – | 461 | 5,825 |
| Debt securities | 5,238 | 5,244 | – | 5,233 | 11 |
| Reverse repos included in above amounts: | | | | | |
| Loans and advances to customers | 40,483 | 40,483 | – | 40,483 | – |
| Loans and advances to banks | 461 | 461 | – | 461 | – |

## Note 50: Financial instruments continued

### 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.

*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 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.

## (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 277).

| | | | Valuation hierarchy | | |
|---|---|---|---|---|---|
| | Carrying value £m | Fair value £m | Level 1 £m | Level 2 £m | Level 3 £m |
| **At 31 December 2019** | | | | | |
| Deposits from banks | **28,179** | **28,079** | **–** | **28,079** | **–** |
| Customer deposits | **421,320** | **421,728** | **–** | **416,493** | **5,235** |
| Debt securities in issue | **97,689** | **100,443** | **–** | **100,443** | **–** |
| Subordinated liabilities | **17,130** | **19,783** | **–** | **19,783** | **–** |
| Repos included in above amounts: | | | | | |
| Deposits from banks | **18,105** | **18,105** | **–** | **18,105** | **–** |
| Customer deposits | **9,530** | **9,530** | **–** | **9,530** | **–** |
| At 31 December 2018 | | | | | |
| Deposits from banks | 30,320 | 30,322 | – | 30,322 | – |
| Customer deposits | 418,066 | 418,450 | – | 412,283 | 6,167 |
| Debt securities in issue | 91,168 | 93,233 | – | 93,233 | – |
| Subordinated liabilities | 17,656 | 19,564 | – | 19,564 | – |
| Repos included in above amounts: | | | | | |
| Deposits from banks | 21,170 | 21,170 | – | 21,170 | – |
| Customer deposits | 1,818 | 1,818 | – | 1,818 | – |

### 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.

## Note 50: Financial instruments continued

### (5) Reclassifications of financial assets

Other than the reclassifications on adoption of IFRS 9 on 1 January 2018, there have been no reclassifications of financial assets in 2018 or 2019.

## Note 51: Transfers of financial assets

There were no significant transferred financial assets which were derecognised in their entirety, but with ongoing exposure. Details of transferred financial assets that continue to be recognised in full are as follows.

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 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 31, included within financial assets measured at amortised cost 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 31). Except as otherwise noted below, none of the liabilities shown in the table below have recourse only to the transferred assets.

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **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** | | | | |
| Financial assets at fair value through profit or loss | **9,186** | **3,364** | 6,815 | 961 |
| Financial assets at fair value through other comprehensive income | **7,897** | **5,875** | 7,279 | 5,337 |
| **Securitisation programmes** | | | | |
| Financial assets at amortised cost: | | | | |
| Loans and advances to customers[1] | **42,545** | **7,335** | 41,674 | 5,479 |

1 The carrying value of associated liabilities excludes securitisation notes held by the Group of £31,436 million (31 December 2018: £31,701 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 or collateral arrangements in place with counterparties.

| | | | | Related amounts where set off in the balance sheet not permitted[3] | | |
|---|---|---|---|---|---|---|
| At 31 December 2019 | Gross amounts of assets and liabilities[1] £m | Amounts offset in the balance sheet[2] £m | Net amounts presented in the balance sheet £m | Cash collateral received/ pledged £m | Non-cash collateral received/ pledged £m | Potential net amounts if offset of related amounts permitted £m |
| **Financial assets** | | | | | | |
| Financial assets at fair value through profit or loss: | | | | | | |
| Excluding reverse repos | 148,920 | – | 148,920 | – | (2,825) | 146,095 |
| Reverse repos | 24,165 | (12,896) | 11,269 | (366) | (10,903) | – |
| | 173,085 | (12,896) | 160,189 | (366) | (13,728) | 146,095 |
| Derivative financial instruments | 79,735 | (53,366) | 26,369 | (7,650) | (13,892) | 4,827 |
| Loans and advances to banks: | | | | | | |
| Excluding reverse repos | 8,220 | – | 8,220 | (3,377) | – | 4,843 |
| Reverse repos | 1,555 | – | 1,555 | – | (1,555) | – |
| | 9,775 | – | 9,775 | (3,377) | (1,555) | 4,843 |
| Loans and advances to customers: | | | | | | |
| Excluding reverse repos | 440,388 | – | 440,388 | (2,392) | (2,123) | 435,873 |
| Reverse repos | 58,959 | (4,359) | 54,600 | – | (54,600) | – |
| | 499,347 | (4,359) | 494,988 | (2,392) | (56,723) | 435,873 |
| Debt securities | 5,544 | – | 5,544 | – | (211) | 5,333 |
| Financial assets at fair value through other comprehensive income | 25,092 | – | 25,092 | – | (5,859) | 19,233 |
| **Financial liabilities** | | | | | | |
| Deposits from banks: | | | | | | |
| Excluding repos | 10,074 | – | 10,074 | (8,016) | – | 2,058 |
| Repos | 18,105 | – | 18,105 | – | (18,105) | – |
| | 28,179 | – | 28,179 | (8,016) | (18,105) | 2,058 |
| Customer deposits: | | | | | | |
| Excluding repos | 413,659 | (1,869) | 411,790 | (1,850) | (2,123) | 407,817 |
| Repos | 9,530 | – | 9,530 | – | (9,530) | – |
| | 423,189 | (1,869) | 421,320 | (1,850) | (11,653) | 407,817 |
| Financial liabilities at fair value through profit or loss: | | | | | | |
| Excluding repos | 10,438 | – | 10,438 | – | – | 10,438 |
| Repos | 28,303 | (17,255) | 11,048 | – | (11,048) | – |
| | 38,741 | (17,255) | 21,486 | – | (11,048) | 10,438 |
| Derivative financial instruments | 77,276 | (51,497) | 25,779 | (5,770) | (16,364) | 3,645 |

## Note 52: Offsetting of financial assets and liabilities continued

| At 31 December 2018 | 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** | | | | | | |
| Financial assets at fair value through profit or loss: | | | | | | |
| Excluding reverse repos | 130,172 | – | 130,172 | – | (978) | 129,194 |
| Reverse repos | 33,472 | (5,115) | 28,357 | (622) | (27,735) | – |
| | 163,644 | (5,115) | 158,529 | (622) | (28,713) | 129,194 |
| Derivative financial instruments | 78,607 | (55,012) | 23,595 | (6,039) | (15,642) | 1,914 |
| Loans and advances to banks: | | | | | | |
| Excluding reverse repos | 5,822 | – | 5,822 | (2,676) | – | 3,146 |
| Reverse repos | 461 | – | 461 | – | (461) | – |
| | 6,283 | – | 6,283 | (2,676) | (461) | 3,146 |
| Loans and advances to customers: | | | | | | |
| Excluding reverse repos | 447,020 | (2,645) | 444,375 | (1,319) | (3,241) | 439,815 |
| Reverse repos | 42,494 | (2,011) | 40,483 | – | (40,483) | – |
| | 489,514 | (4,656) | 484,858 | (1,319) | (43,724) | 439,815 |
| Debt securities | 5,238 | – | 5,238 | – | – | 5,238 |
| Financial assets at fair value through other comprehensive income | 24,815 | – | 24,815 | – | (5,361) | 19,454 |
| **Financial liabilities** | | | | | | |
| Deposits from banks: | | | | | | |
| Excluding repos | 9,150 | – | 9,150 | (5,291) | – | 3,859 |
| Repos | 21,170 | – | 21,170 | – | (21,170) | – |
| | 30,320 | – | 30,320 | (5,291) | (21,170) | 3,859 |
| Customer deposits: | | | | | | |
| Excluding repos | 417,652 | (1,404) | 416,248 | (1,370) | (3,241) | 411,637 |
| Repos | 1,818 | – | 1,818 | – | (1,818) | – |
| | 419,470 | (1,404) | 418,066 | (1,370) | (5,059) | 411,637 |
| Financial liabilities at fair value through profit or loss: | | | | | | |
| Excluding repos | 8,952 | – | 8,952 | – | – | 8,952 |
| Repos | 28,721 | (7,126) | 21,595 | – | (21,595) | – |
| | 37,673 | (7,126) | 30,547 | – | (21,595) | 8,952 |
| Derivative financial instruments | 77,626 | (56,253) | 21,373 | (3,995) | (17,313) | 65 |

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 129 to 187. 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

### (A) Interest rate risk

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. The rates on the remaining deposits are 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.

The Group's risk management policy is to optimise reward whilst managing its market risk exposures within the risk appetite defined by the Board. 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. The structural hedge consists of longer-term fixed rate assets or interest rate swaps and the amount and duration of the hedging activity is reviewed regularly by the Group Asset and Liability Committee. Further details on the Group market risk policy can be found on page 182.

The Group establishes hedge accounting relationships for interest rate risk using cash flow hedges and fair value hedges. The Group is exposed to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The derivatives used to manage the structural hedge may be designated into cash flow hedges to manage income statement volatility. The economic items related to the structural hedge, for example current accounts, are not eligible hedged items under IAS 39 for inclusion into accounting hedge relationships. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The Group applies netting between similar risks before applying hedge accounting.

Hedge ineffectiveness arises during the management of interest rate risk due to residual unhedged risk. Sources of ineffectiveness, which the Group may decide to not fully mitigate, can include basis differences, timing differences and notional amount differences. The effectiveness of accounting hedge relationships is assessed between the hedging derivatives and the documented hedged item, which can differ to the underlying economically hedged item.

At 31 December 2019 the aggregate notional principal of interest rate swaps designated as fair value hedges was £183,489 million (2018: £150,971 million) with a net fair value asset of £569 million (2018: asset of £760 million) (note 17). The gains on the hedging instruments were £1,144 million (2018: gains of £94 million). The losses on the hedged items attributable to the hedged risk were £1,001 million (2018: losses of £32 million). The gains and losses relating to the fair value hedges are recorded in net trading income.

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. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2019 was £426,740 million (2018: £556,945 million) with a net fair value liability of £388 million (2018: liability of £486 million) (note 17). In 2019, ineffectiveness recognised in the income statement that arises from cash flow hedges was a gain of £134 million (2018: loss of £25 million).

#### Interest Rate Benchmark Reform

As discussed in note 1, the Group has applied the hedge accounting amendments *Interest Rate Benchmark Reform* to hedge accounting relationships directly affected by the replacement of interest rate benchmarks. Under these amendments, for the purposes of:

- determining whether a forecast transaction is highly probable;
- determining whether the hedged future cash flows are expected to occur;
- determining whether a hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk; and
- determining whether an accounting hedging relationship should be discontinued because of a failure of the retrospective effectiveness test

the Group has assumed that the interest rate benchmark on which the hedged risk or the cash flows of the hedged item or hedging instrument are based is not altered by uncertainties resulting from the proposed interest rate benchmark reform. In addition, for a fair value hedge of a non-contractually specified benchmark portion of interest rate risk, the Group assesses only at inception of the hedge relationship and not on an ongoing basis that the risk is separately identifiable and hedge effectiveness can be measured.

The Group's most significant hedge accounting relationships are exposed to the following interest rate benchmarks: Sterling LIBOR, US Dollar LIBOR and Euro LIBOR. The notional of the hedged items that the Group has designated into cash-flow hedge relationships that is directly affected by the interest rate benchmark reform is £29,202 million, of which £25,438 million relates to Sterling LIBOR. These are principally loans and advances to customers in Commercial Banking. In addition, the interest rate benchmark reforms affect assets designated in fair value hedges with a notional of £102,969 million, of which £98,278 million is in respect of sterling LIBOR, and liabilities designated in fair value hedges with a notional of £62,295 million, of which £9,186 million is in respect of sterling LIBOR. These fair value hedges principally relate to mortgages in Retail and debt securities in issue.

The Group is managing the process to transition to alternative benchmark rates under its Group-wide IBOR Transition Programme. This programme is working towards ensuring that the Group has the market capability and infrastructure to deal with the reform. The programme also encompasses the associated impacts on accounting and reporting and includes dealing with the impact on hedge accounting relationships of the transition to alternative reference rates. Further information on the Group's programme is set out on page 134.

The significant assumptions and judgements that the Group has made in applying these requirements include the following:

- a hedge accounting relationship is assumed to be affected by the interest rate benchmark reform if the reform gives rise to uncertainties about the timing and/or amount of the interest rate benchmark-based cash flows of the hedged items and/or of the hedging instrument;
- where the hedged item is a forecast transaction then, in the absence of any certainty in relation to the interest rate benchmark reform, assessments have been determined as to whether the forecast transaction is highly probable assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of the interest rate benchmark reform;

## Note 53: Financial risk management continued

– any reclassification of amounts in cash flow hedge reserves to profit or loss have been based on assessing whether the hedged cash flows are no longer expected to occur assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of the interest rate benchmark reform; and

– all benchmark rate referenced hedged items and hedging instruments included in hedging relationships are subject to uncertainty due to interest rate benchmark reform.

In accordance with the Interest Rate Benchmark Reform amendments to IAS 39, the Group will cease to apply prospectively the reliefs outlined above when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item (or for the effectiveness assessments, the hedging instrument). The reliefs will be disapplied earlier if the hedging relationship is discontinued or the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss for a reason other than interest rate benchmark reform.

At 31 December 2019, the notional amount of the hedging instruments in hedging relationships to which these amendments apply was £604,602 million, of which £117,076 million relates to Sterling LIBOR fair value hedges and £400,439 million relates to Sterling LIBOR cash flow hedges.

### (B) 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 187. The Group also manages foreign currency risk via cash flow hedge accounting, utilising currency swaps.

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 ceased all hedging of the currency translation risk of the net investment in foreign operations on 1 January 2018.

The Group's main overseas operations are in the Americas and Europe. Details of the Group's structural foreign currency exposures are as follows:

### (C) Functional currency of Group operations

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Euro £m** | **US Dollar £m** | **Other non-sterling £m** | Euro £m | US Dollar £m | Other non-sterling £m |
| Exposure | **63** | **93** | **48** | 112 | 59 | 60 |

## 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 141 to 161.

### (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.

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Maximum exposure £m | Offset[2] £m | Net exposure £m | Maximum exposure £m | Offset[2] £m | Net exposure £m |
| Loans and advances to banks, net[1] | 9,775 | – | 9,775 | 6,283 | – | 6,283 |
| Loans and advances to customers, net[1] | 494,988 | (2,792) | 492,196 | 484,858 | (3,241) | 481,617 |
| Debt securities, net[1] | 5,544 | – | 5,544 | 5,238 | – | 5,238 |
| Financial assets at amortised cost | 510,307 | (2,792) | 507,515 | 496,379 | (3,241) | 493,138 |
| Financial assets at fair value through other comprehensive income[3] | 24,865 | – | 24,865 | 24,794 | – | 24,794 |
| Financial assets at fair value through profit or loss:[3,4] | | | | | | |
| Loans and advances | 23,475 | – | 23,475 | 40,876 | – | 40,876 |
| Debt securities, treasury and other bills | 40,925 | – | 40,925 | 40,168 | – | 40,168 |
| | 64,400 | – | 64,400 | 81,044 | – | 81,044 |
| Derivative assets | 26,369 | (14,696) | 11,673 | 23,595 | (14,327) | 9,268 |
| Assets arising from reinsurance contracts held | 23,567 | – | 23,567 | 7,860 | – | 7,860 |
| Off-balance sheet items: | | | | | | |
| Acceptances and endorsements | 74 | – | 74 | 194 | – | 194 |
| Other items serving as direct credit substitutes | 366 | – | 366 | 632 | – | 632 |
| Performance bonds and other transaction-related contingencies | 2,454 | – | 2,454 | 2,425 | – | 2,425 |
| Irrevocable commitments and guarantees | 63,504 | – | 63,504 | 64,884 | – | 64,884 |
| | 66,398 | – | 66,398 | 68,135 | – | 68,135 |
| | 715,906 | (17,488) | 698,418 | 701,807 | (17,568) | 684,239 |

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 142.

At 31 December 2019 the most significant concentrations of exposure were in mortgages (comprising 60 per cent of total loans and advances to customers) and to financial, business and other services (comprising 18 per cent of the total).

| | 2019 £m | 2018 £m |
|---|---|---|
| Agriculture, forestry and fishing | 7,558 | 7,314 |
| Energy and water supply | 1,432 | 1,517 |
| Manufacturing | 6,093 | 8,260 |
| Construction | 4,285 | 4,684 |
| Transport, distribution and hotels | 13,016 | 14,113 |
| Postal and telecommunications | 1,923 | 2,711 |
| Property companies | 27,596 | 28,451 |
| Financial, business and other services | 89,763 | 77,505 |
| Personal: | | |
| Mortgages[1] | 299,141 | 297,498 |
| Other | 29,272 | 28,699 |
| Lease financing | 1,671 | 1,822 |
| Hire purchase | 16,497 | 15,434 |
| **Total loans and advances to customers before allowance for impairment losses** | 498,247 | 488,008 |
| Allowance for impairment losses (note 18) | (3,259) | (3,150) |
| **Total loans and advances to customers** | 494,988 | 484,858 |

1 Includes both UK and overseas mortgage balances.

Following the 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 advances

The analysis of lending has been prepared based on the division in which the asset is held; with the business segment in which the exposure is recorded reflected in the ratings system applied. The internal credit ratings systems used by the Group differ between Retail and Commercial, reflecting the characteristics of these exposures and the way that they are managed internally; these credit ratings are set out below. All probabilities of default (PDs) include forward-looking information and are based on 12 month values, with the exception of credit impaired.

Stage 3 assets include balances of £205 million (2018: £250 million) (with outstanding amounts due of approximately £1,700 million (2018: £2,200 million)) which have been subject to a partial write-off and where the Group continues to enforce recovery action.

Stage 2 and Stage 3 assets with a carrying amount of £219 million (2018: £1,000 million) were modified during the year. No material gain or loss was recognised by the Group.

| Gross drawn exposures | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| **Loans and advances to banks:** | | | | | | |
| CMS 1-10 | 0.00-0.50% | 9,777 | – | – | – | 9,777 |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | 9,777 | – | – | – | 9,777 |
| **Loans and advances to customers:** | | | | | | |
| *Retail - mortgages* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 257,028 | 13,494 | – | – | 270,522 |
| RMS 7-9 | 4.51-14.00% | 15 | 2,052 | – | – | 2,067 |
| RMS 10 | 14.01-20.00% | – | 414 | – | – | 414 |
| RMS 11-13 | 20.01-99.99% | – | 975 | – | – | 975 |
| RMS 14 | 100% | – | – | 1,506 | 13,714 | 15,220 |
| | | 257,043 | 16,935 | 1,506 | 13,714 | 289,198 |
| *Retail - unsecured* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 22,151 | 1,098 | – | – | 23,249 |
| RMS 7-9 | 4.51-14.00% | 2,676 | 919 | – | – | 3,595 |
| RMS 10 | 14.01-20.00% | 76 | 189 | – | – | 265 |
| RMS 11-13 | 20.01-99.99% | 18 | 606 | – | – | 624 |
| RMS 14 | 100% | – | – | 678 | – | 678 |
| | | 24,921 | 2,812 | 678 | – | 28,411 |
| *Retail - UK Motor Finance* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 13,568 | 1,297 | – | – | 14,865 |
| RMS 7-9 | 4.51-14.00% | 314 | 368 | – | – | 682 |
| RMS 10 | 14.01-20.00% | – | 99 | – | – | 99 |
| RMS 11-13 | 20.01-99.99% | 2 | 178 | – | – | 180 |
| RMS 14 | 100% | – | – | 150 | – | 150 |
| | | 13,884 | 1,942 | 150 | – | 15,976 |
| *Retail - Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 9,520 | 390 | – | – | 9,910 |
| RMS 7-9 | 4.51-14.00% | – | 409 | – | – | 409 |
| RMS 10 | 14.01-20.00% | – | 7 | – | – | 7 |
| RMS 11-13 | 20.01-99.99% | 134 | 23 | – | – | 157 |
| RMS 14 | 100% | – | – | 150 | – | 150 |
| | | 9,654 | 829 | 150 | – | 10,633 |
| **Total Retail** | | 305,502 | 22,518 | 2,484 | 13,714 | 344,218 |

## Note 53: Financial risk management continued

| Gross drawn exposures (continued) | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| *Commercial* | | | | | | |
| CMS 1-10 | 0.00-0.50% | 59,880 | 379 | – | – | 60,259 |
| CMS 11-14 | 0.51-3.00% | 25,638 | 2,322 | – | – | 27,960 |
| CMS 15-18 | 3.01-20.00% | 1,805 | 3,123 | – | – | 4,928 |
| CMS 19 | 20.01-99.99% | – | 169 | – | – | 169 |
| CMS 20-23 | 100% | – | – | 3,447 | – | 3,447 |
| | | 87,323 | 5,993 | 3,447 | – | 96,763 |
| *Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 754 | 32 | – | – | 786 |
| RMS 7-9 | 4.51-14.00% | 40 | – | – | – | 40 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | 84 | – | 84 |
| | | 794 | 32 | 84 | – | 910 |
| CMS 1-10 | 0.00-0.50% | 56,356 | – | – | – | 56,356 |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | 56,356 | – | – | – | 56,356 |
| **Total loans and advances to customers** | | 449,975 | 28,543 | 6,015 | 13,714 | 498,247 |
| | | | | | | |
| *In respect of:* | | | | | | |
| Retail | | 305,502 | 22,518 | 2,484 | 13,714 | 344,218 |
| Commercial | | 87,323 | 5,993 | 3,447 | – | 96,763 |
| Other | | 57,150 | 32 | 84 | – | 57,266 |
| **Total loans and advances to customers** | | 449,975 | 28,543 | 6,015 | 13,714 | 498,247 |

## Notes to the consolidated financial statements continued

# Note 53: Financial risk management continued

| Expected credit losses in respect of drawn exposures | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| **Loans and advances to banks:** | | | | | | |
| CMS 1-10 | 0.00-0.50% | 2 | – | – | – | 2 |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | 2 | – | – | – | 2 |
| **Loans and advances to customers:** | | | | | | |
| *Retail - mortgages* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 23 | 183 | – | – | 206 |
| RMS 7-9 | 4.51-14.00% | – | 39 | – | – | 39 |
| RMS 10 | 14.01-20.00% | – | 13 | – | – | 13 |
| RMS 11-13 | 20.01-99.99% | – | 46 | – | – | 46 |
| RMS 14 | 100% | – | – | 122 | 142 | 264 |
| | | 23 | 281 | 122 | 142 | 568 |
| *Retail - unsecured* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 188 | 42 | – | – | 230 |
| RMS 7-9 | 4.51-14.00% | 103 | 92 | – | – | 195 |
| RMS 10 | 14.01-20.00% | 7 | 34 | – | – | 41 |
| RMS 11-13 | 20.01-99.99% | 3 | 193 | – | – | 196 |
| RMS 14 | 100% | – | – | 233 | – | 233 |
| | | 301 | 361 | 233 | – | 895 |
| *Retail - UK Motor Finance* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 203 | 30 | – | – | 233 |
| RMS 7-9 | 4.51-14.00% | 10 | 15 | – | – | 25 |
| RMS 10 | 14.01-20.00% | – | 10 | – | – | 10 |
| RMS 11-13 | 20.01-99.99% | 1 | 32 | – | – | 33 |
| RMS 14 | 100% | – | – | 84 | – | 84 |
| | | 214 | 87 | 84 | – | 385 |
| *Retail - Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 25 | 9 | – | – | 34 |
| RMS 7-9 | 4.51-14.00% | – | 27 | – | – | 27 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | 1 | – | – | 1 |
| RMS 14 | 100% | – | – | 51 | – | 51 |
| | | 25 | 37 | 51 | – | 113 |
| **Total Retail** | | 563 | 766 | 490 | 142 | 1,961 |

## Note 53: Financial risk management continued

| Expected credit losses in respect of drawn exposures (continued) | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| *Commercial* | | | | | | |
| CMS 1-10 | 0.00-0.50% | 33 | 1 | – | – | 34 |
| CMS 11-14 | 0.51-3.00% | 50 | 37 | – | – | 87 |
| CMS 15-18 | 3.01-20.00% | 13 | 174 | – | – | 187 |
| CMS 19 | 20.01-99.99% | – | 16 | – | – | 16 |
| CMS 20-23 | 100% | – | – | 941 | – | 941 |
| | | 96 | 228 | 941 | – | 1,265 |
| *Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 6 | 1 | – | – | 7 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | 16 | – | 16 |
| | | 6 | 1 | 16 | – | 23 |
| CMS 1-10 | 0.00-0.50% | 10 | – | – | – | 10 |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | 10 | – | – | – | 10 |
| **Total loans and advances to customers** | | 675 | 995 | 1,447 | 142 | 3,259 |
| | | | | | | |
| *In respect of:* | | | | | | |
| Retail | | 563 | 766 | 490 | 142 | 1,961 |
| Commercial | | 96 | 228 | 941 | – | 1,265 |
| Other | | 16 | 1 | 16 | – | 33 |
| **Total loans and advances to customers** | | 675 | 995 | 1,447 | 142 | 3,259 |

## Notes to the consolidated financial statements continued

# Note 53: Financial risk management continued

| Gross undrawn exposures | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| **Loans and advances to customers:** | | | | | | |
| *Retail - mortgages* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 12,242 | 62 | – | – | 12,304 |
| RMS 7-9 | 4.51-14.00% | 1 | 1 | – | – | 2 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | 8 | 79 | 87 |
| | | 12,243 | 63 | 8 | 79 | 12,393 |
| *Retail - unsecured* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 60,653 | 1,986 | – | – | 62,639 |
| RMS 7-9 | 4.51-14.00% | 389 | 218 | – | – | 607 |
| RMS 10 | 14.01-20.00% | 5 | 39 | – | – | 44 |
| RMS 11-13 | 20.01-99.99% | 1 | 73 | – | – | 74 |
| RMS 14 | 100% | – | – | 83 | – | 83 |
| | | 61,048 | 2,316 | 83 | – | 63,447 |
| *Retail - UK Motor Finance* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 1,181 | – | – | – | 1,181 |
| RMS 7-9 | 4.51-14.00% | 193 | 4 | – | – | 197 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 1,374 | 4 | – | – | 1,378 |
| *Retail - Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 1,240 | – | – | – | 1,240 |
| RMS 7-9 | 4.51-14.00% | – | 62 | – | – | 62 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | 3 | – | 3 |
| | | 1,240 | 62 | 3 | – | 1,305 |
| **Total Retail** | | 75,905 | 2,445 | 94 | 79 | 78,523 |

## Note 53: Financial risk management continued

| Gross undrawn exposures (continued) | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| *Commercial* | | | | | | |
| CMS 1-10 | 0.00-0.50% | 47,707 | 76 | – | – | 47,783 |
| CMS 11-14 | 0.51-3.00% | 5,134 | 850 | – | – | 5,984 |
| CMS 15-18 | 3.01-20.00% | 258 | 327 | – | – | 585 |
| CMS 19 | 20.01-99.99% | – | 43 | – | – | 43 |
| CMS 20-23 | 100% | – | – | 5 | – | 5 |
| | | 53,099 | 1,296 | 5 | – | 54,400 |
| *Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 239 | – | – | – | 239 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 239 | – | – | – | 239 |
| CMS 1-10 | 0.00-0.50% | 391 | – | – | – | 391 |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | 391 | – | – | – | 391 |
| **Total loans and advances to customers** | | 129,634 | 3,741 | 99 | 79 | 133,553 |
| | | | | | | |
| *In respect of:* | | | | | | |
| Retail | | 75,905 | 2,445 | 94 | 79 | 78,523 |
| Commercial | | 53,099 | 1,296 | 5 | – | 54,400 |
| Other | | 630 | – | – | – | 630 |
| **Total loans and advances to customers** | | 129,634 | 3,741 | 99 | 79 | 133,553 |

## Notes to the consolidated financial statements continued

# Note 53: Financial risk management continued

| Expected credit losses in respect of undrawn exposures | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| **Loans and advances to customers:** | | | | | | |
| *Retail - mortgages* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 1 | – | – | – | 1 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 1 | – | – | – | 1 |
| *Retail - unsecured* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 56 | 24 | – | – | 80 |
| RMS 7-9 | 4.51-14.00% | 6 | 8 | – | – | 14 |
| RMS 10 | 14.01-20.00% | – | 3 | – | – | 3 |
| RMS 11-13 | 20.01-99.99% | – | 15 | – | – | 15 |
| RMS 14 | 100% | – | – | – | – | – |
| | | 62 | 50 | – | – | 112 |
| *Retail - UK Motor Finance* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 2 | – | – | – | 2 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 2 | – | – | – | 2 |
| *Retail - Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 11 | – | – | – | 11 |
| RMS 7-9 | 4.51-14.00% | – | 3 | – | – | 3 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 11 | 3 | – | – | 14 |
| **Total Retail** | | 76 | 53 | – | – | 129 |

## Note 53: Financial risk management continued

| Expected credit losses in respect of undrawn exposures (continued) | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| *Commercial* | | | | | | |
| CMS 1-10 | 0.00-0.50% | 11 | – | – | – | 11 |
| CMS 11-14 | 0.51-3.00% | 7 | 9 | – | – | 16 |
| CMS 15-18 | 3.01-20.00% | 1 | 13 | – | – | 14 |
| CMS 19 | 20.01-99.99% | – | 2 | – | – | 2 |
| CMS 20-23 | 100% | – | – | 5 | – | 5 |
| | | 19 | 24 | 5 | – | 48 |
| *Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | – | – | – | – | – |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | – | – | – | – | – |
| CMS 1-10 | 0.00-0.50% | – | – | – | – | – |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | – | – | – | – | – |
| **Total loans and advances to customers** | | 95 | 77 | 5 | – | 177 |
| | | | | | | |
| *In respect of:* | | | | | | |
| Retail | | 76 | 53 | – | – | 129 |
| Commercial | | 19 | 24 | 5 | – | 48 |
| Other | | – | – | – | – | – |
| **Total loans and advances to customers** | | 95 | 77 | 5 | – | 177 |

## Notes to the consolidated financial statements continued

# Note 53: Financial risk management continued

| Gross drawn exposures | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2018 | | | | | | |
| **Loans and advances to banks:** | | | | | | |
| CMS 1-10 | 0.00-0.50% | 6,177 | 3 | – | – | 6,180 |
| CMS 11-14 | 0.51-3.00% | 105 | – | – | – | 105 |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | 6,282 | 3 | – | – | 6,285 |
| **Loans and advances to customers:** | | | | | | |
| *Retail - mortgages* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 257,740 | 10,784 | – | – | 268,524 |
| RMS 7-9 | 4.51-14.00% | 57 | 1,709 | – | – | 1,766 |
| RMS 10 | 14.01-20.00% | – | 262 | – | – | 262 |
| RMS 11-13 | 20.01-99.99% | – | 899 | – | – | 899 |
| RMS 14 | 100% | – | – | 1,393 | 15,391 | 16,784 |
| | | 257,797 | 13,654 | 1,393 | 15,391 | 288,235 |
| *Retail - unsecured* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 22,363 | 1,079 | – | – | 23,442 |
| RMS 7-9 | 4.51-14.00% | 2,071 | 774 | – | – | 2,845 |
| RMS 10 | 14.01-20.00% | 72 | 167 | – | – | 239 |
| RMS 11-13 | 20.01-99.99% | 199 | 687 | – | – | 886 |
| RMS 14 | 100% | – | – | 703 | – | 703 |
| | | 24,705 | 2,707 | 703 | – | 28,115 |
| *Retail - UK Motor Finance* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 12,918 | 954 | – | – | 13,872 |
| RMS 7-9 | 4.51-14.00% | 301 | 318 | – | – | 619 |
| RMS 10 | 14.01-20.00% | – | 111 | – | – | 111 |
| RMS 11-13 | 20.01-99.99% | 5 | 197 | – | – | 202 |
| RMS 14 | 100% | – | – | 129 | – | 129 |
| | | 13,224 | 1,580 | 129 | – | 14,933 |
| *Retail - Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 9,033 | 704 | – | – | 9,737 |
| RMS 7-9 | 4.51-14.00% | 190 | 66 | – | – | 256 |
| RMS 10 | 14.01-20.00% | – | 7 | – | – | 7 |
| RMS 11-13 | 20.01-99.99% | 211 | 23 | – | – | 234 |
| RMS 14 | 100% | – | – | 165 | – | 165 |
| | | 9,434 | 800 | 165 | – | 10,399 |
| **Total Retail** | | 305,160 | 18,741 | 2,390 | 15,391 | 341,682 |

## Note 53: Financial risk management continued

| Gross drawn exposures (continued) | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2018 | | | | | | |
| *Commercial* | | | | | | |
| CMS 1-10 | 0.00-0.50% | 65,089 | 100 | – | – | 65,189 |
| CMS 11-14 | 0.51-3.00% | 25,472 | 3,450 | – | – | 28,922 |
| CMS 15-18 | 3.01-20.00% | 1,441 | 2,988 | – | – | 4,429 |
| CMS 19 | 20.01-99.99% | – | 54 | – | – | 54 |
| CMS 20-23 | 100% | – | – | 3,230 | – | 3,230 |
| | | 92,002 | 6,592 | 3,230 | – | 101,824 |
| *Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 804 | 6 | – | – | 810 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | 55 | – | 55 |
| | | 804 | 6 | 55 | – | 865 |
| CMS 1-10 | 0.00-0.50% | 43,565 | – | – | – | 43,565 |
| CMS 11-14 | 0.51-3.00% | – | 6 | – | – | 6 |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | 66 | – | 66 |
| | | 43,565 | 6 | 66 | – | 43,637 |
| **Total loans and advances to customers** | | 441,531 | 25,345 | 5,741 | 15,391 | 488,008 |

| | | | | | |
|---|---|---|---|---|---|
| *In respect of:* | | | | | |
| Retail | 305,160 | 18,741 | 2,390 | 15,391 | 341,682 |
| Commercial | 92,002 | 6,592 | 3,230 | – | 101,824 |
| Other | 44,369 | 12 | 121 | – | 44,502 |
| **Total loans and advances to customers** | 441,531 | 25,345 | 5,741 | 15,391 | 488,008 |

Notes to the consolidated financial statements continued

## Note 53: Financial risk management continued

| Expected credit losses in respect of drawn exposures | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2018 | | | | | | |
| **Loans and advances to banks:** | | | | | | |
| CMS 1-10 | 0.00-0.50% | 2 | – | – | – | 2 |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | 2 | – | – | – | 2 |
| **Loans and advances to customers:** | | | | | | |
| *Retail - mortgages* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 37 | 141 | – | – | 178 |
| RMS 7-9 | 4.51-14.00% | – | 34 | – | – | 34 |
| RMS 10 | 14.01-20.00% | – | 9 | – | – | 9 |
| RMS 11-13 | 20.01-99.99% | – | 42 | – | – | 42 |
| RMS 14 | 100% | – | – | 118 | 78 | 196 |
| | | 37 | 226 | 118 | 78 | 459 |
| *Retail - unsecured* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 135 | 45 | – | – | 180 |
| RMS 7-9 | 4.51-14.00% | 57 | 83 | – | – | 140 |
| RMS 10 | 14.01-20.00% | 4 | 29 | – | – | 33 |
| RMS 11-13 | 20.01-99.99% | 3 | 172 | – | – | 175 |
| RMS 14 | 100% | – | – | 228 | – | 228 |
| | | 199 | 329 | 228 | – | 756 |
| *Retail - UK Motor Finance* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 114 | 19 | – | – | 133 |
| RMS 7-9 | 4.51-14.00% | 6 | 15 | – | – | 21 |
| RMS 10 | 14.01-20.00% | – | 11 | – | – | 11 |
| RMS 11-13 | 20.01-99.99% | 1 | 34 | – | – | 35 |
| RMS 14 | 100% | – | – | 78 | – | 78 |
| | | 121 | 79 | 78 | – | 278 |
| *Retail - Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 30 | 25 | – | – | 55 |
| RMS 7-9 | 4.51-14.00% | 2 | 2 | – | – | 4 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | 1 | – | – | 1 |
| RMS 14 | 100% | – | – | 60 | – | 60 |
| | | 32 | 28 | 60 | – | 120 |
| **Total Retail** | | 389 | 662 | 484 | 78 | 1,613 |

## Note 53: Financial risk management continued

| Expected credit losses in respect of drawn exposures (continued) | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2018 | | | | | | |
| *Commercial* | | | | | | |
| CMS 1-10 | 0.00-0.50% | 32 | 1 | – | – | 33 |
| CMS 11-14 | 0.51-3.00% | 50 | 86 | – | – | 136 |
| CMS 15-18 | 3.01-20.00% | 11 | 231 | – | – | 242 |
| CMS 19 | 20.01-99.99% | – | 7 | – | – | 7 |
| CMS 20-23 | 100% | – | – | 1,031 | – | 1,031 |
| | | 93 | 325 | 1,031 | – | 1,449 |
| *Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 43 | 1 | – | – | 44 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | 11 | – | 11 |
| | | 43 | 1 | 11 | | 55 |
| CMS 1-10 | 0.00-0.50% | – | – | – | – | – |
| CMS 11-14 | 0.51-3.00% | – | 6 | – | – | 6 |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | 27 | – | 27 |
| | | – | 6 | 27 | – | 33 |
| **Total loans and advances to customers** | | 525 | 994 | 1,553 | 78 | 3,150 |
| | | | | | | |
| *In respect of:* | | | | | | |
| Retail | | 389 | 662 | 484 | 78 | 1,613 |
| Commercial | | 93 | 325 | 1,031 | – | 1,449 |
| Other | | 43 | 7 | 38 | – | 88 |
| **Total loans and advances to customers** | | 525 | 994 | 1,553 | 78 | 3,150 |

## Notes to the consolidated financial statements continued

# Note 53: Financial risk management continued

| Gross undrawn exposures | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2018 | | | | | | |
| **Loans and advances to customers:** | | | | | | |
| *Retail - mortgages* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 12,024 | 19 | – | – | 12,043 |
| RMS 7-9 | 4.51-14.00% | 2 | 1 | – | – | 3 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | 5 | 90 | 95 |
| | | 12,026 | 20 | 5 | 90 | 12,141 |
| *Retail - unsecured* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 57,433 | 1,811 | – | – | 59,244 |
| RMS 7-9 | 4.51-14.00% | 391 | 155 | – | – | 546 |
| RMS 10 | 14.01-20.00% | 10 | 27 | – | – | 37 |
| RMS 11-13 | 20.01-99.99% | 3 | 51 | – | – | 54 |
| RMS 14 | 100% | – | – | 36 | – | 36 |
| | | 57,837 | 2,044 | 36 | – | 59,917 |
| *Retail - UK Motor Finance* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 1,565 | – | – | – | 1,565 |
| RMS 7-9 | 4.51-14.00% | 141 | – | - | – | 141 |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 1,706 | – | – | – | 1,706 |
| *Retail - Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 1,381 | 47 | – | – | 1,428 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | 360 | – | – | – | 360 |
| RMS 14 | 100% | – | – | 3 | – | 3 |
| | | 1,741 | 47 | 3 | – | 1,791 |
| **Total Retail** | | 73,310 | 2,111 | 44 | 90 | 75,555 |

## Note 53: Financial risk management continued

| Gross undrawn exposures (continued) | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2018 | | | | | | |
| *Commercial* | | | | | | |
| CMS 1-10 | 0.00-0.50% | 51,632 | – | – | – | 51,632 |
| CMS 11-14 | 0.51-3.00% | 6,501 | 693 | – | – | 7,194 |
| CMS 15-18 | 3.01-20.00% | 126 | 297 | – | – | 423 |
| CMS 19 | 20.01-99.99% | 31 | 11 | – | – | 42 |
| CMS 20-23 | 100% | – | – | 6 | – | 6 |
| | | 58,290 | 1,001 | 6 | – | 59,297 |
| *Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 246 | – | – | – | 246 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 246 | – | – | – | 246 |
| CMS 1-10 | 0.00-0.50% | – | – | – | – | – |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | – | – | – | – | – |
| **Total loans and advances to customers** | | 131,846 | 3,112 | 50 | 90 | 135,098 |

| | | | | | |
|---|---|---|---|---|---|
| *In respect of:* | | | | | |
| Retail | 73,310 | 2,111 | 44 | 90 | 75,555 |
| Commercial | 58,290 | 1,001 | 6 | – | 59,297 |
| Other | 246 | – | – | – | 246 |
| **Total loans and advances to customers** | 131,846 | 3,112 | 50 | 90 | 135,098 |

**Notes to the consolidated financial statements** continued

## Note 53: Financial risk management continued

| Expected credit losses in respect of undrawn exposures | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2018 | | | | | | |
| **Loans and advances to customers:** | | | | | | |
| *Retail - mortgages* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 1 | – | – | – | 1 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 1 | – | – | – | 1 |
| *Retail - unsecured* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 85 | 26 | – | – | 111 |
| RMS 7-9 | 4.51-14.00% | 5 | 10 | – | – | 15 |
| RMS 10 | 14.01-20.00% | – | 3 | – | – | 3 |
| RMS 11-13 | 20.01-99.99% | – | 10 | – | – | 10 |
| RMS 14 | 100% | – | – | – | – | – |
| | | 90 | 49 | – | – | 139 |
| *Retail - UK Motor Finance* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 2 | – | – | – | 2 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 2 | – | – | – | 2 |
| *Retail - Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 11 | 2 | – | – | 13 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 11 | 2 | – | – | 13 |
| **Total Retail** | | 104 | 51 | – | – | 155 |

## Note 53: Financial risk management continued

| Expected credit losses in respect of undrawn exposures (continued) | PD range | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2018 | | | | | | |
| *Commercial* | | | | | | |
| CMS 1-10 | 0.00-0.50% | 9 | – | – | – | 9 |
| CMS 11-14 | 0.51-3.00% | 7 | 7 | – | – | 14 |
| CMS 15-18 | 3.01-20.00% | 1 | 5 | – | – | 6 |
| CMS 19 | 20.01-99.99% | 1 | 1 | – | – | 2 |
| CMS 20-23 | 100% | – | – | 6 | – | 6 |
| | | 18 | 13 | 6 | – | 37 |
| *Other* | | | | | | |
| RMS 1-6 | 0.00-4.50% | 1 | – | – | – | 1 |
| RMS 7-9 | 4.51-14.00% | – | – | – | – | – |
| RMS 10 | 14.01-20.00% | – | – | – | – | – |
| RMS 11-13 | 20.01-99.99% | – | – | – | – | – |
| RMS 14 | 100% | – | – | – | – | – |
| | | 1 | – | – | – | 1 |
| CMS 1-10 | 0.00-0.50% | – | – | – | – | – |
| CMS 11-14 | 0.51-3.00% | – | – | – | – | – |
| CMS 15-18 | 3.01-20.00% | – | – | – | – | – |
| CMS 19 | 20.01-99.99% | – | – | – | – | – |
| CMS 20-23 | 100% | – | – | – | – | – |
| | | – | – | – | – | – |
| **Total loans and advances to customers** | | 123 | 64 | 6 | – | 193 |

| | | | | | |
|---|---|---|---|---|---|
| *In respect of:* | | | | | |
| Retail | 104 | 51 | – | – | 155 |
| Commercial | 18 | 13 | 6 | – | 37 |
| Other | 1 | – | – | – | 1 |
| **Total loans and advances to customers** | 123 | 64 | 6 | – | 193 |

## Note 53: Financial risk management continued

### Debt securities held at amortised cost

An analysis by credit rating of the Group's debt securities held at amortised cost is provided below:

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Investment grade[1] £m | Other[2] £m | Total £m | Investment grade[1] £m | Other[2] £m | Total £m |
| Asset-backed securities: | | | | | | |
| Mortgage-backed securities | 3,007 | – | 3,007 | 3,263 | 9 | 3,272 |
| Other asset-backed securities | 876 | – | 876 | 763 | 17 | 780 |
| | 3,883 | – | 3,883 | 4,026 | 26 | 4,052 |
| Corporate and other debt securities | 1,650 | 14 | 1,664 | 1,176 | 16 | 1,192 |
| Gross exposure | 5,533 | 14 | 5,547 | 5,202 | 42 | 5,244 |
| Allowance for impairment losses | | | (3) | | | (6) |
| Total debt securities held at amortised cost | | | 5,544 | | | 5,238 |

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (31 December 2019: £nil; 31 December 2018: £6 million) and not rated (31 December 2019: £14 million; 31 December 2018: £36 million).

### Financial assets at fair value through other comprehensive income (excluding equity shares)

An analysis of the Group's financial assets at fair value through other comprehensive income is included in note 19. The credit quality of the Group's financial assets at fair value through other comprehensive income (excluding equity shares) is set out below:

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Investment grade[1] £m | Other[2] £m | Total £m | Investment grade[1] £m | Other[2] £m | Total £m |
| Debt securities: | | | | | | |
| Government securities | 13,084 | 14 | 13,098 | 18,971 | – | 18,971 |
| Bank and building society certificates of deposit | – | – | – | 118 | – | 118 |
| Asset-backed securities: | | | | | | |
| Mortgage-backed securities | 121 | – | 121 | 120 | – | 120 |
| Other asset-backed securities | – | 60 | 60 | – | 131 | 131 |
| | 121 | 60 | 181 | 120 | 131 | 251 |
| Corporate and other debt securities | 11,036 | 15 | 11,051 | 4,934 | 217 | 5,151 |
| Total debt securities | 24,241 | 89 | 24,330 | 24,143 | 348 | 24,491 |
| Treasury and other bills | 535 | – | 535 | 303 | – | 303 |
| Total financial assets at fair value through other comprehensive income | 24,776 | 89 | 24,865 | 24,446 | 348 | 24,794 |

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (31 December 2019: £89 million; 31 December 2018: £85 million) and not rated (31 December 2019: £nil; 31 December 2018: £263 million).

# 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 financial assets at fair value through profit or loss is included in note 16. 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:

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | 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 | 6,791 | – | 6,791 | 7,192 | – | 7,192 |
| Asset-backed securities: | | | | | | |
| Mortgage-backed securities | 1 | 5 | 6 | 10 | – | 10 |
| Other asset-backed securities | 14 | 3 | 17 | 63 | – | 63 |
| | 15 | 8 | 23 | 73 | – | 73 |
| Corporate and other debt securities | 232 | 1 | 233 | 228 | 19 | 247 |
| Total held as trading assets | 7,038 | 9 | 7,047 | 7,493 | 19 | 7,512 |
| Other assets held at fair value through profit or loss: | | | | | | |
| Government securities | 12,044 | 19 | 12,063 | 10,903 | – | 10,903 |
| Other public sector securities | 2,118 | 8 | 2,126 | 2,059 | 5 | 2,064 |
| Bank and building society certificates of deposit | 984 | – | 984 | 1,105 | – | 1,105 |
| Asset-backed securities: | | | | | | |
| Mortgage-backed securities | 452 | 10 | 462 | 208 | 7 | 215 |
| Other asset-backed securities | 241 | – | 241 | 283 | 3 | 286 |
| | 693 | 10 | 703 | 491 | 10 | 501 |
| Corporate and other debt securities | 15,932 | 2,051 | 17,983 | 16,141 | 1,922 | 18,063 |
| Total debt securities held at fair value through profit or loss | 31,771 | 2,088 | 33,859 | 30,699 | 1,937 | 32,636 |
| Treasury bills and other bills | 19 | – | 19 | 20 | – | 20 |
| Total other assets held at fair value through profit or loss | 31,790 | 2,088 | 33,878 | 30,719 | 1,937 | 32,656 |
| Total held at fair value through profit or loss | 38,828 | 2,097 | 40,925 | 38,212 | 1,956 | 40,168 |

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2019: £251 million; 2018: £411 million) and not rated (2019: £1,846 million; 2018: £1,545 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.

### Derivative assets

An analysis of derivative assets is given in note 17. 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 net credit risk relating to derivative assets of £11,673 million (2018: £9,268 million), cash collateral of £7,650 million (2018: £6,039 million) was held and a further £274 million was due from OECD banks (2018: £213 million).

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Investment grade[1] £m | Other[2] £m | Total £m | Investment grade[1] £m | Other[2] £m | Total £m |
| Trading and other | 22,991 | 2,142 | 25,133 | 19,797 | 2,235 | 22,032 |
| Hedging | 1,178 | 58 | 1,236 | 1,534 | 29 | 1,563 |
| Total derivative financial instruments | 24,169 | 2,200 | 26,369 | 21,331 | 2,264 | 23,595 |

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2019: £1,555 million; 2018: £1,920 million) and not rated (2019: £645 million; 2018: £344 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 142. The Group holds collateral against loans and advances and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for financial assets at fair value through profit or loss and for derivative assets is also shown below.

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 financial assets held at amortised cost.

## Note 53: Financial risk management continued

### 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 £1,555 million (2018: £461 million), against which the Group held collateral with a fair value of £1,516 million (2018: £481 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 allowances for indexation error and dilapidations.

In some circumstances, where the discounted value of the estimated net proceeds from the liquidation of collateral (i.e. net of costs, expected haircuts and anticipated changes in the value of the collateral to the point of sale) is greater than the estimated exposure at default, no credit losses are expected and no ECL allowance is recognised.

| | As at 31 December 2019 | | | | | As at 31 December 2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total gross £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total gross £m |
| **Drawn balances** | | | | | | | | | | |
| Less than 70 per cent | **179,566** | **13,147** | **1,174** | **10,728** | **204,615** | 185,556 | 10,728 | 1,035 | 11,846 | 209,165 |
| 70 per cent to 80 per cent | **44,384** | **2,343** | **181** | **1,751** | **48,659** | 41,827 | 1,802 | 190 | 1,884 | 45,703 |
| 80 per cent to 90 per cent | **27,056** | **1,057** | **86** | **677** | **28,876** | 24,854 | 832 | 95 | 1,032 | 26,813 |
| 90 per cent to 100 per cent | **5,663** | **199** | **34** | **207** | **6,103** | 4,957 | 164 | 39 | 302 | 5,462 |
| Greater than 100 per cent | **374** | **189** | **31** | **351** | **945** | 603 | 128 | 34 | 327 | 1,092 |
| **Total** | **257,043** | **16,935** | **1,506** | **13,714** | **289,198** | 257,797 | 13,654 | 1,393 | 15,391 | 288,235 |

| | As at 31 December 2019 | | | | | As at 31 December 2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Purchased or originated credit-impaired £m | Total £m |
| **Expected credit losses on drawn balances** | | | | | | | | | | |
| Less than 70 per cent | **6** | **104** | **41** | **44** | **195** | 3 | 94 | 34 | 19 | 150 |
| 70 per cent to 80 per cent | **7** | **75** | **29** | **38** | **149** | 11 | 51 | 24 | 12 | 98 |
| 80 per cent to 90 per cent | **7** | **58** | **25** | **23** | **113** | 14 | 47 | 27 | 16 | 104 |
| 90 per cent to 100 per cent | **2** | **17** | **12** | **10** | **41** | 4 | 16 | 14 | 9 | 43 |
| Greater than 100 per cent | **1** | **27** | **15** | **27** | **70** | 5 | 18 | 19 | 22 | 64 |
| **Total** | **23** | **281** | **122** | **142** | **568** | 37 | 226 | 118 | 78 | 459 |

*Other*

The majority of non-mortgage retail lending is unsecured. At 31 December 2019, Stage 3 non-mortgage lending amounted to £610 million, net of an impairment allowance of £368 million (2018: £631 million, net of an impairment allowance of £366 million).

Stage 1 and Stage 2 non-mortgage retail lending amounted to £54,042 million (2018: £52,450 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.

#### Commercial lending

*Reverse repurchase transactions*

At 31 December 2019 there were reverse repurchase agreements which were accounted for as collateralised loans with a carrying value of £54,600 million (2018: £40,483 million), against which the Group held collateral with a fair value of £52,982 million (2018: £42,339 million), all of which the Group was able to repledge. There were no collateral balances in the form of cash provided in respect of reverse repurchase agreements included in these amounts (2018: £nil). These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

*Stage 3 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 2019, Stage 3 secured commercial lending amounted to £966 million, net of an impairment allowance of £243 million (2018: £658 million, net of an impairment allowance of £215 million). The fair value of the collateral held in respect of impaired secured commercial lending was £744 million (2018: £590 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

## Note 53: Financial risk management continued

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.

Stage 3 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.

*Stage 1 and Stage 2 secured lending*

For Stage 1 and Stage 2 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.

Stage 1 and Stage 2 secured commercial lending is predominantly managed on a cash flow basis. On occasion, it may include an assessment of underlying collateral, although, for Stage 3 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.

### Financial assets at fair value through profit or loss (excluding equity shares)

Included in financial assets at fair value through profit or loss are reverse repurchase agreements treated as collateralised loans with a carrying value of £11,269 million (2018: £28,356 million). Collateral is held with a fair value of £11,081 million (2018: £36,101 million), all of which the Group is able to repledge. At 31 December 2019, £9,605 million had been repledged (2018: £31,013 million).

In addition, securities held as collateral in the form of stock borrowed amounted to £32,888 million (2018: £51,202 million). Of this amount, £30,594 million (2018: £49,233 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 £11,673 million (2018: £9,268 million), cash collateral of £7,650 million (2018: £6,039 million) was held.

### Irrevocable loan commitments and other credit-related contingencies

At 31 December 2019, the Group held irrevocable loan commitments and other credit-related contingencies of £66,398 million (2018: £68,135 million). Collateral is held as security, in the event that lending is drawn down, on £12,391 million (2018: £10,661 million) of these balances.

### Collateral repossessed

During the year, £413 million of collateral was repossessed (2018: £245 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 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 balances arising from repurchase transactions of £18,105 million (2018: £21,170 million); the fair value of the collateral provided under these agreements at 31 December 2019 was £17,545 million (2018: £19,615 million).

#### Customer deposits

Included in customer deposits are balances arising from repurchase transactions of £9,530 million (2018: £1,818 million); the fair value of the collateral provided under these agreements at 31 December 2019 was £9,221 million (2018: £1,710 million).

#### 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 £8,324 million (2018: £28,438 million).

### Securities lending transactions

The following on balance sheet financial assets have been lent to counterparties under securities lending transactions:

| | 2019 £m | 2018 £m |
|---|---|---|
| Financial assets at fair value through profit or loss | **5,857** | 5,837 |
| Financial assets at fair value through other comprehensive income | **2,020** | 1,917 |
| | **7,877** | 7,754 |

### 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 note 31.

## 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.

### (A) 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 2019** | | | | | | | | | |
| **Assets** | | | | | | | | | |
| Cash and balances at central banks | 55,128 | 2 | – | – | – | – | – | – | 55,130 |
| Financial assets at fair value through profit or loss | 7,195 | 3,689 | 3,016 | 1,710 | 451 | 2,801 | 5,385 | 135,942 | 160,189 |
| Derivative financial instruments | 583 | 739 | 627 | 404 | 336 | 1,294 | 2,763 | 19,623 | 26,369 |
| Loans and advances to banks | 4,953 | 1,017 | 265 | 124 | 91 | 26 | – | 3,299 | 9,775 |
| Loans and advances to customers | 35,973 | 26,036 | 23,283 | 12,626 | 11,425 | 29,917 | 74,416 | 281,312 | 494,988 |
| Debt securities held at amortised cost | 131 | 19 | – | – | – | 74 | 3,085 | 2,235 | 5,544 |
| Financial assets at fair value through other comprehensive income | 111 | 179 | 729 | 102 | 234 | 2,929 | 12,809 | 7,999 | 25,092 |
| Other assets | 2,224 | 1,155 | 533 | 160 | 520 | 568 | 1,218 | 50,428 | 56,806 |
| **Total assets** | **106,298** | **32,836** | **28,453** | **15,126** | **13,057** | **37,609** | **99,676** | **500,838** | **833,893** |
| **Liabilities** | | | | | | | | | |
| Deposits from banks | 4,530 | 2,715 | 267 | 85 | 55 | 15,686 | 433 | 4,408 | 28,179 |
| Customer deposits | 382,885 | 12,945 | 6,716 | 4,377 | 3,207 | 6,742 | 1,752 | 2,696 | 421,320 |
| Derivative financial instruments and financial liabilities at fair value through profit or loss | 5,182 | 6,101 | 2,579 | 784 | 528 | 1,644 | 5,238 | 25,209 | 47,265 |
| Debt securities in issue | 4,070 | 9,159 | 7,135 | 7,418 | 1,963 | 13,618 | 30,897 | 23,429 | 97,689 |
| Liabilities arising from insurance and investment contracts | 1,213 | 1,658 | 2,370 | 2,348 | 2,882 | 9,028 | 24,870 | 104,539 | 148,908 |
| Other liabilities | 4,541 | 1,914 | 772 | 893 | 1,682 | 898 | 906 | 13,990 | 25,596 |
| Subordinated liabilities | – | 1,339 | 96 | 1,137 | 108 | 575 | 4,105 | 9,770 | 17,130 |
| **Total liabilities** | **402,421** | **35,831** | **19,935** | **17,042** | **10,425** | **48,191** | **68,201** | **184,041** | **786,087** |
| At 31 December 2018 | | | | | | | | | |
| Assets | | | | | | | | | |
| Cash and balances at central banks | 54,662 | 1 | – | – | – | – | – | – | 54,663 |
| Financial assets at fair value through profit or loss | 10,686 | 8,826 | 8,492 | 5,133 | 2,587 | 2,090 | 5,467 | 115,248 | 158,529 |
| Derivative financial instruments | 579 | 688 | 418 | 336 | 441 | 1,064 | 3,075 | 16,994 | 23,595 |
| Loans and advances to banks | 2,594 | 520 | 584 | 172 | 203 | 160 | – | 2,050 | 6,283 |
| Loans and advances to customers | 36,326 | 19,383 | 18,415 | 14,378 | 11,318 | 30,459 | 72,028 | 282,551 | 484,858 |
| Debt securities held as at amortised cost | 7 | – | – | 521 | – | – | 2,262 | 2,448 | 5,238 |
| Financial assets at fair value through other comprehensive income | 166 | 453 | 249 | 800 | 1,685 | 2,536 | 11,496 | 7,430 | 24,815 |
| Other assets | 2,667 | 1,552 | 196 | 238 | 219 | 387 | 1,118 | 33,240 | 39,617 |
| Total assets | 107,687 | 31,423 | 28,354 | 21,578 | 16,453 | 36,696 | 95,446 | 459,961 | 797,598 |
| Liabilities | | | | | | | | | |
| Deposits from banks | 2,793 | 1,688 | 748 | 54 | 45 | 4,758 | 16,052 | 4,182 | 30,320 |
| Customer deposits | 380,753 | 10,623 | 5,628 | 4,543 | 4,431 | 6,421 | 3,244 | 2,423 | 418,066 |
| Derivative financial instruments and financial liabilities at fair value through profit or loss | 5,160 | 11,877 | 5,048 | 1,663 | 522 | 1,104 | 4,108 | 22,438 | 51,920 |
| Debt securities in issue | 4,172 | 5,692 | 9,007 | 4,668 | 1,694 | 13,062 | 28,676 | 24,197 | 91,168 |
| Liabilities arising from insurance and investment contracts | 1,844 | 1,850 | 2,316 | 2,302 | 2,104 | 7,995 | 20,986 | 73,330 | 112,727 |
| Other liabilities | 4,403 | 3,201 | 733 | 1,182 | 1,383 | 756 | 232 | 13,652 | 25,542 |
| Subordinated liabilities | 85 | 145 | 95 | 251 | – | 2,600 | 2,559 | 11,921 | 17,656 |
| Total liabilities | 399,210 | 35,076 | 23,575 | 14,663 | 10,179 | 36,696 | 75,857 | 152,143 | 747,399 |

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 2019** | | | | | | |
| Deposits from banks | **5,009** | **2,564** | **762** | **20,066** | **317** | **28,718** |
| Customer deposits | **385,864** | **14,433** | **14,327** | **10,661** | **1,393** | **426,678** |
| Financial liabilities at fair value through profit or loss | **4,370** | **5,543** | **2,255** | **2,690** | **14,653** | **29,511** |
| Debt securities in issue | **5,335** | **9,858** | **19,205** | **54,638** | **36,321** | **125,357** |
| Liabilities arising from non-participating investment contracts | **37,459** | **–** | **–** | **–** | **–** | **37,459** |
| Other liabilities (Lease liabilities) | **2** | **61** | **190** | **803** | **946** | **2,002** |
| Subordinated liabilities | **942** | **1,462** | **1,918** | **7,837** | **14,857** | **27,016** |
| **Total non-derivative financial liabilities** | **438,981** | **33,921** | **38,657** | **96,695** | **68,487** | **676,741** |
| Derivative financial liabilities: | | | | | | |
| Gross settled derivatives – outflows | **43,118** | **44,379** | **34,012** | **36,012** | **18 ,238** | **175,759** |
| Gross settled derivatives – inflows | **(40,829)** | **(42,954)** | **(32,966)** | **(34,758)** | **(17,753)** | **(169,260)** |
| Gross settled derivatives – net flows | **2,289** | **1,425** | **1,046** | **1,254** | **485** | **6,499** |
| Net settled derivatives liabilities | **23,648** | **48** | **122** | **700** | **2,201** | **26,719** |
| **Total derivative financial liabilities** | **25,937** | **1,473** | **1,168** | **1,954** | **2,686** | **33,218** |
| At 31 December 2018 | | | | | | |
| Deposits from banks | 2,820 | 2,710 | 1,022 | 20,920 | 3,502 | 30,974 |
| Customer deposits | 380,985 | 10,584 | 14,169 | 11,634 | 1,554 | 418,926 |
| Financial liabilities at fair value through profit or loss | 9,693 | 10,984 | 7,553 | 930 | 10,771 | 39,931 |
| Debt securities in issue | 5,942 | 7,314 | 22,564 | 48,233 | 24,201 | 108,254 |
| Liabilities arising from non-participating investment contracts | 13,853 | – | – | – | – | 13,853 |
| Subordinated liabilities | 247 | 1,017 | 1,144 | 8,231 | 19,328 | 29,967 |
| Total non-derivative financial liabilities | 413,540 | 32,609 | 46,452 | 89,948 | 59,356 | 641,905 |
| Derivative financial liabilities: | | | | | | |
| Gross settled derivatives – outflows | 39,165 | 27,976 | 23,978 | 43,239 | 33,763 | 168,121 |
| Gross settled derivatives – inflows | (38,301) | (27,283) | (23,134) | (40,690) | (28,933) | (158,341) |
| Gross settled derivatives – net flows | 864 | 693 | 844 | 2,549 | 4,830 | 9,780 |
| Net settled derivatives liabilities | 13,511 | 103 | 209 | 782 | 2,193 | 16,798 |
| Total derivative financial liabilities | 14,375 | 796 | 1,053 | 3,331 | 7,023 | 26,578 |

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 £29 million (2018: £27 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 175 to 180.

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 2019** | **1,340** | **1,240** | **5,378** | **25,349** | **78,142** | **111,449** |
| At 31 December 2018 | 1,667 | 1,624 | 5,925 | 25,414 | 64,244 | 98,874 |

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, commitments and guarantees.

| | 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 2019** | | | | | | | | | |
| Acceptances and endorsements | **25** | **24** | **4** | **–** | **21** | **–** | **–** | **–** | **74** |
| Other contingent liabilities | **381** | **409** | **387** | **177** | **207** | **475** | **101** | **683** | **2,820** |
| Total contingent liabilities | **406** | **433** | **391** | **177** | **228** | **475** | **101** | **683** | **2,894** |
| Lending commitments and guarantees | **68,638** | **2,682** | **15,297** | **4,637** | **7,367** | **17,365** | **14,114** | **3,264** | **133,364** |
| Other commitments | **–** | **1** | **16** | **5** | **–** | **72** | **43** | **52** | **189** |
| Total commitments and guarantees | **68,638** | **2,683** | **15,313** | **4,642** | **7,367** | **17,437** | **14,157** | **3,316** | **133,553** |
| **Total contingents, commitments and guarantees** | **69,044** | **3,116** | **15,704** | **4,819** | **7,595** | **17,912** | **14,258** | **3,999** | **136,447** |
| At 31 December 2018 | | | | | | | | | |
| Acceptances and endorsements | 64 | 83 | 34 | 13 | – | – | – | – | 194 |
| Other contingent liabilities | 450 | 484 | 203 | 223 | 150 | 665 | 133 | 749 | 3,057 |
| Total contingent liabilities | 514 | 567 | 237 | 236 | 150 | 665 | 133 | 749 | 3,251 |
| Lending commitments and guarantees | 67,055 | 2,947 | 4,474 | 6,055 | 16,123 | 17,737 | 15,374 | 4,602 | 134,367 |
| Other commitments | 428 | – | – | 2 | 92 | 20 | 13 | 176 | 731 |
| Total commitments and guarantees | 67,483 | 2,947 | 4,474 | 6,057 | 16,215 | 17,757 | 15,387 | 4,778 | 135,098 |
| Total contingents, commitments and guarantees | 67,997 | 3,514 | 4,711 | 6,293 | 16,365 | 18,422 | 15,520 | 5,527 | 138,349 |

## Note 54: Consolidated cash flow statement

### (A) Change in operating assets

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Change in financial assets held at amortised cost | **(12,423)** | (27,038) | (24,747) |
| Change in derivative financial instruments and financial assets at fair value through profit or loss | **3,887** | 22,046 | 9,916 |
| Change in other operating assets | **(2,513)** | 520 | (661) |
| **Change in operating assets** | **(11,049)** | (4,472) | (15,492) |

### (B) Change in operating liabilities

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Change in deposits from banks | **(2,140)** | 515 | 13,415 |
| Change in customer deposits | **3,248** | (322) | 2,913 |
| Change in debt securities in issue | **6,631** | 18,579 | (3,600) |
| Change in derivative financial instruments and liabilities at fair value through profit or loss | **(5,078)** | (24,606) | (12,481) |
| Change in investment contract liabilities | **2,625** | (1,594) | (4,665) |
| Change in other operating liabilities[1] | **(1,644)** | (1,245) | 136 |
| **Change in operating liabilities** | **3,642** | (8,673) | (4,282) |

1 Includes £82 million (2018: £27 million; 2017: £2 million) in respect of lease liabilities.

## Note 54: Consolidated cash flow statement continued
## (C) Non-cash and other items

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Depreciation and amortisation | **2,660** | 2,405 | 2,370 |
| Revaluation of investment properties | **108** | (139) | (230) |
| Allowance for loan losses | **1,312** | 1,024 | 691 |
| Write-off of allowance for loan losses, net of recoveries | **(1,458)** | (1,025) | (1,061) |
| Impairment charge relating to undrawn balances | **(15)** | (73) | (9) |
| Impairment of financial assets at fair value through other comprehensive income (2017: available-for-sale financial assets) | **(1)** | (14) | 6 |
| Change in insurance contract liabilities | **12,593** | (4,547) | 9,168 |
| Payment protection insurance provision | **2,450** | 750 | 1,650 |
| Other regulatory provisions | **445** | 600 | 865 |
| Other provision movements | **(165)** | (518) | (8) |
| Net charge (credit) in respect of defined benefit schemes | **245** | 405 | 369 |
| Unwind of discount on impairment allowances | **(53)** | (44) | (23) |
| Foreign exchange impact on balance sheet[1] | **533** | 191 | 125 |
| Interest expense on subordinated liabilities | **1,228** | 1,388 | 1,436 |
| Net gain on sale of financial assets at fair value through other comprehensive income (2017: available-for-sale financial assets) | **(196)** | (275) | (446) |
| Hedging valuation adjustments on subordinated debt | **440** | (429) | (327) |
| Value of employee services | **236** | 260 | 414 |
| Transactions in own shares | **(3)** | 40 | (411) |
| Accretion of discounts and amortisation of premiums and issue costs | **445** | 1,947 | 1,701 |
| Share of post-tax results of associates and joint ventures | **(6)** | (9) | (6) |
| Gain on establishment of joint venture | **(244)** | – | – |
| Transfers to income statement from reserves | **(608)** | (701) | (650) |
| Profit on disposal of tangible fixed assets | **(32)** | (104) | (120) |
| Other non-cash items | **(35)** | (34) | – |
| **Total non-cash items** | **19,879** | 1,098 | 15,504 |
| Contributions to defined benefit schemes | **(1,069)** | (868) | (587) |
| Payments in respect of payment protection insurance provision | **(2,461)** | (2,104) | (1,657) |
| Payments in respect of other regulatory provisions | **(778)** | (1,032) | (928) |
| Other | **2** | 14 | – |
| Total other items | **(4,306)** | (3,990) | (3,172) |
| **Non-cash and other items** | **15,573** | (2,892) | 12,332 |

1 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.

## (D) Analysis of cash and cash equivalents as shown in the balance sheet

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Cash and balances at central banks | **55,130** | 54,663 | 58,521 |
| Less: mandatory reserve deposits[1] | **(3,289)** | (2,553) | (957) |
| | **51,841** | 52,110 | 57,564 |
| Loans and advances to banks | **9,775** | 6,283 | 6,611 |
| Less: amounts with a maturity of three months or more | **(3,805)** | (3,169) | (3,193) |
| | **5,970** | 3,114 | 3,418 |
| **Total cash and cash equivalents** | **57,811** | 55,224 | 60,982 |

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 2019 is £49 million (31 December 2018: £40 million; 1 January 2018 £48 million; 31 December 2017: £2,322 million) held within the Group's long-term insurance and investments businesses, which is not immediately available for use in the business.

Notes to the consolidated financial statements continued

## Note 54: Consolidated cash flow statement continued

## (E) Acquisition of group undertakings and businesses

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Net assets acquired: | | | |
| Cash and cash equivalents | – | – | 123 |
| Loans and advances to customers | – | – | 7,811 |
| Available-for-sale financial assets | | | 16 |
| Financial assets at fair value through profit or loss | 7,350 | – | – |
| Assets arising from reinsurance contracts held | 13,616 | – | – |
| Intangible assets | – | 21 | 702 |
| Property, plant and equipment | – | – | 6 |
| Other assets | 29 | 6 | 414 |
| Deposits from banks[1] | – | – | (6,431) |
| Liabilities arising from non-participating investment contracts | (20,981) | – | – |
| Other liabilities | (8) | (1) | (927) |
| Goodwill arising on acquisition | 14 | – | 302 |
| Cash consideration | 20 | 26 | 2,016 |
| Less: Cash and cash equivalents acquired | – | – | (123) |
| Net cash outflow arising from acquisition of subsidiaries and businesses | 20 | 26 | 1,893 |
| Acquisition of and additional investment in joint ventures | 1 | 23 | 30 |
| Net cash outflow from acquisitions in the year | 21 | 49 | 1,923 |

1 Upon acquisition in 2017, the funding of MBNA was assumed by Lloyds Bank plc.

## (F) Disposal and closure of group undertakings and businesses

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Loans and advances to customers | – | – | 342 |
| Non-controlling interests | – | – | (242) |
| Other net assets (liabilities) | – | 1 | 29 |
| | – | 1 | 129 |
| | | | |
| Net assets | – | 1 | 129 |
| | | | |
| Non-cash consideration received | – | – | – |
| (Loss) profit on sale | – | – | – |
| Cash consideration received on losing control of group undertakings and businesses | – | 1 | 129 |
| Cash and cash equivalents disposed | – | – | – |
| **Net cash inflow (outflow)** | – | 1 | 129 |

## Note 55: Adoption of IFRS 16

The Group adopted IFRS 16 *Leases* from 1 January 2019 and elected to apply the standard retrospectively with the cumulative effect of initial application being recognised at that date; comparative information has therefore not been restated. Comparative information was prepared in accordance with IAS 17. Under IAS 17, where the Group was lessee it charged operating lease rentals to the income statement on a straight-line basis over the life of the lease.

Operating lease commitments as at 31 December 2018 amounted to £2,043 million. Lease liabilities amounting to £1,813 million in respect of leased properties previously accounted for as operating leases were recognised at 1 January 2019. These liabilities were measured at the present value of the remaining lease payments, discounted using the Group's incremental borrowing rate appropriate for the related right-of-use asset as at that date, adjusted to exclude short-term leases and leases of low-value assets of approximately £20 million. The weighted-average borrowing rate applied to these lease liabilities was 2.43 per cent in the UK, where the majority of the obligations arise, and 5.10 per cent in the US. The corresponding right-of-use asset of £1,716 million was measured at an amount equal to the lease liabilities, adjusted for lease liabilities recognised at 31 December 2018 of £97 million. The right-of-use asset and lease liabilities are included within property, plant and equipment and other liabilities respectively. There was no impact on shareholders' equity.

In applying IFRS 16 for the first time, the Group has used a number of practical expedients permitted by the standard; the most significant of which were the use of a single discount rate to a portfolio of leases with reasonably similar characteristics; reliance on previous assessments of whether a lease is onerous; and the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease. The Group has also elected not to apply IFRS 16 to contracts that were not identified as containing a lease under IAS 17 and IFRIC 4 *Determining whether an Arrangement contains a Lease.*

## Note 56: Future accounting developments

The following pronouncements are not applicable for the year ending 31 December 2019 and have not been applied in preparing these financial statements. Save as disclosed below, the impact of these accounting changes is still being assessed by the Group and reliable estimates cannot be made at this stage.

With the exception of IFRS 17 *Insurance Contracts* and certain other minor amendments, as at 19 February 2020 these pronouncements have been endorsed by the EU.

### IFRS 17 Insurance Contracts

IFRS 17 replaces IFRS 4 *Insurance Contracts* and is currently effective for annual periods beginning on or after 1 January 2021 although, in its Exposure Draft published on 26 June 2019, the International Accounting Standards Board proposed delaying implementation until 1 January 2022.

IFRS 17 requires insurance contracts and participating investment contracts to be measured on the balance sheet as the total of the fulfilment cash flows and the contractual service margin. Changes to estimates of future cash flows from one reporting date to another are recognised either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it. The effects of some changes in discount rates can either be recognised in profit or loss or in other comprehensive income as an accounting policy choice. The risk adjustment is released to profit and loss as an insurer's risk reduces. Profits which are currently recognised through a Value in Force asset, will no longer be recognised at inception of an insurance contract. Instead, the expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided. The standard will have a significant impact on the accounting for the insurance and participating investment contracts issued by the Group.

The Group's IFRS 17 project is progressing to plan. Work has focussed on interpreting the requirements of the standard, developing methodologies and accounting policies, and assessing the changes required to reporting and other systems. The development of the Group's data warehousing and actuarial liability calculation processes required for IFRS 17 reporting is progressing.

### Minor amendments to other accounting standards

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2020 (including IFRS 3 *Business Combinations* and IAS 1 *Presentation of Financial Statements*). These amendments are not expected to have a significant impact on the Group.

# Parent company balance sheet

at 31 December

| | Note | 2019 £ million | 2018 £ million |
|---|---|---|---|
| **Assets** | | | |
| Non-current assets: | | | |
| Investment in subsidiaries | 10 | 48,597 | 46,725 |
| Loans to subsidiaries | 10 | 14,660 | 24,211 |
| Deferred tax asset | | – | 9 |
| | | 63,257 | 70,945 |
| Current assets: | | | |
| Derivative financial instruments | | 760 | 256 |
| Financial assets at fair value through profit or loss | 2 | 12,516 | 588 |
| Other assets | | 983 | 955 |
| Amounts due from subsidiaries | 3 | 27 | 27 |
| Cash and cash equivalents | | 29 | 57 |
| Current tax recoverable | | 1 | 76 |
| | | 14,316 | 1,959 |
| **Total assets** | | 77,573 | 72,904 |
| **Equity and liabilities** | | | |
| Capital and reserves: | | | |
| Share capital | 4 | 7,005 | 7,116 |
| Share premium account | 4 | 17,751 | 17,719 |
| Merger reserve | 5 | 7,420 | 7,423 |
| Capital redemption reserve | 5 | 4,462 | 4,273 |
| Retained profits[1] | 6 | 3,950 | 2,103 |
| Shareholders' equity | | 40,588 | 38,634 |
| Other equity instruments | 4 | 5,906 | 6,491 |
| **Total equity** | | 46,494 | 45,125 |
| Non-current liabilities: | | | |
| Debt securities in issue | 7 | 20,018 | 20,394 |
| Subordinated liabilities | 8 | 5,961 | 6,043 |
| Deferred tax liabilities | | 2 | – |
| | | 25,981 | 26,437 |
| Current liabilities: | | | |
| Derivative financial instruments | | 438 | 209 |
| Financial liabilities at fair value through profit or loss | 9 | 3,464 | – |
| Other liabilities | | 1,196 | 1,133 |
| | | 5,098 | 1,342 |
| **Total liabilities** | | 31,079 | 27,779 |
| **Total equity and liabilities** | | 77,573 | 72,904 |

1 The parent company recorded a profit after tax for the year of £5,415 million (2018: £4,104 million, restated – see note 1).

The accompanying notes are an integral part of the parent company financial statements.

The directors approved the parent company financial statements on 19 February 2020.

**Lord Blackwell**
Chairman

**António Horta-Osório**
Group Chief Executive

**William Chalmers**
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 2017 | 24,768 | 7,423 | 4,115 | 1,584 | 37,890 | 5,355 | 43,245 |
| Total comprehensive income[1,2] | – | – | – | 2,478 | 2,478 | – | 2,478 |
| Dividends paid | – | – | – | (2,284) | (2,284) | – | (2,284) |
| Distributions on other equity instruments[1] | – | – | – | (415) | (415) | – | (415) |
| Issue of ordinary shares | 63 | – | – | – | 63 | – | 63 |
| Movement in treasury shares | – | – | – | (277) | (277) | – | (277) |
| Value of employee services: | | | | | | | |
| Share option schemes, net of tax | – | – | – | 82 | 82 | – | 82 |
| Other employee award schemes | – | – | – | 332 | 332 | – | 332 |
| Balance at 31 December 2017 | 24,831 | 7,423 | 4,115 | 1,500 | 37,869 | 5,355 | 43,224 |
| Adjustment on adoption of IFRS 9 | – | – | – | (2) | (2) | – | (2) |
| Balance at 1 January 2018 | 24,831 | 7,423 | 4,115 | 1,498 | 37,867 | 5,355 | 43,222 |
| Total comprehensive income[1,2] | – | – | – | 4,104 | 4,104 | – | 4,104 |
| Dividends paid | – | – | – | (2,240) | (2,240) | – | (2,240) |
| Distributions on other equity instruments[1] | – | – | – | (433) | (433) | – | (433) |
| Issue of ordinary shares | 162 | – | – | – | 162 | – | 162 |
| Share buyback programme | (158) | – | 158 | (1,005) | (1,005) | – | (1,005) |
| Issue of other equity instruments | – | – | – | (7) | (7) | 1,136 | 1,129 |
| Movement in treasury shares | – | – | – | (74) | (74) | – | (74) |
| Value of employee services: | | | | | | | |
| Share option schemes, net of tax | – | – | – | 53 | 53 | – | 53 |
| Other employee award schemes | – | – | – | 207 | 207 | – | 207 |
| Balance at 31 December 2018 | 24,835 | 7,423 | 4,273 | 2,103 | 38,634 | 6,491 | 45,125 |
| Total comprehensive income[2] | **–** | **–** | **–** | **5,415** | **5,415** | **–** | **5,415** |
| Dividends paid | **–** | **–** | **–** | **(2,312)** | **(2,312)** | **–** | **(2,312)** |
| Distributions on other equity instruments | **–** | **–** | **–** | **(466)** | **(466)** | **–** | **(466)** |
| Redemption of preference shares | **3** | **(3)** | **–** | **–** | **–** | **–** | **–** |
| Issue of ordinary shares | **107** | **–** | **–** | **–** | **107** | **–** | **107** |
| Share buyback programme | **(189)** | **–** | **189** | **(1,095)** | **(1,095)** | **–** | **(1,095)** |
| Issue of other equity instruments | **–** | **–** | **–** | **(5)** | **(5)** | **896** | **891** |
| Redemption of other equity instruments | **–** | **–** | **–** | **–** | **–** | **(1,481)** | **(1,481)** |
| Movement in treasury shares | **–** | **–** | **–** | **74** | **74** | **–** | **74** |
| Value of employee services: | | | | | | | |
| Share option schemes, net of tax | **–** | **–** | **–** | **71** | **71** | **–** | **71** |
| Other employee award schemes | **–** | **–** | **–** | **165** | **165** | **–** | **165** |
| **Balance at 31 December 2019** | **24,756** | **7,420** | **4,462** | **3,950** | **40,588** | **5,906** | **46,494** |

1 Restated, see note 1.

2 No statement of comprehensive income has been shown for the parent company, as permitted by section 408 of the Companies Act 2006. Total comprehensive income comprises only the profit for the year.

The accompanying notes are an integral part of the parent company financial statements.

# Parent company cash flow statement

for the year ended 31 December

| | 2019 £ million | 2018 £ million | 2017 £ million |
|---|---|---|---|
| Profit before tax | **5,439** | 4,102 | 2,416 |
| Fair value and exchange adjustments and other non-cash items | **(166)** | (715) | 495 |
| Change in other assets | **(11,975)** | (572) | 18 |
| Change in other liabilities and other items | **3,151** | 7,538 | 8,431 |
| Dividends received | **(5,150)** | (4,000) | (2,650) |
| Distributions on other equity instruments received | **(366)** | (324) | (292) |
| Tax (paid) received | **70** | 660 | (197) |
| **Net cash provided by (used in) operating activities** | **(8,997)** | 6,689 | 8,221 |
| **Cash flows from investing activities** | | | |
| Return of capital contribution | **5** | 9 | 77 |
| Dividends received | **5,150** | 4,000 | 2,650 |
| Distributions on other equity instruments received | **366** | 324 | 292 |
| Acquisitions of and capital injections to subsidiaries | **(1,648)** | (12,753) | (320) |
| Return of capital | **–** | 11,114 | – |
| Amounts advanced to subsidiaries | **(1,812)** | (21,577) | (8,476) |
| Repayment of loans to subsidiaries | **11,257** | 12,602 | 475 |
| Interest received on loans to subsidiaries | **395** | 370 | 244 |
| **Net cash (used in) provided by investing activities** | **13,713** | (5,911) | (5,058) |
| **Cash flows from financing activities** | | | |
| Dividends paid to ordinary shareholders | **(2,312)** | (2,240) | (2,284) |
| Distributions on other equity instruments | **(466)** | (433) | (415) |
| Issue of subordinated liabilities | **–** | 1,729 | – |
| Interest paid on subordinated liabilities | **(314)** | (275) | (248) |
| Share buyback | **(1,095)** | (1,005) | – |
| Issue of other equity instruments | **891** | 1,129 | – |
| Redemptions of other equity instruments | **(1,481)** | – | – |
| Repayment of subordinated liabilities | **(3)** | – | – |
| Proceeds from issue of ordinary shares | **36** | 102 | 14 |
| **Net cash used in financing activities** | **(4,744)** | (993) | (2,933) |
| Change in cash and cash equivalents | **(28)** | (215) | 230 |
| Cash and cash equivalents at beginning of year | **57** | 272 | 42 |
| **Cash and cash equivalents at end of year** | **29** | 57 | 272 |

The accompanying notes are an integral part of the parent company financial statements.

# Notes to the parent company financial statements

for the year ended 31 December

## Note 1: Basis of preparation and accounting policies

Lloyds Banking Group plc (the Company) has applied International Financial Reporting Standards as adopted by the European Union in its financial statements for the year ended 31 December 2019. 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 Company has implemented the amendments to IAS 12 *Income Taxes* with effect from 1 January 2019 and as a result tax relief on distributions on other equity instruments, previously taken directly to retained profits, is now reported within tax expense in the income statement. Comparatives have been restated. Adoption of these amendments to IAS 12 has resulted in a reduction in tax expense and an increase in profit for the year in 2019 of £89 million (2018: £82 million; 2017: £79 million). There is no impact on total shareholders' equity.

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. Investments in subsidiaries are carried at historical cost, less any provisions for impairment.

Fees payable to the Company's auditors by the Group are set out in note 12 to the consolidated financial statements.

## Note 2: Financial assets at fair value through profit or loss

| | 2019 £m | 2018 £m |
|---|---|---|
| Debt securities | 12,516 | 588 |

The assets held at fair value through profit or loss represent holdings of debt securities issued by subsidiary companies. The contractual terms of such instruments contain certain write-down and conversion features, and so are not deemed to satisfy the solely payments of principal and interest test.

## Note 3: Amounts due from subsidiaries

These comprise short-term lending to subsidiaries, repayable on demand. As required by IFRS 9, the Company has established an allowance for impairment losses for amounts due from its subsidiaries (31 December 2019: £1 million; 31 December 2018: £5 million) based on the probability of its subsidiaries defaulting on the amounts payable in the next 12 months. The carrying value of the amounts owed by subsidiaries is a reasonable approximation to fair value.

## Note 4: 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 40, 41 and 44 to the consolidated financial statements.

## Note 5: Other reserves

The merger reserve comprises the premium on shares issued on 13 January 2009 under the placing and open offer and shares issued on 16 January 2009 on the acquisition of HBOS plc, 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:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| At 1 January | 7,423 | 7,423 | 7,423 |
| Redemption of preference shares[1] | (3) | – | – |
| **At 31 December** | 7,420 | 7,423 | 7,423 |

1 During the year ended 31 December 2019, the Company redeemed all of its outstanding 6.3673% Non-cumulative Fixed to Floating Rate Preference Shares at their combined sterling par value of £3 million. These preference shares had been accounted for as subordinated liabilities. On redemption an amount of £3 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 shares.

Movements in the capital redemption reserve were as follows:

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| At 1 January | 4,273 | 4,115 | 4,115 |
| Shares cancelled under share buyback programmes | 189 | 158 | – |
| **At 31 December** | 4,462 | 4,273 | 4,115 |

Notes to the parent company financial statements continued

## Note 6: Retained profits

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| At 31 December 2017 | | 1,500 | |
| Adjustment on adoption of IFRS 9 | | (2) | |
| At 1 January | **2,103** | 1,498 | 1,584 |
| Profit for the year[1] | **5,415** | 4,104 | 2,478 |
| Dividends paid[2] | **(2,312)** | (2,240) | (2,284) |
| Issue costs of other equity instruments (net of tax) | **(5)** | (7) | – |
| Distributions on other equity instruments[1] | **(466)** | (433) | (415) |
| Share buyback programme[3] | **(1,095)** | (1,005) | – |
| Movement in treasury shares | **74** | (74) | (277) |
| Value of employee services: | | | |
| Share option schemes | **71** | 53 | 82 |
| Other employee award schemes | **165** | 207 | 332 |
| **At 31 December** | **3,950** | 2,103 | 1,500 |

1 Restated, see note 1.

2 Details of the Company's dividends are as set out in note 45 to the consolidated financial statements.

3 Details of the Company's share buyback programmes are provided in note 42 to the consolidated financial statements.

## Note 7: Debt securities in issue

These comprise notes issued by the Company in a number of currencies, although predominantly Euros and US dollars, with maturity dates ranging up to 2038.

## Note 8: 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 2018 | 566 | 10 | 3,417 | 3,993 |
| Issued in the year: | | | | |
| 1.75% Subordinated Fixed Rate Notes 2028 callable 2023 | – | – | 664 | 664 |
| 4.344% Subordinated Fixed Rate Notes callable 2048 | – | – | 1,065 | 1,065 |
| Foreign exchange and other movements | (12) | – | 333 | 321 |
| **At 31 December 2018** | 554 | 10 | 5,479 | 6,043 |
| Foreign exchange and other movements | **91** | **–** | **(170)** | **(79)** |
| Redemption: | | | | |
| 6.3673% Non-cumulative Fixed to Floating Rate Preference Shares callable 2019 | **(3)** | **–** | **–** | **(3)** |
| **At 31 December 2019** | **642** | **10** | **5,309** | **5,961** |

## Note 9: Financial liabilities at fair value through profit or loss

Financial liabilities designated at fair value through profit or loss, which were all issued in 2019, represent debt securities in issue which are accounted for at fair value to significantly reduce an accounting mismatch. The changes in the credit risk of these liabilities are linked to the changes in credit risk on corresponding assets that the Company holds at fair value through profit or loss, representing debt securities issued by subsidiaries. Given the economic relationship between these assets and liabilities, the Company presents changes in the credit risk of its liabilities in profit or loss in order to avoid creating or enlarging an accounting mismatch.

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2019 was £3,393 million, which was £71 million lower than the balance sheet carrying value. At 31 December 2019 there was a cumulative £101 million increase in the fair value of these liabilities attributable to changes in credit risk, all of which arose in 2019; this is determined by reference to the quoted credit spreads of the Company.

# Note 10: Related party transactions

## Key management personnel

The key management personnel of the Group and the Company are the same. The relevant disclosures are given in note 47 to the consolidated financial statements.

The Company has no employees (2018: 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

| | Ordinary share capital | | Other capital instruments | | Total | |
|---|---|---|---|---|---|---|
| | 2019 £m | 2018 £m | 2019 £m | 2018 £m | 2019 £m | 2018 £m |
| At 1 January | **41,716** | 41,341 | **5,009** | 3,522 | **46,725** | 44,863 |
| Additions and capital injections | **–** | 10,716 | **1,648** | 2,037 | **1,648** | 12,753 |
| Capital contributions | **229** | 265 | **–** | – | **229** | 265 |
| Return of capital contributions | **(5)** | (9) | **–** | – | **(5)** | (9) |
| Capital repayments | **–** | (10,597) | **–** | – | **–** | (10,597) |
| Redemptions | **–** | – | **–** | (550) | **–** | (550) |
| **At 31 December** | **41,940** | 41,716 | **6,657** | 5,009 | **48,597** | 46,725 |

Details of the subsidiaries and related undertakings are given on pages 332 to 337 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

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | **24,211** | 14,377 |
| Exchange and other adjustments | **(106)** | 859 |
| New advances | **1,812** | 21,577 |
| Repayments | **(11,257)** | (12,602) |
| **At 31 December** | **14,660** | 24,211 |

In addition the Company carries out banking activities through its subsidiary, Lloyds Bank plc. At 31 December 2019, the Company held deposits of £29 million with Lloyds Bank plc (2018: £55 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 £105 million (2018: £51 million) due to subsidiary undertakings. In addition, at 31 December 2019 the Company had interest rate and currency swaps with Lloyds Bank plc and Lloyds Bank Corporate Markets plc with an aggregate notional principal amount of £37,555 million and a net positive fair value of £338 million (2018: notional principal amount of £1,379 million and a net positive fair value of £47 million). Of this amount an aggregate notional principal amount of £21,164 million and a net positive fair value of £707 million (2018: notional principal amount of £1,275 million and a net positive fair value of £150 million) were designated as fair value hedges to manage the Company's issuance of subordinated liabilities.

## 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 47 to the consolidated financial statements.

Notes to the parent company financial statements continued

## Note 11: 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.

| | | Mandatorily held at fair value through profit or loss | | | | |
|---|---|---|---|---|---|---|
| | Derivatives designated as hedging instruments £m | Held for trading £m | Other £m | Designated at fair value through profit or loss £m | Held at amortised cost £m | Total £m |
| **At 31 December 2019** | | | | | | |
| Financial assets: | | | | | | |
| Cash and cash equivalents | – | – | – | – | 29 | 29 |
| Derivative financial instruments | 706 | 54 | – | – | – | 760 |
| Financial assets at fair value through profit or loss | – | – | 12,516 | – | – | 12,516 |
| Loans to subsidiaries | – | – | – | – | 14,660 | 14,660 |
| Amounts due from subsidiaries | – | – | – | – | 27 | 27 |
| **Total financial assets** | **706** | **54** | **12,516** | **–** | **14,716** | **27,992** |
| Financial liabilities: | | | | | | |
| Financial liabilities at fair value through profit or loss | – | – | – | 3,464 | – | 3,464 |
| Derivative financial instruments | 43 | 395 | – | – | – | 438 |
| Debt securities in issue | – | – | – | – | 20,018 | 20,018 |
| Subordinated liabilities | – | – | – | – | 5,961 | 5,961 |
| **Total financial liabilities** | **43** | **395** | **–** | **3,464** | **25,979** | **29,881** |
| At 31 December 2018 | | | | | | |
| Financial assets: | | | | | | |
| Cash and cash equivalents | – | – | – | – | 57 | 57 |
| Derivative financial instruments | 150 | 106 | – | – | – | 256 |
| Financial assets at fair value through profit or loss | – | – | 588 | – | – | 588 |
| Loans to subsidiaries | – | – | – | – | 24,211 | 24,211 |
| Amounts due from subsidiaries | – | – | – | – | 27 | 27 |
| Total financial assets | 150 | 106 | 588 | – | 24,295 | 25,139 |
| Financial liabilities: | | | | | | |
| Derivative financial instruments | – | 209 | – | – | – | 209 |
| Debt securities in issue | – | – | – | – | 20,394 | 20,394 |
| Subordinated liabilities | – | – | – | – | 6,043 | 6,043 |
| Total financial liabilities | – | 209 | – | – | 26,437 | 26,646 |

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.

## 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 10, the Company has entered into interest rate and currency swaps with its subsidiaries, Lloyds Bank plc and Lloyds Bank Corporate Markets plc, to manage these risks.

## Credit risk

The majority of the Company's credit risk arises from amounts due from its wholly owned subsidiaries, Lloyds Bank plc, and subsidiaries of that company.

## Liquidity risk

The table below analyses financial instrument liabilities of the Company, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

| | Up to 1 month £m | 1-3 months £m | 3-12 months £m | 1-5 years £m | Over 5 years £m | Total £m |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| Financial liabilities at fair value through profit or loss | 30 | 31 | 41 | 3,554 | – | 3,656 |
| Debt securities in issue | 55 | 126 | 415 | 16,679 | 9,008 | 26,283 |
| Subordinated liabilities | 25 | 28 | 252 | 2,660 | 8,112 | 11,077 |
| **Total financial instrument liabilities** | **110** | **185** | **708** | **22,893** | **17,120** | **41,016** |
| At 31 December 2018 | | | | | | |
| Debt securities in issue | 58 | 99 | 396 | 11,945 | 11,555 | 24,053 |
| Subordinated liabilities | – | 39 | 254 | 1,929 | 9,569 | 11,791 |
| Total financial instrument liabilities | 58 | 138 | 650 | 13,874 | 21,124 | 35,844 |

## Note 11: Financial instruments continued

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £1 million (2018: £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 50 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 (2018: none).

## Fair value of financial assets and liabilities

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | | | 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 | **760** | **760** | **760** | **–** | 256 | 256 | 256 | – |
| Financial assets at fair value through profit or loss | **12,516** | **12,516** | **12,516** | **–** | 588 | 588 | 588 | – |
| Loans to subsidiaries | **14,660** | **14,660** | **14,660** | **–** | 24,211 | 24,211 | 24,211 | – |
| Amounts due from subsidiaries | **27** | **27** | **27** | **–** | 27 | 27 | 27 | – |
| **Total financial assets** | **27,963** | **27,963** | **27,963** | **–** | 25,082 | 25,082 | 25,082 | – |
| Financial liabilities at fair value through profit or loss | **3,464** | **3,464** | **3,464** | **–** | – | – | – | – |
| Derivative financial instruments | **438** | **438** | **438** | **–** | 209 | 209 | 209 | – |
| Debt securities in issue | **20,018** | **20,621** | **20,621** | **–** | 20,394 | 20,352 | 20,352 | – |
| Subordinated liabilities | **5,961** | **7,204** | **7,204** | **–** | 6,043 | 6,325 | 6,325 | – |
| **Total financial liabilities** | **29,881** | **31,727** | **31,727** | **–** | 26,646 | 26,886 | 26,886 | – |

The carrying amount of cash and cash equivalents (2019: £29 million; 2018: £57 million) is a reasonable approximation of fair value.

## Note 12: 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

# Shareholder information

## Annual general meeting (AGM)

The AGM will be held at the Edinburgh International Conference Centre, The Exchange, Edinburgh EH3 8EE on Thursday 21 May 2020 at 11am. Further details about the meeting, including the proposed resolutions and where shareholders can stream the meeting live, 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 scheduled reports and communications to be issued in 2020 is set out below:

| | | Available format | | | |
|---|---|---|---|---|---|
| Report/Communication | Month | Online | Email | RNS | Paper |
| Preliminary results and publication of Annual Report and Accounts | Feb | ✔ | ✔ | ✔ | |
| Pillar 3 report | Feb/Aug | ✔ | | | |
| Group Chief Executive update to shareholders | Mar | ✔ | ✔ | | ✔ |
| Mailing of Annual Report and Accounts, Annual Review or Performance Summary | Mar | ✔ | ✔ | | ✔ |
| Notice of AGM and voting materials | Mar | ✔ | ✔ | | ✔ |
| Q1 interim management statement | Apr | ✔ | ✔ | ✔ | |
| Country analysis[1] | Jun/Jul | ✔ | | | |
| Interim results | Jul | ✔ | ✔ | ✔ | |
| Group Chief Executive update to shareholders | Aug | ✔ | ✔ | | ✔ |
| Q3 interim management statement | Oct | ✔ | ✔ | ✔ | |

1 To be published on the Group's website by 1 July 2020 in accordance with the Capital Requirements (country analysis) Regulations 2013.

## Share dealing facilities

We offer a choice of four 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.bankofscotland.co.uk/sharedealing |
| Halifax Share Dealing | 03457 22 55 25 | www.halifax.co.uk/sharedealing |
| Lloyds Bank Direct Investments | 0345 60 60 560 | www.lloydsbank.com/share-dealing.asp |
| IWeb Share Dealing | 03450 707 129 | www.iweb-sharedealing.co.uk/share-dealing-home.asp |

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.

Shareholder information continued

## 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 Shareowner Services, 462 South 4th Street, Suite 1600, Louisville KY 40202. 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

| Balance Ranges | Total Number of Holdings | Percentage of Holders | Total Number of Shares | Percentage Issued capital |
|---|---|---|---|---|
| 1-999 | 1,915,432 | 81.13% | 567,825,413 | 0.80% |
| 1,000-9,999 | 382,068 | 16.18% | 1,013,949,503 | 1.44% |
| 10,000-99,999 | 59,685 | 2.53% | 1,502,360,668 | 2.13% |
| 100,000-999,999 | 2,783 | 0.12% | 665,848,217 | 0.94% |
| 1,000,000-4,999,999 | 572 | 0.02% | 1,358,100,928 | 1.93% |
| 5,000,000-9,999,999 | 190 | 0.01% | 1,362,623,400 | 1.93% |
| 10,000,000-49,999,999 | 256 | 0.01% | 5,901,629,562 | 8.37% |
| 50,000,000-99,999,999 | 84 | 0.00% | 5,819,172,164 | 8.26% |
| 100,000,000-499,999,999 | 81 | 0.00% | 18,024,809,635 | 25.58% |
| 500,000,000-999,999,999 | 13 | 0.00% | 9,103,085,837 | 12.92% |
| 1,000,000,000+ | 10 | 0.00% | 25,158,227,467 | 35.70% |
| Totals | 2,361,174 | 100.00% | 70,477,632,794 | 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 your activation code in post

**step 3**
Log on

# Five year financial summary for the Group

| | 2019 | 2018[1] | 2017[1,3] | 2016[1,3] | 2015[1,3] |
|---|---|---|---|---|---|
| **Income statement data for the year ended 31 December (£m)** | | | | | |
| Total income, net of insurance claims | **18,359** | 18,626 | 18,659 | 17,267 | 17,421 |
| Operating expenses | **(12,670)** | (11,729) | (12,696) | (12,277) | (15,387) |
| Trading surplus | **5,689** | 6,897 | 5,963 | 4,990 | 2,034 |
| Impairment | **(1,296)** | (937) | (688) | (752) | (390) |
| Profit before tax | **4,393** | 5,960 | 5,275 | 4,238 | 1,644 |
| Profit after tax for the year[2] | **3,006** | 4,506 | 3,649 | 2,605 | 1,036 |
| Profit for the year attributable to ordinary shareholders[2] | **2,459** | 3,975 | 3,144 | 2,092 | 546 |
| | **31 December 2019** | 31 December 2018 | 31 December 2017 | 31 December 2016 | 31 December 2015 |
| **Balance sheet data (£m)** | | | | | |
| Share capital | **7,005** | 7,116 | 7,197 | 7,146 | 7,146 |
| Shareholders' equity | **41,697** | 43,434 | 43,551 | 43,020 | 41,234 |
| Other equity instruments | **5,906** | 6,491 | 5,355 | 5,355 | 5,355 |
| Net asset value per ordinary share | **59.5p** | 61.0p | 60.5p | 60.2p | 57.9p |
| Customer deposits | **421,320** | 418,066 | 418,124 | 415,460 | 418,326 |
| Subordinated liabilities | **17,130** | 17,656 | 17,922 | 19,831 | 23,312 |
| Loans and advances to customers | **494,988** | 484,858 | 472,498 | 457,958 | 455,175 |
| Total assets | **833,893** | 797,598 | 812,109 | 817,793 | 806,688 |
| | **2019** | 2018 | 2017 | 2016 | 2015 |
| **Share information** | | | | | |
| Basic earnings per ordinary share | **3.5p** | 5.5p | 4.4p | 2.9p | 0.8p |
| Diluted earnings per ordinary share | **3.4p** | 5.5p | 4.3p | 2.9p | 0.8p |
| Dividends per ordinary share[4, 5] | **3.37p** | 3.21p | 3.05p | 3.05p | 2.75p |
| Market price (year end) | **62.5p** | 51.9p | 68.1p | 62.5p | 73.1p |
| Number of shareholders (thousands) | **2,361** | 2,404 | 2,450 | 2,510 | 2,563 |
| Number of ordinary shares in issue (millions)[6] | **70,053** | 71,164 | 71,973 | 71,374 | 71,374 |
| | **2019** | 2018 | 2017 | 2016 | 2015 |
| **Financial ratios (%)[7]** | | | | | |
| Dividend payout ratio[8] | **96.6** | 57.6 | 69.8 | 104.0 | 359.3 |
| Post-tax return on average shareholders' equity | **5.7** | 9.3 | 7.2 | 4.9 | 1.3 |
| Post-tax return on average assets[2] | **0.36** | 0.55 | 0.45 | 0.31 | 0.12 |
| Cost:income ratio[9] | **69.0** | 63.0 | 68.0 | 71.1 | 88.3 |
| | **31 December 2019** | 31 December 2018 | 31 December 2017 | 31 December 2016 | 31 December 2015 |
| **Capital ratios (%)** | | | | | |
| Total capital | **21.3** | 22.9 | 21.2 | 21.4 | 21.5 |
| Tier 1 capital | **16.7** | 18.2 | 17.2 | 17.0 | 16.4 |
| Common equity tier 1 capital | **13.6** | 14.6 | 14.1 | 13.6 | 12.8 |

1 The Group has adopted IFRS 16 *Leases* with effect from 1 January 2019, in accordance with the transition requirements of the standard, comparative information has not been restated.

2 The Group has also implemented the amendments to IAS 12 *Income Taxes* with effect from 1 January 2019 and as a result tax relief on distributions on other equity instruments, previously taken directly to retained profits, is now reported within tax expense in the income statement. Comparatives have been restated.

3 The Group adopted IFRS 9 and IFRS 15 with effect from 1 January 2018; in accordance with the transition requirements of the two standards, comparative information for preceding years was not restated.

4 Annual dividends comprise both interim and estimated final dividend payments. The total dividend for the year represents the interim dividend paid during the year and the final dividend which is paid and accounted for in the following year.

5 Dividends per ordinary share in 2016 included a recommended special dividend of 0.5 pence (2015: 0.5 pence).

6 For 2016 and 2015, this figure excluded the limited voting ordinary shares owned by the Lloyds Bank Foundations. The limited voting ordinary shares were redesignated as ordinary shares on 1 July 2017.

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

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

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

# Forward looking statements

This document contains certain forward looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Lloyds Banking Group plc together with its subsidiaries (the Group) and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the 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.

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 the 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.

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.

Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from 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 interest rates, inflation, exchange rates, stock markets and currencies; any impact of the transition from IBORs to alternative reference rates; 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 and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; the ability to achieve strategic objectives; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; concentration of financial exposure; management and monitoring of conduct risk; instability in the global financial markets, including Eurozone instability, instability as a result of uncertainty surrounding the exit by the UK from the European Union (EU) and as a result of such exit and the potential for other countries to exit the EU or the Eurozone and the impact of any sovereign credit rating downgrade or other sovereign financial issues; political instability including as a result of any UK general election; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; 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; risks relating to climate change; changes in laws, regulations, practices and accounting standards or taxation, including as a result of the exit by the UK from the EU, or a further possible referendum on Scottish independence; 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 together with any resulting impact on the future structure of the Group; the ability to attract and retain senior management and other employees and meet its diversity objectives; 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 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, lending companies and digital innovators and disruptive technologies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report or Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission for a discussion of certain factors and risks 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 document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this document to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

# Abbreviations

| | |
|---|---|
| **ADRs** | American Depositary Receipts |
| **BSU** | Business Support Unit |
| **CDS** | Credit Default Swap |
| **CET1** | Common Equity Tier 1 |
| **CRD IV** | Capital Requirements Directive IV |
| **CVA** | Credit Valuation Adjustment |
| **DVA** | Debit Valuation Adjustment |
| **EBA** | European Banking Authority |
| **ECN** | Enhanced Capital Note |
| **EP** | Economic Profit |
| **EPS** | Earnings Per Share |
| **FCA** | Financial Conduct Authority |
| **FLS** | Funding for Lending Scheme |
| **FRC** | Financial Reporting Council |
| **GSR3** | Group Strategic Review |
| **HMRC** | Her Majesty's Revenue & Customs |
| **IAS** | International Accounting Standard |
| **IASB** | International Accounting Standards Board |
| **ICG** | Individual Capital Guidance |
| **IFRS** | International Financial Reporting Standard |
| **LCR** | Liquidity Coverage Ratio |
| **LIBOR** | London Inter-Bank Offered Rate |
| **LTIP** | Long-Term Incentive Plan |
| **OEIC** | Open Ended Investment Company |
| **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 |

# Alternative performance measures

As described on page 56, the Group analyses its performance on an underlying basis. The Group also calculates a number of metrics that are used throughout the banking and insurance industries on an underlying basis as these provide management with a relevant and consistent view of these measures from period to period. A description of the Group's alternative performance measures and their calculation is set out below.

| | |
|---|---|
| **Asset quality ratio** | The underlying impairment charge for the period (on an annualised basis) in respect of loans and advances to customers after releases and write-backs, expressed as a percentage of average gross loans and advances to customers for the period. |
| **Banking net interest margin** | Banking net interest income on customer and product balances in the banking businesses as a percentage of average banking gross interest-earning assets for the period. |
| **Business as usual costs** | Operating costs, less investment expensed and depreciation. |
| **Cost:income ratio** | Total costs as a percentage of net income calculated on an underlying basis. |
| **Gross asset quality ratio** | The underlying impairment charge for the period (on an annualised basis) in respect of loans and advances to customers before releases and write-backs, expressed as a percentage of average gross loans and advances to customers for the period. |
| **Loan to deposit ratio** | Loans and advances to customers net of allowance for impairment losses and excluding reverse repurchase agreements divided by customer deposits excluding repurchase agreements on an underlying basis. |
| **Jaws** | The difference between the period on period percentage change in net income and the period on period change in total costs calculated on an underlying basis. |
| **Present value of new business premium** | The total single premium sales received in the period (on an annualised basis) plus the discounted value of premiums expected to be received over the term of the new regular premium contracts. |
| **Return on risk-weighted assets** | Underlying profit before tax divided by average risk-weighted assets. |
| **Return on tangible equity** | Statutory profit after tax adjusted to add back amortisation of intangible assets, and to deduct profit attributable to non-controlling interests and other equity holders, divided by average tangible net assets. |
| **Tangible net assets per share** | Net assets excluding intangible assets such as goodwill and acquisition-related intangibles divided by the weighted average number of ordinary shares in issue. |
| **Trading Surplus** | Underlying profit before impairment charge |
| **Underlying, or above the line, profit** | Statutory profit adjusted for certain items as detailed on page 56. |
| **Underlying return on tangible equity** | Underlying profit after tax at the standard UK corporation tax rate adjusted to add back amortisation of intangible assets and to deduct profit attributable to non-controlling interests and other equity holders, divided by average tangible net assets. |

# Subsidiaries and related undertakings

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 2019. The list includes each undertaking's registered office and the percentage of the class(es) of shares held by the Group. All shares held are ordinary shares unless indicated otherwise in the notes.

## Subsidiary undertakings

The Group directly or indirectly holds 100 % of the share class and a majority of voting rights (including where the undertaking does not have share capital as indicated) in the following undertakings.

| Name of undertaking | Notes |
|---|---|
| A G Finance Ltd | 50 ii # |
| A.C.L. Ltd | 1 |
| ACL Autolease Holdings Ltd | 1 |
| ADF No.1 Pty Ltd | 8 |
| Alex Lawrie Factors Ltd | 9 |
| Alex. Lawrie Receivables Financing Ltd | 9 |
| Amberdate Ltd | 1 iv |
| Anglo Scottish Utilities Partnership 1 | + * |
| Aquilus Ltd (in liquidation) | 13 |
| Automobile Association Personal Finance Ltd | 4 |
| Bank of Scotland (B G S) Nominees Ltd | 5 * |
| Bank of Scotland (Stanlife) London Nominees Ltd | 5 * |
| Bank of Scotland Branch Nominees Ltd | 5 |
| Bank of Scotland Central Nominees Ltd | 5 * |
| Bank of Scotland Edinburgh Nominees Ltd | 5 * |
| Bank of Scotland Equipment Finance Ltd (in liquidation) | 13 |
| Bank of Scotland LNG Leasing (No 1) Ltd (In liquidation) | 13 |
| Bank of Scotland London Nominees Ltd | 5 * |
| Bank of Scotland Nominees (Unit Trusts) Ltd | 5 * |
| Bank of Scotland P.E.P. Nominees Ltd | 5 * |
| Bank of Scotland plc | 5 iv |
| Bank of Scotland Structured Asset Finance Ltd | 1 |
| Bank of Scotland Transport Finance 1 Ltd (In liquidation) | 13 |
| Bank of Wales Ltd | 2 |
| Barents Leasing Ltd | 1 |
| Barnwood Mortgages Ltd | 12 |
| Birchcrown Finance Ltd | 1 iv vi |
| Birmingham Midshires Financial Services Ltd | 4 |
| Birmingham Midshires Land Development Ltd (in liquidation) | 13 |
| Birmingham Midshires Mortgage Services Ltd (in liquidation) | 13 |
| Black Horse (TRF) Ltd | 1 |
| Black Horse Executive Mortgages Ltd (in liquidation) | 13 |
| Black Horse Finance Holdings Ltd | 1 i vi |
| Black Horse Finance Management Ltd | 1 |
| Black Horse Group Ltd | 1 iv |
| Black Horse Ltd | 1 |
| Black Horse Offshore Ltd | 58 |
| Black Horse Property Services Ltd | 1 |
| Boltro Nominees Ltd | 1 |
| BOS (Ireland) Property Services 2 Ltd | 16 |
| BOS (Ireland) Property Services Ltd | 16 |
| BOS (Shared Appreciation Mortgages (Scotland) No. 2) Ltd | 4 |
| BOS (Shared Appreciation Mortgages (Scotland) No. 3) Ltd | 4 |
| BOS (Shared Appreciation Mortgages (Scotland)) Ltd | 4 |
| BOS (Shared Appreciation Mortgages) No. 1 plc | 4 # |
| BOS (Shared Appreciation Mortgages) No. 2 plc | 4 # |
| BOS (Shared Appreciation Mortgages) No. 3 plc | 4 # |
| BOS (Shared Appreciation Mortgages) No. 4 plc | 4 # |
| BOS (Shared Appreciation Mortgages) No. 5 plc | 4 |
| BOS (Shared Appreciation Mortgages) No. 6 plc | 4 |
| BOS (USA) Fund Investments Inc. | 11 xiii |
| BOS (USA) Inc. | 11 |
| BOS Edinburgh No 1 Ltd (In liquidation) | 65 |
| BOS Mistral Ltd | 1 |
| BOSSAF Rail Ltd | 1 |
| BOS Personal Lending Ltd | 4 i ii |
| British Linen Leasing (London) Ltd | 5 |
| British Linen Leasing Ltd | 5 |
| British Linen Shipping Ltd | 5 |
| C.T.S.B. Leasing Ltd (In liquidation) | 13 |
| Capital 1945 Ltd | 2 |
| Capital Bank Leasing 3 Ltd (in liquidation) | 13 |
| Capital Bank Leasing 5 Ltd | 2 |
| Capital Bank Leasing 9 Ltd (In liquidation) | 13 |
| Capital Bank Leasing 12 Ltd | 5 |
| Capital Bank Property Investments (3) Ltd | 47 |
| Capital Personal Finance Ltd | 4 |
| Cardnet Merchant Services Ltd | 1 i ii iii # ^ |
| CF1 Ltd (in liquidation) | 13 vii viii # |
| Cashfriday Ltd | 9 |
| Cashpoint Ltd | 1 |
| Caveminster Ltd | 1 |
| CBRail S.A.R.L. | 53 |
| Cedar Holdings Ltd (in liquidation) | 1 |
| Central Mortgage Finance Ltd | 12 |
| CF Asset Finance Ltd (in liquidation) | 13 |
| Chariot Finance Ltd (In liquidation) | 13 |
| Cheltenham & Gloucester plc | 12 |
| Chiswell Stockbrokers Ltd (In liquidation) | 13 |
| Clerical Medical Finance plc | 20 |
| Clerical Medical Financial Services Ltd | 20 |
| Clerical Medical International Holdings B.V. | 21 |
| Clerical Medical Investment Fund Managers Ltd | 4 |
| Clerical Medical Managed Funds Ltd (In liquidation) | 13 |
| Clerical Medical Non Sterling Property Company S.A.R.L. | 22 |
| Cloak Lane Funding S.A.R.L. | 56 |
| Cloak Lane Investments S.A.R.L. | 56 |
| CM Venture Investments Ltd | 23 iv |
| Conquest Securities Ltd | 1 iv vi |
| Corbiere Asset Investments Ltd | 1 ii |
| Create Services Ltd | 1 |
| Dalkeith Corporation | 24 |
| Dunstan Investments (UK) Ltd | 1 |
| Eurolead Services Holdings Ltd | 9 |
| First Retail Finance (Chester) Ltd | 4 |
| Forthright Finance Ltd | 2 |
| France Industrial Premises Holding Company | 28 |
| General Leasing (No. 12) Ltd | 1 |
| General Reversionary and Investment Company | 20 |
| Gresham Nominee 1 Ltd | 1 |
| Gresham Nominee 2 Ltd | 1 |
| Halifax Credit Card Ltd (in liquidation) | 13 i ii vii |
| Halifax Financial Brokers Ltd | 4 |
| Halifax Financial Services (Holdings) Ltd | 4 |
| Halifax Financial Services Ltd | 4 |
| Halifax General Insurance Services Ltd | 4 |
| Halifax Group Ltd | 4 |
| Halifax Investment Services Ltd | 4 |
| Halifax Leasing (June) Ltd (In liquidation) | 13 |
| Halifax Leasing (March No.2) Ltd | 1 |
| Halifax Leasing (September) Ltd | 1 |
| Halifax Life Ltd | 4 |
| Halifax Ltd | 4 |
| Halifax Loans Ltd | 4 |
| Halifax Mortgage Services Ltd | 4 |
| Halifax Nominees Ltd | 4 |
| Halifax Pension Nominees Ltd | 29 |
| Halifax Premises Ltd (in liquidation) | 13 |
| Halifax Share Dealing Ltd | 4 |
| Halifax Vehicle Leasing (1998) Ltd | 4 |
| HBOS Covered Bonds LLP | 4 * |
| HBOS Final Salary Trust Ltd | 5 |
| HBOS Financial Services Ltd | 20 |
| HBOS Insurance & Investment Group Ltd | 20 |
| HBOS International Financial Services Holdings Ltd | 20 |
| HBOS Investment Fund Managers Ltd | 4 i |
| HBOS plc | 5 iv vi |
| HBOS Social Housing Covered Bonds LLP | 2 * |
| HBOS UK Ltd | 5 |
| Heidi Finance Holdings (UK) Ltd | 1 |
| Hill Samuel Bank Ltd | 1 |
| Hill Samuel Finance Ltd | 1 iv vi |
| Hill Samuel Leasing Co. Ltd | 1 |
| Home Shopping Personal Finance Ltd | 4 |
| Horizon Capital 2000 Ltd | 5 |
| Housing Growth Partnership GP LLP | 1 * |
| Housing Growth Partnership LP | 1 * # |
| Housing Growth Partnership Ltd | 1 ii |
| Housing Growth Partnership Manager Ltd | 1 |
| HSDL Nominees Ltd | 4 |
| HVF Ltd | 2 |
| Hyundai Car Finance Ltd | 7 i ii |
| IBOS Finance Ltd | 2 |
| ICC Enterprise Partners Ltd (In liquidation) | 32 |
| ICC Equity Partners Ltd (In liquidation) | 32 |
| ICC Holdings Unlimited Company | 16 |
| Inchcape Financial Services Ltd (in liquidation) | 13 i ii # |
| Intelligent Finance Financial Services Ltd | 4 |
| Intelligent Finance Software Ltd | 4 |
| International Motors Finance Ltd | 2 i ii # |
| Kanaalstraat Funding C.V. | 35 * |
| Katrine Leasing Ltd (in liquidation) | 39 |
| LB Healthcare Trustee Ltd | 1 |
| LB Motorent Ltd (in liquidation) | 13 |
| LB Quest Ltd (in liquidation) | 13 |
| LB Share Schemes Trustees Ltd | 1 |
| LBCF Ltd | 9 |
| LBG Brasil Administração LTDA | 38 |
| LBG Capital Holdings Ltd | 1 ^ |
| LBG Equity Investments Ltd | 1 ^ |
| LBI Leasing Ltd | 1 |
| LDC (General Partner) Ltd | 40 |
| LDC (Managers) Ltd | 40 |
| LDC (Nominees) Ltd | 40 |
| LDC GP LLP | 41 * |
| LDC I LP | 41 * |
| LDC II LP | 41 * |
| LDC III LP | 41 * |
| LDC IV LP | 41 * |
| LDC Parallel (Nominees) Ltd | 40 |
| LDC V LP | 41 * |
| LDC VI LP | 41 * |
| LDC VII LP | 41* |
| LDC VIII LP | 40 * |
| Legacy Renewal Company Ltd | 5 |
| Lex Autolease (CH) Ltd | 1 |
| Lex Autolease (VC) Ltd | 1 |
| Lex Autolease Carselect Ltd | 1 |
| Lex Autolease Ltd | 1 |
| Lex Vehicle Finance 2 Ltd (In liquidation) | 13 |
| Lex Vehicle Leasing (Holdings) Ltd (in liquidation) | 13 i ii x |
| Lex Vehicle Leasing Ltd (in liquidation) | 13 |
| Lime Street (Funding) Ltd (in liquidation) | 1 |
| Lloyds (Gresham) Ltd | 1 x |
| Lloyds (Gresham) No. 1 Ltd | 1 |
| Lloyds (Nimrod) Specialist Finance Ltd | 1 |
| Lloyds America Securities Corporation | 11 |
| Lloyds Asset Leasing Ltd | 1 |
| Lloyds Bank (Branches) Nominees Ltd (in liquidation) | 13 |
| Lloyds Bank (Colonial & Foreign) Nominees Ltd | 1 |
| Lloyds Bank (Fountainbridge 1) Ltd | 5 |
| Lloyds Bank (Fountainbridge 2) Ltd | 5 |
| Lloyds Bank (I.D.) Nominees Ltd | 1 |
| Lloyds Bank (International Services) Ltd | 58 |
| Lloyds Bank (Stock Exchange Branch) Nominees Ltd (in liquidation) | 13 |
| Lloyds Bank Asset Finance Ltd | 1 |
| Lloyds Bank Commercial Finance Ltd | 9 |
| Lloyds Bank Commercial Finance Scotland Ltd | 43 |
| Lloyds Bank Corporate Asset Finance (HP) Ltd | 1 |
| Lloyds Bank Corporate Asset Finance (No.1) Ltd | 1 |
| Lloyds Bank Corporate Asset Finance (No.2) Ltd | 1 |
| Lloyds Bank Corporate Asset Finance (No.3) Ltd | 1 |
| Lloyds Bank Corporate Asset Finance (No.4) Ltd | 1 |
| Lloyds Bank Corporate Markets plc | 1 ^ |
| Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH | 17 |
| Lloyds Bank Covered Bonds LLP | 44 * |
| Lloyds Bank Equipment Leasing (No. 1) Ltd | 1 |
| Lloyds Bank Equipment Leasing (No. 7) Ltd | 1 |
| Lloyds Bank Equipment Leasing (No. 9) Ltd | 1 |
| Lloyds Bank Financial Services (Holdings) Ltd | 1 iv |
| Lloyds Bank General Insurance Holdings Ltd | 45 |
| Lloyds Bank General Insurance Ltd | 1 |
| Lloyds Bank General Leasing (No. 3) Ltd | 1 |
| Lloyds Bank General Leasing (No. 5) Ltd (in liquidation) | 13 |
| Lloyds Bank General Leasing (No. 11) Ltd | 1 |
| Lloyds Bank General Leasing (No. 17) Ltd | 1 |
| Lloyds Bank General Leasing (No. 20) Ltd (In liquidation) | 13 |
| Lloyds Bank GmbH | 59 |
| Lloyds Bank Hill Samuel Holding Company Ltd (in liquidation) | 1 |
| Lloyds Bank Insurance Services Ltd | 1 |
| Lloyds Bank International Ltd | 58 |
| Lloyds Bank Leasing (No. 6) Ltd | 1 |
| Lloyds Bank Leasing (No. 8) Ltd (In liquidation) | 13 |
| Lloyds Bank Leasing Ltd | 1 |
| Lloyds Bank Maritime Leasing (No. 10) Ltd | 1 |
| Lloyds Bank Maritime Leasing (No. 13) Ltd (In liquidation) | 13 |
| Lloyds Bank Maritime Leasing (No.16) Ltd (In liquidation) | 13 |
| Lloyds Bank Maritime Leasing (No. 17) Ltd | 1 |
| Lloyds Bank MTCH Ltd | 1 |
| Lloyds Bank Nominees Ltd | 1 |
| Lloyds Bank Offshore Pension Trust Ltd | 33 |
| Lloyds Bank Pension ABCS (No. 1) LLP | 1 * |
| Lloyds Bank Pension ABCS (No. 2) LLP | 1 * |
| Lloyds Bank Pension Trust (No. 1) Ltd | 1 |
| Lloyds Bank Pension Trust (No. 2) Ltd | 1 |
| Lloyds Bank Pensions Property (Guernsey) Ltd | 34 i ii |
| Lloyds Bank plc | 1 ^ x |
| Lloyds Bank Properties Ltd (in liquidation) | 13 |
| Lloyds Bank Property Company Ltd | 1 |
| Lloyds Bank S.F. Nominees Ltd | 1 |
| Lloyds Bank Subsidiaries Ltd | 1 |
| Lloyds Bank Trustee Services Ltd | 1 |
| Lloyds Banking Group Pensions Trustees Ltd | 1 |
| Lloyds Capital GP Ltd | 31 * |
| Lloyds Commercial Leasing Ltd (In liquidation) | 13 |
| Lloyds Commercial Properties Ltd (In liquidation) | 13 |
| Lloyds Commercial Property Investments Ltd (In liquidation) | 13 |
| Lloyds Corporate Services (Jersey) Ltd | 58 |
| Lloyds Development Capital (Holdings) Ltd | 40 |

| | |
|---|---|
| Lloyds Engine Capital (No.1) U.S LLC | 11 * |
| Lloyds Far East S.A.R.L. | 56 |
| Lloyds General Leasing Ltd | 1 |
| Lloyds Group Holdings (Jersey) Ltd | 58 i ii vii |
| Lloyds Holdings (Jersey) Ltd | 58 |
| Lloyds Hypotheken B.V. | 55 |
| Lloyds Industrial Leasing Ltd | 1 |
| Lloyds International Pty Ltd | 8 |
| Lloyds Investment Bonds Ltd (In liquidation) | 13 |
| Lloyds Investment Fund Managers Ltd | 58 |
| Lloyds Investment Securities No.5 Ltd | 1 |
| Lloyds Leasing (North Sea Transport) Ltd | 1 |
| Lloyds Leasing Developments Ltd | 1 |
| Lloyds Nominees (Guernsey) Ltd | 37 |
| Lloyds Offshore Global Services Private Ltd | 48 |
| Lloyds Plant Leasing Ltd | 1 |
| Lloyds Portfolio Leasing Ltd | 1 |
| Lloyds Premises Investments Ltd (In liquidation) | 13 |
| Lloyds Project Leasing Ltd | 1 |
| Lloyds Property Investment Company No. 3 Ltd (In liquidation) | 13 |
| Lloyds Property Investment Company No. 4 Ltd | 1 |
| Lloyds Property Investment Company No.5 Ltd | 1 |
| Lloyds Secretaries Ltd | 1 |
| Lloyds Securities Inc. | 11 |
| Lloyds TSB Pacific Ltd | 51 |
| Lloyds UDT Asset Leasing Ltd (In liquidation) | 13 |
| Lloyds UDT Asset Rentals Ltd (in liquidation) | 13 |
| Lloyds UDT Hiring Ltd (In liquidation) | 13 |
| Lloyds UDT Leasing Ltd | 1 |
| Lloyds UDT Ltd (in liquidation) | 13 |
| Lloyds Your Tomorrow Trustee Ltd | 1 |
| Loans.co.uk Ltd | 47 |
| London Taxi Finance Ltd | 1 i ii |
| London Uberior (L.A.S. Group) Nominees Ltd | 5 * |
| Lotus Finance Ltd | 50 i ii # |
| LTGP Limited Partnership Incorporated | 34 * |
| Mainsearch Company Ltd | 47 |
| Maritime Leasing (No. 19) Ltd | 1 |
| MBNA Direct Ltd | 47 |
| MBNA Europe Finance Ltd | 46 |
| MBNA Europe Holdings Ltd | 47 |
| MBNA Global Services Ltd | 47 |
| MBNA Indian Services Private Ltd (applied for Strike Off) | 49 |
| MBNA Ltd | 47 |
| MBNA R & L S.A.R.L. | 53 |
| MBNA Receivables Ltd | 63 |
| Membership Services Finance Ltd | 4 |
| Mitre Street Funding S.A.R.L. | 56 |
| Moor Lane Holdings Ltd (in liquidation) | 39 |
| NFU Mutual Finance Ltd | 2 i ii vii # |
| Nominees (Jersey) Ltd | 58 |
| Nordic Leasing Ltd | 1 |
| NWS Trust Ltd | 5 |
| Ocean Leasing (July) Ltd (In liquidation) | 13 |
| Oystercatcher Nominees Ltd (in liquidation) | 13 |
| Oystercatcher Residential Ltd (in liquidation) | 13 |
| Pacific Leasing Ltd | 1 |
| Pensions Management (S.W.F.) Ltd | 54 * |
| Peony Eastern Leasing Ltd (In liquidation) | 13 |
| Peony Leasing Ltd (In liquidation) | 13 |
| Peony Western Leasing Ltd (In liquidation) | 13 |
| Perry Nominees Ltd | 1 |
| PIPS Asset Investments Ltd | 1 i ii |
| Prestonfield Investments Ltd | 5 |
| Proton Finance Ltd | 50 i ii # |
| R.F. Spencer And Company Ltd | 2 |
| Ranelagh Nominees Ltd | 1 |
| Retail Revival (Burgess Hill) Investments Ltd | 1 |
| Saint Michel Holding Company No1 | 28 |
| Saint Michel Investment Property | 28 |
| Saint Witz 2 Holding Company No1 | 28 |
| Saint Witz 2 Investment Property | 28 |
| Savban Leasing Ltd | 1 |
| Scotland International Finance B.V. | 21 |
| Scottish Widows Administration Services (Nominees) Ltd | 54 |
| Scottish Widows Administration Services Ltd | 1 |
| Scottish Widows Annuities Ltd (In liquidation) | 65 |
| Scottish Widows Auto Enrolment Services Ltd | 1 |
| Scottish Widows Europe | 27 |
| Scottish Widows Financial Services Holdings | 3 |
| Scottish Widows' Fund and Life Assurance Society | 54 * |
| Scottish Widows Group Ltd | 3 i ii x |
| Scottish Widows Industrial Properties Europe B.V. | 18 |
| Scottish Widows Ltd | 1 |
| Scottish Widows Pension Trustees Ltd | 3 |
| Scottish Widows Property Management Ltd | 54 |
| Scottish Widows Schroder Personal Wealth (ACD) Ltd | 1 |
| Scottish Widows Schroder Personal Wealth Ltd | 1 |
| Scottish Widows Schroder Wealth Holdings Ltd | 1 i ii # |
| Scottish Widows Services Ltd | 3 |
| Scottish Widows Trustees Ltd | 54 |
| Scottish Widows Unit Funds Ltd | 3 |
| Scottish Widows Unit Trust Managers Ltd | 45 |
| Seabreeze Leasing Ltd | 1 |
| Seaspirit Leasing Ltd | 1 |
| Share Dealing Nominees Ltd | 4 |
| Shogun Finance Ltd | 7 i ii # |
| Silentdale Ltd (In liquidation) | 13 iv vi |
| St Andrew's Group Ltd | 20 |
| St Andrew's Insurance plc | 20 |
| St Andrew's Life Assurance plc | 20 |
| St. Mary's Court Investments | 1 |
| Standard Property Investment (1987) Ltd | 5 i ii |
| Standard Property Investment Ltd | 57 # |
| Sussex County Homes Ltd | 4 |
| Suzuki Financial Services Ltd | 50 i ii # |
| SW Funding plc | 3 # |
| SW No.1 Ltd | 3 |
| SWAMF (GP) Ltd (in liquidation) | 13 |
| SWAMF Nominee (1) Ltd (in liquidation) | 13 |
| SWAMF Nominee (2) Ltd (in liquidation) | 13 |
| The Agricultural Mortgage Corporation plc | 45 |
| The British Linen Company Ltd | 5 |
| The Mortgage Business plc | 4 |
| Thistle Leasing | + * |
| Three Copthall Avenue Ltd (in liquidation) | 13 |
| Tower Hill Property Investments (7) Ltd | 47 # |
| Tower Hill Property Investments (10) Ltd | 47 # |
| Tranquility Leasing Ltd | 1 |
| Uberior (Moorfield) Ltd | 5 |
| Uberior Co-Investments Ltd | 5 |
| Uberior ENA Ltd | 5 |
| Uberior Equity Ltd | 5 |
| Uberior Europe Ltd | 5 |
| Uberior Fund Investments Ltd | 5 |
| Uberior Infrastructure Investments Ltd | 5 |
| Uberior Infrastructure Investments (No.2) Ltd | 1 |
| Uberior Investments Ltd | 5 |
| Uberior Nominees Ltd | 5 * |
| Uberior Trading Ltd | 5 |
| Uberior Trustees Ltd | 5 * |
| Uberior Ventures Australia Pty Ltd | 8 |
| Uberior Ventures Ltd | 5 |
| UDT Budget Leasing Ltd (in liquidation) | 13 |
| UDT Sales Finance Ltd (In liquidation) | 13 |
| United Dominions Leasing Ltd | 1 |
| United Dominions Trust Ltd | 1 |
| Universe, The CMI Global Network Fund | 70 * |
| Upsaala Ltd | 16 |
| Vine Street IX LP | 41 |
| Ward Nominees (Abingdon) Ltd | 1 |
| Ward Nominees (Birmingham) Ltd | 1 |
| Ward Nominees (Bristol) Ltd | 1 |
| Ward Nominees Ltd | 1 |
| Waverley – Fund II Investor LLC | 24 |
| Waverley – Fund III Investor LLC | 24 |
| Waymark Asset Investments Ltd | 1 i ii |
| WCS Ltd (in liquidation) | 60 |
| West Craigs Ltd | 5 |
| Wood Street Leasing Ltd | 1 |

## Subsidiary undertakings continued

The Group has determined that it has the power to exercise control over the following entities without having the majority of the voting rights of the undertakings. Unless otherwise stated, the undertakings do not have share capital or the Group does not hold any shares.

| Name of undertaking | Notes |
|---|---|
| Addison Social Housing Holdings Ltd | 61 |
| Cancara Asset Securitisation Ltd | 63 |
| Cardiff Auto Receivables Securitisation 2018-1 Plc | 44 |
| Cardiff Auto Receivables Securitisation 2019-1 Plc | 44 |
| Cardiff Auto Receivables Securitisation Holdings Ltd | 44 |
| Celsius European Lux 2 S.A.R.L. | 30 |
| Cheltenham Securities 2017 Ltd | 61 |
| Cheltenham II Securities 2020 DAC | 42 |
| Chepstow Blue Holdings Ltd | 44 |
| Chepstow Blue plc | 44 |
| Chester Asset Options No.2 Ltd | 69 |
| Chester Asset Options No.3 Ltd | 64 |
| Chester Asset Receivables Dealings Issuer Ltd | 63 |
| Chester Asset Securitisation Holdings Ltd | 69 |
| Chester Asset Securitisation Holdings No.2 Ltd | 63 |
| Clerical Medical Non Sterling Guadalix Hold Co BV | 66 |
| Clerical Medical Non Sterling Guadalix Spanish Prop Co SL | 67 |
| Clerical Medical Non Sterling Megapark Hold Co BV | 66 |
| Clerical Medical Non Sterling Megapark Prop Co SA | 67 |
| Credit Card Securitisation Europe Ltd | 63 |
| Deva Financing Holdings Ltd | 44 |
| Deva Financing plc | 44 |
| Deva One Ltd | 63 |
| Deva Three Ltd | 63 |
| Deva Two Ltd | 63 |
| Edgbaston RMBS 2010-1 plc | 44 |
| Edgbaston RMBS Holdings Ltd | 44 |
| Elland RMBS 2018 plc | 44 |
| Elland RMBS Holdings Ltd | 44 |
| Fontwell Securities 2016 Ltd | 61 |
| Gresham Receivables (No. 1) Ltd | 63 |
| Gresham Receivables (No. 3) Ltd | 63 |
| Gresham Receivables (No. 10) Ltd | 63 |
| Gresham Receivables (No. 11) UK Ltd | 69 |
| Gresham Receivables (No. 12) Ltd | 63 |
| Gresham Receivables (No. 13) UK Ltd | 69 |
| Gresham Receivables (No. 14) UK Ltd | 69 |
| Gresham Receivables (No. 15) UK Ltd | 69 |
| Gresham Receivables (No. 16) UK Ltd | 69 |
| Gresham Receivables (No. 19) UK Ltd | 69 |
| Gresham Receivables (No. 20) Ltd | 63 |
| Gresham Receivables (No. 21) Ltd | 63 |
| Gresham Receivables (No. 22) Ltd | 63 |
| Gresham Receivables (No. 23) Ltd | 63 |
| Gresham Receivables (No. 24) Ltd | 63 |
| Gresham Receivables (No. 25) UK Ltd | 69 |
| Gresham Receivables (No. 26) UK Ltd | 69 |
| Gresham Receivables (No. 27) UK Ltd | 69 |
| Gresham Receivables (No. 28) Ltd | 63 |
| Gresham Receivables (No. 29) Ltd | 63 |
| Gresham Receivables (No. 30) UK Ltd | 69 |
| Gresham Receivables (No. 31) UK Ltd | 69 |
| Gresham Receivables (No. 32) UK Ltd | 69 |
| Gresham Receivables (No. 33) UK Ltd | 69 |
| Gresham Receivables (No. 34) UK Ltd | 69 |
| Gresham Receivables (No. 35) Ltd | 63 |
| Gresham Receivables (No. 36) UK Ltd | 69 |
| Gresham Receivables (No. 37) UK Ltd | 69 |
| Gresham Receivables (No. 38) UK Ltd | 69 |
| Gresham Receivables (No. 39) UK Ltd | 69 |
| Gresham Receivables (No. 40) UK Ltd | 69 |
| Gresham Receivables (No. 41) UK Ltd | 69 |
| Gresham Receivables (No. 44) UK Ltd | 69 |
| Gresham Receivables (No. 45) UK Ltd | 69 |
| Gresham Receivables (No. 46) UK Ltd | 69 |
| Gresham Receivables (No. 47) UK Ltd | 69 |
| Gresham Receivables (No. 48) UK Ltd | 69 |
| Guildhall Asset Purchasing Company (No 3) Ltd | 63 |
| Guildhall Asset Purchasing Company (No.11) UK Ltd | 69 |
| Housing Association Risk Transfer 2019 DAC | 42 |
| Leicester Securities 2014 Ltd | 26 |
| Lingfield 2014 I Holdings Ltd | 44 |
| Lingfield 2014 I plc | 44 |
| Lloyds Bank Covered Bonds (Holdings) Ltd | 44 |
| Lloyds Bank Covered Bonds (LM) Ltd | 44 |
| Molineux RMBS 2016-1 plc | 44 |
| Molineux RMBS Holdings Ltd | 44 |
| Penarth Asset Securitisation Holdings Ltd | 44 |
| Penarth Funding 1 Ltd | 44 |
| Penarth Funding 2 Ltd | 44 |
| Penarth Master Issuer plc | 44 |
| Penarth Receivables Trustee Ltd | 44 |
| Permanent Funding (No. 1) Ltd | 44 |
| Permanent Funding (No. 2) Ltd | 44 |
| Permanent Holdings Ltd | 44 |
| Permanent Master Issuer plc | 44 |
| Permanent Mortgages Trustee Ltd | 44 |
| Permanent PECOH Holdings Ltd | 44 |
| Permanent PECOH Ltd | 44 |
| Salisbury Securities 2015 Ltd | 36 |
| Salisbury II Securities 2016 Ltd | 61 |
| Salisbury II-A Securities 2017 Ltd | 61 |
| Salisbury III Securities 2019 DAC | 42 |
| Sandown 2012-2 Holdings Ltd | 44 |
| Sandown 2012-2 plc (in liquidation) | 6 |
| Sandown Gold 2012-1 Holdings Ltd | 44 |
| Sandown Gold 2012-1 plc (in liquidation) | 6 |
| SARL Coliseum | 62 |
| SARL Hiram | 62 |
| SAS Compagnie Fonciere De France | 62 |
| SCI Astoria Invest | 62 |
| SCI De L'Horloge | 62 |
| SCI Equinoxe | 62 |
| SCI Rambuteau CFF | 62 |
| Swan Funding 2 Ltd | 61 |
| Syon Securities 2019 DAC | 42 |
| Thistle Investments (AMC) Ltd | 44 |
| Thistle Investments (ERM) Ltd | 44 |
| Thistle Financing Holdings Ltd | 44 |
| Trinity Financing plc (in liquidation) | 6 |
| Wetherby II Securities 2018 DAC | 68 |
| Wetherby III Securities 2019 DAC | 42 |
| Wetherby Securities 2017 Ltd | 61 |
| Lloyds Bank Foundation for England & Wales • | 52 |
| The Halifax Foundation for Northern Ireland • | 15 |
| Lloyds Bank Foundation for the Channel Islands• | 52 |
| Bank of Scotland Foundation • | 5 |
| MBNA General Foundation • | 47 |

• A charitable foundation funded but not owned by Lloyds Banking Group

## Subsidiaries and related undertakings continued

# Associated undertakings

The Group has a participating interest in the following undertakings.

| Name of undertaking | % of share class held by immediate parent company (or by the Group where this varies) | Registered office address (UK unless stated otherwise) | Notes |
|---|---|---|---|
| Addo Food Group (Holdings) Ltd | 76.85% | Queens Drive, Nottingham, NG2 1LU | i & |
| Addison Social Housing Ltd | 20% | 35 Great St Helen's, London, EC3A 6AP | |
| Adler & Allan Group Ltd | 89% | 80 Station Parade, Harrogate, HG1 1HQ | i & |
| Archer Topco Ltd | 99% | c/o Crestbridge Limited, 47 Esplanade, St Helier, Jersey JE1 0BD | xvi & |
| Aghoco 1472 Ltd | 89.25% | 58 Evans Road, Liverpool, L24 9PB | i & |
| Airline Services And Components Group Ltd | 94.45% | Squire Patton Boggs (UK) LLP (Ref: Csu) Rutland House 148 Edmund Street Birmingham B3 2JR | i & |
| Allan Water Homes (Heartlands) Ltd | 50% | 24B Kenilworth Road, Bridge Of Allan, Stirling, Scotland, FK9 4DU | i |
| Angus International Safety Group Ltd | 67.03% | Station Road, High Bentham, Near Lancaster, LA2 7NA | xvii |
| | 67.03% | | xvi & |
| Applied Composites Group Ltd (in liquidation) | 85.76% | Victoria Works, Thrumpton Lane, Retford, DN22 6HH | xvii & |
| Aquila Bidco Ltd | 89.25% | Jubilee Buildings, Victoria Street, Douglas IM1 2SH Isle of Man | xvii |
| | 89.25% | | iv |
| Aqualisa Holdings (International) Ltd | 76.12% | Westerham Trade Centre, The Flyers Way, Westerham, TN16 1DE | xvii |
| | 89.25% | | xxi & |
| Asset Solutions Group Ltd | 89.25% | Osprey House Crayfields Business Park, New Mills Road, Orpington, Kent, BR5 3QJ, United Kingdom | xvii & |
| Babble Cloud Holdings Ltd | 89.25% | Bury House, 31 Bury Street, London, EC3A 5AR | i & |
| Bacchus Newco Ltd | 89.25% | Park Lane Industrial Estates, Park Lane Off Wigan Road, Ashton in Makerfield, Wigan, WN4 0BZ,United Kingdon | i & |
| Backhouse (Westbury) JV Ltd | 50% | DAC Beachcroft LLP, Portwall Place, Portwall Lane, Bristol, BS1 9HS, United Kingdom | i |
| Backhouse (Castle Cary) JV Ltd | 50% | DAC Beachcroft LLP, Portwall Place, Portwall Lane, Bristol, BS1 9HS, United Kingdom | i |
| Bergamot Ventures Ltd | 50% | 6th Floor 25 Farringdon Street, London, EC4A 4AB | ii |
| Blue Bay Travel Group Ltd | 99% | A4 Bellringer Road, Trentham Business Quarter, Stoke-On-Trent, ST4 8GB | xvii & |
| BoS Mezzanine Partners Fund LP | n/a | 7 Melville Crescent, Edinburgh, EH3 7JA | * |
| Bowbridge Homes (Raunds) Ltd | 50% | 5 Adelaide House, Corby Gate Business Park, Priors Haw Road, Corby, NN15 5JG | i |
| Brington North Holdco Ltd | 50% | 25 Gresham Street, London, EC2V 7HN | ~ |
| Caedmon Homes (St Johns Mews) Ltd | 50% | Baldwins Wynyard Park House, Wynyard Avenue, Wynyard, TS22 5TB, United Kingdom | i |
| Caedmon Homes Ltd | 50% | Baldwins Wynyard Park House, Wynyard Avenue, Wynyard, TS22 5TB, United Kingdom | i |
| Caedmon Homes Kirby Hill Ltd | 50% | Baldwins Wynyard Park House, Wynyard Avenue, Wynyard, TS22 5TB, United Kingdom | i |
| Cardel Group Ltd | 89.25% | 5 The Marquis Business Centre, Royston Road, Baldock, SG7 6XL | xvii & |
| CIPHR Group Ltd | 89.25% | Abbey Place, 24-28 Easton Street, High Wycombe, HP11 1NT, United Kingdom | i & |
| City & General Securities Ltd | 100% | 10 Upper Berkeley Street, London, W1H 7PE | ii & |
| City Living (Midlands) Ltd | 50% | Old Banks Chambers, 582-586 Kingsbury Road, Erdington, Birmingham, B24 9ND | i |
| Citysprint (UK) Holdings Ltd | 82.03% | Ground Floor, Redcentral, 60 High Street, Redhill, RH1 1SH | xvii |
| | 91.22% | | xvi & |
| Cleanslate Ashford Ltd | 50% | Chobham Farm, Sandpit Hall Road, Chobham, Surrey, GU24 8 HA | i |
| Connery Ltd | 20% | 44 Esplanade St Helier Jersey JE4 9WG | & |
| Croud Holdings Ltd | 99% | First Floor, 39 Tabernacle Street, London EC2A 4AA | i |
| Cruden Homes (Aberlady) Ltd | 50% | Baberton House, Juniper Green, Edinburgh, EH14 3HN, United Kingdom | i |
| Cruden Homes (Longniddry) Ltd | 50% | Baberton House, Juniper Green, Edinburgh, EH14 3HN, United Kingdom | i |
| D.U.K.E Real Estate Ltd | 100% | 1st Floor, Exchange Place, 3 Semple Street, Edinburgh, EH3 8BL | ii ~ |
| Delancy Arnold UK Ltd (in liquidation) | 50% | 4th Floor, 4 Victoria Street, St Albans, Hertfordshire, AL1 3T | ii |
| Delancy Rolls UK Ltd (in liquidation) | 50% | 4th Floor, 4 Victoria Street, St Albans, Hertfordshire, AL1 3T | ii |
| Devonshire Homes (Cullompton) Ltd | 50% | Devonshire House, Lowman Green, Tiverton, Devon, EX16 4LA | i |
| Devonshire Homes (Landkey) Ltd | 50% | Devonshire House, Lowman Green, Tiverton, Devon, EX16 4LA, United Kingdom | i |
| Devonshire Homes (St Austell) Ltd | 50% | Devonshire House, Lowman Green, Tiverton, Devon, EX16 4LA, United Kingdom | i |
| DHHG1 Ltd | 50% | Alexander Fleming House, 8, Southfield Drive, Elgin, Morayshire, IV30 6GR | i |
| Dino Newco Ltd | 89.25% | Unit 2, Orchard Place, Nottingham Business Park, Nottingham, NG8 6PX | i & |
| Duchy Homes (Bowgreave) Ltd | 50% | Middleton House, Westland Road, Leeds, West Yorkshire, LS11 5UH | i |
| Duchy Homes (North Cave) Ltd | 50% | Middleton House, Westland Road, Leeds, West Yorkshire, LS11 5UH | i |
| Duchy Homes (Penistone) Ltd | 50% | Middleton House, Westland Road, Leeds, West Yorkshire, LS11 5UH | i |
| Duchy Homes (Scawthorpe) Ltd | 50% | Middleton House, Westland Road, Leeds, West Yorkshire, LS11 5UH | i |
| Duchy Homes (Winterley) Ltd | 50% | Middleton House, Westland Road, Leeds, West Yorkshire, LS11 5UH | i |
| Duncan and Todd Holdings Ltd | 89.25% | 6 Queens Road, Aberdeen, AB15 4ZT | i & |
| Ediston Homes Sauchie Ltd | 50% | 39/1 George Street, Edinburgh, EH2 2HN | i |
| Eley Group Ltd | 85.86% | Selco Way, Off First Avenue, Minworth Industrial Estate, Minworth, Sutton Coldfield, B76 1BA | i & |
| Ellis Whittam (Holdings) Ltd | 89.25% | Woodhouse, Aldford, Chester, CH3 6JD | i & |
| Ensco 997 Ltd | 30.76% | The Yard Dodd Lane, Westhoughton, Bolton, Bl5 3NU | ix |
| | 32.74% | | xiv & |
| Ensco 1314 Ltd | 99% | 90 Tottenham Court Road, London W1T 4TJ | i & |
| Ensco 1320 Ltd | 99% | One Eleven, Edmund Street, Birmingham B3 2HJ | i & |
| Ensco 1322 Ltd | 99% | Newbury House, 20 Kings Road West, Newbury, Berkshire, RG14 5XR | i & |
| Ensco 1327 Ltd | 99% | One Eleven, Edmund Street, Birmingham B3 2HJ | i & |
| Ensco 1337 Ltd | 99% | Cotton Tree Lane, Colne, BB8 7BH | i & |
| Ensek Holdings Ltd | 89.25% | The Watercourt, 116-118 Canal Street, Nottingham, NG1 7HF | xvii & |
| Erris Homes (Almondbury) Ltd | 50% | Unit 11 Acorn Business Park, Killingbeck Drive, Leeds, LS14 6UF, United Kingdom | i |
| Escapade Bidco Ltd | 99% | 2nd Floor Waverley House, 7-12 Noel Street, London W1F 8GQ | xvii |
| | 99% | | xvi & |
| Everest Acquisition Company Ltd | 89.25% | Freetrade Exchange, 37 Peter Street, Manchester, M2 5GB | i & |
| Express Engineering (Group) Ltd | 99% | Kingsway North, Team Valley Trading Estate, Gateshead, NE11 0EG | i |
| | 99% | | xvii |
| | 99% | | xvi |
| | 99.35% | | iii & |
| FDL Salterns Ltd | 50% | 2 Poole Road, Bournemouth, BH2 5QY | i |
| FHR European Ventures LLP | n/a | CMS Cameron Mckenna LLP, 78 Cannon Street, London, EC4N 6AF | * & |
| Fishawack Limited | 89.25% | 3 Booths Park, Booth Hall, Knutsford WA16 8GS | i & |
| Galion (Lakeview) Ltd | 50% | Higher Hill Farm Butleigh Hill, Butleigh, Glastonbury, Somerset, BA6 8TW, United Kingdom | i |
| Ginger Acquisition Company Ltd | 89.25% | Tudno Mill, Smith Street, Aston-Under-Lyne, OL7 0DB, United Kingdom | i & |
| Great Wigmore Property Ltd | 50% | 33 Cavendish Square, London, W1G 0PW | & |
| Hamsard 3468 Ltd | 89.25% | Sterling House, Grimbald Crag Close, Knarebourgh HG5 8PJ | xvii |
| | 89.25% | | xxii & |
| Hamsard 3541 Ltd | 99% | The Hub, Gelderd Lane, Leeds, England, LS12 6AL | i & |
| Hedge End Place (Durkan) LLP | n/a | 4 Elstree Gate, Elstree Way, Borehamwood, Hertfordshire, WD6 1JD | * |
| Hedge End Place Hold Co Ltd | 50% | 25 Gresham Street, London, EC2V 7HN | ~ |
| Highlands Bidco Ltd | 99% | Commsworld House, Peffer Place, Edinburgh EH16 4BB | i |
| Hillcrest Homes (Hurst Green) Ltd | 50% | Mynshulls House, 14 Cateaton Street, Manchester, M3 1SQ | i |
| Hollins Homes (Aston) Ltd | 50% | Suite 4 No. 1 King Street, Manchester, M2 6AW, United Kingdom | i |
| Hollins Homes (Newton) Ltd | 50% | Suite 4 No. 1 King Street, Manchester, M2 6AW, United Kingdom | i |
| Homes By Carlton (MSTG1) Ltd | 50% | Carlton House, 15 Parsons Court, Welbury Way, Newton Aycliffe, County Durham, DL5 6ZE | i |
| HTF Finco Ltd (applied for strike off) | 33.3% | The Zenith Building, 26 Spring Gardens, Manchester, M2 1AB | i & |
| Iglufastnet Ltd | 89.25% | 2nd Floor, 165 The Broadway, Wimbledon, London, SW19 1NE | i & |
| Ingleby (2016) Ltd | 89.25% | Unit 22, Lodge Way, Lodge Farm Industrial Estate, Northampton, NN5 7US | xvii & |
| James Taylor Homes (Kingston) Ltd | 50% | James Taylor House, St. Albans Road East, Hatfield, AL10 0HE, United Kingdom | i |
| Jupiter Bidco Ltd | 78.29% | The Bungalow, Church Lane, Hixon, Stafford, ST18 0PS | i & |
| Kenmore Capital 2 Ltd (In liquidation) | 100% | Grant Thornton UK LLP, 110 Queen Street, Glasgow, G1 3BX | ii ~ |
| Kenmore Capital 3 Ltd (In receivership) | 100% | Grant Thornton UK LLP, 110 Queen Street, Glasgow, G1 3BX | ii ~ |

| | | | |
|---|---|---|---|
| Kenmore Capital Ltd (In liquidation) | 100% | Grant Thornton UK LLP, 110 Queen Street, Glasgow, G1 3BX | ii ~ |
| Keoghs Topco Ltd | 99% | 2 The Parklands, Bolton, Lancashire, BL6 4SE | ii |
| KHL 2017 Ltd | 84.4% | One Eleven, Edmund Street, Birmingham, England, B3 2HJ | i |
| | 84.4% | | ii & |
| KITE Topco Ltd | 89.25% | Winchester House, Oxford Science Park, Heatley Road, Oxford, OX4 4GE | xvi & |
| LF (Holdco) Ltd | 99% | Price House, 37 Stoney Street, Nottingham NG1 1LS | i & |
| Linley & Simpson Holdings Ltd | 89.25% | 3 Greengate Cardale Park, Harrogate, North Yorkshire, HG3 1GY, United Kingdom | i & |
| London Topco Ltd | 62.82% | Gloucester Road, Cheltenham, Gloucester, GL51 8NR | i & |
| Mableford Ltd | 50% | Lindum Business Park Station Road, North Hykeham, Lincoln, LN6 3QX, United Kingdom | i |
| Magicard Holdings Ltd | 89.25% | Waverley House, Hampshire Road, Granby Industrial Estate, Weymouth, DT4 9XD | xvii & |
| | 89.25% | | xvi |
| MFS Groupco Ltd | 99% | York House, Wetherby Road, Long Marston YO26 7NH | i & |
| Mitrefinch Holdings Ltd | 89.25% | Mitrefinch House, Green Lane Trading Estate, Clifton, York, North Yorkshire, YO30 5YY | i & |
| Motability Operations Group plc | 20% (40%) | City Gate House, 22 Southwark Bridge Road, London, SE1 9HB | |
| | 20% (40%) | | iv |
| Neilson Active Holidays Group Ltd | 65.29% | Locksview, Brighton Marina, Brighton, BN2 5HA | i & |
| Northern Edge Ltd | 39.4% | The Beacon, 176 St. Vincent Street, Glasgow, G2 5SG | ii & |
| Omnium Leasing Company | 39% | N/A | + |
| Onapp (Topco) II Ltd | 82.5% | 3MC Middlemarch Business Park, Siskin Drive, Coventry, United Kingdom, CV3 4FJ | i & |
| | 100% | | iv |
| Onapp (Topco) Ltd | 82.5% | 3MC Middlemarch Business Park, Siskin Drive, Coventry, United Kingdom, CV3 4FJ | i |
| | 82.5% | | ii & |
| Osprey Aviation Services (UK) Ltd | 89.25% | Blackwood House, Union Grove Lane, Aberdeen, AB10 6XU | xvii & |
| | 89.25% | | xvi |
| Paladone Holdings Ltd | 89.25% | Apex House, Dolphin Way, Shoreham-by-Sea, West Sussex, BN43 6NZ, United Kingdom | i & |
| Panther Partners Ltd | 89% | 16 Kirby Street, London, EC1N 8TS | xvii & |
| | 89% | | xvi |
| Patrick Parsons Holdings Ltd | 89.25% | Fourth Floor Central Square, Forth Street, Newcastle upon Tyne NE1 3PJ | xvii & |
| Pertemps Network Group Ltd | 93.83% | Meriden Hall, Main Road, Meriden, Coventry | ii & |
| Personal Touch Holdings Ltd (in liquidation) | 49.9% | Two Snowhill, Snow Hill Queensway, Birmingham, West Midlands, B4 6GA | i & |
| PIHL Equity Administration Ltd | 35% | Cavendish House, 18 Cavendish Square, London, W1G 0PJ | ii |
| PIMCO (Holdings) Ltd | 82.5% | Four Brindleyplace, Birmingham, B1 2HZ, United Kingdom | i & |
| Prestbury 1 Limited Partnership | n/a | Cavendish House, 18 Cavendish Square, London, W1G 0PJ | * & |
| Project Belize Ltd | 89.25% | Sawley Marina, Long Eaton, Nottinghamshire, NG10 3AE | i & |
| Project Chestnut Topco Ltd | 99% | Alton House, Alton Business Park, Alton Road, Ross-on-Wye, HR9 5BP | i & |
| Project Chicago Newco Ltd | 89.25% | Church Lane, Church Lane, Norton, Worcester, WR5 2PR | i & |
| Project Polka TopcoLtd | 89.25% | Roundhouse Road, Faverdale Industrial Estate, Darlington, County Durham, DL3 0UR, United Kingdom | ii & |
| Project Dart Topco Ltd | 97.92% | 3 Long Acres Willow Farm Castle Donington Derbyshire DE74 2UG | i & |
| Project Sketch Ltd | 88.30% | 11 Vantage Way, Erdington, Birmingham, B24 9GZ | i & |
| Quantum (Flimwell) Ltd | 50% | Kings Parade, Lower Coombe Street, Croydon, CR0 1AA | i |
| Quentin Park (Cumwhinton) Ltd | 50% | 4 Cowper Road, Gilwilly Industrial Estate, Penrith CA11 9BN | i |
| Ramco Acquisition Ltd | 89.45% | 6 Queens Road, Aberdeen, Scotland, AB15 4ZT | xv |
| | 89.45% | | xi |
| | 0.18% | | xviii & |
| Right Choice Holdings Ltd | 89.25% | St James House, 27-43 Eastern Road, Romford, Essex, United Kingdon, RM1 3NH | i & |
| Rocket Science Holdings Ltd | 99.17% | Unit 2, Origin Business Park, Rinasford Road, Park Royal, London NW10 7FW | xvii & |
| Rolls Development UK Ltd (In Liquidation) | 50% | 4th Floor , 4 Victoria Square, St Ablans, Hertfordhsire, AL1 3TF, United Kingdom | ii |
| Sanders Brow (Armathwaite) Ltd | 50% | 4 Cowper Road, Gilwilly Industrial Estate, Penrith CA11 9BN | i |
| Scenic Topco Ltd | 89.25% | Unit 1B, Pentwyn Business Centre, Wharfedale Road, Cardiff, Wales, CF23 7HB | i & |
| SDB1 Ltd | 99% | Thompson Close, Whittington Moor, Chesterfield, S41 9AZ | i & |
| Seahawk Bidco Ltd | 89.25% | Unit 2 Springfield Court, Summerfield Road, Bolton, BL3 2NT, United Kingdom | xvii & |
| SHOO 802AA Ltd | 89.25% | Burleighfield House, London Road, Loudwater, Bucks. HP10 9RF | xvii & |
| Sigmat Group Ltd | 89.25% | Birkbecks, Water Street, Skipton, North Yorkshire, BD23 1PB | i & |
| | 89.25% | | xvii |
| | 89.25% | | xvi |
| SOLO Topco Ltd | 99% | Onecom House, 4400 Parkway, Whiteley, Fareham, Hampshire, PO15 7FJ | i |
| Specialist People Services Group Ltd | 82.5% | 7 Bradford Business Park, Kingsgate, Bradford, BD1 4SJ | xvii |
| | 82.5% | | xvi |
| | 82.5% | | iv & |
| SSP Topco Ltd | 89.25% | 2nd Floor, G Mill, Dean Clough, Halifax, HX3 5AX | i & |
| Stewart Milne (Glasgow) Ltd | 100% | The Mound, Edinburgh, EH1 1YZ, United Kingdom | i ~ |
| Stewart Milne (West) Ltd | 100% | The Mound, Edinburgh, EH1 1YZ, United Kingdom | i ~ |
| Stratus (Holdings) Ltd | 82.5% | 3MC Middlemarch Business Park, Siskin Drive, Coventry, West Midlands, England, CV3 4FJ | i |
| | 82.5% | | ii & |
| Stroma Group Ltd | 89% | Unit 4, Pioneer Way, Castleford, West Yorkshire, WF10 5QU | xvii & |
| Stonewood Partnerships (Brook Farm) Ltd | 50% | The Stonewood Office West Yatton Lane, Castle Combe, Chippenham SN14 7EY | i |
| Temple Topco Ltd | 89.25% | Market Place, Henley-On-Thames, Oxfordshire, RG9 2AD | i & |
| The Exceed Partnership LP | n/a | Cavendish House, 39-41 Waterloo Street, Birmingham, B2 5PP | * |
| The Great Wigmore Partnership (G.P.) Ltd | 50% | 33 Cavendish Square, London, W1G 0PW | i ii |
| The Great Wigmore Partnership | n/a | 33 Cavendish Square, London, W1G 0PW | * |
| The Orchards (Burgh by Sands) Ltd | 50% | 4 Cowper Road, Gilwilly Industrial Estate, Penrith CH11 9BN | i |
| The Power Industrial Group Ltd (In liquidation) | 82.5% | Deloitte LLP, 1 City Square, Leeds, LS1 2AL | i & |
| | 82.5% | | xvii |
| Thistlerow Ltd | 50% | Radleigh House 1 Golf Road, Clarkston, Glasgow, G76 7HU | i |
| Timec 1634 Ltd | 89.25% | 5 Silverton Court, Cramlington, Northumberland, NE23 7RY, United Kingdom | xvii & |
| Timec 1667 Ltd | 99% | Unit 7 & 8 Diamond Court, Newcastle Upon Tyne, NE3 2EN | i & |
| Travellers Cheque Associates Ltd | 36% | Belgrave House, 76 Buckingham Palace Road, London, SW1W 9AX | |
| United House Group Holdings Ltd | 82.5% | 26 Kings Hill Avenue, Kings Hill, West Malling, Kent, ME19 4AE | i & |
| Whittington Facilities Ltd (applied for strike off) | 100% | Third Floor Broad Quay House, Prince Street, Bristol, BS1 4DJ | v |
| Williams Topco Ltd | 89.25% | The Old Post Office, St. Nicholas Street, Newcastle Upon Tyne, United Kingdom, NE1 1RH | i & |
| ZWPV Ltd | 89.25% | Zip World Base Camp, Denbigh Street, Llanrwst, LL26 0LL | i & |

**Subsidiaries and related undertakings** continued

# Collective Investment Vehicles

The following comprises a list of the Group's and other external collective investment vehicles (CIV), where the shareholding is greater than or equal to 20% of the nominal value of any class of shares, or a book value greater than 20% of the CIV's assets.

| Name of undertaking | % of fund held by immediate parent (or by the Group where this varies | Notes |
|---|---|---|
| ABERDEEN INVESTMENT ICVC | | 8 |
| Aberdeen European Property Share Fund | 37% | |
| Aberdeen Sterling Bond Fund | 82% | |
| Aberdeen European Global High Yield Bond Fund | 23% | |
| Aberdeen Sterling Opportunistic Corporate Bond Fund | 34% | |
| ABERDEEN INVESTMENTS ICVC II | | 8 |
| Aberdeen Global Corporate Bond Tracker Fund | 99% | |
| ABERDEEN INVESTMENT ICVC III | | 8 |
| Aberdeen Global Emerging Markets Quantitative Equity Fund | 61% | |
| ABERDEEN LIQUIDITY FUND (LUX) | | 7 |
| Aberdeen Liquidity Fund (Lux) – Sterling Fund | 22% | |
| Aberdeen Liquidity Fund (Lux) – Ultra Short Duration Sterling Fund | 45% | |
| ABERDEEN PRIVATE EQUITY FUND OF FUNDS (2007) PLC | 96% | 3 |
| ACS POOLED PROPERTY | | 2 |
| Scottish Widows Pooled Property ACS Fund | 100% | |
| Scottish Widows Pooled Property ACS Fund2 | 100% | |
| AGFE UK REAL ESTATE SENIOR DEBT FUND LP | 78% | 11 |
| BLACKROCK BALANCED GROWTH PORTFOLIO FUND | 36% | 9 |
| BLACKROCK UK SMALLER COMPANIES FUND | 21% | 9 |
| BNY MELLON INVESTMENTS FUNDS ICVC | | 10 |
| BNY Mellon US Opportunities Fund | 37% | |
| Insight Global Multi-Strategy Fund | 44% | |
| Insight Global Absolute Return Fund | 75% | |
| Newton Multi-Asset Growth Fund | 26% | |
| Newton UK Opportunities Fund | 54% | |
| Newton UK Income Fund | 27% | |
| BNP PARIBAS INSTICASH | | 5 |
| BNP Paribas InstiCash GBP | 45% | |
| BNY MELLON MANAGED FUNDS II | | 10 |
| BNY Mellon MF II – Absolute Insight Fund | 84% | |
| FIDELITY ACTIVE STRATEGY | | 24 |
| FAST-UK Fund | 32% | |
| HBOS ACTIVELY MANAGED PORTFOLIO FUNDS ICVC | | 1 |
| Diversified Return Fund | 94% | |
| Absolute Return Fund | 93% | |
| Dynamic Return Fund | 97% | |
| HBOS INTERNATIONAL INVESTMENT FUNDS ICVC | | 1 |
| North American Fund | 95% | |
| Far Eastern Fund | 81% | |
| European Fund | 94% | |
| International Growth Fund | 53% | |
| Japanese Fund | 95% | |
| HBOS SPECIALISED INVESTMENT FUNDS ICVC | | 1 |
| Cautious Managed Fund | 52% | |
| Ethical Fund | 83% | |
| Fund of Investment Trusts | 39% | |
| Smaller Companies Fund | 66% | |
| Special Situations Fund | 51% | |
| HBOS UK INVESTMENT FUNDS ICVC | | 1 |
| UK Equity Income Fund | 61% | |
| UK Growth Fund | 62% | |
| UK FTSE All-Share Index Tracking Fund | 57% | |
| HBOS PROPERTY INVESTMENT FUNDS ICVC | | 1 |
| UK Property Fund | 48% | |
| HLE ACTIVE MANAGED PORTFOLIO KONSERVATIV | 36% | 18 |
| HLE ACTIVE MANAGED PORTFOLIO DYNAMISCH | 39% | 18 |
| HLE ACTIVE MANAGED PORTFOLIO AUSGEWOGEN | 49% | 18 |
| INVESCO AMERICAN INVESTMENT SERIES | | 12 |
| Invesco US Equity Fund (UK) | 21% | |
| INVESCO PERPETUAL FAR EASTERN INVESTMENT SERIES | | 12 |
| Invesco Perpetual Asian Equity Income Fund | 23% | |
| INVESTMENT PORTFOLIO ICVC | | 22 |
| IPS Income Portfolio | 22% | |
| IPS Growth Portfolio | 24% | |
| Balanced Solution | 42% | |
| Cautious Solution | 32% | |
| Discovery Solution | 41% | |
| Strategic Solution | 53% | |
| Dynamic Solution | 55% | |
| Defensive Solution | 70% | |
| Adventurous Solution | 76% | |
| JPM SYSTEMATIC ALPHA | 21% | 26 |
| LAZARD DEVELOPING MARKETS FUND | 89% | 27 |
| MGI FUNDS PLC | | 28 |
| Mercer Diversified Retirement | 72% | |
| Mercer Multi Asset Defensive | 62% | |
| Mercer Multi Asset Growth | 49% | |
| Mercer Multi Asset High Growth | 81% | |
| Mercer Multi Asset Moderate Growth | 53% | |
| MGI UK Equity | 34% | |
| MULTI MANAGER ICVC | | 22 |
| Multi Manager UK Equity Growth Fund | 82% | |
| Multi Manager UK Equity Income Fund | 30% | |
| Multi Manager UK Equity Focus Fund | 20% | |
| NORDEA 1-GBP DIVERSIFIED RETURN FUND | 23% | 14 |
| PAN EUROPEAN URBAN RETAIL FUND | 22% | 19 |
| PEMBERTON EUROPEAN MID-MARKET DEBT FUND II | 100% | 13 |
| RUSSELL INVESTMENT COMPANY PLC | | 15 |
| Russell Euro Fixed Income Fund | 32% | |
| Russell US Bond Fund | 54% | |
| Russell Sterling Bond Fund | 42% | |
| SCHRODER GILT AND FIXED INTEREST FUND | 24% | 16 |
| SCHRODER FUNDS ICAV | | 23 |
| Schroder Sterling Liquidity Fund | 46% | |
| SCHRODER INTERNATIONAL SELECTION FUND SICAV | | 25 |
| Emerging Market Bond Fund | 59% | |
| SCOTTISH WIDOWS INCOME AND GROWTH FUNDS ICVC | | 2 |
| UK Index Linked Gilt Fund | 100% | |
| Corporate Bond PPF Fund | 100% | |
| SW Corporate Bond Tracker | 100% | |
| Scottish Widows GTAA 1 | 84% | |
| Corporate Bond 1 Fund | 98% | |
| Balanced Growth Fund | 27% | |
| Adventurous Growth Fund | 73% | |
| SCOTTISH WIDOWS INVESTMENT SOLUTIONS FUNDS ICVC | | 2 |
| European (ex UK) Equity Fund | 96% | |
| Asia Pacific (ex Japan) Equity Fund | 99% | |
| Japan Equities Fund | 87% | |
| US Equities Fund | 100% | |
| Fundamental Index UK Equity Fund | 88% | |
| Fundamental Index Global Equity Fund | 96% | |
| Fundamental Index Emerging Markets Equity Fund | 95% | |
| Fundamental Low Volatility Index Global Equity | 98% | |
| Fundamental Low Volatility Index Emerging Markets Equity | 96% | |
| Fundamental Low Volatility Index UK Equity | 93% | |
| SCOTTISH WIDOWS MANAGED INVESTMENT FUNDS ICVC | | 2 |
| International Equity Tracker Fund | 74% | |
| Balanced Portfolio Fund | 83% | |
| Progressive Portfolio Fund | 72% | |
| Cautious Portfolio Fund | 60% | |
| Cash Fund | 99% | |
| Opportunities Portfolio Fund | 92% | |
| SCOTTISH WIDOWS OVERSEAS GROWTH INVESTMENT FUNDS ICVC | | 2 |
| Global Growth Fund | 55% | |
| European Growth Fund | 89% | |
| American Growth Fund | 84% | |
| Pacific Growth Fund | 76% | |
| Japan Growth Fund | 94% | |
| SCOTTISH WIDOWS TRACKER AND SPECIALIST INVESTMENT FUNDS ICVC | | 2 |
| UK All Share Tracker Fund | 92% | |
| International Bond Fund | 72% | |
| UK Smaller Companies Fund | 22% | |
| UK Tracker Fund | 46% | |
| UK Fixed Interest Tracker Fund | 96% | |
| Emerging Markets Fund | 88% | |
| UK Index-Linked Tracker Fund | 48% | |
| SCOTTISH WIDOWS UK AND INCOME INVESTMENT FUNDS ICVC | | 2 |
| Corporate Bond Fund | 62% | |
| UK Growth Fund | 62% | |
| Gilt Fund | 97% | |
| High Income Bond Fund | 28% | |
| Strategic Income Fund | 65% | |
| Environmental Investor Fund | 72% | |
| Ethical Fund | 78% | |
| SSGA ASIA PACIFIC TRACKER FUND | 93% | 4 |

| | | |
|---|---|---|
| SSGA EUROPE (EX UK) | 96% | 4 |
| SSGA UK EQUITY TRACKER FUND | 97% | 4 |
| SSGA NORTH AMERICAN EQUITY FUND | 100% | 4 |
| UNIVERSE, THE CMI GLOBAL NETWORK | | 6 |
| CMIG GA 70 Flexible | 100% | |
| CMIG GA 80 Flexible | 100% | |
| CMIG GA 90 Flexible | 100% | |
| Euro Cautious | 86% | |
| European Enhanced Equity | 100% | |
| CMIG Access 80% | 100% | |
| Continental Euro Equity | 98% | |
| UK Equity | 77% | |
| US Enhanced Equity | 90% | |
| Japan Enhanced Equity | 96% | |
| Pacific Enhanced Basin | 80% | |
| Euro Bond | 63% | |
| US Bond | 95% | |
| US Currency Reserve | 81% | |
| Euro Currency Reserve | 99% | |
| US Tracker | 31% | |
| CMIG Focus Euro Bond | 100% | |
| THE TM LEVITAS FUNDS | | 21 |
| TM Levitas A Fund | 42% | |
| TM Levitas B Fund | 37% | |
| UBS INVESTMENT FUNDS ICVC | | 17 |
| UBS Global Optimal Fund | 29% | |
| UBS UK Opportunities Fund | 38% | |
| ZURICH HORIZON MULTI ASSET FUND V | 42% | 20 |

**Principal place of business for collective investment vehicles**
**(1)** Trinity Road, Halifax West Yorkshire, HX1 2RG

**(2)** 15 Dalkeith Road Edinburgh EH16 5WL
**(3)** 39/40 Upper Mount Street, Dublin, Ireland
**(4)** 20 Churchill Place, Canary Wharf, London E14 5HJ
**(5)** BNP Paribas InstiCash, 10, Rue Edward Steichen, L-2540 Luxembourg
**(6)** Lemanik Asset Management S.A 106 route d'Arlon, L-8210 Mamer Luxembourg
**(7)** 35a avenue John F. Kennedy, L-1855, Luxembourg
**(8)** Aberdeen Asset Managers Ltd, 1 Bread Street, Bow Bells House, London, EC4M 9HH
**(9)** BlackRock Fund Managers Ltd, 12 Throgmorton Avenue, London EC2N 2DL
**(10)** BNY Mellon Investment Funds, BNY Mellon Centre, 160 Queen Victoria Street, London, EC4V 4LA
**(11)** 3rd Floor South, 55 Baker Street, London, W1U 8EW
**(12)** Perpetual Park, Perpetual Park Drive, Henley-on-Thames, Oxfordshire, RG9 1HH
**(13)** 2-4, Rue Eugene Ruppert L-2453, Luxembourg
**(14)** Nordea Investment Funds S.A., 562 rue de Neudorf, L-2220 Luxembourg
**(15)** 78 Sir John Rogerson's Quay, Dublin 2, Ireland
**(16)** Schroder Unit Trusts Ltd, 31 Gresham Street, London, EC2V 7QA
**(17)** UBS Investment Funds ICVC, 21 Lombard Street, London, EC3V 9AH
**(18)** Oppenheim Asset Management Services S.à r.l. , 2, Boulevard Konrad Adenauer, L-1115 Luxembourg
**(19)** Jackson House, 18 Saville Row, London, W1S 3PW
**(20)** The Grange, Bishops Cleave, Cheltenham, GL52 8XX
**(21)** Thesis Unit Trust Management Ltd, Exchange Building, St. John's Street, Chichester, West Sussex PO19 1UP
**(22)** 25 Gresham Street, London EC2V 7HN
**(23)** Schroder Funds ICAV, 10 Earlsfort Terrace, Dublin 2, Ireland D02 T380
**(24)** 2a, Rue Albert Borschette, BP 2174, L-1021, Luxembourg
**(25)** 5, Rue Hohenhof, L-1736, Senningerberg, Luxembourg
**(26)** JPMorgan Asset Management (Europe) S.A.R.L., 6, Route de Treves, L-2633, Senningerberg, Luxembourg
**(27)** 50 Stratton Street, London, W1J 8LL
**(28)** 70 Sir John Rogersons Quay, Dublin 2, Ireland

* The undertaking does not have share capital
\+ The undertaking does not have a registered office
\# In relation to Subsidiary Undertakings, an undertaking external to the Group holds shares
^ Shares held directly by Lloyds Banking Group plc
& The Group holds voting rights of between 20% and 49.9%
~ The Group holds voting rights of 50%
(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) Preferred A Ordinary Shares
(x) Redeemable Preference Shares
(xi) A4 Ordinary Shares
(xii) Redeemable Ordinary Shares
(xiii) Common Stock
(xiv) Preferred B Ordinary Shares
(xv) A3 Ordinary Shares
(xvi) A2 Ordinary Shares
(xvii) A1 Ordinary Shares
(xviii) Z Ordinary Shares

**Registered office addresses**
**(1)** 25 Gresham Street, London, EC2V 7HN
**(2)** Charterhall House, Charterhall Drive, Chester, CH88 3AN
**(3)** Port Hamilton, 69 Morrison Street, Edinburgh, EH3 8YF
**(4)** Trinity Road, Halifax, HX1 2RG
**(5)** The Mound, Edinburgh, EH1 1YZ
**(6)** 40a Station Road Upminster Essex RM14 2TR
**(7)** 116 Cockfosters Road, Barnet, Hertfordshire, EN4 0DY
**(8)** Minter Ellison, Governor Macquire Tower, Level 40, 1 Farrer Place, Sydney, NSW 2000, Australia
**(9)** 1 Brookhill Way, Banbury, Oxon, OX16 3EL
**(10)** Sanne Group, 13 Castle Street, St. Helier, Jersey, JE4 5UT
**(11)** The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801
**(12)** Barnett Way, Gloucester, GL4 3RL
**(13)** 1 More London Place, London, SE1 2AF
**(14)** 1095 Avenue of the America's, 34th Floor, New York, NY 10036, United States
**(15)** 2nd Floor, 14 Cromac Place, Gasworks, Belfast, BT7 2JB
**(16)** Rineanna House, Shannon Free Zone, Co. Clare, Ireland
**(17)** 60313 Frankfurth AM Main, Thurn-Und, Taxis-Platz 6, Germany
**(18)** Hoogoorddreef, 151101BA, Amsterdam, Netherlands
**(19)** 6 Rue Jean Monnet, L-2180 Luxembourg,
**(20)** 33 Old Broad Street, London, EC2N 1HZ
**(21)** Prins Bernhardplein 200, 1097 JB, Amsterdam, Netherlands
**(22)** Citco REIF Services, 20 Rue de Poste, L-2346, Luxembourg
**(23)** RL360 House, Cooil Road, Douglas, Isle of Man, IM2 2SP
**(24)** Corporation Service Company, 251 Little Falls Drive, Wilmington, DE 19808, USA
**(25)** Corporation Service Company, Suite 400, 2711 Centre Road, Wilmington, DE 19805, United States
**(26)** 1 Grant's Row, Lower Mount Street, Dublin 2, Ireland
**(27)** 1, Avenue du Bois, Luxembourg, L – 1251, Luxembourg
**(28)** SAB Formalities, 23 Rue de Roule, Paris, 75001, France
**(29)** c/o PATRIZIA, 166 Sloane Street, London, SW1X 9QF
**(30)** 20 Rue de la Poste, L-2346 Luxembourg
**(31)** 2nd Floor, 21 Palmer Street, London, SW1H 0AD
**(32)** McStay Luby, Dargan House, 21-23 Fenian Street, Dublin 2, Ireland
**(33)** 3rd Floor, Standard Bank House, 47-49 La Motte Street, St Helier, JE2 4SZ, Jersey
**(34)** P O Box 186, Royal Chambers, St Julian's Avenue, St. Peter Port, GY1 4EF, Guernsey
**(35)** De Entrée 254, 1101 EE, Amsterdam, Netherlands
**(36)** 47 Esplanade, St. Helier, Jersey, JE1 0BD
**(37)** Sarnia House, Le Truchot, St. Peter Port, Guernsey, GY1 4EF
**(38)** 296 Doctor Chucri Zaidan Avenue, Lamb Village, Sao Paulo, 04583-110 Brazil
**(39)** 2nd Floor, Liberation House, Castle Street, St Helier, JE1 1EY, Jersey
**(40)** 1 Vine Street, London, W1J 0AH
**(41)** 39 Queens Road, Aberdeen, AB15 4ZN
**(42)** 5th Floor, The Exchange, George's Dock, IFSC, Dublin 1, D01W3P9
**(43)** 110 St. Vincent Street, Glasgow, G2 4QR
**(44)** 35 Great St. Helen's, London, EC3A 6AP
**(45)** Charlton Place, Charlton Road, Andover, SP10 1RE
**(46)** Glategny Court, Glategny Esplanade, St Peter Port, GY1 3HQ, Guernsey
**(47)** Cawley House, Chester Business Park, Chester, CH4 9FB, United Kingdom
**(48)** 6/12, Primrose Road, , Bangalore , 560025, India
**(49)** The Residency, 7th Floor, 133/1 Residency Road, Bangalore, 560025, India
**(50)** St William House, Tresillian Terrace, Cardiff, CF10 5BH
**(51)** 18th Floor, United Centre, 95 Queensway, Hong Kong
**(52)** Pentagon House, 52-54 Southwark Street, London, SE1 1UN
**(53)** 1A Heienhaff, Senningerberg, L-1736, Luxembourg
**(54)** 15 Dalkeith Road, Edinburgh, EH16 5BU
**(55)** Lichtenauerlann 170, 3062ME, Rotterdam, Netherlands
**(56)** 48 Boulevard Grande-Duchesse Charlotte, 1330, Luxembourg
**(57)** Caledonian Exchange, 19A Canning Street, Edinburgh, EH3 8HE
**(58)** 11-12 Esplanade, St Helier, Jersey, JE2 3QA
**(59)** Karl-Liebknecht-STR. 5, D_10178 Berlin, Germany
**(60)** P O Box 12, Peveril Buildings, Peveril Square, Douglas, Isle of Man, IM99 1JJ
**(61)** 44 Esplanade, St. Helier, Jersey, JE4 9WG
**(62)** 8 Avenue Hoche, 75008, Paris, France
**(63)** 26 New Street St Helier Jersey JE2 3RA
**(64)** Fifth Floor, 100 Wood Street, London, EC2V 7EX, United Kingdom
**(65)** Atria One, 144 Morrison Street, Edinburgh, EH3 8EB
**(66)** Naritaweg 165, 1043 BW, Amsterdam, Netherlands
**(67)** Calle Pinar 7, 5° Izquierda, 28006, Madrid, Spain
**(68)** 1-2 Victoria Buildings, Haddington Road, Dublin 4, Ireland
**(69)** Wilmington Trust SP Services (London) Limited, Third Floor, 1 King's Arms Yard, London, EC2R 7AF
**(70)** 106 Route d'Arlon, Mamer, L-8210, Luxembourg

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## Head office

25 Gresham Street
London EC2V 7HN

+44 (0)20 7626 1500

www.lloydsbankinggroup.com

## Registered office

The Mound
Edinburgh EH1 1YZ
Registered in Scotland no. SC95000